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Oh, Canada, Will Cuba Stand on Guard for Thee?

Preparing for the End of the U.S. Embargo On Cuba

By Paolo Spadoni and Julia Sagebien

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Oh, Canada, will Cuba stand on guard for thee? Preparing for the end of the U.S. embargo on Cuba[1]

By Paolo Spadoni and Julia Sagebien

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Just how will a lifting of the U.S. trade embargo on Cuba affect Canadian companies? What strategies and scenarios should Canadian managers be considering for a post-embargo era? The answers to these and other key questions are provided in this Ivey Business Journal article.

Canada's investment, trade and cultural links with Cuba are substantial. In fact, Canada is the second-largest foreign investor in Cuba (after Venezuela) and the third-ranking country in terms of joint ventures with Cuba. Canada is also Cuba's fourth-largest merchandise trade partner, behind Venezuela, China, and Spain. And Canada sends more tourists to Cuba each year (about 818,000 in 2008) than any other country. But with the end of the U.S. economic embargo against Cuba seeming more and more likely, Canadian firms may soon find themselves doing business in a much more competitive environment, and forced to modify or change their strategy.

Though a full lifting of Washington's embargo is not imminent, it is very likely that in the next year or two the Obama administration will relax some of the sanctions now in effect. Overall, a partial lifting of the embargo might prove to have more of a positive than negative impact on Canadian business. With the injection of cash from American visitors and relatively little competition from U.S. investors or traders, the time between the end of the travel ban on U.S. citizens and the complete lifting of Washington's embargo will create a rather unique scenario in Cuba. It will be unique because the growing number of U.S. tourists will create business opportunities for all, except the American firms, thus leaving Canadians especially with numerous opportunities.

A complete lifting of the embargo will create a temporary economic boom, as the coffers of international financial institutions (IFIs) open again, foreign direct investment flows back in without the risk of tensions with the United States, and Cuba's external debt arrears are renegotiated. The impact of U.S. businesses, including Cuban-American concerns, on the business landscape of Cuba will be enormous. Some Canadian companies may stand to gain from first-mover advantages. Others will stand to lose when they find that cannot compete effectively with Cuba's natural U.S. trading partners or because compensation for the owners of the nationalized assets they have been using becomes too onerous or cumbersome. For others, it might be a mixture of both first-mover advantage and the loss of competition or hefty compensations. And yet for others, piggy backing on U.S. advances might be the best strategy for market entry or expansion. In the long-run, Cuba will be just another Caribbean Basin country with a trade eco-system similar to that of other countries in the region. This suggests that

[1] The authors wish to thank Ramon Coto Ojeda, Managing Partner, Coto, Malley & Tamargo and Dr. Diego Iribaren, University of Puerto Rico for their helpful suggestions.

Canadian traders with competitive advantages in the region, such as those gained through sustained quality, price, and supply chain efficiencies, will likely have the same competitive advantages in Cuba.

In order to successfully withstand the U.S. competition and take advantage of new opportunities in a post-embargo world, Canada must begin to prepare now. This article provides a brief overview of the embargo, examines how the easing of its restrictions will likely unfold, and explores ways in which Canadian business can start preparing for this eventuality. A list of more in-depth suggested readings is provided at the end of the article.

What is the U.S. embargo against Cuba?

The U.S. embargo against Cuba is not one "thing." It is an aspect of a multi-faceted, far-reaching set of U.S. policies that affect the island nation. The embargo itself is a combination of statutes and regulations that have been modified over time (e.g. the Torricelli Act of 1992). The most important modification is the Helms-Burton Act of 1996, which codified the embargo into law and took the right to lift the embargo away from the president. Now, only a vote by Congress can revoke the Act. Helms-Burton also has implications for companies such as Sherritt International, who are deemed to be "trafficking" in goods that belonged to U.S. citizens, but were expropriated by the Castro government. Other legislation, like the 9-11-inspired Patriot Act, enacted to punish "terrorist states," affects business in Cuba.

