CUBA'S CAPITAL ACCOUNT OF THE BALANCE OF PAYMENTS

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Cuba's debt-servicing travails hinder access to international capital markets even as the country is steadily improving relations with official lenders in developed nations. In the last decade it has been able to raise medium-term commercial debt solely by private placements to friendly institutions. This in addition to an inactive membership in international financial organizations such as the IMF and the World Bank, which means that capital flows to the island are limited to trade finance and investment from a few partners. Cuba lacks published data on capital movements although the national statistical agency ONEI releases foreign trade data. This paper presents estimates of capital account flows for 2009–2015 working from the bottom up by distilling investor and project data, financial statistics from developed countries as well as from analysis of Cuban trade and debt statistics.

FOREIGN DIRECT AND PORTFOLIO INVESTMENT

Except for the period from 1994 to 2000, after the demise of the Soviet Union, foreign investment has played a very small role in the Cuban economy. This is not only the result of Cuba being off-limits to US investments following the Helms-Burton Act and other US legislation, but crucially as a result of an uneven business climate discouraging foreign investors. On paper the current and previous laws governing foreign investment[2] are reasonable, providing a framework for wholly-owned foreign subsidiaries and joint ventures and recourse to a stable judicial system for resolution of commercial disputes. However, the highly discretionary regulatory system in place creates uncertainty beginning with the approval process and continuing with regulations governing basic elements of the operating environment such as centralized price and import controls and the operation of labor markets. Wholly-owned subsidiaries have rarely been approved, for example, depriving foreign companies of control and management authority.[3] Exchange and currency controls derived from both foreign exchange and dual currency regulations complicate financial management. Direct contracting of employees by foreign entities is not allowed even after the new foreign investment law and associated regulations were approved in 2014, geared to the promotion of the Mariel Special Development Zone. Employees are to be hired by means of a contract with state employment companies with salaries payable in hard currency while employees receive wages denominated in Cuban pesos.

Table 1 shows identified components of foreign investment in Cuba for 2009–2015. Direct investment estimates have been obtained from official statistics of the Organization for Economic Cooperation and Development (OECD), the European Union and from corporate reports from Sherritt International, PDVSA and Odebrecht, the main contractor for the

1. This article has benefited from comments by Ernesto Hernández-Catá on an earlier version.

2. Ley 177 of 1995 and Ley 144 of March 2014.

3. The handful of wholly-owned foreign subsidiaries in Cuba are controlled by Venezuela or other friendly foreign governments.

Table 1. Foreign Investment Flows To Cuba *(Million $)*

	2009	2010	2011	2012	2013	2014	2015
Direct Investment	288	273	433	417	370	239	173
DAC countries[a]	3	26	25	69	17	17	4
Mariel	0	49	195	195	195	49	0
PDVSA, Subsea cable	175	100	105	75	75	75	75
Moa JV, Sherritt Oil	110	98	108	78	83	98	94
Portfolio Investment							
DAC countries*	0	0	-166	-153	-82	-169	-18

Source: See note on sources below.

a. DAC countries comprise all members of the OECD except Chile, Estonia, Israel, Latvia, Mexico, and Turkey.

expansion of the port of Mariel. Portfolio investment data is also derived from the OECD, which provides information on flows comprising its developed country members in the Development Assistance Committee (DAC).

Foreign direct investment between 2009 and 2015 averaged $315 million per year or about 0.4% of GDP. The direct investment estimates in the table are understated by the lack of data from investors from China and some Latin American countries. Judging from the investment position in Cuba of European companies, the annual shortfall is well under $50 million. To be sure the direct investment estimates comprise the largest investment projects in the country, the Port of Mariel, the expansion and maintenance of the Cienfuegos refinery, the undersea fiber optic cable between Cuba and Venezuela, the expansion and maintenance of the Moa joint venture and petroleum development projects. DAC countries investment flows contracted substantially in 2013–2015, but even its high point in 2012 showed an inflow of just $69 million. The DAC data is consistent with separate reporting from individual European countries, importantly Spain, Germany and France, although it appears to underestimate flows from Canada. Investments in the Moa Joint Venture and other Sherritt International operations in Cuba are seemingly not included in the DAC numbers even though Sherrit is based in DAC-member Canada. The reporting discrepancy probably arises from Sherrit's reinvestment of profits to fund capital expenditures.

