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Loyola University Chicago School of Law provides an environment where a global perspective is respected and encouraged. International and Comparative Law are not studied only in theoretical, abstract terms but primarily in the context of values-based professional practice. In addition to purely international classes, courses in other disciplines – health law, child and family law, advocacy, business and tax, antitrust, intellectual property – have strong international and comparative components.

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- A 10-day program in Beijing, during the last 10 days of May in the format of a Field Study. Students must take the Introduction to Chinese Law #177 in the Spring Semester. While on the Field Study, students will earn one additional credit for the Spring course #177, with instruction by a leading Chinese Commercial Law expert.

#### *International Field Study*

- A ten-day, between-semester course in London on comparative advocacy, where students observe trials at Old Bailey, then meet with judges and barristers to discuss the substantive and procedural aspects of the British trial system. Students also visit the Inns of the Court and the Law Society, as well as have the opportunity to visit the offices of barristers and solicitors.
- A comparative law seminar on *Legal Systems of the Americas*, which offers students the opportunity to travel to Chile over spring break for on-site study and research. In Santiago, participants meet with faculty and students at the Law Faculty of Universidad Alberto Hurtado.
- A one-week site visit experience in San Juan, Puerto Rico, students have the opportunity to research the island-wide health program for indigents as well as focus on Puerto Rico's managed care and regulation.



- A global law seminar that uses a collaborative immersion approach to learning about the legal system of a selected country, including travel to that country over spring break. Countries of focus have included Tanzania, Thailand, India, Cambodia, Turkey, and Vietnam. Students work in research teams to produce papers of publishable quality.

### **The Annual Wing-Tat Lee Lecture in International and Comparative Law**

This annual event brings to Loyola University Chicago School of Law leading practitioners and scholars to deliver a significant lecture in international and comparative law. The lecture is funded by a grant from the late Wing-Tat Lee, a businessman from Hong-Kong. Previous lecturers include George A. Berman, Karen J. Alter, Thomas Buergenthal, Stephen Schwebel and Eleanor Fox.

### **The Wing-Tat Lee Chair in International Law**

The Wing-Tat Lee Chair in International Law was established to support a leading scholar of international recruited from an international search with a grant from the late Wing-Tat Lee, a businessman from Hong-Kong. The current holder of the chair is James T. Gathii who specializes in international law, international human rights and international trade law. He is also an editor of the *American Journal of International Law* among other leading journals in his field. He serves as an investor-state arbitrator in international investment and contract disputes. He has published over 80 articles and several books and frequently presents his work around the world.

### **International Moot Court Competition**

Students hone their international skills in two moot competitions: the Phillip Jessup Competition, which involves a moot court argument on a problem of public international law, and the Willem C. Vis International Commercial Arbitration Moot, involving a problem under the United Nations Convention on Contracts for the International Sale of Goods. There are two Vis teams that participate each spring in an oral argument involving an international moot arbitration problem. One team participates in Vienna, Austria against approximately 300 law school teams from all over the world, and the other team participates in Hong Kong SAR, China, against approximately 95 law school teams.



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We would like to recognize friends and alumni of the law school who have contributed within the past year to our international law program at Loyola University Chicago by their support of the Willem C. Vis International Commercial Arbitration Moot Program:

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TRENDS IN GLOBAL FINANCE:  
THE NEW DEVELOPMENT (BRICS) BANK

Rumu Sarkar\*

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**I. Introduction**

This Critical Essay will discuss the formation of the New Development Bank (NDB or the “Bank”) by the BRICS nations, i.e., Brazil, Russia, India, China and South Africa. This discussion will critically examine the creation of the NDB in terms of its policy implications in leading up to the formation of the Bank and in its potential downstream consequences. Since the inception of the NDB is so new, this essay will err on the side of raising questions rather than attempting to resolve them at this stage. In furtherance of this objective, the following discussion will review: (1) a brief history giving rise to the creation and formation of the NDB; (2) the structure, operation and mission of the Bank; (3) the impact of the Bank on the hegemony of the U.S. dollar and on U.S.-led economic sanctions regimes; and, finally, (4) the change in the global financial architecture heralded by the NDB, and its potential impact on international development in general.

At the outset, it may seem that the amalgamation of the BRICS nations into a group, let alone a bank, is haphazard and ill-fitting. It was a concept developed by Jim O’Neill, a former economist at Goldman Sachs.<sup>1</sup> In that analysis, Mr. Goldman predicted that in 2001-02, real Gross Domestic Product (GDP) growth in large emerging market economies, namely the BRICs (Brazil, Russia, India and China), will exceed that of the G7. Since that time, the concept of rapid economic growth in the BRICs as a unifying principle has burgeoned, ultimately resulting in conferences, summits, new political and trade alliances, and now a new bank. In the view of Mr. Goldman, however, the inclusion of South Africa in this group is a mistake since its GDP is too low in comparison with the other

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\* This essay summarizes and expands the remarks made by the author at the Loyola University Chicago International Law Colloquium 2015 held on April 29, 2015. Professor Rumu Sarkar is a member of the Loyola University Chicago Advisory Committee (Emerita) for its PROLAW program, located in Rome, Italy, which is designed to provide a Masters of Law degree in international development law issues. Professor Sarkar is also the General Counsel to Millennium Partners, an international development consulting firm located in Charlottesville, VA.

<sup>1</sup> Jim O’Neill, *Building Better Global Economic BRICs*, GOLDMAN SACHS GLOBAL ECON PAPER NO. 66, November 30, 2001.

members.<sup>2</sup> Nevertheless, South Africa was added since the other members felt that the continent of Africa needed to be represented in this group and in its new banking venture.<sup>3</sup>

Certainly, there are obvious distinctions among the BRICS members who have diverging and, in some cases, conflicting interests. While India, Brazil and South Africa are democracies, Russia and China are not. Russia's economy is based on the export of natural resources, whereas China's imports much of its resources and exports manufactured products.

In contrast, India's economy depends heavily on technology and services, and the economies of South Africa and Brazil, also export-driven, are a blend of the above. China and India have long-standing territorial disputes that remain unresolved,<sup>4</sup> and China often vies for economic power with the United States and for political power with Russia. China and Russia are both permanent members of the UN Security Council, but India, also a nuclear power, is not despite its repeated and strenuous attempts to join over the past decade or more.<sup>5</sup> Despite these and many other differences in population, history, languages, and more, the BRICS nations have shown a new resolve in addressing the perceived deficiencies in the current global financial architecture. Their response is both new and innovative, and time alone will reveal whether this partnership will be successful and enduring.

## II. History as Prologue: IMF Reforms as a Backdrop to the Formation of the NDB

The second week of July 2014 marked the 70th anniversary of the signing of the Bretton Woods Agreement that established the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the "World Bank") in Bretton Woods, New Hampshire in 1944. On July 15, 2014, 70 years later, the BRICS announced the formation of the New Development

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<sup>2</sup> See, e.g., Nima Elbagir & Teo Kermeliotis, *South Africa an Economic Powerhouse? Nowhere Near, says Goldman Exec*, CNN (Apr. 5, 2011), <http://edition.cnn.com/2011/BUSINESS/04/05/jim.oneill.africa.bric/> (noting that the Chinese economy is 28 times larger than that of South Africa's according to *The Economist*); see also, *The BRICS Bank: An Acronym with Capital*, ECONOMIST (July 19, 2014), <http://www.economist.com/news/finance-and-economics/21607851-setting-up-rivals-imf-and-world-bank-easier-running-them-acronym> [hereinafter, The BRICS Bank].

<sup>3</sup> J.P.P., *Why is South Africa Included in the BRICS?* ECONOMIST (Mar. 29, 2013), <http://www.economist.com/blogs/economist-explains/2013/03/economist-explains-why-south-africa-brics>.

<sup>4</sup> Michael Forsythe, *China Protests India's Leader Visit to Disputed Border Area*, N. Y. TIMES (Feb. 23, 2015), [http://www.nytimes.com/2015/02/23/world/asia/china-protests-india-leaders-visit-to-disputed-border-area.html?\\_r=0](http://www.nytimes.com/2015/02/23/world/asia/china-protests-india-leaders-visit-to-disputed-border-area.html?_r=0). See generally *India China Border Dispute*, globalsecurity.org, [http://www.globalsecurity.org/military/world/war/india-china\\_conflicts.htm](http://www.globalsecurity.org/military/world/war/india-china_conflicts.htm)[http://www.globalsecurity.org/military/world/war/india-china\\_conflicts.htm](http://www.globalsecurity.org/military/world/war/india-china_conflicts.htm); Shannon Tiezzi, *Can India and China Overcome Their Border Dispute?*, THE DIPLOMAT (Sept. 19, 2014), <http://thediplomat.com/2014/09/can-india-and-china-overcome-their-border-dispute/>.

<sup>5</sup> William Petroff, *What are the Obstacles Faced by India When Becoming a Permanent Member of the UN Security Council? How Can India Tackle It?*, QUORA, <http://www.quora.com/Why-is-India-not-a-permanent-member-of-the-UN-Security-Council> (last updated Sept. 17, 2015); see also Neelam Deo & Karan Pradhan, *Should India Give Up on the UN Security Council?*, THE DIPLOMAT (Nov. 19, 2014), <http://thediplomat.com/2014/11/should-india-give-up-on-the-un-security-council/>.

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Bank and the Contingent Reserve Arrangement (CRA) at its sixth annual summit held in Fortaleza, Brazil. The NDB is designed to finance infrastructure and sustainable development projects, mirroring the function of the World Bank. The CRA was created to make foreign reserves available to provide balance of payments support for BRICS members in financial difficulty, mirroring the function of the IMF. Since the IMF and the World Bank are already well-established and functioning multilateral bodies that the BRICS are all members of, why were the NDB and CRA created?

*A Deeper Dive.* IMF membership is determined by a quota system whereby each member country is assigned a quota, or monetary contribution, that is designed to reflect the size of the member country's relative size as measured by its GDP. These quotas have not been revised much since the inception of the IMF, and no longer reflect the relative economic size or power of its member countries.<sup>6</sup>

For example, the BRICS possess 11% of the IMF's votes but account for more than 20% of global economic activity.<sup>7</sup> In other words, the four major BRICS economies, Brazil, China, India and Russia, have a combined share of the world GDP of 24.5%, but have only 10.3% of the IMF's votes.<sup>8</sup> In contrast, the four largest European economies, France, Germany, the UK and Italy, represent 13.4% of the world GDP, but have 17.6% of the IMF's votes.<sup>9</sup> China makes up approximately 10% of world GDP, but has 5% of the votes.<sup>10</sup> The U.S. at the time of the Bretton Woods conference in 1944 held 33% of the IMF's votes, and now holds 17% of the IMF votes,<sup>11</sup> the largest share held by any country.<sup>12</sup> We will explore the implications of this below.

*Reforming IMF's Quotas System.* The political quest to reform the IMF quota system began in earnest with the Bush Administration in 2008, and was further solidified by President Obama's commitment to IMF reform at the G-20 summit meeting held in Seoul, South Korea in November 2010.<sup>13</sup> The Seoul IMF reform package contained three essential elements:

- (1) Doubling the IMF quotas with a corresponding reduction in the size of the commitment to the New Arrangements to Borrow (NAB) for certain coun-

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<sup>6</sup> Jon Hartley, *The BRICS Bank Born Out of Politics*, FORBES (July 28, 2014), <http://www.forbes.com/sites/jonhartley/2014/07/28/the-brics-bank-is-born-out-of-politics/>.

<sup>7</sup> Barry Eichengreen, *Do the BRICS need their own Development Bank?* THE GUARDIAN (Aug. 14, 2014), <http://www.theguardian.com/business/2014/aug/14/brics-development-bank-imf-world-bank-dollar>.

<sup>8</sup> Robert Wihitol, *Whither Multilateral Development Finance?*, 10 (ADB Institute, Working Paper No. 491, 2014), available at <http://www10.iadb.org/intal/intalcdi/PE/2014/14541.pdf>; see also Hartley, *supra* note 6.

<sup>9</sup> *Id.*

<sup>10</sup> Hartley, *supra* note 6.

<sup>11</sup> *Id.*

<sup>12</sup> Nansel Stobdan & Rucheta Singh, *The BRICS Bank and Its Prospective Place in the World Economy* 4 (Dec. 1, 2014), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2538710](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2538710).

<sup>13</sup> Edwin Truman, *IMF Reform is Waiting on the United States*, 3 (Peterson Inst. for Int'l Econ., Paper No. PB14-9, Mar. 2014), <http://www.piie.com/publications/pb/pb14-9.pdf>.

## Trends in Global Finance: The New Development (BRICS) Bank

tries, most notably the United States, resulting in a reallocation of the quotas and respective voting shares;

- (2) An amendment to the IMF Articles of Agreement permitting an all-elected executive board with a view to reducing and consolidating European representation on the IMF Executive Board. Currently, five nations with the largest quotas are allowed to appoint an executive director, namely, the United States, Japan, Germany, France and the United Kingdom;
- (3) The reduction of the representation of advanced European nations on the 24-person IMF executive board.<sup>14</sup>

In essence, about 6% of the IMF's shares would shift to emerging economies, in particular, China, Brazil and India. Additionally, two seats on the IMF's Executive Board that are currently held by European countries would change over as well.<sup>15</sup>

The Seoul package was formally adopted by the IMF board of governors in December 2010,<sup>16</sup> with passage of the reform package expected from its members by January 2014.<sup>17</sup> As of February 25, 2014, 158 of the 188 IMF members with 78.7% of the votes had consented to the increases of their quotas, representing a doubling of the existing IMF quotas.<sup>18</sup> However, since the United States has 16.75% of the vote, its approval of the amendment to the IMF's articles of agreement is required in order for the amendment to take effect.<sup>19</sup>

The IMF reforms would essentially: (1) increase the size of the U.S. quota while commensurately decrease the U.S. share in the NAB by an equivalent amount of approximately \$63 billion; and (2) accept the changes in the IMF Executive Board while preserving the U.S. seat as well as its veto power on the board.<sup>20</sup> Despite the public urging of the IMF's leadership to act on the proposed reforms by December 2014,<sup>21</sup> and the open expression by certain IMF members

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<sup>14</sup> *Id.* at 2.

<sup>15</sup> *Getting Around Uncle Sam*, *ECONOMIST* (Jan. 31, 2015), <http://www.economist.com/news/finance-and-economics/21641260-how-reform-imf-without-congress-help-getting-around-uncle-sam>.

<sup>16</sup> Press Release No. 10/477, Int'l Monetary Fund, [IMF], IMF Board of Governors Approve Major Quota and Governance Reforms (Dec. 16, 2010), *available at* <https://www.imf.org/external/np/sec/pr/2010/pr10477.htm>. The IMF press release specifically recognized the importance of the BRICs by stating, "The 10 Fund members with the largest voting share will consist of the United States, Japan, plus the so-called "BRICs" (Brazil, China, India, the Russian Federation), and the four largest European countries (France, Germany, Italy, the United Kingdom). *Id.* The major realignment in the ranking of quota shares under this reform will result in a Fund that better reflects global realities." *Id.*

<sup>17</sup> Truman, *supra* note 13, at 3-4.

<sup>18</sup> *Id.* at 4.

<sup>19</sup> *Id.*

<sup>20</sup> Justification for Appropriations, FY 2014 Budget Request, U.S. Treasury Int'l Programs, at 45, *available at* [http://www.treasury.gov/about/budget-performance/Documents/FY2014\\_Treasury\\_International\\_Programs.pdf](http://www.treasury.gov/about/budget-performance/Documents/FY2014_Treasury_International_Programs.pdf).

<sup>21</sup> Anna Yukhananov, *U.S. Closes Out Year Without Passing IMF Reforms*, *REUTERS* (Dec. 10, 2014), <http://www.reuters.com/article/2014/12/11/us-usa-congress-imf-idUSKBN0JO1UC20141211>.

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of their continuing disappointment at the U.S. Congress's failure to act,<sup>22</sup> the United States Congress took no action for over five years.<sup>23</sup>

In fact, there has already been a movement to bypass the United States on these measures. On January 28, 2015, the IMF urged its membership to agree on reform measures by June 2015.<sup>24</sup>

In theory, the IMF could sidestep Congress by leaving America out of the capital-raising. But that would need to be approved by 85% of shareholders, and America has 16.75% of the votes. One reason [the U.S. Congress] might vote against [it] is that its shareholding would drop below 15%, costing it its veto. . . That leaves a more modest option: allowing emerging markets' quotas to increase by enough to give them more say but not by so much as to reduce America's share below 15%.<sup>25</sup>

Critics of the U.S. intransigence in passing these IMF reforms have noted that the failure to reform the institution may weaken it in the long-run, and make it less relevant or powerful as an institution.<sup>26</sup> Further, the diminished power of the IMF, over time, may weaken multilateral approaches to global financial crises, and may give rise to regionalism, bilateralism and other means of dealing with global markets and their disruptions.<sup>27</sup>

On December 18, 2015, President Obama was finally able to sign the IMF reforms into effect as part of an omnibus spending bill.<sup>28</sup> The United States will retain 16.5% of its voting power at the IMF.<sup>29</sup> Nevertheless, further work needs to be done in order to augment an IMF member's voting share as its relative economic strength increases. Moreover, the informal practice of appointing a European to lead the IMF and an American to lead the World Bank may be ended. This may happen as early as July 2016 when the current IMF's managing director, Christine Lagarde, a former French finance minister, ends her term.<sup>30</sup>

Although the U.S. Congress finally acted out of the realization that its inaction was undermining the United States' position and leadership in international monetary policies, its action may be seen as "too little, too late." Efforts to bypass

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<sup>22</sup> Ben Blanchard, *China Expresses Regret at U.S. Failure to Pass IMF Reforms*, REUTERS (Dec. 12, 2014), <http://www.reuters.com/article/us-china-usa-imf-idUSKBN0JQ0PO20141212>.

<sup>23</sup> *Getting Around Uncle Sam*, *supra* note 15; See also Jonathan Weisman, *Senate Democrats Drop I.M.F. Reforms from Ukraine Aid*, N. Y. TIMES (Mar. 25, 2014), <http://www.nytimes.com/2014/03/26/world/europe/senate-democrats-drop-imf-reforms-from-ukraine-aid-package.html>; Blanchard, *supra* note 22.

<sup>24</sup> *Getting Around Uncle Sam*, *supra* note 15.

<sup>25</sup> *Id.*

<sup>26</sup> See generally The Editorial Board, *Past Time to Reform Bretton Woods*, N. Y. TIMES (May 16, 2015), <http://www.nytimes.com/2015/05/17/opinion/sunday/past-time-to-reform-bretton-woods.html>.

<sup>27</sup> Patrice Hill, *IMF Gives U.S. Congress Year-End Deadline for Passing Reforms*, WASH. TIMES (April 14, 2014), <http://www.washingtontimes.com/news/2014/apr/14/imf-gives-us-congress-year-end-deadline-passing-re/>.

<sup>28</sup> The Editorial Board, *Congress Gets Out of the I.M.F.'s Way*, N.Y. TIMES (Dec. 22, 2015), [http://www.nytimes.com/2015/12/22/opinion/congress-gets-out-of-the-imfs-way.html?\\_r=0](http://www.nytimes.com/2015/12/22/opinion/congress-gets-out-of-the-imfs-way.html?_r=0).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

## Trends in Global Finance: The New Development (BRICS) Bank

the U.S. Congress are already underway. In fact, as the discussion below will illustrate, the train may have already left the station.

### III. The Creation of the NDB: Its Organization, Structure, and Mission

In a media note to accompany the informal meeting of the BRICS at the G-20 summit in Brisbane, Australia, in November 15, 2014, it was duly noted that:

The Leaders also reaffirmed their disappointment and serious concern at the non-implementation of the 2010 IMF reforms, and its impact on the Fund's legitimacy and credibility. Undue delays in ratifying the 2010 agreement are in contradiction with joint commitments by the G20 Leaders since 2009. In the event that the United States fails to ratify the 2010 reforms by the year-end, they called on the G20 to schedule a discussion of the options for next steps that the IMF has committed to present in January 2015. They also emphasized the need to continue the IMF reform processes.<sup>31</sup>

Less than a year later, the Forteleza Declaration was released. On July 15, 2014, at the Sixth BRICS Summit in Forteleza, Brazil, the BRICS formally announced the creation of the NDB and the CRA.<sup>32</sup> The Agreement establishing the NDB was also released on the same date.<sup>33</sup> The five signatories shall have equal voting power.<sup>34</sup> Thus, the NDB is not based on a quota system, at least not at its inception.

The NDB will have a president (an Indian for the first six years), a Board of Governors Chair (a Russian), and Board of Directors Chair (a Brazilian), and will be headquartered in Shanghai, China.<sup>35</sup> The NDB Africa Regional Center will be established in South Africa concurrently with the establishment of the NDB headquarters.<sup>36</sup>

The NDB has initial start-up capital of \$50 billion, with each member BRICS country contributing \$10 billion. The goal is to reach \$100 billion.<sup>37</sup> The NDB is designed to provide loans, loan guarantees, long-term credits and make equity

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<sup>31</sup> See *Media Note on the Informal Meeting of BRICS Leaders on the Occasion of the G20 Summit in Brisbane*, BRICS INFORMATION CENTRE (Nov. 15, 2014), <http://www.brics.utoronto.ca/docs/141115-brisbane.html>.

<sup>32</sup> See *Sixth BRICS Summit Forteleza Declaration*, <http://brics6.itamaraty.gov.br/media2/press-releases/214-sixth-brics-summit-forteleza-declaration>.

<sup>33</sup> See *Agreement on the New Development Bank* (July 15, 2014), <http://brics6.itamaraty.gov.br/media2/press-releases/219-agreement-on-the-new-development-bank-forteleza-july-15>.

<sup>34</sup> See Shannon Tiezzi, *Don't Forget About the New BRICS Bank*, THE DIPLOMAT (July 22, 2015), <http://thediplomat.com/2015/07/dont-forget-about-the-new-brics-bank/>.

<sup>35</sup> Raj M. Desai & James Raymond Vreeland, *What the New Bank of BRICS is All About*, WASH. POST (July 17, 2014), <http://www.washingtonpost.com/blogs/monkey-cage/wp/2014/07/17/what-the-new-bank-of-brics-is-all-about/>.

<sup>36</sup> Tyler Durden, *BRICS Announce \$100 Billion Reserve To Bypass Fed, Developed World Central Banks*, ZEROHEDGE (July 15, 2014), <http://www.zerohedge.com/news/2014-07-15/brics-announce-100-billion-reserve-bypass-fed-developed-world-central-banks>.

<sup>37</sup> See *Agreement on the New Development Bank* (July 15, 2014), <http://brics6.itamaraty.gov.br/media2/press-releases/219-agreement-on-the-new-development-bank-forteleza-july-15>.

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investments in support of funding infrastructure and sustainable development projects in the BRICS countries initially.<sup>38</sup> Financing may then be extended to other low and middle-income countries that will be able to apply for loans in time.<sup>39</sup> The membership of the Bank shall be open to members of the United Nations, and shall be open to both borrowing and non-borrowing members.<sup>40</sup>

The BRICS also announced the creation of the CRA at the same time.<sup>41</sup> Unlike the NDB's pool of paid in capital by its members, the CRA is a pool of \$100 billion in available currency swaps to be equally shared by the members in order to provide liquidity to them in the event that balance of payments issues arise.<sup>42</sup> The CRA is funded by China contributing \$41 billion, Brazil, Russia and India contributing \$18 billion each, and South Africa contributing \$5 billion.<sup>43</sup> The agreements establishing the NDB and the CRA will need to be ratified by the legislatures of the respective members before going into effect.<sup>44</sup> A plethora of administrative and operational issues will also need to be addressed and resolved before the two institutions become fully operational.<sup>45</sup>

All five signatory members of the NDB have ratified the agreement establishing it. Russia and China were among the first to ratify the agreement establishing the NDB.<sup>46</sup> Brazil ratified the agreement in June 2015.<sup>47</sup> India and South Africa have also ratified the agreement establishing the NDB.<sup>48</sup> Further, Tito Mboweni, former Governor of the South African Reserve Bank, was appointed as South

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<sup>38</sup> See Agreement on the New Development Bank, *supra* note 33, at art. 19; see also Alex Blomfield & Ivan Davydov, *A New Development Bank – A New Funding Source and a New Way of Doing Things for Energy and Infrastructure Projects Globally*, KING & SPALDING (Aug. 4, 2015), <http://www.energy-lawexchange.com/a-new-development-bank-a-new-funding-source-and-a-new-way-of-doing-things-for-energy-and-infrastructure-projects-globally/>.

<sup>39</sup> See The BRICS Bank, *supra* note 2 (estimating that South Asia alone requires \$2.5 trillion in infrastructure investment over the next ten years).

<sup>40</sup> Agreement on the New Development Bank, *supra* note 33.

<sup>41</sup> Treaty for the Establishment of a BRICS Contingent Reserve Arrangement (July 15, 2014), available at <http://brics6.itamaraty.gov.br/media2/press-releases/220-treaty-for-the-establishment-of-a-brics-contingent-reserve-arrangement-fortaleza-july-15>.

<sup>42</sup> *Id.* at art. 1; see also *BRICS Contingent Reserve Arrangement Treaty comes into force*, RUSSIA & INDIA REPORT (July 30, 2015), [http://in.rbth.com/economics/2015/07/30/brics\\_contingent\\_reserve\\_arrangement\\_treaty\\_comes\\_into\\_force\\_44497](http://in.rbth.com/economics/2015/07/30/brics_contingent_reserve_arrangement_treaty_comes_into_force_44497).

<sup>43</sup> See Wihtol, *supra* note 8, at 12; see also Desai & Vreeland, *supra* note 35.

<sup>44</sup> See Agreement on the New Development Bank, *supra* note 33 at art. 49. Art. 49(a) states that, "This Agreement shall enter into force when instruments of acceptance, ratification or approval have been deposited, in accordance with Article 48 by all BRICS countries." *Id.*; Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, *supra* note 41 at art. 22. Art. 22(a) of the CRA states that, "This Treaty shall be subject to acceptance, ratification or approval, according to the respective domestic procedures of the Parties." *Id.*

<sup>45</sup> See Wihtol, *supra* note 8, at 12.

<sup>46</sup> See Tyler Durden, *De-Dollarization: Russia Ratifies \$100 Billion BRICS Bank*, ZEROHEDGE (Feb. 21, 2015), <http://www.zerohedge.com/news/2015-02-21/de-dollarization-russia-ratifies-100-billion-brics-bank>; See also *China Ratifies the Freshly-Minted BRICS Bank*, EMERGING EQUITY (July 1, 2015), <http://emergingequity.org/2015/07/01/china-ratifies-the-freshly-minted-brics-bank/>.

<sup>47</sup> See *Brazil Ratifies BRICS Bank, Currency Fund*, THE BRICSPPOST (June 9, 2015, 10:28 AM), <http://thebricspost.com/brazil-ratifies-brics-bank-currency-fund/#.ViPiSG7kDz0>.

<sup>48</sup> See *South African Parliament Ratifies BRICS New Development Bank Agreement*, BRICS (June 26, 2015), <http://en.bricts2015.ru/news/20150626/208233.html>.

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Africa's Non-Executive Director to the Board of the BRICS Bank, while Leslie Maasdorp, who has experience working in senior management at Barclays, Goldman Sachs and Bank of America, was nominated as BRICS Bank Vice President by the South African Cabinet.

Kundapur Vaman ("KV") Kamath, was appointed to be the first President of the NDB on May 11, 2015.<sup>49</sup> Bank operations began in July 2015 at the recently opened Shanghai headquarters of the NDB.<sup>50</sup> The first loan issued by the NDB is expected to be denominated in Chinese renminbi.<sup>51</sup>

It may be useful to make certain important distinctions at this point. At first glance, the function of the NDB mirrors the World Bank's, and the CRA mirrors the IMF's. However, the salient question is whether these new institutions conflict with or complement the established ones?<sup>52</sup> The NDB is not exactly parallel to a number of regionally-focused multilateral banks that fall under the rubric of the World Bank (e.g., the European Bank for Reconstruction and Development, the Inter-American Bank, the Asian Development Bank, and the African Development Bank). The NDB does not have a restricted regional focus since all continents are represented in this new venture and all U.N. member states are eligible to be members of the NDB.

Moreover, this is not the first time that non-Western countries have reacted to the stringent structural adjustment conditionality imposed by the IMF as a precondition to borrowing by its sovereign members. For example, in response to the 1997-98 Asian financial crisis, Asian countries initiated the Chiang Mai Initiative (CMI) in 2000.<sup>53</sup> The CMI was then multilateralized in 2009 to become the Chiang Mai Initiative Multilateralized (CMIM).<sup>54</sup> However, it was never used, even in 2008 during the financial crisis that followed the collapse of Lehman Brothers.<sup>55</sup>

Similarly, the BancoSur (Bank of the South) was established in 2009 by seven Latin American countries in response to IMF conditionality imposed on emer-

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<sup>49</sup> "Private Banker KV Kamath Named First BRICS Bank Head," REUTERS (May 11, 2015), <http://in.reuters.com/article/brics-bank-chairman-idINKBN0NW0FI20150511>. Kamath successfully assumed his duties in July 3, 2015. *Id.*; see also "First BRICS Bank head assumes duty-Indian Foreign Ministry," INFOBRICS (July 3, 2015), <http://infobrics.org/blog/news/2015/07/03/2858/>.

<sup>50</sup> Allen Cheng, *KV Kamath Brings an Experienced Hand to the New Development Bank*, INSTITUTIONAL INVESTOR (Aug. 23, 2015), <http://www.institutionalinvestor.com/article/3482095/banking-and-capital-markets-emerging-markets/kv-kamath-brings-an-experienced-hand-to-new-development-bank.html#.ViPcwG7kDz0>.

<sup>51</sup> Timophei Borisov, *New Development Bank to issue first loan in Chinese currency*, RUSSIA BEYOND THE HEADLINES, (July 29, 2015), [http://rbth.com/business/2015/07/29/new\\_development\\_bank\\_to\\_issue\\_first\\_loan\\_in\\_chinese\\_currency\\_48071.html](http://rbth.com/business/2015/07/29/new_development_bank_to_issue_first_loan_in_chinese_currency_48071.html).

<sup>52</sup> See, e.g., Dingding Chen, *3 Reasons the BRICS' New Development Bank Matters*, THE DIPLOMAT (July 23, 2014), <http://thediplomat.com/2014/07/3-reasons-the-brics-new-development-bank-matters/>.

<sup>53</sup> *Chiang Mai Initiative: An Asian IMF*, ASIAN CENTURY INST. (Mar. 26, 2014), <http://asiancentury-institute.com/economy/248-chiang-mai-initiative-an-asian-imf>.

<sup>54</sup> Hal Hill & Jayant Menon, *Asia's new financial safety net: Is the Chiang Mai Initiative designed not to be used?*, VOX (July 25, 2012), <http://www.voxeu.org/article/chiang-mai-initiative-designed-not-be-used>.

<sup>55</sup> *Id.*; see also Desai & Vreeland, *supra* note 35; see also Eichengreen, *supra* note 7.

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agency loans.<sup>56</sup> BancoSur was designed to provide funding for regional development projects, and each member had one vote. However, BancoSur has a variety of complex problems and is widely regarded to be a failure.<sup>57</sup>

In contrast, Andean nations created the *Corporación Andina de Fomento* (CAF), also known as the “Development Bank of Latin America,” in the late 1960’s in order to overcome the strict rules imposed by the World Bank on infrastructure loans. The CAF now funds more infrastructure projects in Latin America than the World Bank and the Inter-American Bank combined.<sup>58</sup> Whether the NDB will go the way of BancoSur or CAF remains to be seen.

Nevertheless, it should be noted that all denominations for the NDB and the CRA are made in U.S. dollars.<sup>59</sup> Further, the CRA, Article 14(b)(v) specifically provides that where a member is requesting liquidity support or other precautionary measures, that it be “in compliance with surveillance and provision of information obligations to the IMF.”<sup>60</sup> Thus, the linkage to the U.S. dollar and to the IMF, however fragile or temporary, is in the organizational documents.

Further, it is also wise to view the NDB and CRA in a broader policy and institutional context. The BRICS have created a new stock alliance<sup>61</sup> designed to cross list derivatives in order to facilitate the needs of institutional investors who may be interested in the members’ stock markets.<sup>62</sup> President Putin introduced the idea of creating an energy association with a fuel reserve bank and an energy policy institute at the sixth BRICS summit where the Forteleza Declaration was made.<sup>63</sup>

Russia has already signed a number of nuclear power cooperation agreements with South American countries, and has entered into negotiations for expanding Russia’s natural gas pipelines to China and to India.<sup>64</sup> Thus, Russia is already forging stronger South-South ties in the energy sector, and its proposal to establish a new BRICS energy association may be in furtherance of that policy objective.

