

**From Cold War Warriors to Business Associates:
Cuba-Puerto Rico Relations in the Last Half of the 20th Century**

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"Cuba y Puerto Rico, de un pájaro las dos alas", Lola Rodríguez de Tío

Despite the limited contact between Cuba and Puerto Rico since the Cuban Revolution, Puerto Ricans and Cubans still maintain strong bonds. These bonds are due, in part to their shared cultural and historical heritage and to the integration of the Cuban exile community into Puerto Rican society. The limited market opening of Cuba in the 1990s brought about a great deal of interest in Puerto Rico in potential post-embargo and post-Castro commercial opportunities.

This paper focuses on these commercial possibilities². In addition to examining previous studies on prospective commercial relations and reviewing current economic data, the authors conducted interviews with business people and government officials on both islands. Because any kind of commercial exchange is bound to be beneficial for Cuba in the long run, the paper focuses more on the strengths and weaknesses of Puerto Rico as a competitor in the Cuban market. Thus the overall aim of the paper is to provide a proper context in which to examine the strengths and weaknesses of Puerto Rico as a competitor in the Cuban market. This context takes into account the effects

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² See White, B. (1959) for a comparative study of the development paths followed by Cuba and Puerto Rico up to 1959.

that politics, economics, transitional business strategies and cultural bonds might have in a rapprochement between the islands.

Our findings suggest that the end of the embargo will bring both losses and gains for Puerto Rico in the areas of trade and foreign direct investment. Key Cuba-relevant economic sectors are likely to include professional services, tourism, manufacturing, construction, agriculture, and small business. Our findings also suggest that the behavior of some economic sectors will respond primarily to the demands of globalization, while others might offer a more local focus of control.

CARIBBEAN COLD WARRIORS

During the cold war, and particularly after the triumph of the 1959 Cuban Revolution, the United States provided both incentives and deterrents to nations in the Americas as a way of enlisting support for its policy of containment of communism in the region. In the Caribbean, for example, the "carrots" included a vast array of economic incentives such as the Caribbean Basin Initiative (CBI), a program implemented in the mid 1980's with the aim of promoting development through private-sector initiatives. The deterrents or "sticks" included the embargo on Cuba, as well as the overt and covert support of numerous "anti-Communist" groups in other countries.

Puerto Rico became the focus of the carrots and Cuba the focus of the sticks. While Puerto Rico received generous financial and technical assistance, welfare benefits, and preferential tax treatment as an incentive for industrialization, Cuba was embargoed, invaded, isolated, and politically and economically undermined in a systematic way.

Given the climate of U.S hostility towards Cuba and towards any real or imagined "other Cuba", it is not surprising that the preeminent objective of Cuba's

foreign policy towards the Caribbean during the Cold War was strategic, and focused on defense (Gonzalez Nuñez 1991). González Nuñez further suggests that a second set of objectives of Cuba policy towards the Caribbean during the Cold War era was based on the achievement of "common" regional goals: 1) freedom from U.S. hegemony; 2) economic and political integration of the Caribbean with Latin American and 3) the struggle to achieve a new international economic order that guaranteed the development of the Caribbean.

The cause of Puerto Rican independence was seen by the Cuban government as a strategic component of this set of foreign policy objectives. To the great irritation of the U.S., Cuba conducted its diplomatic battles against U.S. colonial influence in Puerto Rico, primarily, in two international forums - the United Nations' non-aligned bloc and the General Assembly's Special Committee on Decolonization.

As a result of the political and economic polarization of the region, the relationship between Puerto Rico and Cuba essentially became a "nonrelationship" (no trade, minimal official contact, etc.) circumscribed by the narrow limits of the U.S. embargo, as well as by the strategic and defense interests of the United States.

Though the U.S State Department no longer considers Cuba a military threat to the U.S. or to the region, its embargo on Cuba is not likely to be lifted in the near future. The end result is that Cuba and Puerto Rico are still playing their parts in the Cold War - a war that is by all intents and purposes, over.

AND WHEN THE EMBARGO ENDS?

Since the moderate market opening of Cuba in the mid-1990s, interest in business opportunities in Cuba has emerged in Puerto Rico, much as it has in other countries. Given that any business dealings with Cuba are circumscribed by the U.S. embargo, these discussions focus on post embargo scenarios. Numerous articles have appeared in the Puerto Rican press covering trade and investment news in Cuba, some projecting future business opportunities for Puerto Rico³. In 1993, the Puerto Rican government commissioned a study on the "reopening" of Cuba⁴.and in early 1999 it announced plans to produce a new updated report. There have been numerous general and sectoral conferences and panels on Cuba-related business opportunities⁵. The academic literature on the subject is not particularly extensive, however⁶.

The business, academic, and government papers on the subject written in Puerto Rico bear some resemblance to those published in the United States⁷, although the information on Cuba that they contain is more limited in breadth and depth. The Puerto Rican documents also tend to emphasize economic analysis and thus lack the business-oriented detail of many of the U.S.-produced sectoral opportunity analyses. Both U.S.-mainland and Puerto Rico-based studies are perhaps too "triumphalist" in outlook, minimizing the role of the foreign business enclave already established in Cuba and of the emerging Cuban

³ See Casellas (1999); Collins (1996 a and b), and (February 1999 a and b); Luxner (1993); and Diaz (1999).

⁴ Government of Puerto Rico. "La Reapertura de Cuba" Asamblea Legislativa de Puerto Rico Senado de Puerto Rico, 1994.

⁵ For example, see Caribbean Latin America Action (CLAA) Business And Investment In A Free And Democratic Cuba Conference, Puerto Rico, May 1995; and New Waves Foundation, New Waves in the Caribbean Conference, , San Juan, Puerto Rico, Junio 12-14, 1997.

⁶ See Alegria, Cue and Velez (1992)and Cabarrouy and Cue (1993)

⁷ See for example Babun (1999) and Haines 1997.

managerial class, while at the same time exaggerating the advantages of the business establishment in whichever territory they were written. For both sets of reports, the fact that the opportunity analyses are predicated on such unpredictable events as the end of the U.S. embargo, which in turn is predicated on changes within the Castro regime, makes the opportunities mostly hypothetical. In other words, the time frame within which the reports' recommendations can actually be implemented is unknown.

