Supporting UK foreign direct investment in Africa in 2021

Sherillyn Raga and Dirk Willem te Velde
21 January 2021

Key messages

- UK FDI flows to Africa fell 42% to $7.9 billion (£6.2 billion) in 2019, but the stock increased 10% to $64.6 billion (£50.6 billion), driven by extractives and finance sectors. Profits on UK FDI in Africa are double those in OECD countries.
- UK FDI stocks and flows to Africa are higher than FDI by other major investors such as the US and China but they remain more concentrated in extractives and financial services than those from US and China.
- After the second UK–Africa investment summit on 21 January 2021, the UK should work more closely with its African partners and the AfCFTA to step up aid, trade and investment relationships with a focus on sustainable finance and the digital economy this year.

Introduction

The UK aims to be Africa's partner of choice, by growing investment relationships to deliver more exports, jobs and economic growth that benefit both African and British businesses as well as to help African countries recover and build back from the Covid-19 pandemic. The recent second UK–Africa summit aimed to revive foreign direct investment (FDI) to African countries, in a context in which the pandemic has already led to sharp declines in overall FDI flows (-28%), mergers and acquisitions (-44%) and greenfield projects announcements (-66%) in Africa during the first half of 2020 alone. This note aims to present the trends in UK FDI in Africa, how UK investors compare with other major investors (i.e. China and the US) in the continent and insights on constraints and recommendations to boost the role of UK in bringing quality FDI to Africa.

UK FDI in Africa: recent experiences

According to the UK Office for National Statistics, UK FDI flows to Africa reached £6.2 billion in 2019 (Figure 1), down 39% on 2018. FDI has been volatile as a result of the volatile nature of FDI components such as shareholdings (equity), debt and reinvested earnings. FDI flows had increased in 2017 and 2018 after disinvestments in 2016. UK FDI stocks in Africa grew 15% to £50.6 billion (Figure 2).

The majority of the UK's investments is in the mining and quarrying sector (43%) and financial services (40%) (Figure 3). The UK increased its investment exposure in the extractives and finance sectors by 11% and 13%, respectively, in 2019

Figure 1. FDI flows to Africa, £ million

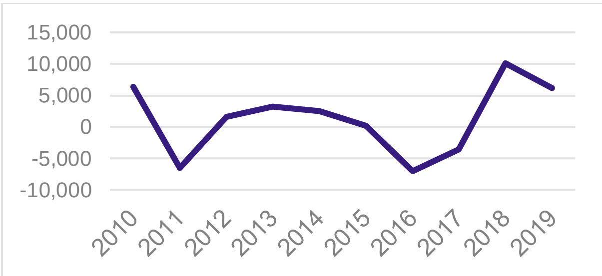


Figure 2. FDI stocks to Africa, £ million

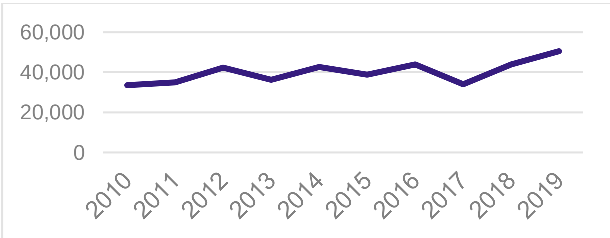
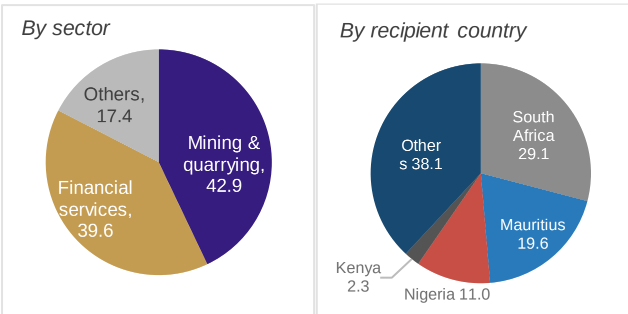


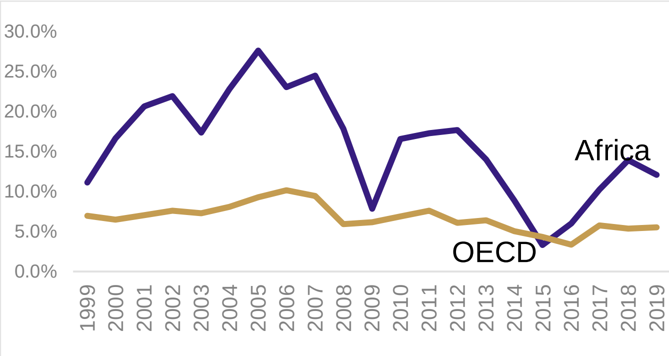
Figure 3. FDI stock in Africa, by sector (2019) and recipient country (2018), % share in total UK FDI in Africa



Source: UK Office for National Statistics

Net earnings (or profits) from UK FDI in Africa are double those in OECD countries (Figure 4).

