What explains the credit ratings in economically advanced democracies?

Unpacking the role of political stability through ideology, corruption, and transparency

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Abstract

Credit rating agencies (CRAs) are often referred to in the literature as the "gatekeepers" of the international credit market. Their assessments may determine a government's ability to finance its budget since good credit ratings allow governments to borrow money on more favorable terms. Several studies have emphasized that democracies receive better access to the credit market than autocracies, and many scholars have attempted to explain this advantage in terms of institutional constraints, veto players, or electoral punishment. However, the global financial crisis (2007–2008) has shown that economically advanced democracies are not immune to debt crises. Thus, the decision-making mechanisms in democratic countries do not always signal the predictability of debt repayment to CRAs. This leads to the following question: What explains the variation in credit ratings among economically advanced democracies? While economic factors are typically seen as the most central determinants of credit ratings, this dissertation suggests that a government's political ideology and institutional quality also influence credit ratings, since CRAs can be expected to value political stability. This dissertation investigates three factors that may have implications for CRAs' perception of political stability: political ideology, corruption, and transparency. This dissertation presents that TAN-leaning governments (Traditionalist–Authoritarian–Nationalist) receive lower credit ratings on average compared to GAL-leaning governments (Green–Alternative–Liberal) and thus shows that the socio-cultural dimension of political ideology may matter for CRAs. Furthermore, both corruption or transparency can have implications for credit ratings, but not necessarily in the same way across all contexts. At the subnational level, federal transfers can allow relatively corrupt states to retain good credit ratings, despite the negative consequences of corruption more broadly. Finally, the extent to which government transparency and media freedom can improve credit ratings may depend on if available information fuel domestic pressures from interest groups or mass protests, as they can be considered as a threat to political stability in the eyes of CRAs.

Sammanfattning

Kreditvärderingsinstitut beskrivs ofta som aktörer med inflytande över länders tillgång till den internationella kreditmarknaden. Deras bedömning kan därmed påverka regeringars statsbudget, eftersom ett högt kreditbetyg ger länder möjlighet att låna på den internationella kapitalmarknaden till förmånliga villkor. Tidigare studier visar att demokratier har bättre tillgång till krediter i jämförelse med autokratier. Dessa studier pekar på den betydelsen som institutioner, vetospelare och regelbundna val spelar, och hur detta kan förklara den demokratiska fördelen på den internationella kreditmarknaden. Däremot visar den senaste finanskrisen från 2007-2008 att demokratier med utvecklade ekonomier inte är befriade från skuldkriser. Kreditvärderingsinstitutet uppfattar således inte alltid demokratiers beslutsfattande som gynnsamt. Detta leder till följande fråga: Vad förklarar variationen i kreditbetyg mellan demokratier med utvecklade ekonomier? Även om ekonomiska faktorer anses vara av mest avgörande betydelse för länders kreditbetyg, pekar den här avhandlingen på politiska förklaringar såom politisk ideologi och institutionell kvalitet. Jag föreslår att dessa faktorer är viktiga för kreditvärderingsinstitutetens bedömning av länders politiska stabilitet, och således att även relativt rika demokratiers politiska stabilitet ifrågasätts. Avhandlingen undersöker tre faktorer som kan påverka kreditvärderingsinstitutens uppfattning av politisk stabilitet: politisk ideologi, graden av korruption och transparens. Den här avhandlingen visar att regeringar med TAN (Traditionella, Auktoritära och Nationalistiska) tendenser i genomsnitt får sämre kreditbetyg än regeringar med GAL (Gröna, Alternativa och Libertarianska) tendenser. Det betyder att den sociokulturella ideologiska dimensionen kan ha betydelse för kreditvärderingsinstitutens bedömning. Dessutom kan institutionell kvalitet, såsom låga korruptionsnivåer eller transparens ha betydelse för kreditbetygen. Dessa faktorer spelar dock inte nödvändigtvis en likartad roll i olika kontexter. Även om korruption har negativa ekonomiska konsekvenser, kan relativt korrupta delstater bibehålla goda kreditbetyg om den federala regeringen ger ekonomiskt bistånd till dessa delstater. Slutligen kan regeringens transparens och pressfrihet förbättra kreditbetygen på nationell nivå, men endast i de kontexter där intressegruppers påtryckningar genom exempelvis protester är mer begränsade. Sådana påtryckningar kan ses som ett hot mot den politiska stabiliteten, och därmed möjligtvis leda till sänkta kreditbetyg.

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1

Introduction

The challenge of managing sovereign debt has taken on a new urgency for governments in various democratic countries. The global financial crisis of 2007-2008 exposed the fact that many democracies have problems with maintaining their creditworthiness.[1] Various debt-related events have made headlines across the world in recent years. Among these have been decisions about sovereign credit ratings, such as multiple downgrades in Greece (2011) and the change of the United States' credit rating from AAA to AA+ (2011). Such events escalated criticism towards credit rating agencies (CRAs) and political leaders. Greece's Finance Ministry reacted resentfully to the downgrade, accusing CRAs of ignoring structural reforms and the government's austerity budget (Darren, 2011). In the United States, opponents of President Barack Obama blamed his leadership for the downgrade by saying that the U.S. credit rating "endured the great depression, World War II, Korea, Vietnam and the terrorist attacks on 9/11" (Haberman, 2011). In Brazil, the downgrade of the credit rating to the "junk" status in 2015 intensified demands for President Dilma Rouseff to step down (BBC, September 10th 2015). At the same time, Sweden and the Netherlands, among other nations, seemed to have remained virtually unaffected by the crises and continued to enjoy strong credit ratings and thereby preferential access to the credit market. This leads to the question that this dissertation seeks to address: What explains the variation in credit

[1] In this dissertation, I use terms like "credit rating" and "creditworthiness" interchangeably. While "creditworthiness" is a broad concept, I conceptualize it as the perception of the ability and willingness to repay sovereign debt. Credit ratings as products of credit rating agencies, represent an interpretation of what is creditworthy in the credit market. I address this relationship between "credit ratings" and "creditworthiness" in Section 2. In Section 5.1, I discuss how credit ratings are measured.

ratings among democratic countries? Specifically, what political factors contribute to a better understanding of differences in credit ratings between economically advanced democracies?

These differences in credit ratings have a profound impact on more than just a country's economy. Favorable access to the credit market enhances a country's budget, as borrowing money can help the government finance its most important public services, including welfare policies (Mosley, 2003, 2005; Paudyn, 2014; Barta & Johnston, 2020). Sovereign credit ratings can also have an impact on corporate credit ratings and private capital flow (Boy, 2015). A bad standing on the credit market can have other implications, like a decline in international trade (Bulow & Rogoff, 1989; Kohlscheen & O'Connell, 2007), or the perceptions of being a less reliable partner in international agreements (Cole & Kehoe, 1998; Rose & Spiegel, 2009; Fuentes & Saravia, 2010).

Since credit rating have an impact on economic performance, scholars aim to understand not only economic but also political determinants of the creditworthiness (Barta & Johnston, 2018, 2020; Barta & Makszin, 2020; Brooks et al., 2019; Breen & McMeniamin, 2013; Shea & Solis, 2018). According to the dominant argument, the credit market considers democracies to be more committed to debt repayment if they have institutional constraints (e.g., North & Weingast, 1989; Schultz & Weingast, 2003; Block & Vaaler, 2004; Vaaler et al., 2006; Saiegh, 2005; Archer et al., 2007; Jensen, 2008; Beaulieu et al., 2012; Biglaiser & Staats, 2012; Bodea & Hicks, 2015). Institutional architecture that includes such elements as an independent central bank (Bodea & Hicks, 2018) or a commitment to democratic principles like the rule of law (Biglaiser & Staats, 2012) increases the confidence of both rating analysts and foreign investors that a government will not break the commitment to debt repayment. However, not all democracies have efficiently operating institutions (Bäck & Hadenius, 2008; Charron & Lapuente, 2010). Credit ratings among economically advanced democratic states still vary, not only due to different degrees of institutional quality but also as an effect of domestic preferences and events occurring on the domestic political scene (Breen & McMeniamin, 2013; Curtis

et al., 2014; Barta & Johnston, 2018; Glaurdić et al., 2019). According to some scholars, markets provide developed democracies with more "room to move" in their politics as long as fiscal and macroeconomic performance follows the market expectations (Mosley, 2003; Ahlquist, 2006). However, the perception of political stability in this group of countries is often taken for granted because their macroeconomic policies are usually more stable and consistent with market's expectations.

While macroeconomic indicators play an important role in the credit assessment, I argue that political ideology and institutional quality also can influence credit ratings, since they may have implications for CRAs' perceptions of political stability. Firstly, changes in governments' partisan socio-cultural affiliations may affect credit assessment. Secondly, while institutional quality, here measured as corruption and transparency can have implications for credit ratings, their effect may not be the same across different contexts. At the subnational level, corruption may only negative affect credit ratings when there is lack of financial support that can ensure the sustainability of debt repayment, despite of the economical inefficiencies caused by corruption. In addition, the effect of government transparency and media freedom may depend on the strength of domestic interest groups. Although results are associational, I believe that this makes for an important contribution to our understanding of credit ratings and why they vary between economically advanced democracies. A more nuanced understanding of these problems is lacking in the political science literature on credit ratings.

This dissertation contributes to the discussion on the variation in credit ratings in several ways. First, it contributes by unpacking the democratic advantage argument and shows that there is variation in credit ratings among economically advanced democracies. While the vast majority of studies have investigated this argument in the context of developing countries (Saiegh, 2005; Archer et al., 2007; Biglaiser et al., 2008), according to this dissertation, economically advanced democracies are also vulnerable to problems of debt repayment and potential political instability (Breen & McMeniamin, 2013; Barta & Johnston, 2018). The commitment of economically advanced democracies may often be taken for granted (Brooks et al., 2019), but changes

in slow-moving political factors can raise concerns about the stability of debt repayment.

Secondly, this dissertation illuminates the role of day-to-day politics in credit rating assessments by broadening our understanding of the relationship between political ideology and credit ratings. In contrast to previous research which has shown that the economic dimension of political ideology matters to CRAs' in assessing future policies (Block & Vaaler, 2004; Vaaler et al., 2006; Breen & McMenamin, 2013; Barta & Johnston, 2018), this dissertation seeks to investigate the impact that the socio-cultural dimension of political ideology has on credit ratings. These findings are particularly useful since current issues, such as migration or human, rights dominate public discussion and also shape economic performance (Bagwell & Hall, 2020).

Furthermore, this dissertation discusses the determinants of credit ratings, by investigating the factors that contribute to the perception of political stability at the domestic level. One can understand the variation in credit ratings by exploring institutional quality. However, institutional quality does not always have the assumed effect on credit ratings (Hameed, 2005; Arbatli & Escolano, 2015; Kim & O'Neill, 2017) because institutions do not exist in isolation from domestic demands and resistance against debt-related policies. Therefore, it is important to study how the interaction between institutional quality and domestic responses impacts perception of political stability. Many studies have emphasized the impact of elections on sovereign debt (Tomz, 2002; Curtis et al., 2014), austerity policies (Lowry et al., 1998; Giger & Nelson, 2011; Kriesi, 2012; Della Porta, 2017), and credit ratings (Block & Vaaler, 2004; Vaaler et al., 2006). However, this dissertation sheds light on domestic responses beyond the electoral mechanism, such as pressures from interest groups and mass protests. Specifically, the extent to which government transparency or media freedom are associated with good credit ratings may depend on if available information fuel domestic pressures from interest groups like trade unions and mass protests. In contrast to previous studies (Depken & Lafountain, 2006; Connolly, 2007; Butler et al., 2009), this dissertation also demonstrates that a lack of institutional quality may not always be associated with bad credit ratings at the subnational level.

Finally, another contribution to the literature is the provision of an empirical investigation at both the national and subnational levels. In particular, this dissertation advances the debate about the factors that shape subnational credit ratings. Despite the growth in borrowing by regions and municipalities, only a few scholars have investigated this relationship at the subnational level (Depken & Lafountain, 2006; Butler et al., 2009; Pérez-Balsalobre & Llano-Verduras, 2020). By examining the effect of corruption, I show that a central government can compensate for institutional inefficiencies and corruption at the subnational level with federal transfers (Butler et al., 2009). The findings indicate that the corruption is associated with lower credit ratings when only in states with low levels of federal transfers.