The following are some of the major differences between the Cuba of the early 1990s (when most of the Puerto Rican-authored reports mentioned earlier were written) and the Cuba of 2000:

- ! The Cuban economy has started to show timid signs of recovery and certain sectors have become more market responsive.
- ! Some moderate market reforms have been implemented, although there are no clear indications of further reforms on the horizon.
- ! There has been a stabilization of the Cuban managerial elite in both the business (e.g., joint ventures, state enterprises) and governmental spheres.
- ! Firms from other countries have made deep inroads in some of the more attractive sectors of the Cuban economy, such as tourism, mining, tobacco, power generation, construction and real estate, and telecommunications.
- ! In the regional context, Cuba's closer ties to the Caribbean Community and the Association of Caribbean States (ACS) mean that ventures with member countries of these groupings are likely to take priority over those with Puerto Rico.

Puerto Rico has also undergone changes, including the following:

- ! A heightened national debate has taken place on the future political status of the island (remaining a commonwealth versus becoming a U.S. state versus independence).
- ! A hemispheric (rather than Caribbean) orientation is emerging.
- ! In 1996, the U.S. Congress decided to eliminate the tax incentives for U.S. companies based in Puerto Rico provided under Section 936 of the U.S. Internal Revenue Code (the Possessions Tax Credit) with regard to new investments and to phase these benefits out over a ten-year period for firms currently taking advantage of these incentives.
- ! Concerns have arisen over the possible erosion of the island's manufacturing base if there are insufficient incentives for reinvestment.

In sum, although their findings are still generally applicable, the opportunity analyses of the aforementioned papers and reports produced in Puerto Rico in the early 1990s are at this point outdated due to both major changes in Cuba and in Puerto Rico.

Despite the embargo, many U.S.-based companies have already staked out their territories in Cuba. Some are even operating legally either overtly or covertly through joint ventures in third countries, not to mention those companies which are in violation of the embargo. U.S.-based business promotion associations have conducted fairly regular trade junkets to Cuba, and numerous memorandums of understanding have been signed by potential future partners. Several Puerto Rican law firms have taken on the Cuba business promotion role and are actively encouraging their clients to prepare contingency plans that include actions which they can legally undertake at present within the embargo rules (e.g., registering trademarks and trading in certain commodities). A number

of formal and informal Puerto Rican business delegations have visited Cuba, and Cuban delegations have been invited to attend business conferences held on Puerto Rican soil. Approximately one hundred Puerto Rican businesspeople visited Cuba on business trips in 1998, paralleling some of the business development moves of U.S.-based firms.

Estimates of bilateral Cuba-U.S. trade point to a possible value of US\$3 billion to US\$7 billion yearly in the first few years after the normalization of relations. Encouraging projections such as these are fueling the enthusiasm of U.S. and Puerto Rican businesspeople. Given the value of the potential market, even minor cracks in the embargo, such as the easing of controls on food and agricultural input sales to Cuba announced by the Clinton administration in January 1999, stimulate a great deal of interest within the U.S.⁸ and Puerto Rican business sectors⁹. Unfortunately, due to the current Cuban political climate and the strict U.S. embargo, taking advantage of these opportunities will be difficult.

A significant actor in the post embargo commercial relationship between Cuba and Puerto Rico is likely to be the Puerto Rico-based Cuban exile community (the second largest after Miami). The 1990 Puerto Rican census found 19,736 persons born in Cuba (a decline from previous census figures, suggesting a net out-migration of exiles to the United States). According to a 1995 book by José A. Cobas and Jorge Duany, the Cuban exile community in Puerto Rico is smaller and more highly stratified (socially, economically, educationally, and racially) than its U.S. counterpart. By and large, the exiles in Puerto Rico were able to establish themselves successfully in commercial, managerial, and professional occupations. Many are self-employed, high-level employees, or

⁸ See Bussey , 1999.

⁹ Casellas (op cit.), Collins (op. cit. 1999 a and b) and Diaz (op. cit.).

business owners. Despite their economic influence, however, Cuban exiles in Puerto Rico have not developed the same degree of influence in local or U.S. politics as their Miami counterparts.

Because the Cuban exiles in Puerto Rico faced fewer linguistic, cultural, and religious differences than they would have in the United States, they have been able to integrate more fully into Puerto Rican society. Relations between the exiles and their Puerto Rican neighbors have generally been positive, although at times there has been conflict over economic competition, ideological differences, and exile voting rights in Puerto Rican elections.

Cuban exile businesspeople have expressed interest in participating in the reconstruction of Cuba, although many of them would likely do so by investing rather than physically returning to Cuba. Exiles in Puerto Rico are likely to present a fair amount of competition to exile groups based in the United States (primarily Florida and New Jersey) in their capacity as managers, investors, and entrepreneurs.

A majority of the exile community in Puerto Rico vigorously supports the U.S. embargo, and business contacts in Cuba remain a delicate issue in San Juan. Exiles' threats of boycott and even violence are a reality that one must contend with if operating a Cuba-related venture (even in compliance with the embargo) from Puerto Rico.

The main visible indication of Cuba's interest in establishing commercial ties with Puerto Rico has been the reception of Puerto Rican commercial delegations that have visited Cuba and the attempts to send Cuban delegations to commercial events in Puerto Rico. There has been little empirical field research focusing on Cuba's managerial class and its commercial interests (the Cuban government regards such information as sensitive). However, a study published in 1997 by Puerto Rico-based Cuban exile Gerardo González Núñez,

albeit somewhat dated (the research was conducted between 1994 and 1995, before the majority of Cuba's economic reforms were put in place), does describe the views of Cuban managers about future commercial relations with the Caribbean and Puerto Rico.