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<sup>56</sup> Desai & Vreeland, *supra* note 35.

<sup>57</sup> *Id.*; see also Isabel Ortiz & Oscar Ugarteche, *Bank of the South: Progress and Challenges*, LATIN AM. NETWORK ON DEBT, DEV. & RIGHTS, (2013), <http://www.realityofaid.org/wp-content/uploads/2013/02/ROA-SSDC-Special-Report9.pdf>.

<sup>58</sup> Desai & Vreeland, *supra* note 35.

<sup>59</sup> *The BRICS Bank*, *supra* note 2.

<sup>60</sup> Treaty for the Establishment of a BRICS Contingent Reserve Arrangement at art. 14(b)(v), *supra* note 39.

<sup>61</sup> See *BRICS Exchanges Alliances*, MOSCOW EXCHANGE, <http://moex.com/s506>

<sup>62</sup> *BRICS establish \$100bn bank and currency pool to cut out Western dominance*, RT.COM (July 15, 2014), <http://rt.com/business/173008-brics-bank-currency-pool/>.

<sup>63</sup> *Russia pushes for BRICS energy association*, RT.COM (July 10, 2014), <http://rt.com/business/171768-russia-brics-energy-association/>; *BRICS plans Energy Association in Wake of New Bank*, WORLD NUCLEAR NEWS (July 21, 2014), <http://www.world-nuclear-news.org/np-brics-states-plan-energy-association-in-wake-of-new-bank-21071401.html>.

<sup>64</sup> Michael Bastasch, *Putin to Form ‘Energy Association’ of Major Developing Countries*, DAILY CALLER (July 22, 2014), <http://dailycaller.com/2014/07/22/putin-to-form-energy-association-of-major-developing-countries/>.

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Thus, the mission, objectives, policies, and influence of the BRICS in creating the NDB, CRA, and supporting alliances may be far-reaching, indeed. However, there is a potentially even more powerful downstream impact of this change to the global financial architecture, as discussed below.

### IV. Does the NDB Signal the End of the U.S. Dollar as a Reserve Currency?

In revisiting the 1944 Bretton Woods conference, there was a clash of the titans, so to speak, between the U.K. delegate, John Maynard Keynes, and the U.S. delegate, Harry Dexter White, then U.S. Treasury Secretary. The U.K. Government, acting through Keynes, proposed the introduction of a new world currency called the “bancor.”<sup>65</sup> The scheme was not accepted, mainly as a result of U.S. reluctance, and the U.S. dollar (tied at the time to the gold standard) became *de facto* the world’s reserve currency. Even when the U.S. dollar was delinked from the gold standard in 1971, it remained the world’s reserve currency.<sup>66</sup>

The status of the U.S. dollar as a “reserve currency” means, in effect, that it remains in high demand for financial transactions conducted globally by foreign governments and private companies.<sup>67</sup> Thus, the U.S. Federal Reserve is able to print currency to meet this international demand, thus easing the need to use U.S. dollar reserves to pay for imports.

Moreover, the liquidity and size of the international market for U.S. sovereign debt remains high,<sup>68</sup> but this is changing dramatically. In 2004, 90% of the world’s reserves were in dollar denominated securities. In 2014, it was down to 60%.<sup>69</sup>

Partly in response to the U.S. dollar moving off the gold standard, the IMF created Special Drawing Rights (SDRs) in 1969.<sup>70</sup> SDRs are composed of a basket of currencies, namely, the U.S. dollar, euro, yen, and English pound. SDRs are allocated to each IMF member based on its percentage of global GDP. SDRs are an interest-bearing instrument that may be freely traded by IMF members.<sup>71</sup>

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<sup>65</sup> Alex Newman, *Waking Up to a World Currency*, THE NEW AMERICAN (Sept. 10, 2010), <http://www.thenewamerican.com/economy/economics/item/4498-waking-up-to-a-world-currency>.

<sup>66</sup> *Id.*

<sup>67</sup> Liam Halligan, *The Dollar’s 70-Year Dominance is Coming to an End*, TELEGRAPH (July 19, 2014), <http://www.telegraph.co.uk/finance/comment/liamhalligan/10978178/The-dollars-70-year-dominance-is-coming-to-an-end.html>.

<sup>68</sup> *Id.*

<sup>69</sup> Asad Ismi & Peter Koenig, *De-Dollarization: Is BRICS a Viable Alternative to the U.S. Dominated World Economic System?*, CAN. CTR. POL’Y ALTERNATIVES (Nov. 22, 2014), <http://www.globalresearch.ca/is-brics-a-viable-alternative-to-the-u-s-dominated-world-economic-system/5415375>.

<sup>70</sup> *IMF Factsheet*, IMF (Oct. 3, 2014), <http://www.imf.org/external/np/exr/facts/sdr.htm>.

<sup>71</sup> *Id.*

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In fact, when the IMF issued bonds designated in SDRs for the first time in 2009, China bought \$50 billion worth.<sup>72</sup> The IMF has also issued SDRs as currency which may be viewed as a “global currency.”<sup>73</sup>

On November 30, 2015, the IMF decided to add the Chinese currency, the renminbi, to the IMF’s SDR basket of currencies, thereby marking China’s transition to having a global currency alongside the U.S. dollar, the Euro, the British pound, and the Japanese yen.<sup>74</sup> The renminbi will officially join the other currencies as the fifth member of the SDR in October 2016.<sup>75</sup> The IMF projects that the weighted currencies in the SDR basket will amount to 8% for the UK pound and the Japanese yen, respectively, 11% for the Chinese renminbi as compared to 31% for the Euro, and 42% for the US Dollar.<sup>76</sup> While China will have to work diligently to make its currency more freely tradable during the remaining months before joining the SDR basket of currencies, the renminbi is widely perceived as replacing the use and the influence of the Euro on financial markets.<sup>77</sup>

This may mean, in effect, that the IMF now views itself as world central bank issuing currency and securities under the direction of the IMF Executive Committee.<sup>78</sup> This practice may harken back to Keynes’ original concept of the “bancor” that was designed to herald a new global currency regime.<sup>79</sup>

The idea of monetary unions is not new. Multinational currencies such as the Euro are in common use. Monetary unions are in existence in Central and West Africa (Communauté Financière Africaine or “CFA”). Another monetary union, the “Common Monetary Area,” uses the South African Rand in South Africa, Lesotho, Namibia, and Swaziland.<sup>80</sup> The African Union’s African Central Bank is scheduled to create a continent-wide currency (called the “afro” for now) within two decades.<sup>81</sup> There is also the Eastern Caribbean Currency Union.<sup>82</sup> Even cyber currencies such as the bitcoin are also in circulation.<sup>83</sup>

There is no reason to believe that the BRICS will not, ultimately, issue their own currencies or securities (e.g., currency reserve bonds and other financial

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<sup>72</sup> Newman, *supra* note 65.

<sup>73</sup> *Id.*

<sup>74</sup> Jeff Sommer, *China Steps Up, but Its Currency Still Has Dues to Pay*, N.Y. TIMES (Dec. 5, 2015), <http://www.nytimes.com/2015/12/06/your-money/china-steps-up-but-its-currency-still-has-dues-to-pay.html>; see also *Add Yuan to IMF Currency Basket*, CHINA DAILY (Apr. 19, 2011), [http://www.china.org.cn/business/2011-04/19/content\\_22390212.htm](http://www.china.org.cn/business/2011-04/19/content_22390212.htm).

<sup>75</sup> Sommer, *supra* note 74.

<sup>76</sup> *Id.*

<sup>77</sup> Keith Bradsher, *China’s Renminbi Is Approved by I.M.F. as a Main World Currency*, N.Y. TIMES (Nov. 30, 2015), <http://www.nytimes.com/2015/12/01/business/international/china-renminbi-reserve-currency.html>.

<sup>78</sup> *Id.*

<sup>79</sup> Alex Newman, *BRICS Regimes Forge New World Bank, Call for Global Currency*, THE NEW AMERICAN (Apr. 3, 2013), <http://www.thenewamerican.com/world-news/africa/item/14983-brics-regimes-forge-new-world-bank-call-for-global-currency>.

<sup>80</sup> Newman, *supra* note 65.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> See, e.g., *Bitcoin Watch*, available at <http://www.bitcoinwatch.com/>.

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instruments).<sup>84</sup> While the paid in subscriptions are denominated in dollars, the members are not necessarily required to make their transactions using the U.S. dollar. In fact, China has entered into numerous agreements with Brazil, India and Russia that use currency swaps that do not use the U.S. dollar.<sup>85</sup>

Thus, the use of BRICS's currencies separately or in a basket may become an alternative to the use of the U.S. dollar as the reserve currency of choice. The use of South-South currency swaps in lieu of using the U.S. dollar is already well underway, and the viability of this continuing trend has yet to be assessed.

However, the diminishing use of the U.S. dollar as a reserve currency, and the waning influence of the United States that may flow from this, has certain serious long-term foreign policy implications.

Most notably, U.S. anti-corruption laws (e.g., Foreign Corrupt Practices Act of 1977, as amended) and economic sanctions regimes (e.g., in relation to Russia, Syria, North Korea, and Iran) are dependent on imposing penalties and exacting economic costs on the wrongdoer, whether a nation-state, private company, or individual.

The persuasive power stemming from the imposition of severe economic costs in order to force compliance with U.S. laws or sanctions will become increasingly difficult if other nations have alternate currencies and global governance regimes from which to choose. Indeed, many U.S. laws are dependent on the nexus with U.S. banking that use the BIS clearing system (or the Society for Worldwide Interbank Financial Telecommunication (SWIFT)). In sum, it is important to note that that use of U.S. banking systems and dollar denominated currency swaps are an important means of imposing economic and political discipline on errant nations.<sup>86</sup>

Further, it is reasonable to expect that a sanctions regime that is dependent on the use of the U.S. dollar will begin to lose its effectiveness as a foreign policy tool commensurate with the diminished use of the dollar. This may become highly problematic for the United States and its allies in the future, and may change the nature and manner in which the United States conducts its foreign relations.

In fact, “[a]s the renminbi becomes more deeply woven into the global economy, it undermines the ability of the West to impose financial sanctions on countries accused of human rights abuses and other violations, like Sudan and North Korea. Such countries can increasingly carry out transactions in renminbi.”<sup>87</sup>

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<sup>84</sup> *BRICS Common Currency Would Help Break Western Financial Hegemony*, BRICS BUS. MAG., (Oct. 22, 2014), [http://in.rbth.com/world/2014/10/22/brics\\_common\\_currency\\_would\\_help\\_break\\_western\\_financial\\_hegemony\\_39193.html](http://in.rbth.com/world/2014/10/22/brics_common_currency_would_help_break_western_financial_hegemony_39193.html).

<sup>85</sup> Halligan, *supra* note 67; see also Jordan Totten, *BRICS New Development Bank Threatens Hegemony of U.S. Dollar*, FORBES (Dec. 22 2014, 5:00 PM), <http://www.forbes.com/sites/realspin/2014/12/22/brics-new-development-bank-threatens-hegemony-of-u-s-dollar/#11acca142945>.

<sup>86</sup> See Hutton and Wishart, *UK Wants EU to Block Russia from SWIFT Banking Network*, BLOOMBERG BUS. (Aug. 29, 2014), <http://www.bloomberg.com/news/articles/2014-08-29/u-k-wants-eu-to-block-russia-from-swift-banking-network>.

<sup>87</sup> Bradsher, *supra* note 77.

## V. A River Runs Through It

In conclusion, there may be a cautionary tale here. The above discussion has demonstrated that there is long-standing and deep dissatisfaction with a number of inequities in international governance of global capital markets. This stems from a perceived level of disproportionate recognition<sup>88</sup> and representation on the UN Security Council, the IMF Executive Committee, and other international bodies. Further, there have been decades-long objections even by European nations, most recently by Greece,<sup>89</sup> to the stringent IMF-imposed austerity measures that are preconditions to sovereign borrowing under its rules.

Moreover, there is a growing sense that international economic sanctions are imposed in order to achieve U.S.-led foreign policy objectives.<sup>90</sup>

In creating the NDB and the CRA, the BRICS are establishing an alternate global currency and balance of payments system that is governed in an equal partnership, despite the major differences among the members themselves. Time will reveal whether this is a viable system and a viable alternative to the existing one. However, it does reflect a deeper need to govern and to be governed in a more fair and equitable way. The BRICS have been very clear in expressing their disappointment in the failure to pass reforms to the IMF quota system after more than four years. But what is the true genesis of such discontent?

This river may meander back to a 70-year old debate that was initially won by Harry Dexter White. But perhaps John Maynard Keynes is winning the argument after all. At the Bretton Woods conference in 1944, Keynes suggested forming an International Clearing Union whereby all countries would have accounts denominated in a common currency called the “banco.”<sup>91</sup> International accounts would be settled by shifting bancos from one account to another.

Whether the country experienced a deficit or a surplus, the country in question would be required to adjust its exchange rates and pay interest. In other words, even surplus countries would be required to make adjustments, perhaps by liberalizing its imports.<sup>92</sup>

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<sup>88</sup> See, e.g., RUMU SARKAR, *INTERNATIONAL DEVELOPMENT LAW 5* (Oxford University Press, 2009) (stating, “Tier I consists of so-called emerging economies of Central and Eastern Europe . . . and those Latin American . . . and South and East Asian countries . . . that are able to successfully attract FDI and wide-scale FPI . . . The final test of “graduating” from Tier I is for the subject nation to itself become a bilateral donor”) (Emphasis in original).

<sup>89</sup> Niki Kitsantonis, *Greeks Go On Strike Over New Austerity Measures*, N.Y. TIMES (Nov. 27, 2014), [http://www.nytimes.com/2014/11/28/world/europe/greeks-go-on-strike-over-new-austerity-measures.html?\\_r=0](http://www.nytimes.com/2014/11/28/world/europe/greeks-go-on-strike-over-new-austerity-measures.html?_r=0).

<sup>90</sup> See Linda Killian, *U.S.-Germany Tensions Sway EU Sanctions on Russia*, WALL ST. J. (Jul. 23, 2014), <http://blogs.wsj.com/washwire/2014/07/23/u-s-germany-tensions-sway-eu-sanctions-on-russia/>.

<sup>91</sup> Nuno Berolsky, *An Evaluation of IMF Structural Adjustment Programmes: Lessons for South Africa* (Feb. 2000) (unpublished M.S.S. thesis, Rhode Island University), available at [http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&ved=0CCwQFjAD&url=http%3A%2F%2Fcon.tentpro.seals.ac.za%2Fiii%2Fcp%2Fapp%3Fid%3D1587414014019082%26itemId%3D1002668%26lang%3Deng%26service%3Dblob%26suite%3Ddef&ei=7L7nVP3gCIm9ggSzgYGQCQ&usq=AFQjCNE\\_NEXon0Jn9D2FfQIUj8QOdzjNMA](http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&ved=0CCwQFjAD&url=http%3A%2F%2Fcon.tentpro.seals.ac.za%2Fiii%2Fcp%2Fapp%3Fid%3D1587414014019082%26itemId%3D1002668%26lang%3Deng%26service%3Dblob%26suite%3Ddef&ei=7L7nVP3gCIm9ggSzgYGQCQ&usq=AFQjCNE_NEXon0Jn9D2FfQIUj8QOdzjNMA).

<sup>92</sup> *Id.* at 9.

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Harry Dexter White offered a different plan whereby only the debtor nations would have to make adjustments by “putting their houses in order” as a precondition to accessing IMF funding.<sup>93</sup> This is the genesis of the “austerity” measures imposed by the IMF through its structural adjustment programs, and is a precondition to borrowing from its coffers. These austerity measures are felt keenly by all sovereign borrowers from the IMF, most recently by Greece.<sup>94</sup> It is this unequal burden sharing that is borne principally, if not exclusively, by debtor nations that is fueling such discontent.

Whether Keynesian economics should triumph lies outside the scope of this essay, but emerging economies have expressed their clear dissatisfaction with the nature of structural adjustments required to be made by the IMF.

The world economic order instituted through the Bretton Woods conference, combined with the use of the U.S. dollar as the world reserve currency, has ensured U.S. financial dominance over the past 70 years, and has helped bolster its political agendas as well. This system is now being called into serious question by the BRICS in establishing the NDB and CRA.

*A Way Forward.* It is clear that the world has been shifting from a bipolar world during the Cold War, to a unipolar one after the fall of the Berlin Wall in 1989, to a multipolar one.<sup>95</sup> For example, the G-7 (France, Germany, Italy, the United Kingdom, Japan, the United States, and Canada), became the G-8 (plus Russia) which then became the G-20 (Brazil, China, Saudi Arabia, Republic of Korea, France, Australia, China, Canada, Germany, Indonesia, Argentina, Turkey, India, Russia, South Africa, Mexico, Japan, United Kingdom, United States, and the European Union).<sup>96</sup>

A shift away from the unipolarity of U.S. dominance in world affairs, backed by the strength of its currency, does signal a significant change in the world order. Nevertheless, multipolarity offers new opportunities for engagement, even for the United States. For example, during the December 2009 United Nations Climate Change Conference, President Obama was expecting to meet with Chinese Prime Minister, Wen Jiabao, at the final hours of the conference.<sup>97</sup> Mr. Obama was prepared for a bilateral discussion with China, but was surprised to discover the heads of state from Brazil, India and South Africa also in attendance.<sup>98</sup> In an instant, bilateralism was replaced with multilateralism with an emerging economies block.

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<sup>93</sup> Robert Skidelsky, *Keynes, Globalisation and the Bretton Woods Institutions in the Light of Changing Ideas about Markets*, 6 *WORLD ECO.* 15, 21 (Jan.- Mar. 2005), available at [http://oxonia.org/WE%20articles/WE\\_skidelsky.pdf](http://oxonia.org/WE%20articles/WE_skidelsky.pdf).

<sup>94</sup> Amar Toor, *Greek Austerity Measures Linked to Increased Suicides*, *THE VERGE* (Feb. 2, 2015), <http://www.theverge.com/2015/2/2/7963911/greek-austerity-increased-suicides-financial-crisis-bmj-study>.

<sup>95</sup> See, e.g., Michael Kakutani, *A Challenge for the U.S.: Sun Rising on the East*, *N.Y. TIMES* (May 6, 2008), [http://www.nytimes.com/2008/05/06/books/06kaku.html?pagewanted=1&\\_r=1](http://www.nytimes.com/2008/05/06/books/06kaku.html?pagewanted=1&_r=1).

<sup>96</sup> Richard Wray, *World leaders relaunch G20 as top economic forum*, *THE GUARDIAN* (Sept. 25 2009), <http://www.theguardian.com/world/2009/sep/25/g20-reform-pittsburgh-developing-nations>.

<sup>97</sup> *The BRICS: The Trillion Dollar Club*, *ECONOMIST* (Apr. 15, 2010), <http://www.economist.com/node/15912964>.

<sup>98</sup> *Id.*

## Trends in Global Finance: The New Development (BRICS) Bank

After all, calling for more equitable participation in world affairs by all members of the international community should be welcomed, not feared or vilified. Indeed, more South-South linkages and greater economic integration will act to strengthen, not compromise, the world economy. There is no doubt that the removal of “conditionality” as a means of imposing economic discipline in following the views of Harry Dexter White and others is a daunting prospect. This is especially true if important concerns on the environment, human rights, and other global issues are ignored or subverted. But let us keep in mind that as of the date of this writing, neither the NDB nor the CRA have issued a single loan. Whether IMF-styled “conditionality” will be imposed through NDB or CRA lending, or not, remains an open-ended question at this point.

The BRICS have demonstrated that there are many roads that lead to economic development, and not all of them stem from liberal economics or liberal political theory as a model. This may dismay those who feel and perhaps rightly, that economic development should be concomitant with the respect for human rights, the equitable participation of women in society, and a number of important issues and approaches. Regrettably, this view is clearly not shared by all international actors. Perhaps the BRICS are also implicitly criticizing the linkage of economic discipline with political discipline. The de-coupling of the two may be painful for many, including many policy-makers worldwide, and not simply those located in advanced Western countries.

Navigating a multi-polar world is more difficult when the spheres of influence are less localized in the West and are more widely distributed throughout the globe. Indeed, is it an accident that the IMF and the World Bank are headquartered in Washington, DC while the NDB headquarters is located in Shanghai? There may be those who are secretly thinking that the “bell tolls for thee,” United States, but I most emphatically disagree.

Rather than seeing the new ascendancy of multilateralism, particularly as exercised by the BRICS and other emerging economies, as a problem, this should be regarded as an opportunity to widen and diversify U.S. interests with new and dynamic players on the world scene. Although U.S. diplomacy and international relations will become more complex and challenging as a result of acting in a multi-party and multi-dimensional world, it also offers a wealth of opportunities for the United States to work in a newly evolving fabric of interwoven interests, values and ideals.



A COMPARATIVE STUDY OF THE POLITICAL AND SOCIAL  
STRUCTURE OF MEXICO (BUCERIAS), CUBA AND THE U.S.  
(ATLANTA): A FIRST IMPRESSION

Frank J. Vandall\*

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**I. Introduction**

The goal of this paper is to begin to examine the widely disparate social, political and legal systems of three (3) countries. The purpose is to explore the question of whether a less intrusive or a more intrusive governmental model works best. Bucerias is a beach community in Mexico. Cuba is one of the few remaining communist countries in the world. Atlanta is the jewel of the southeastern United States. Each city or country will be evaluated based on five factors: politics, infrastructure, taxes, family, and education.

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## II. Bucerias, Mexico

Bucerias is a small ocean side resort on the west coast of Mexico. It is twenty miles north of Puerto Vallarta and hundreds of miles south of Galveston, Texas. Tourists from the U.S. and Canada call it paradise.

### A. Politics

Mexico has a unique two-party democratic system in which all eligible persons are required to vote.<sup>1</sup> On a day-to-day basis, there is no visible evidence of politics at play in Bucerias. No political brochures are distributed and no posters are manifest. Mexicans do not raise the question of politics in casual discussions.

### B. Police

On very rare occasions, police officers observe the movements of the tourists and the Mexican people. Once I observed a truck filled with soldiers driving down a main street. A soldier on the truck appeared to have an automatic weapon at the ready.

While visiting a larger nearby town, Puerto Vallarta, I saw a female police officer dressed in white and wearing a white cap. This went far to lighten the image of the police as their uniforms are traditionally black, dark blue or military tan. It was a nice touch for a town that thrives on tourism.

### C. Infrastructure

#### *Roads*

Many of the streets in Bucerias and Puerto Vallarta are constructed of cobblestones. This ancient material is apparently used in order to enhance the quaint feeling of the towns. It is successful, but surely at a substantial cost to the suspensions of automobiles, trucks and the taxis. The noise and vibration from riding on cobblestones cries that the wheels are about to fall off. As a footnote, the cobblestones appears to help reduce the speeds of vehicles.<sup>2</sup> Large potholes are common in Bucerias.<sup>3</sup>

#### *Bridges*

On the main highway in Bucerias, the two-lane bridge appears well-made, but the road to Sayulita is filled with large, deep potholes. Sayulita is an ocean-side surfer's mecca. In contrast, the nearby road to La Cruz is smooth, except for

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<sup>1</sup> *The World Factbook: Mexico*, U.S. CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html> (last updated Jan. 20, 2016).

<sup>2</sup> Speed bumps were observed outside of Bucerias.

<sup>3</sup> See Linda Shaw, *Sun, Sand, & Silence—Bucerias: Near, But a World Away, From Tourist Swagger*, SEATTLE TIMES (Apr. 28, 1996), <http://community.seattletimes.nwsouce.com/archive/?date=19960428&slug=2326327> (“Twenty minutes after we leave the airport, our taxi turns left off the two-lane highway, then bounces down the hill toward the beach, weaving around potholes big enough to be effective speed bumps.”).

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several speed bumps. However, this road leads to the Four Seasons resort development, Punta Mita, that Bill Gates purchased.<sup>4</sup>

The ocean-side street in Bucerias, Lazarus Cardenas, stops at an arroyo. There it meets a narrow pedestrian bridge that connects the east side of Bucerias with the west. This tiny pedestrian bridge is fine for tourists, but is for people only, not cars. It seems appropriate for this remote beach-side resort.

### *Mass Transportation*

There are three options for public transportation in Bucerias. First, taxis. The Toyotas are new, clean, expensive and air-conditioned. It costs about seven (7) U.S. dollars for a short five mile trip for two.

The second option is the camioneta. These are large Toyota vans that hold anywhere from 10 to 14 passengers. These are air-conditioned, and the charge about seven pesos each (about seventy U.S. cents in 2015) for the same five mile trip. Finally, there are small buses (holding perhaps 40 passengers) that stop very often (until full) and cost about the same or less than the camionetas. They are not air-conditioned.

The last two are great fun. During one of my camioneta rides, the bus was full of teen-aged school boys and girls, plus two American tourists. The driver played loud rock music and the passengers on the bus swayed to the music. All the passengers agreed it was the “party bus”. Not wanting to be out done, a man boarded one of the big buses, put a large, stuffed duck puppet over his hand and told jokes in Spanish while speaking like a duck. Many passengers laughed and gave him small tips. Sometimes jugglers perform at stoplights and drivers provide tips.

Mexican workers, school-aged children, and tourists ride the camionetas and buses. Cabs were used mainly by tourists.

A new modern airport is located only 30 minutes from Bucerias in Puerto Vallarta. The road between the two is a good, but it is also a busy four-lane highway with limited access.

### D. Taxes

The good news is that the highest Mexican income tax rate is 30 percent. The bad news is that there is a hefty sales tax (16%) on most products including food.<sup>5</sup> The yearly property tax is low at .01 percent of assessed value.<sup>6</sup> Foreigners do not actually own real property. What “ownership” of real property by

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<sup>4</sup> Janet I. Tu, *Bill Gates Buys Resort Near Puerto Vallarta for \$200 Million*, SEATTLE TIMES: MICROSOFT PRIO (Dec. 16, 2013, 3:30 PM), <http://blogs.seattletimes.com/microsoftprio/2013/12/16/bill-gates-buys-resort-near-puerto-vallarta-for-200-million/> (“Bill Gates . . . is purchasing the Four Seasons Resort Punta Mita for \$200 million . . . in early 2014.”).

<sup>5</sup> Personal Income Tax Rates: Mexico, PRICEWATERHOUSECOOPERS, (Jan. 20, 2016), <http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Mexico-Individual-Taxes-on-personal-income>. See also PKF INT’L, WORLDWIDE TAX GUIDE (2014), <http://www.pkf.com/media/4335950/worldwide%20tax%20guide%202014%20v3.pdf> (describing Mexico’s income tax rates); *VAT and Sales Tax Rates in Mexico for 2016*, WORLD.TAX-RATES.ORG, <http://world.tax-rates.org/mexico/sales-tax> (last visited Feb. 2, 2016) (referring to sales tax as “value added tax”).

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non-Mexicans means is a 50-year renewable lease.<sup>7</sup> In contrast, foreigners cannot own houses or property in Cuba.<sup>8</sup>

### E. Family

The family structure in Bucerias is as if taken from a fairy tale. Parents keep their children close at hand. Waiters often bring their children to the ocean-side restaurants where they work. Men and women selling trinkets in kiosks or on the beach often take their young children with them.

Children are required to attend school through the sixth grade.<sup>9</sup> However, they only attend until about 1:00 p.m. After that, it is common for them to work with their parents. The result is that children dressed in school uniform are often seen throughout the town in the afternoons. High School matriculation is not required.<sup>10</sup> Marriage and divorce are expensive so Mexican couples often ignore these institutions.<sup>11</sup>

### F. Education

Mexico has a large number of educational institutions.<sup>12</sup> To a tourist eye, they are not visible in Bucerias, except for several grade schools and the sight of high school children dressed in school uniforms.<sup>13</sup> From two short visits to Bucerias, it appears that many young people opt not to pursue education beyond sixth grade<sup>14</sup>, preferring to work with their families in kiosks, restaurants, or walking on the beach selling trinkets. Only 46 percent of the young people decide to pursue education beyond the sixth grade.<sup>15</sup>

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<sup>6</sup> Alicia Parra, *Property Taxes in Mexico*, THE SETTLEMENT COMPANY (Feb. 2, 2016), [http://www.settlement-co.com/articles/Property\\_Taxes.pdf](http://www.settlement-co.com/articles/Property_Taxes.pdf).

<sup>7</sup> Jorge A. Garcia, *The Mexican Trust*, 2, MDTLAW.COM, [http://www.mdtlaw.com/images/uploads/The\\_Mexican\\_Trust\\_Fideicomiso1.pdf](http://www.mdtlaw.com/images/uploads/The_Mexican_Trust_Fideicomiso1.pdf) (Aug. 16, 2015, 2:03PM) (stating that the leases through a bank trust are known in Mexico as a “Fideicomiso”).

<sup>8</sup> Nick Miroff, *\$75,000 Will Get You A Lot of House in Havana – If You’re Cuban*, WASHINGTON POST (May 25, 2015), [https://www.washingtonpost.com/world/75000-will-get-you-a-lot-of-house-in-havana—if-youre-cuban/2015/05/25/bbed3d78-fd8f-11e4-8c77-bf274685e1df\\_story.html](https://www.washingtonpost.com/world/75000-will-get-you-a-lot-of-house-in-havana—if-youre-cuban/2015/05/25/bbed3d78-fd8f-11e4-8c77-bf274685e1df_story.html).

<sup>9</sup> See Mexico’s Education System: Overview, STATEUNIVERSITY.COM, (Feb. 2, 2016), <http://education.stateuniversity.com/pages/981/Mexico-EDUCATIONAL-SYSTEM-OVERVIEW.html> [hereinafter Mexico’s Education System (noting that mandatory school age is from age 6 to age 14; that approximately 92.08% of all children attend school until age 14, when, after that age, the enrollment percentage drops dramatically to about 46%).

<sup>10</sup> *Id.*

<sup>11</sup> See Woodrow Borah & Sherburne F. Cook, *Marriage and Legitimacy in Mexican Culture: Mexico and California*, 54 CAL. L. REV. 946, 946-47 (1966), <http://scholarship.law.berkeley.edu/californialawreview/vol54/iss2/24>.

<sup>12</sup> Higher Education in State of Veracruz Mexico, OECF PUBLISHING (Sept. 7, 2015), <https://www.oecd.org/edu/imhe/46826830.pdf> (noting that “currently Mexico has 1,892 tertiary education institutions, of which 50 are federal and state institutions, 289 are technical institutions, 4 are intercultural universities, 995 are private institutions and 25 are public research centers.”).

<sup>13</sup> See *Back to School Around the World*, 8, SMARTLING (2014), [https://www.smartling.com/wp-content/uploads/2014/09/Smartling\\_eBook\\_BackToSchoolAroundTheWorld1.pdf](https://www.smartling.com/wp-content/uploads/2014/09/Smartling_eBook_BackToSchoolAroundTheWorld1.pdf).

<sup>14</sup> See Mexico’s Education System, *supra* note 9.

<sup>15</sup> *Id.*

### G. Conclusion

A brief overview of Bucerias, Mexico suggests what small government and less taxes actually mean. Compulsory education ends in the sixth grade, and some busy roads have huge, destructive pot-holes. While there is minimal police presence, it may be that they are not apparently necessary because in Bucerias, crime is not a demanding issue.<sup>16</sup> Also, public transportation is readily available and cheap, particularly in comparison with some cities in the United States, such as Atlanta.

There is a wealthy class in Mexico, but there is also a substantial portion of the population that is poor.<sup>17</sup> Perhaps the large gap is due to limited public education and the absence of a progressive income tax.<sup>18</sup>

### III. Cuba

Cuba is an island 90 miles east of Key West, Florida with a population of over 11 million.<sup>19</sup> The people represent many racial backgrounds and speak Spanish. Cuba is one of a few remaining communist countries in the world.<sup>20</sup> In 1960 the Revolutionary Army led by Fidel Castro overthrew the dictatorship of Juan Manuel Batista, who had been strongly supported by the U.S.<sup>21</sup> Shortly after the revolution, Castro nationalized all industries.<sup>22</sup>

Early in 1960, Cuba aligned itself with the U.S.S.R.<sup>23</sup> During this time the U.S. imposed a complete embargo on Cuba.<sup>24</sup> Essentially, nothing American could be sold to Cuba and nothing could be imported from Cuba to the US.<sup>25</sup> The U.S.S.R. infused oil and money into Cuba until 1990 when the Soviet system

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<sup>16</sup> *Mexico Travel Warnings*, U.S. DEPARTMENT OF STATE (Aug. 16, 2015), <http://travel.state.gov/content/passports/english/alertswarnings/mexico-travel-warning.html>. According to the US State Department, there is a travel warning for the State of Jalisco, where Bucerias is located. However, the travel warning only warns of the rural areas that are near the bordering states of Michoacán and Zacatecas. *Id.*

<sup>17</sup> *Mexico Poverty and Wealth*, NATIONS ENCYCLOPEDIA (Sept. 7, 2015), <http://www.nationsencyclopedia.com/economies/Americas/Mexico-POVERTY-AND-WEALTH.html>. “Only 10 percent of Mexicans are wealthy. Another 30 percent are middle class. Fully 60 percent of Mexicans are poor, including peasants and industrial workers.” *Id.*

<sup>18</sup> “Gerardo Esquivel Hernandez, *Extreme Inequality in Mexico Concentration of Economic and Political Power*, OXFAM (2015), <http://cambialasreglas.org/images/inequality.pdf>.

