

Real Estate Investment in Cuba: Is Now the Right Time?

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ABSTRACT

On the eve of the fifty-year anniversary of the Cuban Revolution, change finally appears to be on the horizon for Cuba. In February 2008, Raul Castro succeeded his older brother Fidel as President of the Republic of Cuba. In the United States, a newly elected President and a Congress presumably controlled by the Democratic Party will assume power in 2009. These political developments bring with them the potential for change in U.S. - Cuba relations.

Opportunities are available even today for U.S. investment in the Cuban real estate market. This thesis identifies why now is the right time for Americans to move forward with their investment plans. It explains how real estate transactions are currently being conducted on the island and the challenges of investing in Cuban real estate according to Cubans and foreign investors. Presented as well are strategies for overcoming these hurdles.

Thesis Supervisor: Gloria Schuck
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CHAPTER 1: INTRODUCTION

On the eve of the fifty-year anniversary of the Cuban Revolution, change finally appears to be on the horizon for Cuba. In February 2008, Raul Castro succeeded his older brother Fidel as President of the Republic of Cuba. Upon assuming the presidency, Raul Castro implemented a handful of changes in the country. These changes include the general public's access to cell phone usage, public access to hotels and restaurants previously prohibited, and certain small initiatives toward privatization. While Cuban scholars characterize these changes as having a "minimal" impact on the current economic conditions in the country, they can be viewed as a step in the right direction.

Change of greater magnitude to Cuba could come in November 2008, when the United States might well have a Congress controlled by the Democratic Party and a Democrat as the incoming president. In an attempt to court Cuban-American voters, one U.S. Presidential Candidate has said that he would be willing to meet with Raul Castro "without preconditions."¹ This could potentially bring about a significant change in U.S. policy toward Cuba, including a re-evaluation of the Helms-Burton Law and U.S. trade embargo. In fact, economic change spearheaded by U.S. political efforts is already under way. In 2007, the United State sold over \$437 million of agricultural products to Cuba, up from the \$340 million spent in 2006.² To put this development into perspective, this influx of American agricultural products makes the U.S. Cuba's largest supplier of food. Inversely, Cuba is the United States 37th largest export market for these products.³

While provisions have been made for U.S. investment in the agricultural industry, the same cannot be said for the travel sector. Under the Bush Administration, enforcement of U.S. restrictions on Cuba travel has increased, and restrictions on travel and private remittances to

¹ John, Otis, "U.S. – Cuba Trade has Big Potential," *Houston Chronicle*, 1 March 2008.

² Ibid.

³ Ibid.

Cuba have been tightened.⁴ There is, however, legislation on the Congressional floor that proposes lifting the U.S. travel ban to Cuba. On June 25, 2008, the House Appropriations Committee presented S. 3260 with provisions that would ease restrictions on family travel. On July 14, 2008, the Senate Appropriations Committee presented a version of bill S. 3260 that would ease restrictions on family travel and travel related to the sale of agricultural and medical goods. There are several other initiatives currently in Congress that would ease travel restrictions entirely, including Bills S. 721 and S. 554 (see Appendix A for a list of the most recent developments in Congress).⁵ Should U.S. citizens finally be able to travel freely between the U.S. and Cuba, Raul Castro's regime will experience a tremendous economic boom. Cuba is currently the third most popular tourist destination in the Caribbean region after Mexico and the Dominican Republic. The addition of U.S. travelers to this tourist influx would be a newfound windfall for the island's economy.

While the passage of this proposed legislation would be of great economic benefit to the Cuban economy, it would have very little impact on the U.S. economy. The U.S. government has long-standing legislation in place making it highly illegal for American investors to invest directly in the island. As a result, many American developers, hoteliers, and restaurateurs have been forced to sit idly and watch as their foreign counterparts establish themselves on the island and in some cases flourish from the opportunity. However, according to U.S. attorneys, this is not the case for all real estate professionals.⁶ In fact, according to sources interviewed for this thesis American real estate professionals are currently active in the Cuban tourism market through two different means of investment.

For American real estate professionals interested in pursuing deals on the island this paper provides answers to the following pivotal questions. 1) Why does investing in tourism-related

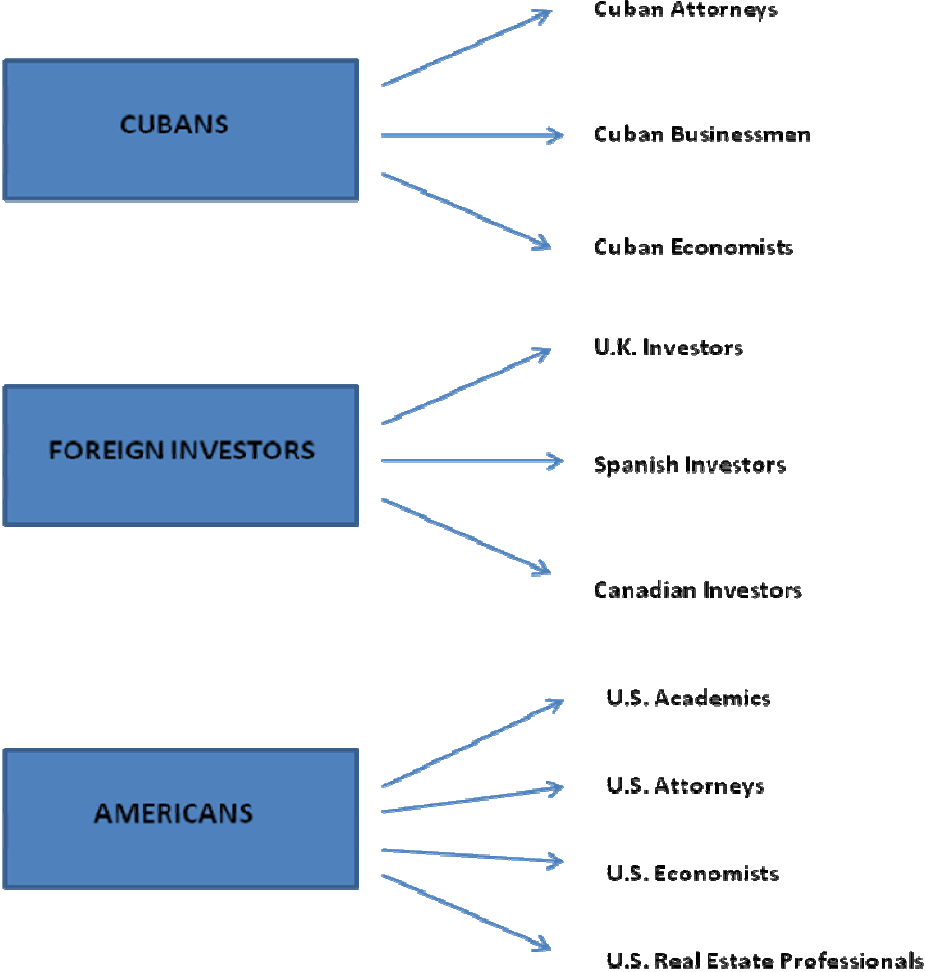
⁴ Mark P. Sullivan, "Cuba: U.S. Restrictions on Travel and Remittances," a report prepared for Members and Committees of Congress, 18 July 2008.

⁵ *Ibid.*, 1.

⁶ Interview with Marco Gonzalez, Partner at Duane Morris Law Firm, Telephone Conversation, 9 July 2008.

real estate make sense today? 2) What are the challenges of investing in the current Cuban real estate market? 3) How can these challenges be overcome? 4) What are the two opportunities for investing in Cuban resort related real estate, today? In order to answer these questions, the author conducted interviews across three groups of people; Cubans, Foreign Investors currently working on the island and Americans (See Exhibit 1). The methodology used to conduct this field research is elaborated on in the “Methodology” section of this thesis (See Page 12).

Exhibit 1: Three Groups of People Interviewed



The next chapter aggregates the opinions of these three groups and articulates the reasons why pursuing real estate today in Cuba makes sense. In chapter 3, the perspectives of these individuals are captured in order to outline the challenges facing foreign businesses trying to work in Cuba. In order to combat these obstacles, Chapter 4 will provide advice from Cubans and foreign investors who have worked on the island. After having explained why working in Cuba makes sense, Chapter 5 will explain the two options American real estate businesses have today for investing in Cuba. The thesis concludes with the thoughts and recommendations of the author for pursuing real estate endeavors in Cuba.

Methodology

The information from field research presented in this thesis is the result of nineteen interviews conducted by the author of individuals with knowledge or experience in Cuba's tourism market. The types of people can be broken down into three groups (Refer to Exhibit 1). The first group consists of Cubans currently working and living on the island. For this research seven Cuban professionals were interviewed. Of these seven, three are attorneys who practice international investment law. One interviewee is an employee of the *Camara de Comercio de Cuba* (Cuban National Chamber of Commerce) and one works for Conas. Conas is a Cuban consulting agency that provides business advice on foreign investment to individuals, foreign investors and Cuban entities. The person interviewed currently consults to foreign businesses and the Cuban Ministry of Foreign Investment and Economic Collaboration (MINVEC), the department in charge of enforcing and controlling government policy on foreign investment. The sixth Cuban interviewed works for CIMEX Corporation, Cuba's largest trading company and the owner of one hundred nineteen gas stations, one hundred seventeen cafeterias, forty-seven photo services (digital and color), the tour operator HAVANATUR, finance and banking facilities, and real estate businesses. And the seventh Cuban interviewed is the Commercial Director of the Havana Libre, managed by the Sol Meliá hotel group out of Spain.

As noted earlier, changes in the travel regulations under the Bush administration have made visiting Cuba more complicated. The only opportunities available for educational travel to Cuba in 2008 are as follows. 1) Participation in a structured educational program in Cuba as part of a course offered at the licensed institution. The program must last a full term and cannot include fewer than ten weeks of study in Cuba. 2) Noncommercial academic research in Cuba specifically related to Cuba for the purpose of obtaining a graduate degree. 3) Participation in a formal course at a Cuban academic institution provided the formal course of study is accepted for credit towards the student's undergraduate or graduate degree. The course cannot be shorter than ten weeks (see Appendix B for a copy of the Academic License). The author was able to qualify under section two of the license, which allows for travel to Cuba in order to complete a graduate degree. The interviews were conducted by the author in June 2008 over a nine day period on the island, and all interviews with Cuban subjects were conducted face-to-face in the Spanish language. The interviews were not tape-recorded because it is against Cuban government's policy.

In addition to the seven Cubans interviewed, the author also conducted interviews with three foreign investors who are executing real estate deals on the island. These foreign investors represent companies from Canada, Spain, and England. Of the three businesses interviewed, the Canadian and Spanish companies are real estate developers while the U.K. Company is a real estate investor.

The remaining ten professionals interviewed for this thesis were U.S. citizens, several of whom are Cuban-Americans. Of this U.S. citizen group, three of the interviewees were real estate professionals, two were real estate attorneys, two were academics, two were economists, and one was a chief of staff for a Massachusetts U.S. Congressman.

This thesis was restricted by the limited number of foreign and American real estate investors willing to talk openly about their real estate experiences in Cuba. Although it is clear that business is currently being accomplished on the island on behalf of both parties, companies are reluctant to disclose pertinent information for fear of creating unwanted market competition or

crossing illegal frontiers. As a result, the opinions included herein tend to weigh heavily towards those of Cubans and American attorneys and academics. Although some of the information provided might be suitable for other fields of real estate the focus of this paper is on tourism-related real estate.

CHAPTER 2: WHY INVEST IN CUBA?

When speaking with Cubans, foreign investors, and U.S. citizens, there appears to be unanimity as to the reasons investing in Cuba makes sense. The reasons most commonly cited are:

1. The “economic boom” resulting from the removal of the U.S. travel ban;
2. Cuba’s unique geography and enticing climate; and
3. The rapid return on investment.

Potential for Economic Boom

The driving force behind the growing investment in tourist-related real estate, according to the Americans interviewed, is the future growth the tourism industry will experience once U.S. travel sanctions are lifted. Unlike other locations that are not natural tourist destinations, such as Dubai, Cuba has an established history and a well-proven track record for being a hotbed for American tourists.

The Prohibition Era in the United States drove many Americans to seek “fun” elsewhere. Searching for venues to gamble and drink, many U.S. tourists flocked to Cuba in the first half of the twentieth century.⁷ It was not uncommon for wealthy Americans to fly down to Havana to spend a weekend or perhaps even one night. Once on the island, Americans were welcomed with trendy rum drinks, high potency Hatuey beer, hand-rolled cigars, fast-paced casino gaming, and prostitution.⁸ The *Hotel Nacional*, completed in 1930, was the premier destination for this type of entertainment (See Photo 1).

⁷ Sergei Khrushchev, Tony L. Henthorne, Michael S. LaTour, “Cuba at the Crossroads: The Role of the U.S. Hospitality Industry in Cuban Tourism Initiatives,” *Cornell Hotel and Restaurant Administration Quarterly*, Volume 48, Issue 4 2007.

⁸ *Ibid.*, 404.

Americans eager to escape the U.S. government's restrictions on drinking brought tremendous growth to the island's tourist industry and fueled Cuba's escalating economy.⁹ Throughout the 1950's, tourism in the Caribbean experienced a growth rate of ten percent. Cuba enjoyed the single largest share of the region's tourism market.¹⁰ Cuba captured twenty percent of the total number of travelers to the Caribbean region during this growth period. This was a much larger market share than any of Cuba's competitors. And of these visitors to Cuba, more than eighty-five percent came from the United States.¹¹



Photo 1: Hotel Nacional, La Habana. Photo taken by Damien Chaviano on June 19, 2008

Recognizing the impact tourist dollars had on the Cuban economy, the Cuban government under President Fulgencio Batista (1952- Dec. 1958) began an aggressive program of expanding its hotel industry. New hotel construction almost doubled the pre-existing hotel capacity in Havana and other major cities. By 1958, the investment in the construction of Cuban hotels was estimated at \$90 million USD with a projected capacity of 6,066 rooms.¹² Tourist expenditure had increased from \$19 million in 1952 to a yearly average of \$60 million in 1957 – 58.

This period of aggressive expansion of Cuba's tourist-related real estate was short lived. The escalating guerilla warfare of Fidel Castro and his rebel forces (beginning in 1957) soon created a climate of fear on the part of tourists planning travel to Cuba. Political instability cast a pall over the tourist industry and caused the demise of Cuba's expansive tourist époque. As

⁹ Khrushchev, Henthorne, LaTour, "Cuba at the Crossroads," 404.

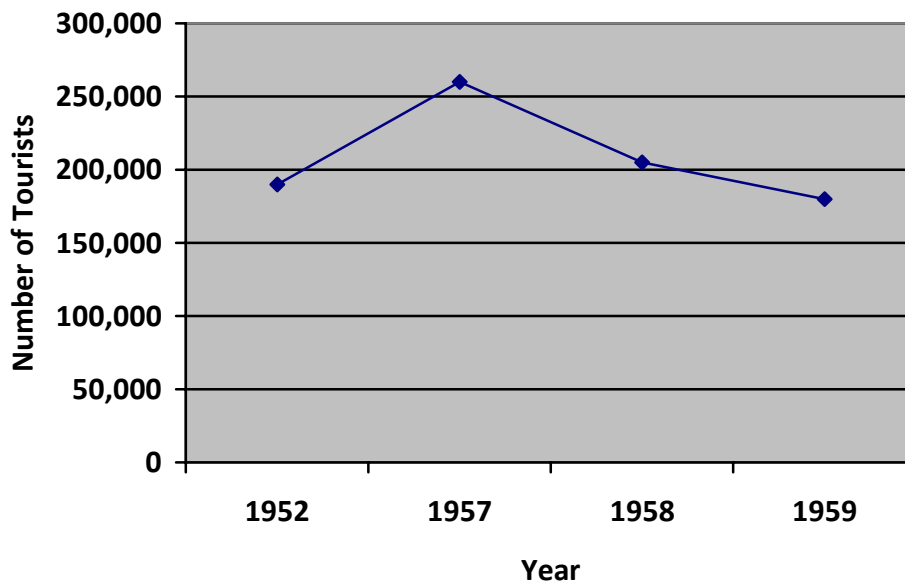
¹⁰ Ibid., 405.

¹¹ Ibid., 405.

¹² Eric N. Baklanoff, "Cuba Before Fidel," *Latin Business Chronicle*, 26 February 2008.

illustrated in Exhibit 2, the number of travelers arriving on Cuban shores by the end of 1959 had fallen to approximately 175,000 people. By the time the Kennedy administration invoked the Trading with the Enemy Act in 1963, officially marking the end of the Golden Age in Cuban tourism, the number of U.S. tourists to Cuba had fallen below three thousand people annually.¹³

Exhibit 2: Tourist Arrivas in Cuba, 1952 - 1959



Source: "Cuba at the Crossroads," *Cornell Hospitality Quarterly*

The Rebirth of Tourism

Following the fall of the Soviet Bloc in December 1991, the redevelopment of tourism in Cuba took on a new urgency. Cuba's economy completely collapsed with the disintegration of the Soviet Union. The country entered the "Special Period" during which time the Cuban government found itself unable to provide for the most basic needs of its people.¹⁴ The

¹³ Khrushchev, Henthorne, LaTour, "Cuba at the Crossroads," 407.