When queried about countries of commercial interest in the Caribbean, the majority of Cuban *empresarios* (managers) responded that the Dominican Republic and Jamaica would be of most interest to them. Those in Havana tended to favor the western Caribbean, while those in Santiago de Cuba leaned toward the eastern Caribbean. The González Núñez study does not mention Puerto Rico as one of the islands mentioned by the *empresarios* when ranking their commercial interest in either the Caribbean Basin overall or the eastern Caribbean.

Obviously, the U.S. embargo would not permit the actual establishment of trade at this point, but it is interesting to note that while Puerto Rican businesspeople, academics, and government officials ponder the impact on Puerto Rico of Cuba's future reintegration into the region's economy, Cuban *empresarios* do not seem to think much about this question at all. Interviews conducted for this paper confirm that the relative importance of Puerto Rico for Cuba is much less than that of Cuba for Puerto Rico.

In order to update the studies presented in this section of the paper, the next section examines a new set of dynamics that is likely to affect any commercial relationship between Cuba and Puerto Rico.

GLOBALIZATION AND TRADE WINDS

Globalization and economic cooperation agreements have altered the way in which Cuban-Puerto Rican competition and cooperation must be conceptualized. A number of economic sectors are more likely to respond to

global demands and conditions than to any action by local management or government. Tourism and manufacturing offer good examples. Puerto Rico's manufacturing base is already facing strong competition not only from other Caribbean Basin countries such as the Dominican Republic, Mexico, and Costa Rica, but also from more distant locales such as Singapore, Ireland, and Chile. As for tourism, the Caribbean faces strong competition for the U.S. Northeast market from rival "sun" destinations such as Florida's Disney World and other family attractions being developed in the U.S. Southeast.

Puerto Rican and Cuban strategies to take advantage of the reintegration of Cuba into the global economy must be examined not only from a relatively static nation-to-nation standpoint, but also in the more fluid context of global commercial dynamics. Countries vying for investment must offer ever-improving rates of return, stability, transparency, and efficiency. Thus, there is an increased need for business and government leaders to forge regional cooperative strategies to protect the viability of sectors such as manufacturing and tourism in the Caribbean as a whole.

The development of a thriving post embargo commercial relationship between Cuba and Puerto Rico will also depend, in large part, on the established trade and investment patterns of each island, their major trade and investment partners, and their comparative advantages. Although a thorough analysis of the trade patterns of the two islands is beyond the scope of this paper, a cursory overview of their major trading partners can provide a context in which to examine possible future bilateral trade relationships¹⁰.

Intraregional trade with their Caribbean and Latin American neighbors has never been a focal point for either Cuba or Puerto Rico. Before 1989, the

¹⁰ See CEPAL (1997), Republic of Cuba (1999 a and b).

Soviet Union and the Council for Mutual Economic Assistance (CMEA) were Cuba's main trading partners. As of 2000 Canada, Spain, and Italy were Cuba's most important commercial partners for trade and investment. By contrast, in 1997 Puerto Rico's trade with the United States accounted for 76 percent of the island's total trade.

Since the collapse of the Soviet bloc, Cuba has made efforts to reengage with the Caribbean Basin, the Western Hemisphere, and the international order. Cuba's revolutionary government had on many occasions manifested its interest in establishing some sort of link with CARICOM countries. However, it was unable to do so, largely because of U.S. pressure to keep Cuba isolated. The 1990s, however, heralded a new era of Cuban-Caribbean relations, due not to any change of heart on the part of the United States but to the efforts of Caribbean nations, particularly those in CARICOM. There is now a joint Cuba-CARICOM commission, relations with most Caribbean nations have been normalized, and Cuba has gained membership in regional organisms such as the Caribbean Tourism Organization and has gained observer status under the Lome Agreement. Nevertheless, efforts to integrate Cuba into hemispheric affairs is hampered by the fact that (due to continuing U.S. pressure) Cuba is still not a member of the Organization of American States or of the major international financial institutions (IFIs).

Though Cuba's Caribbean integration is moving along at a fast clip, intraregional trade remains low at this point. This is, however, likely to change in a post embargo scenario. Given Cuba's size, its highly educated and trainable labor force, and geographic location, it is foreseeable that Cuba may try to become a major hub of commercial activity in the region once relations with the U.S. are normalized and the re-construction of its transportation and industrial infrastructure is undertaken. Cuba is also actively pursuing the development of

multi-destination tourism involving other Caribbean islands. Ironically, while Cuba is beginning to see the Caribbean nations more as economic and commercial partners than as possible political allies in confrontations with the U.S., for many Caribbean nations, strengthening ties with Cuba is a way to counteract U.S. hemispheric commercial and political dominance.

In 2000, Puerto Rico is bucking the Caribbean integrationist trend. Though eligible for associate membership in the Association of Caribbean States, Puerto Rico has not joined, ostensibly because of U.S., as well as its own, opposition to Cuba being a charter member of the organization. In general, the extent to which Puerto Rico's trade orientation is Caribbean as opposed to hemispheric or worldwide seems to ebb and flow with U.S. policy initiatives toward the Caribbean (e.g., the Caribbean Basin Initiative and Section 936¹¹) as well as the dynamics of domestic electoral politics. Whatever status option for the island is proposed by the party in power in San Juan at any given time (continuing as a commonwealth, pursuing U.S. statehood, or seeking independence) appears to form the nucleus of Puerto Rico's conception of its "foreign" and commercial policy toward the Caribbean, the hemisphere, and the world. As Sir Neville Nicholls, president of the Caribbean Development Bank, puts it, "Puerto Rico runs hot or cold in its relations with CARICOM, depending on what party is in power in San Juan" (as quoted in a May 1998 speech by John Collins).

In the 1980s, the administration of pro-commonwealth Governor Rafael Hernandez Colon was instrumental in "Caribbeanizing" Puerto Rico's commercial outlook. During his administration, Puerto Rico played a pivotal role in the region, largely due to the policy initiatives of the Reagan Administration. In 1986, the U.S.

¹¹ The 936 Funds are the profits retained from U.S. corporations with manufacturing facilities in Puerto Rico.

