

Africa Current Issues

Following the Money – Identifying the
Evolving Nature of FDI Trends in Africa

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Summary

- While global growth of FDI stalls, growth on the African continent is set to accelerate, as the continent becomes an increasingly attractive investment destination.
- Heightened trade tensions among developed markets come at a time when African countries are building a continent-wide free trade zone and fostering greater regional cooperation.
- Whether African countries can harness these favourable tailwinds is largely dependent on their willingness to reform and provide a stable policy platform for investors.
- China is rapidly catching Africa's largest investors as it seeks to assert its expanding reach and alliances, while the US and UK turn ever more inward.
- Africa is the emerging battlefield in the struggle for economic and geopolitical relevance.

Introduction

Today's global economic outlook is increasingly uncertain, and yields from investment in developed markets (DM) are in many instances negative. Africa may benefit from public and private sector capital inflows from investors hoping to offset the effects of diminishing yields from low growth regions.

Globally, foreign direct investment (FDI) declined from USD 1.5 trillion in 2017 to USD 1.3 trillion in 2018, sinking for the third consecutive year. FDI flows to developed economies reached their lowest point since 2004, fell by 27 per cent, while FDI flows to developing countries remained stable. However, with global companies seeking to expand their presence in Africa, FDI flows to the region increased 11% year-on-year to USD 46 billion, while FDI to Sub-Saharan Africa (SSA) climbed 13% year-on-year to USD 32 billion.¹ This trend reverses two consecutive years of contraction in inward FDI flows to the continent and coincides with rising trade tensions in developed markets.

Even as trade relations around the world unravel – notably between the US and China, and between the UK and the rest of the Eurozone – Africa is set to move in the opposite direction following signing of the African Continental Free Trade Area (AcFTA).²

Are foreign investors reacting to global tensions or attracted by Africa's growth outperformance?

Powerful exogenous and internal forces are driving this emerging trend to increased investment in Africa. Rising geopolitical, trade and currency tensions in the northern hemisphere have forced DM investors to explore new investment frontiers that will reduce their exposure to an approaching global slowdown. The developed world increasingly views Africa as an important ally and trading partner. The continent's recent progress in governance and policy reform is a proposition that investors find attractive, as noted by the African Peer Review Mechanism (APRM) in 2019.³

Internally, producers on the continent are beginning move up their production and services value chains, steadily shaking off the image of an extractive region. Africa is becoming an indispensable strategic region, rather than merely an easily replaceable commodity supplier to serve growing economies.

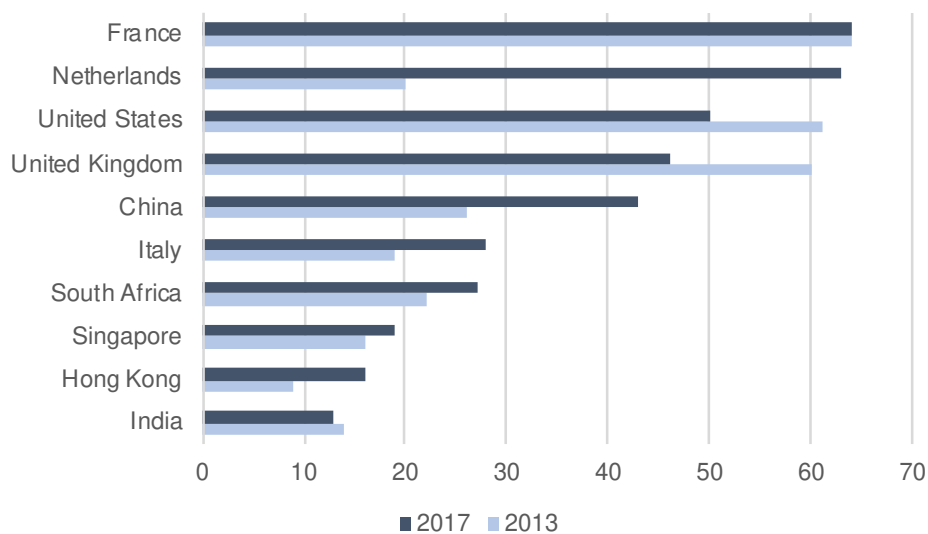
An expanding but shifting investor universe

The media often associates expansive foreign direct investment flows into Africa with Chinese capital inflows to the continent's mining and infrastructure projects. China, with an estimated \$43 billion worth of inflows, is in fact only the fifth largest investor in Africa.