The Port of Mariel development is the largest foreign investment project. In a strict sense Mariel was funded by a project loan and is not an equity investment. The high concessional component of the loan, however, corresponds to a substantial transfer of resources which is neither debt nor equity.[4] The crucial operating role of Odebrecht, a private Brazilian company, provides some justification for including the project as an equity investment. Data available from Odebrecht regarding the total cost of the project is assigned proportionally during the 2010–2014 construction period of the project.

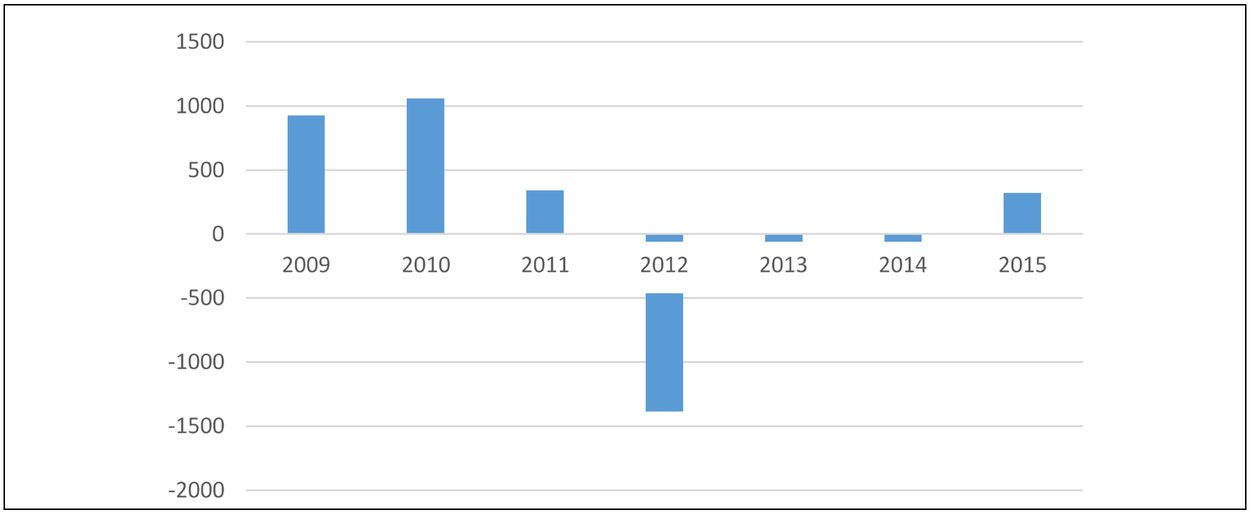
PDVSA projects in Cuba are sizable. The main components of PDVSA investments involve the upgrading and maintenance of the Cienfuegos oil refinery and the fiber optic subsea cable linking Cuba and Venezuela. Project data from PDVSA and 20-year linear depreciation expenses were used to estimate refinery investments. Estimates for the fiber optic cable were calculated using a benchmark of $25,000 per kilometer of the 1150 kilometer length of the cable.

Investments in the Sherrit International Corporation's Moa nickel and petroleum joint ventures were obtained from annual reports of the corporation for 2010–2016. These provide capital and maintenance expenditures in the Cuban joint ventures. At an average outlay of $95 million per year in 2009–2015, Sherrit is the second largest source of foreign investment in Cuba.

Portfolio investments in Cuba consist of accounts in the Cuban banking system as there are no active equity and debt securities listed by Cuban entities.[5] The

4. The author estimates a 78% grant component for the construction loan from BNDES, the Brazilian development bank.

Figure 1. Net Foreign Loans *(Million $)*



only estimates for movements in these accounts are those of the OECD for DAC countries and are shown on Table 1. The DAC data shows net outflows of portfolio investments for every year in 2011–2015. This means foreign companies operating in Cuba are reducing working capital as well as transferring past earnings. This partly comes about from the freezing of hard currency accounts of foreign companies during the 2008–2011 financial crisis and the subsequent repayment and transfer out of the country of some of the funds from these accounts.

LOANS

Loans for 2009–2012, shown on Figure 1, are derived from ONEI statistics on Cuban external debt. The figures represent gross dollar changes in debt and are not adjusted for exchange rate fluctuations. This makes the 2012 net loan outflow more negative than the actual dollar flows. Loans for 2013–2015 are author's estimates of Chinese trade finance plus net lending by entities reporting to the Bank for International Settlements (BIS). China's loans are derived from trade data. The key assumption is that China provides new 180-day loans to cover incremental exports to Cuba. As mentioned, BIS data on foreign bank claims on Cuban borrowers is the other source for the loan estimates.