Congress linked the continued maintenance of Section 936 tax incentives to a commitment by Puerto Rico that it would make an effort to fund development projects in eligible CBI beneficiary countries. The Federal initiative, managed from and funded out of Puerto Rico based financial institutions, established two strategic fronts directed toward investment and economic cooperation with the rest of the Caribbean. One was the availability of 936 funds for investment in eligible projects and, the other, was the "twin plants" model - sharing components in the manufacture of goods. However, in 1996, the U.S. decided to phase out the benefits of section 936 for Puerto Rico. In 1999, 936 funds are draining, a number of the U.S. financial institutions that managed 936 funds have left Puerto Rico.

In 2000, the U.S. State Department is favoring the passage of a proposed CBI enhancement legislation called, the Caribbean Basin Trade Enhancement Act (CBTEA) designed to provide increased preferences to CBI countries and greater market opportunities for U.S. businesses. In general, the bill will authorize the President to provide enhanced temporary trade benefits to CBI countries for apparel products assembled from U.S. fabric, textile handicrafts, and all non-textile products currently excluded from the CBI program. Along with the increased benefits, the CBI enhancement bill also establishes mandatory and discretionary eligibility requirements. These provisions are meant to encourage the CBI countries to adopt sound trade and investment policies, to maintain high standards of environmental protection and workers rights and to cooperate with the United States in anti-narcotics efforts (Larson 1999)¹².

¹² A study of the impact of the re-insertion of Cuba into the regional economic space on the Dominican Republic would be a good follow up to this research paper. Puerto Rico's current trade levels and the dynamic of PR-DR "Twin Plant" manufacturing strategies are likely to be affected by the normalization of U.S. relations with Cuba.

The current administration of Governor Pedro Rosello has downplayed its association with the Caribbean and has preferred to orient Puerto Rican interests towards free trade in the hemisphere. It has also closely allied itself to the hemispheric interests and strategies of the United States. For example, Governor Rosello accompanied President Clinton as Ambassador at large to the Santiago Summit of the Americas. Governor Rosello also supported the phase out of "corporate welfare" as the Clinton administration termed Section 936. Though Puerto Rico still enjoys Observer status in CARICOM, to date, the Governor has not attended a Summit of CARICOM leaders and the relationship is not as strongly advocated as in the past administration. As mentioned earlier, Puerto Rico has also declined associate membership in the Association of Caribbean States in protest over Cuba's membership in the association. Though Puerto Rico has a relatively wide policy space in which to make independent trade agreements with foreign nations, the current administration is not exercising its option in this regard (see Collins, May 1997 and December 1998)). In Latin America, Puerto Rico has commercial offices in the Dominican Republic, Mexico, Costa Rica, Panama, Brazil, Chile and Argentina. Many of these offices are less than five years old and show Puerto Rico's new hemispheric trade commitment (Montano 1999).

One possible explanation for Governor Rosello's re-alignment of trade priorities is that he is perhaps dealing with Puerto Rico's strategic and commercial interests as if the island were already the 51st state of the United States. Therefore, he does not see the need to align Puerto Rico with the interests of Caribbean Basin trading blocs, and would rather align Puerto Rico only with the hemispheric partnerships that the U.S. belongs to as a nation (FTA and NAFTA). This policy alignment is perhaps more of a political maneuver aimed more at gaining favor in the United States for Puerto Rican statehood status, than at increasing trade.

Governor Rosello, however, has made a number of moves that have brought him closer to the policy followed by many Caribbean Basin nations. He has, for example, supported the pursuit of the NAFTA parity option. Though a Caribbean-wide commercial policy has not been explicitly outlined, the government of Puerto Rico has, nevertheless, as per the aforementioned government studies, shown repeated interest in the impact of Cuba's re-integration in the Caribbean on its economy.

In sum, while Puerto Rico is moving away from a Caribbean policy and toward a hemispheric policy, Cuba is forging closer relations with both its Caribbean neighbors and the rest of Latin America (although one could argue that Cuba is willing to join any commercial club that will have it as a member). Puerto Rico's U.S. orientation also stands in sharp contrast to the intense alliance-building¹³ currently under way in most Caribbean Basin nations¹⁴.

ECONOMIC OUTLOOKS

Cuba

The Cuban economy has been showing signs of recovery since it began registering modest growth in 1995. According to Cuban officials, in 1998, the economy grew by 1.2% (Republic of Cuba 1999 b). This is the lowest rate of growth in four years and well below the 2.5% to 3.5% originally projected for the year. The reasons given for the lower growth rate were, weather which affected sugar and other crops, and the

¹³ For example, the G-3 (Mexico, Venezuela and Colombia), CARICOM (British Commonwealth states) and its adjunct Cariforum (CARICOM plus Dominican Republic), the Central American Common Market (CACM), North American Free Trade Agreement (NAFTA), the Association of Caribbean States (ACS), Caribcan (a Canadian program to facilitate trade and investment with Commonwealth countries), the LOME Convention (EU preferential trade agreement with former colonies) and the Free Trade of the America (FTA).

¹⁴ See Girvan's (Girvan, in Girvan and Hatton 1998) analysis of the prospects for CARICOM within the Central American Alliance and the implications of the FTA process. The article makes a number of observations which are helpful in analyzing the of the Caribbean-wide context of these dynamics. Also see Hasham, ed. Roads to Competitiveness, Human Development with Export Growth: The Caribbean Challenge. Association of Caribbean Economists, University of the Netherlands Antilles, 1997

decline in world commodity prices for sugar and nickel. Low commodity prices allegedly caused a decrease in 11% in the value of exports. Imports rose by 6%. Though no official trade balance figure has been published, the commercial deficit is likely to have increased beyond the U.S. \$2,000 million figure reported in 1997. This deficit is affecting liquidity, and foreign traders report a slow down in Cuban enterprises' ability to pay receivable on time. The fact the over U.S. \$11.2 billion in external debt remains to be re-structured further darkens the liquidity and credit picture.