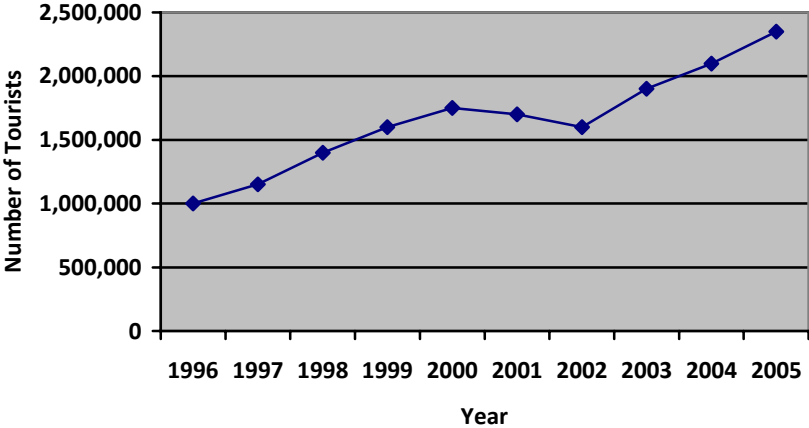
¹⁴ Khrushchev, Henthorne, LaTour, "Cuba at the Crossroads," 408.

government desperately considered every available option for generating revenue for the nation. Cuba looked toward tourism with new and unprecedented vigor as a means of meeting its dire need for income. Fidel Castro expressed a seemingly new attitude toward tourism:

There are people who still don't understand that we need to exploit our sun...We don't live in the North Pole nor do we live in the South Pole. We don't live in cold weather; we live in a country that is warm and rich in culture. Now is the time when tourism can serve as a form of employment for our compatriots, however we need to be prepared and we need to know how to attend to the needs of the tourism.¹⁵

By the end of 1989, Cuba was host to more than three hundred thousand annual tourists – approximately the same number as in the pre-Revolutionary peak tourism year of 1957. As illustrated in Exhibit 3, those pre-Revolutionary numbers would soon be replaced as the arrival of tourists soared. Within four years, the number of annual visitors doubled in number. At present, Cuba now enjoys over two million annual visitors. Over the last decade, Cuba has experienced the highest rate of growth in tourists, becoming the second most popular tourist

Exhibit 3: U.S. Tourist Arrivals to Cuba, 1996-2005



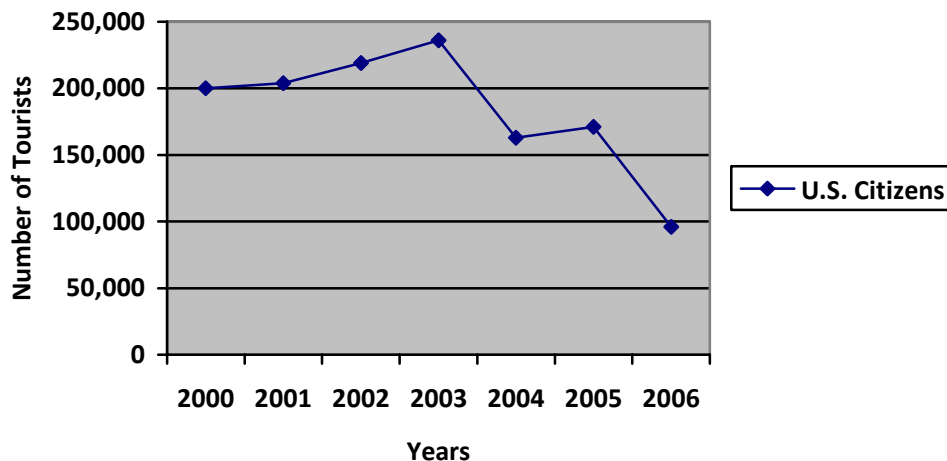
Source: *Cuba at the Crossroads*, Cornell Hospitality Quarterly

¹⁵ Fidel Castro Speech, 1989, Sancti Spiritus, <http://lanic.utexas.edu/cgi-bin/search/lanic>.

destination in the Caribbean region and the second most popular regional destination for European travelers.¹⁶ This influx of tourists brought a windfall of dollars to the Cuban economy. By 1995, Cuba’s annual tourism revenues had reached \$1 billion USD. Ten years later in 2005 that number was greater than \$2 billion. After Canada, the four countries responsible for the largest percentage of visitors to Cuba are Italy, Germany, France, and Spain. Although Cuba experienced a slight decline in tourists in 2006, 2.2 million visitors, the number of visitors dating back to 1996, substantiates a growing tourism industry in Cuba over the last twenty years.

Of the visitors to Cuba, there already exist a small percentage of U.S. citizens. Although no complete data exists on the total number of U.S. visitors to Cuba, several estimates have been made. Exhibit 4 presents the estimates provided by Robyn Dorothy, in a report released by the U.S. International Trade Commission (ITC) in 2007:¹⁷

Exhibit 4: U.S. Tourists to Cuba, 2003 - 2006



Source: “Cuba at the Crossroads,” *Cornell Hospitality Quarterly*

Exhibit 4 illustrates that the number of U.S. travelers to Cuba has declined by fifty-two percent since the year 2000. Cuban officials maintain that overall U.S. travel to Cuba has dropped

¹⁶ Khruschev, Henthorne, LaTour, “Cuba at the Crossroads,” 409.

¹⁷ “U.S. Agricultural Sales to Cuba: Certain Economic Effects of U.S. Restrictions,” report prepared by U.S. International Trade Commission (ITC) requested by the Senate Committee on Finance, Investigation No. 332-489, July 2007, http://www.usitc.gov/publications/abstract_3932.htm.

considerably over the past four years because of the tightening of U.S. travel restrictions.¹⁸ Although there are currently U.S. citizens traveling to Cuba, reports suggest that the number of arrivals would increase significantly with the lifting of the travel ban. A report released by the U.S. International Trade Commission (ITC) in July 2007, using a comparative static model, estimates that the number of overnight U.S. visitors to Cuba would increase from 171,000¹⁹ in 2005 to between 554,000 and 1.127 million visitors per year.²⁰ See Appendix C for calculation methodology. The forecasted number of future U.S. travelers varies with the source. Estimates range from 100,000 to over 3 million visitors. In an interview with a member of the Cuban Chamber of Commerce, the lifting of the travel ban would increase the gross numbers of visitors to the island to between 3 to 5 million a year.²¹ This would signal an annual increase of between 1 to 3 million with the lifting of the embargo. In summary, the estimate of U.S. visitors to Cuba pending the removal of the travel ban ranges from 550,000 to 3 million people annually.

The lifting of the travel ban alone would provide a significant stimulus to the Cuban tourist market. However, the travel ban is not the only factor limiting growth. According to the International Trade Commission report, the current supply of hotel rooms is the second largest constraint for the potential increase in arrivals to Cuba in the absence of U.S. sanctions.²² If the travel ban were to be lifted, there would be a significant need of new hotel stock, as stated by the Americans interviewed. Not only will the demand for new hotel rooms flourish but so will the renovation of the existing hotels.

For real estate developers, the lack of supply presents a myriad of opportunities. The most obvious possibility is the development of new hotels. As stated in the report, the current stock

¹⁸ ITC Report, "U.S. Agricultural Sales to Cuba," 3 – 13.

¹⁹ International Trade Commission estimate of the number of Cuban-Americans and Americans that traveled to Cuba.

²⁰ Ibid., CRS – 14.

²¹ Interview with José R. Méndez Rodríguez, Consultant to the President, *Camara de Comercio* [Cuban Chamber of Commerce], in Havana on 20 June 2008.

²² ITC Report, "U.S. Agricultural Sales to Cuba," 3-16.

of hotel space will not house the estimated influx of travelers.²³ Therefore, Cubans will require new hotel stock, a feat that the country is unable to accomplish on its own.²⁴ In addition to the new construction, there will be a need to redevelop the existing hotels. The following pictures illustrate the poor condition of the current hotel stock. The Havana Libre a five-star hotel²⁵ was in better condition in 1958 at the time of its opening than it is today. The current property suffers from outdated décor (see Picture 2), rusty towel rings (see Picture 4), dirty bathrooms (see Picture 5), damaged elevators (see Picture 6) and an unappealing façade (see Picture 7). None of these characteristics are indicative of a five-star hotel that caters to high-end travelers. Therefore, in order to maintain high occupancy rates at these hotels, the Cuban government will be in search of first class hotel operators.



Photo 2: Havana Hilton Hotel Room, Circa 1958. Photo taken by Damien Chaviano June 22, 2008. This photo was hanging in the lobby of the Habana Libre.



Photo 3: Habana Libre Hotel Room. Photo taken by Damien Chaviano June 22, 2008.

²³ ITC Report, "U.S. Agricultural Sales to Cuba," 3-16.

²⁴ Interview with Rafael Roqueta Garcia, Director of Foreign Business at Conas Consultants S.A., in Havana on 23 June 2008.

²⁵ According to the Havana Libre webpage, <http://www.hotelhabanalibre.com>. [Last checked on August 4, 2008.]



Photo 4: Rusty towel ring in hotel room. Photo taken by Damien B. Chaviano on June 23, 2008. The Havana Libre is described as a five star hotel. This photo of a rusty towel ring questions the five star rating, and suggests that very few renovations have been made.



Photo 5: Dirty Bathroom. Photo taken by Damien B. Chaviano on June 23, 2008.



Photo 6: Photo taken by Damien B. Chaviano on June 23, 2008. There is no air conditioning in either the hallways or elevator. From June 19 through June 22, three of the four elevators were out of service.



Photo 7: Exterior of Habana Libre Hilton. Photo taken by Damien B. Chaviano on June 22, 2008.

Cuba's Geography & Climate

Cuba's unique geography significantly strengthens Cuba's chances of once again being a first class tourist destination. Cuba is the Caribbean's largest country, the largest land mass. Cuba is over 775 miles (1,250 km) in length and has an area of 42,827 square miles (110,992).

Comparatively, Cuba is just a little smaller than the state of Pennsylvania. In addition to being the Caribbean's largest island, Cuba is the second most populated of the islands with 11.9 million people. This robust population provides a large employment opportunity for the tourism sector. But the primary reason hotel and resort investors are drawn to the island according to the Cuban Chamber of Commerce and an investor currently working on the island, is that Cuba has more coastline than all of the Caribbean countries combined.²⁶ For this reason, Cuba's geography serves as a major attraction to foreign investors.

A second geographical attribute attractive to foreign investors is Cuba's location relative to the United States. Shaped like an alligator, Cuba is no more than 90 miles (148 km) from Florida's Key West, 85 miles (140 km) from the Bahamas, 48 miles (77 km) from Haiti, and 21 km from Cancún.²⁷ A member of the Cuban Chamber of Commerce opined:

Given Cuba's proximity to the U.S. relative to other islands why would one not choose Cuba? Cuba is much safer than countries like Jamaica and much more beautiful. Once the travel ban is lifted, a large number of tourists to Jamaica are now going to come to Cuba.²⁸

A recent report released by the International Monetary Fund (IMF), provided to the author by a foreign investor currently developing a resort in Cuba, confirms that geographical distance, or more specifically the "tourist-cost" per mile, is an excellent means for gauging travel. The report released in 2008, states that the cost of travel (due to U.S. policy) is the equivalent of an

²⁶ Interview with José R. Méndez Rodríguez, 20 June 2008.

²⁷ Jason Lawrence Addison, "Real Estate Investment Opportunities in Cuba," Masters Thesis, Massachusetts Institute of Technology (MIT).

²⁸ Interview with José R. Méndez Rodríguez, 20 June 2008.

American traveling to Australia. This is attributable to the significant cost of booking multi-destination travel (e.g., the only nonstop flight departs from Miami and often many Americans travel via third countries to reach Cuba.), visa and license applications, fees, and the time it takes to receive travel approval, often requiring up to six months.²⁹ According to the report, the lifting of U.S. restrictions would significantly lower the cost of travel and in turn, create a surge of tourists to the area.

Cuba's climate also plays an enormous role in making the island a major tourist destination in the Caribbean. Cuba's climate is sub-tropical with warm temperatures and short winters. There are two distinct seasons in Cuba: the dry season, lasting from November to April, and the rainy season, lasting from May to October. The average temperature is 25.5° C (82° F) with a relative humidity of 81% and an average rainfall of 1.359 mm.³⁰ Cuba's favorable weather coupled with the expansive coastline makes the island a premier destination for beach junkies and sun worshippers eleven months out of the year.

The hurricane season makes Cuba an undesirable tourist destination just one month of the year. September brings a period of heavy rain that can sometimes lead to a hurricane. For those working in the "built environment," this can be problematic. However, the impact that hurricanes have on tourism is unclear according to the IMF Report. The study provides evidence that surprisingly indicates an increase in arrivals to the island the year after a hurricane. This surge in tourists does not occur on neighboring islands not hit by the hurricane. Although an explanation of this fact is not clearly stated in the report, the study points to hurricanes *Michelle* and *Hortense*, which hit Cuba in 1996 and 2001. The arrival of tourists to the island increased the immediate years after these hurricanes. The more obvious result of hurricane damage is the increase in private and state capital inflows forcing public and private investors to upgrade facilities. This in turn brings forth new projects in the tourism sector.³¹ For

²⁹ Rafael Romeu, "Vacation Over: Implications for the Caribbean of Opening U.S.-Cuba Tourism," *International Monetary Fund Working Paper* (IMF), 2008 July.

³⁰ Addison, "Real Estate Investment Opportunities in Cuba," 6.

³¹ *Ibid*, 5.

real estate developers, the construction of superior quality structures makes good business sense in view of hurricane season.

Return on Investment

According to a Cuban business consultant and member of the Chamber of Commerce, the third most important reason why foreigners should invest in Cuba's tourist industry is because of the rapid return on their investment. The majority of investors in tourism see a return within two to three years,³² According to Cubans, tourism provides a rapid return on investment. In an interview with a European Opportunity fund manager, the author was informed that the targeted return for their fund was 30 percent IRR per annum. The manager equated this to the type of return that they would be looking for in Estonia. Although the money has been recently invested, the fund manager believed they would see the returns that they had initially hoped for.³³ American businessmen Dr. Timothy Ashby seconds this notion, and states that "tourism investments in Cuba are cash cows. Most hotel deals experience a 30% IRR per annum today."³⁴ Tourism in Cuba continues to be one of the country's most reliable and stable sources of revenue.

Summary

Exhibit 5 (See next page) reiterates the three reasons why investing in Cuban real estate today makes sense. Although to some, the reasons stated below might seem obvious, their importance must not be understated. More specifically, the reasons for conducting business in Cuba cater to an explicit type of real estate investor. For example, a real estate professional who desires a short-term investment horizon will be attracted to Cuba for two reasons. First, as noted earlier, Cuba already benefits from a healthy tourism market even without a strong U.S. presence. According to Cubans interviewed for this research, this is attributable to the island's

³² Interview with José R. Méndez Rodríguez, 20 June 2008.

³³ Interview with Christopher Eddis, Investment Banker at Mornington Capital, Telephone Interview, 5 June 2008.

³⁴ Interview with Dr. Timothy Ashby, Partner and Counsel at Cabesterre LLC, Telephone Interview, 6 August 2008.

tropical climate and white sand beaches. Because these two static attributes already bring travelers to the island the possibility for a return on investment exists now. The second reason, although it requires further research, is the rapid return on foreign capital that is unique to the Cuban tourist sector. Unlike any other sector in the Cuba economy, tourism experiences returns within two to three years of placing the investment.³⁵ For real estate professionals a two to three year time frame might be the perfect investment window. Therefore real estate businesses that target short-term returns on their money should find these two reasons very rational for placing capital in Cuba today.

Exhibit 5: Reasons for Investing in Cuba



On the other hand, real estate professionals, who are looking for a little more risk and a long term return on their capital may be more apt to invest based on the possibility of an economic boom. Although the reports vary on the degree of economic impact that the lifting of the travel ban will have, it is almost certain that the affect will be positive on the stream of revenues for hotel developers. Trying to time the inevitable removal of the travel ban can be a tedious task. However, as noted in Chapter 1 the recent change in guard of key U.S. and Cuban politicians

³⁵ Interview with Rafael Roqueta, 23 June 2008.

coupled with current legislation in Congress might mean the time is almost near. Therefore, further waiting might mean “missing the boat,” as was eloquently put by one U.S. attorney.³⁶

However, investing in Cuba is not without its obstacles. As Cuban consultant, “investing in Cuba is not like any other experience.”³⁷ In order to better understand the risks associated with working in Cuba the next chapter will put forth the challenges that face those interested in conducting business on the island.

³⁶ Interview with Marco Gonzalez, 9 July 2008.

³⁷ Interview with Rafael Roqueta, 23 June 2008.

CHAPTER 3: THE CHALLENGES OF INVESTING IN CUBA

As discussed in Chapter 2, the market for tourism in Cuba has existed for many years. The passing of investment legislation in 1995³⁸ opened the doors for foreign investors to capitalize on the perceived financial opportunity. However, in spite of the passing of this legislation, the question lingers as to whether or not the Cuban government truly welcomes foreign investment. Fidel Castro inherited a booming tourism industry in 1959.³⁹ Rather than cultivating this opportunity, Castro passed the Agrarian Reform Law in February of that same year. Cubans were led to believe the Agrarian Reform Law was about the just and fair reapportionment of land amongst its citizens. Only large land holdings in the country and certain large investments by foreigners would be affected. In the end, the Agrarian Reform Law was the beginning of the government's confiscation of all privately owned enterprises. The Agrarian Reform Law stated that Cuban citizens would have the right to self-determination.⁴⁰ Yet three months after its passage, the Cuban government began the process of nationalizing all foreign investment on the island. In summary, the Agrarian Reform Law was actually the beginning of the nationalization of Cuban companies and the expropriation of Cuban land.

Since the passing of the Agrarian Reform Law, there has been a certain degree of ambiguity surrounding the sentiment of the Cuban government towards foreign investment. For example, in 1999 the Vice President and Economic Czar Carlos Lage stated:

Foreign investment is an important element of the development that we must further, but it is complementary. The main effort is being done by the government with its resources.⁴¹

38 In 1982, the Cuban government issued Decree-Law No. 50 which allowed for joint ventures between government operated companies and foreign entities. However, with little success due to the Cuban government's reluctant to approve these partnerships, the government abolished law No. 50 and replaced it with Law No. 77.

39 Baklanoff, "Cuba Before Fidel," 7.

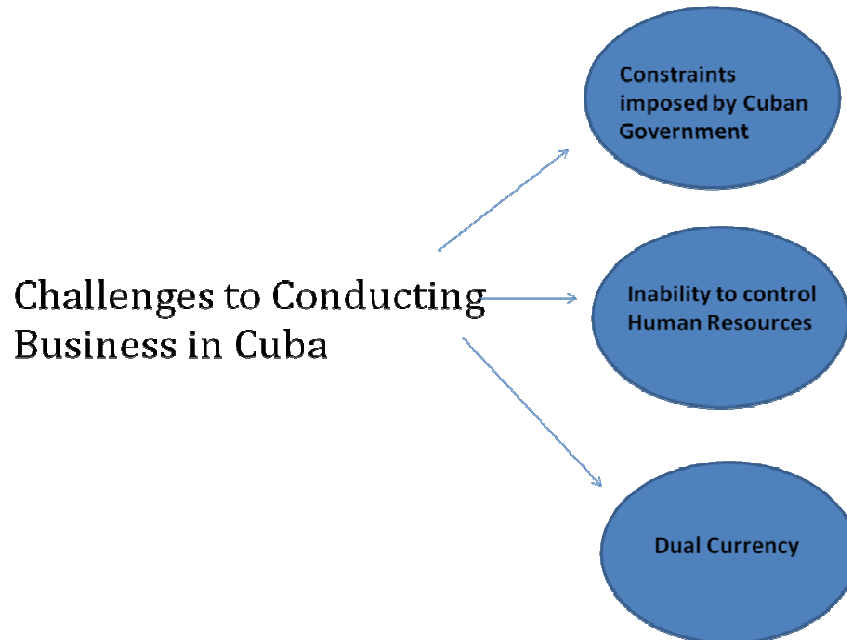
40 The Expropriation and Indemnification Process in Cuba. Buenos Aires: Ediciones Corregidor, 1999.

41 "Lage on Joint Ventures, Foreign Investment in Cuba," Havana Prensa Latina (16 March 1999) as reproduced in "Foreign Investment in Cuba in the Second Half of the 1990's," Pérez-López, Jorge F. 13 April 2000.

The reality of the situation is that following the fall of Eastern Europe and the Soviet Bloc, the economic crisis that followed left the Cuban socialist economy with very few options for cash flow. As a result, Law No. 77 or the Foreign Investment Act was passed in 1995 allowing foreign entities to once again invest in Cuba (see Appendix D for further explanation of Law No. 77). For real estate professionals, Law No. 77 provides the first comprehensive legislation respecting the legal rights of foreign investors in Cuba.⁴²

Although the passing of Law No. 77 reinvigorated foreign direct investment in the island, it does not eliminate all of the dilemmas of investing in Cuba today. In discussions with Cubans and foreign investors, it is evident that there are still challenges facing those interested in pursuing Cuba's tourism industry. This chapter examines the three major problems facing current investors, as identified by Cuban professionals, American professionals, and foreign investors currently working on the island (See Exhibit 6).

Exhibit 6: Challenges to Investing in Cuban Real Estate



⁴² Dr. Timothy Ashby and Scott R. Jablonski. "Land Tenure in Cuba: Implications and Potential Models for Foreign Real Property Holdings and Investment in A Future Cuba," Cuba in Transition ASCE 2006.

