Investing in Cuba: Balancing the Risk
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ABSTRACT
Cuba has been updating its foreign investing laws in expectation for attracting and retaining international investors, however, risks remain. This paper examines the opportunities and challenges presented to would be foreign investors. There is a brief introduction to Law No. 118, Cuba’s revised foreign investing law and a sampling of the various modes of foreign investment opportunities presently available in Cuba. These modes include International Economic Association Contracts (IEA), the full foreign capital company, and joint ventures. There is also a discussion of import and export, franchising and real property.

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1. Introduction

Cuba is working hard to attract foreign investors with reforms to its foreign investing laws; however, whether these reforms will actually reduce investor risk is yet to be seen (Backer et al. 2015). For foreign investors and multi-national entrepreneurs hoping to exploit new business opportunities in Cuba, there will still be many challenges ahead (Paparelli et al. 2015).

2. Change is on the Horizon

Cuba has been in an accelerated state of adapting and adjusting since 2011 (Zamora et al. 2013). The entire economic landscape is currently under reconstruction with diversification of international trade, domestic restrictions being lifted, and Cuban nationals being encouraged to develop entrepreneurial ventures (Piccone & Trinkunas et al. 2014). Cuban Entrepreneurs, who comprise eleven percent of the local labor force, are being trained, in part, through the work of Proyecto Cuba Emprende¹, a school run by the Catholic Church of Cuba dedicated to equipping Cuban entrepreneurs. Since 2012, there have already been nearly 2000 graduates (Paparelli et al. 2015).

3. Reforming Foreign Investing Laws

In April of 2014 the Cuban Legislature adopted Law No. 118, known as the Foreign Investment Act², to strengthen guarantees for investors and offer increased tax incentives in the form of credits and exemptions that allow for flexibility in customs procedures (Law No.118 et al. 2014). The Foreign Investment Act also reformed foreign direct investment with diversification of markets, access to advanced technology, and a substitution of importation, giving priority to agriculture (Law No.118 et al. 2014). The law promises greater protection against expropriation, repatriation of dividends and profits free from taxes in convertible currency and tax incentives including reduced profit tax, exemption from income tax and the elimination of the labor tax (Law No.118 et al. 2014).

¹ For more information visit: http://www.cubaemprendefoundation.org/
² Link: http://www.cubadiplomatica.cu/LinkClick.aspx?fileticket=IisdG-CVp5To%3D&tabid=21894
4. Modes of International Investing in Cuba

The Cuban State encourages three modes of international investing including: (1) International Economic Association Contracts (IEA); (2) full foreign capital company; and (3) joint ventures consisting of both Cuban and foreign shareholders (Travieso-Diaz & Trumbull IV et al. 2003). Travieso-Diaz and Trumbull IV et al. (2003) described the International Economic Association (IEA) as an entity that: “Does not require the establishment of a legal entity separate from the contracting investors. International Economic Association Contracts are normally established because the contracting parties can meet a common objective through cooperation.”

A full foreign capital company is still disfavored by the Cuban State and rarely seen in operation, however, when it does happen it is established through registration with the Chamber of Commerce and authorized by the Cuban government. That leaves the joint venture, the most favored choice of the Cuban State (Feinberg et al. 2013).

5. The Joint Venture

Joint Ventures accounted for an estimated $1.9 billion in exports in Cuba in 2008, with eighty percent coming from a very small number of firms including Sherritt International, Habanos, Havana Club rum, Rio Zaza, & BM and Sol Meliá according to Feinberg et al. (2013) in his report. Further, the report stated Cuba has added $3.5 billion to savings and investments from foreign direct investments in the last two decades. Popular joint ventures between the Cuban government and foreign investors usually include: natural resource exploration, construction, agriculture production, hotel administration and professional service areas (Miranda Diaz et al. 2015). However, foreign direct investments accounted for only seven percent of Cuba’s domestic output in 2013 and joint ventures employed less than one percent (or 34,000 workers) of the active labor force (Feinberg et al. 2013).

These figures may bolster investor confidence, however, it is important to remember that these are joint ventures with the Cuban State. Disputes between partners and judicial resolution can prove to be tenuous (Paparelli et al. 2015). The only private Cuban citizens who may incorporate businesses or form joint ventures are those seeking self-employment such as taxicab services, restaurants, and similar small businesses, or cooperatives consisting of associations of self-employed persons such as taxi drivers (Feinberg et al. 2013).
For investors interested in forming a joint venture Chapter V, Article 14.1 of the Foreign Investment Act provides the following guidance: (1) Start with a company incorporated with nominal shares; (2) The proportion of shares need to be agreed upon by the shareholders; (3) Offices may be maintained in Cuba or abroad; (4) A document created by a notary deed must include the social rules; (5) An inscription in the Cuban commercial registry is required and; (6) Any changes to the shareholders require State approval. According to Cuban attorney Miranda Diaz, controlling ownership in a Cuban joint venture can be negotiated at the time of contracting (Law No.118 et al. 2014).