Though a glance at the physical and commercial infrastructure of Cuba, particularly Havana, show signs of recovery even when compared to 1997 (not to mention 1993), there are many reasons to believe that the economy is stagnant. Foreign analysts are cautious about the growth figures provided by the Cuban government and suggest that the economy probably did not grow much at all in 1998 and 1999. Moreover, the process of economic reform has suffered a considerable slow down with no major reforms announced in some time. The recent crackdown on dissidents and the new hardening of the criminal code suggests that hard-liners are again in control in Havana. The embargo-easing measures put in place by the Clinton administration in January of 1999, were perceived fundamentally as "Track Two" initiatives and precipitated the enactment of a "sovereignty protection law" by the Castro regime. The end of the U.S.-Cuba stalemate is, unfortunately, not in sight despite the anti-embargo lobby efforts of the U.S. business sector and of congressional bi-partisan commissions. Ironically, the longer the embargo lasts - the stronger the Cuban enterprise and political systems will be and the deeper the hold of the non-U.S. foreign business sector.

In sum, though the business climate in 2000 is one of caution and guarded optimism, traders and investors are still forging ahead and profits are being made.

Puerto Rico

Puerto Rico's gross domestic product has experienced a downward trend evident in recent years. Moreover, the rate of growth is expected to continue declining for the next few years (Villamil 1999). In terms of sectoral growth, the chart below presents a good summary of growth prospects for a number of sectors.

GROWTH			
	Low (<2.5%)	Medium (2.5% to 3.5%)	High (>3.5%)
S I Z E	Big	Manufacturing	Retail Sales, Public Administration & Misc. Services
	>10% of GDP		Construction
	Medium		Finance, Insurance Real Estate
	5% -10% GDP		Tourism
	Small	Agriculture	Mining
	<5% of GDP		

Source: Villamil 1999

In 1998, exports grew by 26.4% with manufacturing (and within that pharmaceuticals) leading the way (ibid).

While public sector investment in infrastructure combined with U.S. Federal recovery money for damages inflicted by hurricane Georges are likely to provide a boost to the economy, there is currently a great deal of debate in Puerto Rico about the future of the manufacturing sector. In 1998, manufacturing represented 42% of the GDP of

the island. Though this is not the largest source of employment¹⁵ this sector provided well-paid jobs that create positive linkages in other sectors of the economy (Trinidad, January 28, 1999). The sector has shown a loss in employment, hours worked and total payroll, as well as a slowdown in new investment. On the upside, there are plans for a number of plant expansions.

The Puerto Rican manufacturing sector is being weakened by a combination of factors. The U.S. has experienced a decrease in industrial production, in part, as a result of increased wage competition from less developed countries. This pattern has also affected Puerto Rico's industrial base. For example, Mexico and the Dominican Republic have become strong regional competitors. Another factor affecting the sector is the loss of federal tax incentives for Puerto Rican plants. This loss of incentives is forcing a re-examination of Puerto Rico as an attractive industrial location. There are, however, other incentives in place and new ones are being proposed¹⁶.

Local regulations have also contributed to a positive business environment - new regulations have expanded the areas designated as free zones. But the question remains - are the productivity gains that are projected to follow the end of the so called, "corporate welfare", combined with a new set of industrial and tax incentives - enough to preserve and enhance Puerto Rico's manufacturing sector? Could new incentives be implemented within the framework of the World Trade Organization rules on subsidies? Can Puerto Rico create an attractive manufacturing investment climate by addressing with sufficient vigor its transportation, energy, waste disposal and labor legislation disincentives? Will the Puerto Rican government be able to

¹⁵ For example, in 1997 manufacturing provided 40% of the GDP while it represented only 14% of total employment (CEPAL 1997).

¹⁶ See Mulero 1999

assure transnational corporations a stable economic, political and social environment?

Yet despite uncertainties, the Puerto Rican economy remains strong. Its new emphasis on diversification of export destinations and support of local exporters should strengthen the growth in exports. Strong competition in the manufacturing sector is also beginning to create a regional cooperation imperative in the minds of many manufacturers (Ruano, Jan 28, 1999). These two trends should help prepare the island for future business with Cuba.

COMMERCIAL OPPORTUNITIES AND THREATS

A post embargo Cuba, ruled by a government pursuing economic reform, could only stand to gain from any Puerto Rican trade and investment. On the other hand, the impact on Puerto Rico of Cuba's reintegration into the region would involve both opportunities and threats, and thus merits a more careful analysis.

One of Puerto Rico's competitive advantages in the Cuban market is its somewhat hybrid business culture, part North American and part Latin American. The North American aspect would provide Puerto Ricans with an edge over other Latin Americans because Puerto Rican managers and entrepreneurs usually speak English (an advantage given that the United States is Cuba's natural market), are familiar with U.S. business practices, and, most important, have comparatively easy access to U.S. credit institutions. The Latin American aspect would give Puerto Ricans an edge over their North American and European competitors (except perhaps the Spaniards) because Puerto Ricans share Cuba's language, culture, and sense of history.

As for competition from the Cuban exile community in Miami (which will be formidable), the Cuban exiles in Puerto Rico, as indicated earlier, are less

ghettoized and more integrated into the Puerto Rican business structure. They might, therefore, be able to take part in Cuban opportunities via mixed (exile-Puerto Rican) ventures and thus conceivably be perceived as less threatening to Cuba than their Miami counterparts. Some observers have suggested that there might be a geographically based sharing of the spoils, in which the old Puerto Rican connection with eastern Cuba would be revived while Miami-based businesses would concentrate on western Cuba. However, the majority of the interviews conducted for this paper in Puerto Rico did not reveal a geographical or historical basis for determining the relative competitive advantages between the two sets of exiles, but rather a sectoral and business-strategy basis.

A number of other factors will affect Puerto Rico's competitive standing. For the first few years after the embargo is lifted (assuming that there is a pro-market government in Havana), Cuba will have to address a number of issues: the impact of U.S. market forces and U.S. companies vying for Cuban markets, Cuba's reintegration into the world of international commercial credit, and the need for Havana to balance its commercial relations with its existing partners. Puerto Rico will be only a bit player in this transition. Puerto Rican ventures will also be affected negatively by the Cuban predilection for embarking upon large projects and dealing with large corporate partners (*grandismo*).