The rest of the introductory chapter proceeds as follows. In Section 2, I discuss the CRAs as “gatekeepers” to the credit market. In Section 3, I provide a review of the previous research on the role of institutions and domestic events in credit ratings. Section 4 presents the concept of political stability and its implications for creditworthiness while also discussing the theoretical arguments concerning the impact of political ideology and particular institutional qualities that may matter to CRAs. In Section 5, I describe the operationalization of the main concepts, review the methods used in the articles, and discuss their limitations. Section 6 presents a summary of the articles included in this dissertation. Section 7 concludes this chapter.

2

Creditworthiness and credit rating agencies

The purpose of sovereign credit ratings is to "pertain[s] to a sovereign's ability and willingness to service financial obligations to non-official (in other words, commercial) creditors" (Standard & Poor's 2017, p. 1). CRAs, such as Standard & Poor's, Moody's and Fitch, monitor and signal to international investors whether sovereign governments are able and willing to repay them. As a consequence, they influence what kind of interest rate a specific government has to pay. This means that CRAs determine on what terms governments can access the credit market.

Despite the fact that the history of credit ratings goes back to the nineteenth century, the beginning of the end of the Breton Woods era was a turning point for the rating industry (Bruner & Abdelal, 2005). The liberalization of capital flows contributed to the complexity of financial markets and thus information asymmetries for investors. This demand opened up an opportunity for the rating industry: "the agencies developed to sift through large volumes of information and present it in an easily digested format to investors, over time this information sorting function evolved into rating" (Sinclair 1999, p. 156). The rating business has flourished in particular during the 1980s and 1990s. However, what put credit ratings on the front pages was the global financial crisis. In 2007 and 2008, CRAs mispriced mortgage securities, which contributed to the speculative bubble and the beginning of the crisis. However, as the financial sector is best understood in special regulatory terms, the position of CRAs in the financial architecture depends on their interactions with the regulators, other private actors, and the community of experts (Tsingou, 2009). Despite criticism from various financial organizations, market actors, and researchers, CRAs still maintained their position of "gatekeepers" of the international credit market.[2]

[2] I discuss the attempts to reform the regulatory position of CRAs in the section

As Abdelal and Blyth (2015) pointed out, the reason behind this is the fact that, during the European sovereign debt crisis, credit rating changes were advocacy tools for other market actors to pressure governments to introduce various austerity measures.

This means that when market actors react to changes in credit ratings, they legitimize CRAs' interpretation of creditworthiness (Mennillo & Sinclair, 2019). Dyson (2014, p. 2) defined creditworthiness as "the belief that a state, more precisely those who act on its behalf, possess the will and the capacity to service its debts and honor its contracts, at any point in time". As the "gatekeepers" of the credit market (Kerwer, 2005; Kruck, 2016), CRAs determine those patterns of actions that define a government as creditworthy or not. Credit analysts confront a large sum of qualitative and quantitative data, which are difficult to consume in a time-constrained environment. They often rely on information shortcuts, including the categorization of countries (Brooks et al., 2015). Countries that adhere to the norms and rules set by the international credit market are then rewarded by being considered as stable and creditworthy borrowers (Finnemore & Sikkink, 1998; Wendt, 1999; Tomz, 2007). At the same time, when a government's behavior diverges from the commonly accepted norms, that country is stigmatized, through downgrades, and does not belong to the "audience of normal states" (Adler-Nissen, 2014, p. 152). Therefore it is in the interest of a government to show that its behavior fits within the range of what constitutes "normality" for CRAs.

Nevertheless, the idea of credit ratings as an interpretation of creditworthiness is often confused with other concepts like "debt", "sovereign debt" or "sovereign default", due to the practices of measurement and quantification carried out by economists and financial experts who emphasize macroeconomic and financial determinants (Paudyn, 2014). They have thus become technical and de-politicized concepts. For instance, sovereign debt is a narrower concept than creditworthiness and refers to the amount of sovereign borrowing that can be measured as the total debt to GDP ratio. However, this meaning can be misleading in the context of willingness and ability to repay debt. Sweden, a country that is often considered as creditworthy by

5.5.

CRAs and international organizations, had a lower total debt to GDP ratio during the crisis of 1990-1994 (198% in 1992) than that in 2008 (302%). Some countries have a high level of debt, such as the Netherlands (597% of GDP) and Belgium (265% of GDP), but they still enjoy favorable credit ratings. Another concept, sovereign default, represents a violation of the terms of a debt contract, such as a failure to pay within a specific period (Saiegh, 2005; Kim & O'Neil, 2015). This concept can also include voluntary restructuring debt that reduces the value of the debt paid to creditors (Tomz & Wright, 2010). Sovereign default is a rare event, and a judgment can proceed actual announcement of insolvency. For instance, at the end of 2001, all major CRAs listed Argentina as a defaulting country when the government announced its intention to suspend payment. However, the Argentinian government did not fail to make payment until January 2002 (Dyson, 2014). The final concept is the interest rate, which shows the expectations of investors. However, in contrast to credit ratings, investors are not organized bodies that establish the perception of a country's standing on the credit market.

From the perspective of governments, credit ratings can be perceived as a public good. Sovereign debt can be productive when a government uses loans to finance investments that promote social and political inclusivity and trust by making contributions to education, health, or child care (Vandenbroucke, 2012). Increasing sovereign debt through investments contributes to the well-being of society instead of accumulating indebtedness per se. As long as political leaders are able to convince CRAs that they can service debt, a government with a high level of sovereign debt can receive good credit ratings and be perceived as creditworthy.

3

Previous research: What explains the variation in credit ratings?

Each credit rating agency has its own evaluation methodology. However, CRAs only provide vague definitions and general guidelines for the criteria that are used to decide on ratings. For instance, Standard & Poor's has stated that these "analytical variables are interrelated and the weights are not fixed, either across sovereigns or across time" (Standard & Poor's, 2008, p. 2). Despite CRAs' official guidelines for their assessments, it is evident that countries, such as economically advanced democracies, with similar institutional and economic features can still receive different grades. Thus, the explanation is actually more complex and leads to the question: What explains variation in credit ratings among democratic countries? In particular, what political factors contribute to a better understanding of differences in credit ratings between economically advanced democracies?

Many scholars have focused predominantly on the economic determinants of credit ratings.[3] Cantor and Packer (1996) have shown in their cross-sectional study that GDP per capita, inflation, public debt, and a country's default history are crucial determinants in ratings. To maintain investor confidence in the credit market, governments often introduce various reforms to improve their credit standing. Such reforms can include the reduction of fiscal deficit, liberalization of the labor market, and making monetary authorities independent of political power (Bodea & Hicks, 2015; Campello, 2014; Kaplan, 2012; Maxfield, 1997). However, politics also plays an important role in the assessment of credit rating analysts. Standard

[3] Among those studies that have looked at the relationship between macroeconomic factors and credit ratings are Afonso, 2003; Mulder & Montfort, 2000; Afonso et al., 2012; Eichengreen & Mody, 1998; Nogués & Grandes, 2001

& Poor's highlighted this in their statement: "[a] willingness to pay is a qualitative issue that distinguishes sovereigns from most other types of issuers. Partly because creditors have only limited legal redress, a government can (and sometimes does) default selectively on its obligations even when it possesses the financial capacity for timely debt service" (Standard & Poor's 2008, p. 2).

While economic performance allows credit ratings analysts to assess the government's ability to repay debt, willingness to repay may hinder their assessment of creditworthiness (Eaton & Gersovitz, 1981; Bulow & Rogoff, 1989). Debtors are obliged to make repayment, but markets cannot perfectly assess the credibility of these promises. In contrast to the government's ability to repay debt, the willingness to pay is driven by political factors. Several that are discussed in the literature include membership of an international organization (Gray, 2009), the president's or chief executive's ideology (Johnson & Crisp, 2003; Block & Vaaler, 2004; Barta & Johnston, 2018), and the government's commitment to human rights (Bagwell & Hall, 2020). Scholars have also shown that political incumbents with long tenures are associated with better credit ratings (Shea & Solis, 2018; DiGiuseppe & Shea, 2018).

A significant number of studies have emphasized that the regime type is associated with a standing on the credit market. The regime type "determines the methods of access to the principal public offices; the characteristics of the actors admitted to or excluded from such access; the strategies that actors may use to gain access; and the rules that are followed in the making of publicly binding decisions" (Schmitter & Karl, 1991, p.76). Based on the regime type, countries can be divided through a simple binary distinction between democracies and autocracies, but the classification within these categories can also vary from closed autocracies to liberal democracies (Lührmann et al., 2018). According to the democratic advantage argument, democracies are more likely to pay lower interest rates because they can make more credible commitments (North & Weingast, 1989; Schultz & Wingast, 2003). However, scholars have debated what are benefits of democratic advantage at the credit market. While some studies have argued that

democracies are more likely to recover from insolvency (Kim & O'Neil, 2015) or issue more debt (Ballard-Rosa et al., 2019), others have emphasized preferential access to the credit market (Beaulieu et al., 2012).[4]

Despite several studies investigating the relationship between regime type and creditworthiness, empirical findings have produced inconclusive results. The majority of studies have found that democracy is associated with better creditworthiness both in single-case (North & Weingast, 1989; Schultz & Weingast, 2003; Beaulieu et al., 2012) and cross-national studies (Breen & McMeniamin, 2013; Kim & O'Neill, 2017). However, Archer et al. (2007) found that regime type does not have a significant impact on credit ratings among developing countries. Saiegh (2005) demonstrated that democracies among developing countries are more likely to reschedule debt repayment than non-democracies, and Biglaiser et al. (2008) argued that democracy matters to CRAs only in cases of the poorest developing countries. The existing inconsistencies originate from the fact that various studies rely not only on different samples of countries but also different measures of creditworthiness, such as the probability of default (Saiegh, 2005; Kim & O'Neil, 2015), the price of the sovereign bonds (Breen & McMeniamin, 2013; Ballard-Rosa et al., 2019), and credit ratings (Beaulieu et al., 2012).

The literature has presented several different reasons why democracies may preform better on the credit market than autocracies. One branch of the literature has shown that democracies are more committed to debt repayment due to stronger and better institutions. The literature on sovereign debt has also looked at the institutional characteristics that are sometimes associated with democracies, like the rule of law, an independent judiciary, and strong property rights (Biglaiser & Staats, 2012; Cordes, 2012). The predictability of the legal system, backed by the courts, informs credit analysts that the rules of the political game remain unchanged (North & Weingast, 1989; Ginsburg, 2003). Despite that Ballard-Rosa et al. (2019) argued that investors pay more attention to democratic institutions when global liquidity is low, well-functioning institutions may provide a sense of stability of debt repayment. According to various findings, the credit market also assigns

[4]This issue is discussed in detail in section 5.1.

great value to the transparency of financial data and the policy-making process (Kopits & Craig, 1998, Hameed, 2005; Arbatli & Escolano, 2015; Bastida et al., 2015; Kim & O'Neil, 2015). Scholars have also suggested that a low level of corruption can lead to more favorable access to the credit market, indicating that corrupt countries receive lower credit ratings (Butler et al., 2009; Mellios & Paget-Blanc, 2006; Connolly, 2007; Biglaiser & Staats, 2012; Ozturk, 2014). Using public resources for private gains can reduce the government's ability to repay the debt by limiting government revenues, increasing spending, and decreasing the growth rate (Mauro, 1998; Tanzi & Davoodi, 2002; Rajkumar & Swaroop, 2008; Aidt, 2009; Baum et al, 2017; Liu & Mikesell, 2014).

While the literature has linked several institutional qualities to better creditworthiness, many studies have considered such qualities to be inherent features of democratic regimes. However, there is no clear, direct relationship between democracies and institutional quality (Bäck & Hadenius, 2008; Charron & Lapuente, 2010; Keefer, 2005; Sung, 2004). Previous studies have shown that many democracies differ in terms of quality of government not only cross-nationally but also within countries (Charron et al., 2014). Despite some empirical attempts (Biglaiser & Staats, 2012; Dhillon et al., 2019), the sovereign debt literature has not fully taken into account that variation in institutional quality can help to explain the differences in credit ratings among democracies.

Moreover, the literature has not yet considered that the effect of institutional quality on credit ratings depends on domestic responses. Well-functioning institutions may produce improvements in credit ratings insofar as they can reduce uncertainty associated with incumbent politicians possibly breaking international contracts like debt repayments (Tsbelis, 2002). However, the positive effect of institutional qualities may not be the same across all contexts. For instance, a lack of institutional quality on the subnational level may be compensated by a central government's responses in a form of financial support, and thereby provide the kind of debt repayment guarantee that states need in order to maintain a good credit reputation. In addition, while institutional quality constrains political

incumbents from breaking credit commitments, it also allows citizens to hold politicians accountable. This is important because various interest groups (and voters) also can scrutinize their governments based on the available information about fiscal decision-making. The way in which domestic groups use this information and pressure political leaders may have implications for stability in day-to-day politics, and thus for credit assessment.