Since the embargo is actually a set of economic sanctions that must pass through a series of political processes in order to be amended, lifting it all at once might simply prove too difficult. The most likely scenario will see parts of the embargo lifted a bit at a time, creating a "Swiss cheese" embargo. The most likely measures to be implemented during the Obama administration are: 1) less stringent (e.g. not only on a cash-ahead basis) rules on payment procedures for Cuba's purchases of U.S. food products; 2) an exemption that would allow Cuban oil to be sold to the United States and eventually allow U.S.-based oil corporations to drill for crude in Cuban offshore waters; and 3) a lifting of the travel ban for all American citizens. The removal of the travel ban will put the largest hole in the Swiss cheese embargo, and lobbying to lift parts of, or the entire embargo will follow from the booming flow of U.S. travelers.

U.S. domestic politics and especially the Cuban-American exile community will play a key role in any normalization of relations. However, the full lifting of Washington's economic embargo against Cuba is likely to occur only when both Fidel and Raúl Castro are no longer in power.

The end of the embargo - Chronicle of a death foretold[2]

U.S. policy toward Cuba has already begun to change. Thanks to an October 2000 amendment to the embargo, one lobbied for by powerful U.S. agricultural groups, the United States has become the largest exporter of foodstuffs to Cuba, selling approximately US$710 million worth of goods in 2008. On April 13, 2009, the Obama administration announced the lifting of all restrictions on Cuban-American travel and remittances to Cuba. It also said it would allow U.S.

[2] Cronica de Una Muerte Anunciada is a well-known novel by Gabriel Garcia Marquez, a good friend of Fidel Castro, which narrates in retrospective, the death of an inhabitant in a small Colombian town.

telecommunications companies to set up fiber-optic cable and satellite links with Cuba, start roaming service agreements, and permit U.S. residents to pay for telecoms, satellite radio and television services provided to people in Cuba. Both countries have agreed to reopen talks on migration and direct mail service. Cuba's President Raúl Castro has welcomed U.S. overtures. However, despite the friendly bilateral gestures, Raúl Castro and Barack Obama are not likely to see eye to eye for some time. Two "exceptionalist countries," long at loggerheads, are going to take a long time to find a common ground.

One example of the convoluted U.S.-Cuba realpolitik was the June 3rd 2009 lifting of the 1962 ban on Cuba's membership in the Organization of American States (OAS). The lifting, initiated by the OAS itself and approved by acclamation, was resisted by the United States because of Cuba's human rights record and welcomed with a "Thanks but no thanks" reply from Havana. Perhaps the one factor that will make Cubans welcome U.S. measures to ease the embargo -- such as the end of the travel ban -- with a more open mind is that the Cuban economy is being affected by the deterioration in global nickel prices, a downturn in revenues from international tourism, hurricane damage to its infrastructure, and limits in the oil-backed Venezuelan largesse. Ironically, the specter of another wave of Cuban rafters and a chaotic state of affairs 90 miles from American shores make a rapid easing of embargo restrictions – of all things – a way to protect U.S. national security.

How should Canadian businesses prepare?

For Canadian businesses and for the Canadian government, the basic challenge is how to respond quickly and strategically to the process and dynamics that will unfold as the current embargo goes through the complex, unpredictable iterations of becoming a "Swiss cheese" embargo, one that will eventually make Cuba just another Caribbean island. This is likely to occur in the next one to four years, barring a major Cuban-produced monkey wrench being thrown into the process (e.g. the 1980 Mariel boatlift or the February 1996 shooting of the Brothers to the Rescue planes that guaranteed Helms Burton's passing). Below are nine observations and recommended strategies Canadian companies should consider.

1. **Don't expect much to change in Cuba's business environment.**

The London-based Economist Intelligence Unit ranks the Cuban business environment as one of the world's worst. In recent years, the island was ranked 80 of 82 nations surveyed, with only Iran and Angola rated lower. Neither the business environment nor the general economic "enabling environment" will improve much for some time. Until the end of the travel ban, there will be no major effort to attract foreign investment (except for joint ventures with Venezuela) or to make life easier for traders until market forces and private property are no longer seen as a threat to the ruling elites. The business environment will actually get worse before it gets better. As the embargo is slowly lifted and the reality of "normalization of relations" is constructed, Canadian firms will have to deploy their legal teams and protect themselves from possible claims on expropriated properties by U.S. companies, and even by Cuban-American firms and individuals.

