

ECONOMIC FACTORS IN SELECTING AN APPROACH TO CONFISCATION CLAIMS IN CUBA¹

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“Explicit legal treatment of the rights of former owners not only strengthens the credibility of a country’s commitment to the rights of private property, but also prevents the legal confusion over ownership that could arise if the issue were left to be settled later in courts. However, redress should be provided to former owners in a way that does not slow the privatization process: compensation should **not** take the form of giving the original owners the rights to the property itself, but rather the right to compensation by the state. New owners cannot get on with running businesses if they face the possibility of claims for restitution by former owners.”

— Stanley Fisher, “Privatization in Eastern European Transformation,” in *The Emergence of Market Economies in Eastern Europe*, Christopher Clague and Gordon C. Rausser, eds. (1992), p. 230-231.

INTRODUCTION

Economic stabilization, law and order, food, medicines, the establishment of workable institutions and organizations for policy implementation, the establishment of clear, secure and marketable property rights, national reconciliation and social peace will be critical to Cuba’s reconstruction and transition to a truly open economic and political system, and for

that country to rejoin the international financial community.

While there is almost general agreement on the need to privatize state-owned enterprises and attract foreign investment to Cuba as rapidly as possible, there must first be a determination regarding the issue of property rights. Changes in property rights must be entrusted to institutions that themselves neither exercise property rights nor enforce them. Moreover, unless clear and transparent “rules of the game” are set and implemented, the amount and quality of investment taking place will be less than what is needed to put Cuba on a sustainable and high growth rate.

Privatization has proceeded at a disappointingly slow pace in some Eastern Europe countries, in part due to delays in resolving the property rights issue. Travieso-Díaz has pointed out that based on the widely differing experiences in Czechoslovakia, Hungary and Poland,

“whatever process is followed . . . must provide an unequivocal adjudication of property rights so that no legal obstacles to the privatization of enterprises are interposed by the existence of unresolved property claims against them.”³

1. This paper is based on a previous paper by the authors, “Transition in Cuba: A Comprehensive Stabilization Proposal and Some Key Issues,” in George P. Montalván (ed.), *Cuba In Transition*, Volume 3 (Washington, D.C.: ASCE, 1994), pp. 11-72.

2. The views expressed herein are those of the authors and in no way represent the official views of the Inter-American Development Bank.

3. Matías Travieso-Díaz and Stephan M. Bleisteiner, “Some Lessons for Cuba from the Legal Changes in Eastern Europe,” April 1993, p. 19.

In this paper we explore some basic issues. We do not intend to be exhaustive, but only illustrative of the complexity of the issues. We hope we can learn from the experiences of former socialist countries, so as to increase our understanding of these issues and avoid recommending policies that would lead to costly mistakes.

Following this introduction, we present rough estimates of the breadth and depth of property confiscations in Cuba and the complications created by the foreign investment since 1990 and by the cooperativization of agricultural state enterprises in 1993. The next section includes a presentation of the Eastern European, Nicaraguan and Chilean experiences and some of their lessons for Cuba. Also some considerations will be made regarding restitution. This is followed by presents an overall appraisal of the potential package of measures that might be adopted and will conclude with some specific recommendations to tackle compensations for property confiscations and tort claims.

IDEAS CONCERNING THE MAGNITUDE OF THE PROPERTY RIGHTS ISSUE

A.U.S. Claims

The *casus belli* for the U.S. embargo on Cuba was the nationalization or confiscation of property owned by U.S. citizens and corporations in 1960. Following enactment by Congress of the Cuban Claims Act of 1964, the Foreign Claims Settlement Commission (FCSC) adjudicated close to 9,000 claims by U.S. citizens and firms, and certified awards in 5,911 cases totalling approximately \$1.8 billion, of which \$1.6 billion were corporate claims (see Table 1). The FCSC ruled that *simple* interest of 6 percent per annum should be charged from the date of the actual loss to the date of settlement, bringing the total value of U.S. claims to approximately US\$5.5 billion at the end of 1994.⁴

From our examination of several of these claims, at least some of the FCSC's awards are open to question. In the early 1970's, the Internal Revenue Service established a program under which taxpayers were entitled to deduct from their income taxes losses sustained from confiscations by the government of Cuba. If claims awarded were inflated to a value of twice the actual loss, at a marginal tax rate of 52 percent the tax benefit would roughly compensate entirely for the loss.

As a matter of interest, official U.S. Government statistics place the total value of U.S. investment in Cuba at US\$956 million.⁵ While this figure may represent book value of investment, the significant discrepancy between this figure and the total of corporate awards serves to highlight the need for careful review of the FCSC's awards.

B. Claims by Cuban Nationals

Alonso and Lago⁶ estimated the value of claims by Cuban expatriates to be approximately US\$6.9 billion at 1957 values which, according to their calculations, was equivalent to US\$20.02 billion in mid-1993. This does not include damages from human rights violations for which they indicate there is no data. They do, however, state that "compensation for these human rights claims should be paid."

The IRS program mentioned in the preceding section was extended specifically to Cuban nationals at the time of confiscation losses and were now U.S. taxpayers. Unfortunately the authors have not been able to obtain any information regarding the total amount accepted by the IRS as loss deductions.

In 1994, a group of Cuban-Americans sent a document to Secretary of State Warren Christopher requesting that the Department's Office of International Claims and Investment Disputes (OICAID) take up their claims even though they were not U.S. citizens at the time of confiscation. In doing so, they

4. See FCSC Decision CU-0249, American Cast Iron Pipe Company, for the FCSC ruling of simple interest at 6 percent per annum.

5. *Survey of Current Business*, August 1961, Table 3, p. 22, 23.

6. José F. Alonso and Armando M. Lago, "A First Approximation of the Foreign Assistance Requirements of a Democratic Cuba," in George P. Montalván (ed.), *Cuba In Transition*, Vol. 3, op. cit., pp. 202-204.