Constraints Imposed by the U.S. and Cuban Government

The most commonly cited challenge to investing in Cuba is the Helms-Burton Act. Signed by President Clinton on March 12, 1996, the Helms-Burton Act or Cuban Liberty and Democratic Solidarity Act in essence strengthens and extends the US embargo signed in 1963 to include foreign companies trading with Cuba. The passing of this legislation, in the opinion of one of the American attorneys interviewed for this thesis, has had a “chilling effect” on foreign investors interested in conducting business with Cuba.⁴³ The reason for this is two-fold. First, Title III penalizes foreign companies allegedly “trafficking” in property formerly owned by U.S. citizens that was expropriated by Cuba after the revolution. How does the U.S. government define “trafficking.” According to Cuban scholar Jorge Pérez-López, “trafficking” is described very broadly.⁴⁴ The language is as follows:

Title III of the Act: A trafficker is a person who knowingly and intentionally: (1) sells, transfers, distributes, dispenses, brokers manages, or otherwise disposes of confiscated property, or purchases, leases, receives, possesses, obtains control of, manages, uses, or otherwise acquires or holds an interest in confiscated property; (2) engages in commercial activity using or otherwise benefitting from confiscated property; or (3) causes, directly participates in, or profits from trafficking by another person, or otherwise engages in trafficking through another person, without the authorization of any United States national who holds claim to the property.⁴⁵

In addition to Title III, the second section of the Helms-Burton Act that bears significance is Title IV. In Title IV, the U.S. government establishes a restriction on travel for those businesses thought to be working in Cuba. The language of Title IV is:

Title IV directs the U.S. Secretary of State to deny a visa to, and the Attorney General to exclude from the United States, aliens (including their spouses, minor

⁴³ Interview with Marco Gonzalez, 9 July 2008.

⁴⁴ Jorge Pérez-López, “Foreign Investment in Cuba in the 1990’s,” Cuba in Transition, Association for the Study of the Cuban Economy, 30 April 2000.

⁴⁵ *Ibid.*, 3.

children or agents) involved in the confiscation of property, of the trafficking in confiscated property, owned by a U.S. National.

To date, Title III of the Helms-Burton Act has not been exercised against any foreign investor even though, according to the Cuban Ministry of Foreign Investment and Economic Collaboration (MINVEC), “around half a dozen” of the joint ventures with foreign investors active in mid 1996 were operating with properties expropriated from U.S. citizens.⁴⁶ According to an American Attorney, the Cuban government will not identify whether a piece of property has an approved U.S. claim.⁴⁷ It is up to the investor to due the proper due diligence to determine if there are any encumbrances on the property. To put the magnitude of these claims in perspective, today the total present value of U.S. certified claims, including 46 years of accumulated interest range from \$6 to \$20 billion. According to Dr. Ashby, “until these claims are settled this presents a huge problem for foreign investors.”⁴⁸ The U.S. President has repeatedly exercised a six month waiver authority under the law, postponing the ability of U.S. citizens to file suit.

On the other hand, Title IV of the Helms- Burton Act has been exercised. The U.S. Department of State has reportedly sent letters denying entry into the U.S. to executives and family members from Canada, Mexico, Israel, and a firm selling automobiles in Cuba from Panama.⁴⁹ According to a U.S. Department of State official, by March 1999, three determinations of “trafficking” under Title IV of the Helms-Burton Act had been made. Fifteen executives and their family members had been denied entry into the United States.⁵⁰ Arguably, the most notable case to date has been the restrictions put on the executives at Sherritt International. Sherritt International in Canada is the largest producer of nickel in the world, and Cuba’s largest

⁴⁶ “Foreign Investment Minister of Helms-Burton Law,” *El País* (Madrid) 15 June 1996, as reproduced in “Foreign Investment in Cuba in the Second Half of the 1990’s,” Pérez-López, Jorge F. 13 April 2000.

⁴⁷ Interview with Dr. Timothy Ashby, 6 August 2008.

⁴⁸ *Ibid.*

⁴⁹ Pérez-López, “Foreign Investment in Cuba in the 1990’s,” 6.

⁵⁰ “Advancing Human rights and Property Rights in Cuba: The Role of Multilateral Coalitions,” remarks by Alan P. Larson, Assistant Secretary of State for Economic and Business Affairs, to the U.S.-Cuba Business Council Conference, Coral Gables, March 9, 1999.

trading partner. Sherritt International's CEO, Ian Delaney, has been denied entry into the United States for the last eleven years due to his business ties with Cuba.⁵¹ As a result of these actions, American and Cuban attorneys point to the Helms-Burton Act as a tremendous challenge for investors interested in working on the island.

Challenges to foreign investment are not limited to those imposed by government constraints outlined in the Helms-Burton Act. According to foreign investors working in Cuba and Cuban academics living outside Cuba, two stumbling blocks for conducting business on the island are those constraints imposed by the Cuban government. Of the many restrictions placed on foreign investors, the two greatest hindrances appear to be the investment approval process by the Cuban government and the inability of the foreign investor to secure title to the investment property.

Real estate professionals experienced in markets with high entry barriers are familiar with exorbitant waiting periods required to complete a deal. However, according to a state official at the Cuban Chamber of Commerce, "Investing in Cuba is unlike any other investment experience. You need to demonstrate patience and be persistence because things do not always go as fast as one may wish."⁵² This was also echoed by a U.S. based attorney currently working with a client trying to export commodities. The attorney stated that the time it took to pass through the approval process, resulted in the client having to significantly increase the cost of the commodities, he was obliged to deliver under contract to Cuba.⁵³

While Law No. 77 represents a milestone for Cuban law, it is not without its shortcomings.⁵⁴ More specifically, the enactment of Law No. 77 establishes a sixty-day time period for MINVEC to approve or disapprove a proposed investment. According to Cuban scholars, "A major flaw in [Law 77] is its failure to establish objective criteria for approval of foreign investment

⁵¹ Anthony Boadle, "Canadian Investor Bullish on Raul Castro's Cuba," *Reuters Canada*, 11 June 2008, <http://uscubanormalization.blogspot.com/2007/08/canadian-investor-bullish-on-raul.html>.

⁵² Interview with José R. Méndez Rodríguez, 20 June 2008.

⁵³ Interview with Marco Gonzalez, 9 July 2008.

⁵⁴ Ashby and Jablonski, "Land Tenure in Cuba," 272.

entities, resulting in a bureaucratic and arbitrary approval process.”⁵⁵ As a result, this bureaucratic red tape has caused a significant amount of time to pass before deals are completed, which in turn has had a major impact on the way foreign investors view the opportunity cost of capital.

The Cuban government believes it is starting to address this issue with the passing of the *ventanilla unica*, or Single Window Act. The Single Window is a streamlined administrative process for foreign investments that, according to a Cuban attorney, is expected to diminish bureaucratic burdens and facilitate the timely execution of approved investments.⁵⁶ Many of the individuals I interviewed were familiar with the policy, though none had actually experimented with it. Further review of this policy and its consequences is warranted.

The greater concern, according to investors currently working on the island, is their inability to secure title to the investment property. Cuba, similar to China, does not allow for foreign land ownership. This means that all real estate deals are negotiated with long-term ground leases. The Cuban government claims the signed leases provide certain guaranteed rights to the investor. However, a concern weighing on the minds of investors is what type of protection would be afforded if the government decided to expropriate the land. This question poses a very real problem for foreign direct investment (FDI) in Cuba. As stated by a land scholar:

Land tenure systems are one of the many tools used to regulate society, and their deficiencies in developing countries in particular can greatly affect decisions by foreign investors on whether to invest in a particular country.⁵⁷

⁵⁵ Armando M. Lago, “An Economic Evaluation of the Foreign Investment Law of Cuba,” *Cuba in Transition*, Association for the Study of the Cuban Economy (ASCE), 1992.

⁵⁶ Sebastiaan A.C. Berger and Cameron Young, “Cuban Joint Ventures and Other Forbidden Fruits,” available at http://www.bergeryoung.com/press/CigarAficionado_Art_010207.pdf.

⁵⁷ W.L. Dickinson, “Land Tenure and the Developing Society,” Department of Surveys and Lands, Ministry of Local Government and Lands, Gaborone, Botswana, available at <http://www.unu.edu/unupress/unupbooks/80604e/80604E05.htm>.

Security of land directly affects foreign investment inflows, and is therefore vital to a developing economy such as Cuba's. Security of property rights relates to the time necessary to recuperate and make a profit from an investment.⁵⁸ The longer an investor holds the land or rights to the real property, the less the risk to the investor of not recuperating or profiting from the investment. In developing countries the most commonly used system is the freehold estate. It provides the greatest amount of security to the holder; at least in terms of the risk of investment overtime. However, the freehold system is not a good fit in a Communist country where the land is state-owned.⁵⁹

This is not to say that the Cuban government does not have a registry in place. Prior to the Cuban Revolution, the Cuban government had the Cuban Land Title Registration System, modeled after the Spanish Mortgage Law of 1893. The registry system (called Public Records in the United States), provides for the recording of legal documents for public purposes. As previously noted, more often than not, foreign investors require ownership of land to secure their investment. This is why, in response to Law No. 77, the Cuban government "re-discovered the registry system that once existed prior to Castro's revolution."⁶⁰

According to Jose Manuel Pallí, "the registry system was grounded on the need to satisfy the expectations of foreign investors in real property with regard to the certainty and stability of their rights."⁶¹ For a brief time in the early 1990's, foreigners who bought residential real estate requiring a title were able to go to the registry and have the title to their property recorded at one of the four registries in Havana. This created a short run on Cuban real estate.

For the Cuban government, the establishment of the registry allowed for two changes. First, the government was able to sell property to foreign investors. Secondly, the government could

⁵⁸ This is the opinion of three foreign investors interviewed.

⁵⁹ Ashby and Jablonski, "Land Tenure in Cuba," 273.

⁶⁰ Jose Manuel Pallí, "Land Title Registration in Cuba: Past, Present and Future," *Cuba in Transition*, Association for the Study of the Cuban Economy (ASCE), 6 August 2005.

⁶¹ *Ibid.*, 11.

further keep track and control the daily lives of its citizens.⁶² Due to a loophole in the system, the Cuban government ended the approval of all forms of “pure” real estate-- condominiums, apartments, office space, etc. Many foreigners formed relationships with Cubans who could eventually claim a stake over property. Once the government realized what was taking place there was a sudden change in Cuba’s attitudes towards foreign investment in 2000. As an explanation for this change, the government declared that the condominium high rises being built for the foreign investment market (mostly in the Miramar area of Havana) were straining the city’s utilities infrastructure. This called for an exhaustive reassessment of the viability of the pending projects.⁶³

In an interview with a MINVEC consultant in June 2008, he confirmed that “pure” real estate investments have been discontinued due to inadequate infrastructure. In turn, the registry system that appeared to be returning to pre-Fidel Castro levels, now exist at an unacceptable status. Titles are filed with incomplete data (e.g. missing addresses) and the habitual dissolution of property has presented a challenge to investors. One of the founding principles of property rights, protecting purchasers and mortgages, has not been honored. As a result, title provides questionable value to the investor.

Human Resources

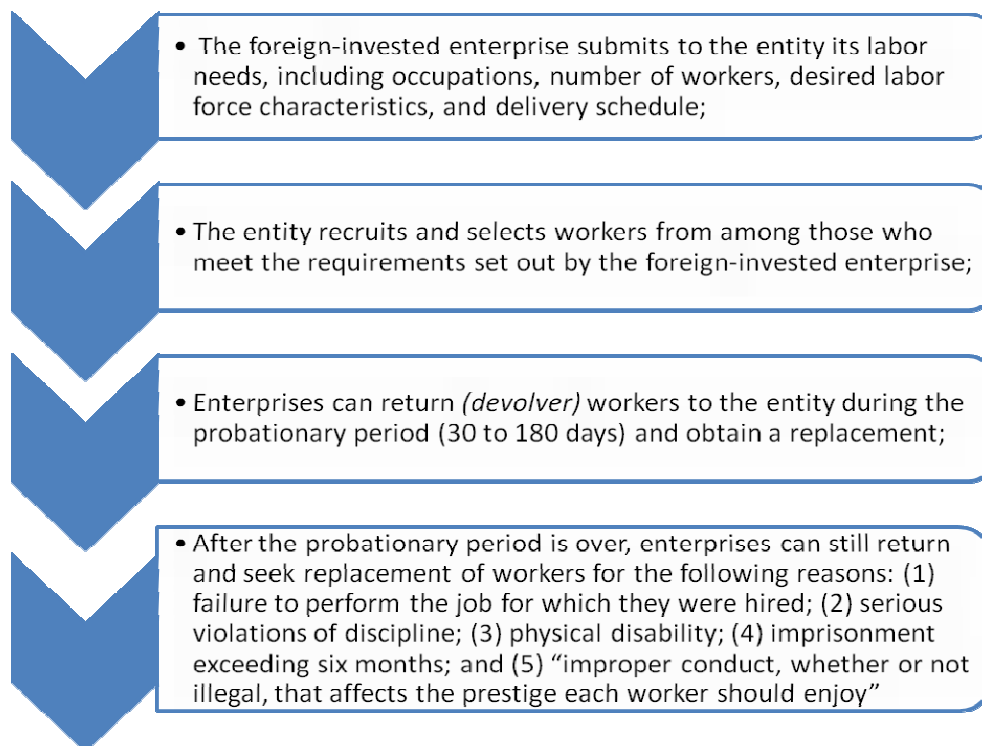
The manner in which labor is sourced in Cuba provides another challenge for foreign investors. In Cuba, Resolution No. 3/96 of the Ministry of Labor and Social Security issued in 1996 establishes regulations for workers of foreign-invested companies operating in Cuba. This resolution states that workers of foreign-invested companies are formally hired by an “entity” of the Cuban Government. This so called “entity” contracts with the foreign-invested company for labor services. In contracting with the government entity, the foreign investor pays the government entity directly for the labor services. In addition, the government entity also

⁶² Ibid., 7.

⁶³ Ibid., 12.

selects the laborers who will be employed by the foreign investor. Exhibit 7 illustrates the relationship between the foreign-invested enterprises and the “entity,” as put forth in Article 7 of Resolution 3/96.⁶⁴

Exhibit 7: Article 7 of Resolution 3/96



A concern that has arisen over the use of the government entity is the methodology used in selecting employees. The jobs provided by foreign investors tend to be the most sought after jobs on the island. These jobs bring Cubans in contact with hard currency; i.e., tips. As a result, all individuals, whether retired army generals or college graduates, covet these jobs. Yet it is not uncommon for the government entity to favor certain classes of workers more politically aligned to the government over other workers such as retired members of the armed forces.

⁶⁴ Pérez-López, “Foreign Investment in Cuba in the 1990’s,”18.

Among the complaints of a group of Mexican investors in tourism was the requirement that they hire Cuban Communist Party members and retired personnel of the armed forces. According to the Mexican investors, these individuals were far from being qualified for the jobs they held.⁶⁵

In addition to the selection process, Resolution No. 3/96 also establishes criteria for dismissing workers. Stated in the resolution are “suitability” requirements that give the entity the power to screen out workers for political correctness. This “suitability” requirement might suggest that there is a much higher emphasis on the relationship with the Cuban government than on the performance of a job assignment. Obviously this could negatively impact the quality of work.⁶⁶

Convertible Currency

One of the biggest challenges to foreign investment, according to Cuban and American economists, is the use of dual currencies on the island. In Cuba, there are two national currencies: *la moneda nacional* or the “Cuban Peso,” and the *Peso Convertible* or CUC. In the opinion of an American economist, this dual currency coupled with the fact that labor is procured directly through the state, has allowed the Cuban government to “skim off the top.”⁶⁷ From the vantage point of a Cuban economist, the dual currency impedes an accurate depiction of the state of the economy.

In Cuba, there is no relationship between the foreign invested entity and the Cuban worker (as mentioned above). The foreign investor is responsible for paying the Cuban entity in convertible currency (CUC) for the total compensation (i.e. salary plus benefits and social security contributions of the workers). The workers then receive paychecks from the Cuban government. However, workers are paid in the domestic currency or Cuban peso rather than

⁶⁵ Pérez-López, “Foreign Investment in Cuba in the 1990’s,” 19.

⁶⁶ *Ibid*, 21.

⁶⁷ Jorge F. Pérez-López, Economist with Fair Labor Association, Telephone Conversation, 12 July 2008.

the CUC. In this transaction, the Cuban government uses the official exchange rate, one U.S. dollar to one peso. This creates a significant discrepancy between the money in and money out. The exchange rate over the last five years has ranged from 20 – 24 Cuban pesos to one U.S. dollar. At a 20:1 exchange rate, the Cuban government appropriates 95% of the salaries of the approximately 60,000 Cuban workers employed by foreign investors.⁶⁸

Often the workers' salaries in pesos do not provide a living wage, therefore, managers of some foreign invested entities have been known to provide gifts. A small stipend in hard currency, a basket (*jaba*) of goods only available in hard currency stores, free lunches or a meal allowance, or free transportation are examples of such gifts. It is important to note that some of these practices are illegal, though they seem to be condoned.⁶⁹ Managers consider these supplements a useful means for motivating workers and increasing productivity. However, the ability of managers to provide stipends or additional resources that “meet the basic needs of their workers is limited because of the relatively high payments that foreign-invested enterprises already make to the Cuban state through the domestic labor entity.”⁷⁰ Additional financial contributions foreign investors are required to make for each employee are:

1. 1/12 or 9.09% is set aside to pay for the one-month paid vacation all workers receive annually.
2. A payroll tax equivalent to 25% intended to pay for social security and other programs.
3. A monthly commission of 10% is paid to the government for procuring the labor.⁷¹

To illustrate the impact of this currency discrepancy, Exhibit 8 indicates the salary of an engineer working for a foreign entity. The annual salary paid to the engineer is \$439.08. With the additional employer contributions, the foreign invested enterprise is responsible for paying

⁶⁸ Philip Peters, *A Different Kind of Workplace: Foreign Investment in Cuba*. Arlington Virginia: Alexis de Tocqueville Institution, March 1999.

⁶⁹ *Ibid.*, 6.

⁷⁰ Pérez-López, “Foreign Investment in Cuba in the 1990’s,” 21.

⁷¹ *Ibid.*, 23.

\$646.64. If the employee’s base salary were \$439 a month with a 20:1 conversion rate, the monthly take home pay of the Cuban engineer is the equivalent of \$22 or 3.4% of the total outlay incurred by the foreign invested entity for his or her services

Exhibit 8: Compensation Chart for Cuban Employee

	Amount \$USD	%
Annual Base Salary	\$439.08	--
Vacation (One Month)	\$39.91	9.09%
Payroll Tax to cover Social Security and other Employee Benefits	\$119.75	25% of adjusted salary or 27% of base Salary
Labor Commission	\$47.90	10% of adjusted salary or 11% of base salary
Gross Pay by Foreign employer	\$646.64	
Cuban Take Home Pay After Conversion*	\$21.95**	3.4% of Initial Outlay
Amount Kept by Cuban Government	\$624.69	96.6%

*Conversion calculated at 20:1.

**The \$21.95 is calculated off the base salary. ($\$439.08 / 20 = \21.95). The vacation stipend, payroll tax and labor commission go directly to the Cuban government.