2. **Cubans will not be loyal to established suppliers and will bargain for the best deals.**

Canadian traders will face fierce competition from U.S. producers. Cuban authorities will remain sensitive to prices and bargain hard to find the best deals. Their roster of approved suppliers should also expand as more financial resources (funds from IFIs and U.S. entities pouring into the island) become available. Canada will not have a “special relationship” with Cuba if competitors provide better credit terms. The benefits of a full lifting of the embargo will be considerable, but Canadian suppliers will need to create competitive advantages just like any others.

3. Venezuela.

Cuba’s recent efforts to buy from China and Latin American countries are beginning to negatively affect Canadian food suppliers and Canada’s position as a leading foreign investor. Canadian traders could see a reduction in sales to Cuba, due to the latter’s attempts to stimulate its productive (agriculture and manufacturing) base as well as to diversify its list of trading partners by, for example, starting to trade with China and the ALBA countries (Alternativa Bolivariana para las Américas or Bolivarian Alternative for the Americas). Traders will have to learn how to import Canadian goods and know-how into the Cuban import substitution and national distribution network strategies. For instance, Cuba’s import-substitution policies on the agricultural side may bring opportunities for Canadian firms in agrifood input areas such as fertilizers and machinery. In particular, Canada’s exports of potassium chloride (mainly used in the production of fertilizers) to Cuba have already grown noticeably in recent years. The post-2004 expansion of medical cooperation programs between Cuba and Venezuela could significantly boost Canadian exports of medical devices to the island.

4. **Take advantage of the end of the travel ban.**

The huge influx of U.S. tourists will probably lead to fewer European and Canadian visitors, some of whom like to go to Cuba for the very reason that few Americans go there. Nevertheless, travel agents and airlines from Canada and other countries could easily move people to other destinations once Americans do come in.

Because of its heavy reliance on sugar production, the island has never been self-sufficient in food and it is doubtful that it could stimulate domestic agricultural production in order to significantly reduce food imports. Thus, Havana’s authorities will have to import substantial amounts of agricultural products. Given the good reputation of its products, Canada should be able to reap considerable benefits. Anecdotal evidence indicates that better-quality Canadian wheat sold to Cuba is mixed with U.S. wheat for bread, and when high-quality parts and equipment are required, Canadian goods are usually preferred. Further easing of restrictions on U.S. food trade to Cuba (e.g. ability to sell on credit) will surely follow; this will intensify pressure on some Canadian agricultural producers. However, Canada’s principal food exports to the island, such as cereals, meat (except frozen chicken), and vegetables have already weathered substantial U.S. competition, albeit with some problems.

Besides the need for more food imports, the Cuban government will face tremendous pressure to improve tourist facilities and, in general, all kinds of infrastructure (e.g. energy) across the island to make sure that Cubans do not suffer from the extra-demand created by tourists. Scheduled blackouts, housing shortages, transportation problems and other basic infrastructure deficiencies have been ameliorated, though only somewhat. This will require some additional foreign investment. According to Havana’s authorities, the island would have to more than double its current capacity of 48,000 hotel rooms to accommodate an estimated 3 million American tourists. Although the presence of Canadian equity investors in new hotels could remain limited due to their exposure to the U.S. market and potential problems with the Helms-Burton law, the presence of Canadian companies in many other tourism and non tourism-related sectors could expand significantly. Curiously, there are no Canadian hotel management contracts on the island at the moment, despite the fact that more Canadians go to Cuba than any other internationality.

The Cuban government is already bracing itself for a probable ending of the U.S. embargo. The island's authorities will likely try to control the flow of U.S. tourists through visas and, due to capacity constraints, a temporary rise in hotel rates. Hotel service is not on a par with Caribbean standards and the food is not as good as in other sun-and-beach destinations (this mostly explains why there is a low rate of repeat visitors to Cuba).