Capital inflows to Africa remain heavily skewed toward the oil and gas sector. France and the Netherlands, European countries with close historical ties to the continent, usurped the US as Africa’s largest investors in 2018. France (\$64 billion) is followed by the Netherlands. The US is now closely followed by the United Kingdom, which aspires to become Africa’s largest investor.⁴

Total African investment stock levels from the US and the UK, both facing trade headwinds, are well below 2013 levels. Increasingly isolationist and protectionist policies in these two nations have shifted their focus inwardly at Africa’s expense. Expanding Chinese appetites for investment, combined with the country’s need to foster new partnerships, are filling this breach (see Figure 1).

Figure 1: Top 10 investors in Africa by FDI stock – USD billion (2013 vs. 2017).



Source: UNCTAD

China has almost doubled its exposure to the continent over the past four years. Despite the UK’s stated intention of being the largest foreign investor in Africa, China may well surpass it in 2019 in terms of capital stock as the Asian powerhouse assertively pursues strategic commodity, energy and infrastructure investment ties in Africa to feed its growing economy and extend its global influence.

Russia, Japan and India have all increased their investment exposure in Africa, funding electricity generation, mineral extraction, infrastructure, manufacturing and telecommunications projects. Russia aggressively pushed nuclear energy on the continent; both to offset the impact of US sanctions and to bring home much needed foreign currency.⁵ Meanwhile, India and Japan continue to scour the continent for new trading ties to buoy their sinking domestic growth.

Gulf states are increasingly seeking to extend their reach and influence on the continent, with Saudi Arabia, the United Arab Emirates (UAE), Bahrain and Qatar all looking to deepen their strategic ties with Africa in an era of escalating political fragmentation and tensions in the Middle East.

Djibouti leveraged its strategic geographic location along Middle East oil trade routes to obtain cash, infrastructure and investment from the US, China, France, Italy and Japan. These countries invest in the tiny state to maintain the military presence required to protect these strategic shipping lanes.

Africa attracts growing interest from newer funding sources. Africa is emerging as the battleground on which global powers seek to stamp their presence, expand their reach and claim strategic geopolitical dominance in increasingly divided political landscapes. This economic and ideological race to forge alliances is fuelled by a mix of regional geopolitical tensions, scrambles to place strategic investments

and needs to recruit new allies. There is perhaps no better opportunity for African states to leverage the developing political and trade contest between east and west.

Changes in capital stock, flows and new projects clarify changing investment patterns. The distinction between investment stock and investment flow is important: stock represents the total value of investments at a point in time, whereas flow refers to inward and/or outward movement of investment flows over a period, typically a year. Greenfield investments represent new projects.

Taking stock

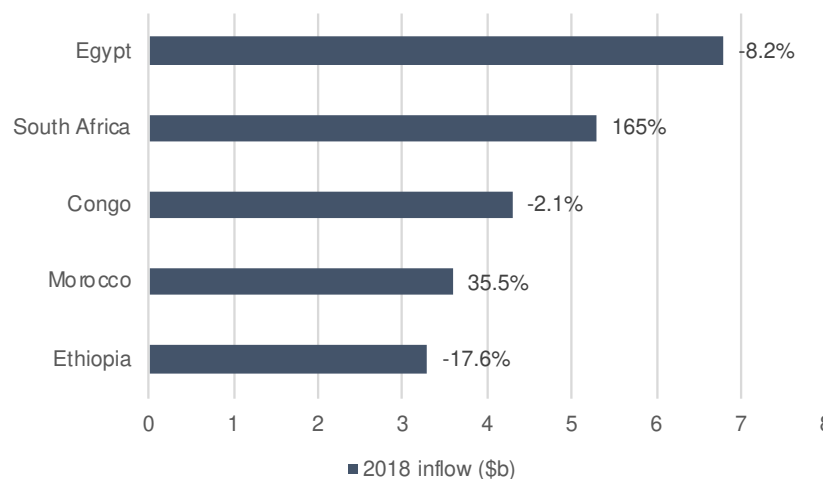
In 2018 African FDI stock totalled USD 900 billion, of which North Africa attracted 32%. Southern Africa accounted for 26% of the continent’s foreign investment and West Africa, 21%.

On a country basis, while South Africa maintains its status attracting the largest foreign investment stock on the continent, the country experienced significant investment outflows in 2018 amid low growth and political and policy uncertainty. Egypt, Nigeria and Morocco maintained their previous positions as the following three holders of investment stock from foreign sources.⁶

Going with the flow

Analysis of new investment inflows and the number of greenfield projects tells a clear story. In 2018, driven by political change, and the resulting promise of greater political stability and policy certainty, FDI inflows into South Africa increased 165% year-on-year. President Cyril Ramaphosa’s initiative to attract USD 100 billion over the next five years apparently led to this increased flow of investment (see Figure 2). This increase was unfortunately insufficient to mitigate the impact of USD 4.5 billion in investment outflows, the main cause of the country’s declining investment stock levels.⁷

Figure 2: Top 5 African recipients of FDI in 2018



Source: UNCTAD.