<sup>19</sup> See *The World FactBook: Cuba*, U.S. CENT. INTELLIGENCE AGENCY (Aug. 1, 2015), <https://www.cia.gov/library/publications/the-world-factbook/geos/cu.html> (estimating the total Cuban population at 11,031,433 as of July 2015).

<sup>20</sup> *Id.*

<sup>21</sup> *Batista forced out by Castro-led Revolution*, HISTORY CHANNEL (Aug. 2, 2015), <http://www.history.com/this-day-in-history/batista-forced-out-by-castro-led-revolution>.

<sup>22</sup> See TOM GJELTEN, *BACARDI AND THE LONG FIGHT FOR CUBA: THE BIOGRAPHY OF A CAUSE* 224-245 (Penguin Books 2009).

<sup>23</sup> FIDEL CASTRO, JEFFERY M. ELLIOT & MERVYN M. DYMALLY, *FIDEL BY FIDEL: AN INTERVIEW WITH DR. FIDEL CASTRO RUZ, PRESIDENT OF THE REPUBLIC OF CUBA* 10 (Borgo Press 2007).

<sup>24</sup> *Id.*; see also Gary Clyde et al., *Case Studies in Economic Sanctions and Terrorism*, Peterson Inst. for Int'l Econ. 1 (2011); See also Christopher P. Baker, *Organic Chemistry* 516 (5th ed. 2010); See also *U.S. Relations with Cuba*, Bureau of Western Hemisphere Affairs (July 21, 2015), <http://www.state.gov/r/pa/ei/bgn/2886.htm>.

<sup>25</sup> See CASTRO, *supra* note 23.

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collapsed.<sup>26</sup> What followed for Cuba was referred to by Cubans as the “special period.”<sup>27</sup> This meant near starvation and many black-outs due to oil shortages.<sup>28</sup> Times were so bad that “pre-rats,” or nutria, were sometimes eaten for food.<sup>29</sup>

As is the norm in a communist regime, everything is given to the Cuban government and then doled out as the government deems appropriate.<sup>30</sup> All workers are government employees.<sup>31</sup> Health care, housing,<sup>32</sup> and food are free. Education is free and compulsory up to age 15 for boys and girls.<sup>33</sup> There may not be enough food available, however. For example, people are limited to 5 eggs per month. The “free” food typically runs out the third week of each month.<sup>34</sup>

Before addressing the details, Cuba is beautiful, hot, unique, colorful, and a wonderful place to visit. There is much to see and do. The Cubans go out of their way to make American visitors feel welcome. All musical concerts and dance recitals concluded on my eight-day “Person-to-Person” tour of Cuba with the hope stated by the performers that the embargo will soon be lifted and the expression “We are amigos.”

Free Cuban health care means it is available to everyone at no charge.<sup>35</sup> Visitors pay \$37.00 for eight days of health care coverage.<sup>36</sup> Doctors are reported to be outstanding,<sup>37</sup> and they receive a free education.<sup>38</sup> Presently some Cuban doctors are being sent to Africa to fight Ebola.<sup>39</sup>

Housing is free, if available.<sup>40</sup> If your husband or wife has a house you can live there. Often many generations live together.<sup>41</sup> If no housing is presently available, a Cuban may have to live in a shelter.<sup>42</sup> Often people without a great

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<sup>26</sup> *Id.* at 14; *see also* Clyde, *supra* note 24.

<sup>27</sup> *See* Clyde, *supra* note 24.

<sup>28</sup> LOUIS A. PEREZ JR., *CUBA: BETWEEN REFORM AND REVOLUTION* 381-387 (Oxford U. Press 4th ed. 2010).

<sup>29</sup> *See* BAKER, *supra* note 24, at 496.

<sup>30</sup> BAKER, *supra* note 24, at 522, 538, 539.

<sup>31</sup> BAKER, *supra* note 24, at 547.

<sup>32</sup> BAKER, *supra* note 24, at 553-54.

<sup>33</sup> BAKER, *supra* note 24, at 522.

<sup>34</sup> Joe Lamar, *For Cubans, the Struggle to Supplement Meagre Rations is a Consuming Obsession*, THE GUARDIAN, <http://www.theguardian.com/world/2015/apr/24/cubans-food-struggle-rations-consuming-obsession>; *see also* BAKER, *supra* note 24, at 551.

<sup>35</sup> BAKER, *supra* note 24 at 560.

<sup>36</sup> Paid by the author, April 2015. *See* BAKER, *supra* note 24, at 559-60.

<sup>37</sup> JULIA COOKE, *THE OTHER SIDE OF PARADISE: LIFE IN THE NEW CUBA* 86, 165, 187 (2014) [hereinafter “COOKE”].

<sup>38</sup> *Id.*

<sup>39</sup> Benny Avni, *To Fight Ebola, Cuba Is Sending Its Biggest Export – Doctors*, NEWSWEEK (Dec. 15, 2014), <http://www.newsweek.com/cubas-biggest-export-doctors-292067>.

<sup>40</sup> COOKE, *supra* note 37, at 153. Bedrooms with high ceilings are often divided vertically and called *barbacoa*. *Id.*

<sup>41</sup> BAKER, *supra* note 24, at 553. .

<sup>42</sup> Fernando Ravsberg, *Housing in Cuba: An Unresolved Nightmare*, HAVANA TIMES (Oct. 7, 2013), <http://www.havanatimes.org/?p=99258> (explaining that “nearly 28 Thousand (housing) units would have to be constructed in Havana alone [to remove Cubans from shelters].”).

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deal of money live in impressive old houses in Havana. But the houses need paint and repair. Not surprisingly, architecturally impressive houses are often in a state of substantial deterioration.<sup>43</sup>

Each Cuban owns his house or condominium, but no one owns the building.<sup>44</sup> The land under the building is owned by the state.<sup>45</sup> This creates huge problems for the historical restoration program.<sup>46</sup> People cannot be forced out during repairs and restorations because the residents own their homes and have nowhere to go.<sup>47</sup>

### A. Education

For those Cubans wishing to go to school beyond age 15, they can do so free of charge. They are not required to attend high school.<sup>48</sup> Literacy is stated to be 99 percent.<sup>49</sup> For those desiring graduate education, there are three critical requirements. First, there must be a need for their profession. For example, Cubans have little manufacturing, so it is very hard to get a mechanical engineering degree.<sup>50</sup> Second, graduate student applicants must do well on the state administered tests.<sup>51</sup> Third, each student is required to perform two years of governmental service after graduation.<sup>52</sup>

### B. Family

It is common in Cuba for several generations often live together. A recent college graduate may have to live with his mother or grandmother.<sup>53</sup> Julia Cooke finds this to be one of the most pleasant cornerstones of Cuban life because political and intellectual discussions go on for hours.<sup>54</sup>

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<sup>43</sup> BAKER, *supra* note 24, at 553.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> COOKE, *supra* note 37, at 190.

<sup>47</sup> *Id.*

<sup>48</sup> BAKER, *supra* note 24 at 158.

<sup>49</sup> See generally COOKE, *supra* note 37 (explaining that “prior to the nineties . . . Literacy rates hit 99 percent . . .”).

<sup>50</sup> Baker, *supra* note 24 at 558, 559 (stating that “children with special talents may opt to attend specialist schools that foster skills in art, music, or sports . . . . Cuba had four universities. [T]he hyper educated population is hard pressed to find books . . . The state often dictates what university students will study. . . . And thousands of qualified Cuban school graduates are denied university place reserved for Venezuelans and other “solidarity” students.”).

<sup>51</sup> *Id.*; see also COOKE, *supra* note 37, at 68.

<sup>52</sup> COOKE, *supra* note 37, at 17. “After graduating from the University of Havana, Lucía was putting in the two years of social service that paid for the degree.” *Id.*

<sup>53</sup> COOKE, *supra* note 37, at 153 (noting that Barbacoa are “Cuban lofts constructed to divide a room vertically into four floors . . . The four of them lived in one bedroom.”).

<sup>54</sup> *Id.* at 134-135, 144, 207, 225.

C. Infrastructure: Roads

In the historical parts of Camaguey and Havana, the streets are paved with cobblestones and there are numerous potholes. Other streets in Camaguey are in fair condition but also filled with potholes. It is the same case in Havana. A substantial part of the road from Camaguey to Havana is apportioned in three lanes on each side, and heavily populated with old-cars, trucks, buses, new cars and cattle. Vehicle traffic is light, however,<sup>55</sup> and it is a crime to hit a steer that wanders onto the highway.<sup>56</sup> However, the infrastructure and stability of the roads in and around Havana are much better than in the countryside.

D. Public Transportation

At the bottom of the Cuban transportation chain is the *bicitaxi*.<sup>57</sup> This is a bike with a seat in the back that holds two people (similar to a rickshaw). Next is the horse-drawn wagon. These wagons carry up to eight people and are very common in Camaguey and the countryside, but are not seen in Havana.<sup>58</sup> The *peditaxi* almost always has a roof of some type (cloth, leather, blue or gray plastic tarps). Perhaps the most shocking mode of transportation is the truck-bus. These are trucks with huge boxes in the back painted gray or black.<sup>59</sup> There are holes at about head height and are packed as tightly as possible with people, even in 100 degree temperatures.<sup>60</sup> The truck buses are privately owned and charge about 25 cents (USD) for a short trip. Although they have roofs, they look like vehicles used to transport German prisoners during World War II.

Buses come in two other varieties as well. Old, dilapidated buses are found in the cities. These are cheap to ride and have fares about the same as the truck-buses. They are also packed with passengers.<sup>61</sup> Of course, the tour companies use clean, new, air-conditioned buses. These are often Lutong buses made in China.<sup>62</sup>

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<sup>55</sup> *Message for U.S. Citizens – Traffic Accidents and Road Safety*, U.S. EMBASSY, HAVANA CUBA (June 27, 3013), [http://photos.state.gov/libraries/havana/231771/PDFs\\_001/Traffic-Accidents-and-Road-Safety-06-27-13M2.pdf](http://photos.state.gov/libraries/havana/231771/PDFs_001/Traffic-Accidents-and-Road-Safety-06-27-13M2.pdf). (Highlighting that in the past two years there has been a marked increase in the number of [traffic] accidents. Vehicles are now the leading cause of accidental death in Cuba.)

<sup>56</sup> Gary Marx, *Cubans have beef with chronic cattle shortage*, CHICAGO TRIBUNE (Mar. 18, 2004), [http://articles.chicagotribune.com/2004-03-18/news/0403180191\\_1\\_pedro-alvarez-cattle-cuban-economy](http://articles.chicagotribune.com/2004-03-18/news/0403180191_1_pedro-alvarez-cattle-cuban-economy). (Noting that in Cuba, citizens who kill a cow can get a 10 year prison sentence. The same thing can occur if a cow is hit by a car.)

<sup>57</sup> Ana Lorena Fernandez, *Bicitaxis*, LAHABANA (May 2012), [http://www.lahabana.com/Travel/article\\_transport.php?id=Bicitaxis](http://www.lahabana.com/Travel/article_transport.php?id=Bicitaxis). The bicitaxi is “a small human powered means of transport” in Cuba. *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> Tyler Westermall, *Our Girl in Havana: The Necessary Hazard of Cuba’s Trucks*, HUFFINGTON POST TRAVEL (Mar. 28, 2013), [http://www.huffingtonpost.com/tyler-wetherall/cuba-camiones-travel\\_b\\_2544565.html](http://www.huffingtonpost.com/tyler-wetherall/cuba-camiones-travel_b_2544565.html).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> Michael Martinez, *Cuba Puts Humped Camel Bus Out to Pasture*, CHI. TRIB. (Nov. 19, 2007), [http://articles.chicagotribune.com/2007-11-19/news/0711190093\\_1\\_raul-castro-cuban-american-studies-months-after-fidel-castro](http://articles.chicagotribune.com/2007-11-19/news/0711190093_1_raul-castro-cuban-american-studies-months-after-fidel-castro).

## Political and Social Structure of Mexico, Cuba and the U.S.

At the very top of the transportation chain, are a large number of old cars from before 1960, which are used as taxis.<sup>63</sup> Many are apparently in excellent condition, but some appear tired and are covered in *bondo*.<sup>64</sup> The prices for riding in these is the same as the state-owned, new yellow-cabs.<sup>65</sup> Many of these old-cars have worn-out their original engines and now have Russian imported diesel engines. They are often loud and smoke profusely.<sup>66</sup>

Unique to Havana are “coco” taxis. These are two passenger, three-wheeled cabs with small gas engines. They have fiberglass wraparound roofs painted bright yellow, and they look like half a peanut shell.<sup>67</sup>

Cabs come in two versions. First, there are the yellow state-owned cabs. They are new and air-conditioned.<sup>68</sup> Second, there are old, privately owned cars. The problem with the old cars used as cabs in Cuba is that they are in disrepair and are unavailable. Often they are frequently out of service.

### E. Government

When Raul Castro finishes his second term in 2018, there are 600 representatives who will determine his successor. The representatives are elected by the people, but there is only one party. It is not clear when or where the 600 representatives will meet to elect the successor.

In both Camaguey and Havana, the police (male and female) are seen in groups of three or more.<sup>69</sup> Their uniforms are blue or brown and appear freshly pressed. They are armed and do not smile. The streets are reported to be safe for visitors in Havana.<sup>70</sup>

Compared to Atlanta, it was a pleasure to walk the dark streets of Cuba without fear of being mugged or robbed.<sup>71</sup>

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<sup>63</sup> BAKER, *supra* note 24, at 588-589.

<sup>64</sup> See generally BONDO, <http://www.bondo.com> (last visited May 2, 2016). Bondo is a plastic resin used to fill holes and dents in metal. *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> Bradford Wernle, *On the Streets of Cuba*, AUTOMOTIVE NEWS (Jun. 28, 2015), <http://www.autonews.com/article/20150628/OEM/150629921/on-the-streets-of-cuba>.

<sup>67</sup> BAKER, *supra* note 24, at 590.

<sup>68</sup> BAKER, *supra* note 24, at 588-590.

<sup>69</sup> COOKE, *supra* note 37, at 129, 140 (reporting that a person is assigned to each block in Havana, and reports to the government on the comings and goings of visitors. Fines may be issued for not having a carnet.).

<sup>70</sup> See *Is it safe to walk the streets of Cuba?* HAVANA TIMES, (Mar. 7, 2009).

<sup>71</sup> Overseas Security Advisory Council, *Cuba 2015 Crime and Safety Report* (Mar. 3, 2015), <https://www.osac.gov/pages/contentreportdetails.aspx?cid=17198>. In Cuba, “Pickpocketing and purse snatching continue to be a problem. . . . Violent crimes is not common.” *Id.*

## Political and Social Structure of Mexico, Cuba and the U.S.

### F. Taxes

The tax rate in Cuba is 100 percent and everyone is employed by the state.<sup>72</sup> Workers receive back what the government deems appropriate.<sup>73</sup> There are some new exceptions to state ownership of all property and means of production. Paladares are privately owned restaurants that now can seat up to fifty people. A portion of what the restaurant owner brings – in goes to the state. Similarly, the privately-owned cabs owned by farmers can use a portion of their farm to raise personal crops or sell at the market. Not all farm products go to the state. *Paladares*, cabs, and farms are experiments in capitalism.

### G. Conclusion

A person does not necessarily receive more government services or choices as a result of more taxes. He or she may receive additional free health care, education and housing, but he or she may also experience disadvantages, such as poorly constructed roads, dilapidated houses, no meaningful work, boredom, food shortages, no parts to repair vehicles, and the loss of freedom to travel, or the lack of resources to start a business. Hope in Cuba is in short supply, except in regard to the ending of the embargo. Cubans live with the understanding that their entire future lies with the U.S. embargo being lifted. They have no dream that anything will improve substantially under Castro-communism.

## IV. Atlanta, Georgia, United States

Atlanta, Georgia, located in the southern part of the United States, is one of the most beautiful and livable cities in the world.<sup>74</sup> With a population of 450,000,<sup>75</sup> it is located on low rolling hills. To the north by 50 miles is a large, beautiful, and popular body of water: Lake Lanier.<sup>76</sup> Thirty miles further to the north are gorgeous low-rolling mountains.<sup>77</sup>

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<sup>72</sup> BAKER, *supra* note 24, at 547.

<sup>73</sup> *Id.* at 548.

<sup>74</sup> *World's most livable city is . . .*, CNN TRAVEL (Aug. 15, 2012), <http://travel.cnn.com/explorations/life/worlds-most-livable-city-525619/>; The Livability Index: The 35 Best U.S. Cities for People 35 and Under, VOCATIV, <http://www.vocativ.com/culture/media/livability/>; *see also Best cities ranking and report*, THE ECONOMIST (Aug 15., 2012), [http://pages.eiu.com/rs/eiu2/images/EIU\\_BestCities.pdf](http://pages.eiu.com/rs/eiu2/images/EIU_BestCities.pdf); Todd Elrick, *Best Places to Live and Work as a Moviemaker 2015: Top 10 Big Cities*, MOVIE MAKER (Jan. 22, 2015), <http://www.moviemaker.com/archives/news/best-places-to-live-and-work-as-a-movie-maker-2015-top-10-big-cities/5/>; Kenneth Rapoza, *The Best (And Worst) Cities On Earth*, FORBES (Aug. 28, 2013), <http://www.forbes.com/sites/kenrapoza/2013/08/28/the-best-and-worst-cities-on-earth/#7b819aad7f3c>; Gilly Wright & Valentina Pasquali, *The Best Cities to Live in the World*, GLOBAL FINANCE (Aug. 16, 2015), <https://www.gfmag.com/global-data/non-economic-data/best-cities-to-live>.

<sup>75</sup> *See* 2011 Transportation Fact Book, Atlanta Region Commission 8 (2011), ([http://documents.atlanaregional.com/transportation/TPD2011factbook\\_v04.pdf](http://documents.atlanaregional.com/transportation/TPD2011factbook_v04.pdf)). There are 1.46 registered cars per household in Fulton and DeKalb, the lowest of the 10 county region. The average for the 10 county area was 1.84 for 2010. *Id.*

<sup>76</sup> *See generally* LANIER ISLANDS, <http://www.lanierislands.com> (last visited May 2, 2016) (explaining that the Lanier Island feature the unparalleled natural beauty of North Georgia).

<sup>77</sup> *See generally* GEORGIA MOUNTAINS, <http://www.georgiamountains.org/> (last visited May 2, 2016) (describing the “Lush green forests” of Georgia).

## Political and Social Structure of Mexico, Cuba and the U.S.

### A. Education

Education in Atlanta and the United States is free of cost through the 12th grade.<sup>78</sup> This also includes kindergarten education.<sup>79</sup> Some states even provide free pre-kindergarten education to young children.<sup>80</sup> Several years ago, Georgia permitted gambling in the form of a lottery, with the understanding that the proceeds would fund college education.<sup>81</sup> The promise is that if a high school student maintains a “B” average, he or she can go to a state college for “free.”<sup>82</sup>

There are numerous outstanding state universities and community colleges in Georgia as well as private colleges and universities.<sup>83</sup> Many of these are located in Atlanta.<sup>84</sup> Private universities can cost as much as \$50,000 per year for tuition.<sup>85</sup>

There is no free housing, food, or medicine in Atlanta as in Cuba (food banks are an exception). A year ago, President Obama developed a program that requires each person to purchase health insurance (“Obamacare”)<sup>86</sup>. Insurance is not provided by the government like in Cuba, but rather is available through private insurance carriers.<sup>87</sup> A large portion of the population now has the mandated health insurance.<sup>88</sup> Before “Obamacare,” 40 percent of Americans did not have health insurance.<sup>89</sup>

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<sup>78</sup> 20 U.S.C. § 3401 (1979).

<sup>79</sup> *Id.*

<sup>80</sup> *Pre-K Funding Overview*, ATLAS (Jun. 8, 2015), <http://atlas.newamerica.org/pre-k-funding#toc-child-care-programs-that-receive-public-subsidies>. “[S]tates that do not fund any state pre-K programs are Hawaii, Idaho, Indiana, Mississippi, Montana, New Hampshire, North Dakota, South Dakota, Utah, and Wyoming.” *Id.*

<sup>81</sup> O.C.G.A. § 50-27-3(11) (2010); *see also* Kim Severson, *Georgia Facing a Hard Choice on Free Tuition*, N.Y. TIMES (Jan. 7, 2011), [http://www.nytimes.com/2011/01/07/us/07hope.html?\\_r=0](http://www.nytimes.com/2011/01/07/us/07hope.html?_r=0) (discussing how the Georgia education lottery has become so popular that budget shortfalls may cause a rollback of the program).

<sup>82</sup> *See* GACOLLEGE411.ORG, [https://secure.gacollege411.org/Financial\\_Aid\\_Planning/HOPE\\_Program/Georgia\\_s\\_HOPE\\_Scholarship\\_Program\\_Overview.aspx](https://secure.gacollege411.org/Financial_Aid_Planning/HOPE_Program/Georgia_s_HOPE_Scholarship_Program_Overview.aspx) (last visited Aug. 2, 2015) (noting that a 3.0 GPA is required; the ‘promise’ of the free education has been called in to question. The program is so popular that it is draining the fund); *See also* Kim Severson, *supra* note 81.

<sup>83</sup> *See e.g.* Georgia Institute of Technology (GA Tech) – Atlanta, Clark Atlanta, University of Georgia – Athens, Georgia State University – Atlanta, Georgia Southern University – Statesboro, Kennesaw State University – Kennesaw, Albany State University – Albany, Emory University – Atlanta, Mercer University – Macon, Morehouse College – Atlanta, Oglethorpe – Atlanta, Spelman College – Atlanta.

<sup>84</sup> *Id.*

<sup>85</sup> *See* Emory University, *Tuition and Fees*, EMORY.EDU, <http://apply.emory.edu/apply/tuition.php> (last visited Aug. 16, 2015). Tuition and fees for Emory – tuition is \$45,700; estimated cost of attendance is an additional \$36,058 over the cost of tuition. *Id.*

<sup>86</sup> *See generally* Affordable Care Act, H.R. 3590, 111th Cong. (2010) (enacted).

<sup>87</sup> *Id.*

<sup>88</sup> *See generally* *The Affordable Care Act Is Working*, HHS (Jun. 24, 2015) (<http://www.hhs.gov/healthcare/facts/factsheets/2014/10/affordable-care-act-is-working.html/>) (noting that especially among the traditionally uninsured/underinsured, the number of persons gaining access to healthcare has increased by tens of millions); *See also* *ObamaCare Enrollment Numbers*, OBAMACARE FACTS (Feb. 5, 2015), <http://obamacarefacts.com/sign-ups/obamacare-enrollment-numbers/> (noting the uninsured percentage of Americans is the lowest in over 50 years).

<sup>89</sup> *Id.*

## B. Infrastructure

The roads in Atlanta are smooth and generally free of potholes. Atlanta is ringed by an eight to twelve lane perimeter highway that is part of the federal interstate highway system.<sup>90</sup> The majority of the population in Atlanta has one or more cars.<sup>91</sup> This is a necessity because there is essentially no public transportation.<sup>92</sup> Clean modern buses travel from the center to the outside of the city and back but not across town. This means that a car is a practical necessity to get from east to west anywhere except for central Atlanta. For example, my friend's car broke down and it took him three hours and several bus transfers to get to his work, which is located only six miles from his home.

There is a modern, short subway system, but a car or taxi is necessary to reach a subway station.<sup>93</sup> It costs \$2.50 to travel twelve miles. Taxicabs fill the huge gap left by public transportation. Uber cabs owned by individuals (and not a cab company such as Yellow Cab) have begun to make a dent in the taxi service available in Atlanta.<sup>94</sup>

## C. Form of Government

The United States, is a democracy.<sup>95</sup> This is an oversimplification because most important questions track corporate policy.<sup>96</sup> Every financial interest of meaningful size has a political lobby and the lobbies educate and persuade the

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<sup>90</sup> Mitchell Landsberg, *After 35 Years, Nation's Ribbon of Interstates Nearly Complete: Transportation: It has profoundly influenced the country's evolution. When Eisenhower began the system, he envisioned an American Autobahn*, L.A. TIMES, (Jul. 23, 2000), [http://articles.latimes.com/1991-07-21/news/mn-198\\_1\\_interstate-highway-system](http://articles.latimes.com/1991-07-21/news/mn-198_1_interstate-highway-system).

<sup>91</sup> See *2011 Transportation Fact Book*, ATLANTA REGION COMMISSION (Jul. 2011), [http://documents.atlantaregional.com/transportation/TPD2011factbook\\_v04.pdf](http://documents.atlantaregional.com/transportation/TPD2011factbook_v04.pdf). The 2010 census has approximately 4,107,750 living in the 10 county Atlanta Regional Commission's area. *Id.* Those counties are; Cherokee, Clayton, Cobb, DeKalb, Douglas, Fayette, Fulton, Gwinnett, Henry, and Rockdale. *Id.*

<sup>92</sup> See MARTA, <http://www.itsmarta.com> (last visited Feb. 5, 2016). MARTA (Metro Atlanta Rapid Transit Authority) operates the public transportation system; while there is public transportation in Atlanta (buses, trains, and a trolley), there is no easy route to take across the metro area. *Id.* Transfers are not free, are limited to 4 per 3 hour period, and to travel across the Metro Area requires at least one transfer on the bus. *Id.*

<sup>93</sup> *Rail Stations & Schedules*, MARTA (Jul. 31, 2015), <http://www.itsmarta.com/rail-schedules-or-route.aspx>. The train system is both above and below ground. There are parking areas at the end of the 4 lines (Red and Gold go N-S, Blue and Green go W-E). *Id.*

<sup>94</sup> See Thomas Wheatley, *Atlanta's taxi industry declares war on Uber, Lyft*, CREATIVE LOAFING ATLANTA (Jan. 30, 2014), <http://clatl.com/atlanta/atlantas-taxi-industry-declares-war-on-uber-lyft/Content?oid=10295234>; See also Erica Byfield, *Channel 2 investigates Uber drivers ticketed, impounded at Atlanta airport*, WSB-TV ATLANTA 2 (Apr. 27, 2015) <http://www.wsbtv.com/news/news/local/channel-2-investigates-uber-drivers-ticketed-impou/nk4TC/> (stating that "Yonis said profits are down 40 percent for taxicab drivers operating out of the airport, a dip he blames on rideshares like Uber.").

<sup>95</sup> See U.S. CONST.; see GA CONST.; see also Atlanta City Charter (1996).

<sup>96</sup> See Frank Vandall, HISTORY OF CIVIL LITIGATION: POLITICAL AND ECONOMIC PERSPECTIVES, 209 (2011); See also Joanna Shepherd & Michael S. Kang, *Citizens United, Television Advertising and State and State Supreme Court Justices' Decision in Criminal Cases*, SKEWED JUSTICE (Feb. 5, 2016), <http://skewedjustice.org>.

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elected representatives.<sup>97</sup> The recent Supreme Court case *Citizens United*,<sup>98</sup> supports and encourages this. *Citizens United* held that money can be given to political action committees and they can use the donations as they wish to support or attack political candidates.

Jack Paar, a TV host in the 1960's, visited Cuba and reported that the U.S. offered aid to Cuba after the overthrow of the Batista government, but Fidel Castro rejected U.S. aid because it would be tied to a substantial American corporate presence and influence in Cuba.<sup>99</sup> Cuba instead turned instead to the U.S.S.R. for assistance and the U.S. responded with the Cuban embargo.<sup>100</sup> U.S. governmental leaders are elected by the people of the United States, but the leaders tend to follow the guidance of financial lobbies.<sup>101</sup>

### D. Taxes

The maximum federal income tax rate is 39.6 percent<sup>102</sup> and the maximum income tax rate in the state of Georgia is 6 percent.<sup>103</sup> Atlanta is located in Fulton County and collects its money from a tax of 7 percent on each sale.<sup>104</sup> Food bought in a supermarket is not taxed, but food purchased in a restaurant is taxed.<sup>105</sup>

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<sup>97</sup> *Id.* at. 138-39. Lawrence Lessig, a Harvard Law School professor has announced his candidacy for president. *Id.* His campaign is that “the system is broken” and that Congress does the bidding of the corporations, not the people. *Id.*

<sup>98</sup> *Citizens United v. Federal Election Com'n*, 588 U.S. 310 (2010).

<sup>99</sup> Fidel Castro, THE JACK PAAR TONIGHT SHOW (NBC, 1959).; see also Nan Robertson, *Jack Paar Reminisces*, N.Y. TIMES (Feb. 20, 1984), <http://www.nytimes.com/1984/02/20/arts/jack-paar-reminisces.html>.

<sup>100</sup> Vandall, *supra* note 96, at 139 (stating that political candidates must early-on in their campaigns secure financial support).; see also Shepherd & Kang, *supra* note 96.

<sup>101</sup> Frank Vandall, *History of Civil Litigation: Political and Economic Perspectives*, 139 (2011) (stating that, “almost every major financial interest seeks to lobby state law makers. Georgia is a good example.”); see also Joanna Shepherd and Michael S. Kang, *Skewed Justice Citizens United, Television Advertising and State and State Supreme Court Justices’ Decision in Criminal Cases*, SKEWEDJUSTICE.org (Sug. 1, 2015), <http://skewedjustice.org>.

<sup>102</sup> See *Tax Forms and Instructions*, GPO (Aug. 1, 2015), <http://www.gpo.gov/fdsys/granule/CFR-2012-title26-vol20/CFR-2012-title26-vol20-sec601-602>.

<sup>103</sup> See St. of Ga., DEPT. OF REV. 2014 INDIVIDUAL INCOME TAX 500 AND 500EZ FORMS AND GENERAL INSTRUCTIONS 24 (2014); See also *Schedule for Estimating Ga. Income Taxes*, Official Ga. Dept. of Rev. (2009), [http://dor.georgia.gov/sites/dor.georgia.gov/files/related\\_files/document/TSD/Form/TSD\\_Individual\\_Estimated\\_Tax\\_Worksheet\\_and\\_Tax\\_Rates\\_1.pdf](http://dor.georgia.gov/sites/dor.georgia.gov/files/related_files/document/TSD/Form/TSD_Individual_Estimated_Tax_Worksheet_and_Tax_Rates_1.pdf).

<sup>104</sup> *2015 Fulton County, Georgia Sales Tax*, TAX-RATES.org (Aug. 1, 2015), [http://www.tax-rates.org/georgia/fulton\\_county\\_sales\\_tax](http://www.tax-rates.org/georgia/fulton_county_sales_tax). The City of Atlanta collects the 4% St. of Ga. sales tax, plus an additional local 3% sales tax, for a combined total of 7%. *Id.*

<sup>105</sup> O.G.C.A. § 48-8-3(57)(A) (noting that food purchased for off-premises human consumption exempt); see also O.G.C.A. § 48-3-3(57)(B) (prepared food not exempt).

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### E. Crime

Atlanta has a substantial crime rate.<sup>106</sup> The U.S. has no meaningful gun control therefore guns are freely sold and there are about 400 million guns in the U.S.<sup>107</sup> Between 25,000 and 36,000 people die in the U.S. each year from gun violence.<sup>108</sup> By comparison, there is no omnipresent risk of death from being murdered in Cuba or Bucerias.<sup>109</sup>

### F. Conclusion

In regard to government, it is often true that citizens get what they pay for. The taxes are lower in Atlanta than Cuba, but there is little public transportation, and having a car is necessary. There is no free food (except for food banks), free healthcare or free housing in Atlanta.<sup>110</sup> Crime is substantial in Atlanta but sta-

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<sup>106</sup> See Danielle Kurtzleben, *The 11 Most Dangerous Cities*, U.S. NEWS AND WORLD REP. (Feb. 16, 2011), <http://www.usnews.com/news/articles/2011/02/16/the-11-most-dangerous-cities>; see also Les Christie, *Most Dangerous U.S. Cities*, CNN (Jan. 23, 2013), [http://money.cnn.com/gallery/real\\_estate/2013/01/23/dangerous-cities/7.html](http://money.cnn.com/gallery/real_estate/2013/01/23/dangerous-cities/7.html); see also Julie Wolfe, *Atlanta named No. 9 'Most Dangerous' city*, CHANNEL 11 ATLANTA 11 ALIVE (Oct. 28, 2013), <http://archive.11alive.com/news/article/311371/40/Atlanta-named-No-9-Most-Dangerous-city> (explaining that since 2011, three different news orgs. compiled stat. about Atlanta and came to the conclusion that Atlanta is a “most dangerous city”). Regardless of how Atlanta is ranked by various news organizations, crime continues to be a problem.).

