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# Special Economic Report

## Foreign Investment Law and GDP Growth

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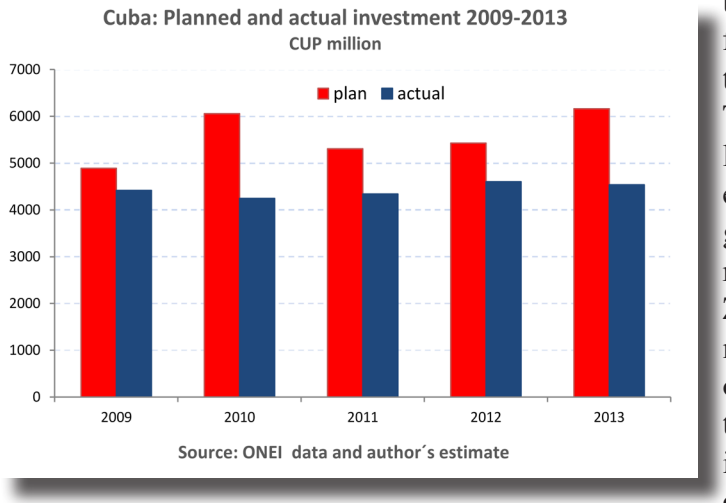
# GDP growth, investment goals, and the new foreign investment law

The Cuban economy closed 2013 with a GDP growth of 2.7%, below the official target and the kind of growth that should be expected after six years of structural reforms.

There are various explanations for the failure of the reform to meet its growth goals, but one of the most significant reasons is the unfulfilment of investment plans. The country's authorities put their biggest hopes for economic growth in a group of investment projects for refineries and petrochemical plants, offshore oil prospecting, in golf course real estate projects, in nickel, in light manufacturing, and in construction. Some of them have materialized, but in general they have remained below expectations.




In the figure, we compare the amount of annual investment plans with that of actual investments from 2009 to 2013. Notice that each year, actual investments were below plan. On average, investments were 20% below the target.

For 2011 and 2012, the government planned an increase in investments by approximately 25% each year. But ultimately, gross capital formation — in constant prices — grew only 7.1% in the first year, and 8.6% in the second. The chairman of the National Assembly's Economic Affairs Committee stated in his December 2012 speech that for 2013 a 35% growth in investments was planned. However, according to data published by the National Statistics and Information Office (ONEI) for the first half of 2013, investments grew just 4.4%. According to our estimates, it's probable that they actually ended the year with growth very close to zero. The gross capital formation rate in relation to GDP has remained on average at 13.6% during the past six years (measured in constant prices), very much below the average in Latin America, which has been higher than 20%.

The failure of investment plans can be blamed on inefficient state enterprises, Cuba's difficulties to tap into international sources of financing, and the lack of change in the country's foreign investment policy. The reform of state enterprises will take time, and Cuba's access to international financial markets will remain limited, among others due to U.S. sanctions. Therefore, the government's apparently most expeditious option to comply with its investment plans and accelerate GDP growth is opening the economy more to international capital.

For this, a far-reaching step will be taken this March with the presentation of a new foreign investment law to the National Assembly. The content of the new law is unknown, but it is expected, in principle, to generalize some of the rules applied to the Mariel Zone. They include mechanisms to speed up approval of investment projects, the option of developing investment projects 100% owned by foreign capital, and allowing a more direct link for foreign investors to hire workers.

Furthermore, the new foreign investment law should reduce government officials' discretionarity in decision-making allowed by the previous law. Finally, it should be coherent with a broader strategy towards international capital, breaking the previous thinking that considered foreign investment only as a complement to domestic investment, in sectors the state considers priority at any given moment. The new regulations for real estate projects will be crucial, because this is where international investors have

the highest expectations.

The new law could also break the tendency since the early 2000's to only approve large-scale investments, and foreign investment could even reach the new cooperatives and emerging private enterprises. In particular, Cubans residing abroad are closely following the signals sent by the new policy, in terms of their possibilities and investment guarantees.

It is possible to elaborate the forecast of a scenario in which investment growth reaches up to 20% in 2015, and 25% in 2016. This scenario intends to capture the effect of an opening to international capital, such that the government can achieve investment growth rates of 25%, as planned in previous years (see CUBA STANDARD -- ECONOMIC TREND REPORT).

In the forecast, GDP growth would accelerate to 6.3% in 2015 and 6.7% in 2016, as a result of the positive investment shock, which has its origin in the opening towards international capital. Average economic growth in the 2012-2016 period would be 4.1%, closer to the planned goal of 4.4%.

In summary, the new foreign investment law is the last opportunity for the reform to come close to the growth goals planned through 2016. At the same time, it will help diversify the island's international relations, as well as reduce vulnerability due to its links with Venezuela.