5. **Trade will probably continue to follow investment.**

A discernible pattern in Canada-Cuba commercial relations to date is that trade has tended to follow investment. In other words, a significant share of Canadian exports to Cuba targets sectors with notable Canadian investments. This is typically the result of an existing synergy between traders and investors that provides clear advantages in the home country and makes commercial sense, not necessarily because of a particular preference for Canadian suppliers. Sherritt's investment activities in oil, natural gas, nickel extraction, and electricity generation on the island are emblematic in this regard. Between 2001 and 2008, Canada sold Cuba more than $300 worth of equipment and machinery for producing oil, gas, mining, and electricity. U.S. initiatives to permit Cuban oil to be sold in the United States would open up a new, important market for Canadian investors on the island and remove some legal issues related to the embargo. Yet, a major discovery of light crude oil in Cuba's Gulf of Mexico waters would raise the likelihood of U.S. corporations being allowed to bid for exploration rights in these offshore areas and to participate directly in the Cuban oil trade.

It would seem natural to suggest that more joint ventures on the island should be promoted. However, this represents a major challenge for Canadian business and it is unlikely to happen under the current conditions in Cuba. The Cuban government has rationalized its investment portfolio and it continues to be selective when choosing joint ventures, showing a predilection for projects involving Venezuelan partners. It is doubtful that the overall investment environment in Cuba could attract many new Canadian joint ventures in the short term, except in some specific situations such as construction and energy. In fact, Havana's authorities recently authorized only one new joint venture with Canada, in soybean production. Additionally, China's growing trade with Cuba might have some negative repercussions for Canadian business. So far, Chinese firms are supplying Cuba with relatively low-quality products, but they could trade up on quality and eventually replace some Canadian providers.

6. **Prepare for an aggressive export credit policy as financing will be key to protecting and expanding Canada's market share.**

Canadian traders are likely to see trade volumes reduced as U.S. firms come in with vigorous, share-gaining strategies that involve price advantages and especially U.S. government support for credit. Canada has been supporting business transactions with Cuba through financing provided by banks (e.g. National Bank of Canada), factoring companies and other private entities, as well as the Export Development Canada (EDC), the government body charged with helping Canadian exporters and investors. The island has relatively modest credit arrears with Canada, and the EDC financing experience, in particular, has been positive, mainly due to the establishment of clear repayment schedules and guarantees. But the EDC's credit lines are currently at limit, and even the Canadian Wheat Board is in a similar situation. Cubans are asking for more credit. Once the embargo is lifted, EDC support will become key to increasing exports to Cuba and securing additional business for Canadian companies. Interestingly, while American food sales to Cuba are conducted on a cash-only basis, Canadian banks have assumed an intermediary role by providing credit to U.S. agricultural producers. Easier credit terms will certainly be an issue once U.S. financial entities can support commercial transactions with Cuba. At that time or before, Canadian credit will have to be reviewed and probably revamped.

The Canadian Commercial Corporation (CCC)-sponsored programs that act as trading houses are very important because their personnel have very good market knowledge. The CCC has helped Canadian companies win contracts in Cuba by acting as a prime contractor. Havana's officials prefer government-to-government negotiations, thus making procurement simpler. The deals have a Canadian government-backed contract completion guarantee. The CCC searches for deals involving hard-currency, export receivables, acceptable secured payment mechanisms (often offshore), and acceptable repayment terms (depending on the type of goods from 120 days to 2 years). Though the CCC faces substantial constraints on business expansion because of its current level of exposure to Cuba, its project criteria are useful for traders and should be studied carefully. The strength of supplier/buyer relationships and suppliers' track record on the ground are indeed crucial. Assuming that Cuba will not privatize its state-owned firms in the near future, and perhaps even after the end of the U.S. embargo, Canadian Crown corporations could provide appropriate business models and a base for future relationships.

7. **Identify sectors where Canada has a competitive advantage and plan promotional activities in these sectors. Gather the know-how while the U.S. embargo is still in place. Promote visits – now – of Canadian consulting firms to identify business opportunities in emerging sectors.**

This should be done, especially in sectors where Canadians have clear advantage over Europeans, Chinese and Venezuelans (e.g. energy). Canada could use the time between now and the full lifting of Washington's embargo to get its engineering companies to work with the Cubans on infrastructure upgrading. The entry proposition could be the end of the travel ban and the huge increase in demand on electrical, water, and sewage infrastructures, as well as demand for the construction of new hotels and tourism facilities. An entry point for Canadian service engineering might pass through Venezuelan partners.