<sup>107</sup> William J. Krouse, *Gun Control Legislation*, FEDERATION OF AMERICAN SCIENTISTS (Nov. 14, 2012), <http://www.fas.org/sgp/crs/misc/RL32842.pdf>. Krouse cites the number of guns available to civilians in 2009 as approximately 310 million. *Id.* However, this number does not include antique guns, unregistered guns, or the guns in use by the United States military. *Id.* Report notes that approximately 1-2 million handguns are manufactured each year; 1-1.5 million rifles and fewer than 1 million shotguns. *Id.* There were approximately 2 million handguns imported, 864,000 rifles and 559,000 shotguns by 2009. By 2009, there was at least 1:1 civilian to gun ratio in the US.). *Id.*

<sup>108</sup> See Donna L. Hoyert and Jiaquan Xu, *Deaths: Preliminary Data for 2011*, 61 Nat'l Vital Stat. Rep., U.S. DEPT. OF HEALTH AND HUMAN SERVICES (Oct. 10, 2012), [http://www.cdc.gov/nchs/data/nvsr/nvsr61/nvsr61\\_06.pdf](http://www.cdc.gov/nchs/data/nvsr/nvsr61/nvsr61_06.pdf) (stating that for the years 2010-2011, the number of gun-related deaths in the U.S. (homicide and suicide) were 30,470 and 30,867, respectively).

<sup>109</sup> Martin Evans, *Teacher who visited Cuba to study 'low crime rate' strangled in hotel room*, THE TELEGRAPH (Sept. 24 2013), <http://www.telegraph.co.uk/news/uknews/10330241/Teacher-who-visited-Cuba-due-to-low-crime-rate-strangled-in-hotel-room.html>. Cuba does not have an official report for murders; there have been several high profile cases in recent years, including British teacher Lara Jones who was asphyxiated in March of 2012 by a hotel security guard. *Id.*

<sup>110</sup> While true there is no widespread “free” food, healthcare, or housing in Atlanta, the U.S. government does have programs that supplement food (previously known as ‘food stamps’, now known as ‘EBT’ benefits), health insurance (Medicaid, if a citizen can find a doctor that accepts Medicaid), and housing (Known as ‘Section 8’ housing; the name refers to the section of U.S. Code that defines the program). However, these programs are only ‘supplemental’, that is, not intended to provide for all a person will need. There is no guarantee of benefits, the benefit must be applied for – often through an intrusive process that in some states that require drug screenings – and can be easily lost; *contra* GA. FOOD STAMPS, <http://food-stamps.com/Georgia> (last visited May 2, 2016) (noting that Georgia does not require drug screenings).

tistically rarer than in Cuba and Mexico.<sup>111</sup> There are violent kidnappings and drug wars in parts of Mexico, however.<sup>112</sup>

Education at the lower grade levels is free in Mexico, Cuba and Atlanta. But at \$25,000 to \$50,000 in Atlanta, a college education can bankrupt a family or put a student in substantial debt for 20 to 25 years.<sup>113</sup> Roads are smooth and plentiful in Atlanta because they are a necessity. Navigating Atlanta requires a car. Unemployment is at 13 percent in the black community of Atlanta.<sup>114</sup> Cuba promises free housing, education and healthcare, but food is often in short supply and depleted by the end of week three.<sup>115</sup> Some Cubans have cars, but they are from before 1960.<sup>116</sup> There is almost no visible unemployment in Cuba, but the American CIA suggests unemployment to be close to 8 percent.<sup>117</sup> The Soviet collapse and withdrawal from Cuba in 1990 and the U.S. embargo has left Cuba on the verge of starvation.<sup>118</sup> Fifty years after the imposition of the Cuban embargo, the Cuban people live at a subsistence level.<sup>119</sup> The Economist reports “Nobody starves, but hard-currency supermarkets go for weeks without basics such as milk and bread.”<sup>120</sup>

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<sup>111</sup> *Murders with Firearms Per Million: Countries Compared*, NATIONMASTER (Aug. 1, 2015), <http://www.nationmaster.com/country-info/stats/Crime/Murders-with-firearms-per-million>. When it comes to crime, especially gun crimes, the U.S. has 19 times the rate of gun crimes in Cuba and 6 times more than Mexico. *Id.* The U.S. has 8 times more total crime than Mexico, and the U.S. murder rate is 23 times more than Cuba. *Id.*

<sup>112</sup> Joshua Partlow, *Kidnappings in Mexico surge to highest number on record*, THE WASHINGTON POST (Aug. 15, 2014), [https://www.washingtonpost.com/world/the\\_americas/kidnappings-in-mexico-surge-to-the-highest-number-on-record/2014/08/15/3f8ee2d2-1e6e-11e4-82f9-2cd6fa8da5c4\\_story.html](https://www.washingtonpost.com/world/the_americas/kidnappings-in-mexico-surge-to-the-highest-number-on-record/2014/08/15/3f8ee2d2-1e6e-11e4-82f9-2cd6fa8da5c4_story.html).

<sup>113</sup> Allie Bidwell, *Student Loan Expectations: Myth vs. Reality*, U.S. NEWS AND WORLD REPORT (Oct. 7, 2015), <http://www.usnews.com/news/blogs/data-mine/2014/10/07/student-loan-expectations-myth-vs-reality> (explaining that student loan debt is a burden taken on by many to pay for school. A law student with approximately \$100,000.00 in school debt, stands a chance of actually paying off the debt. Others that do not enter careers with an expectation of good pay do not have such an optimistic outlook. There are programs that allow for persons in the public sector to have their loans forgiven after completing a certain number of payments, but that does not help students entering the private sector.).

<sup>114</sup> See Valerie Wilson, Josh Bivens, *Fact Sheet: Estimates of Unemployment Rates by Race and Ethnicity at the MSA Level for the Third Quarter of 2014*, ECONOMIC POLICY INSTITUTE (Nov. 12, 2014), [http://www.epi.org/files/2013/fed\\_fact\\_sheet.pdf](http://www.epi.org/files/2013/fed_fact_sheet.pdf). Actual unemployment rate was at 13.67% for the black community in Atlanta, compared with 4.64% for whites and 6.02% for Hispanics. Asian community unemployment rate was unknown. *Id.*

<sup>115</sup> Rosa Tania Valdes, *Raul Castro's reforms fail to end Cuba's chronic shortages*, REUTERS U.S. (May 9, 2014), <http://www.reuters.com/article/2014/05/09/us-cuba-shortages-idUSBREA480DC20140509>; see also *Cuban Government Acknowledges Food Shortages*, LATIN AMERICAN HERALD TRIBUNE (Aug. 2, 2015), <http://laht.com/article.asp?ArticleId=353160&CategoryId=14510>.

<sup>116</sup> Jonathan Watts, *Cuba's classic cars set to disappear with rule change on new vehicle imports*, THE GUARDIAN (Jan. 3, 2014), <http://www.theguardian.com/world/2014/jan/03/cuba-classic-car-streets-rule-change-new-purchase>.

<sup>117</sup> Ian Talley, *5 Things You Need to Know about Cuba's Economy*, THE WALL STREET J. BLOG (Dec. 17, 2014), <http://blogs.wsj.com/briefly/2014/12/17/5-things-you-need-to-know-about-cubas-economy/> (explaining that “while the Cuban government says the unemployment rate in 2013 was around 4.13%, the CIA says unofficial estimates are likely double that rate.”).

<sup>118</sup> BAKER, *supra* note 24; see also COOKE, *supra* note 37.

<sup>119</sup> COOKE, *supra* note 37. Returning Cubans bring toilets, toilet lids, and feminine napkins. *Id.*

<sup>120</sup> *Cuban Food Shortages: Hungry for Change*, THE ECONOMIST (Mar. 25, 2010), <http://www.economist.com/node/15769891>.

## Political and Social Structure of Mexico, Cuba and the U.S.

From a socio-economic perspective, Mexico lies somewhere in the middle between the U.S. and Cuba. Food is available, as are public transportation and public healthcare.<sup>121</sup> Taxes, in Cuba are 100 percent because everything is owned by the state and all products go to the state.<sup>122</sup> In contrast, U.S. taxes (a maximum of 39.6 percent) are less than Cuba's 100 percent "tax rate."<sup>123</sup> Mexican taxes are lower still. There is much less government intrusion in the U.S. than in Cuba. However, government presence is almost invisible in Bucierias.

In the U.S., the Republican party argues for less governmental intrusion and lower taxes. This sounds like Mexico, where the results of such policies are poor roads, free education up to the age of 14, and few students matriculating from high school to college. Public transportation is widely available, however. The Democrats in the U.S., on the other hand, are traditionally depicted as favoring more governmental intrusion and higher taxes. This sounds something like Cuba where the result of these policies, at the extreme, are a 99% literacy rate, free housing, food and healthcare, but the food runs out before the end of the month. Hope is also in short supply in Cuba.

This preliminary comparison suggests that a careful evaluation of socio-economic policies is needed before implementation. Perhaps the best form of government is one that is not set in stone and takes the best ideas from several economies.

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<sup>121</sup> Karen Feldscher, *Mexico achieves universal health coverage, enrolls 52.6 million people in less than a decade*, HARVARD SCHOOL OF PUBLIC HEALTH (Aug. 15, 2012), <http://www.hsph.harvard.edu/news/features/mexico-universal-health/>.

<sup>122</sup> BAKER, *supra* note 24, at 537-42.

<sup>123</sup> See COOKE, *supra* note 37.

# FUTBOL: THE 2014 CHILEAN TAX REFORM AND THE ELIMINATION OF CHILE'S FUT

Cash Kinghorn\*

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## I. Introduction

On September 30, 2014, the Chilean legislature passed Law No. 20.780, substantially changing the country's tax structure.<sup>1</sup> This significant modification seeks to raise 3 percent of GDP through an increase in the corporate tax rate, the elimination of tax exemptions or loopholes, generally used for tax avoidance or evasion, and a number of other tax alterations.<sup>2</sup> This tax reform is expected to fund a variety of social programs, including an education reform following the 2011-2012 student protests.<sup>3</sup> This reform also attempts to close the largest income gap (between the highest and lowest deciles) in Latin America and the Organisation for Economic Co-operation and Development ("OECD").<sup>4</sup> However, the best way to close this gap and retain sufficient levels of investment and growth is an area of significant debate both internally within Chile and externally among economists.<sup>5</sup>

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<sup>1</sup> Rodrigo Benítez & Jorge Narbona, *Chile Tax News: Executive Summary Tax Reform, Law No. 20.780*, 1, (BDO, December 2014).

<sup>2</sup> Elif Ture, *Chile's Experience with Inclusive Growth*, in CHILE: SELECTED ISSUES PAPER 9, 10 (International Monetary Fund, July 2014).

<sup>3</sup> Roland Benedikter & Katja Siepmann, *Chile in Transition: Prospects and Challenges for Latin America's Forerunner*, 150 (Springer, 2015).

<sup>4</sup> Daniel Rodriguez-Delgado & Roberto Schatan, *Chile's Tax System and the 2014 Tax Reform*, in CHILE: SELECTED ISSUES PAPER 26, 26 (International Monetary Fund, July 2014).

<sup>5</sup> Benedikter, *supra* note 3, at 150.

## The Elimination of Chile's FUT

This paper will first provide a brief history of Chilean tax law (1975-2013) as well as information regarding the 2014 Tax Reform and its alterations to Chile's tax structure.<sup>6</sup> Next will be a brief discussion of several of the reforms primary provisions and what they could mean for the Chilean economy.<sup>7</sup> Following this will be an analysis of the changes to both the corporate income tax ("CIT") and personal income tax ("PIT") rate, the elimination of the Taxable Profits Fund ("FUT") tax exemption, and how these changes will affect small and medium-sized enterprises ("SMEs") operating in Chile.<sup>8</sup> Finally, this paper will conclude with a few proposals, specifically relating to the repeal of the FUT, and what its potential effect could be on investment and growth in Chile.<sup>9</sup>

### II. Background

#### A. The History of Chilean Tax Law (1975-2013)

To fully understand how Chile has progressed since 1990 and how substantial of a step the 2014 Tax Reform is for the future of Chile, it is important to briefly discuss the taxation and government policies enacted by General Pinochet's government from 1973-89.<sup>10</sup> Immediately following the 1973 coup d'état that brought Pinochet to power, inflation skyrocketed to 375 percent in 1974, and unemployment rose from 3 percent to approximately 15 to 20 percent.<sup>11</sup> Subsequently, in 1975, economists trained and taught by Milton Friedman at the University of Chicago joined the Chilean government as economic advisors.<sup>12</sup> This group of individuals, both endearingly and disdainfully, were labeled the "Chicago Boys."<sup>13</sup> The "Chicago Boys" quickly exerted substantial influence over economic policy, especially when Sergio de Castro (a "Chicago Boy") became the Minister of Finance at the end of 1976, subsequently surrounding himself with other "Chicago Boys."<sup>14</sup>

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<sup>6</sup> Francisco Rosende, *Commentary on Chile: Bachelet's Tax Reform—Some Preliminary Thoughts*, in *Progressive Tax Reform and Equality in Latin America* 57, 57 (Woodrow Wilson Center, 2015).

<sup>7</sup> Benítez, *supra* note 1, at 1-2; *see also* Regina Scherzer, Joseph Courand & Hugo Hurtado, *Chile Tax Alert*, 1-2, 5 (Deloitte, August 23, 2014).

<sup>8</sup> Scherzer, *supra* note 7, at 1-2; *see also* Rosende, *supra* note 6, at 58.

<sup>9</sup> Benedikter, *supra* note 3, at 150.

<sup>10</sup> Tasha Fairfield, *The Political Economy of Progressive Tax Reform in Chile*, Woodrow Wilson Center: Update on the Americas, March 2014, at 1; *see also* Rosende, *supra* note 6, at 150.

<sup>11</sup> Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism*, 97 (Henry Holt and Co., July 2008); *see also* Ricardo Ffrench-Davis, *Economic Reforms in Chile: From Dictatorship to Democracy*, 191 (University of Michigan Press, 2002). The former citing the 20 percent and the latter citing to 15.7 percent unemployment. The latter also shows that unemployment stood at around 19 percent in 1983 or 31.3 percent if you exclude emergency job programs. *Id.*

<sup>12</sup> Milton Friedman & Rose D. Friedman, *Two Lucky People: Memoirs. Milton Friedman and Rose D. Friedman*, 398 (The University of Chicago Press, 1998); *see also* *Commanding Heights: Chicago Boys and Pinochet*, PBS (2002) [http://www.pbs.org/wgbh/commandingheights/shared/video/qt/mini\\_p02\\_07\\_300.html](http://www.pbs.org/wgbh/commandingheights/shared/video/qt/mini_p02_07_300.html).

<sup>13</sup> Friedman, *supra* note 12, at 398; *see also* Gary S. Becker, *What Latin America Owes to the "Chicago Boys"*, (Hoover Digest, 1997 No. 4).

<sup>14</sup> Friedman, *supra* note 12, at 398; *see also* Hernán Büchi, *The Economic Transformation of Chile: A Personal Account*, 33 (HACER, 2009).

## The Elimination of Chile's FUT

The “Chicago Boys” outlined their systematic economic reforms for Chile in “Program for Economic Development” or *El ladrillo* (a.k.a. “The Brick”).<sup>15</sup> The Brick advocated widespread deregulation and privatization, along with cutting tariffs and reducing taxes, a system commonly referred to as *laissez-faire* economics.<sup>16</sup> The deregulation and privatization reforms implemented cut public spending in half and led to the privatization of approximately 500 state-owned companies and banks by 1980.<sup>17</sup> Tax reforms during this time coincided with a shift in domestic economic policy in an attempt to correct the widespread inflation ravaging Chile since Pinochet’s rise to power.<sup>18</sup> These reforms included the creation of a value-added tax (“VAT”), and the abolition of special tax regimes, exceptions, and privileges.<sup>19</sup> The first VAT was implemented in 1974, at a rate of 20 percent, and subsequently became the pillar of the tax system that still exists in Chile.<sup>20</sup>

Despite (or arguably because of) these economic steps, the Chilean economy lagged until 1982, when a banking crisis forced significant changes to the system.<sup>21</sup> In 1985, following this economic contraction, the newly-appointed economic minister, Hernán Büchi (not a “Chicago Boy”) implemented a neoliberal, pragmatic approach, allowing for greater government intervention.<sup>22</sup> Under this approach, the government’s primary focus was on fiscal solvency and economic growth issues, as opposed to privatization and deregulation, which allowed Chile’s GDP to expand at a robust 5 percent between 1984 and 1997.<sup>23</sup> Part of this policy shift included tax reformation in 1984, as the previous tax structure ignored how their provisions adversely impacted savings and investment for businesses or individuals.<sup>24</sup> The 1984 reform implemented a reduction in the marginal tax rate, a modification of the income tax base, integration of the PIT

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<sup>15</sup> Büchi, *supra* note 14, at 23.

<sup>16</sup> Büchi, *supra* note 14, at 23; *see also* Becker, *supra* note 13. *See generally Laissez-faire Economics Definition*, BUSINESS DICTIONARY, <http://www.businessdictionary.com/definition/laissez-faire-economics.html> (last visited Mar. 27, 2016). (Laissez-faire economics is grounded in the belief that individuals are naturally motivated by self-interest, therefore their economic activities should be unrestrained by the government and driven only by market forces).

<sup>17</sup> Omar Sanchez, *Mobilizing Resources in Latin America: The Political Economy of Tax Reform*, 20 (Palgrave, McMillin, July 6, 2011); *see also* Moisés Naím & Joseph S. Tulchin, *Competition Policy, Deregulation, and Modernization in Latin America*, 77 (Lynne Rienner Publishers, 1999). Privatization is the process by which an enterprise or industry is transferred from public-sector, government control to private, individual investor control. *Id.*

<sup>18</sup> Sanchez, *supra* note 17, at 21.

<sup>19</sup> *Id.* A value-added tax is a type of consumption tax that is placed on a product when value is added during stages of production or at its distribution. *Id.*

<sup>20</sup> Sanchez, *supra* note 17, at 21-23 (explaining that during this time period, direct tax reform looked to tax all income sources at the same rate, so as not to favor certain economic activities over any others, i.e. income from investment would be taxed at the same rate as income from wages).

<sup>21</sup> Sanchez, *supra* note 17, at 24; *see also* Büchi, *supra* note 14, at 81-82. The recession (1982-1984) further contracted GDP by approximately 12-14 percent. . *Id.*

<sup>22</sup> Javier Santiso, *Latin America's Political Economy of the Possible: Beyond Good Revolutionaries and Free-Marketeters*, 112 (MIT Press, 2007).

<sup>23</sup> Santiso, *supra* note 22, at 112; *see also* Becker, *supra* note 13.

<sup>24</sup> Sanchez, *supra* note 17, at 23.

## The Elimination of Chile's FUT

and CIT, and, the creation of the Taxable Profits Fund ("FUT"), a tax exemption distinguishing between how reinvested and distributed income would be taxed.<sup>25</sup> These modifications, along with the creation of the VAT in the 1974 tax reform, provide the basis for the Chilean tax system, and play a major role in the 2014 Tax Reform.<sup>26</sup>

Chile experienced a dramatic, countrywide shift in 1988 with the ousting of the Pinochet government.<sup>27</sup> With the subsequent tax reform in 1990, Chile began to move away from the laissez-faire economics and neo-liberalism policies of the 1970s-80s, towards a more progressive tax system.<sup>28</sup> This progress has been achieved gradually through marginal tax increases, using a multitude of strategies in coordination with favorable political timing.<sup>29</sup> One element that has worked in the favor of tax reform since 1990 is the Chilean constitutional grant of exclusive authority in the executive branch to initiate tax reform and policy changes.<sup>30</sup> Despite this unilateral authority, the executive branch does not have independent power to implement their tax reform, instead requiring a vote in both the upper and lower houses of the legislature to become law.<sup>31</sup> However, the legislature does not have the authority to amend the tax proposal, but can only vote to approve or to deny the proposal's measures.<sup>32</sup> To ensure that the reform has sufficient support, the executive branch consults with individuals, businesses and legislators alike to create reform initiatives that realistically can be enacted.<sup>33</sup>

During the 1990 tax reform, the VAT was lowered from 20 percent to 18 percent and remained that way until 2003, when it was again raised, this time to 19 percent.<sup>34</sup> In response to the massive cuts in public spending during the Pinochet regime, which depleted the pension and education systems, Chile again implemented tax reforms in 1995.<sup>35</sup> Then-President Frei announced that the government would increase taxes on gasoline and cigarettes to fund a 10 percent readjustment in the pension fund and a 5 percent increase in school subsidies.<sup>36</sup> Another tax reform in 2001 increased the corporate tax rate from 15 percent to 17 percent, while concurrently reducing the top two personal income tax brackets

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<sup>25</sup> Chang-Tai Hsieh & Jonathan A. Parker, *Taxes and Growth in a Financially Underdeveloped Country: Evidence from the Chilean Investment Boom*, *ECONOMIA*, Fall 2007, at 8-9.

<sup>26</sup> Sanchez, *supra* note 17, at 23.

<sup>27</sup> Fairfield, *supra* note 10, at 3.

<sup>28</sup> *Id.* (explaining a progressive tax system is based on the ability to pay, wherefrom high-income groups are taxed at a higher percentage than low-income groups).

<sup>29</sup> Fairfield, *supra* note 10, at 3 (explaining that there has been significant pushback from businesses regarding tax reform. This arises primarily through the use of political parties (Unión Demócrata Independiente, UDI, and Renovación, RN) who still have some ties to the Pinochet government).

<sup>30</sup> *Id.* at 5.

<sup>31</sup> Fairfield, *supra* note 10, at 3.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* (explaining that if there is significant pushback at this stage, even if the reform will still pass, those options are generally discarded).

<sup>34</sup> *Id.*

<sup>35</sup> Sanchez, *supra* note 17, at 50.

<sup>36</sup> *Id.*

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from 45 and 35 percent to 40 and 32 percent respectively.<sup>37</sup> Finally, in 2010, another tax reform again increased the corporate tax rate.<sup>38</sup> This reform increased the corporate tax rate to 20 percent, however, this was only temporary due to a confluence of circumstances (a devastating earthquake attributed as the primary reason), and the tax rate was once again at 17 percent by 2013.<sup>39</sup>

### B. The 2014 Chilean Tax Reform

As Chile has slowly built its tax system since 1990, it has yet to implement a substantial change to its tax code at one time.<sup>40</sup> However, this part-and-parcel method of reform became obsolete in the 2013 elections, when President Michelle Bachelet was reelected after having previously served from 2006-2010.<sup>41</sup> President Bachelet's Chilean Socialist Party also gained a majority of both houses of legislature in this election.<sup>42</sup> This provided President Bachelet with an opportunity to make extensive changes to the current tax code, specifically responding to the 2011 and 2012 student protests and the large income equity gap pervading the country.<sup>43</sup>

Since 1990, the national poverty level in Chile has fallen from 39 percent to 14.4 percent in 2013.<sup>44</sup> Despite these reductions, the top 10 percent of the populace is responsible for 41.5 percent of the income share, and the top one percent is estimated at 22 to 24 percent of that amount.<sup>45</sup> Furthermore, compared to other Organisation for Economic Co-operation and Development ("OECD") countries, Chile still has one of the highest percentages (15.9 percent) of the population living below 50 percent of median income.<sup>46</sup> This massive income gap led Chile to have the highest level of inequality of OECD countries according to the Gini Index.<sup>47</sup> Finally, an IMF Report determined that under the 2013 tax structure, with the primary tax method being consumption-based indirect

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<sup>37</sup> Fairfield, *supra* note 10, at 12.

<sup>38</sup> *Id.* at 15.

<sup>39</sup> *Id.*

<sup>40</sup> Fairfield, *supra* note 10, at 12.

<sup>41</sup> Pascale Bonnefoy, *Former President of Chile Poised to Regain Her Seat*, N.Y. TIMES (Nov. 17, 2013), [http://www.nytimes.com/2013/11/18/world/americas/chile-election.html?\\_r=0](http://www.nytimes.com/2013/11/18/world/americas/chile-election.html?_r=0) (explaining that the Chilean constitution does not allow a president to serve two consecutive terms).

<sup>42</sup> Anthony Esposito, *Chile's Bachelet Promises Reforms After Landslide Election Win*, REUTERS (Dec. 16, 2013) <http://www.reuters.com/article/us-chile-election-idUSBRE9BE09720131216>.

<sup>43</sup> *Id.*; see also Fairfield, *supra* note 10, at 1.

<sup>44</sup> Ture, *supra* note 2, at 9-10.

<sup>45</sup> Tasha Fairfield & Michael Jorratt, *Top Income Shares, Business Profits, and Effective Tax rates in Contemporary Chile* 7, 10 (Int'l Ctr. for Tax and Dev., Working Paper No. 17, 2014); see also Income share held by highest 10%, <http://data.worldbank.org/indicator/SI.DST.10TH.10/countries/CL?display=graph> (last visited Jan. 9, 2016).

<sup>46</sup> Ture, *supra* note 2, at 10.

<sup>47</sup> *Id.* The Gini Index (also referred to as Gini Coefficient) is a measure as to the extent which the income distribution of a nation is away from a perfectly equal distribution. *Id.*

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taxes (i.e. VAT and excise taxes<sup>48</sup>), the top 10 percent of income-earners actually had a lower tax incident than the lowest 10 percent.<sup>49</sup>

In response, on August 9, 2014, the Bachelet-led Chilean executive branch submitted to the legislature the 235-page tax reform bill.<sup>50</sup> This bill was initially approved on September 10, 2014 by both houses of the legislature.<sup>51</sup> The primary goals of the reform included: the collection of additional annual revenue yield of 3 percent of current GDP, the establishment of a more equitable tax system (through the elimination of structural deficiencies), new incentives for investments and savings (primarily for individuals), the reduction of tax evasion and avoidance, and to close the income gap and finance a widespread education reform (looking to provide more equal access).<sup>52</sup>

Its terms will be implemented incrementally, with the full scope of the reform being applicable by 2018.<sup>53</sup> It is significant for tax administration purposes that these social changes and their associated costs are matched to the projected revenue yields this tax reform will provide.<sup>54</sup> One element that will not change in Chile's tax structure is the full integration between the CIT and the PIT.<sup>55</sup> Even without any changes to full integration, the weighty modifications on income taxes, including the provision closing the gap between the CIT and the PIT, supports the equity goals of the overall reform.<sup>56</sup>

In terms of closing the gap between the CIT and the PIT, the tax reform decreases the top personal income tax rate from 40 percent to 35 percent.<sup>57</sup> This is coupled with a general increase in the corporate tax rate from 20 percent to 25 or 27 percent, depending on type of business and the company's tax system elec-

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<sup>48</sup> *Excise Taxes*, IRS (Oct. 10, 2015), <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Excise-Tax> (explaining that excise taxes are those that are paid when a specific good is purchased, i.e. gasoline or cigarettes).

<sup>49</sup> Ture, *supra* note 2, at 11. The tax incident is the tax payment as a fraction of disposable income. *Id.*

<sup>50</sup> Scherzer, *supra* note 7, at 1.

<sup>51</sup> Javiera Quiroga, *Chile Congress Passes Tax Bill to Finance Free Education*, BLOOMBERG BUSINESS (Sept. 10, 2014), <http://www.bloomberg.com/news/articles/2014-09-11/chile-congress-passes-corporate-tax-rise-to-narrow-inequality>.

<sup>52</sup> Rodriguez-Delgado, *supra* note 4, at 31. The government estimated 0.8 percent attributable to new personal tax accrued, 0.59 percent to corporate tax increases, and 0.52 percent to reduction in evasion and avoidance; the remaining 1.09 percent is made up of green, real-estate, stamp, alcohol and sugary drinks, and other tax changes. *Id.*

<sup>53</sup> Rodriguez-Delgado, *supra* note 4, at 32; *see also* Scherzer, *supra* note 7, at 2.

<sup>54</sup> Rodriguez-Delgado, *supra* note 4, at 32; *see also* Charles Kramer & Tamim Bayoumi, *Chile: 2014 Article IV Consultation – Staff Report; Press Release; And Statement By The Executive Director For Chile*, 19-20, (International Monetary Fund, July 2014).

<sup>55</sup> Rodriguez-Delgado, *supra* note 4, at 32 (explaining that they still interact with one another for each individual taxpayer, arriving at one tax rate and tax liability, even though both rates were changed in the 2014 Reform).

<sup>56</sup> Rodriguez-Delgado, *supra* note 4, at 32.

<sup>57</sup> *Id.* at 31; *see also* Rosende, *supra* note 6, at 61.

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tion.<sup>58</sup> The tax reform also looks to prevent the avoidance of tax through a variety of methods, specifically: deductibility of financing expenses, thin capitalization rules, controlled foreign company ("CFC") rules, limits on payments to foreign related parties, and general anti-avoidance rule ("GAAR").<sup>59</sup>

### III. Discussion

#### A. Initial Domestic and International Feedback

More than a year after the tax bill was initially approved, the 2014 Tax Reform and President Bachelet's approval, have faltered substantially.<sup>60</sup> A portion of the tribulations inhibiting economic advance is attributable to the economic slowdown in China and its effect on the Chilean copper export.<sup>61</sup> Conversely, some have attributed this economic downturn to the election of Bachelet and her tax reform policies.<sup>62</sup> This line of reasoning cites an increase in the unemployment rate and a decrease in manufacturing production from the end of 2013 and the beginning of 2014.<sup>63</sup> Additionally, the tax reform that was passed with such promise is now back before the legislature awaiting additional amendments, making the implementation process, unlikely to begin in 2016.<sup>64</sup>

An area of substantial, ongoing debate is the effect the 2014 Tax Reform will have on savings, investment, and growth, both for businesses and individuals.<sup>65</sup> This debate was set in motion as far back as 1975, because of how Chile initially organized its tax code, focusing on consumption (VAT and excise taxes) rather than income taxes (CIT and PIT).<sup>66</sup> This left the current government with few options of how to implement a more progressive tax regime without modifying income taxes.<sup>67</sup> By effectuating a progressive reform which increases the CIT, decreases the PIT, and closes tax loopholes (or exemptions/deductions/credits

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<sup>58</sup> Scherzer, *supra* note 7, at 1-2; *see also* Alberto Maturana, *What to Expect From Chile's Latest Tax Reform Package*, BAKER & MCKENZIE (Sept. 24, 2014) <http://www.internationaltaxreview.com/Article/3383640/What-to-expect-from-Chiles-latest-tax-reform-package.html>.

<sup>59</sup> Scherzer, *supra* note 7, at 3-4; *see also* Ernst & Young Americas Tax Center, *Chile Enacts Tax Reform*, 3-4 (Oct. 10, 2014).

<sup>60</sup> Brianna Lee, *Chile's President Michelle Bachelet Approval Sinks Over Economic Malaise, Corruption And Stalled Reforms*, IBT (Sept. 16, 2015) <http://www.ibtimes.com/chiles-president-michelle-bachelet-approval-sinks-over-economic-malaise-corruption-2098204> (explaining that according to an opinion by Chilean Plaza Pública Cadem, President Bachelet's approval rating stood at 20 percent as of September 2015. Another poll, this one conducted by GfK Adimark reported an approval rating of 24 percent in December 2015).

<sup>61</sup> Rosalba O'Brien & Marion Giraldo, *Amid Slowdown, Chileans Adjust to New Economy*, REUTERS (Aug. 25, 2014) <http://www.reuters.com/article/chile-economy-slowdown-idUSL6N0QK5NV20140825>.

<sup>62</sup> *Reform in Chile: The Lady's for Turning: Is Michelle Bachelet Putting Her Country's Growth Model at Risk?* THE ECONOMIST (May 24, 2014) <http://www.economist.com/news/americas/21602681-michelle-bachelet-putting-her-countrys-growth-model-risk-ladys-turning>.