6. Import and Export

In an effort to encourage foreign import and export, Cuba has recently allowed the building of the Mariel Port and Free-Trade Zone by Odebrecht, a Brazilian construction company (Morris et al. 2014). This joint venture with Brazilian bank, BNDES, is believed to be “the largest infrastructure investment since 1990.” Raul Castro said of the Port: “This container terminal, and the powerful infrastructure accompanying it, are a concrete example of the optimism and confidence with which we Cubans see a socialist and prosperous future.” (Morris et al. 2014). Chapter X, Article 26.1 of the Foreign Investing Act specifically provides that, “Joint ventures, national and foreign investors which are parties to international economic association agreements and totally foreign capital companies shall be entitled, in accordance with the provisions set for such purposes, to directly export and import whatever is needed for their operation.” (Law No.118 et al. 2014).

7. Franchising

Presently there are no foreign owned traditional franchises, however, there are joint ventures with licensing rights (Paparelli et al. 2015). The 2014 changes to the Foreign Investing Law, however, allow for direct and wholly owned investments, preparing the way for franchising and the development of new laws addressing the unique needs of franchising (Zamora et al. 2015)³.

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8. Real Estate Development

Real estate development is also addressed in the new Foreign Investing Law under Chapter VI, Article 17.1, which allows for faster approval processes for golf ventures, special economic zones, and marina developments and provides a ten-year reprieve from paying taxes and lower taxes on profits (Law No. 118 et al. 2014). When it comes to real property, investors should exercise caution, as a large number of outstanding U.S. property settlement claims, representing 8,821 claims, valued at over seven billion dollars still exist according to the Foreign Claim Settlement Commission of the United States Cuban Claims Program Certified Claimant List et al. (2009) (Scott et al. 2014).

9. Options for U.S Investors

U.S. investors are particularly limited in their investment opportunities due to the U.S. embargo and the Helms-Burton Act, which restricts anyone subject to United States jurisdiction from trading with Cuba (Kennedy et al. 1962, Narine et al. 2015). The United States Congress held hearings in July 2015 to address property rights in Cuba and it is likely that Congress will not lift the embargo until there is some path to resolution on the confiscation claims.

These limitations, however, are not a complete bar as the 49/49 Rule offers legally permissible options (Paparelli et al. 2015). Under the 49/49 Rule, a U.S investor may invest in a non-Cuban, third country entity engaged in commercial ventures that receives the majority of its revenue from sources outside of Cuba. However, the United States investment must not be controlling (49%) and the majority of revenues of the third country entity must not be derived from Cuba (49%) (Paparelli et al. 2015).

Recent amendments to the Cuban Assets Control Regulations by the Obama administration in September of 2015 have eased some of the restrictions (United States Department of the Treasury et al. 2015). A complete list of the amendments can be found in 31 Code of Federal Regulations part 515 and 15 Code of Federal Regulations parts 740, 746, and 772. Some of those changes include permission:
1. To expand telecommunications and internet-based services.
2. To establish and maintain a physical presence in Cuba such as an office, retail outlet, or warehouse.
3. To export certain goods authorized by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury, which administers and enforces economic and trade sanctions.
4. To provide mail or transport of parcels, organizing or conducting educational services, or religious organizations.
5. To provide travel services. These individuals may also employ local Cubans and open and maintain bank accounts in Cuba.
6. For legal services to be provided to Cuba and Cubans and be received from Cuba or Cuban nationals under a general license.
7. For limits on donative remittances to Cuban nationals and limits on remittances individuals may carry into Cuba to be removed entirely.

10. Conclusion

Investing in Cuba, even with the reforms in foreign investing laws, is still risky business. As with any frontier market, risk will be reduced as the market is established both nationally and globally. The legal issues surrounding banking and currency, entity formation, distribution, intellectual property and dispute resolution will need to be closely monitored. Other issues like infrastructure and socio-political climate must be considered as well. In the end, there will be those who dare to take the risk, and those who dare not.

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years. He is the author of numerous scholarly publications dealing with Latin America and the Caribbean. He is also a founder of the Cuban American Bar Association.

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Marcia Narine, Ten Ethics-Based Questions for U.S. Companies Seeking to do Business in Cuba (Aug. 29, 2015). Available at SSRN: http://ssrn.com/abstract=2653034. The United States Congress held hearings in July 2015 to address property rights in Cuba and it is likely that Congress will not lift the embargo until there is some path to resolution on the confiscation claims.