In contrast, Morocco was a standout performer, increasing investment flows by 35% in the wake of the country re-joining the African Union after a 33-year absence, and its intention to become the leading trade corridor between Africa and Europe.

Greenfields

2018 saw a 7% increase in the number of greenfield projects announced in Africa, with the bulk of new projects (110) destined for South Africa. Despite growth in FDI inflows to Morocco, the country saw 20 fewer new project announcements in the year compared to 2017, with Kenya and Nigeria attracting 12 and 19 more investments respectively.

Africa's share of new greenfield projects has hovered at 4% over the past five years, but this figure is set to increase as developed markets look to Africa to assert their global reach and prowess, ever more important as political and ideological fragmentation gathers pace around the world.

Winners and losers

The changing investment flows and project announcements on the African continent clearly reveal that countries offering higher economic growth rates, investor friendly policies, structural reform and political stability significantly outperform their continental peers in attracting FDI.

Egypt, South Africa and Morocco, demonstrating a willingness to reform policy and build investor trust, have been the big winners. Countries such as Zimbabwe, Angola, and Nigeria, slow to adopt the reformist agenda, have registered net investment outflows, or at best watched FDI stagnate.⁸

African countries looking to attract foreign direct investment will do well to remember that other regions actively compete for FDI, particularly those in South America, Eastern Europe and Asia, and that their needs for investment will become increasingly urgent as the global growth outlook dims.

Foreign investors are acutely aware that countries on the continent, and indeed around the world are hungry for capital inflows to fund their development, providing them with a wide choice among destinations, and the leverage to negotiate extremely favourable investment terms.

Policy stability and lasting respect for the agreed investment terms are in and of themselves a major drawcard for investors. These will ultimately lead to further capital inflows to fund the continent's much needed development agenda and migration from primary sector dependence toward value added production and services.

Despite growing foreign interest in investing in Africa, some countries on the continent have tended to make policy missteps that deter foreign investment. Nigeria and Tanzania's telecommunication's sector bungles are examples: Both placed onerous fines, taxes and ownership prescriptions on foreign owned telco companies, moves likely to deter new market entrants. South Africa's disjointed mining policy, despite several iterations, is another lesson in how to discourage capital investment, even as the country's Minerals Council South Africa (MCSA) unequivocally voiced its resistance.

As important as it is for the continent to attract external direct investment, African countries also need to become more introspective and intra-dependent, and focus on driving greater regional investment flows among African nations.

Intra-African investment is on the rise

Currently, direct investment from within Africa accounts for only 10% of the continent's FDI, against levels of 81% and 47% in Europe and Asia respectively, and a 46% world average.

Morocco is the clear star on the intra-African investment stage, an achievement facilitated by the King's desire to make the country the primary corridor between Europe and Africa. The Moroccan example demonstrates the abundance of low hanging fruit for African countries; many of which can change their investment fate through a simple pronouncement, economic diplomacy and sufficiently attractive investment incentives.

South Africa appears to be catching on as it desperately searches for new investors to generate job creation from foreign investment. The country must, however, lift business confidence to avoid a repeat of 2018's net FDI outflows.

The AcFTA is an important step toward greater regional integration, trade and investment. The agreement, signed by 54 of the continent's 55 countries, will create the world's largest free-trade bloc and drive greater market liberalisation. These will act as a drawcard for foreign donors and investors (8). With US President Donald Trump withdrawing from the Trans-Pacific Partnership, threatening to leave the World Trade Organisation (WTO) and upping the trade ante against China, the AcFTA provides a new, more stable frontier platform for foreign investors looking to reduce costs and increase market access.⁹

Conclusion

The shifts in both flows and greenfield projects among African countries reveal that the battle for investment is not a simple matter of Africa versus other emerging regions. These shifts provide evidence that African countries, despite their growing commitment toward working together, will need to battle each other to attract foreign direct investment. The fight for geopolitical relevance is not limited to large global powers, but is intra-continental. By proxy, the battle extends to diplomacy, the creation of business-friendly policies and the ability of African countries to provide a stable labour environment.

At a time when much of the rest of the world grows further apart, Africa is growing closer. The current geopolitical and economic environment offers a favourable window of opportunity for Africa to accelerate inter-continental cooperation. Before this window closes, African countries must work together to build the hard and soft infrastructure needed to facilitate internal trade while foregoing policy shifts that promise only short-term financial gains so they can pursue longer term, more sustainable foreign direct investment and economic growth.

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