Concern about domestic responses leads to another set of studies that has emphasized that governments' decisions are constrained either by political partners or the electorate. The first of these attempts to explain why democratic governments do not break credit commitments due to the number of veto players. According to the veto players theory (Tsebelis, 2002), a number of actors, individual politicians, or political parties can block proposals to renege on the status quo's policies. If few actors are able to veto the policy proposals, then policy changes are more easily achieved. In the context of sovereign debt, the literature has paid special attention to coalition governments. While some studies have shown that coalition government are more likely to accumulate more debt (Alesina & Drazen, 1991; Hallerberg & Basinger, 1998; Persson & Tabellini, 1999; Bäck & Lindvall, 2015), others have provided evidence that a multiparty government reduces the risk of the default (Stasavage, 2003; Kohlscheen, 2010; Saiegh 2009). Van Rijckeghem and Weder (2009) emphasized that the probability of the default is lower in parliamentary than in presidential democracies. The veto players argument has been empirically studied in the context of sovereign default both for developing (Saiegh, 2009; Kohlscheen, 2010) and developed countries (Breen & McMeniamin, 2013).

Another set of studies has highlighted that democracies are more likely to sustain debt repayment because voters can punish an incumbent government when a credit commitment is broken. For instance, Schultz and Weingast (2003) have argued that representative institutions provide an effective way of enforcing debt repayment. Incumbent democratic leaders have an incentive to be dedicated to debt repayment because they can risk losing office if they default (North & Weingast, 1989). Acharya and Rajan (2013) have indicated that a popularity-seeking government may repay its external debt as long

as it can increase current spending. To understand the impact of political factors on foreign debt repayment, the literature has paid special attention to elections cycles (Biglaiser & Brown, 2003; Brooks et al., 2019). Market actors may worry that, during election periods, the incumbent government may be more willing to engage in the fiscal or monetary expansion (Block & Vaaler, 2004; Valeer et al., 2006). What binds these arguments together is the assertion that democracies are more likely to repay their debts because voters will punish incumbent politicians otherwise.

While several studies have shown that debt-related policies (e.g. fiscal consolidation) do not lead to electoral disadvantages for governments (Peltzman, 1992; Lowry et al., 1998; Alesina et al., 2012; Brender & Drazen, 2008; Giger & Nelson, 2011), some other studies have indicated that governments do get punished when important social groups are negatively affected by austerity measures (Pierson, 2001; Afonso et al., 2015; Hübscher et al., 2020). Fiscal studies have presented several reasons why citizens may punish governments for these type of policies, including the fact that voters can be either short-sighted (Buchanan & Wagner, 1977) and exploit future generations (Alesina et al., 1998; Cukierman & Meltzer, 1989). Moreover, Tomz (2002) found that some domestic groups may be opposed to upholding the commitment to credit repayment when they consider it as not beneficial to their economic self-interest. In fact, the global financial crisis of 2007 - 2008 resulted in the direct voting on sovereign debt resettlement. Curtis et al. (2014) studied voting behavior during the Icelandic debt referendum in 2010 and 2011, and these findings provided evidence that after the global financial crisis of 2007 - 2008, many governments became more responsible than responsive. In other words, domestic audiences may have felt that governments were agents of market actors or international organizations (Streeck, 2011) and therefore not primarily concerned with the well-being of their citizens. Such public perceptions may motivate citizens to express their grievances both in the form of popular protests (Bremer et al., 2020) and voting for populist parties (Mair, 2009, 2013) that do oppose strict terms of debt repayment and aim to “restore the country’s sovereignty”.

As populist movements are putting their mark on the landscape of

political parties in many democratic countries (Mudde, 2014; Rooduijn, 2018), their potential involvement in the government could raise CRA's concerns regarding the stability of debt repayment. Most studies examining the relationship between political ideology and credit ratings have found that left-wing governments receive lower credit ratings (Block & Vaaler, 2004; Vaaler et al., 2006; Brooks et al., 2019). However, other studies have indicated that CRAs discriminate against left-wing governments despite there being no significant difference between right-wing and left-wing debt-related policies (Campello, 2014; Hübscher 2016; Barta & Johnston, 2018). In this instance, one might expect that some other dimension of political ideology could also be important for the credit rating assessments. As issues like the violation of the rule of law, immigration, and individual rights are a big part of the current political debate, they may also have an impact on the stability of debt repayment. Following this assumption, the socio-cultural dimension of political ideology (Hooghe et al., 2002; Hooghe & Marks, 2018) can influence how credit rating analysts perceive credit risk for a given country.

Despite the fact that some scholars have signaled that domestic grievances can have an impact on debt repayment (Tomz, 2007), this mechanism has not been studied in the specific context of credit ratings. CRAs may consider domestic pressures as an obstacle to debt repayment that limits the government's interventions in times of economic downturn. Therefore, the absence of domestic pressures on debt-related policies may boost perception of political stability in the eyes of credit rating analysts and thus signal compliance with debt repayment. As CRAs are the "gatekeepers" of the credit market, it is important to understand how domestic dynamics can contribute to a country's standing in the credit market. Furthermore, most studies looking at domestic pressures have focused only on the electoral punishment and neglected other mechanisms, like pressures from interest groups or mass protests (Della Porta, 2017; Bremer et al., 2020). Accordingly, in considering the subnational level, this dissertation looks at how federal transfers influence the credit ratings of corrupt subnational units. In this sense, federal transfers represent additional domestic pressure from central governments on subnational ones (Depken & Lafoutain, 2006; Butler et al.,

2009; Hernández-Trillo & Smith-Ramírez, 2009).

Finally, many studies investigating the political determinants of credit ratings, have focused primarily on democracies in developing countries (Saiegh, 2005; Archer et al., 2007; Biglaiser et al., 2008). Some scholars have argued that the variation in government policies is greater in the developing world (Mosley, 2003; Ahlquist, 2006), but the global financial crisis of 2007 - 2008 has provided evidence that several democracies in the developed world also exhibit different levels of uncertainty regarding debt repayment (Baker et al., 2015). This shows that developed countries are not immune to debt crises, and that they need to be concerned about their creditworthiness as well (Breen & McMeniamin, 2013; Barta & Johnston, 2018). In previous versions of their methodologies, CRAs have stated that developed countries are generally associated with lower levels of uncertainty. For instance, Moody's and Standard & Poor's have confirmed that prestigious "clubs" like the European Union are seen more favorably during the assessment of creditworthiness (Moody's, 2008; Standard & Poor's, 2006). However, Barta and Makszin (2020) highlighted that such statements have recently been removed from credit rating documents. Moreover, as fiscal performance tend to be taken for granted in economically developed democracies (Keefer, 2005; Elgie & McMenamin, 2008), shifts in partisan affiliation in a government or minor institutional changes can signal potential risk for debt repayment in the eyes of CRAs. Therefore, even small domestic changes may produce different credit rating assessments in stable democratic countries.

In short, while both credit ratings and sovereign debt have received significant scrutiny in the literature, there are still gaps that limit our understanding of the relationship between market and state actors in the global economy. In terms of the literature on determinants of credit ratings, many scholars investigated both the economic and political factors related to sovereign debt. However, the debate about the political determinants of credit ratings is still dominated by the democratic advantage argument. Instead of discussing the variation in credit ratings among economically advance democracies, a vast amount of the literature is dedicated to explaining why democracies are more committed to debt repayment than autocracies.

Although developed countries also suffer from debt repayment problems, a greater number of studies have emphasized developing countries. Moreover, while scholars of sovereign debt have attempted to understand the democratic advantage, there may still be a significant difference in institutional quality between economically advanced democracies. In addition, institutions do not exist in isolation from domestic events. This means that the effect of institutional quality on credit ratings may not always be as one assumes. Finally, the significance of day-to-day politics is not often investigated in the context of credit ratings. Based on the rising popularity of populist parties and the decline of traditional mainstream parties, the public debate in many countries has shifted from economic policies towards issues like immigration, individual rights, and the violation of the rule of law. However, the relationship between the socio-cultural dimension of political ideology and credit ratings has not been studied in the literature. To address these issues, this dissertation seeks to provide a better understanding of what political factors explain the variation in credit ratings among economically advanced democracies. In particular, I argue that political ideology and institutional quality influence credit ratings, since these factors may have implications for CRAs' perceptions of political stability.

4

Theory

4.1 The perception of political stability – theoretical framework

This section outlines the theoretical framework of this dissertation. It identifies three factors that contribute to the perception of political stability and thus improves credit ratings. There is a lack of agreement among scholars about the concept of political stability, and depending on the literature, scholars employ different concepts instead. Research in economics literature more often uses the concept of political risk that represents unwanted political change or government interference with business operations (Kobrin, 1979; Jensen, 2008; Henisz & Zelner, 2010). In the literature of political science, there are both narrow and wide approaches to the concept of political stability. For instance, Hurwitz (1973) presents a broad definition of political stability and defines it as the absence of violence. Some other studies have emphasized the durability of the political regime. Lipset (1959, p.73) defines democratic stability as "uninterrupted continuation of political democracy". The literature on political agency (e.g., Barro, 1973; Besley, 2006) or economic voting (e.g. Duch & Stevenson, 2008; Kayser & Peress, 2012) tend to refer to political stability as the likelihood of incumbent leaders to continue in office. In some instances, scholars define political instability instead. For instance, Alesina et al. (1996) define political instability as the propensity of change in executive power, either by constitutional or unconstitutional means. Generally, these concepts of stability or instability refer to changes in the political system and its challenges. However, from the perspective of information asymmetries that attracts demand for a country's

credit assessment, what matters for political stability is the regularity or predictability of behavior patterns. Such patterns are key components of Ake's (1975) concept. In his definition, political stability occurs when actors behave according to expectations that fall within imposed limits. In contrast, "any act that deviates from these limits is an instance of political instability" (Ake, 1975, p.273). However, this does not mean that all potential institutional changes or shifts in leadership can signal political instability. One can classify an act as a contribution to political instability when it overwhelms other actor's ability to respond promptly (Margolis, 2010).

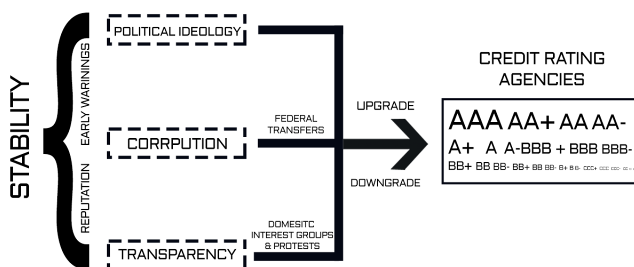

Figure 1: The perception of political stability – framework

Standard & Poor's defines credit stability as an issuer's "ability or capacity to largely maintain credit quality under conditions of moderate stress" (Standard & Poor's 2014, p. 2). Political stability matters to CRAs because they expect governments to provide predictable policy responses, especially in times when governments face either an economic crisis or social upheaval. As favorable access to the credit market should be an incentive

for governments to commit to the debt repayment, credit markets are never able to perfectly assess the credibility of these promises (Shea & Solis, 2018). Therefore, it is in the interests of political incumbents to ensure a certain degree of stability, and to outline to CRAs the general direction of policy-making.

Figure 1. illustrates the theoretical framework of this dissertation and shows those factors that may influence credit ratings, since they can shape CRAs perceptions of stability. All these factors provide some form of information that can be expected to help CRAs in assessing the extent to which government behavior is predictable and thereby its potential consequences for debt repayment. Political ideology helps CRAs to assess the direction of future actions. While corruption levels provide information about the extent to which governments violate predictable patterns of behavior, transparency expresses a government's willingness to disseminate data and facilitates access to information. Although these are not the only possible determinants that shape the perception of political stability, I believe that in democratic countries, in which governments are held accountable by domestic audience, it is essential to account for factors that provide CRAs with information about changes in government's behavior. These three factors may have implications for CRAs' perceptions of political stability, and represent institutional quality and its interaction with domestic responses. Secondly, these factors represent either governments' decision-making within an institutional framework or domestic pressures on the former.