Table 1. U.S. Corporate Claims Against Cuba: Awards Exceeding US\$20 Million at Time of Loss

Corporate Claimant	Decision	Award US\$million
Cuban Electric Company	CU-4122	267.6
International Telephone & Telegraph ITT as Trustee	CU-5013	130.7
North American Sugar Industries Cuban-American Mercantile Corp. West India Company	CU-3578	109.0
Moa Bay Mining Company	CU-6049	88.3
United Fruit Sugar Company	CU-3824	85.1
West Indies Sugar Company	CU-5969	84.9
American Sugar Company	CU-3969	81.0
Standard Oil Company	CU-3838	71.6
Bangor Punta Corporation Baragua Industrial Corporation Florida Industrial Corp. of NY Macareno Industrial Corp. of NY	CU-6034	53.4
Francisco Sugar Company	CU-6066	52.6
Texaco, Inc.	CU-4546	50.1
Manatí Sugar Company	CU-6020	48.6
Nicaró Nickel Company	CU-6247	33.0
Coca-Cola Company	CU-6818	27.5
Lone Star Cement Company	CU-6217	24.9
New Tuinucú Sugar Company, Inc.	CU-6817	23.3
Other Corporate Claimants (approx. 882)		335.2
Individual and Other Claimants (5,013)		221.0
Total Amount Awarded		1,799.5

Source: United States Foreign Claims Settlement Commission, 1972.

cited precedents such as the Bernstein case (210 F.2d 375, 1954) and the “Second Italian Claims Program.”⁷ This was reflected in the initial provisions of the “Helms-Burton” bill considered by Congress in 1995.

C. Other Claims

Spain is the other country whose citizens sustained losses due to confiscation after January 1959, and Alonso and Lago indicate that the value of Spanish claims was US\$350 million. A compensation agreement was reached between the two governments, al-

7. See Alberto Díaz-Masvidal, “Scope, Nature and Implications of Contract Assignments on Cuban Natural Resources,” in George P. Montalván (ed.), *Cuba In Transition*, Volume 3, pp. 55-60.

though the government of Cuba has not been able to comply with the agreed amortization schedule.

D. Foreign Investment 1990 to Present— Implications re Property Rights

According to the Cuban Chamber of Commerce, as of July 1994 there were 146 joint ventures operating in four main sectors: industry, tourism, mining/oil and telecommunications. Several of these companies, however, have two or more separate joint ventures in Cuba. Carlos Lage declared that as of November 1994, there were 105 joint ventures with different companies. Most of the joint ventures are with Canadian, Mexican and European companies, particularly Spanish, French and Italian. Also, there were approximately 400 companies with representatives and/or offices in Cuba, among them *Bayer, Castrol, Hoechst, Pegaso, Sandoz* and *Total* as of November 1994.

All investment in Cuba is in the form of joint ventures with the Cuban government or with a Cuban state company. The Cuban side contributes the fixed assets and the foreign partner the working capital, the technical expertise and access to external markets. Sometimes the foreign partner merely supplies management. According to Lage the estimated accumulated foreign investment at the end of 1994 would have reached US\$1,500 million.

In mid-June 1994, during a state visit to Cuba by former Mexican President Carlos Salinas de Gortari, the most important individual agreement for the purchase of 49 percent of EmtelCuba by Grupo Domos was announced, for a total of US\$1.5 billion. This amount includes a direct payment of about US\$500 million for its share in the company, US\$200 million in the form of a swap of Cuba's outstanding debt with Mexico, and the remaining US\$800 million to be invested over a 7-year period, with the Cuban government contributing half that amount. As part of the deal, EmtelCuba received a 55-year monopoly concession on local and long-distance service as well as data and image transmission. Officials of Grupo Domos indicated that the contract had been structured such that it would be

“ . . . viable financially, politically and legally.”

E. The Cooperativization of State Farms— Implications re Property Rights

In 1993 most of state-owned farms were transformed into basic units for cooperative production (UBPC) (Decree-Law No. 142 of September 15, 1993). UBPC can lease land and animals from the state for an indefinite period of time and retain part of their profits for reinvestment purposes. UBPCs organize themselves and select their own leadership. UBPC start the demise of state and collective farms, can lay off inefficient workers and cut back excess personnel. According to preliminary figures, with the establishment of the UBPC, the state sector's share of total agriculture fell from 75 percent to 34 percent while its share of cultivated land fell from 80 percent to 25 percent.

This is a striking and significant change in land tenancy in Cuba, because the UBPC are de facto “owners” of the farms. These “stakeholders” have existing ownership rights, in the sense of being able to exercise control over assets effectively. Moreover, it is likely that these stakeholders will take both economic and political action to defend their rights. Unless these stakeholders are somehow appeased, bribed or disenfranchised, the privatization of UBPC's cannot proceed or there will be “pseudo-privatization” (the transfer or “give-away” of public assets to private owners without an exchange of financial resources, skills and technological expertise).

SOME CRITERIA FOR AN APPROACH TO CONFISCATION CLAIMS

Obviously, the property rights issue is primarily a political issue, not a technical or economic one. In the final analysis, any solution should have the support of the majority of the Cuban people in order for the solutions to be enforceable, the outcome peaceful and also to encourage the proper and speedy reconstruction of the Cuban economy.

Privatization of state property and attraction of foreign investment are central tasks in the transition from socialist economies to market economies. It is now widely accepted that the transformation from a socialist economy to a market economy and the urgently-needed improvements in enterprise efficiency are unlikely to occur without extensive and fast

privatization. In a socialist state, no one has the incentive to “mind the shop” of public property. Hence, privatization must be accomplished in a speedy and comprehensive manner based on the principle that “any productive activity that the government can do, the private sector can do as well or better.”

Swift creation of a legal framework that defines property rights clearly facilitates public understanding of privatization, stimulates broad-based ownership, prevents abuse of power, and speeds up privatization and foreign investment. Ronald Coase (1960) and Olivier Williamson (1985) argued that once property rights are well-defined, individuals have very strong incentives and face reduced risks to work for efficient outcomes, but these outcomes will be independent of the allocation of those property rights.