8. **As procurement patterns are likely to favor U.S. suppliers, develop a strategy to position Canadian suppliers as part of U.S.-based global supply chains.**

Successful export strategies have as much to do with competitive supply chains as they do with product price/quality. For many Caribbean Basin-bound U.S. goods, the capacity of U.S. ports to consolidate goods is a crucial competitive advantage. Once the embargo is lifted, Canadian traders will have to compete with U.S. producers who have greater economies of scale and much more efficient supply chains, as restrictions on ships using U.S. ports after touching Cuba (established by the Torricelli law) will also be lifted. Therefore, supply chain strategies that involve using U.S. ports should be studied. Supply-chain, goods-consolidation and shipping efficiency-based strategies that incorporate Cuba in Caribbean Basin trade patterns should be quickly developed.

Distance and relatively small volumes are Canadian disadvantages that could be minimized through a careful look at supply chain efficiencies, trade consolidation, and synergistic trade patterns involving several islands and countries. Cuba's trading patterns, both pre and post-embargo, should be included in all Caribbean Basin studies addressing supply chain issues (e.g. Canadian Embassy in Jamaica's shipping study, and the Canadian Consulate in Miami's Gateway Study). The Miami Gateway Study's preliminary results indicate that Miami, which offers adequate quality in all the necessary services in one single place, acts as a gateway to Latin American trade and may provide efficiencies and service advantages to Canadian exporters. Tampa is another location that is aggressively seeking business and might be a consolidator port to explore further. Major U.S.-based corporations like Wal-Mart and Costco are exploiting their supply chain technologies and volume purchasing price advantages to act as wholesalers/consolidators for smaller businesses in Latin America (e.g. supermarkets). Canadian goods could be sold to smaller Latin American buyers, if available, through these companies. Moreover, once the embargo is removed, some Canadian goods will appear as components of American products exported to Cuba or may even be shipped from the United States to the island after they are sold to U.S. firms. Finally, it would be useful to study the role Canadian subsidiaries of U.S. firms could play in supplying the Cuban market with made-in-Canada products and services.

9. **Benchmark your products against U.S. competitors in other Caribbean and Latin American markets.**

Some day, Cuba will just be "another Caribbean country," trading with the United States and having access to international credit. Therefore, Canadians must begin to build strategies that leverage what they already do well in the region. Far from arguing that Canadian traders will not be affected by growing U.S. competition in Cuba, the actual impact of the lifting of the embargo on their commercial dealings with the island might not be as harmful as it seems at first glance. In terms of revenues (see Table 1), Canada's biggest exports to all countries are oil and mining preparations, agricultural goods, motor vehicles and related parts, energy equipment, and trucks. Canadian firms are already involved in most areas in Cuba. More importantly, a closer look at Canada's regional trade patterns reveals that the country's principal products exported to Latin America are quite similar to those sold to Cuba.

Thirteen of the top 15 Canadian products exported to Latin America (excluding Mexico), are also the top products exported to Cuba. This means that Canadians could have a natural advantage in certain sectors. For instance, wheat ranked first and second among goods Canada exported to Latin America and Cuba in 2008, respectively. Sulfur, mainly used for oil and nickel processing, ranked third and first, respectively. Potassium chloride, whose chief use is in the production of fertilizers, was Canada's top exported product to all countries in 2008, the second-largest in Latin America, and the fourth-largest in Cuba. Furthermore, the composition of Canada's exports to Cuba resembles that of its exports to the Dominican Republic, a Caribbean island with strong economic ties with the United States. As Canadian companies were generally able to withstand U.S. trade competition in Latin America, there is a good chance that, after a process of adjustment, they would have the same competitive advantages in a post-embargo

Cuba. And if there are Canadian firms serving Latin American markets well, it makes sense that they would want to expand to Cuba or work with Canadians and others already on the ground, once all U.S. economic sanctions are lifted.

