Afronomicslaw Sovereign Debt Quarterly Brief No. 10, 2026: Development Finance in Africa and the Institutionalized Risk Premium

By:

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Abstract

The notion of an “African risk premium” has often been understood narrowly as an outcome of market perception, driven either by bias or by beliefs about structural weaknesses in the region. This study develops a new framework for understanding the premium by introducing the concept of an “institutionalized” African risk premium. In doing so, the study identifies three distinct forms of the African risk premium: (a) the perceived African risk premium; (b) the real African risk premium; and (c) the institutionalized African risk premium. The latter is “institutionalized” in the sense that it is rooted in regulatory frameworks that govern the global financial market. It is therefore not a matter of what the market thinks of the continent, but rather what it is compelled to

do. Drawing on the cost of capital theory, the study proves the presence of the institutionalized component by examining how current regulatory capital frameworks applicable to internationally active banks and insurance companies reinforce the risk premium.

It is of profound importance that the institutionalized component of the premium is recognized so that the solutions proposed are effective. Building on the clear framework it establishes for understanding the premium, this study proceeds to assess the effectiveness of the new African Credit Rating Agency (AfCRA) in addressing it. The study argues that, while AfCRA can address the perceived component, it has limited scope to address the real and institutionalized risk premiums. This is not a criticism of AfCRA. Rather, the study reflects that the premium problem is multifaceted, and addressing it requires interventions on various levels. In the context of the institutionalized premium, genuine cooperation is necessary between African institutions and the predominantly Western institutions that shape the global rule-making process. Such cooperation is essential not only for recalibrating how risk is assessed and priced but also for ensuring that the global financial system supports, rather than constrains, sustainable development on the continent.

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