While institutional quality can contribute to the perception of political stability, domestic responses can provide early warnings to credit rating analysts. Early warnings represent signals that may demonstrate to CRAs that there is a greater risk to debt repayment. Based on these early warnings, CRAs can adjust their initial assessment by providing policy-makers with guidelines for corrective actions that would help mitigate the approaching crisis (Dawood et al., 2017). The literature largely refers to various financial indicators as being early warning systems (ibid.), but domestic responses to different political decisions can also add up to indicators that are helpful for the credit assessment. The available information about the introduction of

specific austerity measures or fiscal consolidation can motivate the domestic public to express the opposition to such policies, for example, in a form of mass protests (Bremer et al., 2020) or lobbying by organized interest groups. CRAs can take such events as early warnings signs that the debt repayment is threatened. These signs can also be related with partisan shifts in the government, such as when the winning party either does not have a great governance experience or declares institutional reforms that can violate the rule of law. For instance, in 2016, after a change of government, Standard & Poor's downgraded Poland from an A- to a BBB+ for challenging the independence of its constitutional court and seizing control of the country's public media (Yuk, 2016).

Finally, political stability contributes to the reputation in the credit market. Reputation is a crucial factor that promotes international cooperation in the absence of global governance. States and non-state actors can build a trustworthy relationships by honoring international agreements (Keohane, 1984). This can also have a spillover effect into future agreements. Some scholars have argued that the most crucial mechanism that motivates governments to repay debt is their reputation on the credit market (Eaton & Gersovitz, 1981; Eaton, 1996; Tomz, 2007). A poor reputation can lead to higher borrowing costs or limited access to the credit market. Investors and credit analysts favor states that maintain a good reputation, or, in other words, they expect that these states will be committed to debt repayment. Therefore, governments have an incentive to honor the debt contract. Political leaders have even addressed this issue publicly. For instance, in 2012, the Polish Minister of Foreign Affairs, Radek Sikorski, acknowledged the importance of creditworthiness as a reflection of a country's sovereignty in a parliamentary speech (March 29th, 2012): "fighting for financial creditworthiness represents the strength of our country and well-being of our citizens. It is also a sign of our actual sovereignty. Nowadays, countries which have neglected reforms and lived beyond their means face the fear of losing their right to enact their financial and economic policies". The reputational effect can have a long-term implications for countries' access to the credit market. A good reputation can also help countries that announce a partial

default to recover faster from the consequences of the failure of repayment (Saiegh, 2005; Manasse & Roubini, 2009; Kim & O'Neill, 2015).

The government can also make deliberate actions to maintain its reputation in the credit market. These domestic responses can include financial assistance for other public entities within the country that struggle with servicing. Puerto Rico, which is an unincorporated territory of the United States, has suffered from a debt crisis that is the effect of a decade-long recession. In 2014, two major CRAs downgraded the island (Standard & Poor's, February 4, 2014; Reuters, 2014). To keep control of the financial situation, the U.S. president introduced a financial oversight board in 2016, which aimed to proceed with debt restructuring in Puerto Rico (Brown, 2016). Such a move demonstrates the intertwined nature of subnational and sovereign creditworthiness. If a federal government does not take responsibility for the default of a specific region, the sovereign rating may also be downgraded. Consequently, a federal government may feel pressured into intervening in subnational finances to sustain its reputation at the credit market (Hallberg, 2011).

4.2 Political ideology and credit ratings

In this section, I outline the argument that CRAs assess a government's behavior based on political ideology and its role in shaping CRA's perception of political stability. Political ideology plays an important role in credit rating assessment because credit rating analysts do not react as promptly to various political and economic events as other sectors of the financial market. Therefore, a government's political affiliation can provide analysts with information shortcuts regarding future policies (Brooks et al., 2015). Previous research has demonstrated that there is a correlation between higher credit ratings and traditional right-wing, market-oriented policy choices (Paudyn, 2014). Among such choices, while there is a preference of economic freedom and deregulation, there is also an inclination toward reduction in

government spending (Castro & Martins, 2019; Pickering & Rockey, 2013). Consequently, the literature contains discussions of a bias against left-wing governments on the credit market (Campello, 2014; Hübscher, 2016; Barta & Johnston, 2018). While the differences in economic policies between left- and right-wing governments have become less distinct over time, the rise of populist movements has introduced new topics to the political debate that go beyond the economic left-right dimension (Mudde, 2014; Rooduijn, 2018). Therefore it is important to investigate the socio-cultural dimension of political ideology, which may affect governments' actions and thereby credit ratings. Some scholars have explained the rise of populist movements as a consequence of the difficulties related to the regulation of macroeconomic policies. Specifically, Mair (2009) argues that when a government has fiscal commitments, there is more room for populist movements to gain support based on a promise to renegotiate the terms of debt repayment and restore the country's sovereignty.

In this dissertation, I investigate the impact of the socio-cultural dimension of political ideology on credit ratings. For this purpose, I have utilized the concept of GAL-TAN dimension (Hooghe et al., 2002). This dimension refers to the organization of society and various cultural and moral issues. "Liberal" or "post-materialist" parties represent the GAL-side (GAL: "Green, Alternative, Liberal") and favor personal freedoms and international cooperation. In contrast, "traditional" or "authoritarian" parties represent the TAN-side ("Traditional, Authoritarian, Nationalism") and often reject these ideas in favor of the roles of nationalism and protectionism. This type of party also believes that the government should be a firm moral authority (e.g., Kitschelt, 1994; Kitschelt & McGann, 1995; Marks et al., 2006; Hooghe et al., 2002; Bakker et al., 2015). However, TAN-leaning parties are more likely to produce illiberal or anti-democratic policy changes (Sedelmeier, 2014; Meijers & van der Veer, 2019).

I argue that CRAs may perceive TAN-leaning governments to be a greater risk to debt repayment, and there are several reasons why (Sychowiec, 2021). First, TAN-leaning parties can undermine the rule of law, which plays an important role in credit ratings assessment (Biglaiser & Staats, 2012).

The governance of TAN-leaning parties is still relatively unknown in many countries, and thus credit analysts may follow the political developments in other countries that have experienced the governance of TAN-leaning parities (Brooks et al., 2015). For example, after the formation of the new Italian government in 2018, which included such parties as the Five Star Movement and the Northern League, Moody's expressed their concern about Italy's commitment to debt repayment as follows: "Far from offering the prospect of further fiscal consolidation, the 'contract' for government signed by the two parties includes potentially costly tax and spending measures, without any clear proposals on how to fund those" (Moody's May 29th, 2018).

Moreover, TAN-leaning parties are less prone to cooperate with both domestic and international actors. On the international level, TAN-leaning parties emphasize the role of the sovereignty, and they may be less willing to adhere to the rules of international organizations. This type of behavior can signal to CRAs that the government is less likely to respect other international commitments, including debt repayment (Gray, 2009; Gray & Hicks, 2014). In contrast to GAL-leaning parties, TAN-leaning parties more often rely on anti-establishment rhetoric that entails disregard for the roles and policies of international organizations such as the European Union (Polk et al., 2017; Brigevich et al., 2017; Hooghe & Marks, 2018). At the domestic level, radical views on socio-cultural issues make it difficult for TAN-leaning parties to cooperate with other domestic political parties, especially in the context of coalition governments (Mudde, 2014; Helénsdotter, 2019). In other words, if TAN-leaning parties have difficulties when it comes to participating in government formation, this can lead to gridlocks that can harm the commitment to debt repayment (Bernhard & Leblang, 2002; Bäck & Lindvall, 2016).

Finally, TAN-leaning parties are often skeptical of market liberalization (Mayda & Rodrik, 2005; Wolfe & Mendelsohn, 2005). In order to attract opponents of supranationalism, TAN-leaning parties promote the view that market liberalization and immigration are threats to cultural identity (Kriesi et al., 2006; Vachudova & Hooghe, 2009; van der Waal & de Koster, 2017; Mudde, 2007). The literature shows that there is a relationship between

attitudes against market liberalization, in particular trade openness, and ethnocentrism (Edwards, 2006; Mayda & Rodrik, 2005; Wolfe & Mendelsohn, 2005). Such a perspective may introduce capital controls, which leads to less favorable access to the credit markets and thus lower credit ratings (Ostry et al., 2009; Andreasen & Valenzuela, 2016). CRAs have publicly stated that they positively evaluate governments whose economies are financially integrated with the rest of the world. In contrast, planned restrictions on capital flows are likely to constrain the ability to meet debt obligations (Paudyn, 2014).

This discussion leads to the following hypothesis:
H1: The more TAN-leaning government is, the lower the credit rating a country receives.

4.3 Institutional quality

Institutions have received a significant amount of scholarly attention, especially in the context of economic performance. North (1990, p. 477) defined institutions as “humanly devised constraints that shape the interaction between people”. Such constraints can be both formal rules and informal limitations that are shaped by the characteristics that enforce them. As institutions shape the norms of social interactions, good institutions constitute mechanisms that reduce “socially useless” and “unproductive” behaviors, such as rent-seeking activities. Despite the lack of consensus around a single definition of good governance or institutional quality, it is important to shed some light on existing concepts. Many scholars, especially those trying to understand the relationship between institutions and economic performance, define good institutions based on their outcome. According to Acemoğlu and Robinson (2012), good institutions provide economic prosperity. Kaufmann et al. (2009, p.5) understand good governance as “processes by which governments are selected, monitored and replaced; the

capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them”. They also provide a set of categories to determine whether a government follows the principles of good governance. Among these categories are the rule of law, control of corruption, government effectiveness, regulatory quality, political stability and absence of violence, and voice and accountability. However, according to Agnafors (2013), some of these categories are interrelated, and their inclusion is stated, but not justified. Another closely related definition is quality of government, which is constructed around the norm of impartiality (Rothstein, 2011; Rothstein & Teorell, 2008). However, this concept is focused on the output side of politics, or the exercise of power by a public authority, which contrasts with the input side with access to power and decision-making processes (Easton, 1953). Agnafors (2013) proposed a way to augment this concept with several different dimensions. One of them is good decision-making, which means that public officials are able to exercise power impartially while avoiding “the common pitfalls of irrationality and unreasonableness” (p.439). Therefore, public officials need to provide the reasoning behind their decision to the public. Without provided explanations, neither citizens nor international actors can assess whether a given decision was rational from a government’s point of view. Providing reasons to the public can not only help to mitigate opportunistic behavior, but it may also contribute to improvement and maintenance of its quality. Following this discussion, I conceptualize institutional quality in this dissertation as the impartial and reasonable exercise of power.

Given the impact of the bureaucrats’ performance, institutional quality can contribute to solving a problem, which is related to credit commitment - political instability (Kydland & Prescott, 1977; Rogoff, 1985). However, a strong rule of law together with a non-corrupt, competent bureaucracy and government transparency can strengthen CRAs trust in governments’ willingness to debt repayment (Simmons, 2000). High quality institutions do not only constrain but also routinize the practices of political incumbents. In their guidelines, CRAs highlight such categories as the “quality of a

country's institutional framework and governance", which includes factors like the "predictability of government action" and "the degree of consensus on the key goals of political action" (Moody's, 2008, p.2). In this dissertation, I focus on two aspects of institutional quality: corruption and transparency.

Corruption and credit ratings

The impartiality, competence, and capacity of the bureaucracy are important for the successful implementation of public policies and the efficient allocation of resources for public services that produce beneficial outcomes for the general public in the long-term against short-term interests (Gormley & Balla, 2008). The rules for good administrative performance and the presence of the rule of law secures the impartial implementation of political decisions (Rothstein, 2011; Charron & Lapuente, 2010). In contrast, corruption reflects one of the strongest violations of impartiality in the exercise of public power (Rothstein, 2014). Corruption is most commonly defined as "the abuse of public office for private gain" (World Bank, 1997, p.8). Among their list of corrupt activities, Fisman and Golden (2017) include cash bribes, fraud, violations of public procurement or cronyism, and nepotistic practices of providing jobs or contracts to various types of relatives. A lack of strong institutions that do not constrain political leaders may open up the possibility for corrupt activities to emerge, thereby making leaders' commitments less credible (Butler et al., 2009).

Corruption is considered to be a threat to various economic outcomes, and it also can have implications for the sovereign credit rating assessment. For instance, corruption decreases the rate of growth (Del Monte & Papagni, 2007; Mauro, 1998; Tanzi & Davoodi, 2002; Rajkumar & Swaroop, 2008; Aidt, 2009), increases public debt (Cooray et al., 2017; Liu et al., 2017; Benfratello et al., 2018) and public deficits (Peralias et al., 2013), reduces tax revenue (Imam & Jacobs, 2010), and increases government expenditures by reducing the productivity of government spending (Mauro, 1998).