To put this in perspective, if the monthly cost of a sales assistant is \$382, and there are 60,000⁷² sales assistants employed by Cuban entities, the monthly amount collected by the government would be \$21.78 million or \$261 million per annum.⁷³

It is very challenging to substantiate the claim that the government “skims off the top.” The Cuban government tightly controls the inflow and outflow of information. As a result, I was unable to document such an occurrence on the island. However, in 2006, a lawsuit was filed in Miami on behalf of Cubans sent to work in Curacao. The lawsuit claims that in order for the Cuban government to repay debts to the Curacao Dry Doc, Cuban nationals were sent to work as “slave labor.”⁷⁴ The employee contracts put in place state that the workers were to be paid \$1,500 a month. The gentlemen allege that instead of the \$1,500, they were provided money for food amounting to 400 Cuban pesos or \$18 USD a month.⁷⁵ In addition, the laborers were forced to work 116 hours a week in substandard conditions. If the Cubans refused to work under these circumstances, they were sent back to Cuba and imprisoned. This occurred on a number of occasions.⁷⁶

In addition to the impact the double currency has on human resources, per Cuban economists and businesses, the impact on the overall economy is even larger. For example, the overvaluation of the official exchange rate of the Cuban peso distorts any measurement of the economy, the accounting balances of businesses and the calculation of the GNP.⁷⁷

⁷² The estimate of 60,000 workers in foreign-invested enterprises is from Peters, *A Different Kind of Workplace: Foreign Investment in Cuba*, p.9, and is based on 1997-98. There is also a more recent estimate of 160,000 workers employed directly and indirectly by foreign-invested enterprises, but this figure is not used here since it is not clear how indirect employment has been defined. See Olance Noguerras, “Empleados sufren ‘explotación extrema,’” *El Nuevo Herald* (13 December 1998), p. 6A.

⁷³ $\$382.01 = \19 is the amount actually paid to Cuban laborer $\$382 \times 20 = \19 . Amount kept by Cuban government $\$363$ or $\$382 - 19$, multiplied by 60,000 - $\$363 \times 60,000 = \$21,780,000$ per month.

⁷⁴ Frances Robles, “Cuba Paid Debt with Forced Labor,” *Miami Herald*, 17 July 2008, <http://www.miamiherlad.com/581/story/607434.html>.

⁷⁵ Ibid.

⁷⁶ Ibid.

⁷⁷ Pavel Vidal Alejandro, “Cuba’s Convertible Peso: Monetary Duality and Economic Distortion,” *FOCAL Point* 7, No. 1703-7964, May 2008.

Summary

In order to depict the investment climate in Cuba, the biggest hurdles for working on the island have been presented. The reasons why different types of American real estate professionals might be drawn to the island have been presented in this chapter. From that information we identified two types of potential investors. Those individuals consist of real estate professionals who have a short-term investment objective and professionals in addition to investors who are looking for an opportunity to let their money grow over an extended period of time. The challenges in Cuba are important to these individuals because they allow companies to gauge the risk associated with Cuba. By determining the level of risk associated with Cuban real estate, investors can set the necessary “hurdle rates” for working in Cuba. In a conversation with a U.K. based investment bank, “right now, the return in Cuba is equal to what it was in Estonia, about 30%.”⁷⁸ The calculation of risk premiums for the three respective challenges is left for a further date.

For many these obstacles would dissuade individuals from pursuing investment opportunities. For others, these obstacles would present an opportunity to capitalize on overcoming these challenges. In order to provide insight on how to overcome these hurdles, chapter 4 will offer the advice of Cubans and foreign investors of how to successfully work on the island.

⁷⁸ Christopher Eddis, Telephone Interview, 5 June 2008.

CHAPTER 4: ADVICE FOR INVESTING IN CUBA

The challenges of investing in Cuba have been highlighted against the backdrop of its 2008 investment climate and the Raul Castro regime. Whether it is restrictions enacted by the governments of Cuba or the United States, the fact that investors are prohibited from procuring labor directly, or the obstacles resulting from the use of dual currencies, investment in Cuba presents a number of challenges.⁷⁹ This chapter will provide advice from Cubans and investors working on the island as to how to get past these encumbrances.

The “Right” Fit

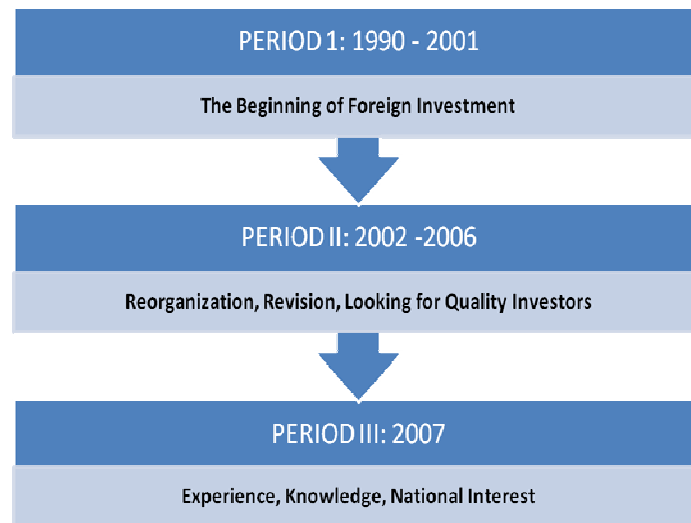
As previously mentioned, the rhetoric of key government officials has created a cloud of doubt over Cuba’s desire for foreign direct investment (FDI). However, this sentiment has appeared to change. Mark Entwistle, Canada’s past Ambassador to Cuba, conducts real estate transactions on the island and has this to say on the subject, “FDI has been dusted off the shelf because Cubans have recognized that the most successful companies are the ones that are foreign managed. They are the ones really driving the economy.”⁸⁰ State officials working for Conas and the Cuban Chamber of Commerce agree.⁸¹ In a power point presentation provided by the Cuban Chamber of Commerce, Cuban officials have characterized this relationship as having moved through three periods since the enactment of the Foreign Investment Law in 1995 (See Exhibit 9).

⁷⁹ Carmelo Mesa-Lago, “The Cuban Economy in 2006 – 2007,” *Cuba in Transition*, ASCE, 2007.

⁸⁰ Duane Morris Webinar, *How Your Company Can Position Itself for Doing Business in Cuba*, webcast presentation by Mark Entwistle, Dr. Timothy Ashby and Marco Gonzalez, March 2007.

⁸¹ This was confirmed by an employee at the Cuban Chamber of Commerce and a Conas Consultant.

Exhibit 9: Periods of Foreign Direct Investment in Cuba



During Period I, according to Cubans working for Conas and the Chamber of Commerce, Cuba was initially very skeptical of foreign investment. Having had bad experiences with both Spain and the United States, Cuba did not want to lose control of its economic capabilities. These experiences, in the minds of Cuban officials, have allowed Cubans to better recognize the type of investors they would like to attract.⁸² Following the passage of the Investment Act in 1995, Cuba opened its doors to a number of foreign investors. While some of the investors who penetrated the market were highly qualified, others lacked the expertise they initially promised.⁸³ As a result of this problematic situation, Cuba has become much more selective of the companies they allow to invest, and are highly focused on finding the “right fit” with potential business partners.⁸⁴ A consultant to MINVEC explains, “If you are looking to do

82 Interview with Rafael Roqueta Garcia, 23 June 2008.

83 Ibid.

84 Interview with Jorge F. Pérez-López, 12 July 2008.

business in Cuba, you need to be at the top of your respective field if you want to get your idea approved.”⁸⁵

For Cubans, an experienced background helps in two ways. First of all, the possibility of failure due to inexperience in hotel development lessens. This is important because the Cuban government feels that the initial influx of foreign business brought a number of inexperienced investors. The subsequent failure of these investors, in the opinion of the Cuban, was due to the lack of experience in their respective field.⁸⁶ Therefore, having a proven track record mitigates against this risk. Secondly, an established name brand brings an inherent level of “branding” to a future project. Investors who are likely to succeed in Cuba are those with a well-recognized name or that partner with someone who brings that attribute to the table.

Understanding What Cubans Want

The second most important piece of advice, according to Conas and the Cuban Chamber of Commerce, is understanding exactly what type of business ventures the Cubans are looking to pursue. A Conas employee said that Cubans are not willing to pursue any foreign investment that they feel they can complete themselves.⁸⁷ Rather, Cubans are “looking for foreign investment that complements their national efforts.”⁸⁸ A thorough understanding of this philosophy might well expedite the approval of a project.

Today, the Cuban government is interested in developing two types of tourism as it relates to real estate. The first is the development of golf course resort communities. This is in stark contrast to Raul’s older brother’s sentiment towards the sport. In 1962, Fidel Castro lost a round of golf to Ernesto “Che” Guevara and his defeat had disastrous consequences for the sport. A journalist who wrote about the defeat suffered by Cuba’s Leader also described Fidel as a notoriously bad loser; the journalist was fired the next

⁸⁵ Interview with Rafael Roqueta Garcia, 23 June 2008.

⁸⁶ Interview with José R. Méndez Rodríguez, 22 June 2008.

⁸⁷ Interview with Rafael Roqueta Garcia, 23 June 2008.

⁸⁸ Ibid.

day. Subsequently, Fidel had one Havana golf course turned into a military school and another into an art school. Mocking the members of the Havana Biltmore Yacht and Country Club in a 1960 speech, Fidel said, “These guys don’t even think in Cuban.”⁸⁹ Yet a change in dictators has brought about a change in attitude. In the eyes of Raul Castro’s new regime, golf course resort developments are very important to the further expansion of the tourist industry. In 2007 Cuba’s Minister of Tourism, Manuel Marrero, announced plans to build as many as ten golf courses to lure upscale tourists to the island.⁹⁰

The Cuban government has taken the process one step further by setting up an interagency golf task force. To ensure the success of golf tourism, the task force proposes extending ground leases to identified golf properties that would last up to seventy-five years. The hope would be that foreigners might further invest in villas and condos on which modern golf depends.⁹¹ The chance to build condos in conjunction with golf course communities identifies a potential opportunity that has otherwise been unavailable to foreign investors. According to Conas, the Cuban government does not allow for “pure” forms of real estate on the island. Condominiums, office buildings, and retail space all fall under the heading of “pure” real estate, and as of 2008 cannot be pursued by foreign investors. A clear understanding of the type of development desired by Cubans will help open doors to investment opportunities that were previously unattainable.

The second form of real estate currently being pursued by the Cuban government is eco tourism. Eco tourism, defined as tourism activities conducted in harmony with nature, is one of the most sought after forms of development on the island. Fidel Castro advocated sustainable development policies and practices as a means of preserving Cuba’s fragile biosphere. Sergei Khrushchev rallied that the promotion of eco tourism in Cuba would be key to bringing the

⁸⁹ José de Córdoba, “Hooking Left: Cuba Tees up Golf’s Revival.” *Wall Street Journal*, 23 February 2008.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

“hearts and minds” of U.S. tourists and Cuban service providers together for a deep appreciation of Cuba’s ecology and culture.⁹²

Establishing Trust

Part of the Cuban government’s skepticism of direct foreign investment dates back to an attitude of distrust prevalent during colonization. Dating back to the arrival of the Spaniards in 1492, continuing through the Spanish American War, and ending with Fidel Castro’s revolution, Cuba has been controlled by foreign countries. Following the arrival of Christopher Columbus, Spain quickly set up a strategic trade market in Havana. Cuba would act as the primary provider of products such as sugar, tobacco, coffee and rum for Spain. A rebellion would later free Cuba of its obligations to Spain. With the departure of Spain would come the arrival of another super power, the United States. Although the U.S. Congress passed the Platt Amendment to assure the world that they were not claiming sovereignty in Cuba, it was widely believed that Cubans had traded one set of colonial masters for another.⁹³

The Cuban government’s reluctance to open its economic doors to the international market is in part due to lack of trust of the outside world. For Cubans, there is a fear that history will repeat itself. As a result, former Cuban Ambassador Mark Entwistle notes, “Those who expect to be welcomed with open arms once the embargo drops are naively mistaken.”⁹⁴ Cuban officials fear that the return of foreign investors will mean a resumption of foreign control over the island. Therefore spending the time to establish trust is critical. According to a U.S. attorney, “forming a strong business relationship is a ‘Latino thing.’ If that is not in place, chances of gaining project approval could take much longer.”

As mentioned earlier in the chapter, proving to the Cuban government that your company has an established name in the field is critical is one way for establishing trust. Cubans believe that they have allowed real estate professionals to work on the island who have misrepresented

⁹² Khrushchev, Henthorne, LaTour, “Cuba at the Crossroads,” 413.

⁹³ Addison, “Real Estate Investment Opportunities in Cuba,” 7.

⁹⁴ Entwistle, Ashby and Gonzalez, Duane Morris Webinar.

themselves. Therefore having a name with a high degree of credibility will go a far way. The most important mechanism for establishing trust is conceding control. In the tourism industry, this means being able to assure Cuban hospitality management and government officials that there is no interest in assuming control and that control should stay in the hands of the Cubans in any joint venture.⁹⁵ Although there have been economic changes, the majority of the Americans interviewed for this paper believe that the Cuban government will not relinquish control of its real estate assets. Therefore, working with Cuban real estate will require concession of control to the Cuban government.

Summary

Although Cuba presents a number of challenges for investing there are opportunities to overcome these hurdles. The three ways to do so are as follows:

1. Make sure your company is the “right fit”;
2. Understand what the Cubans want; and
3. Establish trust.

The Cuban government is not looking for real estate companies to arrive in Cuba and “test the waters.”⁹⁶ Instead, the Cubans would like to see real estate companies arrive well versed in the needs of the Cubans. Understanding the needs of the Cubans also requires understanding the capabilities of the Cubans. One must not forget that foreign direct investment is complimentary to national efforts. Therefore, any idea must be out of the scope of the Cuban’s capabilities. In addition, Cubans will not be willing to concede control of their real estate assets anytime soon. Forming relationships with Cubans is integral to a successful venture. For those who are able to overcome those hurdles the opportunities to make money on the island do exist. The next chapter will provide three options for investing in Cuba.

⁹⁵ Khrushchev, Henthorne, LaTour, “Cuba at the Crossroads,” 412.

⁹⁶ Interview with Marco Gonzalez, 9 July 2008.

CHAPTER 5: HOW TO INVEST IN CUBA

The Cuban real estate market already has a number of major players. In the resort market, companies such as Sol Meliá of Spain, the NH Hotel Group of Spain, and Leisure Canada have spent years establishing a relationship with the Cuban government. As these companies have asserted themselves in the Cuban market, American hoteliers have had to sit idly and watch. According to hotel developers, watching closely is a more accurate depiction of the last years.⁹⁷ The U.S. government's lifting of the trade embargo on agricultural products and medical supplies coupled with the upcoming elections, have real estate professionals closely monitoring the U.S.-Cuba relationship. However, according to an American scholar and a number of U.S. attorneys interviewed, the opportunity to invest in Cuba real estate already exists. This chapter presents three options for foreign investment in Cuba:

1. Indirect investment through a third-company currently working in Cuba;
2. Creating an off-shore entity with a non-Cuban entity that invest in Cuba; and
3. Executing a non-binding Letter of Intent (LOI) with the Cuban government.

Indirect Investment

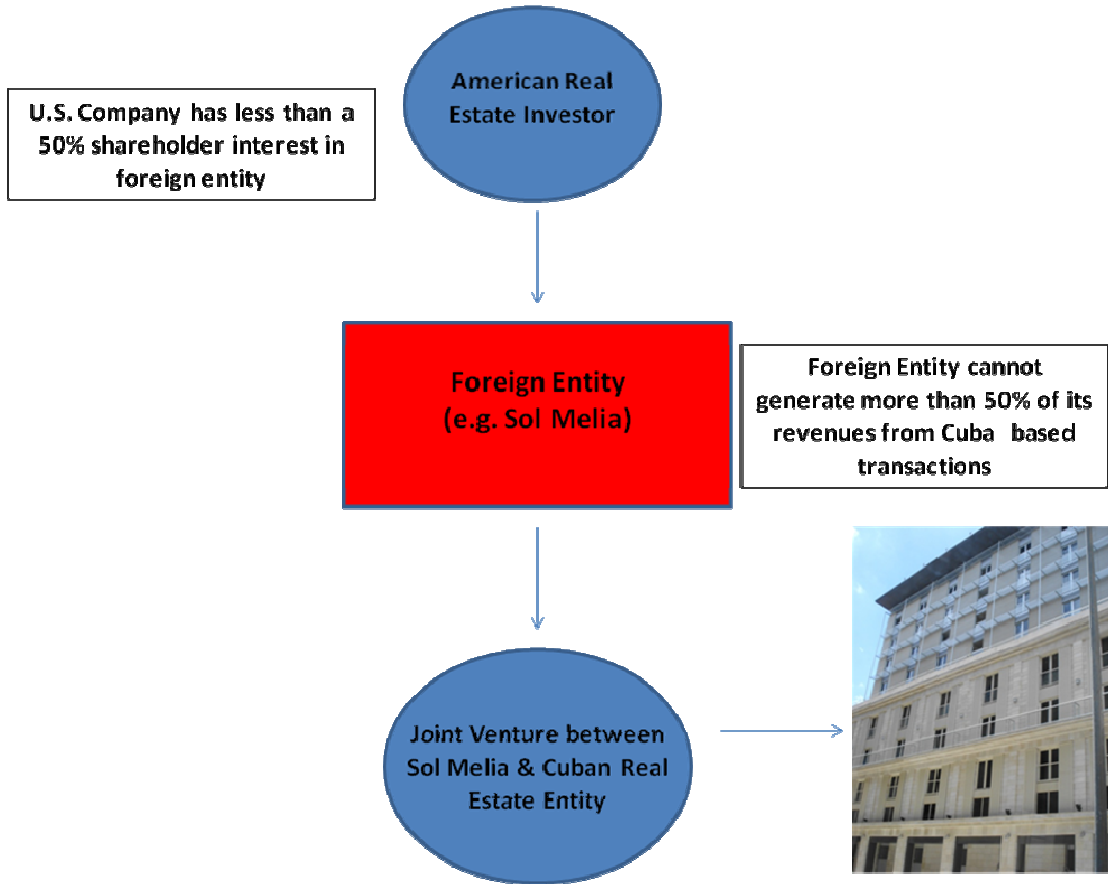
According to an American academic, U.S. indirect investment in Cuba is an increasingly important and largely unexplored aspect of U.S.-Cuba economic relations.⁹⁸ American businesses that have successfully "made a presence" in foreign firms trading with Cuba have access to indirect investment possibilities. The U.S. Department of Treasury authorizes individuals and firms subject to U.S. laws the opportunity to invest in a third-country company that has commercial activities in Cuba.

⁹⁷ Interview with Michael Harrison, Senior Vice President at Hines Southeast Regional Office, Telephone Interview, 18 April 2008.

⁹⁸ Paolo Spadoni, "U.S. Financial Flows in the Cuban Economy," *Transnational Law & Contemporary Problems*, Vol. 14:81, 2004.

Exhibit 10 depicts the manner in which indirect investment occurs in Cuba. Essentially, an American real estate professional becomes a shareholder in either a public or private foreign company who conducts business in Cuba. The foreign entity then partners with a Cuban real estate related entity, per Law No. 77 (See Appendix D), in order to invest in Cuban real estate.

