Banks and investment treaties: key for economic diplomacy with Africa

Summary

India and Africa share a long trade history; many African trading centres in the past accepted Indian currency. But after Independence India focused on developing its economic and trade ties primarily with the West; after the financial crisis,of 2008 attention has once again reverted to rekindling trade and investment relations with Africa.

Three factors were responsible for the renewed thrust: an India-Africa summit in 2008, the global financial crisis, and China's growing footprint across the African continent.

The commerce ministry of the government of India has made a concerted and strategic effort after 2008 to push exports to African countries. India also diversified its oil purchases by increasing imports from Nigeria.

Two-way trade between India and Africa has improved as a result: from $4.5 billion during 1996-97 (April-March) to $67.85 billion by 2013-14, reflecting a compound annual growth rate of 28%.

However, this impressive performance hides two facts: that trade will miss the $90-billion target set for 2015, and India imports more from Africa than it exports.

Even direct investment from India is stuck at around $33 billion. A granular study reveals some more disappointing facts: more than half the investment heads to tax haven Mauritius, from where it can go anywhere. Another large chunk has been invested in oil and gas properties. Bharti Airtel's $10-billion acquisition of Zain Telecom further distorts the picture.

Any efforts to revive the relationship will require two essential ingredients: deeper banking links and a wider range of bilateral investment treaties. Both will require intensive intervention by the Indian government.

Indian banks have been present in Africa for over 100 years; but they have focused only on an ethnic customer base, thereby restricting their presence to certain parts of the continent and excluding large parts of the indigenous population from their business plans.

A deeper and wider Indian banking presence through joint ventures, wholly-owned entities, or correspondent banking relationships with a larger number of local African banks will be necessary to bring down the transaction costs of India-Africa trade.

India has concluded only five bilateral investment treaties with African countries. Apart from revising these treaties, India will need to sign many more treaties to provide some comfort to potential Indian investors.

Introduction

India and Africa are linked by a long and shared history that spans trade, finance, culture, and politics. Many Indian entrepreneurs from Gujarat have been living and conducting business in various African countries, especially east Africa, for over 100 years. Historical accounts speak of how the Indian currencies were acceptable in many African entrepôts.

The moral and political strategy adopted by Mahatma Gandhi during India's independence struggle has inspired many anti-colonial and anti-apartheid movements and leaders in Africa, including the recently-deceased former South African president and Nobel laureate Nelson Mandela. [1]

It therefore seems counter-intuitive that, post-Independence, India's economic diplomacy efforts

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focused largely on the developed and western economies, and India paid little attention to Africa. There was lots of rhetoric but the gap between intention and action kept widening.

Trade with Africa (export plus imports) barely touched $1 billion, and investments were a trickle on both sides, before India embarked on economic reforms and trade liberalisation in 1991. And though both trade and investment relations are now on an upswing, any efforts to elevate the relationship with Africa to a higher plane will require two essential ingredients: deeper and wider banking links, and a more comprehensive range of bilateral investment treaties. Both will be impossible to achieve without the active intervention of the Indian government.

A crisis-driven turnaround

What changed India's dormant trade and investment relationship with Africa? The static relations were recharged with the onset of economic reforms and trade liberalisation in the early 1990s. Successive governments thereafter started pushing for a greater Indian presence on the African continent, but without any significant impact.

It is only in the past 10-15 years that the "Look Africa" impetus has acquired some momentum. Two events in 2008 accelerated this drive: India hosted the India-Africa Forum Summit in New Delhi and a financial crisis spread across the globe.

There could be a third unacknowledged factor: the ubiquitous and growing presence of China in Africa, through extractive industries, agricultural expansion, infrastructure projects, and manufacturing capacity.

While the summit provided an excellent platform for cementing India-Africa ties, the overall focus of this structured framework has been on enhancing human capacity in the African nations, through training and institution-building.

Oddly, and propitiously, the 2008 global financial crisis was the change agent. The global financial meltdown and the attendant global economic slowdown translated into decelerating economic growth for India as well. But, more importantly, it brought into sharp relief the perils of India's excessive reliance on western developed economies, mainly North America and Europe, for trade and investment. This forced India to diversify its focus towards other economies in Asia, Latin America, and Africa.