Table 2 shows foreign loan components. As explained, the figures for 2009–2012 are derived from debt stocks published by ONEI. The BIS data and Chinese trade finance estimates are included for the entire period 2009–2015. A residual labeled "Other" is also calculated. The estimates for 2013–2015 are derived from BIS statistics and the estimated Chinese trade finance. Lending from BIS reporting institutions was negative in every year in 2010–2015 although credit lines were relatively stable in 2014–2015. Some of the decline in BIS lending follows Cuba's diversification of trade away from suppliers in Europe towards Chinese, Brazilian and other sources in Asia and Latin America that provide better financial terms through export credit agencies. A recent surge in Chinese imports is purported to be accompanied by a corresponding rise in trade finance from that country. The "Other" residual largely comprises commercial credits from suppliers. Large repayments in 2012 reflect the settling of arrears to foreign firms incurred in 2008–2011. Available data from DAC countries and not included in Table 2 indicates an increase of $96 million in trade credits in 2014 and a decrease of $45 million in 2015. It is not possible to

5. Central Bank of Cuba notes issued in London during 2005–2008 have been redeemed. There are Liquidity Certificates backed by convertible currencies which allow repatriation of capital.

disentangle these figures from the BIS data, though the DAC numbers are largely non-bank lending by suppliers. The DAC data suggests that the residual "Other" may be positive for 2014 and negative for 2015 though data from non-OECD sources required to obtain a firm number is lacking.

Table 2. Net Foreign Loans *(Million $)*

	2009	2010	2011	2012	2013	2014	2015
Foreign Loans (net)	926	1058	341	-1384	-99	-111	321
BIS Lending to Cuba	52	-172	-150	-273	-248	-11	-33
China trade finance flow	0	26	29	-23	149	-100	354
Other	874	1204	462	-1088	0	0	0

Table 3. Cuba: BIS Claims 2015 and 2016 *(Million $)*

Country	2015	2016	Change
Austria	11	1	-10
Canada	189		
France	305	293	-12
Germany	105	82	-23
Japan	11	30	19
Korea	7	17	10
Mexico	10	7	-3
Spain	287	253	-34
Switzerland	5	51	46
UK	9	9	0
Other	198	734	
Total	1137	1477	340
of which			
Banks	832	1029	197
Non-Banks	306	448	142

Source: Bank for International Settlements

Newly released data (Table 3) shows $340 million in lending to Cuba in 2016 by BIS reporting institutions, a sharp reversal from the previous year. The BIS data also shows for the first time specific country sources of lending for 2015 and 2016. The new lending is a positive sign amidst generally weakening liquidity conditions in Cuba and reflects progress made in renegotiating obligations to the Paris Club and other creditor countries though France, Germany and Spain-based entities' lending declined. Although Canadian data is not available for 2016, it appears Canadian banks and other firms sharply increased lending in 2016.

DEVELOPMENT FINANCE

Development finance comprises concessional net financing by official bilateral and multilateral agencies. The figures are Official Development Assistance (ODA) of the OECD for operations by the member states of its Development Assistance Committee (DAC) as well as from multilateral agencies and other providing countries not in DAC.

While ODA averaged less than $100 million per year before 2014 a surge in assistance took place in the last two reported years (Table 4). This is linked to bilateral debt negotiations between Cuba and members of the Paris Club and an opening of credit lines. Spain provided $125 million in such finance in 2015, for example. Multilateral flows are centered on cooperation in fields such as health, education and culture. The contribution of countries outside of DAC has become more important since 2013 and reached $356 million in 2015. This includes concessional finance associated with debt rescheduling with Mexico and other Latin American countries.

IDENTIFIED CAPITAL ACCOUNT

Table 5 shows a surplus on Cuba's identified capital account for every year in 2009–2015 except in 2012 when sizable debt arrears were repaid to suppliers. The capital account, when added to the current account surplus, yields an overall surplus in the balance of payments reported as Overall Balance in the table.