Privatization improves allocative and productive efficiency based on individual freedoms and on private rights. Privatization has had, in general, eight objectives:

1. swift transfer of property and management from the public sector to private individuals to increase the economic and political power of the private sector and reduce the economic and political power and the size of the state;
2. to eradicate fiscal financing of state enterprises (soft budget and loans constraints will be replaced with hard budget and loans constraints);
3. promote the building and operating of competitive structures and environments whenever possible;
4. to improve the quality of public services (i.e., telecommunications, electricity, railways, highways, and ports), that are required for the modernization process of the economy;
5. maximize income proceeds;
6. select the “right” buyers;

7. safeguard employment; and
8. obtain investment guarantees.

Some of these goals are not necessarily independent of each other nor mutually compatible.

A. Other Experiences

From the very inception of transition policies, the clear delineation of private property rights and the fast reestablishment of private property from the inherited all-but-exclusive state ownership have been core tenets in the political debates of how best to forge ahead.

A sociopolitical consensus on restituting property that was earlier confiscated, as one notable wrong to be righted, first emerged in Czechoslovakia after the “velvet revolution” as early as October, 1990. Generally speaking, the Eastern European and Baltic countries, as well as Nicaragua, made a strong commitment to undo injustices of the past. The privatization programs of these countries address the issue of restitution of property based on their specific economic, political and social conditions, setting different time limits for claims and offering different remedies according to their reality (restitution, compensation or other). In some countries the relevant legislative work is still incomplete. As indicated in Tables 2 and 3, restitution is now on the policy and privatization agenda in these countries, at least for some classes of assets and is being resolved in different ways in each country. Certainly, the measures embraced are anything but uniform.

In Russia and in other successor states of the Soviet Union (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan) the possibility of doing justice after 75 years was considered unfeasible because of difficulties in identifying rightful former owners or their rightful heirs and, hence, the issue of restitution of or compensation for property (except in Kyrgyzstan) was thus never formally placed on the agenda.⁸

8. A Land Fund covering up to 25 percent of arable land is to be created, for redistribution of land or compensation for nationalization in past decades. Criteria for eligibility are still under discussion (European Bank, *Transition Report 1995*, p. 33-64).

At the start it is necessary to decide how far back a country should redress injustice and what types of grievances should be considered. Evidently, violations of personal rights and freedoms in general and unjust and illegal confiscations of property in particular did not start with the communist takeover and did not necessarily end after the communist governments were established. Arbitrary and capricious violations of basic rights and freedoms, confiscations of different types of property, pensions and the fruits of labor have been an endless practice during the communist governments. Some of the people whose properties were confiscated received at least partial compensation. Some properties were obtained ini-

tially through misconduct or wrongdoing. Some of the properties were abandoned or the owners were out of the countries with no intention of returning. There were title and tax disputes at the time of the confiscations. Another critical issue is defining citizenship for the purpose of restitution laws. Most countries have defined that only those individuals who were citizens of the country and who had lived there permanently when the law came into effect are eligible for restitution, especially for agricultural and forestry lands. Also, most countries do not espouse claims against foreign governments brought by persons who were not their own citizens at the time of the confiscation.

Table 2. Main Characteristics of Restitution and Compensation Measures in Selected Eastern European and Baltic Countries

ELIGIBILITY AND FORMS OF COMPENSATION	Bulgaria	Hungary	Poland	Latvia	Former East Germany
Restitution to:					
Resident citizens	YES	NO	YES	YES	YES
Individuals, including foreigners	NO	NO	YES	YES	YES
Resident institutions	YES	YES	YES	NO	YES
Compensation to:					
Resident citizens	YES	YES	YES	YES	YES
Individuals, including foreigners	YES	YES	YES	YES	YES
Resident institutions	YES	NO	YES	NO	YES
Forms of Compensation:					
Allocation of a similar asset	YES	NO	YES	NO	NO
Cash payment	YES	NO	NO	YES	YES
Tradable vouchers, life annuities, securities, pensions supplements, etc.	YES	YES	NO	YES	NO
Non-tradable privatization vouchers	NO	NO	NO	YES	NO

Source: Economic Commission for Europe, *Economic Survey of Europe in 1992-1993*, p. 197.

Table 3. Restitution and Compensation Measures in Eastern Europe and the Baltic Countries

Country	Property Restitution and Compensation
Albania	According to two laws passed in 1993, former owners and their heirs can claim compensation or restitution for earlier government expropriation of non-agricultural land. For property that has been privatized, the law prescribes co-ownership between new and former owners.
Bulgaria	Significant restitution has taken place, following the Law on Ownership Restoration (1992) and the Compensation Law (1993). Few land titles have been issued, partly because the new owner must pay a high fee for the issue of the title deed, but 60 percent of agricultural land has been handed back to the original owners through “final land decisions” recognized as ownership documents and accepted as collateral. Recent legislation that favors cooperatives restrict the ability to sell restituted land under certain circumstances. Approximately 25,000 privately owned and managed small and medium-sized businesses were created in 1992 through restitution of urban business properties.
Croatia	No law on restitution has yet been sent to parliament, although a law is under preparation.
Czech Republic	A Restitution Law was adopted in October 1990. About 30,000 industrial and administrative buildings, forests and agricultural (nationalized between 1948-55) and 70,000 commercial and residential entities (nationalized during 1955-59) have been handed back to the original owners. The value of assets returned has been estimated in the range of CZK 70-120 billion.
Estonia	More than 200,000 claims for restitution of homes, farms and businesses had been submitted by the April 1993 deadline. By February 1994 approximately half of these had been validated. However, the need to carry out land surveys as well as legal problems have slowed the process.
FYR Macedonia	A draft law of restitution is in preparation and has received a first reading in parliament.
Hungary	About 1.2 million Hungarians have been granted “compensation coupons” as restitution, mainly for nationalization of property. The coupons carry a total nominal value of Ft 300 billion and are traded in the Budapest Stock Market. Coupons have in practice been usable mainly towards the purchase of land, apartments, and shares in state-owned companies. By the end of 1994 about 2 million hectares of land had been sold to 0.5 million people for compensation coupons. A further round of compensation was initiated in 1994 and land auctions for 185,000 hectares were to be completed with coupon participation in 1995.
Latvia	By the end of 1994, some 231,000 restitution claims for land in towns and cities had been submitted. Of these 13 percent had been settled. Claims for the restitution of urban land can be submitted during a period of 10 years. In order to avoid uncertainties for new owners of privatized property, the government issues guarantees to the new owners, which basically provide for the security of ownership of the privatized land and compensation for the claimants in case their claims are accepted.