Exhibit 10: Indirect Investment in A Foreign Company



In order for an American company to invest in a third party the American company must meet two requirements. First, the U.S. Company cannot have a controlling interest in the third party,

and secondly, the majority of the revenues of the third-party company cannot come from Cuba.⁹⁹

Exhibit 11 provides data on the presence of U.S. held shares in selected foreign companies operating in Cuba's markets. As observed by John Kavulich, "U.S. companies have affiliations with and U.S. citizens have investments in Sol Meliá, Unilever, Accor, Alcan, Fiat, Daimler Chrysler, and Nestlé among many other companies, which have commercial activities within Cuba."¹⁰⁰ Kavulich also notes "most of the largest U.S. financial institutions and investment banks provide services for companies that have commercial activities within Cuba."¹⁰¹ The data in Exhibit 11 has been aggregated based on public information. The presence of American investors in certain companies might even be higher than reported.¹⁰²

⁹⁹ Spadoni, "U.S. Financial Flows in the Cuban Economy," 110.

¹⁰⁰ *Ibid.*, 111.

¹⁰¹ *Ibid.*, 112.

¹⁰² *Ibid.*, 112.

Exhibit 11: U.S. Investment in Selected Foreign Companies Operating in Cuba¹⁰³

Yr.	Company	Country	Type of Operations in Cuba	Presence of U.S. Investors (%)	Major U.S. Investors
2000	Hotetur	Spain	Management Contract in 3 hotels	26%*	Florida Based Carnival Corporation
2000	Iberia Airlines	Spain	Two Joint Ventures in cargo terminal and aircraft maintenance	2%	Texas-based American Airlines, Inc.
2000	Mitsubishi Motors	Japan	Exporter of Vehicles	10.41%	California-based Capital Research and Management Co.
2000	Nestlé	Switzerland	Mineral water and soda-bottling joint venture	14%	--
2000	Sol Meliá	Spain	23 Management Contracts and 4 equity interests in Cuba's tourist sector	16%	--
2000	Telecom Italia	Italy	Joint Ventures in telecommunications	3%**	New York – based Lehman Brothers Holdings, Inc.
2001	Alcan	Canada	Exporter of aluminum products	23%	--
2002	Fiat Group	Italy	Exporter of vehicles	20%	Michigan-based General Motors Corporation
2002	Leisure Canada	Canada	Developer of luxury multi-destination resorts	30%	California-based Robertson Stephens, Inc.
2002	LG Electronics Investment	South Korea	Exporter of refrigerators, washing machines, air conditioners, televisions	6.6%	New York-based The Goldman Sachs Group
2003	Accor	France	Several Management contracts in Cuba's tourist sector	16%	--
2004	Souza Cruz	Brazil	Joint venture in tobacco sector	5.5%***	--

¹⁰³ Ibid., 111.

*In 2000, Carnival Corporation owned 26% of U.K. –based Airtours PLC, which owned 50% of Hotetur.

**In 2000, Lehman Brother owned 3% of Italy-based Olivetti S.p.A. Telecom Italia is a subsidiary of Olivetti.

***In March 2004, U.K.-based British American Tobacco (BAT), which also has U.S. capital, held 75.3% of the shares of Souza Cruz.

The following are details of specific U.S. indirect links with Cuba as reported by the U.S.-Cuba Trade and Economic Council and by financial reports of individual companies.¹⁰⁴

- In 2000, individuals subject to U.S. law held approximately sixteen percent of the shares of Spain-based Sol Meliá. Sol Meliá, the largest hotel company in Spain, is the leader in Cuba’s tourist sector with equity interests in four hotels and twenty-three management contracts.
- Likewise in 2000, Florida-based Carnival Corporation increased indirect minority presence in Cuba with the purchase of Airtours. Airtours, a UK based company, has a fifty percent ownership of the Spain-based hotel group, Hotetur Clun S.L. Carnival Corporation owns twenty-six percent of the shares of Airtours. Hotetur Club has management contracts in three hotels in Cuba--the Deauville in Havana, the Hotetur Palma Real, and the Hotetur Sun beach in Varadero.
- Leisure Canada is developing five-star hotels, timeshare condominiums, and a PGA golf course in Cuba, with an estimated investment cost of \$400 million. Leisure Canada announced that the company is positioned to capitalize on the economic growth of Cuban tourism and the future growth fueled by the U.S., pending the inevitable normalization of U.S.-Cuba relations. Leisure Canada proclaims that it is perfectly legal for potential U.S. Investors to purchase shares of the Canadian company, and adds that U.S. investment banks already control twenty percent of Leisure Canada.
- In December 2003, U.S. investors held sixteen percent of the shares of the French group Accor. The Accor group manages several hotels in Cuba with establishments that

¹⁰⁴Spadoni, “U.S. Financial Flows in the Cuban Economy,” 112 – 114.

operate under the Novotel, Sofitel, Coralia, and Mercure brand names. More specifically, Accor runs the Sofitel Sevilla hotel in Havana, the Mercure Cuatro Palmas hotel in Varadero Beach, and the Sofitel Casa Granda Hotel in Santiago de Cuba. Accor also plans to partner with Corali Club Bucanero, anticipating the management of more than fifteen facilities on the island under the consortium's different brands.

Although public information highlights American companies with indirect business ties to Cuba, it is difficult to make a comprehensive analysis of U.S. indirect business connections. Private companies are not required to publicize their list of shareholders. American scholar, Paolo Spadoni points out that the origin of financing for specific business operations is often unknown, because millions of dollars are often moved around the world via electronic transaction.¹⁰⁵ Cuban economist Omar Everleny Pérez Villanueva notes,

[t]here are many companies in Cuba that are based in the Bahamas, other Caribbean islands, Spain or Britain, and you really cannot tell if these companies receive U.S. funds attracted by the high interest rates we [Cubans] pay.¹⁰⁶

Exhibit 11 illustrates that American entities hold publicly traded shares of major foreign firms engaged in business with Cuba, many of which are in the real estate tourism industry. According to Mr. Spadoni, understanding the real intentions of American businesses with indirect ties to Cuba can be complicated. American companies are reluctant to reveal any interest in Cuba for fear of punishment from the U.S. government.¹⁰⁷ American businesses deny that the Cuba component is the driving force behind investing in a company when they are questioned on the matter. They maintain that it is the overall economics of the company that attracts their involvement. Paolo Spadoni reminds us "American investments in foreign companies that operate on the island are just another example of the gaping holes in the United States' effort to

¹⁰⁵ Spadoni, U.S. Financial Flows in the Cuban Economy, 115.

¹⁰⁶ Ibid., 119.

¹⁰⁷ Interview with Paolo Spadoni, Professor at Rollins College Department of Political Science, Telephone Interview, 10 June 2008.

economically isolate Cuba.”¹⁰⁸ So for American entities interested in pursuing real estate ventures, the opportunity exists for companies to obtain a Cuba-related stock portfolio if their mode of investment is an indirect one.

“Off-Shore” Entity with Non-Cuban Partner

According to Dr. Timothy Ashby, for a less passive business there is a more direct opportunity for real estate investment in Cuba today. American real estate investors have been able to joint venture (JV) with non-Cuban foreign entities to invest directly in Cuban real estate, which according to Dr. Ashby, “Has happened already on a number of occasions (See Exhibit 12).”¹⁰⁹ In essence a U.S. real estate company JV’s with a non-Cuban foreign entity. Together, this joint venture structures an “offshore vehicle”¹¹⁰ for investing in Cuban real estate. Similar to the procedures in place for a foreign investor working in Cuba, that off-shore vehicle must set up another joint venture with a Cuban real estate related entity. Through this JV, American real estate professionals can invest directly in Cuban real estate.¹¹¹

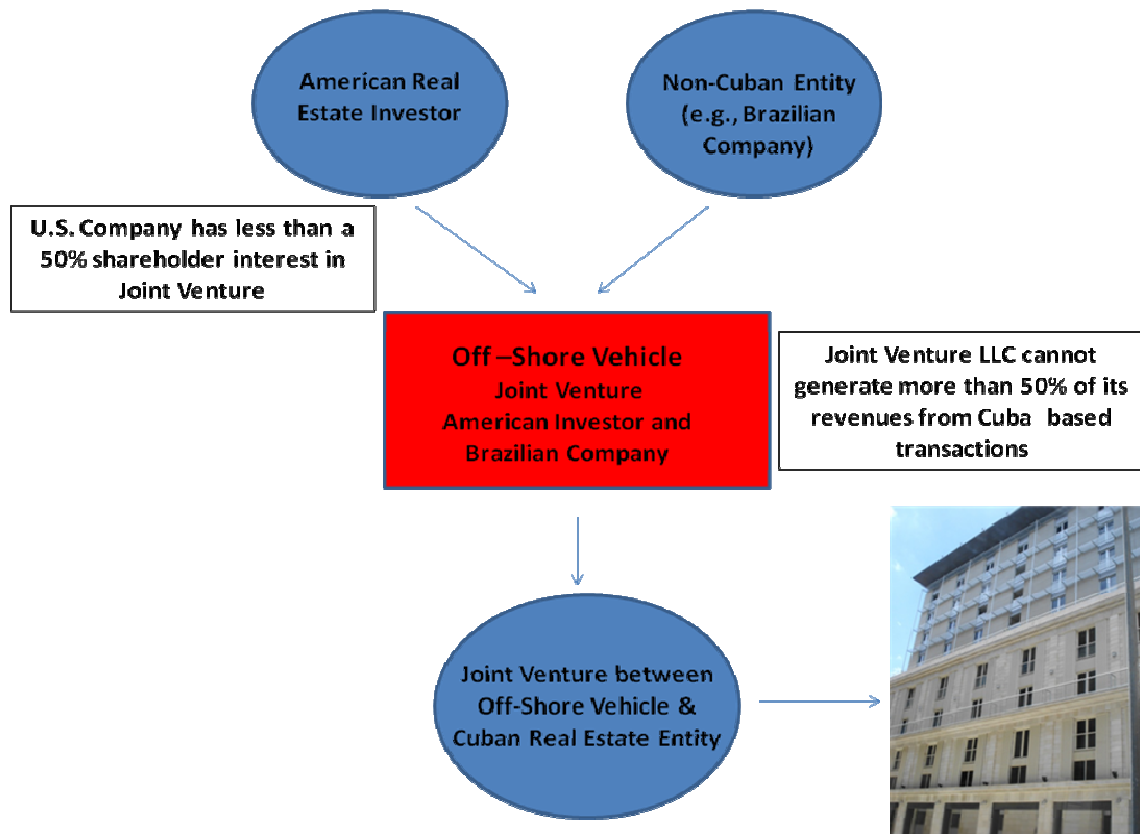
¹⁰⁸ Ibid., 119.

¹⁰⁹ Interview with Dr. Timothy Ashby, 6 August 2008.

¹¹⁰ An offshore investment vehicle is an entity created outside of one’s home country that is used to accomplish certain investment objectives. The entity is typically created for tax-shielding purposes. In order to create an offshore investment vehicle, an individual must establish a legal presence in the offshore country where he/she intends for investment gains to be taxable.

¹¹¹ Ibid.

Exhibit 12: Off-Shore American Investment



In order for an American company to avoid violating U.S. trade legislation, the Company must meet the same criteria as an investment through a foreign entity, outlined above. First, the U.S. Company cannot have a controlling interest in the third party, and secondly, the majority of the revenues of the third-party company cannot come from Cuba. In addition, the American company cannot have control of the board of directors.¹¹² Meaning, if there are ten board members, the American investor cannot control more than four of those seats. Although what constitutes ownership and control is not particularly clear at the Office of Foreign Asset Control. According to Dr. Ashby, the general assumption is that, “Ownership means 100 percent stakeholder interest and control means more than 50 percent stakeholder interest.”¹¹³

¹¹² Ibid.

¹¹³ Ibid.

In lieu of a lifting of trade restrictions, Dr. Ashby recommends that these metrics be used as a guideline for investing.¹¹⁴

Letters of Intent (LOI)

According to U.S. attorneys, the process of investing in Cuba is already under way for American companies. Although it is illegal to conduct business with Cubans outside of the agricultural and medical sectors, it is not illegal, according to attorneys from Duane Morris, to sign non-binding Letters of Intent (LOI).¹¹⁶ In fact, this is a phenomenon that is happening quite regularly with American companies across many sectors. However, those businesses that are signing LOI's are proceeding with the utmost secrecy out of concern for creating further market competition.

So why are American companies moving forward with non-binding Letters of Intent? According to U.S. attorneys, there is a fear that once the U.S. embargo is lifted, "the train will have already left the station."¹¹⁷ There are a number of American companies fearful that once the doors open to U.S. investors, there will be such an influx of potential business that getting a foot in the door will be very difficult. Not only will you have to compete against the companies that have spent the last twenty years establishing themselves but also the American companies that have watched patiently waiting for the embargo to be lifted. Former Cuban Ambassador Mark Entwistle commented that "Cuba is not an empty playing field, it is not an empty vessel. It is a market that has people in it already, a market that is developed and quite sophisticated." As a result, investors are spending money now to court the Cubans in hopes of securing a non-binding letter of intent for the rights to develop future properties. These investors hope to establish an agreement that provides their company with the first opportunity to build once the embargo is lifted.

¹¹⁴ Ibid.

¹¹⁵ Entwistle, Ashby and Gonzalez, *Duane Morris Webinar*.

¹¹⁶ Interview with Marco Gonzalez, 9 July 2008.

¹¹⁷ Entwistle, Ashby and Gonzalez, *Duane Morris Webinar*.

Will the Cuban government honor these non-binding Letters of Intent? In the opinion of U.S. attorneys, the execution of these Letters of Intent is not just an “academic exercise” for the Cuban government. Cuba does not have the time to spend courting American businesses and considers this procedure to be a valuable use of time, according to the attorneys interviewed. The Cuban government has executed non-binding LOIs with countries in the past and these agreements have been honored.¹¹⁸ Furthermore, U.S. attorneys believe that Cuba places a strong emphasis on its reputation as having an internationally friendly investment climate.¹¹⁹ Cuba would not want to risk jeopardizing this perception by dishonoring the agreements now in place. An attorney from Duane Morris is confident that the U.S.-Cuba relationship is going to change and Letters of Intent pertaining to “entertainment, resorts, and food and beverage are going like gang busters.”¹²⁰ As a result, Americans are taking action so as not to arrive “late to the dance.”¹²¹

Summary

This chapter presents three different types of opportunities for American real estate professionals to invest in Cuba. 1) Indirect investment through a public or private foreign company. 2) Partnering with a non-Cuban foreign entity and setting up an offshore investment vehicle. And 3) securing a non-binding letter of intent for future rights to develop in Cuba. Now that these three options have been laid out, the final chapter articulates what this all means for American real estate investors.

118 Interview with Marco Gonzalez, 9 July 2008.

119 Entwistle, Ashby and Gonzalez, Duane Morris Webinar.

120 Interview with Marco Gonzalez, 9 July 2008

121 Ibid.

CHAPTER 6: CONCLUSION

This thesis has shown that Cuba provides American real estate developers the opportunity to work in Cuba albeit under challenging conditions. Even with stringent U.S. governmental legislation, a lack of transparency towards property rights and a highly discretionary approval process on the part of Raul Castro's administration, real estate deals involving Americans are still being consummated. So what does this suggest for American real estate professionals who would like to seek investment in Cuba today?

The implications for American real estate developers are two-fold. Indirect investment through a third company allows American developers the opportunity to take a passive investment role and capitalize on the tremendous resources already present on the island. More specifically, Cuba enjoys an expansive coastline with white sandy beaches and a tropical climate. These stable, enduring characteristics account for the arrival of over two million visitors to the island every year. Cuba is the third most-frequented travel destination in the entire Caribbean region, even without the presence of U.S. tourists.¹²² For passive real estate investors interested in placing their capital in a real estate venture with a short-term investment window, Cuba is an attractive opportunity.

Indirect investment in a third company conducting business in Cuba provides more than a short-term investment horizon for American real estate ventures. One global private equity firm suggests that its current investment in Sol Meliá has significant long term potential. According to one of the firm's analysts in New York, the annual revenue of Sol Meliá could double with the removal of the travel embargo due to the heightened volume of U.S. tourist traffic.¹²³ Therefore, investing by way of a third company also provides American businesses with the opportunity to profit on the long run potential of the island. American companies with

¹²² Khruschev, Henthorne, LaTour, "Cuba at the Crossroads," 408.

¹²³ Corey Dade and Valerie Bauerlein, "Businesses Hold Few Hopes of More Trade Soon," *Wall Street Journal*, 20 February 2008.

passive mindset intent on investing in Cuba have the option to invest with a long-term and/or a short-term investment strategy.

There is also the opportunity for investors who want a more active role in managing the real estate. The ability to joint venture with a foreign Company and create an off-shore vehicle, allows businesses to get more involved in the day-to-day decision making. Like indirect investment, this method also presents long and short-term investment objectives. Companies that would like to benefit from the current tourist market can do so and those that would like to wait until the U.S. travel ban is lifted can plan accordingly. This mode of investment caters well to the larger hotel groups who create a value-add through management expertise.

Off-shore vehicles are being set-up today. Unlike indirect investing in an established company, it will take time for a joint venture to establish credibility with the Cuban government. The Cubans are very fearful of a clandestine U.S. takeover; therefore they have tended to move cautiously when working with these types of arrangements.¹²⁴ However, spending the money now to structure the company should not only allow an investor to reap the benefits of the current tourist market but also catapult into an ownership role subsequent to the lifting of the U.S. embargo.¹²⁵

For real estate developers working in the built environment, the business options in Cuba are not as readily apparent. They do exist however. The securing of a Letter of Intent for the development of a hotel property is a practice currently being exercised in Cuba according to U.S. attorneys. The implication of this practice for American developers is that once the embargo is lifted, these companies will be "first in line to begin working on their respective project."¹²⁶ American developers working in markets with high barriers to entry are accustomed to a long approval process. By obtaining a Letter of Intent, they could reduce the wait that would obstruct completion of their deal.

¹²⁴ Interview with Dr. Timothy Ashby, 6 August 2008.

¹²⁵ Ibid.

¹²⁶ Interview with Marco Gonzalez, 9 July 2008.

The inevitable removal of the U.S. travel ban and embargo will allow Cuba to be transformed into the world-class travel destination it has the potential of becoming. For Americans who want a stake in Cuba's future growth, now is the time to begin the entry process. The time is right to begin formulating relationships with Cuban nationals, establishing bonds with businessmen on the island, and fostering common real estate goals for which Cubans will require foreign assistance. This is essential groundwork that must be secured prior to submitting a business plan to the Cuban government. While foreign real estate development on the island of Cuba is far from ensured, the changing political climate brings hope for increased freedom and opportunity in this sector of Cuban society.

Real Estate Investment in Cuba: Now is the Right Time!

APPENDIX A: RECENT CUBA DEVELOPMENTS IN CONGRESS

Cuba: U.S. Restrictions on Travel and Remittances

Most Recent Developments

On July 17, 2008, the Senate Appropriations Committee approved a draft FY2009 agriculture appropriations bill with a provision that would ease restrictions on travel to Cuba for the sale of agricultural and medical goods by allowing for a general license for such travel instead of a specific license that requires permission from the Treasury Department.

On July 14, 2008, the Senate Appropriations Committee reported its version of the FY2009 Financial Services and General Government Appropriations bill, S. 3260 (S.Rept. 110-417), which includes provisions easing restrictions on family travel and on travel to Cuba relating to the commercial sale of agricultural and medical goods. With regard to family travel, the bill would provide that no funds may be used to administer, implement, or enforce the Administration's June 2004 tightening of restrictions related to travel to visit relatives in Cuba. With regard to travel for agricultural or medical sales, the bill would allow for a general license for such travel instead of a specific license that requires permission from the Treasury Department.