The Commerce Department's annual report for 2010-11 acknowledged this shift while describing the new Trade Policy: "The immediate and the short term objective of the policy was to arrest and reverse the declining trend of exports as well as to provide additional support especially to those sectors which were hit badly by recession in the developed world. Towards achieving these objectives, several steps were announced in the Policy. Some of the important steps included addition of new markets under the Focus Market Scheme, coverage of Africa, Latin America and large part of Oceania under Focus Market Scheme (FMS) and the Market Linked Focus Product Scheme (MLFPS)…" [2]

The department's annual report for 2013-14 confirms the changing pivot: "There is an increasing shift in India's trade from conventional destinations i.e. the U.S. and EU towards South Asia, ASEAN, Africa and Latin America." [3]

The government too has stepped up

The Indian government and its various institutions have also realised the costs of neglecting relations with Africa. For instance, the Indian Technical and Economic Cooperation (ITEC) programme, part of the government's development diplomacy, which focuses on capacity building in developing countries across the world, celebrated its 50th anniversary in 2014, but it is only in recent years that the government has started providing additional thrust to this programme's footprint in Africa.

The technology sector is also an agent of change. For example, the Pan-Africa e-Network Project, encompassing 48 African countries and providing a grid for tele-education and tele-medicine, is already changing the lives of thousands of African students.

The government's other tool for development diplomacy—lines of credit (LOCs), which are disbursed through the Export-Import Bank of India (explained later in this report)—have also seen a quantum jump in the outlays for African nations.

The payback

This strategic pro-Africa adjustment in India's trade policy has paid some dividends: through increased exports and by helping India diversify its energy supply chain by including African oil suppliers such as Nigeria.

This is evident in the trade data. India's trade with Africa (exports plus imports) grew from only $4.5 billion during 1996-97 (April-March) to $39.54 billion during 2008-09, the year that Lehman Brothers collapsed. By the end of 2013-14, two-way trade reached $67.85 billion. [4] The data indicates an impressive CAGR of 28% in trade between the two regions.

However, this admirable growth not only masks some realities, it also papers over the fact that the degree of increase has actually not been that spectacular. The contrast also seems pronounced when viewed from the prism of India's accelerated economic diplomacy and development cooperation with the continent.

To begin with, the gap between the 2013-14 achievement ($67.85 billion) and the $90-billion target for 2015—set by former commerce minister Anand Sharma [5]—seems unbridgeable in two years. The numbers also hide another aspect of the relationship: India's trade balance with Africa has been negative for some time, with oil and gas imports accounting largely for the deficit.

Evidently, trade seems to be levelling off and needs a fresh impetus to reach the next stage. As mentioned above, one way to improve the trade links is to deepen the banking links. So, how can banks help?

Banks as change agents

Indian banks have traditionally been present in areas with a large concentration of ethnic Indians, such as Uganda, Kenya, or Mauritius. A look at the spread of Indian bank branches and offices in overseas locations as on 31 January 2014,pro vided by the Finance Ministry, [6] shows the overwhelming presence of Indian banks in countries with substantial Indian settlements—such as most East African countries (Uganda, Kenya, Tanzania) or South Africa. For example, Bank of Baroda—which has traditional ties with Indians settled in Africa—has branches in South Africa, Mauritius, Seychelles; subsidiaries in Uganda, Kenya, Botswana, Tanzania, Ghana, and a joint venture in Zambia. The footprint of most other Indian banks operating in Africa—Bank of India, State Bank of India (SBI), ICICI Bank, and HDFC Bank—is similar.

In contrast, Indian banks have no presence in Nigeria, which is one of India's largest oil suppliers—SBI's presence is through a token 11.81% shareholding in Sterling Bank Nigeria plc. In fact, save for Bank of Baroda's two offices in Ghana through its wholly-owned subsidiary there, Indian banks have bypassed all of West Africa. The same, unfortunately, also holds true for North Africa, with the exception of SBI's lone representative office in Cairo.

Consequently, this has restricted the banking services offered by these banks to only ethnic Indians. This strategy might have been relevant in the past, but as India's economic engagement has evolved, banking has been slow to adapt—making, the Indian banking footprint somewhat misaligned with India's trade ambitions. This has cost implications, especially in the provision of export credit and other fee-based services.

