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Post-embargo Cuba: How Risky?

By Jerry Haar

Last month's announcement of a U.S.-Cuba normalization accord has produced euphoria among American companies and entrepreneurs, even though the trade and financial provisions of the agreement are more fine-tuning than major change. Only full removal of the embargo (which only Congress can do) will create a myriad of profitable opportunities in sectors such as tourism and agribusiness, despite the first-mover advantages of Canadian, European and Asian companies presently doing business with Cuba.

American business should be fully aware of the risks involved in a post-embargo environment. To begin with, there is the economic landscape. Cuba is an economic basket case and a deadbeat borrower with an anemic economic growth rate forecast to be 1.2%. Total hard currency debt is approximately $75 billion (making Cuba technically insolvent), and the country's GDP is only $72.3 billion—less than Belarus, Angola, and Home Depot's annual sales *ten years ago.*

Regarding trade, the U.S. and Cuba do have a trade relationship; however, it is restricted primarily to agricultural commodities and products, medicines, and health care products. Post-embargo, Cuba will be a fruitful market for telecom and IT equipment, agribusiness and construction products and equipment and scores of other goods. However, who is going to finance trade with Cuba and under what terms? Without U.S government guarantees for trade financing and insurance, neither banks nor companies will not extend credit to a nation that is notorious for squelching on its loans.

As for consumer markets, there is the question of access and affordability. Cubans can presently purchase a wide range of imported goods—providing they are available and affordable. (Doubtful on both counts.) Samsung products (South Korea), Adidas athletic shoes (Germany), Diesel jeans (Italy) as well as gray market goods are but a few. But at what price? The average annual income in Cuba is $240. It is 7 times greater in the Dominican Republic, nearly 5 times more in Haiti, and 15 times more in Jamaica. The first two countries have populations roughly equivalent to Cuba's, so even if the embargo were to be lifted tomorrow, how attractive is the Cuban consumer market—a market where the monthly wage is equal to one Cohiba "Lancero" cigar?

Finally, there is the investment environment. Ranked by the Economist Intelligence Unit as one of the four riskiest countries on the planet to invest, #176 out of 177 on the Heritage Foundation's Index of Economic Freedom, and 63rd out of 177 in Transparency International's 2013 corruption index (tied with Ghana and five spots lower than the previous year), Cuba is high risk, to say the least.

Cuba did promulgate a new foreign investment law in April 2014; but it is laden with inherent contradictions and an absence of investor protection. On the plus side, it now allows 100% ownership of ventures, a 50% cut in profits tax, and the free transfer of profits and dividends. On the other hand, foreign companies cannot hire their own employees. The firm must pay a government employment agency in dollars for labor, while the agency pays the firm's workers in pesos—which can be 40-60 times less! As for small enterprise owners, there are virtually no deductions on gross income, and they are slammed with effective tax rates approaching or exceeding 100%. They must make all purchases through the state, are limited to certain sectors, and are restricted as to how many employees they can hire.

With few takers to the incentives offered in the foreign investment law, Cuba issued an appeal to international companies last year to invest over $8 billion in 246 specific developments projects, 80% of which are in agro-food, oil, and tourism. But as Brookings economist and Cuba expert Richard Feinberg points out, Cuba's invitation is imbued with many contradictory impulses—turn-offs for the international investor community. These include a mandate to sell their output to state distribution systems and pre-fixed prices, a "guarantee" of foreign markets (performance requirements for exporting), a prohibition on partnering with small private enterprises, and

Finally, it is not alarmist to caution foreign business executives about doing business at their own personal risk. During the last three years, businessmen from Canada, the U.K., Panama and Lebanon have been sentenced to jail on corruption charges or spying and their projects confiscated. It is no surprise that for security as well as economic reasons of the 400 firms invested in Cuba in 2000, half have pulled out. One should note, too that about 600 foreign European suppliers have had $1 billion in assets frozen in banks by the Cuban government over the last five years.

Doing business in or with Cuba today is risky. That will not change immediately in a post-embargo environment. So best to heed the advice of Victor Hugo who counseled: "Caution is the eldest child of wisdom."

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