Table 3. Restitution and Compensation Measures in Eastern Europe and the Baltic Countries

Country	Property Restitution and Compensation
Lithuania	The deadline for restitution applications by former owners of nationalized land was March 1994. Restitution has been granted in 86,000 cases, based on 500,000 applications. Property restitution has been impeded by administrative and legal difficulties and full resolution is likely to take many years. Uncertainty surrounding the legal ownership of properties, which may yet to be returned to the original owners, continues to complicate a number of privatization cases.
Poland	Under current law, restitution claims may only be enforced if the original nationalization law provided for compensation and none was paid. While several thousand restitution claims have been filed, compensation has been awarded to individuals in only a few cases, although a significant amount of property has been returned to the Church.
Romania	A new law on property restitution, passed by both houses of parliament in June 1995, was overruled by Romania's constitutional court in July 1995. This law would have granted restitution rights to former owners of around 250,000 residential properties that had been confiscated by the state in the post-war period.
Slovak Republic	A Restitution Law was adopted in October 1990. About 30,000 industrial and administrative buildings, forests and agricultural (nationalized between 1948-55) and 70,000 commercial and residential entities (nationalized during 1955-59) have been handed back to the original owners. A further law of restitution covering former church property was adopted in the Slovak Republic in October 1993. A restitution fund was established in 1993 to provide financial compensation to those whose claims could not met by the return of property. The fund receives 3 percent of each privatized company and currently has stakes in some 500 companies with a market value of over SK 2 billion. Revenues from sales of shares and dividends are used to meet claims.
Slovenia	Under the 1993 Law of Denationalization, land and buildings can be returned to former owners. A compensation fund is being recapitalized with shares in privatized companies.

The new commitment to democratic values and respect for the rule of law in Nicaragua and in the Eastern European and Baltic countries argues in favor of restitution or compensation for moral and ethical reasons. But, it has been argued that restitution or compensation also belong to the fundamentals, not only as a matter of justice, but also as a technical precondition for individual, collective and social stability, domestic capital formation and the influx of foreign capital. However, there are numerous legal, moral, economic, and technical objections that seriously call into question its feasibility.

Secure, clear and marketable property rights are key to the private sector's ability to respond to the changing economic environment. Privatization sales can-

not start as long as the ownership of a given asset is under dispute. Few people are willing to invest, given the threat that the assets might be claimed by a former owner. The greater the risks they perceive, the less they will be willing to bid for the assets. What makes matters worse is that some of those willing to invest may lack access to credit, since the absence of a title makes it impossible for banks and other financial intermediaries to accept the assets as collateral.

Also, demarcated and unambiguous adjudication of property rights and an environment conducive to enforce them in law are a necessary prelude to the establishment of a market economy and for attracting foreign investment. However, the settlement of

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property rights is an issue of political economy (or normative economics) *par excellence* rather than exclusively a technical one.

While restitution may be justified on moral and ethical grounds, it implicitly favors people who used to possess physical assets over those who used to possess financial assets, rights, valid contracts or human capital and it is quite complicated to implement. Especially problematic in this context has been the question of agricultural land ownership. Yet rapid progress is urgent, for without it there will be no stimulus to increase output generation from the farm sector. Similar issues arise in connection with non-agricultural land and housing.

Some countries, such as Germany and Bulgaria, use extensive in-kind restitution as an integral part of their privatization programs. Others such as Hungary have chosen a moderate financial compensation over a direct return of physical assets in order that restitutions, which have become a transformation trap or long detour in Germany, do not muddle and delay the transformation of these societies into market entities in general and the privatization process in particular.

In Germany, where large parts of all land and buildings are subject to restitution claims, the issue of restitution has tended to obscure fundamental property rights, slow the process of privatization and give disincentives to potential investors. As a result, the Treuhandanstalt, the German privatization agency, was authorized to use financial compensation instead of in-kind restitution when it deemed this solution to be indicated by overriding public interest. In Bulgaria, Estonia, Latvia and Lithuania there is a clear danger that restitution questions will further delay privatization and foreign investment. In Hungary, where the government decided to compensate rather than to reconstitute, the problem has been solved by offering compensation in the form of property vouchers that can only be used for certain purposes such as buying stocks or acquiring land, apartments, or commercial properties.

In general, most of the Eastern European and Baltic countries have favored less extensive restitution or financial compensation than Germany or Bulgaria.

In Chile, the military government reduced the total number of enterprises under state control from 529 in 1973 to 47 in 1983. It began through the restitution of the seized enterprises to their original owners. The process was conducted quite rapidly; by the end of 1974, 202 had already been returned, and by 1978 only 2 had not been returned. Likewise, the government decided to regularize the situation of seized farms, to terminate the agrarian reform program, under which approximately 52 percent of agricultural land had been expropriated, and to privatize the legally expropriated land under state ownership. This process was practically completed by 1979. Of the expropriated land, 30 percent had been returned to the original owners; 44 percent allotted or sold to private owners, mainly individual families and cooperatives; and 18 percent transferred to nonprofit institutions. Of the land returned, the former owners had to renounce any legal action they may have been entitled to against the state. The shares of some enterprises were also used as payment to settle legal actions taken against the state by former farm owners who used when their land was expropriated in the agrarian land reform of the early 1970's.