There are several reasons to believe that corruption undermines stability

in the eyes of CRAs. Corrupt politicians tend to funnel public resources into sectors where they can seek private gains, such as infrastructure (Liu & Mikesell, 2014) or large capital investments (Tanzi & Davoodi, 2002). Rent-seeking makes such publicly funded projects more costly and can reduce the state's ability to repay debt (Depken & Lafountain, 2006). Corruption can also reduce trust between citizens and the government (Rothstein, 2009), and this can lead to tax evasion (Richey, 2010; Matsaganis et al., 2012; Litina & Palivos, 2016; Baum et al., 2017). Low levels of trust in governments can reduce successful law enforcement and undermine tax compliance because citizens do not have incentives to pay taxes when they believe that their government cannot spend their tax contributions wisely. When there is a low level of trust, potential tax-payers also anticipate that their fellow citizens do not pay taxes, thus providing fewer incentives to comply (Hammar et al., 2009). As a result, tax evasion may reduce the government's ability to introduce the reforms that are needed in order to react in times of economic distress.

However, the relationship between corruption and credit ratings at the subnational level may be more complex. Federal and subnational governments are interlinked in the financial network, and subnational units can rely on financial assistance from the federal government. While some scholars have suggested that corruption can also hamper credit ratings at the subnational and municipal level (Hernández-Trillo & Smith-Ramírez, 2009; Depken & Lafountain, 2006), I argue that the relatively high level of federal transfers may contribute to maintaining good credit ratings among corrupt subnational governments (Sychowiec et al., 2021). The rich literature on decentralization and fiscal dependency has shown that fiscal transfers can improve the perception of creditworthiness (Rodden, 2002; Ahrend, 2012; Vigneault, 2010; Escolano et al., 2012). Federal transfers can thus signal to CRAs that the government is responsive and capable of providing a financial safety net for corrupt subnational units that struggle with financial inefficiencies. Figure 2 illustrates that when subnational units receive high levels of federal transfers, they can potentially either maintain or improve their credit ratings. However, when corrupt subnational units have low levels

of federal transfers, they can also suffer from lower credit ratings.

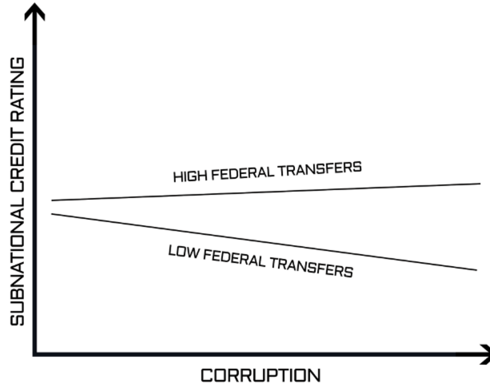

Figure 2: Effect of federal transfers on the relationship between corruption and credit ratings

The federal government's interest in sustaining subnational finances is related to their own sovereign credit rating. The federal government may also be willing to compensate for a lack of institutional quality at the subnational level to avoid punishment by local voters for their failure in public service delivery (Enderlein, 2010, pp. 423-437). Through such domestic responses like transfers, the federal government shapes beliefs among credit rating analysts that federal politicians are not ignoring the financial difficulties of a specific subnational unit (Rodden, 2006). Otherwise, such actions could be signaling that that the federal government does not have enough capacity to maintain financial stability in the country. Consequently, subnational credit ratings become less about the solvency of the subnational borrower and more about the creditworthiness of the implicit guarantor, which is the federal government in this case (Hallerberg, 2011; Rodden, 2006).

Based on this section, I present the following hypotheses:
H2: Corruption does not have a direct effect on subnational credit ratings
H3: Corruption has a negative effect on credit ratings only in states with low levels of fiscal dependence

Transparency and credit ratings

Another factor that may affect credit ratings is transparency. In this dissertation, I conceive of transparency as being of two different kinds. The first one is defined as a government's willingness to disseminate policy-relevant data (Hollyer et al., 2011; Renzio & Masud, 2011), that is, "ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities" (Kopits & Craig, 1998, p.1).[5] The second concept is media freedom, which Whitten-Woodring and Van Belle (2014) have defined as the media's ability to function independently of the government and other external forces.

There are several reasons why transparency is an important component of institutional quality. A vast amount of literature emphasizes that the timely publication of information on revenue flow and operations is an important condition for improving the quality and accountability of a government (Stiglitz, 2002; Bauhr & Grimes, 2014; Renzio & Wehner, 2017). Transparency helps in reducing information asymmetries between incumbent governments and the public opinion by informing the latter about outcomes of specific policy choices and decision-making processes (Hollyer et al., 2011). As a result, transparency contributes to the deterrence of corruption by reducing the scope of special interest groups and rent-seekers in influencing policy (Arbalti & Escolano, 2015; Bauhr & Nasiritousi, 2012). Disclosing information on the political incumbents' behaviors to the public could pressure governments into exercising their authority in better ways (Rose-Ackerman, 1996; Stiglitz,1998). However, the effectiveness of

[5] I refer to this concept as "government transparency".

government's transparency may be contingent on demands for accountability and the ability of citizens to process available information in order to act upon it (Fenster, 2005; Kolstad & Wiig, 2009; Bauhr & Nasiritousi, 2012). When citizens are able to effectively use available information, they can hold politicians accountable for their actions, especially during elections (Murphy et al., 2017). Transparency can also constrain actions across different institutions, as access to information allows them to glean greater insights into one another's operations (Fox, 2007). Finally, transparency can increase trust between politicians and both domestic and international actors (de Fine Licht et al., 2014; Kim & O'Neil, 2015; Roelofs, 2019).

From the perspective of credit rating assessment, access to information may ensure a certain degree of trust in the rated government. According to Eaton and Gersovitz (1981), lenders assume that borrowing governments "are inherently dishonest" (p. 290). This lack of trust is a pre-condition for the costly process of gathering information to assess whether a government is committed to debt repayment. However, if governments are more transparent, gathering and processing information is less costly. CRAs can assess fiscal adjustments and other debt-related policies when political decision-making is transparent and the relevant data are properly presented in the budget documents with a high degree of clarity (Potreba & von Hagen, 1999). This information can be evaluated in the context of the possible economic and social implications (Craig & Kopits, 1998). In this sense, if external actors, like CRAs, have access to information, they can deter decision-makers not only from stealing money but also from increasing the expenditure side of the budget (Alt & Lassen, 2006).

The second way in which this dissertation looks at transparency is through media freedom. Media freedom can affect both the policy-making process but also how institutions execute implemented policies (Färdigh, 2012). As freedom of expression is an important component of democratic regimes (Graber, 2017), the extent to which media freedom is respected depends on how democratic governments exercise its power. If the role of the media in a democratic system is not abused by political and economic actors, the media can serve as one of the channels for the dissemination of information

about policy proposals, their consequences, and the policy-making process. Therefore, media freedom may act to constrain power and holding political incumbents accountable for their actions. An important difference between government transparency and media freedom is the government's control over the amount of revealed information. It is upon the government to decide how much and what type of information is revealed to the public. For instance, governments that self-report to international organizations may feel incentivized to deliver manipulated fiscal reports, which can lead to incorrect conclusions regarding economic performance (Grigorescu, 2007). Independent media coverage can overcome this obstacle and provide sensitive information about government's performance to the public (Thrall, 2000). However, if a government applies political or economic pressure, for example, through dictating advertising to selected media outlets, the control and scope of the information about government activities can become very limited (Szeidl & Szucs, 2017).

One might expect, however, that in some instances, greater transparency could be a reason to question the reliability of disseminated information. When the rationality behind new laws is not clear enough, the trust between the government and the public can be violated (Grimmelikhuijsen, 2010). Regardless of the amount of publicly available information, it is important to consider who is reading it and how (Fenster, 2017). As the credit rating industry is information-driven, the activities of rating analysts heavily rely on access to information. Their assessment requires extensive expertise, and thus it involves detailed information selection (Bruner & Abdelal, 2005; Paudyn, 2014). Therefore I expect that transparency may have be positively associated with credit ratings.

Based on this discussion, this part of the dissertation proposes the following hypotheses:
H4: Higher levels of government transparency are associated with higher sovereign credit ratings
H5: Media freedom is associated with better sovereign credit ratings

Transparency not only has impact on credit rating assessments but is also considered to be a necessary condition for democratic governments to be held accountable and responsive to their citizens (Dahl, 1991). The dissemination of information is of key importance in enhancing government accountability through competitive elections, public debates, and checks and balances. Thus, the effect of transparency on credit ratings may depend on domestic responses. The release of information is a public good that benefits citizens in the first place (Rose-Ackerman, 1999; Persson & Tabellini, 2000). Maintaining favorable access to the credit market can have a significant impact on public finances and the quality of welfare services that are delivered to the people. However, some of the government's debt-related decisions may clash with the interests of the domestic groups, as the public carries the final cost of the government's defaults or rescheduling of credits (Tomz, 2002, 2007).

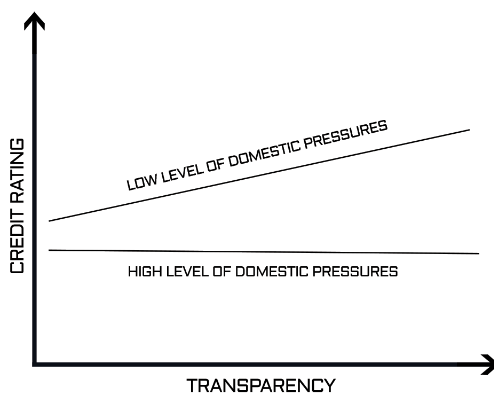

Figure 3: Effect of domestic pressures on the relationship between transparency and credit ratings

Figure 3 illustrates the effect of domestic pressures on the relationship between transparency and credit ratings. It shows that when the level of

domestic pressures is low, higher level of transparency can be associated with better credit ratings. When government disseminate information on debt-related policies, specific interest groups like trade unions can conduct actions against government. Trade unions can represent interests of those groups which are the most affected by debt-related policies like austerity measures. Despite the fact that trade unions in some countries can still support government's policies in order to sustain economic competitiveness (Baccaro & Lim, 2007; Lindvall, 2013), during the process of cooperation with government, they can use available information and demand conditions that are less harmful to those they represent (Addison & Schnabel, 2003). In contrast, when interest groups are weak, lack of inferring with government's debt-related decision-making can signal to CRAs that political leaders are able to flexibly counteract these issues in times of economic or social distress.

In some instances, the publicly available information about government's actions can lead to mass mobilization against new policies. Media coverage has a special role in the emergence of protests (Strömback, 2008; Walgrave & Vliegenthart, 2012). When France lost its top credit grade (AAA), Standard & Poor's acknowledged that "growth-enhancing structural measures could run counter to powerful national interest groups". The downgrade was preceded by protests of French trade unions and civil society organizations protesting against budget cuts and austerity policies (Paudyn, 2013, p. 793). Domestic pressures may not only undermine the implementation of debt-related policies but also contribute to significant changes in domestic politics, including early elections (Bremer et al., 2020) or the emergence of new parties (e.g. Passarelli & Tuorto, 2018). Both long-lasting negotiations and protests (led by organized interest groups) are examples of measures beyond election that citizens can use to hold political incumbents accountable. It is possible that if a domestic audience uses available information to oppose government's policies, credit rating analysts may perceive it as a concern for political stability.

This discussion leads thus to the following hypotheses:
H6: The more powerful the trade unions are, the lower the positive association between government transparency and sovereign credit ratings.
H7: Economic protests weaken the the relationship between media freedom and credit ratings.

5

Research design

This dissertation consists of four articles, each of which examines a particular factor that contributes to better understanding of variation in credit ratings from within the broader domains of political ideology and institutional quality (transparency and corruption). This section problematizes the dependent and independent variables as well as the methods used in this dissertation to answer the research question.

5.1 Dependent variable: credit ratings

All four articles have a common dependent variable of credit ratings. Credit ratings provide guidelines for investors about a government's willingness and ability to the debt repayment. In the first and second articles, I employ credit ratings which are obtained from Standard & Poor's. While I implement long-term sovereign credit ratings in the first article, I use subnational credit ratings in the second article. In the remaining two articles, I rely on credit ratings from Moody's. Standard & Poor's and Moody's are among the three most influential agencies in the credit market (together with Fitch). As a matter of fact, Standard & Poor's and Moody's controlled 83% of the credit rating market (2019) according to the United States Securities and Exchange Commission. Although they are separate companies with different methodologies and interpretations of creditworthiness, the correlation between the ratings from these two agencies has been shown to be 0.98 (Hanniman, 2018). In addition, assessments from two of these three agencies are usually a condition to receive access to the market (Bruner & Abdelal, 2005). Using ratings from two different agencies may also show whether specific factors have implications for the perception of political stability rather than being just the result of an extraordinary judgment of an

individual agency.