<sup>63</sup> O'Brien, *supra* note 61.

<sup>64</sup> Lee, *supra* note 60.

<sup>65</sup> Rosende, *supra* note 6, at 32-33; *see also* Benedikter, *supra* note 3, at 119.

<sup>66</sup> Rodriguez-Delgado, *supra* note 4, at 28-29; *see also* Fairfield, *supra* note 10, at 3-4.

<sup>67</sup> Rodriguez-Delgado, *supra* note 4, at 28-29; *see also* Fairfield, *supra* note 10, at 3-4.

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depending on your point-of-view), the Chilean government is attempting to address equity at the potential expense of efficiency.<sup>68</sup>

Conducting their own analysis of the tax reform, the IMF concluded that based on the large gap in Chile's income distribution, the emphasis on income taxes, particularly reducing the gap between the CIT and the PIT, is an appropriate resolution.<sup>69</sup> Moreover, the IMF stated that this contraction, as well as the elimination of opportunities for tax evasion and/or avoidance, primarily used by the top-income earners (the FUT), will increase equality.<sup>70</sup> Even with these changes, Chile will still be below (but closer to) the regional average CIT rate, bringing it more in line with recent global economic changes.<sup>71</sup>

### B. The Dual Tax Method

Part of this progressive reform to the Chilean tax system is a move to a dual-tax method system, again with the plan of starting in 2017.<sup>72</sup> Prior to passing the reform, the Chilean tax code provided that a company or enterprise in Chile is subject to a 20 percent First Category Income Tax ("FCIT").<sup>73</sup> Those earnings are subject to income tax on a cash basis when they are distributed to shareholders.<sup>74</sup> The tax rate at that point is determined based upon that shareholders status as a resident or nonresident.<sup>75</sup> The reform outlines that shareholders must opt for either an Attributed Income system using the accrual method or the Semi-Integrated system, if the taxpayer elects to use the cash basis method.<sup>76</sup>

Under the Attributed Income system, profits would be attributed to shareholders when they are available to the individual taxpayer regardless of whether any physical distribution is made.<sup>77</sup> Using this system, the FCIT is now imposed at 25 percent on those earnings.<sup>78</sup> In addition, residents of Chile are subject to any

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<sup>68</sup> Rodriguez-Delgado, *supra* note 4, at 32-34; *see also* Ryan Dube, *Chile Approves Tax-Reform Legislation*, THE WALL STREET JOURNAL (May 15, 2014) <http://www.wsj.com/articles/SB10001424052702304908304579564352222188352>.

<sup>69</sup> Rodriguez-Delgado, *supra* note 4, at 32.

<sup>70</sup> Rodriguez-Delgado, *supra* note 4, at 33.

<sup>71</sup> Rodriguez-Delgado, *supra* note 4, at 29; *see also* Luigi Bernardi ET AL., *Tax Systems and Tax Reforms in Latin America*, 55 (Routledge, 2008).

<sup>72</sup> Scherzer, *supra* note 7, at 1-2; *see also* Maturana, *supra* note 58. The integration system refers to how the PIT and the CIT interact, whereas the dual-tax system being implemented determines when revenue and expenses are to be attributed. *Id.*

<sup>73</sup> Scherzer, *supra* note 7, at 1-2; *see also* Service de Impuestos Internos ("SII"), *Information for Foreign Investors*, 1, [http://www.sii.cl/pagina/actualizada/noticias/2014/160114noti01ae\\_anexo1.pdf](http://www.sii.cl/pagina/actualizada/noticias/2014/160114noti01ae_anexo1.pdf) (last visited Jan. 9, 2016).

<sup>74</sup> Scherzer, *supra* note 7, at 1.

<sup>75</sup> Scherzer, *supra* note 7, at 1; *see also* SII, *supra* note 73, at 2.

<sup>76</sup> Benítez, *supra* note 1, at 1; *see also* Scherzer, *supra* note 7, at 1-2 (explaining that the accrual method of accounting determines revenues and expenses as being received when the taxpayer has the right to them, whereas the cash method is only upon receipt (for revenue) or when paid (for expenses)).

<sup>77</sup> Scherzer, *supra* note 7, at 1; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

<sup>78</sup> Benítez, *supra* note 1, at 1; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

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global complementary tax at progressive rates.<sup>79</sup> For nonresident shareholders, they must pay an additional withholding income tax ("AWIT") of 35 percent, with the FCIT being 100 percent creditable for these shareholders.<sup>80</sup> This leaves nonresidents with a tax charge of 35 percent, regardless of distribution or non-distribution by the enterprise.<sup>81</sup>

In contrast, by using the Semi-Integrated system, the shareholder is taxed when the profits are distributed to them, commonly called the cash basis method of accounting.<sup>82</sup> Under the Semi-Integrated system, the shareholder is taxed at a FCIT rate of 25.5 percent for 2017, increasing to 27 percent for 2018 and beyond.<sup>83</sup> The AWIT would still be credited for the FCIT, however, 35 percent of the FCIT liability would have to still be paid (as opposed to zero percent under the Attributable Income system), thereby leaving 65 percent as the maximum amount creditable against the AWIT.<sup>84</sup> Therefore, the primary benefit derived from using the Semi-Integrated system is that the shareholder/taxpayer would defer their taxation until profits are distributed; however, they would potentially face a higher overall income tax rate at this time than under the Attributed Income system.<sup>85</sup>

Another step in implementing this new tax code will be the company electing which of the two tax systems, either Attributed or Semi-Integrated, to apply to its accounting procedures.<sup>86</sup> The choice of the system to use differs based on the type of entity, as a limited liability corporation and companies divisible by shares require a unanimous decision whereas stock corporations require two-thirds of voting stock.<sup>87</sup> New entities must determine at the time of their formation and registration which method they will choose and notify the Chilean tax authorities as such.<sup>88</sup> If an existing entity wants to change systems, they must inform the authorities during the last three months preceding the year in which they intend

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<sup>79</sup> Scherzer, *supra* note 7, at 1; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2 (explaining that the global complementary tax is applied at a rate of 0-40 percent, depending on income bracket, to those who receive additional income apart from employment income, have been granted a tax benefit, or if they are entitled to a tax refund).

<sup>80</sup> Scherzer, *supra* note 7, at 1-2; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2-3 (stating that a tax credit is an incentive which directly reduces the tax bill (whereas a deduction reduces the tax base, therefore, for example, the taxpayer determines what their tax liability is then subtracts the tax credit from that amount)).

<sup>81</sup> Scherzer, *supra* note 7, at 2; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

<sup>82</sup> Scherzer, *supra* note 7, at 2; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2-3.

<sup>83</sup> Benítez, *supra* note 1, at 1; *see also* Scherzer, *supra* note 7, at 2.

<sup>84</sup> Scherzer, *supra* note 7, at 2; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

<sup>85</sup> Scherzer, *supra* note 7, at 1-2.

<sup>86</sup> Ernst & Young Americas Tax Center, *supra* note 59, at 2; *see also* Scherzer, *supra* note 7, at 2 (explaining that the reform does outline the default regime that each different type of business will fall into if they fail to make an election).

<sup>87</sup> Scherzer, *supra* note 7, at 2.

<sup>88</sup> *Id.*

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to implement the new system.<sup>89</sup> Finally, that switching entity is then required to remain under their newly-elected system for at least five years.<sup>90</sup>

### C. The Elimination of the FUT

As previously mentioned, another one of the biggest changes in the 2014 Tax Reform is the elimination of the FUT, describe as either a tax loophole or distributed income reinvestment method.<sup>91</sup> The FUT was an advantageous part of the Chilean tax code providing companies with a tax exemption on reinvested profits.<sup>92</sup> For example, shareholders, once corporate taxes are paid on the businesses profits (FCIT), could allocate their portion of the distributed profits to a FUT.<sup>93</sup> These earnings do not need to be reinvested in the company which distributed them, rather they may be invested in approved FUT investments.<sup>94</sup> At that point the taxpayer is no longer liable to pay individual income tax on those profits until they elect to withdraw them from the FUT.<sup>95</sup>

### D. Potential Impacts to SMEs

The 2014 Tax Reform also contains substantial provisions specifically related to small and medium-sized enterprises (“SMEs”).<sup>96</sup> Medium-sized companies (sales up to approximately \$4,178,000 USD) would be able to deduct a percentage of their reinvested, undistributed profits.<sup>97</sup> Under the Attributed Income system that deductible percentage is limited to 20 percent of these earnings, whereas that ceiling rises to 50 percent under the Semi-Integrated system.<sup>98</sup> Regardless of the tax system, the deduction allowable to the enterprise is capped at approximately \$166,000 USD.<sup>99</sup> Furthermore, the taxpayer's income derived from participation in other companies, securities, and a variety of other sources may not exceed 20 percent of gross income to be eligible for the deduction.<sup>100</sup>

In reference to small businesses (up to approximately \$2,090,000 USD), these enterprises may elect to take part in a special tax system exempting themselves

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<sup>89</sup> *Id.*

<sup>90</sup> Scherzer, *supra* note 7, at 2; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

<sup>91</sup> Benítez, *supra* note 1, at 2 (explaining that the FUT was a special ledger that was required to keep track of retained profits and the corresponding tax credit); *see also* Benedikter, *supra* note 3, at 145.

<sup>92</sup> Benedikter, *supra* note 3, at 143; *see also* Scherzer, *supra* note 7, at 5 (explaining that a tax exemption, as opposed to a tax credit or a deduction, involves income or investment where tax is generally levied but thanks to a statutory exception, this particular type of activity is not taxed).

<sup>93</sup> Rosende, *supra* note 6, at 58.

<sup>94</sup> Rosende, *supra* note 6, at 58.

<sup>95</sup> *Id.* The FUT does not mean that they must reinvest the profits back in the distributing company, rather an investor may put the distributions into special FUT funds to gain the same benefit so long as it was less than 20 days after profits were distributed. *Id.*

<sup>96</sup> Scherzer, *supra* note 7, at 5.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

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from carrying full accounting books.<sup>101</sup> Additionally, these small enterprises would only be liable for taxes on their cash flows for that taxable year.<sup>102</sup> Furthermore, for entities that are owned exclusively by individuals, they may elect to be exempt from the FCIT.<sup>103</sup> Those who make the election will only be subject to the PIT on those amounts which they withdraw from the enterprise.<sup>104</sup>

Two more provisions that may have a substantial impact on SMEs are the reduction in the maximum sales thresholds for different business types, and the allowance of an immediate depreciation for fixed assets.<sup>105</sup> First, regarding the sales threshold, this drastic reduction will potentially bring many more enterprises into the taxable population base.<sup>106</sup> Additionally, the immediate depreciation provision applies to taxpayers at all earnings levels,<sup>107</sup> but it holds considerable weight to SMEs due to its ability allowing them to expand their physical capital assets at a rate and in a manner not previously achievable.<sup>108</sup> Unfortunately for these businesses, this provision has been eliminated in the revised reform and is unlikely to be resurrected in the current amendment negotiations.<sup>109</sup>

### IV. Analysis

#### A. The Connection of the CIT and the PIT

There are three main provisions in the tax reform that require further analysis, first, the PIT-CIT changes and what they mean for investment, growth and savings, second, the repeal of the FUT and its consequences, and third, particularly how this repeal will affect SMEs and what this could mean for growth and investment in Chile.<sup>110</sup> As this new tax regime does not borrow upon international experience in its provisions, it is difficult to determine, without any data and before implementation, if it has been a failure or success.<sup>111</sup> That being said, there is historical data regarding the increase in corporate tax rates and how it affects investment and growth, as well as how closing loopholes and tax avoidance strategies affects equality and efficiency.<sup>112</sup>

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<sup>101</sup> *Id.*

<sup>102</sup> *Id.* (stating that in this instance cash flows simply meaning revenue received and expenses paid).

<sup>103</sup> Scherzer, *supra* note 7, at 5.

<sup>104</sup> *Id.*

<sup>105</sup> Rodriguez-Delgado, *supra* note 4, at 32; *see also* Scherzer, *supra* note 7, at 5.

<sup>106</sup> Scherzer, *supra* note 7, at 5 (explaining that the reductions include limits of \$200,000 USD for transport business, \$375,000 USD for agriculture, and \$710,000 USD for mining).

<sup>107</sup> *Id.* This provision is only available for the first 12 months following the enactment of the reform for large and medium-sized enterprises. There is not a similar cutoff date for small enterprises on their physical capital investments. *Id.*

<sup>108</sup> Rodriguez-Delgado, *supra* note 4, at 33; *see also* Kramer, *supra* note 54, at 19.

<sup>109</sup> Scherzer, *supra* note 7, at 6.

<sup>110</sup> Rodriguez-Delgado, *supra* note 4, at 31.

<sup>111</sup> Victoria Alvarez & Renaud Roquebert, 2015: *The Time for Major Tax Reforms in Chile, Columbia, and Other South American Countries*, 44 INT'L LAW NEWS 2, 13 (2015).

<sup>112</sup> Rodriguez-Delgado, *supra* note 4, at 27; *see also* Benedikter, *supra* note 3, at 143.

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Turning first to the CIT increase coupled with the PIT decrease, it needs to be determined what their impact on investments and growth will be, as they are both subject to a great deal of scrutiny.<sup>113</sup> On the one hand, the decrease in the PIT alongside the elimination of the FUT may lead to increased investment in sectors and outside enterprises not previously a part of that allocation system.<sup>114</sup> Alternatively, the increase in the CIT could lead to a decline in investment and growth as companies will now have a higher tax burden.<sup>115</sup> This increased burden, coupled with the elimination of the FUT and its ability to reinvest working capital cheaply, could lead to increased leverage and decreased liquidity for businesses.<sup>116</sup>

Comparably, according to recent OECD and IMF studies, income taxes and social contributions (notably two of the main provisions of this tax reform) have the most adverse effects on investment and growth.<sup>117</sup> These studies also indicate that corporate taxes discourage capital accumulation and productivity improvement.<sup>118</sup> As the 2014 Tax Reform increases the CIT rate, companies will now face an increased tax burden, thereby inhibiting their potential level of capital accumulation.<sup>119</sup> The Chilean government refutes this argument pointing to the education reform agenda as a sufficient counterbalance.<sup>120</sup> They assert that any reduction in growth and investment will be stymied as the younger generation's increased educational options will lead to long-term growth and equity.<sup>121</sup> This goal is strengthened by the fact that the government has established a permanent connection between the tax income this reform is bringing in and the educational reform it is funding.<sup>122</sup>

### B. The Elimination of the FUT and How will that Effect SMEs

The most divergent area of opinion regarding the 2014 Tax Reform, however, is undoubtedly the repeal of the FUT.<sup>123</sup> The FUT allows for an easy (or at least more economical) means of reinvestment for companies and shareholders, while offering a simultaneous source of working capital of those undistributed profits.<sup>124</sup> On the other hand, the FUT has been labeled a system of tax evasion almost exclusively for the top-income earners, costing the government in terms

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<sup>113</sup> Rodriguez-Delgado, *supra* note 4, at 32-33; *see also* Kramer, *supra* note 54, at 17.

<sup>114</sup> Rodriguez-Delgado, *supra* note 4, at 33.

<sup>115</sup> *Id.*; *see also* Rosende, *supra* note 6, at 61.

<sup>116</sup> Rodriguez-Delgado, *supra* note 4, at 33; *see also* Rosende, *supra* note 6, at 61 (explaining that companies may now be forced to carry increased debt burdens and therefore have decreased liquidity due to that increase).

<sup>117</sup> Rodriguez-Delgado, *supra* note 4, at 27.

<sup>118</sup> *Id.*; *see also* Rosende, *supra* note 6, at 61.

<sup>119</sup> Rodriguez-Delgado, *supra* note 4, at 27; *see also* Rosende, *supra* note 6, at 61.

<sup>120</sup> Kramer, *supra* note 54, at 17.

<sup>121</sup> *Id.*

<sup>122</sup> Benedikter, *supra* note 3, at 143; *see also* Rodriguez-Delgado, *supra* note 4, at 34.

<sup>123</sup> Benedikter, *supra* note 3, at 150; *see also* Rosende, *supra* note 6, at 58.

<sup>124</sup> Rosende, *supra* note 6, at 58.

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of lost tax revenues and increased administration costs.<sup>125</sup> This tax exemption was of particular importance to SMEs who were able to avoid financing their activities and growth with debt, instead continuing to grow through direct reinvestment.<sup>126</sup> The FUT has been a fundamental part of the Chilean financial system since its inception, and it has undoubtedly helped growth and investment within the country.<sup>127</sup> In fact, it is estimated that at the end of 2013, resources in all of the FUTs totaled \$250 billion, an amount on par with Chile's GDP and its total savings.<sup>128</sup>

The Record of Profits will replace the FUT, and will differ depending on which of the new tax methods (either Attributed Income or Semi-Integrated system) the taxpayer has chosen.<sup>129</sup> By eliminating the FUT, these earnings will be taxed when distributed (regardless of whether they are reinvested), thereby creating additional present revenue for the government with an eye towards simultaneously eliminating and/or reducing tax avoidance and evasion.<sup>130</sup> President Bachelet recently stated that since the FUTs inception, the government has lost potential tax revenue of approximately \$50 million.<sup>131</sup> Moreover, the government states that the closing of the FUT along with the concurrent upgrade to infrastructure will incentivize innovation, consequently aiding growth and investment rather than inhibiting it.<sup>132</sup> However, Rodrigo Vergara Montes (the current President of the Chile's Central Bank), recently stated, while discussing the tax reform and the FUT, that the reform financed "permanent outcomes" (i.e. increasing education funding) "through permanent incomes" (i.e. the increase to CIT).<sup>133</sup> The FUT, therefore, was unnecessarily eliminated and the effects its removal could have on Chilean macroeconomic factors in the future will need to be closely monitored.<sup>134</sup>

As discussed previously, in terms of the increase in the CIT, income taxes have been found to have a negative correlation with investment and growth.<sup>135</sup> The eradication of the FUT is not a direct income tax increase like the CIT rate increase.<sup>136</sup> However, by eliminating the FUT as a reinvestment tool and subsequently taxing shareholders on the amount they would have reinvested the gov-

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<sup>125</sup> Kramer, *supra* note 54, at 17; *see also* Rosende, *supra* note 6, at 58.

<sup>126</sup> Rosende, *supra* note 6, at 61.

<sup>127</sup> *Id.* at 58; *see also* Benedikter, *supra* note 3, at 143 (explaining how the FUT helps growth and investment and posing the question "Is the FUT the Factual Basis for the Chilean Miracle?").

<sup>128</sup> Rosende, *supra* note 6, at 58.

<sup>129</sup> Benítez, *supra* note 1, at 2.

<sup>130</sup> Rosende, *supra* note 6, at 58-59; *see also* Kramer, *supra* note 54, at 17.

<sup>131</sup> Benedikter, *supra* note 3, at 143; *see also* THE ECONOMIST, *Reform in Chile: The Lady's for Turning*, *supra* note 62.

<sup>132</sup> Rosende, *supra* note 6, at 62.

<sup>133</sup> Benedikter, *supra* note 3, at 147.

<sup>134</sup> *Id.* at 143; *see also* Rosende, *supra* note 6, at 59.

<sup>135</sup> Rodriguez-Delgado, *supra* note 4, at 27-28.

<sup>136</sup> Rosende, *supra* note 6, at 59.

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ernment is increasing the tax burden those investors face.<sup>137</sup> In fact, as the maximum individual tax rate (for the top two tax brackets) will be 35 percent, it is reasonable to conclude that the maximum tax rate applicable to an investor would total up to 44.4 percent.<sup>138</sup>

Additionally, the elimination of the FUT will be disproportionately burdensome on SMEs as they are losing a major source of cheap, unleveraged working capital vital to expanding their enterprises.<sup>139</sup> The FUT is a simple exemption that allowed these SMEs and their shareholders to grow with reinvested working capital as opposed to costly external debt financing.<sup>140</sup> This advantage strikes a bold contrast with other developed and emerging economies and can reasonably be concluded to be a significant part of Chilean financial growth since its integration.<sup>141</sup> In fact, in 2004, Rodrigo Vergara Montes suggested that “macroeconomic evidence for the period of 1975-2003 in Chile indicates that the tax [law] explains an increase in private investment.”<sup>142</sup> Furthermore, larger enterprises will be able to compensate for this loss of working capital by increasing their debt burden and becoming more leveraged with only muted side effects, whereas SMEs will not be able to enjoy the same luxury of cheap debt financing.<sup>143</sup>

Joining in the chorus of dissents regarding the tax reform and especially the repeal of the FUT is the conservative group *Centro de Estudios Púlplicos* (“CEP”) led by their new director, Harald Beyer, who is closely tied to the “Chicago Boys.”<sup>144</sup> In response to the reform, Beyer wrote that the higher tax burden will only reduce the Gini coefficient by around 0.014 (or 1.4 percent) and almost exclusively affect the top 5 percent of income earners.<sup>145</sup> The CEP paper also outlines how, by their most recent estimates, the CIT increase and the elimination of the FUT will reduce the GDP by about 4.5 percent in the near term, inhibiting growth, investment, and savings.<sup>146</sup> However, as the FUT was a tax law and reinvestment strategy wholly unique unto itself, it is difficult to determine what effects its elimination will have at this time, but the projections of how it will affect investment and growth are worrisome at best.<sup>147</sup> Finally, the former Prin-

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<sup>137</sup> *Id.* at 59-61; *see also* Benedikter, *supra* note 3, at 145.

<sup>138</sup> Rosende, *supra* note 6, at 59; *see also* Ernst & Young Americas Tax Center, *supra* note 59, at 2.

<sup>139</sup> Benedikter, *supra* note 3, at 145, 150; *see also* Rosende, *supra* note 6, at 59, 61.

<sup>140</sup> Rosende, *supra* note 6, at 58.

<sup>141</sup> *Id.* at 58-59.

<sup>142</sup> Rodrigo Vergara Montes, *PUC Economics Institute Working Paper No. 268: Taxation and Private Investment: Evidence for Chile*, in INSTITUTO DE ECONOMÍA, PONTIFICIA UNIVERSIDAD CATÓLICA DE CHILE (PUC), 14, 14-15 (June 2004); *see also* Benedikter, *supra* note 3, at 144.

<sup>143</sup> R. Montes, *supra* note 142, at 14-15; *see also* Benedikter, *supra* note 3, at 143.

<sup>144</sup> Benedikter, *supra* note 3, at 147 (stating that Harald Beyer was the Minister of Education during the Piñera administration (2010-2014)).

<sup>145</sup> *Id.* The Gini coefficient is based on a scale of 0-1 (indicating percentages), where a Gini coefficient of 1 represents maximum inequality. *Id.*

<sup>146</sup> *Id.* at 148.

<sup>147</sup> *Id.* at 147.

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cipal Regional Adviser of UNELAC/CEPAL,<sup>148</sup> Ricardo Ffrench-Davis identified the issue as: “We are right in the middle of a discussion among the deaf. Some argue that the reform could affect primarily the small and medium-sized companies. Others claim exactly the opposite. There are opposite poles of the debate [on every detail].”<sup>149</sup>

Only furthering the debate is the fact that former Chilean Ministers of Finance have vastly different positions when it comes to eliminating the FUT.<sup>150</sup> Former Minister of Finance, Eduardo Aninat<sup>151</sup> stated that the elimination of the FUT, even if accomplished through a gradual elimination (i.e. over three to four years), is at the very least an imprudent reformation policy.<sup>152</sup> Aninat goes on to state that the government ignores that investment is a “dynamic variable” that is “characterized by risk.”<sup>153</sup> Therefore, the tax reform provides substantial risk for investment and growth to Chile and is coming at an inopportune time for Chilean enterprises and investors.<sup>154</sup> Furthermore, the elimination of the FUT would put a particular strain on Chile's Internal Revenue Service (“SII”) as they would need to collect detailed information regarding company structure, which could be particularly complicated for larger enterprises, rather than focusing on the application of new CIT and PIT rates.<sup>155</sup>

Additionally, the former Minister of Finance during President Bachelet's first term, Andrés Velasco<sup>156</sup> stated that elimination of the FUT involved “risks” and could ultimately have adverse effects on the middle class.<sup>157</sup> Velasco continued, reasoning that “the tax reform could lead to a threefold decrease of investment, growth, and job creation, and thus ultimately on savings.”<sup>158</sup> Velasco's address of the FUT and the negative effect its elimination will have on the middle-class could also be viewed as an opinion regarding SMEs.<sup>159</sup> These enterprises will most likely experience the greatest impact to profitability, investment, and

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<sup>148</sup> See About ECLAC, <http://www.cepal.org/en/about> (last visited Feb. 4, 2016) (United Nations Economic Commission for Latin America and the Caribbean).

<sup>149</sup> Benedikter, *supra* note 3, at 147.

<sup>150</sup> Benedikter, *supra* note 3, at 149-150.

<sup>151</sup> EDUARDO ANINAT, <https://www.imf.org/external/np/omd/bios/ea.htm> (last visited March 18, 2016). Minister Aninat served from 1994-2000 under the government of Eduardo Frei. *Id.* Aninat is also the former subsecretary of the IMF. *Id.*

<sup>152</sup> Benedikter, *supra* note 3, at 150; see also Aninat *por Reforma Tributaria: “¿Que hierba está fumando?”*, ECONOMÍA TERRA CHILE (Roland Benedikter & Katja Siepmann eds. trans., April 27, 2014) (explaining that under the current specific circumstances, i.e. recession in Latin America, falling commodity prices, and economic slowdown in China, eliminating the FUT is unnecessary).

<sup>153</sup> Benedikter, *supra* note 3, at 150; see also Economía Terra Chile, *supra* note 152.

<sup>154</sup> Benedikter, *supra* note 3, at 150; see also Rosende, *supra* note 6, at 61-62.

<sup>155</sup> Rodríguez-Delgado, *supra* note 4, at 33.

<sup>156</sup> ANDRÉS VELASCO, <https://sipa.columbia.edu/faculty/andr-s-velasco> (last visited March 18, 2016) Minister of Finance from 2006-2010 (President Bachelet's first term). *Id.*

<sup>157</sup> Benedikter, *supra* note 3, at 150; see also Cooperativa Chile: Andrés Velasco: *La reforma tributaria puede tocar el bolsillo de la class media*. (Roland Benedikter & Katja Siepmann eds. trans., May 5, 2014).

<sup>158</sup> Benedikter, *supra* note 3, at 150; see also Cooperativa Chile: Andrés Velasco, *supra* note 157.

<sup>159</sup> Benedikter, *supra* note 3, at 150.

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growth, and this in turn will affect the amount of revenue the government generates from these entities; it is only a matter of time until we see how adversely the repeal affects both sides of the equation.<sup>160</sup> Even savings decisions will be detrimentally affected as a tremendous long-term savings tool for investors and business-owners is being eradicated, limiting savings opportunities and potential returns for individuals.<sup>161</sup>

Contrasting this point-of-view, former Minister of Finance, Alejandro Foxley,<sup>162</sup> in support of eliminating the FUT, stated that the FUT has been a significant source of tax evasion.<sup>163</sup> He propositions that because of the abuses the FUT enables, it is the government's responsibility to eliminate the FUT.<sup>164</sup> This assertion is bolstered by the ongoing investigation (called Pentagate) into the Penta Group for passing along illegal payments to current and former officials, prior to and after elections.<sup>165</sup> The FUT was established as the first link when Chile's SII received an anonymous letter requesting an investigation of an SII official, spurring a new scandal, subsequently named FUT-Gate.<sup>166</sup> SII discovered that the employee made illicit changes in 2007 to previous tax declarations thus causing SII to return greater amounts to certain taxpayers than they were rightfully due.<sup>167</sup> It is instances like this that help provide the basis behind the FUT being eliminated.<sup>168</sup>

Therefore, the arguments surrounding the increase in the CIT, decrease in the PIT, the elimination of the FUT and how all of these changes particularly affect SMEs have a myriad of conflicting viewpoints and statistics to cite.<sup>169</sup> Unfortunately, Chile faces unique challenges exclusively within its borders (i.e. OECD-leading inequality and being China's largest provider of copper to name a few) in conjunction with the 2014 Tax Reform being largely incomparable to any other reforms on an international scale.<sup>170</sup> Even among three former Ministers of Finance, there are significant variations in each opinion as to the short, middle and long-term perspectives of the tax reform.<sup>171</sup> If the reform is in fact passed by the

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<sup>160</sup> Rosende, *supra* note 6, at 61-62.

<sup>161</sup> Rosende, *supra* note 6, at 61.

<sup>162</sup> ALEJANDRO FOXLEY, [http://carnegieendowment.org/experts/index.cfm?fa=expert\\_view&expert\\_id=448&prog=zgp&proj=zie](http://carnegieendowment.org/experts/index.cfm?fa=expert_view&expert_id=448&prog=zgp&proj=zie) (last visited March 18, 2016) (explaining that Foxley was a former Minister of Finance from 1990-1994 under the government of Patricio Aylwin. Foxley is currently the president of the influential think tank (based in Santiago) *Corporación de Estudios para Latinoamérica* (CIEPLAN)).

<sup>163</sup> Benedikter, *supra* note 3, at 150; *see also* Foxley *propone que reforma incentive compra de viviendas para la clase media*, EMOL (Roland Benedikter & Katja Siepmann eds. trans. May 17, 2014).

<sup>164</sup> Benedikter, *supra* note 3, at 150.

<sup>165</sup> Adriana Peralta, *Chile's Penta Case Pulls Dozens into Corruption Scandal*, PANAM POST (January 16, 2015) (explaining that this investigation includes former President Piñera and Andrés Velasco, along with current deputies, and other former presidential candidates).

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> Benedikter, *supra* note 3, at 150; *see also* Peralta, *supra* note 165.

<sup>169</sup> Benedikter, *supra* note 3, at 143, 146-150; *see also* Rosende, *supra* note 6, at 58-62.

<sup>170</sup> Ture, *supra* note 2, at 10; *see also* Rodriguez-Delgado, *supra* note 4, at 34.

<sup>171</sup> Benedikter, *supra* note 3, at 150.

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legislature, following the most recent round of amendments, it is uncertain what these reforms mean for Chile, but until that point, speculation will continue to pervade the conversation.<sup>172</sup>

### V. Proposal

Therefore, based on the analysis above it seems apparent that something needs to be changed in the 2014 Tax Reform to lessen the effect it has on SMEs, and keep portions of the FUT functional.<sup>173</sup> There are three basic options when it comes to the FUT: (1) Eliminate the FUT in-line with the current tax reform, (2) Keep the FUT as it currently exists, or (3) Amend the FUT by addressing tax evasion issues but keeping reinvestment provisions.<sup>174</sup> In terms of the increase in the CIT and its adverse effect on investment and growth, these provisions are most likely a necessary measure to reduce the rampant inequality in Chile.<sup>175</sup> It is important to note that Chile (pre-reform) has a lower CIT than the Latin American and OECD average, yet a higher PIT, and the reform is bringing Chile more in line with those averages.<sup>176</sup> However, increasing the tax burden on enterprises and potentially their investors through the increase in the CIT rate, while also simultaneously eliminating the FUT in its entirety, is an undue burden on investors and SMEs.<sup>177</sup> The FUT does need to be scaled back as the current investigation into Penta is only one indication of its potential misuse, however, it is too strong of an investment incentive and tool for entrepreneurs and innovators to be eliminated forthwith.<sup>178</sup>

One possible solution would be to eliminate the use of designated FUT funds and rather require the distributed profits to be reinvested within the distributing enterprise to be eligible for the FUT deduction.<sup>179</sup> This will be extremely useful, especially to SMEs as they will still be able to take full advantage of the FUT while simultaneously increasing their opportunity for working capital to be returned to them from any earnings they do distribute.<sup>180</sup> By implementing this solution, SMEs and all companies in Chile will be able to maintain a comparatively light debt burden, instead relying on their unique ability to use reinvestment from shareholders to build their business.<sup>181</sup> However, this solution does not fix the tax avoidance/evasion issue that the government was hoping to ad-

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<sup>172</sup> *Id.* at 143, 146-150; *see also* Rosende, *supra* note 6, at 58-62.

<sup>173</sup> Rodríguez-Delgado, *supra* note 4, at 34; *see also* Rosende, *supra* note 6, at 61-62.

<sup>174</sup> Benedikter, *supra* note 3, at 146, 150.

<sup>175</sup> Rodríguez-Delgado, *supra* note 4, at 33.

<sup>176</sup> Rodríguez-Delgado, *supra* note 4, at 32.

<sup>177</sup> Rosende, *supra* note 6, at 61; *see also* Benedikter, *supra* note 3, at 150.

<sup>178</sup> Benedikter, *supra* note 3, at 150.