In Nicaragua, about 200,000 petitions regarding the violation of property rights encompassing about 1.7 million hectares of a total of 5.7 million hectares of cultivated land and for a substantial number of houses and urban lots were presented to the Attorney General between 1990 and 1993. The agrarian reform affected about 36 percent of the total land of the country. The lack of clear ownership has encouraged land invasions and violent confrontations that have been met with a weak response from law enforcement agencies. It can take the government up to 90 days to carry out evictions, by which time the intruders have caused severe damage to property. The uncertainty created by these unresolved property conflicts and resulting climate of violence arguably constitutes the single most important obstacle to increased private investment and productivity in agriculture, and in turn negatively affects the rest of the

economy. The Nicaraguan government devised a compensation scheme based on cadastral value for those whose property was unjustly expropriated or confiscated but who cannot recover the property. Transfers based on the agrarian reform laws have in general been considered legal. The compensation will be in bonds with a 20-year maturity at an annual interest rate of 3 percent (indexed to the US dollar exchange rate) that can either be kept to maturity or used to buy public assets. In general, the cadastre value of the property is less, and sometimes substantially less, than their market value.

In most countries budget deficits appear to determine the lack of feasibility of direct, prompt, adequate and effective cash or other monetary compensation. The only feasible compensation is a present good-faith gesture, together with future rights and obligations that stimulate the economic growth of the country and create future ability to pay. In some countries the government has limited restitution by imposing a strict deadline for filing claims and by restricting the amount of restitution.

In Germany, Czechoslovakia, and Hungary the restitution claims numbered in millions, most of which have not been settled. In Nicaragua the restitution/compensation issue has polarized society, created frictions between the Nicaraguan and the US governments, divided the Sandinistas and “it is the core issue holding this country back.”⁹ These difficulties have raised the political stakes for governments and caused logjams in administration and in the courts. Also, the expectation of engineering quick changes in property rights were frustrated in a matter of a few months.

Lawmakers in these countries have also learned that there is no way to regulate the entire process simply by passing one or two legislative acts. Indeed, implementations problems always led to modifications to the basic principles. In short, a comprehensive and just codification of restitution procedures and legal institutions for orderly adjudications of conflicting

claims proved to be a daunting task, even in the relatively more developed countries of Eastern Europe and the Baltic countries. There have been many complex and dynamic changes, refinements and amendments. In some countries restitutions and compensations, or even privatizations, were formally suspended because of underlying tensions. The changes that have occurred over the past six years taken together have fallen short even of “the most realistic expectations.”

It has been this potential problem that has been slowing down the process of privatization notably in Germany. Radical policy measures were adopted in early 1991 that sought to replace the right to restitution with a right to compensation, guaranteed by the German government, in cases where the contested property could be put into productive use by a potential buyer making a commitment to invest in the asset that was the object of contention.

B. Implementation Problems: Some Lessons for Cuba

One of the fundamental implementation problems that arises with restitution can be summarized as follows. Even if the former rightful owners or their rightful heirs can be clearly identified, which is usually a very complex and demanding task, where justice lies is by no means self-evident if, after so many years, restitution of property requires an immediate declaration that all confiscations are declared null and void. This creates dislocation and pain from the revocation of the usufruct of property that was entrusted to others, or of clear property rights that were acquired by others according to existing law. At least in some countries, there have been significant investments by management and/or workers who had some authority over the usufruct of assets. Moreover, the essence of the confiscated property rights can no longer be separated from presently existing property rights, however inadequately they may have been defined and monitored under central planning. Thus

9. An unidentified diplomat in Nicaragua, quoted in “Americans’ land claims unsettling for Nicaragua,” *The Washington Post*, December 21, 1994, p. A-28.

resorting to restitution generates enormous difficulties.

One of the greatest problems facing any but the narrowest form of *restitutio in integrum*—for example, the return of confiscated paintings or sculptures now in museums or book manuscripts or collections in libraries to original owners—is that the legal professionals and infrastructure in the transformation economies, already inadequate at the inception of the process, is likely to get hopelessly entangled in an endless tide of grievances, claims and litigation for years to come. Forging ahead with divestment in the absence of clear titles will likely embroil the divestment agency with crippling long-term claims and litigation.

C. Physical Assets and Human Capital

“In general, favoring people who used to own real estate over those who used to own financial assets or human capital should be avoided.”

—Gerd Schwartz, “Privatization in Eastern European Countries,” in *Transition to Market*, Vito Tanzi, ed., (Washington, D.C.: International Monetary Fund, 1993) p. 244.

We take the position that *claims against the Cuban state should not be limited to property claims, but should include all manner of torts*—involuntary or uncompensated work, unjust imprisonment, loss of life or limb, loss of loved ones, physical or psychological abuse and harassment by agents of the state, discontinuance of pension payments, etc.¹⁰ The people of Cuba, *especially those currently residing in that country*, have suffered incalculable losses. We see no legal, moral or ethical basis for assigning priority to settling

claims against physical property over those claiming civil damages such as those suggested above.

According to Section 503(b) of Title V of the International Claims Settlement Act of 1949,¹¹ claims of U.S. nationals were allowed “for disability or death resulting from actions taken by or under the authority of the government of Cuba...” This included pecuniary losses and damages (e.g., loss of support, medical and funeral expenses, or other expenses).¹²

In at least one case, that of Jenny M. Fuller, et. al. (Decision CU-6199), the FCSC made an award based on what it considered to be wrongful death, because it felt that Cuban authorities had discriminated against two U.S. citizens in executing them although they had admitted guilt to armed uprising. Loss of pension benefits were also allowed by the FCSC.

D. Restitution: A Long Detour or a Transformation Trap?

“Wherever a country has adopted property restitution legislation, several consequences quickly resulted: 1) a dramatic economic decline; 2) an increase in the number of property disputes between former owners and -or their heirs- and the property possessors; 3) the abandonment of property maintenance caused by trial delays; 4) a decline in the flow of foreign investment toward areas where property disputes might affect their business; and 5) an increase in tensions between the local and exile communities.”

—Juan C. Consuegra-Barquín, “Cuba’s Residential Property Ownership Dilemma: A Human Rights Issue Under International Law,” in *Rutgers Law Review*, Winter 1994, p. 923.