Figure 4. Net earnings from UK FDI, % of UK FDI stock



Source: UK Office for National Statistics

Comparing UK FDI to US and China

In 2019, the UK invested more in Africa than the US or China did. While across the three investors FDI flows declined between 2018 and 2019, the UK's FDI was $7.9 billion, higher than FDI flows from China ($2.7 billion) and disinvestments from the US (-$2.4 billion) (Figure 4). In 2019, only the UK increased its FDI stock to Africa, by 9.8% to $64.6 billion; China and the US recorded disinvestments by 3.7% and 2.7% (Figure 5). Recipients of UK FDI are more concentrated (60% in the top three recipient countries, Figure 3) compared with the US (45%) and China (31%) as of 2018. In addition, in terms of recipient sectors, the UK allocates a relatively higher share in its FDI stock to Africa's mining and quarrying sector (43%) compared with China (25%) and the US (37%) as of 2019.

Figure 5. FDI flows to Africa, US$ million

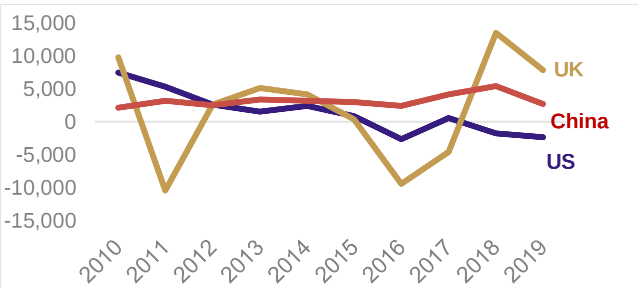
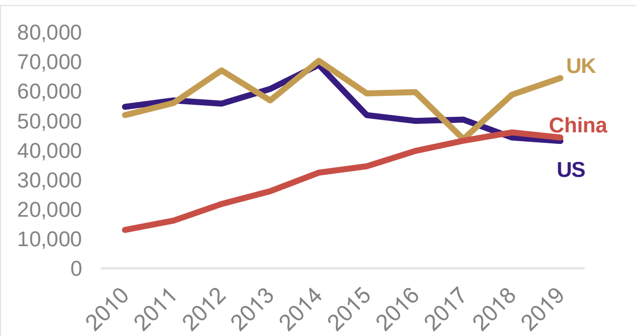


Figure 6. FDI stock in Africa, US$ million



Sources: China Africa Research Initiative, UK Office for National Statistics, US Bureau of Economic Analysis

Promoting FDI to Africa: an agenda for 2021

Step up economic development aid to overcome investor constraints. Previous ODI analysis shows UK investment decisions in Africa are affected by several conditions: human resources; quality and quantity of infrastructure, particularly electricity; size of the market, the regulatory framework; political risks; and security.

A survey of UK companies highlights country-specific investment constraints – such as volatility in exchange rates, frequent tax audits and imposed minimum capital requirements in Ghana; differential treatment against foreign investors (compared with domestic investors) in terms of taxes regulations in Kenya; poor infrastructure, corruption and discretionary regulations in Nigeria; and stringent and costly labour policies in South Africa.

Aid for Trade programmes such as TradeMark East Africa reduce trade costs and benefit UK investors too. The Manufacturing Africa programme helps countries to attract manufacturing investment crucial for economic transformation and job creation. CDC plans to invest $1 billion in Africa in 2021. If recently announced cuts in aid are implemented this would harm UK investor prospects significantly. Any cuts need to be slowed or reversed.

Support AfCFTA trade and investment negotiations. The African Continental Free Trade Area was launched on 1 January 2021. As African investment facilitation, regulation and infrastructure become connected and harmonised, a successful AfCFTA will enable access to Africa's growing population and market base. This requires continuous support from international partners, especially from Africa's major trade and investment partners such as the UK. Support to African countries can also build up towards a UK–Africa FTA.

Focus on sustainable investment. The UK government will end direct support to fossil fuel energy sector abroad. Funds could be redirected towards incentivising low-carbon energy investment overseas, especially in Africa, where the UK's FDI is largely in the extractives sector. The focus of the 2021 UK–Africa summit on sustainable infrastructure, renewable energy, financial and professional services, and agriculture and agri-tech is promising. The UK should support the City of London to promote green finance in the run-up to UNFCCC/COP.

Focus on the digital economy. Africa's digital divide (internally and with the rest of the world) needs to be addressed. The government should use fora such as the WTO and CHOGM to promote e-commerce and digital connectivity. This could also lead to closer collaboration between UK and African digital companies.

Support Africa's Covid-19 recovery plan. Covid-19 has affected Africa in a major way, given that it lacked the resources to respond. The UK should support African economic recovery and vaccine roll-out. It could propose an UK–Africa Prosperity Commission for the UK to support African countries in the recovery and enhance close aid, trade and investment relationships.