A credit rating is a type of grade that represents the creditworthiness of a particular government based on the assessment of credit rating analysts. All major CRAs use an alphabet-oriented rating scales that vary between AAA (Aaa for Moody's) to D. AAA represents the prime investment grade and refers to those issuers that are the most creditworthy. First ten highest ratings represent investment-friendly grades. Grades between BB+ (Ba1 for Moody's) and D (C for Moody's) are considered speculative and represents a very high risk of borrowing. Table 1 presents grading scales of the three major CRAs.

CRAs differentiate between long-term and short-term credit ratings, depending on the termination of repayment, and also between ratings for debt repayment in foreign and local currency. Taking into consideration that political factors do not change "overnight", long-term credit ratings as a perception-based judgment are the most appropriate measure. In addition, this dissertation focuses on credit ratings for debt repayment in a foreign currency. Most countries issue debt in mixed currencies. However, foreign currency debt seems to be attractive, as it results in lower costs of borrowing due to resistance to the inflation rate (Eichengren & Hausmann, 2005). Foreign currency debt is more often associated with developing countries, but it is not ignored in developed countries as well. For instance, in Austria, Finland, and Sweden, more than ten percent of their sovereign debt is denominated in foreign currency (Wolswijk & de Haan, 2006).

Despite providing guidelines for the assessment, the CRA's methodologies are not publicly available, meaning that it is inexplicable how each rating is arrived at, and how they weight the specific criteria of the assessment (Fight, 2001; Biglaiser et al., 2011; Gray, 2013).[6] In fact, some CRAs

[6] In the aftermath of global financial crisis, in order to increase the transparency of credit rating methodologies, some of governments of economically advanced democracies introduced regulatory frameworks for CRAs. In 2010, the Dodd-Frank Act was passed in the United States (Dimitrov et al., 2015). In the European Union, such a framework was gradually introduced from 2009 (Amtenbrink & Haan, 2009). However, as Amstad and Packer (2015) have shown in their study, despite relying more on quantitative data for credit rating assessment, methodological improvements have not been confirmed by empirical analysis. This suggests that

openly stated that analytical variables are not fixed across both countries and time (Standard & Poor's, 2008). As Fitch highlighted: "ratings are not themselves facts and therefore cannot be described as 'accurate' or 'inaccurate"' (Rona-Tas & Hiss, 2010, p. 122). Some researchers emphasize that credit analysts often rely on "cognitive shortcuts", which means that analysts use various categories to assess countries that share some similarities or belong to the same international organizations (Brooks et al., 2015; Gray, 2009). On the influence of credit ratings, Bruner and Abdelal (2005) concluded that "the significance of a rating in today's global economy derives not from the ideas or information conveyed so much as from the various social, financial, and legal institutions that favor dominant agencies' opinions by hinging various financial and regulatory consequences on their ratings" (p.200).

Table 1: Credit rating scales of Fitch, S&P's & Moody's

	Fitch	Standard & Poor's		Moody's	
	Grade	Grade	Rating Grade Description	Grade	Rating Grade Description
Investment Grade	AAA	AAA	Highest Grade Credit	Aaa	Rated as the highest quality and lowest credit risk.
	AA+	AA+	Very High-Grade Credit	Aa1	Rated as high quality and very low credit risk.
	AA	AA		Aa2	
	AA-	AA-		Aa3	
	A+	A+	High-Grade Credit	A1	Rated as upper-medium grade and low credit risk.
	A	A		A2	
	A-	A-		A3	
	BBB+	BBB+	Good Grade Credit	Baa1	Rated as medium grade, with some speculative elements and moderate credit risk.
	BBB	BBB		Baa2	
	BBB-	BBB-		Baa3	
Speculative Grade	BB+	BB+	Speculative Grade Credit	Ba1	Judged to have speculative elements and a significant credit risk.
	BB	BB		Ba2	
	BB-	BB-		Ba3	
	B+	B+	Very Speculative Grade Credit	B1	Judged as being speculative and a high credit risk.
	B	B		B2	
	B-	B-		B3	
	CCC+	CCC+	Substantial Risks - In Default	Caa1	Rated as poor quality and very high credit risk.
	CCC	CCC		Caa2	
	CCC-	CCC-		Caa3	
	CC	CC		Ca	Judged to be highly speculative and with likelihood of being near or in default, but some possibility of recovering principal and interest.
	C	C			
	DDD	SD		C	Rated as the lowest quality, usually in default and low likelihood of recovering principal or interest.
	DD	D			
	D				

subjective component is still strong in the credit rating assessment.

In the case of political determinants, Standard & Poor's inspects any governmental "separation of powers" and "civil institutions, particularly an independent press", and whether "political errors" can be "identified and corrected" quickly (Beers & Cavanaugh, 2004). The correction of "political errors" can be understood as an ideological preconceptions of CRAs: on the one hand, governments with higher ratings tend to show "openness to trade and integration into the global financial system" with economic policies that are "flexible and market-oriented"; on the other hand, lower-rated governments apply "more restrictions" and their "economic policies are usually not [as] well established", as those that do not a represent the most common prescription (Cavanaugh, 2003).

Many scholars and experts remain skeptical about CRAs and their assessments, pointing out that ratings, rather than providing guidelines for future investment, only follow the existing measures (Stiglitz, 2002; Bruner & Abdelal, 2005). While CRAs often codify what markets already know, credit ratings are part of market governance by establishing a "conventional judgment" about the sovereign's commitment to debt repayment (Abdelal & Blyth, 2015). CRAs fight back against this criticism with the idea that "ratings are predictive opinion forecasts about an uncertain future, not statements of fact" (Moody's, July 28 2003), or that a rating is a relative measure of credit risk.

However, the CRAs actions (although often appearing often late) still influence various measures in the credit market. For instance, the information that CRAs provide to investors can lead to returns of sovereign credit default swap spreads, or bond yield spread. In addition, the literature shows that CRAs do contain new information for markets (Cavallo et al., 2013), in particular, negative announcements (Boot et al., 2006; Afonso et al., 2012). Sovereign credit ratings also have an impact on the real economy. For instance, some scholars have shown that the corporate ratings of a company cannot be higher than the sovereign credit rating (Borensztein at el., 2007; Adelino & Ferreira, 2016). Research shows that sovereign credit ratings may also influence both countries' and regional stock markets (Brooks et al., 2004; Ferreira & Gama, 2007). As a result, by reacting to changes in credit ratings,

various market actors legitimize CRAs' interpretation of creditworthiness (Mennillo & Sinclar, 2019).

Figure 4 illustrates the number of credit rating changes in OECD countries between 1995 and 2017. This figure shows that until 2007, OECD countries have experienced more upgrades than downgrades. Since then the trend was reversed until 2016, when upgrades surpassed downgrades again.

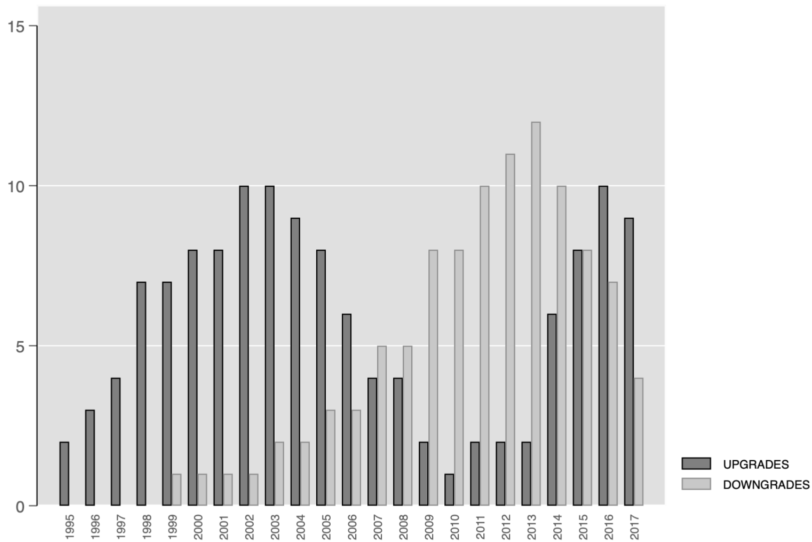

Figure 4: Downgrades and upgrades of credit ratings in the OECD countries (1995-2017)

5.2 Independent variables

Each of empirical studies included in this dissertation relies on various independent variables. Therefore, in this section, I discuss measures of independent variables used in studies included in this dissertation.

The first article, *Does Political Ideology Affect a Government's Credit Rating? The Evidence on Parties' Socio-cultural Positions in European Countries* examines if socio-cultural dimension of political ideology matters for credit rating assessments. This study relies on the GAL-TAN dimension (Hooghe et al., 2002), which captures several non-economic issues, including environmental protection, individual rights, immigration, and ethnic minority issues (Hooghe et al., 2002). GAL-leaning parties typically support more expansive personal freedoms, such as greater civil liberties, same-sex marriage, and a more significant role for citizens in the governance. Conversely, parties on the TAN end of the spectrum typically reject these ideas, favoring instead national sovereignty, tradition, and the belief that the government should be a strong moral authority. In this article, I assigned a GAL-TAN score to each government based on the biggest party that controlled the government at time *t*. Usually this was the party that held the most ministerial posts in a government or office of the prime minister.

Figure 5 demonstrates the relationship between the government's position on both the economic left-right and GAL-TAN dimensions in 2014. According to this plot, the correlation between these two dimensions of political ideology is very low (0.15). Based on the graph, some governments could be both TAN-leaning and left-wing at the time. Figure 5 shows that one such examples is the government in Hungary run by party Fidesz. On the other side of the spectrum, there is the Estonian government that was led by the liberal Estonian Reform Party in 2014.

This data were obtained from the Chapel Hill Expert Survey (the CHES; Polk et al., 2017). The survey asks experts to estimate the positions of European parties on a variety of issues, including the socio-cultural and economic dimension of political ideology, preferences for European integration, multiculturalism, or various policy dimension. However, in

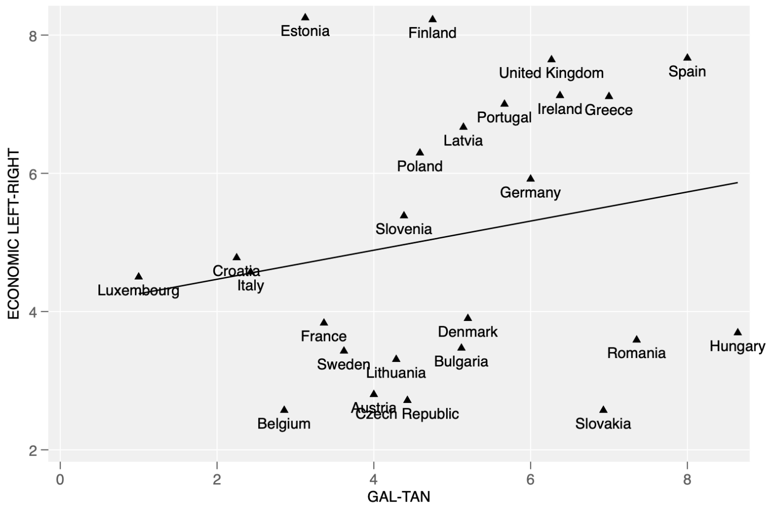

Figure 5: Governments' position on the left-right and the GAL-TAN dimensions (in 2014)

expert surveys, the position of a specific observation depends on the expert's subjective assessment. Alternatively, another option would have been to apply content analysis in party manifestos, which are developed for specific elections. However, such data could make it difficult to make comparisons across different countries and time, as manifestos are country- and time-dependent (König et al., 2013). Moreover, some issues can be interpreted differently depending on different points in time and local socio-political context. Sometimes political parties do not even release manifestos (i.e. Hungarian Fidesz has not released a new manifesto since 2010). In contrast, the CHES provides a comprehensive measure of socio-cultural party positions instead of dividing the task into several categories, as would be the case with manifesto-based datasets. Finally, experts who participated in the CHES assess party positions based on on

various sources, such as parliamentary speeches, television debates, voting for specific bills, and party manifestos. Therefore, the expert survey accounts for what parties said as well as what parties did. Finally, parties' positions are also comparable in the CHES because the same experts assess parties from different countries and they respond to the same question across editions of the surveys.

The second article, *Does Corruption Lead to Lower Subnational Credit Ratings? Fiscal Dependence, Market Reputation, and the Cost of Debt* investigates whether corruption always has a negative impact on subnational credit ratings. Corruption is often understood as "the abuse of public office for private gain" (World Bank, 1997, p.8). However, its secretive nature makes it impossible to measure directly. The decision on how to measure corruption often depends on the level of analysis. At the cross-country level, scholars have employed expert assessment measures like Transparency International's Corruption Perception Index or World Governance Indices (Mellios & Paget-Blanc, 2006; Butler et al., 2009; Connolly, 2007; Afonso et al., 2012). Such measures, while often employed at the country level, are not available to the same extent at the subnational level. For the U.S. states, this type of data is available only for a single year (e.g. Boylan & Long, 2003).