10. To use some well-known examples, poet Jorge Valls could make a claim for damages resulting from 22 years of unjust imprisonment; the mother of student leader Pedro Luis Boitel could likewise claim damages resulting from the wrongful death of her son while unjustly incarcerated; human rights activist and poet María Elena Cruz Varela could bring suit against the government for assault and unjust incarceration. Well-documented examples of state-sponsored mistreatment and torture are detailed in Charles J. Brown and Armando M. Lago, *The Politics of Psychiatry in Revolutionary Cuba* (New Jersey: Transaction Press, 1991). It is interesting to note that Article 26 of the 1976 Cuban Constitution provides that “any person suffering damages or loss income or value unduly caused by public officials or government agents during the performance of their duties has the right to claim and obtain the corresponding reparation or indemnification as provided by law.”

11. Title V was added by Public Law 88-666 (78 Stat. 1110), approved October 16, 1964.

12. Edward D. Re, “The Foreign Claims Settlement Commission and the Cuban Claims Program,” in *The International Lawyer*, Vol. 1, No. 1 (October 1966).

In the case of Cuba, various arguments have been advanced in favor of the return of confiscated property to former owners.¹³ These arguments fall into the following categories:

- Property rights were protected against confiscation by the Cuban Constitution of 1940; they should therefore be returned to their rightful owners.
- Since the government of Cuba does not have (and will not soon have) the means to compensate promptly, adequately and fairly, restitution is the best (only) workable alternative.
- Restitution is the best way to implement rapid privatization and encourage recapitalization of the economy; there would be output and employment-related benefits.
- In the case of corporate claims, former owners have the managerial talent necessary for rapid development of the enterprise.
- Other formerly socialist countries (Eastern Europe, Nicaragua) have implemented restitution policies.

Fortunately, most Cuban expatriate groups have recognized that restitution of dwellings or residential property is not advisable. The discussion can then be restricted to non-residential property.

First, restitution would not be accomplished quickly, and thus there would be legal encumbrances on a significant amount of non-residential property. Lawyers representing claimants are being disingenuous in arguing that restitution could be accomplished quickly.¹⁴ In the 35 years that have transpired since the confiscations, there have been significant transformations of the assets, property markers have been removed, records (including mortgages and other liens on properties claimed) have been lost, witnesses have passed away, etc. Ruling out restitution simply means that any litigation would be limited to challenges concerning the validity and quantification of the value of losses, and the compensation, if any. By ruling out restitution, a future government of Cuba could proceed immediately to privatize all small and medium-size businesses that do not require a significant regulatory framework, corporatize large enterprises and take steps to improve their financial footing prior to privatization.¹⁵

As pointed out by Gerd Schwartz in a recent book published by the IMF containing lessons from the privatization process in Eastern Europe,

“Generous restitution programs are likely to result in a flood of claims that will strain administrative capacities and impede the clarification of property rights. Direct financial compensation will add further adverse pressure on state budgets.”¹⁶

13. An interesting paper in support of restitution is Robert E. Freer, Jr., “The Significance of Restitution in the Economic Recovery of Cuba,” paper prepared for the Cuban American National Foundation’s Blue Ribbon Committee on the Economic Reconstruction of Cuba, May 25, 1993. The author indicates that he represents certified claimants who seek the return of their property. The National Association of Sugar Mill Owners of Cuba (Asociación Nacional de Hacendados de Cuba, Inc.) is also very active in this regard. A.R.M. Ritter, while acknowledging that it has “only a limited role to play,” does not rule out restitution; see “Financial Aspects of Normalizing Cuba’s International Relations: The Debt and Compensation Issues,” *Cuba In Transition*, Florida International University, 1993.

14. Freer recognizes that a process of restitution “will, to some degree, inhibit the rapid privatization of property. Forcing claims into the courts could well cause a lengthy lag between the claim and the actual vindication of title.” Freer, *op. cit.*, p. 12.

15. “In general, accumulated experience suggest that while small firms in the manufacturing sector can be sold early on and rapidly, the divestiture of large monopolies, banks, insurance companies and public utilities that wield monopoly power is substantially more complicated. In particular, in most cases, it is desirable to define a clear regulatory framework before firms are put in the block.” (Edwards, 1995, p. 175).

16. Gerd Schwartz, “Privatization in Eastern European Countries,” in *Transition to Market*, Vito Tanzi, ed., (Washington, D.C.: International Monetary Fund, 1993) p. 244.

The issue of modifications to property making restitution impractical is not trivial.¹⁷ As a result of modifications, some former owners would receive nothing while others could receive more than they lost. In the case of small business owners (there were 855 corporate awards totalling US\$123.3 million), the likelihood of physical disappearance and/or substantial modification is extremely high.

Secondly, restitution would lock the country back into the pre-1959 pattern of distribution of wealth and production structure; it would not be supported by the majority of the people of Cuba. If we were to take only the fifteen largest U.S. claims (totalling US\$1.2 billion, which is equivalent to 67 percent of total U.S. claims), we would find that U.S. nationals owned:

- 90 percent of all electricity generated on the island (Cuban Electric Co.)
- The entire telephone system (ITT)
- Most of the mining industry (Moa Bay Mining Co. & Nicaro Nickel Co.)
- Significant tracts of some of the best land in Cuba (between 1.5 and 2 million acres)¹⁸

Returning these properties, *ipso facto*, to U.S. ownership, even if it were feasible to do so, would be tantamount to insisting that nationalistic feelings in Cuba due to foreign ownership of the country's principal assets never had a basis in fact. Moreover, it would tend to lock the country back into a sugar-dominated structure of production, precisely at a time when an unintended benefit of Cuba's economic collapse is having the opportunity to diversify away from this declining industry. In the case of public utilities, the value of a concession to provide electric power or

telephone service to a country of 11 million is significantly greater than for a country of 6.5 million, which Cuba was in 1959.¹⁹ We consider that Cuba must have a very competitive, dynamic and export-oriented economy at the time of NAFTA and the WTO and such monopolistic concessions would be incompatible with this objective.