<sup>179</sup> Rosende, *supra* note 6, at 61; *see also* Rodríguez-Kogan, Mauricio, *Andrés Velasco: "Proponemos que los balances del FUT paguen interés, porque es un préstamo que hace el Fisco"*, LA TERCERA (Feb. 2, 2013).

<sup>180</sup> Rosende, *supra* note 6, at 58, 61.

<sup>181</sup> *Id.*

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dress with the repeal of the FUT, as largely the same reinvestment and tax evasion opportunities would present themselves under this system.<sup>182</sup>

Another solution, first suggested by Andrés Velasco in 2013, would include a ceiling on non-taxable income, make investment abroad taxable, and subject the amount held in the FUT fund to carry an interest rate equal to the Treasury rate.<sup>183</sup> Under the current FUT law, the company is able to take advantage of the reinvested funds at a zero percent rate on the “loaned” money and avoid taxation until withdrawal.<sup>184</sup> The estimated gain in GDP by implementing the Treasury rate upon FUT funds is 0.3 percent; roughly half of what the estimate gain due to total elimination of the FUT was determined to be.<sup>185</sup> Velasco further identifies that Chile has a low individual savings rate, even with the FUT bolstering this rate by providing shareholders a means of savings.<sup>186</sup> By uniformly abolishing the FUT in its entirety, the government is eradicating one of the few incentives for savings and incentive in Chile.<sup>187</sup> Therefore, the FUT should survive this tax reform, either by one of measures outlined above or in another way.<sup>188</sup> The FUT is too vital and unique of an investment tool for Chilean investors and enterprises to be eliminated completely.<sup>189</sup>

### VI. Conclusion

While the 2014 Tax Reform is attempting to alleviate its OECD-leading income inequality gap, some of its provisions are misguided. The increase to the CIT and the decrease in the PIT are acceptable hindrances to efficiency in the name of equality, but need to be closely monitored to ensure they are not significantly adverse to investment and growth. However, the repeal of the FUT exemption in its entirety is too extreme as the FUT has been one of the leading reasons behind the level of investment and growth that Chile has experienced since 1984. By repealing the FUT completely, the Chilean government has placed an undue burden on SMEs as they are losing a significant source of working capital. As the FUT is an entirely unique tax exemption, it is very hard to predict how its repeal will affect the Chilean economy, but by cutting off a substantial source of cheap, reinvested capital, the repeal of the FUT will likely severely hinder Chilean enterprises, of all sizes.

Amendments could be made to the FUT, such as only allowing the distributed funds to be reinvested in the distributing company, or charging a very low rate of interest (Treasury rate) on those reinvested funds. Neither of these solutions,

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<sup>182</sup> Kramer, *supra* note 54, at 17, 19; *see also* Benedikter, *supra* note 3, at 150.

<sup>183</sup> Rodriguez-Kogan, *supra* note 179 (explaining that the Treasury rate would be the lowest possible rate a taxpayer could receive. The Treasury rate is the equivalent interest rate that the government must pay when debt rises).

<sup>184</sup> Rodriguez-Kogan, *supra* note 179.

<sup>185</sup> *Id.*; *see also* Rodriguez-Delgado, *supra* note 4, at 31.

<sup>186</sup> Rodriguez-Kogan, *supra* note 179.

<sup>187</sup> *Id.*; *see also* Rosende, *supra* note 6, at 61-62.

<sup>188</sup> Rosende, *supra* note 6, at 61-62; *see also* Rodriguez-Kogan, *supra* note 179.

<sup>189</sup> Rosende, *supra* note 6, at 61-62; *see also* Rodriguez-Kogan, *supra* note 179.

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however, eliminate the opportunity for the FUT to be used for tax evasion purposes. The FUT is too important of an investment and growth tool to be amputated completely; rather it needs to be adjusted in order to function at a high investment level while simultaneously eradicating the tax avoidance and evasion it proliferates. Once this balance is achieved, Chile will be able to address its inequality issues without unduly hindering growth and investment.



EL BLOQUEO AND SMALL BUSINESS:  
REVISITING TRADEMARK PROTECTIONS AMIDST CHANGING  
UNITED STATES-CUBA RELATIONS

Christian Morgan

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**I. Introduction**

The primary conflict discussed in this Note is the United States embargo against Cuba and its impact on the intellectual property rights—specifically, trademarks—of small businesses in both countries. The embargo (or “El Bloqueo” as it is called in Cuba), which is still in effect, is the most enduring trade embargo of modern history at fifty-five years and counting.<sup>1</sup> Despite President Obama’s announced moves to reestablish diplomatic relations and loosen economic policies, uncertainty runs rampant as the embargo still limits American

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<sup>1</sup> S. Tamer Cavusgil et al., *INTERNATIONAL BUSINESS: THE NEW REALITIES* 198 (2014). For the purpose of isolating and punishing a particular government for some disapproved policies or acts, an embargo is an official ban on exports and imports to and from the country of said government. *Id.* at 199. Other countries currently under a trade embargo include: North Korea since 2006, barred from importing luxury goods and arms; and Syria since 2011, barred from importing arms and other countries barred from importing Syrian oil. *Sanctions List Countries*, BUS. & SANCTIONS CONSULTING NETH. (Jan. 7, 2016), <http://www.bscc.nl/sanctions-consulting/sanctions-list-countries>.

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businesses—both small and large—from conducting business with Cuban interests.<sup>2</sup> Only an act by Congress can lift the embargo and end the half-century of disconnect and turmoil with this Caribbean island.<sup>3</sup>

This Note offers much needed practical perspective and guidance to those small businesses navigating trademark law in an embroiled United States-Cuban relationship. This article addresses two distinct groups: small *American* businesses seeking to expand into the (potentially) opening Cuban market and small *Cuban* businesses seeking recourse in American courts, as well as preparing for an unprecedented wave of competition.

Section II provides historical perspective for small American businesses on the development of Cuban trademark law—focusing on three successive epochs in Cuban history—and serves to highlight its intricacies both domestically and in relation to the United States. Beginning with the Spanish colonization, shifting to the Paris Convention, and then ending with the U.S. embargo against Cuba, Section II will provide the necessary backdrop to understanding Cuban trademark law today.

Section III is dedicated to the current state of Cuban trademark law and focuses on the effect of “El Détente” (which is the loosening and potential elimination of the economic embargo) on both American and Cuban small businesses alike. It offers guidance to American businesses seeking to register trademarks in Cuba, providing both legal and pragmatic analysis of the state of affairs and the outlook going forward. Section III concludes by arguing that, although United States-Cuba relations seem to be thawing, small American businesses should not yet register their trademarks in Cuba, as several key obstacles are in the way of lifting the embargo.

Section IV expands beyond Cuba and discusses international treaties and agreements, to which both Cuba and the United States are contracting parties, that affect trademark rights, registration, and procedures. Specifically, this section discusses the two countries involvement with the World Trade Organization and the Agreement on Trade-Related Aspects of Intellectual Property Rights. It will then highlight United States’ transgressions of these agreements and discuss the harmful consequences realized by Cuban trademark holders. Section IV concludes with guidance for those small Cuban businesses that seek recourse for trademark violations in American courts and elsewhere.

And lastly, Section V concludes this Note with general observations, key takeaways, and argues for the lifting of the economic embargo against Cuba and the continued effort to normalize relations between the two discordant nations.

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<sup>2</sup> James Stewart & Ashley Green, *Legal Alert: Change in U.S. Policy Towards Cuba*, DLA PIPER: RE: MARKS ON COPYRIGHT AND TRADEMARK (Dec. 22, 2014), <http://www.remarksblog.com/legal-alert-change-in-us-policy-towards-cuba/>.

<sup>3</sup> *Id.* (noting that although “President Obama announced plans to authorize certain types of travel to Cuba, exports of telecommunication devices and industrial materials to help build Cuba’s infrastructure, and the use of U.S. debit cards [ . . . ] these changes will not take effect immediately, and Congressional approval is also required [ . . . ].”).

## II. The Genesis of Cuban Trademark Law

Industrial property law<sup>4</sup> began to take its shape and form part of Cuban legislation during the nineteenth century.<sup>5</sup> Since its ratification of the Paris Convention for the Protection of Industrial Property of 1883 (“Paris Convention”) in 1904, Cuba has seen occupation, independence, revolution, political unrest, and isolation from the international community.<sup>6</sup> In order for any small business owner to understand Cuban trademark law as it stands today, and where it will be going forward, knowledge of the political and social influences exerted on Cuba throughout its history is critical.

### A. Pre-1904: Cuban Industrial Property Law in its Infancy

Cuban industrial property law originates, in the first instance, from Spanish colonization of the nation.<sup>7</sup> By 1833, fifty years before the first signatories ratified the Paris Convention, the Spanish Royal Decree established the first “legal instrument relating to Industrial Property rights” in Cuba.<sup>8</sup> In 1884, the first Legislation of Trademarks was adopted through another Royal Decree.<sup>9</sup> The driving force behind the implementation of the Legislation of Trademarks in Cuba was tobacco: “[the purpose of this legislation was to] assure the unquestionable trademark and product rights of individuals who invest their capital and dedicate their work to the industry of the production of tobacco.”<sup>10</sup>

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<sup>4</sup> “Industrial Property” is the term given to protective rights conferring an exclusive monopoly on exploitation and, unlike copyright, is obtained upon completion of filing and registration formalities. If copyright, otherwise known as literary and artistic property rights, which are obtained without filing formalities and arise simply from creative activity, is added to industrial property, the resulting whole forms intellectual property. WORLD INTELLECTUAL PROP. ORG., UNDERSTANDING INDUSTRIAL PROPERTY 3-5, [http://www.wipo.int/edocs/pubdocs/en/intproperty/895/wipo\\_pub\\_895.pdf](http://www.wipo.int/edocs/pubdocs/en/intproperty/895/wipo_pub_895.pdf) (last visited Jan. 8, 2016).

<sup>5</sup> *Que es la OCPI? Breve reseña histórica*, OFICINA CUBANA DE LA PROPIEDAD INDUSTRIAL, [http://www.ocpi.cu/quienes\\_somos/node/1012](http://www.ocpi.cu/quienes_somos/node/1012) (last visited Mar. 7th, 2016). [hereinafter OCPI].

<sup>6</sup> *The World Factbook: Cuba*, CENTRAL INTELLIGENCE AGENCY (2015), <https://www.cia.gov/library/publications/the-world-factbook/geos/cu.html>.

<sup>7</sup> Already in the first three decades of the nineteenth century every colony of Spain had been released save two: Cuba and Puerto Rico. OCPI, *supra* note 5. It was at this time that the Spanish monarch decided to give the Royal Decree of July 30, 1833, which extended an earlier decree granting privileges for inventions and improvements on the basis of the first Patent Act enacted in Spain in 1820. *Id.* This was followed by a long line of royal orders and decrees: the Royal Order of 1842 established provisions to allow review before the courts of the privileges granted to those who submitted false data, the Royal Order of 1849 which stated the manner and conditions of checking the implementation of inventions, aspects that were not well defined in the earlier Royal Decrees. *Id.* The Royal Order of 1849 provided that the demands of cancellation of privileges designed for reasons of lack of novelty were the jurisdiction of the ordinary courts. *Id.* This all set the stage for the first Legislation of Trademarks. *Id.*

<sup>8</sup> *Id.*; see also OFICINA INTERNACIONAL DE LAS REPÚBLICAS AMERICANAS, LEYES Y REGLAMENTOS SOBRE PRIVILEGIOS DE INVENCION Y MARCAS DE FÁBRICA EN LOS PAISES HISPANO-AMERICANOS, EL BRASIL Y LA REPÚBLICA DE HAITÍ 198 (Rev. Aug. 1904), available at <http://babel.hathitrust.org/cgi/pt?id=hvd.32044097780639;view=1up;seq=204> [hereinafter Oficina Internacional].

<sup>9</sup> OCPI, *supra* note 5. The draft decree was developed by the Colonial Secretary, Manuel Aguirre de Tejada, who presented it to the King of Spain, who believed that the development of the tobacco industry and the rise of their brands required effective protection. *Id.*

<sup>10</sup> Ana Cristina Carrera, *A Comparative Analysis of the Evolution of Trademark Law in Cuba and the Dominican Republic*, 96 J. PAT. & TRADEMARK OFF. SOC’Y 600, 605 (2014) (citing Oficina Internacional, *supra* note 8, at 198).

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Spanish colonization gave way, which, shortly thereafter, led to U.S. occupation.<sup>11</sup> Cuban industrial property law, still in its infancy, continued to develop—now under U.S. direction—during the brief U.S. occupation of Cuba in 1899.<sup>12</sup> Importantly, during this time the U.S. ordered that all industrial property rights granted in the U.S. also be protected in Cuba.<sup>13</sup>

In 1904, two years after its independence, Cuba ratified the Paris Convention, which signaled a turning point in Cuban industrial property law and pushed the nation to establish its first autochthonous law on industrial property by 1936.<sup>14</sup> Understanding this interplay of Spanish colonization and U.S. occupation illuminates the underpinnings of today's complex Cuban trademark law.

### B. The Paris Convention: Modernization of Cuban IP Rights

Modern Cuban industrial property law traces back to 1904, when Cuba ratified the Paris Convention.<sup>15</sup> The Paris Convention, a multilateral intellectual property agreement, was among the first of its kind.<sup>16</sup> It was also the first contact developing countries, such as Cuba, had with international industrial property laws.<sup>17</sup>

The goal of the Paris Convention was to harmonize the diverse and, at often times, conflicting industrial property laws of countries throughout the world.<sup>18</sup> Prior to the Paris Convention, it was exceedingly difficult to provide consistent protection—or protection at all—for industrial property because of the varying laws among the countries of the world.<sup>19</sup> The Paris Convention, in turn, sought to protect patents, trade names, and trademarks.<sup>20</sup> In addition, the Paris Conven-

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<sup>11</sup> OCPI, *supra* note 5.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* American intervention also introduced changes by way of setting the term of patent validity to seventeen years as well as setting the amount of concession rights to thirty-five pesos.

<sup>14</sup> Oficina Internacional, *supra* note 8.

<sup>15</sup> Carrera, *supra* note 10.

<sup>16</sup> Carolyn Deere-Birkbeck, *Developing Countries in the Global IP System before TRIPS: The Political Context for the TRIPS Negotiations*, in RESEARCH HANDBOOK ON THE PROTECTION OF INTELLECTUAL PROPERTY UNDER WTO RULES 22, 25 (Carlos M. Correa ed., 2010).

<sup>17</sup> In fact, Cuba was among the first developing countries in the Americas to ratify the Paris Convention. *Paris Convention for the Protection of Industrial Property*, WIPO, [http://www.wipo.int/wipolex/en/wipo\\_treaties/details.jsp? treaty\\_id=2](http://www.wipo.int/wipolex/en/wipo_treaties/details.jsp? treaty_id=2) (last visited Jan. 10, 2016). Cuba acceded to the Paris Convention for the Protection of Industrial Property Rights of 1883 on September 22, 1904. *Id.* The Paris Convention went into force in Cuba on November 17, 1904. *Id.* Also among some of the first countries to ratify the Paris Convention for the Protection of Industrial Property of 1883 were the United States in 1887, Brazil in 1884, and Mexico in 1903. *Id.*

<sup>18</sup> *Summary of the Paris Convention for the Protection of Industrial Property*, WIPO, [http://www.wipo.int/treaties/en/ip/paris/summary\\_paris.html](http://www.wipo.int/treaties/en/ip/paris/summary_paris.html) (last visited Jan. 10, 2016) [hereinafter Paris Convention Summary].

<sup>19</sup> See generally Seth M. Reiss, *Commentary on the Paris Convention for the Protection of Industrial Property*, LEX-IP.COM, <http://www.lex-ip.com/Paris.pdf> (last visited Feb. 25, 2016) (“Prior to the Convention, those wanting protection for inventions in multiple countries needed to file patent applications in all such countries simultaneously, and needed to do so prior to any publication or exhibition of the invention at a trade fair, in order to avoid the unintentional loss of eligibility of patent protection in one or more of the countries.”).

<sup>20</sup> Paris Convention Summary, *supra* note 18.

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tion sought to protect, promote, and indeed mandate, the ideals of fair competition.<sup>21</sup>

Regarding trademarks, some of the major provisions of the Convention include national treatment, right of priority, and common rules to be had among the contracting States (those States that ratified the agreement).<sup>22</sup> National treatment of industrial property, as the Paris Convention provides, mandates that “each contracting State must grant the same protection to nationals of the other contracting States as it grants to its own nationals.”<sup>23</sup> The Paris Convention further provides that each contracting State must grant the same protection to nationals who are not from a contracting state but are instead domiciled in a contracting State or, alternatively, have an industrial or commercial business in the contracting State.<sup>24</sup>

As to trade names, a national of a contracting State registering her mark cannot be denied such registration, “unless, for example, the mark would infringe on third party rights, would be contrary to morality or public order, would deceive the public, or was obtained without authorization.”<sup>25</sup>

Important for small businesses, the Paris Convention is still in effect and currently has 176 contracting parties, including both the United States and Cuba.<sup>26</sup>

After Cuba’s ratification and adoption of the Paris Convention, Cuba began to focus on the development of its own IP laws, but saw little change for over thirty years, until 1936 when Cuba established its first autochthonous law on industrial property.<sup>27</sup> Then, in 1983, Cuba’s Law No. 68 of Scientific Inventions, Industrial Designs, Trademarks, and Appellations of Origin repealed the 1936 industrial property laws.<sup>28</sup> Finally, in response to Cuba’s ratification of the agreement

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<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> Carrera, *supra* note 10, at 601-02 (citing Paris Convention Summary, *supra* note 18).

<sup>26</sup> *WIPO-Administered Treaties > Contracting Parties/Signatories > Paris Convention*, WORLD INTEL. PROP. ORG., [http://www.wipo.int/wipolex/en/wipo\\_treaties/parties.jsp?treaty\\_id=2&group\\_id=1](http://www.wipo.int/wipolex/en/wipo_treaties/parties.jsp?treaty_id=2&group_id=1) (last visited Jan. 10, 2016).

<sup>27</sup> Oficina Internacional, *supra* note 8.

<sup>28</sup> *Cuba*, WIPO, <http://www.wipo.int/fypolex/en/profiIe.jsp?code=CU> (last visited Jan. 10, 2016). Law No. 68 defined trademarks as all “signs, words, name or material medium, whatever their class, form and color, that identifies and distinguishes products or services from others of the same class.” Decreto-Ley N° 68 (May 14, 1983) de invenciones, descubrimientos científicos, modelos industriales, marcas y denominaciones de origen, art. 134-135, May 14, 1983 (Cuba) (Ana Cristina Carrera trans.), available at [http://www.wipo.int/wipolex/en/text.jsp?file\\_id=241337](http://www.wipo.int/wipolex/en/text.jsp?file_id=241337). That which was excluded from trademark protection include trademarks that were composed solely of “coat of arms, flags, signs, hallmarks, insignias, honorary titles, national or foreign decorations or other emblems of States, governments, social and mass organizations or intergovernmental organizations, names or images of officials, leaders, or national heroes.” *Id.* at art. 139. Furthermore, Law No. 68 mandated the use of a trademark within three years after the approved registration with a lifespan of ten years, subject to renewal. *Id.* at art 141, 145. In addition, it stated that “geographic indications belong to the national heritage,” and that only Agencies of the Central Administration of the State, Businesses, Provincial and Municipal Organs of the Populist Power, Small Farmers, and Agricultural Cooperatives could solicit the registration of a geographic indication. *Id.* at art.164, 167.

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establishing the World Trade Organization and the TRIPS Agreement<sup>29</sup> in 1995, Law No. 203 of Trademarks and Other Distinctive Signs—which remains in effect as Cuban domestic trademark law today—repealed Law No. 68 in 1999.<sup>30</sup>

The Madrid Agreement Concerning the International Registration of Marks, the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks, and the Trademark Law Treaty helped to shape Law No. 203.<sup>31</sup> Those seeking to register trademarks in Cuba must note that the law implemented major changes to Cuban IP law.<sup>32</sup> For example, Law No. 203 defines trademarks as:

(1) (a) denominative signs such as letters, words, numbers and all combinations of these signs; b) figurative signs such as images, figures, drawing, symbols, and graphics, like color, as long as it is delimited by a given form, and the combination of colors; c) mixed signs from the combination of words and figurative marks; d) three-dimensional shapes, provided that the products can be delimited, including wrappings, packaging, the products shape, or the products presentation; e) smells; f) the sounds and combinations of sounds; and (2) The names of specific individuals can be word signs, as long as authorization is given, expressed by public document and it does not cause confusion or mislead the public.<sup>33</sup>

In order to facilitate the registration process, which had become convoluted and ineffectual, Law No. 203 also created the Cuban Office of Industrial Property.<sup>34</sup> In addition, the application of the International Classification of Goods and Services for the Registration of Marks, established by the Nice Agreement, became mandatory.<sup>35</sup> Modernization of its trademark laws, registration, and procedures sought to streamline and encourage new businesses to protect their assets through Cuban IP law in what should have been the country's economic emergence. Instead, the U.S. trade embargo against Cuba, coupled with the Cuban regime's own actions, ensured a downward economic spiral of over fifty years.

### C. El Bloqueo: Effects of the U.S. Embargo Against Cuba on Trademark Rights

The embargo, which is currently in effect in the United States, is the single greatest factor that affects how businesses—both large and small—deal with and inside of Cuba. Essential to successful, and sanction free, operation of any busi-

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<sup>29</sup> See *infra* pp. 17-21.

<sup>30</sup> OCPI, *supra* note 5; Decreto- Ley NO. 203 De Marcas Y Otros Signos Distinctivos, art. 2, May 2, 2000 (Cuba) (Ana Cristina Carrera trans.) [hereinafter Law No. 203].

<sup>31</sup> Yosleidys I. Gonzalez et al., *Legislation de marcas en Cuba: Consideraciones esenciales*, GESTIOPOLIS (2006), <http://www.gestiopolis.com/canales7/mkt/brand-legislacion-sobre-las-marcas.htm> (last visited Jan. 10, 2016).

<sup>32</sup> See *supra* note 28 and accompanying text.

<sup>33</sup> Law No. 203, *supra* note 30, at art. 3.1.

<sup>34</sup> Gonzalez et al., *supra* note 31.

<sup>35</sup> Law No. 203, *supra* note 30, at art 10.

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ness dealing with Cuban interests requires keen awareness and relentless attention to the intricacies of the embargo.

Beginning in 1963, the U.S. imposed a commercial, economic, and financial embargo on Cuba.<sup>36</sup> The imposition of the embargo was the American response to the Cuban government, specifically the Castro Regime, appropriating and nationalizing the property of United States citizens and corporations.<sup>37</sup> That same year, the United States also established the Cuban Assets Control Regulations (CACR).<sup>38</sup> The CACR “prohibits persons subject to U.S. jurisdiction from engaging in transactions involving property where Cuba or a Cuban national has an interest, including transactions related to travel, trade, and remittances, without authorization, that is a government license from the Treasury.”<sup>39</sup> But, the CACR did authorize a general license for transactions related to the “renewal of patents, trademarks, and copyrights in which the Cuban government or a Cuban national has interest.”<sup>40</sup>

Then, however, under the Section 211 of the Omnibus Appropriations Act of 1998 (“Section 211 of the Omnibus Act”), the U.S. prohibited courts from “considering or enforcing trademark claims of Cuban national[s], or their successors in interest, regarding property confiscated by the Cuban government.”<sup>41</sup> Section 211 of the Omnibus Act has had a consistent, ongoing negative impact on holders of Cuban trademarks.<sup>42</sup>

Section 211 compounded an already difficult Cuban economic climate that was struggling due to the U.S. Cuban Liberty and Democratic Solidarity Act (“Helms-Burton Act”) of 1996, which strengthened and continued the U.S. embargo against Cuba.<sup>43</sup> Seeking to fiscally asphyxiate the Cuban government, the oft-maligned Helms-Burton Act—which remains in effect today—extends the territorial application of the embargo to also apply to foreign companies trading with Cuba.<sup>44</sup> It also penalizes foreign companies for allegedly “trafficking” property formerly owned by U.S. citizens.<sup>45</sup> In short, the Helms-Burton Act attempts to further isolate Cuba by forcing foreign companies to choose between

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<sup>36</sup> Melisa Rivière, *What Does the US-Cuba Détente Mean for the Culture Industries and Ethnographic Praxis?*, EPIC (Jan. 23, 2015), <https://www.epicpeople.org/us-cuba-detente/>.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-951R, U.S. EMBARGO ON CUBA 1, 4 (2009), <http://www.gao.gov/products/CAO-09-951R> (last visited Jan. 16, 2016).

<sup>40</sup> *Id.* at 23.

<sup>41</sup> *Id.*

<sup>42</sup> *See infra* p. 14.

<sup>43</sup> Rivière, *supra* note 36. Until 1991, Cuba's primary trading partner since its revolution had been the Soviet Union. *Id.* When Soviet President Mikhail Gorbachev resigned and declared his office extinct, signaling the fall of the Soviet Union, Cuba saw immediate economic contraction. *Id.* During this economic contraction, which was called the “Special Period in Time of Peace (or “Período especial” in Spanish), Cubans endured electrical black outs, transportation shortages, and water rationing. *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

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the United States and Cuba.<sup>46</sup> In this regard, the Helms-Burton Act has been successful. Small businesses have been forced to side with the United States in order to avoid stiff sanctions that threaten to ruin its continued success.<sup>47</sup>

No executive order can undo the embargo or the Helms-Burton Act; both are retractable only by a majority vote in Congress.<sup>48</sup>

### III. The Freeze Thawing? El Détente and the Shift in United States-Cuba Relations

Despite the end of the Cold War, an ideological and political conflict endured and continued to hinder relations between the U.S. and Cuba for over fifty years.<sup>49</sup> But, in light of increased international outcry regarding the United States' treatment of Cuba, especially the embargo, the potential lift of the embargo is becoming an even hotter hot-button in the American political sphere.

#### A. The Obama Administration and the Theoretical Underpinnings Spurring Normalization

Perhaps in response to the overwhelming international backlash and the growing collective voice of small business owners advocating for an open market with Cuba, the Obama Administration released Cuba's political prisoners in December 2014 and proposed to normalize diplomatic relations between the two countries.<sup>50</sup>

In one of the first steps toward normalization, President Obama, using his executive powers, has eased travel restrictions for Americans to Cuba.<sup>51</sup> For example, recent amendments to the Office of Foreign Assets Controls (OFAC) regulations permit travel to Cuba for professional research and meetings.<sup>52</sup> In fact, President Obama himself visited the island, becoming the first sitting U.S. President to do so since Calvin Coolidge in 1928.<sup>53</sup> And although U.S. travelers

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<sup>46</sup> *Id.*

<sup>47</sup> Rupinder Hans, *The United States' Economic Embargo of Cuba: International Implications of the Cuban Liberty and Democratic Solidarity Act of 1995*, 5 J. Int'l L. & Prac. 327 (1996).

<sup>48</sup> See Section 211 of the Omnibus Appropriations Act of 1998.

<sup>49</sup> Rivière, *supra* note 36.

<sup>50</sup> *Id.*

<sup>51</sup> While the U.S. eases travel restrictions, Cuba braces for the massive influx of tourism and business. Rivière, *supra* note 36. The Associated Press reports that Cuba is unprepared to handle the massive wave of U.S. travelers expected in 2015 and beyond, which will lead to greater development of the private sector and the micro-economies independent of the state-government. Michael Weissenstein & Andrea Rodriguez, *Obama's New Cuba Policy Depends Partly On Hotel Hand Towels*, ASSOCIATED PRESS (Jan. 16, 2015), <http://bigstory.ap.org/article/2e54d8617d5d429e8ed4bdaf658fcdc4/obamas-new-cuba-policy-depends-partly-hotel-hand-towels>.

<sup>52</sup> Amendments to section 515.564 of the Cuban Assets Controls Regulations published January 16, 2015. The amendments also permit travel to Cuba for education activities (515.565), support for the Cuban people (515.574), humanitarian projects (515.575), public performances or athletic competitions (515.567), and activities of private foundations or research and educational institutes (515.576).

<sup>53</sup> Tanya Somanader, *Big News: President Obama is Headed to Cuba*, WHITEHOUSE.GOV BLOG (Feb. 18, 2016, 7:01 PM), <https://www.whitehouse.gov/blog/2016/02/18/big-news-president-obama-headed-cuba>.

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are still required to go on supervised group trips, U.S. companies and organizations are now able to design such trips without the lengthy documentation and inspections that OFAC previously required.<sup>54</sup> Furthermore, amendments to CACR have legalized the use of U.S. debit and credit card transaction on the island as well as facilitate institutional banking transactions.<sup>55</sup> This is especially important for small businesses in the area geared toward lodging, food, and entertainment, which all will undoubtedly experience a new boom.<sup>56</sup>

For many large companies and organizations that have been trying to get into Cuba, these recent and rather sudden changes by the Obama Administration come at a great surprise.<sup>57</sup> In 2014, the beverage company Red Bull was fined for failing to get travel authorization to Cuba to film a documentary.<sup>58</sup> Carlson Wagonlit Travel and American Express paid \$5.9 million and \$5.2 million, respectively, to the U.S. Treasury Department after they violated the embargo when they booked travel to Cuba from third-party countries.<sup>59</sup>

Regardless, the changes seem to be spurred by U.S. companies, both small and large, that do not want to be left out of prime, and now burgeoning, the Caribbean investment prospects that Cuba now offers.<sup>60</sup> Private property is becoming more and more available to businesses as Cuba seeks to rectify the confiscation of such property dating back to before the embargo of 1963, which is a key indicator of lasting change.<sup>61</sup> Notwithstanding, it is easy to confuse movement with action, and as any Cuban artist will tell you, change comes slow for Cuban IP laws.

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<sup>54</sup> Rivière, *supra* note 36.

<sup>55</sup> Amendments to section 515.584 of the Cuban Assets Controls Regulations published January 16, 2015.

<sup>56</sup> Rivière, *supra* note 36. (“Small businesses geared toward providing lodging, food and entertainment such as bed and breakfasts, restaurants, salons, cabarets, and guided tours will experience a new boom. In order to be competitive in the market they will also be looking to upgrade their standards (from toilet paper to flat screen televisions) in order to draw clientele.”). American agricultural companies also stand to experience a new boom in their economy with sales of products and farming equipment in the Cuban market. *Id.* U.S.-based agricultural companies, as well as the United States Agriculture Coalition for Cuba, stated purpose are to “re-establish Cuba as a market for U.S. food and agricultural exports.” UNITED STATES AGRICULTURE COALITION FOR CUBA, <http://www.usagcoalition.com/> (last visited Jan. 9, 2016).

<sup>57</sup> *Id.*

<sup>58</sup> Patrick M. Sheridan, *Red Bull Settles with U.S. on Cuba Violations Claims*, CNNMONEY (June 27, 2014, 4:04 PM), <http://money.cnn.com/2014/06/27/news/companies/red-bull-cuba/>.

<sup>59</sup> Gay Nagle Myers, *Carlson Wagonlit to Pay Fine for Unlawful Cuba Bookings*, BUS. TRAVEL NEWS (Apr. 23, 2014), <http://www.businesstravelnews.com/Business-Travel-Agencies/Carlson-Wagonlit-To-Pay-Fine-For-Unlawful-Cuba-Bookings/?ida=Travel%20Mgt%20Companies&a=trans>; Peter Orsi, *Cuba Criticizes U.S. Embargo Fine for AmEx, Bank*, ASSOCIATED PRESS (July 30, 2013, 3:52 PM), <http://bigstory.ap.org/article/cuba-criticizes-us-embargo-fine-amex-bank>.

<sup>60</sup> Stewart, *supra* note 2.

<sup>61</sup> Damien Cave, *Cuba to Allow Buying and Selling of Property, With Few Restrictions*, N.Y. TIMES (Nov. 3, 2011), <http://www.nytimes.com/2011/11/04/world/americas/cubans-can-buy-and-sell-property-government-says.html?pagewanted=all>.

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### B. Learning from the Artists: Treatment of Cuban Copyrights as a Comparator

As changes are on the horizon (with the untapped Cuban market ready to open its doors to America once again), small businesses planning to expand and take advantage of the Cuban market must plan now to ensure long-term success. Of key importance to establishing a foothold in the Cuban market, is the registration of one or more trademark on branding such as the business's name, logo, and/or slogan. However, when to register such trademarks is a bit of a gambling game that businesses will have to play over the next several months and years. If the business owner waits too long, a competitor has the opportunity to register the mark first, causing her to lose market share, potential revenue, and time spent developing a brand in that market. On the other hand, if the business registers too early, then it runs the risk of paying unnecessary registration and maintenance fees or even losing the mark due to abandonment if U.S.-Cuba relations take a turn for the worse. A look at the treatment and evolution of copyrights is illustrative of a possible timeline for business owners as they await change in the context of trademark law.