SECTORAL ANALYSIS

At present, Cubans cannot afford to pay for much, yet there are many companies already competing for their business. In the post embargo period, more goods and services will be needed; more money will likely be available as a result of new credit, foreign investment, and economic growth; and there will be even more competitors (of which the United States will be the most formidable). Thus, the analysis of Cuba-related opportunities and threats for

Puerto Rico presented below restricts itself to the sectors in which there are some clear advantages or risks to Puerto Rico-based firms. This, of course, does not preclude a firm in any other sector from finding the right niche either directly or indirectly through association with a Cuban or foreign firm.

A general consensus exists that the sectors of most interest (or concern) to Puerto Rican business people in a post embargo Cuba would be professional services, construction, manufacturing, small and medium-size business, tourism, and agriculture. Although mining and fisheries are important sectors in Cuba, they are not important in Puerto Rico and have therefore been excluded from this analysis. Most sectors should provide excellent opportunities for Puerto Rican firms participating in Cuba's redevelopment--generally a win-win scenario. The revival of Cuba's tourism and agriculture sectors, however, could present a challenge to Puerto Rico.

White-Collar Services

Puerto Rican white-collar (professional, technical, financial, managerial) workers are likely to participate in Cuba's reconstruction as managers. Puerto Rican managers are well prepared in a number of sectors that will be in high demand. Moreover, as already mentioned, their U.S.-Latin hybrid business culture should provide a competitive advantage relative to their U.S.-based and Latin American counterparts.

According to the aforementioned 1994 Puerto Rican government report, Puerto Rico could benefit from its experience in sectors such as "research and development, general and financial consultancy, design and construction of industrial facilities.." Upper and middle managers, as well as technical and support personnel in all manufacturing sectors and in all areas of ancillary services, are likely to encounter opportunities as the Cuban manufacturing and

industrial sectors are developed. There will be a great need for the services of professional-service firms in areas such as marketing, law, accounting, and business and technical services.

There will also be opportunities for small, specialized schools that can provide technical, vocational, and business training (for would-be beauticians, electronics repair specialists, automotive body shop workers, secretaries, etc.). In addition, the two islands are likely to see an increase in contacts in the music and artistic sectors¹⁷.

Puerto Rico's financial sector would also stand to gain from a "normalized" Cuba. Banks that have already established fund transfer networks in the region could simply open a node in Cuba to serve their clients. Puerto Rican entrepreneurs would also need financial services for trade and investment purposes in Cuba, which can be provided by Puerto Rico-based financial institutions.

Real estate will offer some of the most attractive opportunities. Although there has been some liberalization in this sector and a number of foreign-financed projects are under way, the Cuban government is still quite hesitant to open this sector fully. Moreover, the property claims settlement process with U.S.-based claimants cannot take place until the embargo is lifted. The good news for Puerto Rico is that there will be many opportunities left when the embargo lifts. The competition, however, will be fierce and contingency plans that can be implemented on short notice are needed¹⁸.

¹⁷ See Paternostro (1999) for a description of the Cuban music sector.

¹⁸ See Haines (1997) for an analysis of this sector.

Telecommunications

The telecommunications sector is often cited as one that could offer opportunities for Puerto Rican companies. However, two factors are likely to dampen this enthusiasm. First, the Puerto Rican telephone company has been privatized and now belongs to a U.S. firm. Thus, the key to Puerto Rican participation in this sector in Cuba would be lobbying efforts by Puerto Rico-based executives in favor of a corporate expansion strategy managed out of Puerto Rico rather than U.S. headquarters (or Miami). Second, major portions of the Cuban telecommunications sector are already in the hands of U.S., Italian, and Canadian competitors. However, neither of these realities would prevent Puerto Rican firms from providing ancillary goods and services or taking part in joint ventures.

Construction

Construction (of housing, hotels, shops, offices, factories, and facilities in the new free-trade zones) and infrastructure development, including transportation and power, are attractive sectors in Cuba. Although there are strong competitors already established in Cuba (e.g., the Canadian companies that built the new terminal at Havana's José Martí airport), a major construction boom is likely to occur once IFIs begin to finance these kinds of projects. Most real estate projects would also have a construction component. Moreover, the provision of materials for construction could be profitable.

The construction sector in Puerto Rico grew rapidly between 1995 and 1998, and is expected to continue doing so (Villamil 1999). This experience, combined with that gained from the construction of recent mega projects in Puerto Rico (e.g., urban trains and super aqueducts), should help position Puerto Rican construction firms well for competition in Cuba. While Miami has

refurbished much of its Art Deco architecture, Puerto Rico has done a spectacular job of refurbishing its colonial-era buildings in the Old San Juan area. This experience should be of great value in bidding for jobs to restore the colonial-era architectural heritage of old Havana and many other cities in Cuba. However, given the traditional large size of IFI projects, Puerto Rican companies in these sectors would be well advised to begin to search for partners.

Manufacturing

Both Cuba and Puerto Rico aligned their economies to suit the commercial needs of their respective hegemonic powers. While Cuba deepened its monoculture and traded sugar for oil and manufactures from COMECON countries, Puerto Rico developed a strong manufacturing base for export to the United States in response to preferential trade policies and beneficial federal tax structures. The result is that whereas Cuba has a small and generally obsolete manufacturing base (mostly concentrated on light manufacturing and sugar processing), Puerto Rico has a large and modern one. Within Cuba's manufacturing Jurassic Park, however, the biotechnology sector (the most advanced in Latin America) stands out as a jewel. Another plus is Cuba's labor force, which is as well educated and healthy as Puerto Rico's, although in great need of retraining. Cuba will need to scrap most of its existing plant, modernize some of the remainder, and diversify into many more sectors.

Cuba is not expected to present a threat to Puerto Rican manufacturers, but rather a number of opportunities. The basic logic determining how Puerto Rican-based firms respond will be that of globalized production, not inter-island competition or cooperation. Moreover, the future of this sector in Puerto Rico once Section 936 benefits are completely phased out is unknown. What is clear, though, is that as Puerto Rican manufacturing specializes ever more on high-

tech products and wages increase, less-skilled production is likely to be transferred out of Puerto Rico. But transferred where? Cuba will be only one manufacturing relocation contender among many others.