On June 30, 2008, a group of south Florida travel agencies specializing in travel to Cuba filed suit in U.S. federal court in Miami challenging a recent Florida state law related to Cuba travel. That law requires travel agencies that sell trips to countries on the State Department's list of state sponsors of terrorism (currently Cuba, Iran, Syria, Sudan, and North Korea, which could be removed this summer) to pay annual fees up to \$2,500 and to post up to a \$250,000 bond required for the agencies to operate in Florida.

On June 25, 2008, the House Appropriations Committee approved its version of the FY2009 Financial Services and General Government Appropriations bill that includes provisions easing restrictions on family travel and U.S. agricultural exports to Cuba. The bill would liberalize family travel to Cuba by allowing for such travel once a year (instead of the current restriction of once every three years) and by allowing such travel to visit aunts, uncles, nieces, nephews, and first cousins. The House Appropriations Subcommittee on Financial Services and General Government had approved the measure on June 17.

On March 5, 2008, Cuban Americans living in Vermont filed a complaint in U.S. federal court in Burlington, Vermont, that U.S. restrictions on family travel to Cuba violate their civil rights. Affiliates of the American Civil Liberties Union of Florida, Massachusetts, and Vermont filed a brief in support of the complaint on May 16, 2008.

On December 17, 2007, the joint explanatory statement on H.R. 2764, the FY2008 Consolidated Appropriations Act, dropped provisions that would have eased restrictions on travel to Cuba for the marketing and sale of agricultural and medical goods that had been included in the Senate Appropriations Committee-reported versions of the FY2008 Financial Services and General Government appropriations bill, H.R. 2829, and the FY2008 agriculture appropriations bill, S. 1859.

On December 11, 2007, the Senate Finance Committee held a hearing on the issue of “Promoting American Agricultural and Medical Exports to Cuba” and a related bill, S. 1673 (Baucus), that contains a provision that would lift restrictions on travel to Cuba.

On November 30, 2007, the Government Accountability Office (GAO) issued a report on U.S. enforcement of the Cuba embargo. The report recommended: 1) that the Secretary of Homeland Security direct Customs and Border Protection (CBP) to re-evaluate whether the level of resources dedicated to inspecting passengers from Cuba at the Miami International Airport effectively balances its responsibility for enforcing the Cuba embargo with its responsibilities for keeping terrorists, criminals, and inadmissible aliens out of the country; and 2) that the Treasury Department direct the Office of Foreign Assets Control to reassess the allocation of resources for investigating and penalizing violations of the Cuba embargo with respect to the 20 other sanctions programs it administers. (See the full report available at [<http://www.gao.gov/docsearch/abstract.php?rptno=GAO-08-80>].)

On July 24, 2007, the Senate Appropriations Committee report its version of the FY2008 Agriculture appropriations bill, S. 1859 (S.Rept. 110-134), which includes a provision, in Section 741, that would authorize travel to Cuba under a general license for the sale and marketing of U.S. agricultural and medical goods.

On July 19, 2007, the U.S. International Trade Commission issued a report, requested by the Senate Committee on Finance, which maintained that lifting travel restrictions would result in travel by U.S. citizens to Cuba rising to between 550,000 and 1 million. See the full report available at [http://www.usitc.gov/publications/abstract_3932.htm]

On July 13, 2007, the Senate Appropriations Committee reported its version of the FY2008 Financial Services and General Government Appropriations Act, H.R. 2829 (S.Rept. 110-129), which contains a provision in Section 620 that would allow for travel to Cuba under a general license for the marketing and sale of agricultural and medical goods. Another provision in Section 619 of the bill would clarify the definition of “payment of cash in advance” in order to ease restrictions on U.S. agricultural exports to Cuba.

On February 22, 2007, the U.S. Attorney’s Office in Miami filed criminal charges against two individuals for conspiracy to violate Cuba travel regulations. One of the defendants was also charged with making false statements to obtain a license for religious travel to Cuba.

On February 2, 2007, a federal judge upheld a Florida law prohibiting state colleges from using public or private resources for travel to Cuba or other countries

listed by the State Department as a state sponsor of terrorism. The American Civil Liberties Union had filed the court challenge on behalf of Florida International University faculty members.

On October 10, 2006, the U.S. government established an inter-agency Cuban Sanctions Enforcement Task Force, chaired by the U.S. Attorney for the Southern District of Florida, with support from the FBI, and the Treasury, Homeland Security, and Commerce Departments. The primary goals of the task force are the investigation of Cuba embargo violations and enforcement through federal criminal prosecutions.

On June 22, 2006, the Senate Appropriations Committee reported its version of the FY2007 Agriculture appropriations bill, H.R. 5384 (S.Rept. 109-266), which contained a provision (Section 755) liberalizing travel to Cuba related to the sale of agricultural and medical goods. Final action on the measure was not taken before the end of the 109th Congress.

On June 14, 2006, the House rejected two amendments to the FY2007 Transportation/Treasury appropriation bill, H.R. 5576, that would have eased Cuba travel restrictions: H.Amdt 1050 (Rangel) would have eased overall Cuba embargo restrictions, and H.Amdt. 1051 (Lee) would have eased educational travel restrictions.

On June 13, 2006, a group of some 450 scholars known as the Emergency Coalition to Defend Educational Travel (ECDDET) filed suit in U.S. federal court in Washington against the Treasury Department, maintaining that the Cuba travel restrictions violate academic freedom.

On May 30, 2006, Florida Governor Jeb Bush signed into law a bill that prohibits state colleges from using public or private money or resources on any aspect of organizing or supporting travel to a country designated by the Department of State as a state sponsor of terrorism, which currently consists of Cuba, Iran, North Korea, Sudan, and Syria.

Background to Travel Restrictions

Since the United States imposed a comprehensive trade embargo against Cuba in the early 1960s, there have been numerous policy changes to restrictions on travel to Cuba. The embargo regulations do not ban travel itself, but place restrictions on any financial transactions related to travel to Cuba, which effectively result in a travel ban. Accordingly, from 1963 until 1977, travel to Cuba was effectively banned under the Cuban Assets Control Regulations (CACR) issued by the Treasury Department's Office of Foreign Assets Control (OFAC) to implement the embargo. In 1977, the Carter Administration made changes to the regulations that essentially lifted the travel ban. In 1982, the Reagan Administration made other changes to the CACR that once again restricted travel to Cuba, but allowed for travel-related transactions by certain categories of travelers. Under the Clinton Administration, there were

APPENDIX B: MIT LICENSE



Attachment A

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Cuban Assets Control Regulations

License No. CT-11845

L I C E N S E

(Granted under the authority of 50 U.S.C. App. 5(b), 22 U.S.C. 2370(a),
22 U.S.C. 6001 et seq., Proclamation 3447, and 31 CFR Parts 501 and 515)

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77 Massachusetts Avenue, Building 3-208
Cambridge, MA 02139-4307
Attn: L. Rafael Reif, Provost

1. Pursuant to your application dated **April 30, 2008, as supplemented May 7, 2008 (collectively, the "Application")**, the following is hereby licensed:

*****SEE REVERSE*****

2. This license is granted upon the statements and representations made in your application, or otherwise filed with or made to the Treasury Department as a supplement to your application, and is subject to the conditions, among others, that you comply in all respects with all regulations, rulings, orders, and instructions issued by the Secretary of the Treasury under the authority cited above and the terms of this license.

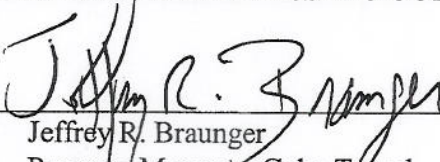
3. The Licensee shall furnish and make available for inspection any relevant information, records or reports requested by the Secretary of the Treasury or any duly authorized officer or agency of the Secretary.

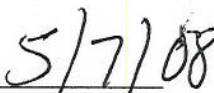
4. This license expires on **May 15, 2009**, and is not transferable, is subject to the provisions of 31 C.F.R. Parts 501 and 515, and any regulations and rulings issued pursuant thereto and may be revoked or modified at any time at the discretion of the Secretary of the Treasury acting directly or through the agency through which the license was issued, or any other agency designated by the Secretary of the Treasury. Willful misrepresentation by you or your agent to secure this license is grounds for declaring it void from the date of its issuance, or from any other date, and may constitute a violation of law. 18 U.S.C. 1001. Violations of this license or other provisions of 31 C.F.R. Parts 501 or 515 may subject you to the penalties described in 31 C.F.R. §515.701. Attention is also directed to 18 U.S.C. 545, 19 U.S.C. 1592 and 1595a, and 50 U.S.C. App. 16.

5. This license does not excuse compliance with any law or regulation administered by the Office of Foreign Assets Control or another agency (including reporting requirements) applicable to the transactions(s) herein licensed, nor does it release Licensee(s) or third parties from civil or criminal liability for violation of any law or regulation.

Issued by direction and on behalf of the Secretary of the Treasury:

OFFICE OF FOREIGN ASSETS CONTROL

By: 
Jeffrey R. Braunger
Program Manager, Cuba Travel


Date

[Attention is direct to 19 U.S.C. 1592 and 1595a, 18 U.S.C. 545, 18 U.S.C. 1001,
50 U.S.C App. 16, and 31 CFR 515.701 et seq. for provisions relating to penalties.]

Licensee: Massachusetts Institute of Technology

SECTION 1 – AUTHORIZATION: (a) This license authorizes the Licensee, students enrolled in an undergraduate or graduate degree program at the Licensee, and its full-time permanent employees to engage in travel-related transactions involving Cuba set forth in 31 CFR § 515.560(c) of the Cuban Assets Control Regulations (the “Regulations”) and such additional transactions as are directly incident to participation in the educational activities listed in § 515.565(a)(1)-(a)(6) of the Regulations, subject to the conditions set forth in Section 2 below.

(b) This license authorizes **multiple trips** during the validity period of the license.

Authority: 31 CFR §§ 515.560(c) and 515.565(a).

SECTION 2 - CONDITIONS: (a) It is a condition of this license that the transactions undertaken in Cuba conform to the scope of activities set forth in § 515.565(a)(1) – (a)(6) of the Regulations.

(b) It is a condition of the license that the educational activities described in § 515.565(a)(1), (a)(3) and (a)(4) authorized by the license shall be no shorter than ten weeks.

(c) It is a condition of this license that any students who use the Licensee’s license must be enrolled in an undergraduate or graduate degree program at the Licensee.

(d) It is a condition of this license that the Licensee provide each traveler with a letter confirming that the travel will be consistent with § 515.565(a)(1) – (a)(6) of the Regulations.

(e) It is a condition of this license that the Licensee inform each traveler of his/her responsibilities under the Regulations, by, for example, providing each traveler with OFAC’s brochure “*Cuba: What You Need To Know About The U.S. Embargo*” or other document providing information concerning the travel-related transactions authorized by 31 CFR 515.560(c) of the Regulations prior to travel.

SECTION 3 – WARNINGS: (a) Except as authorized in Section 1 above, nothing in this license authorizes any person subject to the jurisdiction of the United States to engage in any transaction or activity prohibited by the Regulations. This license only authorizes travel-related transactions consistent with a full-time schedule of activities authorized by this license.

(b) Travel-related transactions not involving academic study pursuant to a degree program, i.e., noncredit educational activities, are not authorized and travel-related transactions related to such activities are prohibited.

SECTION 4 – RECORDKEEPING REQUIREMENT: (a) The Licensee shall keep a list of the individuals who engaged in travel-related transactions under this license. This list shall be available for examination upon demand for at least five years from the date of each transaction.

(b) Each individual traveler must also retain records related to his/her travel transactions. Such records shall be available for examination for five years from the date of each transaction.

Licensee: Massachusetts Institute of Technology

(c) The Office of Foreign Assets Control may require the submission of a report from Licensee, or students or employees concerning activities undertaken pursuant to this license. A report from the Licensee is required on activities undertaken pursuant to this license in conjunction with an application to renew or extend this license.

SECTION 5 – INFORMATION: (a) For information concerning the categories of travel for which licenses may be issued, please refer to our *Comprehensive Guidelines for License Applications to Engage in Travel-Related Transactions Involving Cuba* on our Internet website at www.treas.gov/ofac (Sanctions Programs & Country Summaries – Cuba, Guidelines and Information).

(b) The Department of State publishes consular information sheets (and, when necessary, travel warnings) on every country and territory in the world, including Cuba, which are available on the Internet at <http://travel.state.gov>, or through the State Department’s fax-on-demand service at (202) 647-3000. An abridged version of consular information sheets can be heard by calling (202) 647-5225.

SECTION 6 – PRECEDENTIAL EFFECT: The authorization contained in this license is limited to the facts and circumstances specific to the application.

§515.565

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not authorize transactions by other persons who might travel with the fish biologist but whose principal purpose in travel is to engage in recreational or trophy fishing. The fact that such persons may engage in certain activities with or under the direction of the professional fish biologist, such as measuring or recording facts about their catch, does not bring these individuals' activities within the scope of professional research and similar activities.

(e) A person will not qualify as engaging in professional research merely because that person is a professional who plans to travel to Cuba.

Example 1 to paragraph (e): A professor of history interested in traveling to Cuba for the principal purpose of learning or practicing Spanish or attending general purpose lectures devoted to Cuban culture and contemporary life does not qualify for the general license in paragraph (a) of this section or for a specific license issued pursuant to paragraph (b) of this section.

Example 2 to paragraph (e): A professional photographer who wishes to take photographs in Cuba that will become the basis for creating post cards, paintings, and other secondary products or that merely document the photographer's travel does not qualify for the general license in paragraph (a) of this section or for a specific license issued pursuant to paragraph (b) of this section.

[64 FR 25815, May 13, 1999, as amended at 69 FR 33772, June 16, 2004]

§515.565 Educational activities.

(a) *Specific institutional licenses.* Specific licenses for up to one year in duration may be issued to an accredited U.S. undergraduate or graduate degree-granting academic institution authorizing the institution, its students enrolled in an undergraduate or graduate degree program at the institution, and its full-time permanent employees to engage, under the auspices of the institution, in the travel-related transactions set forth in §515.560(c) and such additional transactions that are directly incident to:

(1) Participation in a structured educational program in Cuba as part of a course offered at the licensed institution, provided the program includes a full term, and in no instance includes fewer than 10 weeks, of study in Cuba. An individual planning to engage in such transactions must carry a letter from the licensed institution stating that the individual is a student cur-

rently enrolled in an undergraduate or graduate degree program at the institution or is a full-time permanent employee of the institution, stating that the Cuba-related travel is part of a structured educational program of the institution that will be no shorter than 10 weeks in duration, and citing the number of the institution's license;

(2) Noncommercial academic research in Cuba specifically related to Cuba and for the purpose of obtaining a graduate degree. A student planning to engage in such transactions must carry a letter from the licensed institution stating that the individual is a student currently enrolled in a graduate degree program at the institution, stating that the research in Cuba will be accepted for credit toward that degree, and citing the number of the institution's license;

(3) Participation in a formal course of study at a Cuban academic institution, provided the formal course of study in Cuba will be accepted for credit toward the student's undergraduate or graduate degree at the licensed U.S. institution and provided the course of study is no shorter than 10 weeks in duration. An individual planning to engage in such transactions must carry a letter from the licensed U.S. institution stating that the individual is a student currently enrolled in an undergraduate or graduate degree program at the U.S. institution, stating that the study in Cuba will be accepted for credit toward that degree and will be no shorter than 10 weeks in duration, and citing the number of the U.S. institution's license;

(4) Teaching at a Cuban academic institution by an individual regularly employed in a teaching capacity at the licensed institution, provided the teaching activities are related to an academic program at the Cuban institution and provided that the duration of the teaching will be no shorter than 10 weeks. An individual planning to engage in such transactions must carry a written letter from the licensed U.S. institution stating that the individual is a full-time permanent employee regularly employed in a teaching capacity at the U.S. institution and citing the number of the U.S. institution's license;

(5) Sponsorship, including the payment of a stipend or salary, of a Cuban scholar to teach or engage in other scholarly activity at the licensed institution (in addition to those transactions authorized by the general license contained in § 515.571). Such earnings may be remitted to Cuba as provided in § 515.570 or carried on the person of the Cuban scholar returning to Cuba as provided in § 515.560(d)(3); or

(6) The organization of and preparation for activities described in paragraphs (a)(1) through (a)(5) of this section by a full-time permanent employee of the licensed institution. An individual engaging in such transactions must carry a written letter from the licensed institution stating that the individual is a full-time permanent employee of that institution and citing the number of the institution's license.

NOTE TO PARAGRAPH (a): See §§ 501.601 and 501.602 of this chapter for applicable record-keeping and reporting requirements. Exportation of equipment and other items, including the transfer of technology or software to foreign persons ("deemed exportation"), may require separate authorization from the Department of Commerce.

(b) *Other specific licenses.* Specific licenses may be issued to individuals on a case-by-case basis authorizing the travel-related transactions set forth in § 515.560(c) and other transactions directly incident to the educational activities described in paragraphs (a)(2) and (a)(3) of this section but not engaged in pursuant to a specific license issued to an institution pursuant to paragraph (a) of this section.

(c) Transactions related to activities that are primarily tourist-oriented, including self-directed educational activities that are intended only for personal enrichment, are not authorized by this section.

[64 FR 25816, May 13, 1999, as amended at 68 FR 14147, Mar. 24, 2003; 69 FR 33772, June 16, 2004]

§ 515.566 Religious activities in Cuba.

(a) *Specific license for U.S. religious organizations—(1) Issuance; renewal.* A specific license may be issued to a religious organization located in the United States authorizing the organization and individuals and groups affiliated with the organization to en-

gage, under the auspices of the organization, in religious activities involving transactions (including travel-related transactions) in which Cuba or a Cuban national has an interest. The application for the specific license must set forth examples of religious activities to be undertaken in Cuba. The religious organization's specific license may be renewed after a period of two years to authorize the organization and individuals and groups affiliated with the organization to continue to engage in the transactions authorized under the organization's license.

(2) *Scope of transactions authorized under U.S. religious organization's specific license; documentation.* Upon receipt by the religious organization located in the United States of a specific license pursuant to paragraph (a)(1) of this section, the organization and individuals or groups affiliated with the organization are authorized to engage in the travel-related transactions set forth in § 515.560(c) and such additional transactions as are directly incident to religious activities in Cuba under the auspices of the organization. Travel-related transactions pursuant to this authorization must be for the purpose of engaging, while in Cuba, in a full-time program of religious activities. Financial and material donations to Cuba or Cuban nationals are not authorized by this paragraph (a)(2). All individuals who engage in transactions in which Cuba or Cuban nationals have an interest (including travel-related transactions) pursuant to this paragraph (a)(2) must carry with them a letter from the specifically-licensed U.S. religious organization, citing the number of the organization's specific license and confirming that they are affiliated with the organization and are traveling to Cuba to engage in religious activities under the auspices of the organization.

NOTE TO PARAGRAPH (a): See §§ 501.601 and 501.602 of this chapter for applicable record-keeping and reporting requirements. Exportation of items to be used in Cuba may require separate licensing by the Department of Commerce.

(b) *Specific licenses.* Specific licenses may be issued on a case-by-case basis authorizing the travel-related transactions set forth in § 515.560(c) and

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§ 515.560 Travel-related transactions to, from, and within Cuba by persons subject to U.S. jurisdiction.