The treatment of copyright (and trademark) registration reveal fundamental differences between the United States and Cuba—that is, between capitalism and socialism—regarding labor, private property, and social equality.<sup>62</sup> This was evident when Fidel Castro, in an attempt to socialize the nation, removed individual intellectual property rights.<sup>63</sup> Thus, under Fidel's Marxism-Leninism regime, authorship became property of the state, making independent artists everywhere nothing more than “cultural laborers.”<sup>64</sup> Regarding copyrights, Cuban authors were no longer entitled to royalties from their American publishers and distributors, which was further justified by the U.S. embargo.<sup>65</sup> This allowed American publishers and distributors to “hyper-capitalize” on Cuban copyrights.<sup>66</sup>

However, in 1974, Cuba joined the United Nations World Intellectual Property Organization (WIPO).<sup>67</sup> Cuba's inclusion in WIPO led the U.S. to lift restrictions and reestablish copyright payments to Cuban copyright owners, also known as the “informational material exemption” found in § 2502(a) of the Omnibus Trade and Competitiveness Act.<sup>68</sup> However, this only came fourteen years later in 1988.<sup>69</sup> Today, royalty payments and registrations of copyrights are synchro-

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<sup>62</sup> Rivière, *supra* note 36.

<sup>63</sup> *Id.*

<sup>64</sup> Rivière, *supra* note 36.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> Ariana Hernández-Reguant, *Copyrighting Che: Art and Authorship Under Cuban Late Socialism*, 16 *PUB. CULTURE* 1, 1-29 (2004).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

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nizing between the U.S. and Cuba,<sup>70</sup> which is facilitating an unprecedented cultural exchange.<sup>71</sup>

A quick look at the past, and an examining look at the present state of affairs, reveals that changes now may only be the beginning of a long road. For small business owners, this should be a signal that now is still not the right time to register a trademark in Cuba.<sup>72</sup> Fees and expenses to such registration can quickly become cost prohibitive; especially considering that conducting business with the island is still prohibited, thus reducing the return on investment to little or nothing for the foreseeable future.<sup>73</sup> In addition, if the trademark is not used in Cuba within three years of the date of registration, or has not been used for a continuous period of three years—which, for American businesses, will be the case until a formal act by Congress—it may be subject to cancellation.<sup>74</sup>

### C. Recognizing the Need to Address Unresolved Issues

Recognizing the issues that Cuba still needs to resolve, as well as the uncertainty with the upcoming election cycle, a formal act by Congress lifting the embargo might not soon be on the political horizon.

#### 1. *International Human Rights Violations*

To be sure, Cuba has committed serious crimes against its own people.<sup>75</sup> From abridging the rights of free press and free speech by imprisoning opposition journalists and political dissenters,<sup>76</sup> to widespread corruption of political officials, law enforcement, and the like, Cuba has committed obvious human rights

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<sup>70</sup> Travel-related transactions to, from, and within Cuba by persons subject to U.S. jurisdiction, 31 C.F.R. § 515.560 (2015).

<sup>71</sup> Randy Kennedy, *Bronx Museum of the Arts Plans Exchange With Cuba*, N.Y. TIMES (Jan. 21, 2015), [http://mobile.nytimes.com/2015/01/22/arts/design/bronx-museum-plans-ambitious-art-exchange-with-cuba.html?\\_r=1&referrer](http://mobile.nytimes.com/2015/01/22/arts/design/bronx-museum-plans-ambitious-art-exchange-with-cuba.html?_r=1&referrer). For example, Cuba's Museo Nacional de Bellas Artes (National Museum of Fine Arts) and the Bronx Museum of Art had one of the largest exchanges of collections in over fifty years in the summer of 2015. *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Trademark Registration in Cuba*, HUNTON & WILLIAMS, LLP (2015), <https://www.hunton.com/files/News/0cd4acf2-b112-41b9-bb95-8bc12ef1ba91/Presentation/NewsAttachment/aa3a6fa4-f882-4ed9-a4e4-9179ef61cf7c/trademark-registration-cuba.pdf> (explaining that those seeking to file a national trademark in Cuba must use the assistance of an official local agent, pay a fee for the formal examination process, pay a fee to register the mark—if the application is accepted—as well as renewal fees thereafter; not to mention attorney's fees and expenses).

<sup>74</sup> *Id.*

<sup>75</sup> U.S. DEP'T OF STATE, BUREAU OF DEMOCRACY, HUMAN RIGHTS AND LABOR, CUBA 2014 HUMAN RIGHTS REPORT 12 (2014), <http://www.state.gov/documents/organization/236892.pdf> [hereinafter Cuban Human Rights Report].

<sup>76</sup> See Julie Hirschfeld Davis & Damien Cave, *A 'New Day' of Openness, Taxed By Old Grievances*, N.Y. TIMES, Mar. 22, 2016, at A1. Cuban President Raúl Castro, while meeting with President Obama in Cuba, engaged with various reporters after one asked about dissidents his government has arrested. *Id.* Playing possum, President Castro asked, "what political prisoners?" *Id.* President Castro then "sought to turn the human rights criticism on the United States, arguing that countries that do not provide universal health care, education and equal pay are in no position to lecture Cuba." *Id.*

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violations.<sup>77</sup> However, the United States continues to use these violations as justification for invalidating and/or not enforcing Cuban trademarks in the U.S. and for its anti-Cuban laws, including the trade embargo, despite evidence that the embargo only exacerbates Cuba's problems.<sup>78</sup>

The United States' long-running embargo against Cuba stands out as a vivid illustration, experts argue, that coercive economic measures tend to exacerbate economic inequality, encourage corruption, spawn black markets, and stoke nationalistic sentiments that strengthen the hand of oppressive regimes.<sup>79</sup> In fact, U.S. measures have had little to no impact on persuading the Cuban government to release its political prisoners or take any other action to comply with international human rights laws.<sup>80</sup> On the other hand, U.S. measures have significantly burdened economic development and access to things such as effective medical care.<sup>81</sup> Furthermore, the United Nations Human Rights Commission found that the economic embargo prevented Cuba from introducing political reforms.<sup>82</sup> And finally, allies of the United States, and even the United Nations, have continually and increasingly urged the U.S. to repeal the embargo.<sup>83</sup>

### 2. Political Opposition and Uncertainty

Another impediment is political opposition that has curtailed any legitimate attempt to outright lift the Cuban embargo.<sup>84</sup> Lifting the embargo has only recently re-emerged as a hot-button issue with candidates, and has not seen much agreement to date.<sup>85</sup> Aside from efforts by the Obama Administration, there should be broad negotiations with Cuba. In the past, the U.S. has negotiated with repressive regimes like Vietnam, North Korea, and China; but U.S. officials say that in those instances the U.S. had important strategic interests to safeguard, which are not present in Cuba.<sup>86</sup>

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<sup>77</sup> Cuban Human Rights Report, *supra* note 75, at 12.

<sup>78</sup> Hans, *supra* note 47, at 327.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*; see also Davis & Cave, *supra* note 76, at A1 (noting President Castro's comment that the Embargo was "the most important obstacle to [Cuba's] economic development and the well-being of the Cuban people.").

<sup>82</sup> *Id.*

<sup>83</sup> Evan J. Criddle, *Standing for Human Rights Abroad*, 100 CORNELL L. REV. 269 (2015); U.N. Secretary-General, *Necessity of Ending the Economic, Commercial and Financial Embargo Imposed by the United States Against Cuba*, 27, U.N. Doc. A/RES/67/4 (Jan. 29, 2013); AMNESTY INT'L, *The U.S. Embargo Against Cuba: Its Impact on Economic and Social Rights* 13-19 (2009), <http://www.amnesty.org/en/library/info/AMR25/007/2009> [hereinafter Amnesty Report].

<sup>84</sup> Sahil Kapur, *Congress Stands in the Way of Lifting the U.S. Embargo on Cuba*, TALKINGPOINTSMEMO.COM (Dec. 17, 2014, 1:02PM), <http://talkingpointsmemo.com/dc/cuba-embargo> (noting scathing criticisms from U.S. senators regarding President Obama's attempts to normalize relations by establishing a U.S. embassy in Cuba; for example, Senator Marco Rubio, who is of Cuban descent, who said that he is "committed to doing everything [he] can to unravel as many of these changes as possible.").

<sup>85</sup> *Id.*

<sup>86</sup> Amnesty Report, *supra* note 83, at 13-19.

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In the meantime, President Obama is using his executive powers to ease travel restrictions.<sup>87</sup> Nonetheless, even these steps toward change can be just as quickly undone by the next administration as long as the economic embargo remains in place and in the hands of Congress, which will likely defer any such major vote until after the 2016 Presidential Election.<sup>88</sup> Like many social (and even economic) battles, the greatest assurance of bilateral cooperation and long-term normalization remains at the grassroots level—with the collective voices of the American small business owners urging its legislature to readdress the trade embargo issue, and seek new ways of political resolution. These will be the defining features of the new era of U.S.-Cuba relations.

### IV. An Unharmonious International Regime: The WTO, TRIPS and U.S. Disregard of Treaty Obligations

Although both the U.S. and Cuba are members of the TRIPS Agreement and the Paris Convention, Section 211 has allowed U.S. courts to permit infringement of Cuban trademarks, as evidenced by *Havana Club Holding, S.A. v. Galleon S.A.*, and *Empresa Cubana del Tabaco v. Culbro*.<sup>89</sup>

#### A. The Transfer of Non-existent) Rights and Havana Cuba

In *Havana Club Holding, S.A.*, the plaintiff (HCH) was a joint stock company organized under the laws of Cuba.<sup>90</sup> HCH owned the “Havana Club” trademark in certain countries outside of the US.<sup>91</sup> However, the “Havana Club” trademark had been owned by Jose Arechabala, S.A (JASA), a Cuban corporation.<sup>92</sup> JASA owned the mark before Castro’s government seized and expropriated the company’s assets in 1960.<sup>93</sup> After Cuba seized and expropriated JASA’s assets, Cubaexport, a Cuban state enterprise, registered the “Havana Club” trademark with the USPTO in 1976.<sup>94</sup> Although unable to export any of its products to the United States, Cubaexport registered with the USPTO with the intent to begin export to the U.S. if and when the embargo was lifted.<sup>95</sup> Cubaexport then, in

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<sup>87</sup> MARK P. SULLIVAN, CONG. RESEARCH SERV., RL31139, CUBA: U.S. RESTRICTIONS ON TRAVEL AND REMITTANCES I (2015).

<sup>88</sup> Mike DeBonis & Paul Kane, *Republicans Vow No Hearings and No Votes for Obama’s Supreme Court Pick*, WASH. POST (Feb. 23, 2016), <https://www.washingtonpost.com/news/powerpost/wp/2016/02/23/key-senate-republicans-say-no-hearings-for-supreme-court-nominee/> (illustrating political deadlock, Senate Republicans, who make up a majority of the Senate, have vowed not to hold hearings or vote on any Obama-nominee to the Supreme Court vacancy).

<sup>89</sup> *Havana Club Holding, S.A. v. Galleon S.A.*, 203 F.3d 116, 119 (2d Cir. 2000); *Empresa Cubana del Tabaco v. Culbro Corp.*, 399 F.3d 462 (2nd Cir. 2005).

<sup>90</sup> *Havana Club*, 203 F.3d at 119.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at 120.

<sup>95</sup> Dale L. Carlson et al., *Trapped by TRIPS? Intellectual Property Rights, the Cold War, and the Cuban Embargo Revisited*, 21 QUINNIPIAC L. REV. 43, 44 (2001).

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1994, assigned its United States registration for “Havana Club” to HCH.<sup>96</sup> In 1995, the Office of Foreign Assets Control (OFAC) authorized Cubaexport to complete the transactions relating to the assignment of the mark.<sup>97</sup>

In 1996, HCH renewed the U.S. registration of “Havana Club” for a term of ten years.<sup>98</sup> However, in 1997, the defendants, Bacardi & Company Ltd. and Bacardi-Martini USA, Inc, American corporations, purchased from JASA the “rights (if any) to the Havana Club trademark.”<sup>99</sup> Although the OFAC authorized Cubaexport to complete the transactions in 1995, OFAC issued a Notice of Revocation after the lawsuit was filed.<sup>100</sup> OFAC relied on § 515.805 of CACR to nullify the transactions.<sup>101</sup>

In the ensuing lawsuit, the Second Circuit held that the Cuban Embargo barred assignment of the “Havana Club” mark to HCH.<sup>102</sup> It also held that the Embargo precluded recognition of any trademark rights that HCH “might have to trade name protection under the General Inter-American Convention for Trade Mark and Commercial Protection.”<sup>103</sup> In other words, the Second Circuit held that U.S. law effectively bars Cuban companies from possessing or transferring U.S. trademarks and trade names that were confiscated from their prior owners by the Cuban government.<sup>104</sup> The ruling, while seemingly in line with the U.S. embargo of Cuba, conflicts with several international agreements and treaties to which the U.S. is a contracting party.<sup>105</sup> Specifically, the U.S., through its involvement in the TRIPs Agreement, is required to recognize those trademarks, trade names, and their transfer and may not discriminate against WTO members in such a way that would disrespect obligations fundamental to TRIPs.<sup>106</sup>

As a result of the *Havana Club Holding* decision, which caused uproar in the international community, a complaint was filed before the World Trade Organization.<sup>107</sup> Specifically, the European Communities filed complaint against the

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<sup>96</sup> *Havana Club*, 203 F.3d at 120.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> Read in full, OFAC’s Notice of Revocation stated: “You are notified that, as a result of facts and circumstances that have come to the attention of this Office which were not included in the application of October 5, 1995, License No. C-18147 . . . is hereby revoked retroactive to the date of issuance. The determination to revoke License No. C-18147 is made pursuant to § 515.805 of the Cuban Assets Control Regulations, 31 C.F.R. Part 515. Any action taken under this specific license from the date of issuance until now is null and void as to matters under the jurisdiction of the Office of Foreign Assets Control.” *Id.* at 120-21.

<sup>102</sup> *Havana Club*, 203 F.3d at 120-21.

<sup>103</sup> *Id.* at 119.

<sup>104</sup> Carlson et al., *supra* note 95, at 43.

<sup>105</sup> *Id.*

<sup>106</sup> Carlson et al., *supra* note 95, at 44.

<sup>107</sup> Request for Consultations by the European Communities, *United States—Section 211 Omnibus Appropriations Act of 1998*, WT/DS176 (Jul. 8, 1999) [hereinafter Request DS176].

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U.S. alleging illegality of Section 211 of the Omnibus Act, in light of the United States' obligations under international treaties.<sup>108</sup>

On January 2, 2002, the Appellate Body of the World Trade Organization concluded—and the Dispute Settlement Body (DSB) of the WTO adopted—that in relation to trademarks, Section 211 of the Omnibus Act was inconsistent with the United States' obligations under Articles 2.1, 3.1, and 4 of the TRIPS Agreement in conjunction with Article 2(1) of the Paris Convention.<sup>109</sup> The Appellate Body of the WTO noted the United States' failure to comply with the requirements to recognize trademarks, trade names, and their transfer and not to discriminate against WTO members.<sup>110</sup>

The Appellate Body, thus, recommended that the U.S. bring Section 211 of the Omnibus Act into conformity with the agreement.<sup>111</sup> The U.S., however, did not revise or repeal Section 211.<sup>112</sup> Instead, on February 19, 2002, the U.S. requested a “reasonable period of time to comply with the DSB recommendations,” with the deadline being set for December 31, 2002.<sup>113</sup> To date, over 10 years later, the U.S. has not adopted the DSB recommendations.<sup>114</sup>

*Havana Club* is just the first lesson for Cuban trademark holders who seek protections for their marks in the United States.

### B. The “Cohiba” Mark and Empresa Cubana

In *Empresa Cubana del Tabaco v. Culbro Corporation*, the plaintiff, Empresa Cubana, a Cuban corporation, first registered in Cuba its “Cohiba” mark for use on cigars in 1969.<sup>115</sup> By 1978, Empresa Cubana had registered its “Cohiba” mark in seventeen other countries and was selling its products all over the world.<sup>116</sup> However, Empresa Cubana did not register the mark in the U.S. because the embargo prevented it from even selling the Cohiba cigars at all in the United States.<sup>117</sup>

In 1981, General Cigar, an American company, obtained a registration for the “Cohiba” mark in the U.S. and, in an attempt to profit off of the goodwill of the “Cohiba” mark, began selling cigars under that name.<sup>118</sup> But for five years starting in 1987, General Cigar ceased using the “Cohiba” mark.<sup>119</sup> Then, in 1992,

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<sup>108</sup> *Id.*

<sup>109</sup> Appellate Body Report, *United States- Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R ¶ 360 (Jan. 2, 2002) [hereinafter Section 211 Appellate Body Report].

<sup>110</sup> *Id.* at 103.

<sup>111</sup> *Id.*

<sup>112</sup> Carrera, *supra* note 10, at 610.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Empresa Cubana del Tabaco v. Culbro Corp.*, 399 F.3d 462, 465 (2nd Cir. 2005).

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 466.

<sup>119</sup> *Id.*

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General Cigar relaunched the “Cohiba” cigar in the U.S. and, in a 1997 marketing campaign, even attempted to create an association in “the consumer’s mind to Cuba and the Cuban “Cohiba” because Empresa Cubana’s “Cohiba” mark had gained worldwide recognition.<sup>120</sup>

In 1997, Empresa Cubana commenced a proceeding to cancel General Cigar’s registration of the “Cohiba” mark based on the theory that General Cigar abandoned its original registration of the mark and that Empresa Cubana deserved protection under the famous marks doctrine.<sup>121</sup>

The U.S. Court of Appeals for the Second Circuit held that the trademark infringement claim failed because “acquisition of the mark via the famous marks doctrine” is prohibited by the embargo and thus precluded Empresa Cubana from “acquisition of property rights in the U.S. ‘Cohiba’ trademark.”<sup>122</sup> In addition, the court concluded that the embargo also barred Empresa Cubana from both cancelling General Cigar’s registration of the “Cohiba” mark and obtaining an injunction barring General Cigar’s use of the mark in the U.S.<sup>123</sup>

*Empresa Cubana* once again serves as a reminder to small Cuban businesses that they will not be able to seek the same sort of protections required by international agreements; but instead must look for alternate, unique methods to protect their trademark rights.

### C. Lessons for Cuban Business Owners and Alternate Forms of Protection

For large and small businesses alike, the role of foreign investment is growing and critical.<sup>124</sup> Foreign investment is, often times, mutually beneficial.<sup>125</sup> For the investing business, it can provide access to new skills, products, labor, financing, and technology, as well as access to new markets and marketing channels, and cheaper production facilities.<sup>126</sup> The host country receiving the foreign investment is afforded a source of new technology, capital, and products, which in turn fosters economic growth and development.<sup>127</sup> Because trademark protection may bring capital to a country, the trademark itself is a form of foreign investment, albeit an intangible one.<sup>128</sup>

As a result, governments pursuing economic growth have realized the importance of Foreign Direct Investments (“FDI”).<sup>129</sup> Countries such as Cuba are

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<sup>120</sup> *Empresa Cubana*, 399 F.3d at 466.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* at 471-72.

<sup>123</sup> *Id.*

<sup>124</sup> Julien Chaisse & Puneeth Nagaraj, *Changing Lanes: Intellectual Property Rights, Trade and Investment*, 37 HASTINGS INT’L & COMP. L. REV. 223, 248 (2014).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> Jean R. Homere, *Intellectual Property Rights Can Help Stimulate the Economic Development of Least Developed Countries*, 27 COLUM. J.L. & ARTS 277, 277 (2004).

<sup>129</sup> Alexander J. Belohlavek & Filip Cerny, *Law Applicable to Claims Asserted in International Investment Disputes*, 54 INT’L J.L. & MGMT. 443 (2012).

competing to attract greater FDI, which in turn forces each to create an investment environment that is both stable and secure for potential investors such as small businesses.<sup>130</sup>

In order to provide a legal framework for protecting foreign investors, and thus ensuring a stable and secure investment market, states are entering into bilateral investment treaties (“BITs”) or other international investment agreements (“IIAs”).<sup>131</sup> The shift to a knowledge-based global economy has led many developed nations to adopt stronger domestic IPR protection in the hopes of attracting FDI.<sup>132</sup> Furthermore, perceived inadequacies of TRIPS and weak enforcement mechanisms for IPR violations in developing countries have catalyzed a movement toward “TRIPS plus” protection.<sup>133</sup>

Because neither the WTO nor GATT 1994 (the predecessor to the WTO) dealt with the issues of foreign investment rules, nations were left to develop their own policies through BITs and IIAs.<sup>134</sup> BITs guarantee certain standards of protection and treatment—such as non-Expropriation, MFN, National Treatment, and Fair and Equitable Treatment (“FET”—of which a host country must afford to foreign investors).<sup>135</sup> In addition to these standards, most BITs also provide for a dispute settlement mechanism.<sup>136</sup> In such BITs, foreign investors have access to international tribunals when they feel they have not been fairly treated or adequately protected.<sup>137</sup>

Cuba is a contracting party to over forty BITs and other IIAs.<sup>138</sup> While not the easiest or cheapest mechanism for protection, these treaties act as a back-pocket option for small business owners that are seeking to enforce their rights but have been turned away by American courts.

## V. Conclusions and A Proposal for Change

While Cuban trademark law remains wildly uncertain, it is important to remember how far it has come, that it is going in the right direction, and that a more stable future awaits. From an American perspective, small businesses

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<sup>130</sup> Chaisse & Nagaraj, *supra* note 124, at 247; Julien Chaisse, *Promises and Pitfalls of the European Union Policy on Foreign Investment—How will the New EU Competence on FDI Affect the Emerging Global Regime*, 15 J. INT’L ECON. L. 51 (2012).

<sup>131</sup> Genevieve Fox, Note, *A Future for International Investment? Modifying BITs to Drive Economic Development*, 46 GEO. J. INT’L L. 229, 229 (2014).

<sup>132</sup> Chaisse & Nagaraj, *supra* note 124, at 248.

<sup>133</sup> *Id.*

<sup>134</sup> Michael Mortimore & Leonardo Stanley, *Justice Denied: Dispute Settlement in Latin America’s Trade and Investment Agreements*, 4-8 (Working Group on Development and Environment in the Americas Discussion Paper No. 27, 2009), [https://ase.tufts.edu/gdae/Pubs/rp/DP27Mortimore\\_St StanleyOct09.pdf](https://ase.tufts.edu/gdae/Pubs/rp/DP27Mortimore_St StanleyOct09.pdf).

<sup>135</sup> Santiago Montt, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL LAW IN THE BIT GENERATION, 302-304 (Hart Publishing 2009).

<sup>136</sup> Mortimore & Stanley, *supra* note 134, at 18.

<sup>137</sup> *Id.* at 20.

<sup>138</sup> *Bilateral Investment Treaties (BITs): Cuba*, INVESTMENT POLICY HUB, UNITED NATIONS UNCTAD, <http://investmentpolicyhub.unctad.org/IIA/CountryBits/52#iaInnerMenu>.

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should be mindful of the current events, as changes are coming more rapidly in the long saga that is the U.S.-Cuban relationship. With a presidential election around the corner, small business owners should vote for the candidate that he or she feels will promote an open and close relationship with our Cuban neighbors. Even more, those small businesses wishing to expand into the untapped Cuban market should urge for broad negotiations, which will foster positive political relationships and growing economies. From a Cuban perspective, businesses should be savvy in preparing for the wave of competition and influx of consumerism, as well as prepare their trademark portfolios to register in the United States when full-protection is guaranteed.

# USE AND ABUSE OF PRE-TRIAL DETENTION IN COUNCIL OF EUROPE STATES: A PATH TO REFORM

Sarah Nagy

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## I. Introduction

Of all incarcerated persons in the world, as many as one out of three has not been convicted of a crime.<sup>1</sup> Some of these detainees, held during criminal investigations for reasons of personal safety or a risk of flight, will be given a just and timely trial; but many others will remain in custody for weeks or months, separated from their families, their livelihoods, and any form of legal help, despite the fact that they are legally still presumed innocent.<sup>2</sup> While prisoners' rights have become a matter of close international attention, the problem of pre-trial detention is often overlooked, even where international standards exist to govern the use of pre-trial detention by domestic criminal courts.<sup>3</sup> Numerous international organizations agree that pre-trial detention should be a measure of last resort in criminal proceedings, but abuse is still widespread: In some jurisdictions, whether as a result of judicial inefficiency, corruption, or lack of oversight, "pre-trial detainees outnumber convicted prisoners."<sup>4</sup>

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<sup>1</sup> Michael Schönteich, PRESUMPTION OF GUILT: THE GLOBAL OVERUSE OF PRETRIAL DETENTION 1 (2014), <https://www.opensocietyfoundations.org/sites/default/files/presumption-guilt-09032014.pdf>.

<sup>2</sup> *Id.*

<sup>3</sup> See AM. BAR ASS'N RULE OF LAW INITIATIVE, HANDBOOK OF INTERNATIONAL STANDARDS ON PRETRIAL DETENTION PROCEDURE 4 (2010), [https://www.ilsa.org/jessup/jessup16/Batch%201/handbook\\_of\\_international\\_standards\\_on\\_pretrial\\_detention\\_procedure\\_2010\\_eng.authcheckdam.pdf](https://www.ilsa.org/jessup/jessup16/Batch%201/handbook_of_international_standards_on_pretrial_detention_procedure_2010_eng.authcheckdam.pdf) [hereinafter ABA] (compiling language from relevant instruments of international human rights law to illustrate standard practice across jurisdictions).

<sup>4</sup> Schönteich, *supra* note 1, at 1.

## Pre-Trial Detention in Council of Europe States

Even in jurisdictions with well-developed and well-regulated criminal justice systems, pre-trial detention overwhelmingly affects the poor, non-nationals, ethnic and racial minorities, and other vulnerable populations.<sup>5</sup> In some individual Council of Europe member states, a third or more of pre-trial detainees are foreign-born, detained under the belief that they pose an inherent risk of flight – in some cases even when the crime with which they are charged yields a non-custodial sentence.<sup>6</sup> In Europe, the average length of detention before trial is close to five months, and national criminal codes sometimes permit maximum detention periods of multiple years.<sup>7</sup> Though numerous alternatives to the custodial detention of accused persons exist and are even encoded in much domestic criminal law, many states have been slow to adopt widespread use of these alternatives, as evidenced by high (and in some cases increasing) rates of pre-trial detention.

This paper will address the use and abuse of pre-trial detention in Council of Europe states, focusing on member states' compliance with the legal standards outlined in the European Convention on Human Rights and since given shape by the European Court of Human Rights. I will provide background on the problems most commonly associated with the use of pre-trial detention in European states, as well as the Council of Europe's approach to ensuring that members comply with international standards governing the use of pre-trial detention. I will also briefly examine the relevant case law within the European Court of Human Rights, especially as it pertains to recent or ongoing criminal justice reform within member states. I will analyze a selected group of data about pre-trial detention in four Council of Europe member states and discuss recent reform efforts within those states. Finally, I will discuss alternatives to pre-trial detention successfully in use in Council of Europe member states, as well as the possibility of their implementation in other jurisdictions.

## II. Background

### A. International legal framework for use of pre-trial detention in Council of Europe member states

Pre-trial detention (called detention or custody on remand in some jurisdictions) is “any period of detention of a suspected offender ordered by a judicial authority and prior to conviction.”<sup>8</sup> Officially, pre-trial detention is a measure of

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<sup>5</sup> Schönteich, *supra* note 1, at 7.

<sup>6</sup> Voislav Stojanovski, *Pre-Trial Detention of Foreigners in the European Union*, 2 ANNALS CONSTANTIN BRĂNCUSU U. TÂRGU JIU JURID. SCI. SERIES 85, 89 (2009); *World Prison Brief: Europe*, INT'L CTR. PRISON STUDIES, <http://prisonstudies.org/map/europe> (reporting, for example, rates of foreign-born pre-trial detainees at 73% of the total pre-trial population in Switzerland, 42.9% in Belgium, and 33% in Italy) (last visited Mar. 2, 2016).

<sup>7</sup> Schönteich, *supra* note 1, at 25 (citing Rick Sarre, Sue King & David Bamford, *Remand in Custody: Critical Factors and Key Issues*, 310 TRENDS & ISSUES IN CRIM. JUST. 2-3 (2006)).

<sup>8</sup> Eur. Consult. Ass., *Recommendation of the Committee of Ministers to member states on the use of remand in custody*, 947th sess., Rec(2006)13 (2006), available at <https://wcd.coe.int/ViewDoc.jsp?id=1041281>. [hereinafter Eur. Cons. Ass.] This definition includes any period of detention relating to international judicial cooperation and extradition, which encompasses the large population of foreign nationals held in pre-trial detention in European countries.

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last resort, to be used in circumstances involving crimes punishable by incarceration where the accused poses a risk of flight or of committing a serious offense upon release, and where no alternative measures would properly address that risk.<sup>9</sup> Alternative, non-custodial measures to prevent flight or further offense might include requiring the accused to appear periodically before a judicial authority during the criminal investigation process; placing limits on engagement in particular activities or restricting the accused's movement to certain areas before trial; requiring supervision by an agency appointed by a judicial authority; or requiring the surrender of some form of identification or a financial guarantee of conduct prior to trial.<sup>10</sup> The international approach to pre-trial detention may be summarized by the principle that “[c]ourts should only detain an individual during the adjudication process if, having considered the widest possible range of alternatives, they conclude that detention remains necessary to address the risk identified.”<sup>11</sup>

Among the 47 member states of the Council of Europe, the rights of prisoners and detainees are enumerated in the European Convention on Human Rights of 1953 (hereafter “the Convention”). Article 5 of the Convention establishes the fundamental right of the individual to liberty, with the corresponding right not to be subject to any arbitrary deprivation of that liberty.<sup>12</sup> It states in full that “Everyone has the right to liberty and security of person. No one shall be deprived of his liberty save in [certain cases] and in accordance with a procedure prescribed by law.”<sup>13</sup> Article 5(1) lists six categories enumerating the circumstances under which public authorities may lawfully deprive an individual of his or her liberty (of which pre-trial detention is the third); it is an exhaustive list, containing the *only* permissible circumstances under which a contracting state may allow such a deprivation.<sup>14</sup> Articles 5(2)-(5) enumerate the accused person's affirmative right to prompt notification of arrest; to stand trial within a reasonable period of time; to have the lawfulness of any pre-trial detention measure speedily examined and decided; and to have an enforceable right to compensation should the accused be the victim of detention in contravention of the terms of the Article.<sup>15</sup>

The Convention, unlike other instruments of international law of its time, contains the “institutional machinery for supervision and enforcement” of its terms in the form of the European Court of Human Rights (hereafter “the Court”).<sup>16</sup>

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<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> See ABA, *supra* note 3, at 5 (quoting substantively similar provisions in documents by the United Nations Human Rights Committee, the European Convention on Human Rights, the African Commission on Human and People's Rights, and the Inter-American Commission on Human Rights).

<sup>12</sup> European Convention for the Protection of Human Rights and Fundamental Freedoms art. 5, Nov. 4, 1950, E.T.S. No. 5, 213 U.N.T.S. 222 [hereinafter European Human Rights Convention].

<sup>13</sup> *Id.*

<sup>14</sup> Yue Ma, *The European Court of Human Rights and the Protection of the Rights of Prisoners and Criminal Defendants Under the European Convention on Human Rights*, 10 INT'L CRIM. JUST. REV. 54, 62-63 (2000).

<sup>15</sup> European Human Rights Convention, *supra* note 13.

<sup>16</sup> *Id.* at 54-55.