There will also be opportunities for many smaller and locally owned firms. For example, small companies should be able to supply intermediate products to foreign-owned large manufacturing companies that establish themselves in Cuba, as they already do for those foreign companies based in Puerto Rico.

As the Cuban market itself recuperates, Puerto Rican entrepreneurs could participate in the growth of import substitution enterprises (e.g., food processing, construction materials). The establishment of export-oriented plants would depend on finding inherent advantages to Cuban production over production in other countries or in Puerto Rico itself.

As of 2000 , Cuba's free-trade zones are hampered by the lack of a coherent set of incentives, a lack of investment in infrastructure and facilities, and a lack of access to Cuba's natural market--the United States. In the long run, however, these zones could play a part in a competitive manufacturing, export, or transshipment strategy that involves Cuba and Puerto Rico.

Whether or not actual manufacturing plants are established by Puerto Rico-based firms, a fair amount of Puerto Rican investment participation is likely in firms operated by Cubans or foreign nationals. As mentioned earlier, investment would be one of the preferred business strategies of Cuban exiles living in Puerto Rico.

Can Cuba become an export market for Puerto Rico's manufactured goods? Cuba will need a variety of inputs for both industrial production and consumer consumption. It is not yet clear, however, whether Puerto Rican-made products would have a competitive advantage over U.S.- or foreign-manufactured products. The diversification of Puerto Rican trade away from its

over reliance on the U.S. market and toward other Latin American and European markets would be a good preparatory step for gaining competitive advantages in export markets. The fact that the Puerto Rican government's commercial offices abroad are putting increased emphasis on helping Puerto Rican entrepreneurs should help prepare *criollo* (native Puerto Rican) traders.

In sum, if markets can be secured (in and out of Cuba), if credit can be obtained, if Cuban wages and manufacturing costs can remain competitive, and if Cuban market reforms can create an attractive business climate, Cuba is a natural place to expand production. Whether specific Puerto Rico-based firms have a competitive advantage over foreign firms as manufacturers, investors, or traders is yet to be determined.

Small and Medium-Size Enterprises

Small business has become an important agent of economic growth in Puerto Rico. Small businesses employ around 75 percent of the island's private-sector workforce, and businesses with fewer than fifty employees represent 94.7 percent of total business establishments (Caribbean Business Supplement, January 1994 and Gigante 1999). Small business are highly represented in construction, manufacturing, services, and retail. There are also a number of strong locally owned medium-size enterprises. The strength and composition of Puerto Rico's small and medium-size companies, along with the fact that they are *criollo* firms, augur well for their participation in Cuba's redevelopment.

The strength of Puerto Rican small businesses was recently demonstrated by a Caribbean Business exercise (Lozana, November 5, 1998). The publication merged the Hispanic Business Top 500 list of largest Hispanic-owned business in the U.S. with its own Caribbean Business Top 300 list of Puerto Rican owned and based businesses. The

result was that 249 of Caribbean Businesses Top 300 firms would have gained a spot in the Hispanic Business 500 list. Many of these firms are in financial services, wholesale and retail, manufacturing and food and beverage distribution. The strength and composition of Puerto Rico's small and the medium size companies, along with the fact that they are *criollo* firms, augurs well for a participation Cuba's re-development.

Despite a host of new retail stores (mostly in Havana) which accept only U.S. dollars, Cuba desperately needs a modern retail sector. Opportunities for foreign firms in this sector will be constrained by the fact that the retail sector is likely to remain a state monopoly as long as the government can keep it that way because it is a major source of governmental revenue (although there is a budding microenterprise sector--*paladares* [small restaurants], vending carts, etc.--whose actors stand in contrast to the large state-owned *sociedades anónimas*).

There is currently some foreign presence in the wholesale sector, and the post embargo period will see great pressure to open the distribution and transportation sector. Major U.S. retailers will likely establish beachheads as the spending power of Cubans begins to rise, and Puerto Rican managers might find opportunities in this expansion. An entire distribution and domestic transportation network for food, consumer items, and industrial goods will have to be developed. Here again, the hybrid U.S.-Latin nature of Puerto Rican retailers, along with their access to U.S. supply chains and credit, should make expansion to or investment in Cuba feasible. There will also be many possibilities for franchise operations (e.g., food and clothing outlets, gas stations, dry cleaners, copy centers).

Tourism

Cuba's tourism assets are formidable. The island possesses not only many unspoiled beaches, but also the possibility for historical, ecological, mountain,

and cultural tourism. By 1998, tourism had become the driver of the Cuban economy, easily surpassing sugar as the main source of foreign exchange. In 1998, over 1.4 million tourists visited the island, bringing US\$1.8 billion in earnings. Tourists came primarily from Canada, Germany, Italy, Spain, France, Britain, Mexico, and Argentina. Unfortunately, most earnings from tourism are spent on inputs. Moreover, occupancy rates and the average daily spending of tourists are still low by U.S. standards.

Despite these obstacles, the industry is expected to continue growing at a fast pace, and services and facilities are continually being upgraded. Cuba is moving away from the low-end budget travel segment toward the middle range, and is aiming even higher. Cuban estimates projected that 1.7 million tourists would visit the island in 1999 (an increase of some 20 percent over the previous year). Cuba's objective is to have fifty thousand rooms for tourists available by 2000. As prices go up, hotel chains in Cuba are developing segmented offerings for a range of visitor budgets.

Foreign companies (primarily Canadian, Spanish, Dutch, Italian, Jamaican, French, and German) are making Cuba one of the fastest-growing tourism destinations in the Americas. These companies are participating in Cuban tourism through direct investment and management contracts and through the provision of services such as flights and tours. Cruise ships have already begun to dock in Havana. Several U.S. companies and hotel chains have plans ready to be implemented once the U.S. investment ban ends. It is clear that Cuba would have to upgrade its facilities in order to meet U.S. standards and guest expectations. Considering what Cuba has been able to accomplish in less than a decade of tourism development, however, the advent of true four- and five-star hotels that would suit U.S. tastes is probably not far off.