Thirdly, the output and employment benefits that have been estimated by some researchers²⁰ are based largely on unrealistically positive assumptions regarding its feasibility and insufficient consideration of the benefits of alternatives to restitution.

E. Privatization and Compensation

Large enterprises can be privatized by two modes: (i) the free distribution of assets to the public at large and (ii) following a case-by case commercial approach with four main variants: (a) sale of a controlling percentage of share to a private company; (b) initial public offering of shares on a stock exchange, either domestic or international; (c) employee or management buyout; and (d) liquidation of the enterprise and sale of its assets. In the free distribution of assets, while managers are liberated from government supervision, they are not put under the control of the new owners. Effective controls can be imposed gradually, no matter how fast the formal rights are distributed. Under the second mode, when a state enterprise is sold to new owners, corporate governance is immediately established, the necessary adjustments begin to follow and additional financing is often forthcoming. However, the mode proceeds case by case, it takes a long time to privatize a majority of state firms. Therefore the dilemma is to choose between a wide and shallow privatization or a deep and narrow one.

17. See Jorge A. Sanguinety, "Some Issues About Expropriation Claims In Cuba," *ASCE Newsletter*, Spring Issue, May 1993, p. 10, 11.

18. North American Sugar Industries alone owned a tract of land of approximately 42 miles by 30 miles (3,300 square kilometers) and three sugar mills, including two of Cuba's largest.

19. In June 1994, Grupo Domos, a Mexican enterprise, purchased 49% of EmtelCuba for US\$1.5 billion. See Ted Bardacke, "Mexican firm breaks new ground in Cuban telecom field," *Development Business*, July 31, 1994. Compare that figure, which represents half of a broken-down telephone system, to the FCSC award of US\$130.7 million in the ITT case for the entire telephone system of Cuba in 1960, which functioned adequately.

20. See, for example, José F. Alonso, "An Economic Exercise in Restitution," July 8, 1994, mimeo.

As pointed out above, to be fair to all parties any consideration of compensation for property loss in Cuba must be matched by arrangements to compensate for tort claims.

One essential question to be answered is whether attempting to arrange some form of non-cash compensation for tort claims will be more conducive to reconciliation than adopting a no-compensation policy. For example, in Romania it was felt that like many of its citizens, the country was suffering from post-traumatic stress syndrome, for which it had to undergo a difficult process of critical self-examination, healing, and reconstruction. Under a victim compensation law, more than 100,000 Rumanians have claimed compensation which, aside from cash, has been granted in the form of benefits such as free public transportation and preservation of job seniority.²¹

A commitment to compensate those whose assets were earlier confiscated is easier. It encompasses a *tabula rasa* approach, that is, mandates forging restitution and limiting to compensation the claims of economic agents whose property had earlier been confiscated. Swift economic progress in this environment is a distinctive possibility. Of course, compensation presents some complexities too. It could put pressure on current or future government budgets and assessing the property of claims would still have to be tackled. Ascertaining values of confiscated property is a hazardous undertaking under the best of circumstances. This is even true when the object of assessment is being narrowed down to real estate, plant and equipment. Some of them have changed to such an extent in the intervening years that fair compensation is fundamentally an impractical choice, some of them are in a physically dilapidated shape, and it is unfair to ignore many other assets such as goodwill, technologies, contracts, rights, licenses and patents, financial instruments, market position and human capital. Aside from generating much work for accounting firms and lawyers, at the great expense, in the end, to the taxpayer in the countries in transfor-

mation, such cumbersome, costly evaluations are in any case rather meaningless in the disorderly, highly inflationary and increasingly competitive environment of the countries going through the transformation. There is also the problem of the introduction of modern tax systems and accounting procedures.

Any attempt to ask a new Cuban government to compensate former rightful owners in cash or cash equivalent out of general revenues must be considered dangerous, given the already exceedingly weak fiscal base of the economy. Perhaps a commitment in principle to compensate former rightful owners from the proceeds of the sale of capital assets, including the transfer of shares in state firms to be privatized if so desired, or providing future rights and preferences would go a long way to see justice done without disrupting the transformation process.

There are two U.S. laws related to compensation for U.S. claims that are critical to Cuba's reconstruction. One bans aid to countries that confiscated property owned by U.S. citizens without equitable compensation and the other requires the U.S. to vote against aid by multilateral lending institutions to such countries. Hence, U.S. laws require resolution of U.S. citizens' confiscation claims before foreign aid can resume.

Bilateral negotiations are desirable to resolve U.S. claims. We would argue that by the act of filing claims before the FCSC, U.S. citizens and corporations formally requested the U.S. government to demand compensation, and the U.S. government did so by first placing and then maintaining an embargo on trade with Cuba.

Furthermore, the U.S. government paid at least partial compensation to claimants through the tax system. As mentioned in preceding sections of this paper, in the early 1970's, the Internal Revenue Service implemented a program allowing individual and corporate *taxpayers* (i.e., including Cuban expatriates who were taxpayers and suffered losses) to take feder-

21. See Geneva Initiative on Psychiatry, *Psychiatry Under Tyranny: An Assessment of the Political Abuse of Romanian Psychiatry During the Ceausescu Years*, Amsterdam, 1992, p. 14.

al income tax deductions for losses of property confiscated by the government of Cuba (see Appendix). Those who filed tax returns claiming deductions for losses also transferred their claims to the U.S. government. Groups of Cuban-Americans have also formally requested the Secretary of State to take up their cases.

Therefore, all U.S. claimants (citizen and non-citizen taxpayers) made their claims subject to international negotiation and, if the doctrine of espousal is invoked (as it should be), must abide by the settlement made by the U.S. government. Rather than negotiating with each claimant, the government of Cuba should indicate its readiness to negotiate this matter bilaterally with the U.S. government.

The purpose of massive privatization is to provide Cuba a realistic change for a fresh start as a market economy and representative democracy because Cuba faces a solvency problem and not a liquidity problem. Only interest payments on foreign loans could swallow about half of Cuba's export earnings. All compensation claims for confiscations of property and other torts must be reduced or postponed, and emergency and development economic assistance must be provided expeditiously in order that comprehensive and difficult transformation reforms are implemented and have time to take hold.