According to a joint publication by the World Trade Organisation and the Confederation of India Industry: "Common problems faced by banks in African economies include low capital and foreign exchange reserves, lack of know-how in the process of extending documentary credits, and a lack of international ratings. Exporters requiring guarantees from local banks find that either a bank may be unwilling to assume the associated risk or may do so only with high collateral requirements against trade loans. The net result is that trade finance becomes costly and inaccessible, particularly for firms with limited cash flow or liquidity. As such, most SMEs in Africa find it difficult to finance the gap between shipment and payment when accessing newer markets like India." [7]

The same report—which is based on surveys conducted across Indian and African businesses and trade associations—also states: "Due to high shipping costs, and cost of insurance in exports to African countries, many Indian exporters prefer to sell free on-board basis instead of on-delivery basis. This is generally not a good practice when exploring new markets and engaging with newer or smaller buyers. Lowering transaction costs and risks are crucial to enhanced trade between India and Africa. The export credit and trade finance institutions of India are playing a major role in market access initiatives of Indian firms in Africa."

Part of the reason behind the high costs is the shallow financial system in these countries and the absence of documented credit risk profiles of importers. Therefore, when granting credit to such a buyer, the risk premium is obviously higher. Letters of credit opened by local banks on behalf of African exporters or importers are not accepted by Indian banks; it then has to be reconfirmed by another international bank, which increases costs and adds to delays.

Some of the building blocks for remedying the situation are already in place: for instance, Indian government's Export Credit Guarantee Corporation tied up with the African Trade Insurance (ATI) Agency in 2013 to provide insurance cover to exporters and importers in both the areas. Once the insurance cover is in place, banks can take over and provide pre-shipment or post-shipment financing against the cover as collateral. While this does provide some comfort to banks in extending credit, insurance is not free. There's another hitch: ATI is also present in mostly East and South African nations. [8]

This provides a pioneering opportunity for Indian banks to expand their footprint and prise open business options in, say, West Africa. For example, Ghana in West Africa has seen some buoyancy in its financial services sector after reforms were introduced in 2003. The overhauling of the finance sector has attracted praise from multilateral institutions, including the International Monetary Fund. [9]. A deepening financial sector usually leads to an improved credit delivery system and the fostering of a robust entrepreneurial culture. Indian banks should be tapping into this trend.

It is therefore logical that if India wants to increase and reinforce its trade relations with Africa, and synchronise it with the efforts being made in development cooperation, it must overcome this drought in trade finance. A viable alternative is through a greater physical presence on the African continent. This can be achieved in multiple ways: branch presence or comprehensive joint ventures, either through an equity stake or through a wide variety of relationships, such as correspondent banking tie-ups. The nature or structure of such a presence will, of course, be circumscribed by the bank licensing laws of that country; Indian banks will have to coordinate their entry in conjunction with the Indian diplomatic corps in that jurisdiction.

The Industrial and Commercial Bank of China (ICBC), owned by the Chinese government, bought a 20% stake in South Africa's Standard Bank in 2007. Standard Bank has a presence in 19 African countries. Interestingly, ICBC has been buying up subsidiaries put on sale by Standard Bank—for example, Standard Bank's business in Argentina, or the bank's subsidiary in London for currency, bonds, stocks, and commodities trading.

Most multinational banks have been scaling back their global presence, after the global financial crisis, because of enhanced capital requirements at home and a greater sense of risk aversion. This applies to Indian banks as well. In addition, banks are also wary of the considerable risks involved in venturing out into West Africa or North Africa, and the consequent adverse impact it can have on their capital.

The Indian government could explore the possibility of introducing a product or an instrument of comfort for banks, either through a capital guarantee scheme or through a backstop mechanism, for private or public sector banks willing to open branches in select, untapped African countries. This instrument will act as seed capital as well as a risk-mitigation factor. It can then be extended to other countries on different continents as well. The expansion spree will be tempered, of course, by India's reciprocal banking arrangements with the host country.

The role of Exim Bank

Exim Bank of India has published a paper on West Africa, which explicitly states: "In view of the potential for enhancing bilateral trade and investment relations with the countries of West Africa, opening branches/subsidiaries/representative offices in the region, and developing correspondent banking relations with select banks in the region would serve to facilitate and promote commercial relations." [10]

Exim Bank has been working for some years on trying to improve India's trade relations with African countries, apart from offering the usual bouquet of products, such as buyer's credit to facilitate African importers' purchases from Indian exporters. In March 2002, it launched a five-year, $550-million 'Focus Africa' programme, with the objective of identifying areas of bilateral trade and investment in 24 African countries.

Exim Bank is also the agency through which the government disburses Lines of Credit (LOCs), a strategic tool for promoting India's development diplomacy. Under the scheme, Exim Bank provides concessional credit to a recipient country for executing a project, with the proviso that 75% of the project's inputs be imported from Indian manufacturers. The Indian government provides Exim Bank with the difference between the market interest rate and the concessional rate, and the loan is guaranteed by the recipient country government with the Indian government providing a counter-guarantee. [11]

Till 10 May 2014, Exim Bank had a total of 187 operative LOCs worth $10.21 billion; of this, 133 LOCs amounting to $6.28 billion were earmarked for 48 African countries.