Moreover, cruise lines would be able to add Cuban ports quickly by deploying much of the on-island tourism infrastructure themselves.

Tourism is also a key driver of the Puerto Rican economy. Room capacity and luxury liner docking spaces are being increased and a new convention center is under development. San Juan has become the largest home port for cruise ships in the Caribbean (CLAA 1999) (and one of the largest in the world).

The potential impact on Puerto Rico's tourism sector of an end to the U.S. ban on travel by its citizens to Cuba is cause for concern. An estimated six million U.S. residents would visit Cuba annually if the travel restrictions were lifted. It is reasonable to assume that some portion of these would have otherwise visited Puerto Rico. Every day that the embargo is in place allows the Cuban government and its foreign partners to prepare a tourism infrastructure that can successfully and profitably receive a future influx of U.S. tourists. Cuba's efforts to develop its product and garner market share are likely to divert financial and managerial assets away from Puerto Rico and other Caribbean sites.

The silver lining for Puerto Rico is the likelihood that Cuba-bound tourism will increase the total number of visitors to the Caribbean. This would create opportunities for multideestination packages similar to those developed for the European holiday market. Increased interest in the Caribbean should also help pull into the region some of the visitors lost to U.S. "sun" destinations. As increased demand pushes up prices in Cuba, Puerto Rico could also attempt to penetrate Cuba's current European market, not necessarily through lower prices but rather through similarly priced offers providing better overall value.

Agriculture

Before the 1959 Cuban Revolution, both Cuba and Puerto Rico grew sugar and tobacco, among other crops. The apparent opportunity for increased

Puerto Rican agricultural exports presented by the break in relations between the United States and Cuba was not realized. Such factors as soil erosion and inefficient production practices contributed to this failure, but the crucial reason was the Puerto Rican government's focus on providing incentives for industrialization (as well as the ensuing trend toward urbanization). These incentives diverted resources from agriculture, and wage increases in the manufacturing sector made agriculture a less attractive employment and investment option¹⁹.

In 1997, the agricultural sector in Puerto Rico accounted for only 1 percent of GDP and 3 percent of employment. Puerto Rico's trade in agricultural and food products has been characterized by a perennial deficit. Although the general decline in this sector is expected to continue, there are a number of niches (such as tropical fruits) that have been identified as export opportunities. Nevertheless, the agricultural sector could be seriously affected by an end to the U.S. embargo, because pre-Revolutionary Cuba was a traditional supplier of agricultural products to the U.S. market, and Cuba could easily develop a competitive advantage again.

Although Cuba's agricultural sector suffered a drastic decline as result of the revolutionary government's policies (Kost 1998), it is starting to recuperate, and a number of commodities (e.g., sugar, citrus, vegetables, tropical fruits, and fish) will likely be exported from Cuba to the United States once the embargo is lifted (Foreign Agricultural Service 1999). Some of these products may reach Puerto Rican supermarket shelves as well. It is also possible that Puerto Rican agricultural producers will create joint ventures with Cuban growers for food production or processing.

¹⁹ See Taylor and Thompson (1992.)

According to some estimates, agricultural sales by the United States to Cuba could range from US \$300 million to US\$1 billion in the first year of trade alone. The major U.S. exports would likely be rice, grains, beans, and animal products. In addition, increased production of the Cuban crops mentioned earlier would require imported inputs such as fertilizers, oil, and machinery. Puerto Rico is not strong in any of these sectors. A "normalized" Cuba could be expected to add to Puerto Rico's agricultural trade deficit.

CONCLUSION

In terms of regional dynamics, Cuba is seeking stronger alliances in both the Caribbean and the hemisphere, while Puerto Rico is aligning itself ever more closely with the United States and its hemispheric agenda. This is evidenced by the two countries' respective proliferation and paucity of formal and informal relations with regional associations. Yet, in a world of globalized competition, the task of making the Caribbean Basin an attractive manufacturing location and tourist destination may require the active involvement of Puerto Rico, whether it remains a commonwealth or becomes a U.S. state.

In any case, the following steps to strengthen Puerto Rico's export and foreign investment competitiveness in the Cuban market deserve to be considered by private- and public sector leaders in San Juan:

- ! The tourism offering should be continuously improved in order to provide more value to visitors and a possible basis for differentiation from the Cuban market.
- ! The possibility of multiple-destination tour packages should be pursued over the longer term, and efforts to capture the European tourism market should be initiated.

- ! An attractive manufacturing environment should be maintained through a mixture of new incentives, improved infrastructure, and increased corporate efficiency.
- ! Puerto Rican managers in U.S.-owned large manufacturing companies, hotel chains, and professional service firms should start lobbying headquarters for Cuba-related expansion plans that include a Puerto Rican base.
- ! The competitiveness of Puerto Rican exports should be improved through the continuation of current efforts to export to new markets.
- ! Trade missions and individual company visits aimed at developing firm-specific contingency plans (such as the memorandums of understanding that many U.S. firms have signed) should be sponsored.
- ! Embargo-compliant alliances and joint ventures with companies currently on the ground in Cuba should be explored, as well as participation in the plans of U.S. firms with implementable contingency strategies.

In order for the post embargo commercial relationship between Cuba and Puerto Rico to be a fruitful one, both islands will have to invest in creating "enabling" environments that enhance business competitiveness. Rapid change in the political economy of the two islands and in the globalized corporations will make these environments hard to engineer. For Puerto Rico, the main uncertainties involve the resolution of the status question and the impact on the manufacturing base of the phaseout of Section 936 and of the global rationalization of production. For Cuba, the main unknowns are the timing and conditions of the end of the U.S. embargo and the rate at which the Cuban government (with or without Castro) will allow a transition toward open markets and, ideally, a more pluralistic form of governance. Nevertheless, when the

"transition" in Cuba does happen in a not too distant future, whether Cuba is seen as a pirate or a partner in newly created business opportunities, will depend in great measure on the proactive measures taken by Puerto Rican business leaders and politicians - today.

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APPENDIX A INTERVIEW LIST

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