In agricultural trade, Canadian products that are competitive in Cuba include wheat, peas, potatoes, pork, and seafood. Canada is already strong in certain commodities in the Caribbean. For example, it has a clear comparative advantage over Americans in legumes because of the greater availability of cheap land and the fact that the U.S. government does not offer subsidies to legumes farmers. Existing Canadian advantages in the region bode well for a post-embargo, Caribbean Basin supply chain-based strategy. Canada is also strong in some packaged foods like French fries and pork products.

About 6-7 percent of the goods imported by Caribbean countries come from Canada, making the latter a main supplier in the region. One advantage for Canadian firms in the Caribbean Basin is that they are relatively small compared to U.S. giants and capable of selling customized goods and services to niche or small markets (e.g. customized cabinets, staircases, and private label food products). Canadian firms could serve custom niches in Cuba competitively, although there may be many small and medium-sized enterprises (SMEs) in the southern coastal region of the U.S. thinking the same thing. Therefore, Canada should look to where it is already competitive. Besides agriculture, Canadian goods in the Caribbean Basin include custom medical equipment, IT/electronic/telecom products, and construction material. In the broader Latin American region, Canada is also strong in electrical machinery and copper wire, motor vehicles and related parts, iron/steel products, and newsprint.

When the U.S. embargo on Cuba is fully lifted, Cuban authorities will not stand on guard for their Canadian commercial partners. There will be no special concessions. However, established know-how and relationships will continue to be important in building and sustaining business ties. Once Cuba becomes "just another country" in Latin America (albeit one with a lot to build on, very well educated people and relatively large state control of the economy), whatever works for Canadian companies in other parts of the Americas should become the core of a company's strategy for Cuba. Advantages can be built in terms of products and services, transportation links, supply chain efficiencies, and very importantly, credit terms. The Canadian government, in particular, might provide crucial help with credit availability since Cuba's economic leaders will face many demands. Furthermore, when Cuba regains access to long-term external financing and stops being primarily an indebted cash economy, the accumulated knowledge Canadian firms have about the Cuban market and its infrastructure needs should boost the position of Canadian firms vis-à-vis competitors, as infrastructure-rebuilding money from international financial institutions comes on line. Firms should also ensure that their lawyers are ready to address any property claims and to interpret legal/commercial frameworks as they develop.

In sum, Canadian firms' investment and trade links with Cuba will have substantial value as long as these firms remain competitive and prepare adequately.

SUGGESTED READINGS

Brookings Institution. Cuba: A New Policy of Critical and Constructive Engagement. Report of the Brookings Project on U.S. Policy Toward a Cuba in Transition, April 2009.

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TABLE 1. Canada's Main Exports to Latin America and Cuba in 2008
(value in '000 of Canadian dollars and rank among largest export products)

Product	All Countries		Latin America (excl. Mexico)		Dominican Republic		Cuba	
	value	rank	value	rank	value	rank	value	rank
Sulfur	406,045	10	158,763	3	--	--	90,859	1
Wheat and Meslin	5,209,729	2	814,874	1	10,607	3	72,897	2
Peas (dried and shelled)	780,809	7	108,370	5	131	8	62,013	3
Potassium Chloride	6,296,611	1	620,527	2	19,330	1	25,369	4
Parts of automatic data processing machines	1,138,577	5	27,925	7	131	9	22,417	5
Motor vehicle parts	2,853,278	3	26,369	8	493	5	16,175	6
Parts of boring or sinking machinery	1,345,172	4	109,568	4	641	4	14,581	7
Copper Wire	975,905	6	80,142	6	14,459	2	14,557	8
Clothing and other worn textile articles	187,072	12	19,146	10	3	12	12,592	9
Milk/Cream Powder	39,732	15	17,105	12	--	--	12,569	10
Parts for diesel engines	417,477	9	14,186	13	260	6	9,300	12
Parts for work trucks	36,696	16	9,028	14	16	11	8,138	13
Additives for mineral	48,018	14	8,895	15	2	13	7,114	15

Source: Industry Canada, Trade Data Online.
Note: Excluding Mexico, Cuba was Canada's third largest export market in Latin America after Brazil and Venezuela in 2008.