(a) The travel-related transactions listed in paragraph (c) of this section may be authorized either by a general license or on a case-by-case basis by a specific license for travel related to the following activities (see the referenced sections for the applicable general and specific licensing criteria):

(1) Visits to members of a person's immediate family (specific licenses) (see § 515.561);

(2) Official business of the U.S. government, foreign governments, and certain intergovernmental organizations (general license) (see § 515.562);

(3) Journalistic activity (general and specific licenses) (see § 515.563);

(4) Professional research (general and specific licenses) (see § 515.564);

(5) Educational activities (specific licenses) (see § 515.565);

(6) Religious activities (specific licenses) (see § 515.566);

(7) Public performances, athletic and other competitions, and exhibitions (specific licenses) (see § 515.567);

(8) Support for the Cuban people (specific licenses) (see § 515.574);

(9) Humanitarian projects (specific licenses) (see § 515.575);

(10) Activities of private foundations or research or educational institutes (specific licenses) (see § 515.576);

(11) Exportation, importation, or transmission of information or informational materials (specific licenses) (see § 515.545); and

(12) Certain export transactions that may be considered for authorization under existing Department of Commerce regulations and guidelines with respect to Cuba or engaged in by U.S.-owned or controlled foreign firms (specific licenses) (see §§ 515.533 and 515.559).

(b) Effective October 28, 2000, no specific licenses will be issued authorizing the travel-related transactions in paragraph (c) of this section in connection with activities other than those referenced in paragraph (a) of this section.

(c) Persons generally or specifically licensed under this part to engage in transactions in connection with travel to, from, and within Cuba may engage in the following transactions:

(1) *Transportation to and from Cuba.* All transportation-related transactions ordinarily incident to travel to and from (not within) Cuba, provided no more than \$500 may be remitted to Cuba directly or indirectly in any consecutive 12-month period for fees imposed by the Government of Cuba in conjunction with such travel unless otherwise authorized.

(2) *Living expenses in Cuba.* All transactions ordinarily incident to travel anywhere within Cuba, including payment of living expenses and the acquisition in Cuba of goods for personal consumption there, are authorized, provided that, unless otherwise authorized, the total for such expenses does not exceed:

(i) For visits to members of a person's immediate family pursuant to § 515.561, \$50 per day plus up to an additional \$50 per trip, if needed, to cover within-Cuba transportation-related expenses.

(ii) For all other authorized activities, the "maximum per diem rate" for Havana, Cuba, in effect during the period that the travel takes place. The maximum per diem rate is published in the State Department's "Maximum Travel Per Diem Allowances for Foreign Areas," a supplement to section 925, Department of State Standardized Regulations (Government Civilians, Foreign Areas), which is available from the Government Printing Office, Superintendent of Documents, P.O. Box 371945, Pittsburgh, PA 15250-7954 and on the Internet at <http://www.state.gov/m/als/prdm>.

(3) *Importation of Cuban merchandise prohibited.* Nothing in this section authorizes the importation into the United States of any merchandise purchased or otherwise acquired in Cuba, including but not limited to any importation of such merchandise as accompanied baggage. The importation of Cuban-origin information and informational materials is exempt from the prohibitions of this part, as described in § 515.206.

(4) *Carrying remittances to Cuba.* The carrying to Cuba of any remittances that the licensed traveler is authorized to remit pursuant to § 515.570 is authorized, provided that:

(i) The total of all family household remittances authorized by §515.570(a) does not exceed \$300, and

(ii) No emigration remittances authorized by §515.570(b) are carried to Cuba unless a U.S. immigration visa has been issued for each payee and the licensed traveler can produce the visa recipients' full names, dates of birth, visa numbers, and visa dates of issuance.

NOTE TO PARAGRAPH (c)(4): This paragraph does not authorize a traveler to carry remittances on behalf of other remitters.

(5) *Processing certain financial instruments.* All transactions incident to the processing and payment of checks, drafts, travelers' checks, and similar instruments negotiated in Cuba by any person authorized pursuant to this part to engage in financial transactions in Cuba. For purposes of this section, the authorized transactions may be conducted using currency, which is defined as money, cash, drafts, notes, travelers' checks, negotiable instruments, or scrip having a specified or readily determinable face value or worth, but which does not include gold or other precious metals in any form.

(d) A Cuban national departing the United States may carry currency, as that term is defined in paragraph (c)(5) of this section, as follows:

(1) The amount of any currency brought into the United States by the Cuban national and registered with the U.S. Customs Service upon entry;

(2) Up to \$300 in funds received as remittances by the Cuban national during his or her stay in the United States; and

(3) Compensation earned by a Cuban national from a U.S. academic institution up to any amount that can be substantiated through payment receipts from such institution as authorized pursuant to §515.565(a)(5).

(e) The following transactions by persons generally or specifically licensed to engage in travel-related transactions to, from, and within Cuba are prohibited by §515.201 unless specifically authorized:

(1) All transactions by persons subject to U.S. jurisdiction related to the utilization of charge cards, including but not limited to debit or credit cards, for expenditures in Cuba.

(2) All transactions related to the processing and payment by persons subject to U.S. jurisdiction, such as charge card issuers or intermediary banks, of charge card instruments (e.g., vouchers, drafts, or sales receipts) for expenditures in Cuba. The issuer of a charge card, or a foreign charge card firm owned or controlled by persons subject to U.S. jurisdiction, is not authorized to deal with a Cuban enterprise, a Cuban national, or a third-country person, such as a franchisee, in connection with the extension of charge card services to any person in Cuba.

(f) *Carrying accompanied baggage to Cuba.* The carrying to Cuba of accompanied baggage, as described in 15 CFR 740.14, provided that no more than 44 pounds of accompanied baggage per traveler may be carried unless otherwise authorized by the Bureau of Industry and Security of the Department of Commerce or, for exportations of non-U.S. origin accompanied baggage from third countries to Cuba, by a specific license from OFAC.

(g) Nothing in this section authorizes transactions in connection with tourist travel to Cuba, nor does it authorize transactions in relation to any business travel, including making or agreeing to make any investment in Cuba, establishing or agreeing to establish any branch or agency in Cuba, or transferring or agreeing to transfer any property to Cuba, except transfers by or on behalf of individual or group travelers authorized pursuant to this part.

[64 FR 25814, May 13, 1999, as amended at 66 FR 36688, July 12, 2001; 68 FR 14146, Mar. 24, 2003; 69 FR 33771 and 33773, June 16, 2004]

§515.561 Persons visiting members of their immediate family in Cuba.

(a) *Visiting a family member who is a national of Cuba.* Specific licenses may be issued on a case-by-case basis to persons subject to U.S. jurisdiction to engage in the travel-related transactions set forth in §515.560(c) for the purpose of visiting a member of the person's immediate family who is a national of Cuba, as that term is defined in §515.302 of this part, in Cuba for a period not to exceed 14 days in duration, provided it has been at least three years since the

APPENDIX C: INTERNATIONAL TRADE COMMISSION TOURIST FORECAST

Introduction

Several different approaches are taken to estimate the effects of removing the restrictions on U.S. travel to Cuba. The first approach, which is considered to be a long-run estimate, is based on U.S. demand for tourism services in Cuba being proportionally similar to Canadian demand for tourism in Cuba; it results in a total of approximately 4 million tourists from the world, 2.8 million of which are U.S. citizens, visiting Cuba each year. A second approach considers Cuba's short-run capacity limits and the U.S. demand shift is based on the number of U.S. visits to the Dominican Republic. Here the total number of visits to Cuba is slightly over 2.8 million, of which 1.1 million are U.S. citizens, per year. A third approach estimates the travel restriction as an equivalent ad valorem tariff. Removing the equivalent tariff eventuates in a smaller response, with less than 2.5 million total visits (554,000 U.S. citizens) by tourists to Cuba. The wide range of estimates in the different approaches results from the lack of a close correspondence between the legally defined restrictions and the economic concepts to model the removal of restrictions. The responses of U.S. tourists and Cuban suppliers to removal of the restrictions are also unknown. The lower range of these estimates is deemed more likely, at least in the short run. In the long run, the number of tourists could approach the higher estimate.

This appendix presents the model that was used to estimate the effects on Cuban tourism of eliminating the U.S. restriction on travel to Cuba. Only overnight stays are examined; cruise travel is not addressed. This model is similar to partial equilibrium trade models that are frequently used in studies estimating the effects of trade liberalization. In those studies, known tariffs in the affected industries are removed to estimate the effects of trade liberalization. The U.S. restrictions on travel to Cuba, which is a type of non-tariff barrier, cannot be modeled with an equivalent tariff that is known with certainty. Issues related to the uncertain nature of the travel restriction are discussed below. These types of models also depend upon elasticities that give information about the demand and supply relationships. Ideally these are estimated empirically, but only limited information about the elasticities is available in this case. This analysis focuses on the interrelated effects in the Cuban and associated tourist markets that would likely occur given particular representations of the U.S. travel restriction and model elasticities.

The U.S. Travel Restriction

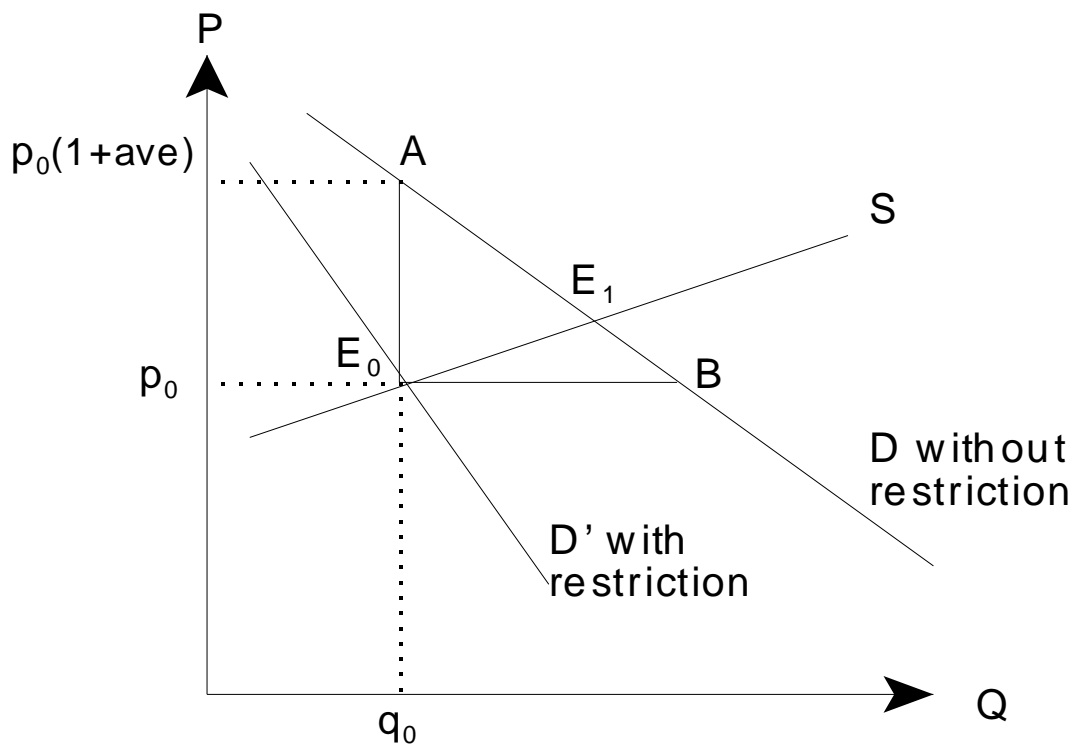
The travel restriction prohibits U.S. citizens from spending money in Cuba on hotels and other tourism services unless they obtain a license from OFAC. Expenditures abroad by U.S. citizens are classified as U.S. imports of services. Thus, the travel restriction acts to limit imports of tourism services from Cuba, and such trade restrictions are often represented by a gap between the demand price and the supply price, such as the distance E_0A in figure F.1, where E_0 represents the initial equilibrium and q_0 represents the number of U.S. residents who go to Cuba while the restriction is in place.¹ Because the distance E_0A is unknown, we take two approaches to estimate the response if the travel restriction were lifted. The first approach, which is similar to that of Robyn and others,² focuses on estimating the distance E_0B . It is assumed that U.S. citizens in the absence of restrictions will travel to Cuba in a

¹ The initial price, p_0 , is a composite price for all tourism services.

² Robyn, Dorothy, et al, "The Impact on the U.S. Economy of Lifting Restrictions on Travel to Cuba."

proportion similar to Canadians.³ Cuba is the fifth largest tourist destination for Canadians, and this approach generates a long-run estimate. Almost 518,000 Canadians traveled to Cuba in 2005; if the same proportion of U.S. citizens were to go to Cuba, almost 4.8 million U.S. citizens would go to Cuba annually. Thus point B is established, and removing the restriction shifts the demand curve to D in figure F.1. Although this approach moves out the demand curve to match proportionally the number of Canadians visiting Cuba at current prices, supply is upward sloping; thus price rises, and the resulting number of tourists is less than if price had remained the same. The effect on the numbers of tourists is the same as if the price wedge E_0A were removed.

Figure F.1 U.S. travel restriction



³ Robyn et al. argue that this is plausible because Canada and the United States are similar from socioeconomic and demographic viewpoints and have roughly similar percentages of their populations visiting the Caribbean region. Robyn, Dorothy, et al, "The Impact on the U.S. Economy of Lifting Restrictions on Travel to Cuba," 7.

Canadians have a history of visiting Cuba and may have developed an affinity for certain Cuban vacation sites that increases their propensity to return. Because these relationships have developed over a long period, U.S. citizens may not immediately respond in a similar fashion. Although tourism in the Dominican Republic is more developed than in Cuba, the Dominican Republic has a range of Caribbean tourism services and offers somewhat similar vacation opportunities as Cuba. For example, the Dominican Republic, which is also Spanish speaking, offers several all-inclusive beach-centered tourism options similar to Cuba. To represent a short-run demand shift, it is assumed that an equal number of U.S. citizens would travel to Cuba as currently travel to the Dominican Republic. In 2005, 1.4 million U.S. citizens visited the Dominican Republic. Because U.S. citizens may have become partial toward particular aspects of the Dominican tourism experience, this may be considered as a fairly large short-run response.⁴ This approach is similar to the previous one in that an estimate of point B in figure F.1 has been made.

The final approach focuses on estimating the ad valorem equivalent tariff (E_0A in figure F.1, where D' is effective demand with the restriction); the effects of removing the restriction are then calculated by removing the estimated equivalent tariff. Some U.S. travelers circumvent the restriction by going through a third country. An ad valorem equivalent tax is estimated as the extra cost that such a traveler has to pay. Under these circumstances, the full price of a trip for a U.S. citizen (p_f) includes regular air (or boat) fare (p_A); the additional fare for traveling through a third country (p_{Axl}); an ad valorem risk premium (r) related to the possible negative consequences associated with circumventing the travel restriction;⁵ and spending in Cuba on lodging, food, and other items (p_c).

$$p_f = p_A + p_{Axl} + (1 + r) p_c$$

The extra cost of making the trip with the restriction in place includes the additional expenses for traveling through a third country (p_{Axl}) and the risk premium ($r p_c$). The unit price (p_0 in figure F.1) of a trip without the travel restriction does not include these extra costs and is simply $p_A + p_c = p_0$. The ad valorem equivalent tariff (ave in figure F.1) is thus estimated as the extra costs over the unit price without the restriction $(p_{Axl} + r p_c)/p_0$.

The Commission estimates these expenditures as follows. Regular U.S. airfare to Cuba is estimated at \$600 based on round trip airfare between St. Louis (which is near the population center of the United States) and the Dominican Republic. Under the restrictions the traveler first goes to Cancun (also about \$600 round trip) and pays an additional \$450 for round trip airfare between Cancun and Cuba.⁶ We assume the risk premium is half of the in-country price of tourism services. If a tourist spends \$1000 per visit in-country, the unit price without the restriction would be $\$600 + \$1000 = \$1,600$. The extra costs under the restriction are $\$450 + 0.5 \times (\$1000) = \$950$. The ad valorem equivalent tariff is thus estimated as $(100 \times (\$950/\$1600)) = 59$ percent.

⁴ A similar response would be obtained by selecting another destination with similar numbers of visits by U.S. citizens. For example, approximately the same number of U.S. tourists visited Jamaica as the Dominican Republic in 2005.

⁵ Tourism travel to Cuba is not licensed, and the restriction applies to travel through third countries. Such travelers may face civil penalties and criminal prosecution when they return to the United States. See http://travel.state.gov/travel/cis_pa_tw/cis/cis_1097.html.

⁶ Other popular third-country sites include Canada, Cayman Islands, Jamaica, Nassau, and the Dominican Republic. Although fares vary somewhat, fares through Cancun are competitive with these other sites.

Model

Despite little U.S. travel, tourism in Cuba is well developed, with over two million foreign visitors per year in recent years. International visitors account for all of the more developed types of tourism in Cuba, as Cuban nationals cannot afford most accommodations for international visitors and are also prohibited from doing so. The demand for tourism services in Cuba is represented as the horizontal or quantity sum of the demand by U.S. residents and the demand by non-U.S. visitors. International visitors, as well as Cuban suppliers of tourism services,⁷ respond to price signals; thus the equilibrium number of tourists in the Cuban market is represented by setting the supply of tourism services in Cuba, as a function of price, equal to the sum of the U.S. and non-U.S. demands. In figure F.2, D^1 represents non-U.S. demand, and effective U.S. demand is the difference between total market demand D^0 and D^1 . Initial equilibrium is at the point (q^0, p^0) ; q^1 is the number of non-U.S. visitors, and $q^0 - q^1$ are the U.S. visitors. When the restriction on U.S. travel is removed, total market demand shifts out to D^* , and the resulting equilibrium is (p^*, q^*) . Because $p^* > p^0$, fewer non-U.S. visitors demand tourism services in Cuba; examination of the non-U.S. demand curve D^1 at price p^* shows that the resulting number of non-U.S. visitors is q^2 , and the number of U.S. visitors is $q^* - q^2$. Implicitly a price wedge has been removed for U.S. residents as their quantity expands. While the market price increases for non-U.S. tourists, the implicit price for U.S. tourists decreases. Thus, U.S. residents will substitute away from similar markets for tourism services into Cuba, but non-U.S. residents will find the relatively lower prices in alternative markets more attractive and substitute towards those markets.

Demand

Demand for international tourism depends upon the preferences and income of the tourist and relative prices in the destination countries. U.S. tourists because of their high income are believed to spend more than tourists from many other countries. Europeans are also believed to stay longer and spend more than many other tourists.⁸ As incomes rise, consumers tend to spend a greater portion of income on tourism.⁹ In this model, income is assumed to remain constant and is not discussed further.