Table 4. Official Development Assistance to Cuba *(Net Disbursements in Million $)*

	2011	2012	2013	2014	2015
DAC Countries	60.3	52.8	60.7	66.3	167.1
of which Spain	19.7	7.7	13.4	5.4	125.9
Multilateral	26.4	23.7	33.7	12.6	29.6
Other Providing Countries	0.6	9.3	5.1	183.1	356.3
GRAND TOTAL ODA	87.3	85.8	99.5	262.0	553.0

Source: OECD

Table 5. Cuba: Capital Account *(Million $)*

	2009	2010	2011	2012	2013	2014	2015
Direct Investment	288	273	433	417	370	239	173
Portfolio Investment	0	0	-166	-153	-82	-169	-18
Loans (net)	926	1058	341	-1384	-99	-111	321
Development Finance	118	133	87	86	99	262	553
Identified Capital Account	1332	1464	695	-1034	288	221	1029
Current Account Balance	-162	1491	1437	2382	1639	2672	1300
Overall Balance	1170	2955	2132	1348	1927	2893	2329
Errors & Omissions (- outflow)	269	-1840	-3425	-2711	-2404	-2519	-2890
International Assets at BIS	4288	5403	4110	2747	2270	2644	2083

The Overall Balance can be compared to the assets of Cuban banks, including the Central Bank, at banks and other institutions in over 45 countries and territories reporting to the BIS. Lacking reported official statistics, Cuban assets at the BIS are a proxy for international reserves. Interestingly such assets decreased during 2010–2015 while the overall balance of payments is in surplus. The difference between the Overall Balance and Cuban asset changes at BIS banks are entered as Errors and Omissions in the table and averaged $-2.2 billion per year in 2009–2015.

The Errors and Omissions account suggests that Cuba is accumulating net international assets by adding assets and/or reducing liabilities outside of the BIS area. This will be international reserves or other net assets held by Cuban banks, government entities, state enterprises and other Cuban residents. There may also be Net Errors and Omissions in the current account of the balance of payments, for example the unrecorded presence of transfers providing compensation for either exports or imports.

It is not possible to pinpoint the sources of the Errors and Omissions. Its size and consistent sign (outflow of capital) suggests that systematic factors are present. Cuba's tight international liquidity means that a large accumulation of official liquid assets is not taking place. Nonetheless it is reasonable that Cuba is building up some assets in mainland China banks and perhaps others such as Russian banks that do not report to the BIS.[6] Some of these assets would be part of international reserves. Other assets could be used in the financing of trade transactions. It is also possible that Cuba provides finance to countries in Latin America and elsewhere thus accumulating assets in the form of debt obligations from such countries. One item in the current account that can explain this would be income from exports of services. As an example, because of its severe economic difficulties, Venezuela is unable to meet fully obligations to Cuba of payments in hard currency and oil due for its medical and other services. The unpaid balance would be registered as a debt obligation of Venezuela to Cuba, or alternatively as a transfer from Cuba to Venezuela. There is no public information regarding such debt or transfer but it would be consistent with negative Errors and Omissions entries. A similar situation may be present in other countries receiving Cuban medical and other services. To sum-up, Cuba may not be monetizing some of its surplus on current account. It may also be amortizing medium-term debt not recorded in BIS and OECD data due to China and to trade finance agencies in Europe and elsewhere.

CONCLUDING COMMENTS

The identified capital account points to the hurdle faced by the authorities in achieving much better access to foreign finance and investments. Foreign di-

6. China began reporting to the BIS in 2015. This reporting includes Taiwan China and partial reporting from MaInland entities. A fall in reported Cuban assets in BIS banks in 2015 suggests that there is limited asset accumulation in Chinese entities or underreporting by these institutions.

rect investment, only 0.4% of GDP in 2009–2015, is targeted at a minimum of 2% of GDP by the government. Completion of infrastructure work in the Mariel complex and more responsive officials to foreign investors are a step in the right direction. The slow pace of fundamental economic reforms aimed at deepening retail and wholesale markets, freeing labor markets, streamlining regulation and opening access to foreign exchange remains a hard constraint. This and the lack of access to the US market is a barrier to export-oriented investment. In fact few of the potential foreign investment projects identified by the Ministerio de Comercio Exterior y la Inversión Extranjera have links to international value chains.

Recent debt renegotiation agreements with Japan, Mexico, Russia and members of the Paris Club have opened access to new trade finance and concessional loans. OECD export credit agencies remain sensitive to low Cuban creditworthiness, and it is unlikely that Cuba can greatly expand access to longer term credits from either official or private sources without a forward reform push. Improving creditworthiness is a difficult task that goes well beyond successful negotiating efforts with the Paris Club but it could be advanced by regaining access to the main multilateral financial agencies. Creditworthiness will be gained only by policies that improve the climate for business and productive employment.

It is perplexing that Cuba has a surplus in both its current account and on the identified capital account in practically every year during 2009–2015 and has an overall balance of payments surplus while experiencing acute pressure on international liquidity. The mystery can be dispelled by better statistics on the current account, timely data on external debt and transparency on capital flows.

NOTES ON SOURCES

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