Exports made under LOCs contribute to the total India-Africa trade, though the proportion is not known. However, despite Exim Bank's impressive role in trying to bridge the India-Africa trade gap, the physical presence of commercial banks is still required to meet the growing demand for trade finance.

Providing Investment Momentum

Apart from trade, a wider banking footprint will also help impart some velocity to India's investment ties with Africa. The growth in trade has, unfortunately, not been matched by a growth in investment, with India's foreign direct investment (FDI) flows into Africa stuck at around $35 billion (WTO-CII report).

Again, this data needs to be seen in its more granular form: more than half the outflows from India to Africa at $19.5 billion are destined for Mauritius for obvious tax-planning reasons. The problem with these flows is that their final destination is unknown since Mauritius is only a conduit. In addition, Bharti's acquisition of Zain Telecom for close to $10 billion further skews the larger picture. Also, large investments by the Oil and Natural Gas Corporation and other Indian public sector oil companies in African petro-assets (Sudan, Angola) also contribute to the uneven flow of outward FDI from India.

The need for a concerted strategy on investment ties is urgent. During August 4-6, U.S. president Barack Obama hosted a three-day U.S.-Africa Leaders' Summit where over 45 African heads of states and 90 American companies were present. This is the first time that the U.S. has organised such an event. But it is the $33-billion of investments promised by the U.S. during those three days that set the cat among the pigeons. India, which has traditionally seen China's presence in Africa as its strategic competitor, now has a new additional factor to think about.

India has many things going for it in Africa. One, its traditional and historic ties with many African countries and peoples. Two, the contrasts between Indian and Chinese investments are stark—Chinese investments are mostly made by state-owned companies while Indian FDI is spearheaded by the private sector, and while Chinese investments are largely concentrated in extractive industries, India's investments are mainly in manufacturing. Three, as a result of the nature of their investments, Indian companies employ local labour and material, which upgrades skills and provides some boost to the local economy.

All this has helped limit adverse local reactions to Indian investments in Africa, but it has also resulted in the total volume of investment being smaller when compared to China's inflows into Africa.

A logical precondition for achieving the quantum leap in outward direct investments is greater government involvement. The strategic space available for Indian investments in Africa is shrinking because of active intervention by the Chinese and U.S. governments. This report is not suggesting that the Indian government invest itself; it should do so only in strategic cases. But the government definitely has a facilitator's role to play. Even its involvement in development diplomacy through LOCs has been slow, halting and half-hearted. [12]

There are many ways for the government to get involved. A paper by Exim Bank on overseas direct investment suggests that the Indian government take some lessons from the Chinese model. [13] In addition, among other things, the government must examine the possibility of creating an agency for promoting outward direct investment and earmarking a separate pool of funds—from either foreign exchange reserves held by the Reserve Bank of India or from the budgetary pool—to stimulate cross-border investments.

But it is uncertainty and enhanced risk perceptions that inhibit private sector investment into Africa. This can be obviated if the Indian government aggressively promotes bilateral investment treaties with various African governments. Currently, India has signed only five such treaties in Africa—with Ghana, Mozambique, Mauritius, Egypt, and Morocco. Besides, some of these treaties are dated. For instance, the bilateral investment treaty (BIT) with Egypt was agreed upon in 1997 and enforced in 2000.

A BIT has a specific purpose—it protects investments in foreign jurisdictions and provides the investments with fair and equitable treatment, as well as recourse to dispute settlement through international arbitration mechanisms. In most cases, Indian BITs for outward direct investment read like the treaties signed for inward foreign direct investments. But BITs also give Indian investors in Africa a sense of comfort about their investments through legal protection.

The Indian government has said that it will review the existing BIT regime and will defer signing any new agreements in the interim. This could be a good time to complete the groundwork for signing more BITs with African countries.

Conclusion

India and a host of African countries are keen to elevate the level of trade and investment ties. However, this narrative has often been limited to rhetoric and any remedial or pioneering action has been slow and guarded. In contrast, most other countries—especially China—have marked their presence through prompt and aggressive action, even in government-to-government negotiations and contracts.

India's Africa narrative seems to be trapped in a discourse from another era. Growth impulses in Africa have changed: demographics have transformed, governance structures are being overhauled, electoral reforms have been undertaken,

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