Following previous studies on corruption in the U.S. states (Fisman & Gatti, 2002; Glaeser & Saks, 2006; Depken & Lafountain, 2006; Liu et al., 2017), this study relied on federal convictions for public corruption as a measure of corruption (i.e. accepting bribes, awarding government contracts to vendors without public procurement, fraud or campaign-finance violations, and obstruction of justice). The data for this measure were obtained from the Public Integrity Section which covers 50 U.S. states between 2001 and 2015. To compare different states, I transformed this variable into federal convictions per capita (100,000 inhabitants).

One area of concern may be the validity of this measure. Federal convictions could also be interpreted as measures of law enforcement rather than indicators of the level of corruption. However, based on existing research, these data are not associated with state-level capacities, like caseloads or expenditures on state judiciary (Liu et al., 2017). While

some have emphasized that non-federal officials commit different crimes than federal ones (Cordis & Milyo, 2016), this measure reports on convictions according to a uniform set of laws that remain consistent over time. Therefore, a focus on federal convictions for public corruption keeps the 50 U.S. state as comparable as possible (Depken & Lafountain, 2006).

Figure 6 plots the federal convictions for corruption in 2014 (x-axis) against the subnational credit ratings obtained from Standard & Poor's (y-axis). Previous studies have shown that corruption has a negative effect on credit ratings at the national level (Hernández-Trillo & Smith-Ramírez, 2009; Bastida et al., 2015). However, in the case of corruption and subnational credit ratings, this graph shows that corruption explains only 5% of the variation.

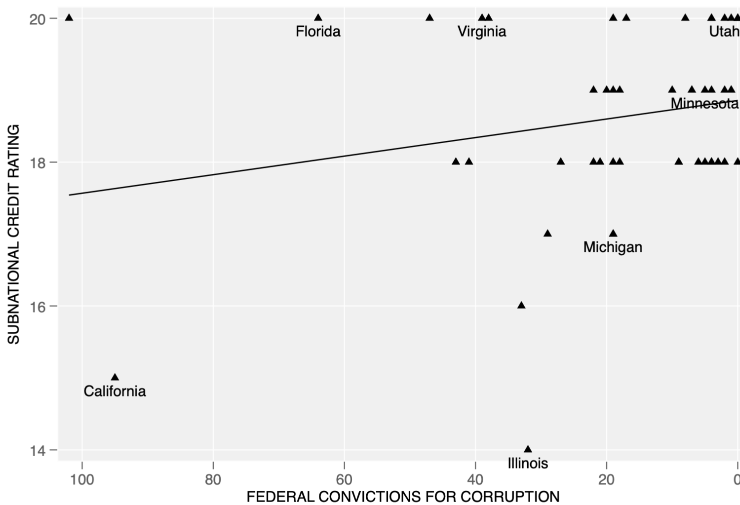

Figure 6: Relationship between corruption (reversed) and subnational credit ratings

The third article, *Do Transparent Countries Receive Better Credit Ratings? Domestic Audience Costs in Democracies*, uses government transparency as an independent variable that I conceptualized as a government's willingness to disseminate policy-relevant data (Hollyer et al.,2011). Transparency is a concept that is difficult to measure. While some studies have relied on perception-based measures like surveys (Arbatli & Escolano, 2015; Bastida et al., 2015), others have attempted to implement measures based on available textual reports (Hameed, 2005). However, this article aimed to show whether the logic of "good governance" can be applied to the relationship between transparency and credit ratings. Alternative measures of transparency used in other studies come from international organizations like the International Monetary Fund or the World Bank. Unfortunately, these measures are based on observations that are reported only to the organization by governments themselves, leaving out important information that is available domestically. In fact, some governments can limit their reporting to selective set of information (Grigorescu, 2007). Therefore, the measure of transparency should account for the ways in which information about government's activities is disseminated on the domestic ground as well. In this study, I relied on the measure of information transparency that was acquired from Williams's database (2015). This measure, based on 13 sources, is an index consisting of three main components: (a) the quantity of information released by governments (following Hollyer et al., 2011), (b) the quality of that information i.e., the standards used to produce that information, and (c) the information infrastructure of countries that enable the dissemination of that information to the citizens. This index helps to capture such complex phenomenon as transparency.

The fourth article, *Does Media Freedom Benefit Sovereign Credit Ratings in Times of Mass Mobilization?*, implemented media freedom as the independent variable which was defined as an environment in which journalists can safely criticize political and economic elites at both the national and local levels (Van Belle, 2000; Whitten-Woodring & Van Belle, 2014). Journalists' work can be constrained in various ways, including

through censorship and commercial pressures but also by organized crime, opposition parties, and religious organizations (Czepek, 2009). If the media environment is free, and criticism of the government is part of the political dialogue, journalists can keep incumbents accountable for their actions.

To capture the concept of media freedom, I relied on the Global Freedom Dataset (Whitten-Woodring & Van Belle, 2014). In this dataset, the media environment is coded into one of three categories for specific country-year. The first category represents countries in which the media environment is free, meaning that domestic news outlets can publish or broadcast the full story about scandals that involve a particular government. The next category refers to the imperfectly free media environment. Countries that fall into this category have limited possibilities to publicly criticize the government, yet there is still the presence of investigative journalism, and criticism of policies can occur. If journalists cannot provide coverage that criticizes incumbent leaders, and if the media is controlled by the government, the country falls into the category of a media environment that is not free. However, when considering a sample that consists of democratic countries, Whitten-Woodring and Van Belle advise combining the “not free” and “partially free” categories into one (“not free”). In contrast to other similar measures, the Global Media Freedom Dataset provides some advantages. First, it accounts for a methodologically consistent historic measure of media freedom. Some other popular measures, like Freedom House or Reporters Without Borders indices, have changed their coding methods over time and are mainly based on identifying media restrictions. Nevertheless, despite their different methodologies, these measures are highly correlated with the Global Media Freedom Dataset (0.84). It is important to add that the regime type does not always determine a state’s media environment. In this study, I focused on countries coded as democratic by Polity IV/members of the OECD. Although the sample consisted of democratic countries at the time of coding, there was still the variation in media freedom, and some countries, such countries as Portugal (1990-1994), Italy (2003-2005), Israel (1998-2001, 2008, 2012-2014), Hungary (2011-2014), and Mexico have not been classified as having free media.

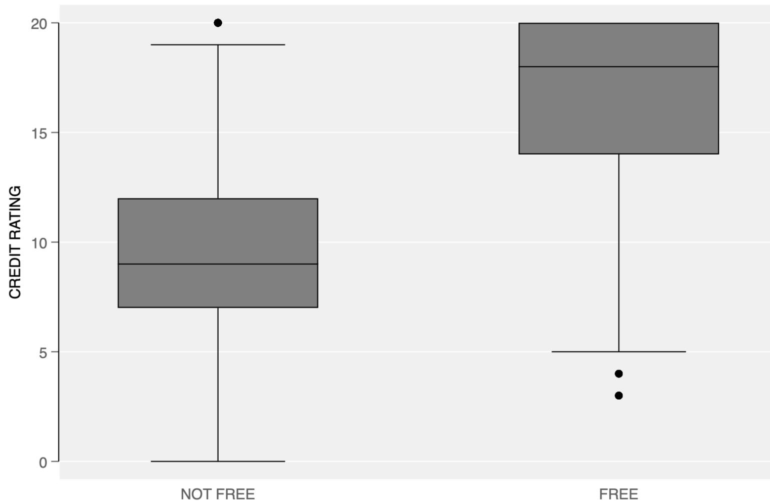

Figure 7: Distribution of credit ratings - grouped by media freedom

Figure 7. demonstrates that, on average, countries that had free media (x-axis) received significantly better credit ratings (y-axis) than those with politically or economically constrained mass media. Approximately 75% of countries with free media receive a rating higher than an A3 grade, (upper-medium grade and low credit risk). In contrast, 75% of countries without a free media environment reach a Baa3 grade at most (medium grade, with some speculative elements and moderate credit risk). Each rating below this grade belonged to the speculative category.

5.3 Case selection

The dissertation aims to improve our understanding of the variation in credit ratings among democratic countries. This group includes not just Western countries but also more recent democracies and post-communist countries that have exhibited the hallmarks of economic development and democratic governance. Each article focuses on a different aspect of this sample. The fourth article looks at a global sample of democratic countries. The first and the third articles focus on OECD countries. Finally, the second article, which investigates the role of corruption in subnational credit rating assessment, examines this relationship in the U.S. states. Therefore, this dissertation provides a comprehensive perspective on credit ratings in democratic countries.

However, this dissertation emphasizes "economically advanced democracies". As a benchmark for this group of countries, I use the membership to the Organization for Economic Cooperation and Development. The global financial crisis of 2007 - 2008 has shown that advanced democracies are not immune to problems of debt repayment and can react differently. Several economically advanced democracies such as Greece, Ireland, and Spain, have experienced difficulties with debt repayment because of the deep-rooted lack of institutional quality (Alt et al. 2014). Despite these events, the literature on credit ratings places a great deal of emphasis on political factors in democracies among developing countries due to their fragile financial systems (Saiegh, 2005; Archer et al., 2007; Biglaiser et al., 2008). Some scholars have argued that political factors are more important for determining credit ratings in developing countries (Mosley, 2003; Ahlquist, 2006) and that credit ratings are biased towards advanced economies (Gültekin-Karakaş et al., 2011; De Moor et al., 2018).

While sovereign defaults are rare events in general, stability matters mostly among economically advanced democracies because there is a greater expectation that governments in this group of countries will be more likely to maintain debt repayment (Barta & Johnston, 2020). In contrast to the frequent episodes of political instability in less developed democracies, a

change of slow-moving political factors, like shifts of governments' political ideology or institutional quality, can raise a concern about the stability of debt repayment of economically advanced democracies in the eyes of credit rating analysts. For instance, populist movements have attracted increasing levels of support in several countries and have raised concerns among international investors (Mair, 2009; Simpson, 2016; Oesch & Rennwald, 2018). In addition, transparency can give a voice to dissatisfied citizens to express their grievances, for example, in a form of pressures from organized interest groups. As Figure 8 shows, there is a reasonable variation in credit ratings among democratic countries. The level of electoral democracy explains 0.43 (p=0.00) variation in credit ratings (in 2014). However, when the sample is restricted to those observations with an electoral democracy index higher than 0.7, the level of electoral democracy that explains variation in credit ratings decreases to 0.28 (p=0.00).

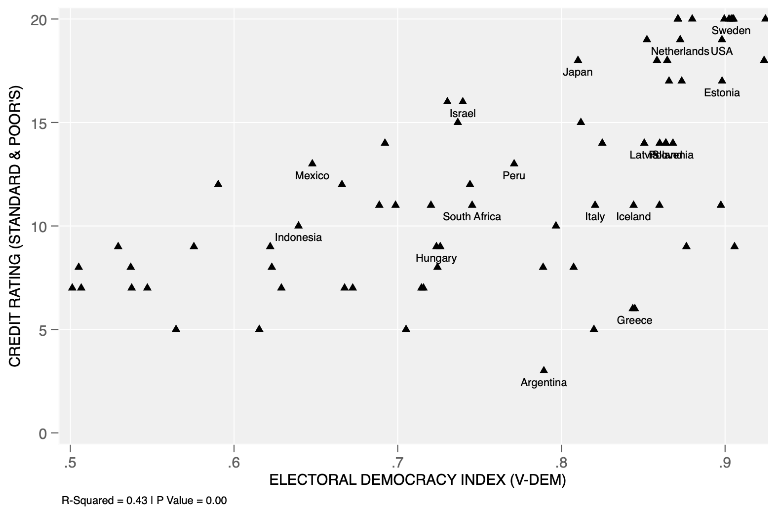

Figure 8: The level of democracy (V-DEM) and credit ratings (Standard & Poor's) in 2014

Finally, compared to autocracies, the factors that contribute to maintaining debt repayment in democracies are more complex and tend not rely on the leader's survival as they do in autocratic countries. Apart from this, some studies have shown that autocratic leaders are more dependent on credit access than democratic ones (DiGiuseppe & Shea, 2018; Shea & Solis, 2018). This fact demonstrates that CRAs may perceive democratic countries as being less predictable because of leadership change, which is part of domestic accountability and electoral mechanisms.

