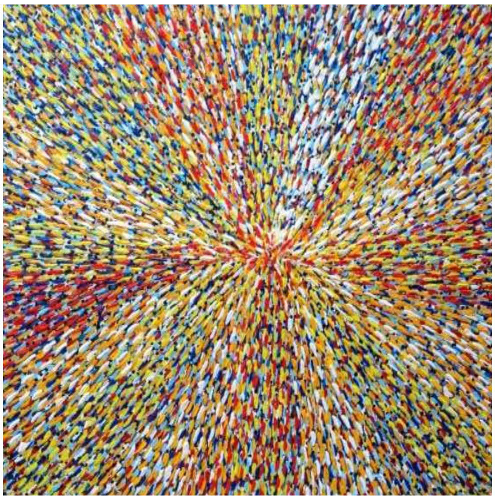
Political risk in Africa



Political risk in Africa tends to excite a degree of unease and caution, however it is often uninformed and without due cause. This article seeks to dispel some myths by considering (i) what we see as the real political risks, (ii) the perception issue, (iii) the improvements of the last decade and (iv) the opportunities.

1. The real political risks

Africa is not one country but a large continent (it is bigger than the US, China and all of Europe combined) with 54 very different sovereign states. Some African countries are as stable and transparent than some Western jurisdictions. For example, Mauritius is a full democracy according to the Economist Intelligence Unit report, it ranks ahead of France and Italy (which are classified as "flawed democracies" along with Botswana, Namibia, Cape Verde, Mali, Ghana, Lesotho and Benin).

It is true that some countries in Africa suffer from riots, coups and contested elections. The Arab Spring and most recently instability in Mali, the Central African Republic and Sudan confirm that. It is also true that foreign and local investments are very sensitive to stability, and therefore political risk hinders growth. For example, the Kenyan Investment Authority (KenInvest) blamed the slump on security lapses in the country and Kenya's intervention in Somalia to explain the 61% drop of investments from 2011 to 2012 (which reduced from USD1.84bn to USD712m).

In the political and social unrest heat map produced in 2011 by RBC in its report entitled "The political and social unrest index - who's next?", most of Africa is bright red indicating the highest level. But so is the Middle East and a large proportion of Asia, hence, political risk is a global issue rather than just uniquely African.

2. The perception issue

As highlighted in the latest Africa report from Ernst & Young entitled: Building Bridges, there is a perception gap "between those already doing business in Africa who are believers in the emerging Africa growth story, and those who have not yet invested and continue to associate the continent primarily with instability, conflict and corruption". Below are two examples of common misconceptions related to Africa.

(a) There is often insufficient data available on Africa, therefore making it difficult to reach founded conclusions. For instance, as most of the established rating agencies only rate a handful of African countries, the true investment climate is difficult to grasp. For example Botswana's country rating is A- (according to S&P) and A2 (according to Moody's), and in both cases with a stable outlook. This is better than many Western and emerging market countries, including Brazil, Russia, India, Portugal, Ireland, Spain and Italy. Botswana is not rated by Fitch.

(b) Despite the inconsistencies of data, the perception of Africa is slowly changing. Mainstream media such as the Economist and Time Magazine have had cover features focusing on "Africa Rising". Additionally, many major news sites now have Africa-focused pages. However, Africans are not waiting for mainstream media to boost Africa's profile. More Africans are using social media to tell their own stories and reports on Africa and are therefore increasing the neutral as well as Afro-optimistic messages on Africa.

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3. Improvements of the last decade

Although governance challenges remain, there is little doubt that political risk in Africa has reduced in the last decade. Additionally, the rule of law, including transparency and accountability keep improving (in contrast with the general trend highlighted by the Economist Intelligence Unit's title of its last Democracy Index: *Democracy in retreat*).

As illustrated in the previously mentioned Africa report by Ernst & Young, between 1960 and 1990 there was only one instance of an African leader or ruling party being voting out of office. Since 1990, over 30 ruling parties or leaders have changed through a democratic process. The 2011 elections in Zambia and 2012 elections in Ghana are recent examples of relatively smooth transfers of power.

Further improvements are visible from the annual World Bank Doing Business survey. In the 2013 report, five African countries rank ahead of Italy and 15 ahead of India. According to this same survey, investor protection is higher in South Africa, Mauritius, Rwanda, Sierra Leone, Tunisia, Botswana, Ghana, Mozambique, Burundi, the Seychelles, Nigeria and Madagascar and Angola than it is in France.

In addition, the rise of instantaneous communications (through the spread of internet) act as deterrent for greedy governments: if one foreign investor is unfairly treated, even if the rule of law is poor, even if a fair trial will not take place, it is very likely that the story will swiftly be known by the entire world. As national brand values increase, naming and shaming will become a significant tool to prevent corruption.

4. The opportunities

Recent research on productivity published by the Skolkovo Institute for Emerging Markets studies establishes that two key factors trigger exceptional growth: (i) family values and (ii) reduced freedom. According to this report, authoritarian cultures are the best environments for productivity growth. In this research which analyses the most productive states, African countries score high, explaining the 7% GDP growth forecasted by the IMF for 2013.

The controversial idea that democracy is wrongly associated with growth is not new. Dambisa Moyo, the Zambian born economist and best-selling author famously wrote in Dead Aid that "in a perfect world what poor countries at the lowest rungs of economic development need is not a multi-party democracy, but in fact a decisive benevolent dictator to push through reforms required to get the economy moving". Whether "benevolent" and "dictator" can coincide in one person is another question.

Conclusion – opportunities overcome all risks

According to the Africa report issued by the McKinsey Global Institute entitled Lions on the move, "today the rate of return on foreign investment in Africa is higher than in any other developing region". Because Africa is the last frontier market and the competition in the continent is reduced in comparison to Western countries and the usual BRICS and MIST (Mexico, Indonesia, South Korea, and Turkey) jurisdictions, the few investors who know and understand the market are and will likely continue to do extremely well.