It is assumed that both the representative U.S. and non-U.S. tourists have a category of demand that can be called Caribbean tourism services.¹⁰ It is assumed that these consumers

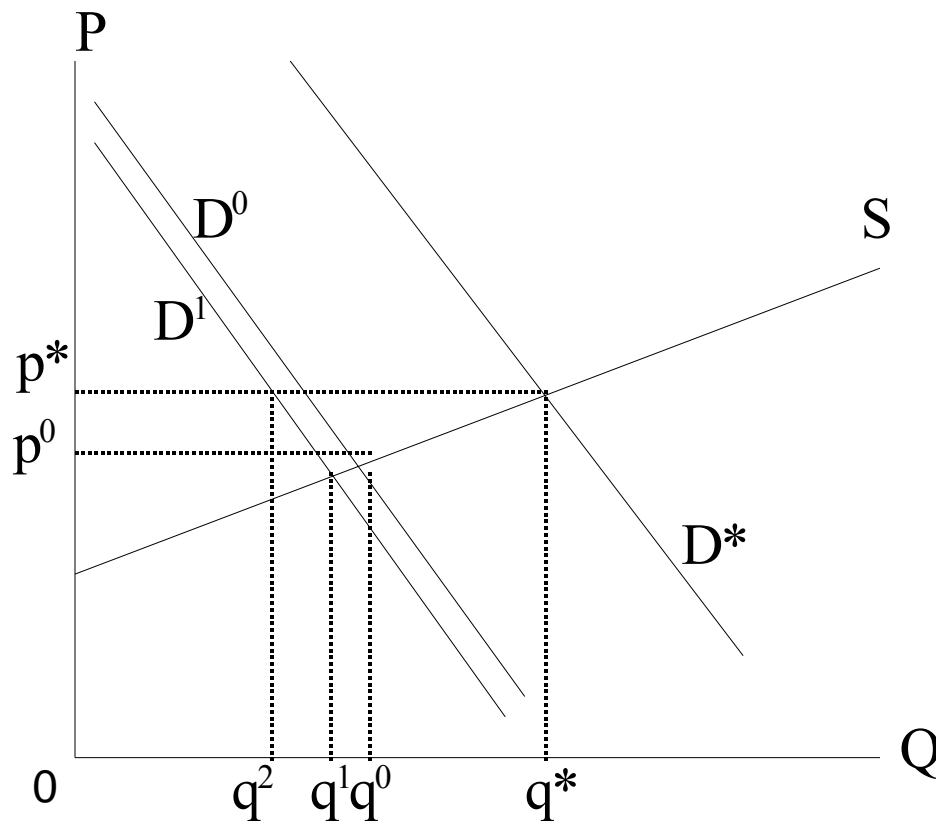
⁷ Various parts of the Cuban government and multinational firms provide tourism services and hold equity positions in hotels in Cuba. Private Cuban residents supply only a very small part of these services through room and board arrangements (*casas particulares*) and local eateries (*paladares*). Because tourism is a global market, monopolistic concerns are not considered here.

⁸ ARA Consulting Group, Systems Caribbean, and KPMG Peat Marwick. "A Study to Assess the Economic Impact of Tourism on Selected CDB Borrowing Member Countries," 42.

⁹ For example, Rosensweig finds an income elasticity of international tourism of 1.5. Rosensweig, "Elasticities of Substitution in Caribbean Tourism," 89-100.

¹⁰ To some degree, a tourist may substitute any destination with any other somewhat similar destination, but Rosensweig finds greater substitution within Caribbean destinations than between Caribbean and European or North American destinations. Rosensweig, "Elasticities of Substitution in Caribbean Tourism," 89-100.

Figure F.2 Removal of restriction on U.S. travel



have similar but not identical preferences¹¹ for tourism services in (1) Cuba, (2) South Florida, (3) Puerto Rico and the U.S. Virgin Islands, and (4) other Caribbean destinations.¹²

Generally, the demand for tourism is thought to be elastic because of the discretionary nature of tourism compared to food, for example, and empirical studies in Europe have found own-price demand elasticities in the range of -1.8.¹³ However, studies in the Caribbean have found the demand for tourism to be inelastic, allegedly because of the different characteristics of each island. Crouch and Shaw found the price elasticity of tourism spending to be -0.39; Hiemstra and Ismail found the demand elasticity of hotel rooms to be -0.44.¹⁴ This study uses

¹¹ This is the "Armington assumption." The technical details can be seen in Armington, "A Theory of Demand for Products Distinguished by Place of Origin," 159-178, and Francois and Hall, "Partial Equilibrium Modeling," 135-139.

¹² Included are Anguilla, Antigua and Barbuda, Aruba, Barbados, Bonaire, Cancun, Cayman Islands, Curacao, Dominica, Dominican Republic, Grenada, Jamaica, Montserrat, St. Lucia, St. Maarten, St. Vincent and the Grenadines, and Trinidad and Tobago.

¹³ Durbarry, "Long-Term Structural Tourism Demand Modeling: An Application to France."

¹⁴ These studies were summarized in Dixon, et al, "Tourism and the Environment in the Caribbean: An Economic Framework," 45-46. Papers in this series are not formal publications of the World Bank, but are circulated to encourage thought and discussion.

an aggregate demand elasticity for Caribbean tourism services of -1.2.¹⁵ Similar aggregate demand elasticities for the category of Caribbean tourism were used for U.S. and non-U.S. consumers.

The degree that one tourist destination can be substituted for another is measured by the elasticities of substitution, which theoretically ranges between 0, indicating no substitution, and infinity, indicating perfect substitution. There is little empirical work on substitution elasticities for this region.¹⁶ The elasticities of substitution used for this study are shown in table F.1; they indicate a relatively small degree of substitution between these markets.¹⁷ U.S. tourists are believed to be less likely to substitute between Cuba and markets such as South Florida, Puerto Rico, and the U.S. Virgin Islands that do not require visas. Non-U.S. tourists are believed to substitute more between Cuba and other Caribbean destinations than destinations associated with the United States.

Table F.1 Elasticities of substitution for U.S. and non-U.S. travelers

	South Florida	Puerto Rico & U.S. Virgin	Other Caribbean
For the U.S. tourist			
Cuba	2	2	4
South Florida	4	2	2
Puerto Rico & U.S. Virgin Islands	3	3	3
For the non-U.S. tourist			
Cuba	2	2	3
South Florida	3	2	2
Puerto Rico & U.S. Virgin Islands	3	3	3

Source: Commission estimate.

Representative U.S. and non-U.S. consumers or travelers currently purchase tourism services from all Caribbean market segments. The representative U.S. traveler currently purchases most of these services in South Florida and other Caribbean destinations and very little from Cuba (first column of table F.2), and the representative non-U.S. traveler purchases most Caribbean tourism services from other Caribbean destinations and relatively little from South Florida (second column of table F.2). Theory requires that these should be shares of expenditures of each representative traveler in the different market segments. Comprehensive data on expenditures are unavailable, and these estimates are based on the numbers of tourists in the different market segments. This approach implicitly assumes that expenditures are the same in different destinations. The relative importance of U.S. and non-U.S. travelers, again based on the number of tourists, are also shown for each destination in the last two columns of table F.2.

¹⁵ An aggregate demand elasticity of -0.7 was tried but did not greatly affect the results, and runs with that elasticity are not reported.

¹⁶ Rosensweig reported intra-Caribbean elasticities in the range of 2 to 3. Rosensweig, J.A., "Elasticities of Substitution in Caribbean Tourism," *Journal of Development Economics* 29 (1988): 89-100.

¹⁷ Simple demand functions that are linear in logs were used, which, unlike demand functions using the CES functional form, permit different elasticities of substitution for different destinations.

Table F.2 Market shares by representative U.S. and non-U.S. travelers and the shares of foreign tourist expenditures attributed to U.S. and non-U.S. tourists in each destination

	Representative U.S. traveler's share of purchases in each market	Representative Non-U.S. traveler's share of purchases in each market	U.S. market share	Non-U.S. market share
	<i>Percent</i>			
Cuba	3.4	13.7	7.5	92.5
Other Caribbean destinations	36.7	58.5	47.5	52.5
Puerto Rico & Virgin Islands	12.9	16.2	83.5	16.5
South Florida	47.0	11.6	90.8	9.2

Source: Staff calculations based on data in Caribbean Tourism Organization, *Statistical Report 2002-2003* and "Latest Statistics 2005," (September 2006) and "Tourist Arrivals by Main Market - 2005"; Rochell Broder-Singer, "Tourism Statistics South Florida," (June 2004); Office of Travel and Tourism Industries, U.S. Dept. of Commerce, "U.S. Citizen Air Traffic to Overseas Regions," 2005.

Supply

Cuba offers a number of beaches both on the main island and on keys and the number of hotel rooms has been increasing, as shown in table F.3. It is believed that within the present framework (no major policy changes in Cuba) supply will likely continue to increase in the intermediate run. Cuba's cost of supplying tourism services is believed to be similar to that of other islands in the Caribbean.¹⁸ Hiemstra and Ismail estimated a supply elasticity for hotel rooms in the Caribbean of 2.86.¹⁹ An elasticity of supply of 3 was used for each country.

Table F.3 Cuban travel data

	International arrivals of overnight tourists (1,000)	Number of rooms in hotels & other establishments	Mean annual occupancy rate (percent)
2000	1,741	38,072	74.2
2001	1,736	40,158	64.7
2002	1,656	41,323	59.7
2003	1,847	43,696	61.8
2004	2,017	45,270	63.5
2005	2,261	45,644	63.6

Source: Cuban Oficina Nacional de Estadística, *Anuario Estadístico de Cuba, 2005*, chap. 13.

In the short run the lack of hotel rooms and other tourist amenities hinder Cuba's ability to respond to large increases in the number of tourists. To represent this situation, a short-run upper bound was calculated by assuming that the trend rate of increases in the number of rooms between 2000 and 2005 would continue for the next three years and that the mean annual occupancy rate would increase from a mean of 65 percent to 80 percent, which is a practical upper limit given the seasonal peaks during the winter months but allow for the fact

¹⁸ The extensive requirements and approvals necessary for infrastructure development raise Cuba's capital costs somewhat in comparison to competing suppliers, but its labor costs are thought to be less. Cuba has a well-educated population and over 20 hospitality schools to train tourism professionals. Cerviño and Cubillo, "Hotel and Tourism Development in Cuba: Opportunities, Management Challenges, and Future Trends," 223-246.

¹⁹ Hiemstra and Ismail, "Incidence of the Impacts of Room Taxes on the Lodging Industry," 22-26.

that some Americans typically travel during the summer.²⁰ This approach results in a short-run capacity limit of 2.8 million tourists per year. When the capacity constraint is reached, the supply curve becomes vertical; thus price can still rise, but quantity cannot increase beyond this point. Sustained high prices signal investors that profits can be made by investing in tourism infrastructure, so the lack of hotel rooms is not expected to constrain the number of overnight tourists in the long run.

Market Equilibrium

Equilibrium in each market occurs where supply equals the sum of the demands of the representative U.S. and non-U.S. consumers. The following group of equations constitute the model where the left-hand side is supply, the first term on the right-hand side is demand by U.S. residents and the second term is demand by non-U.S. residents.

where

- the p 's are prices;
- the k 's, the K 's, and J 's are constants related to initial conditions;
- the c 's, F 's, V 's, and O 's are subscripts representing, respectively, Cuba, South Florida, Puerto-Rico and the U.S. Virgin Islands, and the rest of the Caribbean; c -US indicates the special implicit price for U.S. tourists in the Cuban market;
- b shifts U.S. demand in the Cuban market in the quantity shock version; otherwise it equals 1; t is the ad valorem equivalent tariff that is removed in the price wedge version; otherwise it equals 0;
- the ε 's are supply elasticities;

$$\begin{aligned}
 k_c p_c^{\varepsilon_c} &= K_c b \left(\frac{P_{c-US}}{1+t} \right)^\eta P_F^{\psi_{cF}} P_V^{\psi_{cV}} P_O^{\psi_{cO}} + J_c P_c^\phi P_F^{\chi_{cF}} P_V^{\chi_{cV}} P_O^{\chi_{cO}} \\
 k_F p_F^{\varepsilon_F} &= K_F P_{c-US}^{\psi_{FC}} P_F^{\eta_F} P_V^{\psi_{FV}} P_O^{\psi_{FO}} + J_F P_c^{\chi_{FC}} P_F^\phi P_V^{\chi_{FV}} P_O^{\chi_{FO}} \\
 k_V p_V^{\varepsilon_V} &= K_V P_{c-US}^{\psi_{VC}} P_F^{\psi_{VF}} P_V^{\eta_V} P_O^{\psi_{VO}} + J_V P_c^{\chi_{VC}} P_F^{\chi_{VF}} P_V^\phi P_O^{\chi_{VO}} \\
 k_O p_O^{\varepsilon_O} &= K_O P_{c-US}^{\psi_{OC}} P_F^{\psi_{OF}} P_V^{\psi_{OV}} P_O^{\eta_O} + J_O P_c^{\chi_{OC}} P_F^{\chi_{OF}} P_V^{\chi_{OV}} P_O^\phi
 \end{aligned}$$

- the ϕ 's and η 's are own-price elasticities, respectively, for non-U.S. and U.S. demand; and
- the χ 's and ψ 's are cross price elasticities, respectively, for non-U.S. and U.S. demand.

The own-price and cross-price demand elasticities are calculated from the aggregate demand elasticities, the substitution elasticities, and the market shares using the approach of Francois and Hall.²¹ The simulations based on this model are reported below.

²⁰ Cerviño and Cubillo point out that related infrastructure, such as airports, and tourist attractions must be developed at the same time as hotels and that these related investments may be less developed than hotels in Cuba. Cerviño and Cubillo, "Hotel and Tourism Development in Cuba: Opportunities, Management Challenges, and Future Trends," 223-246.

²¹ Formulas 5.43 and 5.44 in Francois and Hall, 138 were used.

Results

In this model, the initial equilibrium in the Cuban market has 2.261 million total tourists of which 171,000 are U.S. citizens, and the market clearing price for purchases in Cuba is \$1000 per tourist. These figures are based on Cuban government and World Tourist Organization data and adjusted for the numbers of Cuban Americans traveling to Cuba as reported in Chapter 3.

First, the demand for tourism services in Cuba by U.S. citizens is shifted out in similar proportion to that of Canadian demand. The results are large, and the total of over 4 million tourists must be viewed as a long-run response because it exceeds Cuba's current capacity to absorb tourists (table F.4).

Table F.4 Long-run results from removing travel ban under the Canadian-like demand shift

Market	Price	Quantity	Value
	<i>Percent change</i>		
Cuba	21.8	80.6	102.3
South Florida	-2.8	-8.5	-11.3
Puerto Rico & U.S. Virgin Islands	-2.0	-6.1	-8.1
Other Caribbean destinations	-4.6	-13.8	-18.4
Number of tourists in Cuba	U.S. origin (1,000)	Non-U.S. origin (1,000)	Total (1,000)
Resulting total by source	2,799	1,283	4,083
Net change by source	2,628	-807	1,822

Source: Staff estimation.

Note: Totals may not add due to rounding.

In this scenario, large numbers of U.S. citizens shift purchases of tourism services toward the Cuban market, which negatively affects the other markets. However, non-U.S. tourists shift into those other markets, which mitigates the negative effects somewhat. The effect is largest in the other Caribbean destination which is thought to be most substitutable with the Cuban market.

Next, the short-run response is examined in which demand shifts out as if the same number of U.S. citizens visit Cuba as currently visit the Dominican Republic and limits on Cuba's ability to furnish tourism services is taken into account. Applying the estimated capacity constraint of 2.8 million tourists per year increases the price of tourism services in the Cuban market (table F.5). Shifting out the U.S. demand crowds some non-U.S. visitors out of the market, but changes in the numbers of tourists by source are smaller than in the long-run scenario.²² Effects in the other markets are also less than in the long-run scenario.

²² The capacity constraint, as previously discussed, is based on limits to hotel occupancy. Other short-run constraints likely apply specifically to U.S. travel. For example, a new air transport agreement between Cuba and the United States would have to be negotiated, and Cuba is not currently in compliance with FAA safety regulations and would not be permitted to fly into the United States. Although these barriers could be overcome in the long run, they would be additional constraints that limit the number of U.S. travelers to Cuba in the short run.

Table F.5 Results with the short-run supply restriction from removing travel ban under the Dominican-Republic-like demand shift

Market	Price	Quantity	Value
	<i>Percent change</i>		
Cuba	9.4	23.8	33.3
South Florida	-1.0	-3.1	-4.1
Puerto Rico & U.S. Virgin Islands	-0.7	-2.2	-2.9
Other Caribbean destinations	-1.6	-4.9	-6.5
Number of tourists in Cuba	U.S. origin (1,000)	Non-U.S. origin (1,000)	Total (1,000)
Resulting total by source	1,127	1,672	2,799
Net change by source	956	-418	538

Source: Staff estimation.

Finally, the approach of removing an ad valorem equivalent tariff of 59.4 percent was taken. The effects under this scenario are much smaller (table F.6) than under the other approaches. The estimated equilibrium total number of tourists is less than the short-run quantity constraint. Effects in the other markets are also modest.

Table F.6 Short-run results from removing travel ban under the ad valorem tariff approach

Market	Price	Quantity	Value
	<i>Percent Change</i>		
Cuba	3.2	10.0	13.2
South Florida	-0.4	-1.2	-1.6
Puerto Rico & U.S. Virgin Islands	-0.3	-0.9	-1.2
Other Caribbean destinations	-0.7	-2.0	-2.7
Number of tourists in Cuba	U.S. origin (1,000)	Non-U.S. origin (1,000)	Total (1,000)
Resulting total by source	554	1,932	2,487
Net change by source	383	-158	226

Source: Staff estimation.

Note: Totals may not add due to rounding.

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APPENDIX D: LAW NO. 77 OR FOREIGN INVESTMENT

Law No. 77

In 1994, a team of attorneys were mandated to formulate regulations that would accompany a new foreign investment law, replacing Decree Law No. 50. After a year of studying similar legislation, mainly that of China and Vietnam Law No. 77 was enacted. Law No. 77, otherwise known as the *Foreign Investment Act*, authorized foreign investment in all sectors, excluding the population's health, educational, and Armed Forces institutions, with the exception of the Armed Forces commercial divisions.

Law No. 77 recognizes three forms of foreign investment in Cuba. These three forms, as defined by the *Camara de Comercio* are as follows:¹

- Joint Venture – Implies the establishment of a legal status different from that of any of the parties. Profit is shared according to the contributions of each party;
- Contracts of International Economic Association – they do not imply a legal entity separate from those of the contracting parties. Profit is distributed among the parties;
- 100% Foreign Capital Companies - Foreign investor manages the company.

Law No. 77 also contains a number of “so called” guarantees to investors. In essence the guarantees are granted on basis that foreign investment will enjoy full protection and security and will not be subject to expropriation except for reasons of public utility or social interest, according to the Constitution.²

- According to the legislation, expropriations will be “exceptional” and will receive a monetary compensation equivalent to the value of the expropriated goods and with all the guarantees for the determination of their value;

¹ These definitions are taken directly from a PowerPoint presentation prepared by the Cuban Chamber of Commerce.

² Cuban Foreign Trade, No. 3/2007, pg.40.

- Another guarantee allows the foreign investor in an international economic association to sell or transfer total or partial participation in the association to the State or to a third part (following government authorization) at any time and following agreement of the parties, and to receive the corresponding price in free convertible currency. Take a breath! Too long. In turn, the foreign investor of a 100% foreign capital enterprise may at any time sell or transfer to the State or third party (again, following governmental authorization) his total or partial participation in it;
- And finally, the law guarantees the tax free transfer of remittances abroad (i.e. dividends) in free convertible currency of net income or dividends for the exploitation of the investment, and the amounts he received for expropriations, termination of the investment, total or partial sales or transfer of its participants; as well as the right of foreign citizens who work for these entities and are not permanent residents to transfer abroad the salaries they receive in the amount fixed by Banco Nacional de Cuba (BNC).

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