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The Court possesses the authority to investigate and adjudicate violations of the Convention in contracting states, and while it has no authority to strike down national laws, it may issue binding decisions ordering corrective action by states found to be in violation.<sup>17</sup> Such corrective action might include the release of a detained person, or a change in the conditions of their detention.<sup>18</sup> Under Article 5(1)(c) of the Convention, pre-trial detention is a permissible form of deprivation of liberty, provided that it constitutes “the lawful arrest or detention of a person effected for the purpose of bringing him before the competent legal authority on reasonable suspicion of having committed an offence or when it is reasonably considered necessary to prevent his committing an offence of fleeing after having done so.”<sup>19</sup> Lawful pre-trial detention, therefore, must be ordered by a judge or other judicial officer<sup>20</sup> and must involve a “genuine inquiry into the basic facts of a case in order to verify whether a complaint was well-founded.”<sup>21</sup> The detainee must be charged with a specific and concrete criminal offense – a person may not be held on account of a perceived propensity to commit a crime.<sup>22</sup>

In determining whether specific cases constitute unlawful deprivations of liberty, “the Court does not consider itself bound by the legal conclusions of domestic authorities,” but undertakes an autonomous assessment with emphasis on the context in which detention has been imposed by a domestic judicial authority.<sup>23</sup> The Court considers a series of objective and subjective factors to determine whether detention violates the individual’s right to liberty, including (but not limited to) the length of detention; the purpose of detention; the effect of detention on the detainee; and the manner in which the measure in question is implemented.<sup>24</sup> Importantly, the Court has chosen not to establish a minimum length of detention required to constitute a deprivation of liberty under Article 5, holding for example in *Iskandarov v. Russia* that where involuntary detention is imposed by state agents, shortness of duration is not decisive in determining whether a detainee’s rights have been violated.<sup>25</sup> Periods as short as four days have been found to violate the provisions of Article 5, while periods of three years have also been found lawful based on the surrounding circumstances.<sup>26</sup> Likewise, no other single factor is determinative in finding an Article 5 violation; every case is de-

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<sup>17</sup> *Id.* at 62.

<sup>18</sup> *Id.*

<sup>19</sup> European Human Rights Convention, *supra* note 13, at art. 5 § 1(c).

<sup>20</sup> *Schiesser v. Switzerland*, App. No. 7710/76, 1979 Eur. Ct. H.R. 9.

<sup>21</sup> *See Stepuleac v. Moldova*, App. No. 8207/06, 2008 Eur. Ct. H.R. 18 (holding that where prosecutors included applicant’s name in a list of suspects absent any evidence of applicant’s involvement, there existed no reasonable suspicion that applicant had committed an offence, and therefore arrest was in violation of Article 5(1)).

<sup>22</sup> *Shimovolos v. Russia*, App. No. 30194/09, 2011 Eur. Ct. H.R. 12.

<sup>23</sup> EUR. COURT OF HUMAN RIGHTS, GUIDE ON ARTICLE 5 OF THE CONVENTION: RIGHT TO LIBERTY AND SECURITY 5 (2012), [http://www.echr.coe.int/Documents/COUREDH-2012-Guide\\_on\\_article\\_5\\_ENG.pdf](http://www.echr.coe.int/Documents/COUREDH-2012-Guide_on_article_5_ENG.pdf) [hereinafter Article 5 Guide].

<sup>24</sup> *Id.* at 6.

<sup>25</sup> *Iskandarov v. Russia*, App. No. 17185/05, 2010 Eur. Ct. H.R. 23.

<sup>26</sup> *Ma*, *supra* note 15, at 63-64.

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cided within its own context, based on the totality of the circumstances.<sup>27</sup> With this approach, the Court seeks to balance the freedom of individual states to form their own penal codes (for declaring a strict maximum period of legal detention might invalidate national legislation, which is beyond the power of the Court to do) with the right of individuals not to be detained in a manner that violates their fundamental rights.

In practice, the heavily contextual nature of the Court's analysis of pre-trial detention cases allows for a wide variety of circumstances in which detention might be found permissible. So long as it does not deem an order of detention "arbitrary," the Court may find detention lawful when permitting release would present some danger to the accused, to a potential witness in the future trial, or to society generally (especially where the investigated offense is of particular severity); when allowing the accused total freedom might lead to a breach of confidentiality; or when the accused might pose a risk of flight out of the jurisdiction in which trial is pending.<sup>28</sup> Council of Europe member states are free to set their own limits on permissible length of pre-trial detention, and may permit maximum limits of just a few weeks or of several years.<sup>29</sup> Detention periods as short as five days have been found unlawful, while periods as long as two years have been found to be appropriate to the circumstances. Overall, however, some variation in terms between domestic legal systems notwithstanding, the European legal framework for pre-trial detention established in the Convention is in keeping with the standards espoused by most of the international community, which hold that "pretrial detention can only be justified when used to prevent the accused from absconding, committing a serious offense, or interfering with the administration of justice."<sup>30</sup> Consistent enforcement within national jurisdictions presents the greater difficulty.

### B. Problems presented by overuse of pre-trial detention

Because modern judicial thought is founded on a universal presumption of innocence, custodial detention before trial poses an inherent problem: Detainees held in custody under suspicion of having committed a crime must still be presumed innocent, despite the fact that custodial detention is a penalty otherwise levied only against convicted criminals. Because of this strong association between custodial detention and proven guilt, the overuse of pre-trial detention can prejudice judicial authorities against detainees held for purposes of an investigation, leading to the use of detention as a punitive or preventive measure rather than a regulatory one.<sup>31</sup> And while international law calls for strict regulation of

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<sup>27</sup> Article 5 Guide, *supra* note 17, at 25.

<sup>28</sup> *Commission Green Paper on the Application of EU Criminal Justice Legislation in the Field of Detention*, at 8-9, COM (2011) 327 final (June 14, 2011), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0327:FIN:en:PDF> [hereinafter *Commission Green Paper*].

<sup>29</sup> *Id.*

<sup>30</sup> American Bar Association, *supra* note 3, at 4.

<sup>31</sup> Stephen Jones, *Guilty Until Proven Innocent? The Diminished Status of Suspects at the Point of Remand and as Unconvicted Prisoners*, 32 COMM. L. WORLD REV. 405 (2003); *See also* Sue King et al.,

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the use of pre-trial detention in criminal proceedings, in many jurisdictions detention remains the default solution rather than the exception.<sup>32</sup> Judges seeking to adhere to the international standards discussed above must take a wide variety of factors into account in every individual case, which may lead to arbitrary imposition of pre-trial detention and runs the risk of decisions influenced by unconscious prejudice or the pressure of accustomed practice.<sup>33</sup>

Domestic criminal justice systems must therefore draw a balance between the needs of criminal investigations and the right of individuals not to be detained for crimes of which they have not been found guilty. Mindful of this balance, international law-making bodies seek to define carefully the circumstances under which pre-trial detention may be used to ensure a fair and just trial.<sup>34</sup> International standards are difficult to enforce, however, even where courts have some power to intervene; the European Court of Human Rights might be able to issue binding decisions in limited individual cases, but most instruments of international law, including the Convention, lack the binding legal power to change individual states' behavior.

### III. Discussion

#### A. Current problems in Council of Europe member states

The Council of Europe has set clear standards for the use of pre-trial detention in member states, but states have put these standards into practice inconsistently. International prisoners' rights groups support the universal adoption of the standards set down in the Council of Europe's Recommendation Rec(2006)13, a guidance document which calls for pre-trial detention to be used "only when strictly necessary and as a measure of last resort."<sup>35</sup> However, due to the long list of factors judges are expected to consider in determining whether an alternative measure would suffice, judges can sometimes order pre-trial detention without strong justification – so long as there exists a "reasonable suspicion" that the accused committed the crime with which they are charged, there are no objective standards to determine how viable an alternative measure would be.<sup>36</sup> Judges seeking to adhere to international standards are expected to take into considera-

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*The Remand Strategy: Assessing Outcomes*, 19 CURRENT ISSUES CRIM. JUST. 328 (2008) (arguing that "without greater clarity of focus on the purposes for which the remand strategy should be deployed, custodial remand is in danger of being utilised for policy purposes other than those initially sought and pursued by legislators,"); see also Marian R. Williams, *The Effect of Pretrial Detention on Imprisonment Decisions*, 28 CRIM. JUST. REV. 299 (2003) (showing that "defendants who had been subject to pretrial detention were more likely to be incarcerated, and to receive longer sentences if they were incarcerated, than defendants who had been released pending case disposition" in a study of detention decisions in a Florida county).

<sup>32</sup> Schönteich, *supra* note 1, at 97.

<sup>33</sup> Schönteich, *supra* note 1, at 98 (noting that "even well intentioned decision makers are subject to "random fluctuations in attention, perception, mood, and so on").

<sup>34</sup> See American Bar Association, *supra* note 3, at 5.

<sup>35</sup> Matt Loffman & Faye Morton, *Investigating Alternatives to Imprisonment within Council of Europe Member States*, QUAKER COUNCIL FOR EUR. AFFAIRS 6 (Feb. 24, 2010), available at <http://www.qcea.org/wp-content/uploads/2011/06/rprt-alternatives-en-jan-2010.pdf>.

<sup>36</sup> Schönteich, *supra* note 1, at 166.

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tion not only the severity and potential penalty for the crime of which the potential detainee has been accused, but “the age, health, character, antecedents and personal and social circumstances of the person concerned,” though what weight to give individual circumstances is still left up to the individual judge.<sup>37</sup> Where judges have wide discretion to declare individuals sufficiently dangerous to justify pre-trial detention, there is greater danger that detention will be used for preventive, rather than regulatory, reasons.<sup>38</sup> And in jurisdictions where prosecutors and police have significant power to affect the outcome of detention decisions, criminal proceedings can be unfairly influenced in their early stages by the arresting authorities, leading to too many “rubber-stamped” detention orders.<sup>39</sup> As admitted by a Dutch judge, prior to the publication of Recommendation Rec(2006)13: “If you are skillful, you can virtually detain anybody.”<sup>40</sup>

International law-making bodies regularly emphasize the ways in which the overuse of pre-trial detention undermines the universal presumption of innocence. But looking beyond the discussion of abstract rights, prison reform advocates point out that pre-trial detention also has serious negative effects on the well-being of detainees.<sup>41</sup> Prisoners’ rights and detainees’ rights are closely connected; detainees are often kept in the same facilities as (and sometimes with no separation from) convicted prisoners, and may be subject to the same human rights abuses to which prisoners are particularly vulnerable.<sup>42</sup> In jurisdictions already burdened with overcrowding in prisons, pre-trial detainees face an “increase in noise and tension, along with [a] decrease in prison visits, food, and personal space.”<sup>43</sup> According to a report published by the Quaker Council for European Affairs, in 2010 twenty-five Council of Europe member states had more prisoners than penitentiary facilities were able to accommodate, leading to problems of overcrowding and lack of resources for prisoners and detainees alike.<sup>44</sup> Even where conditions in detention centers and penitentiaries are adequate and overcrowding is not a problem, pre-trial detention can break down

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<sup>37</sup> Eur. Consult. Ass., *supra* note 8.

<sup>38</sup> Schönteich, *supra* note 1, at 165.

<sup>39</sup> Schönteich, *supra* note 1, at 165; *See also* Jones, *supra* note 29, at 404 (discussing the tendency of England’s Crown Prosecution Service to defer to the judgment of police in a majority of bail decisions, even following highly successful penal reform).

<sup>40</sup> Lonneke Stevens, *Pre-Trial Detention: The Presumption of Innocence and Article 5 of the European Convention on Human Rights Cannot and Does Not Limit its Increasing Use*, 17 EUR. J. CRIME CRIM. L. & CRIM. JUST. 165, 166 (2009) (pointing out areas of wide judicial discretion in implementing pre-trial detention in Dutch, German, and English courts, though Stevens ultimately argues that the negative effects of judicial leniency are less severe than commonly reported).

<sup>41</sup> *See* Schönteich, *supra* note 1, at 2; *See also* Samuel Deltenre & Eric Maes, *Pre-trial detention and the overcrowding of prisons in Belgium*, 12 EUR. J. CRIME CRIM. L. & CRIM. JUST. 4, 348-70 (2004).

<sup>42</sup> *See* José Luis Díez-Ripollés & Cristina Guerra-Pérez, *Pre-trial Detention in Spain*, 18 EUR. J. CRIME CRIM. L. & CRIM. JUST. 381-83 (2010) (discussing the rights of remand prisoners in Spain, points out that “there are no differences between them and convicted prisoners” with regard to visitation and other social rights. The authors also express concern with the fact that pre-trial detainees are not permitted certain forms of external interaction and penitentiary benefits, as these are considered part of the correctional process and available only to convicted prisoners).

<sup>43</sup> Loffman, *supra* note 33, at 26.

<sup>44</sup> *Id.*

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social relationships much like a prison sentence.<sup>45</sup> Persons held in pre-trial detention cannot work, attend social functions, or be with their families, all forms of punishment it would be unjust to levy against innocent persons – which pre-trial detainees must be assumed to be until proven otherwise.

Even in resource-rich jurisdictions with fairly low rates of pre-trial detention, the poor are particularly vulnerable to abuse by the system. Most states have bail systems, wherein an individual may pay a financial penalty to guarantee his or her appearance in court. Those who are unable to pay bail set by the court are sometimes required to serve detention because the inability to pay translates legally to a flight risk.<sup>46</sup> Relatedly, factors that correlate highly with poverty – lack of employment, problems with mental or physical health, lack of education, and so on – are also associated with high rates of pre-trial detention.<sup>47</sup> The United Nations Working Group on Arbitrary Detention reported in 2006:

People having stable residence, stable employment and financial situation, or being able to make a cash deposit or post a bond as guarantee for appearance at trial are considered as well-rooted. These criteria of course are often difficult to meet for the homeless, drug users, substance abusers, alcoholics, the chronically unemployed and persons suffering from mental disability, who thus find themselves in detention before and pending trial when less socially disadvantaged persons can prepare their defense at liberty.<sup>48</sup>

As discussed above, in many jurisdictions judges have broad discretion to order pre-trial detention based on an individual's personal circumstances and perceived likelihood of cooperating with the court's demands.<sup>49</sup> As evidence has shown in other jurisdictions, being placed in pre-trial detention increases an individual's risk of being given a custodial sentence. A greater burden on the poor in pre-trial detention can lead to a greater burden on the poor in the justice system as a whole.

Finally, many member states within the Council of Europe struggle with a high incidence of pre-trial detention for non-nationals. In fact, pre-trial detention of non-nationals is substantially higher than conviction of non-nationals in some states, because even in jurisdictions where alternative measures are regularly put into practice for resident citizens, non-nationals are considered an automatic flight risk.<sup>50</sup> The Council of Europe has recommended that member states adopt

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<sup>45</sup> Eur. Consult. Ass., *supra* note 8 (referring to “the irreversible damage that remand in custody may cause to persons ultimately found to be innocent or discharged” and the “detrimental impact that remand in custody may have on the maintenance of family relationships”).

<sup>46</sup> Jones, *supra* note 29.

<sup>47</sup> Schönteich, *supra* note 1, at 33.

<sup>48</sup> Working Group on Arbitrary Detention, Civil and Political Rights, Including the Question of Torture and Detention, 20, U.N. Doc. E/CN.4/2006/7 (Dec.12, 2005) (by Leila Zerrougui).

<sup>49</sup> Eur. Consult. Ass., *supra* note 8.

<sup>50</sup> FAIR TRIALS INT'L., DETAINED WITHOUT TRIAL: FAIR TRIALS INTERNATIONAL'S RESPONSE TO THE EUROPEAN COMMISSION'S GREEN PAPER ON DETENTION 9 (2011), available at <https://www.fairtrials.org/documents/DetentionWithoutTrialFullReport.pdf>.

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legislation ensuring that “the fact that the person concerned is not a national of . . . the state where the offence is supposed to have been committed shall not in itself be sufficient to conclude that there is a risk of flight.”<sup>51</sup> However, such recommendations have not found their way into most domestic criminal codes, as evidenced by the fact that a 2009 Council of Europe study found that over a quarter of pre-trial detainees were non-nationals.<sup>52</sup> In some member states, more than half of pre-trial detainees are non-nationals at any given time.<sup>53</sup> Non-nationals face linguistic barriers that can impede their ability to communicate with counsel and slow proceedings, and due to the perceived risk of flight, they can in some circumstances be held even when charged with crimes not punishable by a custodial sentence.<sup>54</sup> Because the European Union has continued to open its borders to free travel between member states, it has proven difficult for European countries to balance the need to prevent non-nationals avoiding trial by leaving the jurisdiction with the desire to promote easy movement between states by all citizens.<sup>55</sup>

### IV. Analysis

On average between 20 and 30 percent of total European state prison populations consist of pre-trial detainees.<sup>56</sup> The average is lower (around 12 percent) in Central Europe, slightly higher among Eastern European countries (around 17 percent), and highest in Western and Northern Europe (between 20 and 25 percent).<sup>57</sup> The table below illustrates pre-trial detention statistics from 2010 to 2015 in four selected Council of Europe member states, all of which are parties to the European Convention on Human Rights.<sup>58</sup> Statistics are collected annually by the International Centre for Prison Studies, currently the only body that compiles state-by-state statistics about the makeup of prison populations as reported by national agencies on a worldwide scale.<sup>59</sup>

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<sup>51</sup> Eur. Consult. Ass., *supra* note 8.

<sup>52</sup> FAIR TRIALS INT’L, *supra* note 48, at 6; Stojanovski, *supra* note 7, at 89 (reporting a rate of 21% in 2006, indicating an increase in the following decade).

<sup>53</sup> PRE-TRIAL DETENTION COMPARATIVE RESEARCH: APPENDIX 2, FAIR TRIALS INT’L. (2011), available at [http://ec.europa.eu/justice/newsroom/criminal/opinion/files/110510/appendix\\_2\\_-\\_comparative\\_research\\_en.pdf](http://ec.europa.eu/justice/newsroom/criminal/opinion/files/110510/appendix_2_-_comparative_research_en.pdf).

<sup>54</sup> Loffman, *supra* note 33.

<sup>55</sup> Tapio Lappi-Seppälä, *Imprisonment and Penal Policy in Finland*, 54 SCANDINAVIAN STUDIES L. 348, 368 (2009).

<sup>56</sup> See *Highest To Lowest-Pre-Trial Detainees/Remand Prisoners*, WORLD PRISON BRIEF INST. CRIM. POL’Y RESEARCH, [http://prisonstudies.org/highest-to-lowest/pre-trial-detainees?field\\_region\\_taxonomy\\_tid=14](http://prisonstudies.org/highest-to-lowest/pre-trial-detainees?field_region_taxonomy_tid=14) (last visited Mar. 7, 2016).

<sup>57</sup> Schönreich, *supra* note 1, at 18.

<sup>58</sup> *Europe*, WORLD PRISON BRIEF INST. CRIM. POL’Y RESEARCH, <http://www.prisonstudies.org/map/europe> (last visited Mar. 7, 2016). Statistics last updated January of 2015. Where possible, the Brief indicates whether pre-trial detainees are included in counts of national prison populations. Most statistics in use by intergovernmental organizations such as the European Union are derived from this database.

<sup>59</sup> *Id.*

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State	Number of prisoners (total)	Pre-trial detainees as percentage of prison population
Austria	8,188	21.8%
Russian Federation	644,237	18.1%
Poland	71,806	6.0%
Finland	3,105	19.9%

These states are chosen for illustrative purposes: both to examine the different challenges faced by states with differing criminal justice systems and policy goals, and to show the complexities in data relating to pre-trial detention. Statistics relating to pre-trial detention may be misleading. As the Open Society Foundations point out in their 2012 report on issues in pre-trial detention worldwide, not all national reporting agencies count pre-trial detainees among their total prison populations.<sup>60</sup> Even those that do may define pre-trial detention differently, for example by choosing to count not only detainees who have not been convicted, but those who are in custody while appealing a conviction or sentence.<sup>61</sup>

Statistics that only show rates of pre-trial detention as a function of total prisoner population can mask huge differences in the actual number of people affected across different penal systems. Showing the absolute number of total detainees and prisoners makes clear the difference in impact of different pre-trial detention rates on different populations.<sup>62</sup> For example, Finland's total detainee population, based on the rate of pre-trial detention among the entire prison population as illustrated in the above table, would be about 620 persons.<sup>63</sup> However, Poland's pre-trial detention rate, which is less than a third of Finland's and the lowest of all Council of Europe states, would represent some 4,300 persons because of the relative size of Poland's population.<sup>64</sup> Meanwhile Russia, which has a rate of pre-trial detention close to the European average but also one of the largest prison populations in the world, would have more than 115,000 pre-trial

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<sup>60</sup> Schönteich, *supra* note 1, at 13-14. Open Society Foundations maintains that, due to differing definitions of "pre-trial detention" in use in different jurisdictions, possible underreporting by prison authorities, and failure to count individuals detained in police lockups rather than detention centers, ICPS's database must be viewed as providing thorough but conservative estimates of total detainee populations. *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> These estimates are used only for general illustrative purposes and represent a very rough approximation of actual prison populations, based on the numbers used in the above table. Constant fluctuations in numbers of prisoners make current data difficult to utilize accurately. However, such approximation can be used to show that even a low percentage of pre-trial detainees among a prison population may represent a large absolute number of human beings.

<sup>63</sup> See generally, *World Prison Brief: Europe*, *supra* note 58.

<sup>64</sup> *Id.* Microstates such as Monaco and San Marino, which may have fewer than ten total prisoners at a given time, are not counted here, as issues with pre-trial detention are statistically significant only in states with sufficiently large prison populations. *Id.*

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detainees according to the above data.<sup>65</sup> For this reason, simple percentages must be examined more closely to draw accurate conclusions about problems in individual states. Factors such as the average length of detention and the demographic breakdown of detainee populations must be taken into account (though unfortunately this information is not always readily available). As shown by comparing the hypothetical examples of Finland and Poland, efficient and resource-rich legal systems might have high rates of pre-trial detention compared to those in more resource-poor states; but this may indicate that they simply have smaller prison populations overall, or the ability to process detainees more quickly.<sup>66</sup> Finland, for example, requires by law that detention orders be administered no later than four days after arrest, and permits detainees to request new detention hearings every two weeks, meaning that while its total population of detainees might seem high, the vast majority of detainees are not held for very long – a indicator of judicial efficiency that makes unjust detention less prevalent.<sup>67</sup> Average rates of detention might also disguise problems that affect some states more than others. In Austria, for example, pre-trial detainees make up approximately one-fifth of the total prison population, which is close to the average for the Council of Europe. However, as of 2015, over half of the prisoners in Austria were non-nationals, and in recent years that rate has been even higher for pre-trial detainees.<sup>68</sup> An investigation of pre-trial detention in Austria might therefore require greater attention to the issue of detention of non-nationals than it would in other jurisdictions where that population is represented at a more normal rate.

### V. Proposal

#### A. Improving data collection and expanding research

As discussed above, statistics relating to pre-trial detention are not always widely available, and can be misleading when they fail to take into account states' differences in standard length of detention and their approaches to custodial detention in general. Therefore, the first step in implementing reforms to prevent the abuse of pre-trial detention must be an increased emphasis on data collection that assesses individual states' use of pre-trial detention, including the frequency with which it is implemented regardless of any available alternatives, and the people against whom it is most likely to be implemented (with emphasis on its effect on marginalized or economically vulnerable groups). The Council of Europe publishes yearly reports on member states' penal statistics, collected through the administration of questionnaires to national probation and peniten-

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<sup>65</sup> *Russian Federation*, WORLD PRISON BRIEF INST. CRIM. POL'Y RESEARCH, <http://prisonstudies.org/country/russian-federation> (last visited Mar. 7, 2016).

<sup>66</sup> See Schönreich, *supra* note 1, at 13.

<sup>67</sup> *Factsheet: Pretrial Detention and Remand to Custody*, JUSTICE POL'Y INST. 1, 1 (2011), [http://www.justicepolicy.org/uploads/justicepolicy/documents/pretrial\\_detention\\_and\\_remand\\_to\\_custody.pdf](http://www.justicepolicy.org/uploads/justicepolicy/documents/pretrial_detention_and_remand_to_custody.pdf).

<sup>68</sup> See *Austria*, WORLD PRISON BRIEF INST. CRIM. POL'Y RESEARCH, <http://prisonstudies.org/country/austria> (last visited Mar. 7, 2016).

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tiary authorities.<sup>69</sup> Prisoners' rights advocacy organizations, academic institutions, and nonprofits such as the International Centre on Prison Studies, the United Nations Office of Drugs and Crime, and Open Society Foundations also collaborate to compile international prison statistics. However, due to differences in definitions between legal jurisdictions, the non-participation of some states in some aspects of reporting, and a lack of emphasis on the unique circumstances of remand prisoners in prisoner advocacy, available data remains difficult to analyze. Clearer standards for data collection and analysis would aid in gaining a more realistic picture of the changes in detainee populations in Council of Europe member states, granting a clearer understanding of how penal reform can decrease the use of pre-trial detention and improve the situation of pre-trial detainees.

### B. Encoding non-custodial measures in domestic law

In order to achieve less arbitrary and more just implementation of pre-trial detention measures, European countries that have not yet done so should begin by encoding a preference for non-custodial alternatives in their national criminal codes, leaving fewer subjective factors to the discretion of individual judicial authorities. While the European Court of Human Rights is unusually powerful among international judicial bodies in that it may issue binding decisions on member states in specific cases where pre-trial detention is unjustly imposed, it does not have the power to change domestic law.<sup>70</sup> This enables the continued overuse of pre-trial detention in numerous cases not deemed exceptional enough to come before the Court. The Council of Europe has taken a strong first step by recommending a series of strict and specific circumstances under which domestic courts *should* be permitted to impose pre-trial detention, but implementation has been slow in member states.<sup>71</sup>

Finland provides a strong example of a country that has codified strict limits on pre-trial detention and removed much of judges' discretionary power to impose custodial sentences. Since the 1970s, Finland has been reforming its penal code to de-emphasize custodial sentences, choosing to replace sentencing for almost all non-violent crimes with alternative sentences such as income-based day fines, community service, mandatory mediation, and community service.<sup>72</sup> Furthermore, following the Council of Europe's 2006 publication of recommendations for detention reform, Finland chose to change its criminal code to closely match those recommendations, helping to ensure that alternatives to pre-trial detention find wider usage.<sup>73</sup>

Finland, with its small and relatively homogeneous population, well-funded judicial system, very low poverty rate, and low rates of violent crime, is an out-

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<sup>69</sup> See generally COUNCIL OF EUROPE ANNUAL PENAL STATISTICS, <http://wp.unil.ch/space> (last visited Mar.8, 2016).

<sup>70</sup> Ma, *supra* note 14, at 56.

<sup>71</sup> Eur. Consult. Ass., *supra* note 8.

<sup>72</sup> Lappi-Seppälä, *supra* note 53, at 336.

<sup>73</sup> *Id.* at 342.

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lier even in the Council of Europe – Russia, for example, in addition to having a population many times larger than Finland’s, has more than twice its poverty rate.<sup>74</sup> In proposing that other Council of Europe member states follow Finland’s example, it is important to emphasize the nature of its penal reform, which aims to change not only the criminal code but the “custodial culture” that makes detention and incarceration the default method for dealing with any criminal behavior.<sup>75</sup> One researcher notes that in Finland, “the role of punishment came to be seen as relative. Once regarded as the primary means of criminal policy, it came to be regarded as only one option among many.”<sup>76</sup> Reform in other Council of Europe member states might take a similar form in the long term – where emphasis in criminal justice falls away from custody-as-punishment and becomes more open to alternative forms of sentencing, emphasis on pre-trial detention as the primary form of guaranteeing the accused’s presence at trial could also become more open to alternatives.

### C. Current problems in Council of Europe member states

As discussed in Part II, numerous international organizations and lawmaking bodies have set standards for the treatment of pre-trial detainees, but are unable to change individual states’ national legal systems even where those states are party to treaties such as the European Convention on Human Rights. Therefore, it must be the responsibility of individual states either to agree to accept decisions by bodies like the European Court of Human Rights as binding, or to introduce legislation that causes criminal codes to adhere more closely to international standards. It must also be the responsibility of states to create mechanisms to enforce adherence by domestic courts.

Poland, which has seen a decrease in its pre-trial detention rate from 30 percent to 6 percent since 2000, has written the Article 5 standards for just pre-trial detention espoused by the European Convention on Human Rights into its criminal code.<sup>77</sup> However, some penal reform advocates find that despite this necessary change, alternative measures are still not administered uniformly – where prosecutorial proceedings move for detention, judges still order detention in an overwhelming majority of cases.<sup>78</sup> However, discussion continues about the potential for Poland to incorporate decisions by the European Court of Human Rights into binding law.<sup>79</sup> Responses by legal professionals suggest that some courts view such decisions as binding precedent and some do not, and that estab-

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<sup>74</sup> *World Development Indicators*, THE WORLD BANK, <http://data.worldbank.org/country/russian-federation> (last visited Mar. 8, 2016).

<sup>75</sup> Lappi-Seppälä, *supra* note 55, at 362 (emphasizing the “political will as consensus” as a driving factor in national penal reform).

<sup>76</sup> *Id.* at 350.

<sup>77</sup> FAIR TRIALS INT’L, COMMUNIQUÉ ISSUED AFTER THE MEETING OF THE FAIR TRIALS INTERNATIONAL LOCAL EXPERTS GROUP (POLAND) 4 (2012), available at <https://www.fairtrials.org/wp-content/uploads/Poland-PTD-communique.pdf>.

<sup>78</sup> *Id.* at 1.

<sup>79</sup> *Id.* at 4.

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lishing a rule that enforces the binding nature of Court decisions with regard to Poland would be useful in continuing to reduce Poland's rate of pre-trial detention.<sup>80</sup>

The European Union acknowledges the problem of pre-trial detention of foreign-born persons who are seen as an inherent flight risk, pointing out in its 2011 Green Paper on criminal justice in the field of detention that such detainees "are regularly denied release, and consequently their right to liberty, simply because they have fewer ties with the jurisdiction."<sup>81</sup> It has been suggested that the continued increase in the detention of foreign-born persons, particularly in northern and western Europe, is a result of the EU's ongoing efforts to open its borders to free travel, increasing the risk that a non-national charged with a crime will return to his or her own home following pretrial release in an attempt to leave the jurisdiction.<sup>82</sup> One proposed alternative to detaining foreign-born persons automatically is to permit non-nationals to return to their own states of residence during criminal proceedings (provided doing so does not pose a risk to the success of the investigation or the safety of any involved persons).<sup>83</sup> There, they may be subject to court supervision to ensure their cooperation, or be required periodically to return to the jurisdiction in which they are charged with a crime.<sup>84</sup> While no international framework to ensure such cooperation between member states yet exists, the idea is one espoused by the Council of Europe, which recommends that "[w]herever practicable, alternative measures shall be applied in the state where a suspected offender is normally resident if this is not the state in which the offence was allegedly committed."<sup>85</sup> Such a measure would require extensive international cooperation, but would prevent non-nationals charged with crimes from becoming isolated in foreign territory with little recourse to local legal aid.

## VI. Conclusion

Ideally, continued progress in the arena of criminal justice will lead to a widespread cultural shift across all European states that emphasizes restorative justice, strong human rights protections, and a move away from punitive and custody-centered criminal codes. Over decades, states can continue to reduce the size of their prison populations and commit greater resources to ensuring that judicial authorities adhere to international standards in administering pre-trial detention and are not unduly influenced by prosecutorial power or personal prejudice. However, such a shift is years away, and justice for pre-trial detainees in Europe will require more immediate changes on a state-by-state level. Reform will re-

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<sup>80</sup> *Id.*

<sup>81</sup> *Commission Green Paper*, *supra* note 28, at 9.

<sup>82</sup> See Lappi-Seppälä, *supra* note 55, at 368 (discussing the effects of open borders on increasing crime in Finland); Stojanovski, *supra* note 6, at 86 (discussing the use of pre-trial detention to preemptively prevent flight of non-nationals even in cases involving crimes with non-custodial penalties).

<sup>83</sup> Stojanovski, *supra* note 6.

<sup>84</sup> Stojanovski, *supra* note 6.

<sup>85</sup> Eur. Consult. Ass., *supra* note 8.

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quire a more widespread use of alternatives to remand in custody, with strong national commitments to ensuring that custodial detention measures are carried out efficiently, justly, and only under necessary circumstances.

While no single solution will have equal effectiveness across all member states, due to differences in their legal systems, their populations, and their political and economic circumstances, reform must begin with better and more detailed collection of data, which could be used to draw more useful comparisons between states and to pinpoint more exactly where problems persist. Further study would also help to determine problems' sources, whether they stem from a lack of resources for proper oversight of criminal proceedings, from some weakness in the criminal code that facilitates abuse of pre-trial detention, or from corruption within the legal system. Some states require attention to issues of basic human rights, such as adequate conditions in detention centers, separation of prisoners and detainees, and statutory maximums on length of pre-trial detention. Other states, having taken the vital step of adding protections for detainees into their criminal codes, require further oversight to ensure that judges do not abuse their discretion in choosing to order pre-trial detention over possible alternatives. In all states, greater care must be taken to ensure that pre-trial detention is a measure used to improve judicial efficiency and to protect both the accused and other involved persons during a criminal investigation, not a measure used to punish the poor, the marginalized, and non-nationals.