An analogy to U.S. bankruptcy proceedings is pertinent here. When an enterprise works its way through a Chapter 11 bankruptcy in the United States, three things normally happen. First, creditors are forced to refrain of pressing their claims. This breathing space, or financial standstill, provides the debtor the chance to get back on its feet. Second, the debtor may be allowed to borrow fresh funds on a privileged basis to replenish its working capital and the new creditors have higher priority than the old ones. Third, the old creditors are usually compelled to cut a deal with the debtor, in which they cancel or restructure part of the debt or convert part of it to equity, to allow the debtor to emerge from bankruptcy with an opportunity for continued operations. This is the type of scenario that will have to take place in relation to Cuba's serious financial obligations if the country is to get back on its feet.

However, an important issue to be considered is the negative impact a no-compensation policy might have on the government's credibility in reestablishing private property rights. It is also felt that future investment will be discouraged unless there is some form of official recognition of past losses, for which special consideration might be given during the process of privatization.

In a previous paper, we suggested the corporatization of certain large military bases in Cuba and their conversion to free trade zones, with labor being provided by the deactivated military. In a NAFTA and WTO world, free trade zones may be less attractive possibilities. Nevertheless, as an example of one possible means of compensation, a scheme might be built into the corporatization of military bases, converting them into poles for industrial development, and compensating with shares in these corporations.

In this regard, the government of Cuba could negotiate the earlier termination of U.S. rights to Guantánamo Bay, with its airport, port, structures and other facilities covering 117 Km² and occupying one of the three best Cuban ports, establish the Guantánamo Development Corporation, and use shares or profits from that corporation to compensate the government of the United States for U.S. claims.

Obviously, there is no reasonable way for a future government of Cuba to justify compensating the U.S. and not its own citizens. Compensation of Cuban and other claimants who did not receive tax benefits from the U.S. could take the form of issuance of shares or discount coupons to be used to purchase shares in selected corporations.

CONCLUSIONS AND RECOMMENDATIONS

The government of Cuba should take the following steps:

1. Reaffirm at the outset that all non-residential property in Cuba belongs to the state.
2. Declare its recognition that confiscations of properties that took place after January 1, 1959 were illegal, except properties initially obtained through misconduct or wrongdoing, and its intention to negotiate settlement of the claims.

3. Declare its willingness to enter into negotiations with the Government of the United States for direct bilateral settlement of the debt owed for properties of U.S. citizens confiscated after January 1, 1959. This debt includes (a) claims presented to the U.S. Foreign Claims Settlement Commission and found to merit awards, and (b) assets claimed as losses to the Internal Revenue Service by U.S. citizens and former Cuban nationals.

Lifting of the U.S. embargo is a necessary though not sufficient condition for Cuba to have the ability to service its obligations, apply for debt rescheduling and debt relief, and have access to fresh credit. In our view, as a result of the combination of the Foreign Assistance Act of 1961 and the Cuban Democracy Act of 1992, only a transition government of Cuba, committed to holding free and fair elections, will be able to negotiate the issue of U.S. claims with the government of the United States in order to resolve this matter.

Since the lifting of the U.S. embargo is a priority, Cuba must indicate its agreement to enter into formal bilateral (government-to-government) good-faith negotiations regarding U.S. claims, but the embargo must be lifted prior to concluding the negotiations.

Some have indicated disingenuously that lifting the embargo prior to settling all claims would “compromise the entire U.S. Cuba claims issue” and that the United States “would lose any leverage it may otherwise have had with regard to the prompt resolution of the U.S. Cuba claims matter.”²² This argument seems to us absurd, since Cuba’s development hopes and ability to compensate are inextricably tied to its relations with the United States. The challenge for both the U.S. and Cuba will be to build a relationship based on mutual respect and trust.

4. Establish the Guantánamo Development Corporation (GDC), as a Cuban corporation, on the property to be vacated by the U.S. Naval Base on the basis of an agreement as part of Point (3), as an industrial development zone. The government of Cuba would retain a minimum of 25 percent of its shares, the remainder to be distributed by the government of the United States as further compensation for losses sustained by its citizens and former Cuban nationals who claimed losses to the Internal Revenue Service. Suitable agreement should be reached to safeguard the value of the GDC’s shares in order for compensation to be meaningful.
5. Establish a semi-autonomous agency such as the CACUCOCO²³ to examine all other claims not included in Point (4) above, and to make a determination regarding the amount of the loss in each case.
6. Select major military bases with good infrastructure (especially port access) and establish one other industrial development corporations modelled after the GDC. Shares in these corporations would be used to compensate claims awarded by the CACUCOCO.
7. *Implement a privatization program for the non-residential properties specified in Point 1 above, providing for swift distribution of small and medium state enterprises and giving priority to Cuban residents.*²⁴ Privatization should be carried out with absolute transparency and without any suspicion of impropriety. This will provide robust political foundations to the economic transformation.
8. Adopt a modern foreign investment law, join the Multilateral Investment Guarantee Agency (MIGA), and invite and sign agreements with the Overseas Private Investment Corporation (OPIC) and other similar European organizations to

22. Ralph J. Galliano, “The Resolution of U.S. Cuba Claims: Toward a Democratic, Free Market, Post-Castro Cuba,” Washington, D.C., the Selous Foundation, May 20, 1993, p. 5, 6.

23. Cámara Cubana de Compensación Constitucional. See Emilio Cueto, “La Cacucoco: Fantasía en MI Sostenido,” *La Crónica* (Mexico, D.F.), 15 September 1994, p. 11-12.

24. See Castañeda and Montalván, *op. cit.*, pp. 68-70.

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begin financing and insuring investments in order to reduce the country risk of investing in Cuba. Cuba should also sign the International Convention for the Settlement of Investment Disputes (ICSID) and enter negotiations with the

aim of securing bilateral investment agreements to avoid double taxation in order that foreign investors can receive credit for the taxes they pay in Cuba from taxes payable in their country of origin.