5.4 Methods

This dissertation follows the majority of studies on credit ratings and relied on a time-series cross-sectional analysis using country- or subnational-year as a unit of analysis. Comparing countries or subnational units is an insightful way to understand the relationship between the variables of interest, as countries (and subnational units) are a key form of political organization of the people they affect.

In the literature on credit ratings, there are two dominant approaches. The most popular method uses regression methods on the numerical representation of the ratings, and mainly OLS regression to account for the linear representation of ratings (Cantor & Packer, 1996). This methodology has been replicated in several studies on the political determinants of credit ratings (Block & Vaaler, 2004; Archer et al., 2007; Biglaiser & Staats, 2012; Shea & Solis, 2018; Bagwell & Hall, 2020). OLS analysis allows for a straightforward generalization to panel data. The second approach generally relies on binary variables that code the events of either downgrades or upgrades, while some other scholars consider credit rating as an ordered response variable (Agresti, 2007). While linear transformation assumes that there is an equal distance between rating categories, a non-linear transformation makes these distances different. When logistic regression is applied, the transformation will be "S-shaped", which means that the

distance between the ratings in the middle is larger than the ones at the tails. For example, a rating change from the speculative to investment grade can lead to more favorable access to the credit market than when a rating changes within a specific grade (Eliasson, 2002). Even though the non-linear approach seems to reflect the nature of credit ratings in a more accurate way, some studies have shown that both linear and non-linear approaches provide similar results (Ferri et al., 1999; Beers & Cavanaugh, 1998). Moreover, Batra and Johnston (2018) argue that logistic regression is not the best alternative because it suffers from a quasi-separation problem in which several observations predict zero outcomes. This can occur when logit models rely on fixed effects. While fixed effects help to control for omitted confounders, they may lead to imprecise estimates with large standard errors. Based on these assessments, I follow the linear approach in this dissertation.

All datasets used in this dissertation suffer from similar issues, such as the presence of positive serial correlation and heteroscedasticity. As a result, I implemented dynamic models with a lagged dependent variable and robust standard errors that are clustered by country. To address the heterogeneity of the country over time and omitted time-invariant variables, I applied fixed effects. Ultimately, fixed effects can help to eliminate the individual characteristics of countries (like culture), which can disturb the model.

However, fixed effects estimations may generate some additional problems, as fixed effects reduce the variation between countries. An alternative estimation would be to rely on random effects, but in such cases, the OLS estimation may be inconsistent because the lagged dependent variable is correlated with the error term, even if the latter is not serially correlated (e.g., Arellano & Bond, 1991). To address this issue, some studies that are included in this dissertation implement dynamic panel data estimators in the form of either an instrumental (IV) estimator (Anderson-Hsiao, 1981) or the system of generalized method of moments (GMM; Arellano & Bover, 1995). An instrumental (IV) estimator, which was used in the second article, allows the second lag of the dependent variable that is exogenous to the random intercept to be employed (Baltagi, 2013). In order to apply this estimator, the generalized, two-stage estimator (G2SLS)

is an appropriate choice in the second article, as the dataset consists of a relatively large number of units of observations and a small number of time units.

In the case of the third article, and excluding the OLS estimation that is used in all articles, I applied the GMM system as robustness checks. The base for this estimator is the difference GMM estimator that was developed by Arellano and Bond (1991). I took the first differences in the dynamic equations and instrumented endogenous variables with their available lags in levels. However, lagged levels may be weak instruments for first differences if the series are persistent (Blundell & Bond, 1998), as is the case for credit ratings as a dependent variable. According to Arellano and Bover (1995), this problem can be alleviated by combing the first-differenced and levels equations.

Finally, as several economically advanced democracies are consistent recipients of top credit grades, one could expect that the findings may be biased. For the purpose of comparison, I implemented Tobit regression, which allows censoring of the dependent variables (Sigelman & Zeng, 1999). In this context, I set a threshold from above the top credit grade (AAA) values. As a result, Tobit regression produces a latent variable that is observed for values below the threshold, and observations are censored otherwise.

5.5 Limitations

Despite the benefits of statistical generalization, there are a few limitations related to the statistical analysis. In this section, I address several of these.

First of all, many observational studies in the social sciences have difficulty establishing causal relationships. Generally, one needs to rely on strong assumptions to claim the presence of causality between phenomena of interest (Keele, 2015). It is thus important to emphasize that the conclusions of the analyses in this dissertation are more associational than causal in nature, especially considering the ambiguity of credit rating assessment. However,

with the help of theory and some strategies, it is possible to address the problem of causal inferences related to omitted variables. In data with a temporal dimension, as is the case in this dissertation, such strategies include fixed effects[7] and lags of dependent variables (Angrist & Pischke, 2009). Fixed effects adjust for potential time-invariant confounders, and thus we may assume that the predictors are independent from potential outcomes (Mummolo & Peterson, 2018). As outcomes are the function of both observable and unobservable variables, including lagged dependent variables can partially control for unobservable effects.

Secondly, both credit ratings and institutional features do not change rapidly over time. This problem makes it difficult to model the short-run relationships and leads to a potential autocorrelation between the values of variables at time $t - j$, which explains the value at time t. This means that previous values of a variable can explain the current value. Another issue related to the short-run relationship is that it is difficult to say how fast this process occurs. The conventional solution for addressing this problem is to arbitrarily employ predictors as control variables with values from the prior year. I include lagged dependent variables in the second, third and fourth articles. An alternative would be to control for lagged changes in credit ratings. In the first article, I control for the occurrence of a downgrade ($t - 1$). However, the potential downside of this approach is the reduced variance for the outcome explained by the predictor variable in a regression. Taking this into account, in this dissertation, cross-sectional results are more concrete than results over time.

The other issue is related to the time frame. In this dissertation, I examine the variation in credit ratings among economically developed democracies during the three decades after 1990. Data from the global financial crisis period of 2007–2008 and the European sovereign debt crisis period are

[7] In addition, the problem of reversed causality can be an issue for many political phenomena. The change in explanatory variables may also be the effect of a government's response to the recommendations of CRAs. Therefore it is highly plausible that institutional quality and the actions related to political ideology could affect the credit ratings. A potential way of addressing this is to employ state fixed effects models.

included. Based on this fact, one could expect that the data for credit ratings would not be stationary. Stationarity represents statistical properties, such as the mean and variance, that are all constant over time. In contrast to stationary data, non-stationary data are unpredictable. The results could therefore be spurious (Choi, 2001). Despite this concern about non-stationary data, Fisher's test indicates that this is not a problem in this dissertation. In the third article, this problem was addressed by controlling for year-trend. Moreover, I run supplementary robustness checks that examine whether rating changes during periods of crisis could affect the overall results. Based on these findings, the results in respective studies do not depend on financial crises.

There are also limitations associated with the data used in this dissertation. First, the measure of socio-cultural political ideology (GAL-TAN) that is obtained from the CHES is an expert-based subjective measure. While some expert-based initiatives evaluate the quality of data and deal with cross-country and cross-expert comparability, it is important to be aware that, in the context of expert-based measures, it may be difficult to ensure that all experts will understand the questions and concepts in the surveys in a similar manner. At the same time, in some instances, even official statistics may elicit ambiguous interpretations. This is the case with federal convictions for public corruption, which are discussed in the second article. One may interpret convictions for public corruption as a measure of law enforcement rather than corruption per se. However, these data are not associated with other state-level statistics that represent a measure of state-level law enforcement (Liu et al., 2017). Finally, in the third and fourth articles, I test the interaction effects between institutional quality and domestic responses in the form of the strength of interest groups and mass protests, respectively. As a proxy of the strength of an interest group, I use trade union density, which represents the ratio of the number of employees who are members of a specific trade union (public and private) to all the employees in the country. While trade union density may not reflect bargaining power in all countries, it is the most comprehensive measure available to date. A potential alternative could be implementing

pact structure measures that show a different configuration of tripartite agreements between governments and the representation of employees and employers. However, such measures may not provide a guarantee that having a seat at the negotiation table shows the greater bargaining power of trade unions. In the fourth article, I rely on the number of economic protests in a given year but with a different operationalization, such as the duration of protests or the number of participants, which could lead to different conclusions.

Another important constraint is an ambiguous understanding of CRAs' position is in the architecture of the global financial market. Before the financial crisis of 2007–2008, transnational communities of global financial policies, including representatives of central banks, regulators, managers of large financial conglomerates, and selected academics, were responsible for writing the rules of global finances (Tsingou, 2014), and for a long time, they accepted credit ratings as a regulatory instrument (e.g., Basel II Accord). However, during the financial crisis of 2007–2008, CRAs demonstrated their weakness by providing mispriced risk (Abdelal & Blyth, 2015). Some scholars and experts consider credit ratings not only as tools that regulate access to the financial market, but also as triggers that can stimulate undesirable market movements, thus creating systemic risk in a global economy by facilitating a self-fulfilling prophecy in sovereign debt markets (Gärtner & Griesbach, 2012). In this sense, CRAs are not entirely exogenous from the financial markets they assess. However, after the crisis, these communities attempted to regulate the credit rating industry, and these attempts were relatively half-hearted due to the policy's path dependency. Both public and private actors are structurally dependent on CRAs. As a result, there have been difficulties in reaching agreement between various market representatives on the role of CRAs in financial regulations (Verma, 2015). For instance, in its reports of the Financial Stability Board (2010, 2012), it suggested reducing the reliance on credit rating. However, the Basel Committee on Banking Supervision agreed in the Basel III Accord to maintain credit ratings as a potential approach to measuring credit risk (2019). There are a few reasons why actors within transnational standard-setting bodies may veto changes

related to reducing reliance on credit ratings. First of all, potential reforms imply difficulties associated with the replacement of credit ratings with similar instruments that could reduce uncertainty in the market (Helleneir & Wang, 2018). Not only do policy-makers find it too costly to look for alternatives to CRAs that can provide risk assessment expertise, but also, as Mennillo & Roy (2014) have pointed out, tighter regulation of the credit rating industry can even create a higher demand for credit ratings. Moreover, the loss of authority in matters of financial regulation is exchanged for less political responsibility in cases of regulatory failure. As a result, credit ratings, as an available instrument in financial regulation, re-enforce the "epistemic authority" of the CRAs (Sinclair, 1999, p. 165). In this sense, the interests of private actors like CRAs are aligned with other participants of transnational standard-setting bodies and they together managed to control the reform process (Tsingou, 2015). However, CRAs are still important "gatekeepers" of the international credit market as long as decision-makers and market participants treat them as such.

Moreover, the credit rating data come from both Standard & Poor's and Moody's. The other major agency, Fitch, does not provide data as comprehensive as Standard & Poor's. While Moody's data on sovereign credit ratings is publicly available, the subnational ratings are accessible only after purchasing services from this agency. At the same time, Fitch does not provide data on sovereign or subnational ratings to the public. As a result, this dissertation relies on the assumption that credit ratings of these agencies are highly correlated with each other (Caouette et al., 2008).[8] Another data-related problem is the availability of several variables that limit the sample to OECD countries. This is the case with the Chapel Hill Expert Survey, which only collects data for European countries. Moreover, many social and political phenomena are not measured directly, and they are based on subjective expert surveys, indexes, or instrument variables.

Despite these limitations, the panel data analysis provides insightful

[8] However, in the third and fourth articles, I use Moody's ratings for baseline specifications. In the second article, I rely on subnational credit ratings from Standard & Poor's.

information about the relationship between political factors that contribute to the perception of stability and credit ratings because one can observe the same countries across multiple periods. The statistical approach can offer compelling insights under the condition that the limitations of modeling such estimations are acknowledged. While it is possible to investigate whether corruption, political ideology, and transparency are associated with credit ratings in the case of specific countries, statistical analysis establishes whether patterns among variables of interest are systematic.

Table 2: Summary of the articles

Article number	**Article 1**	**Article 2**
Title	Does Political Ideology Affect a Government's Credit Rating? The Evidence on Parties' Socio-Cultural Positions in European Countries	Does Corruption Lead to Lower Subnational Credit Ratings? Fiscal Dependence, Market Reputation, and the Cost of Sovereign Debt
Hypothesis	-The more TAN-leaning a major government party is, the lower the credit rating a country receives	-Corruption leads to lower subnational credit ratings
		-The effect of corruption on subnational credit ratings is contingent on the level of federal transfers
Dependent Variable	Long-term sovereign credit rating (Standard & Poor's)	Long-term subnational credit rating (Standard & Poor's)
Independent variable/variables in interaction	-The socio-cultural dimension of political ideology (GAL-TAN)	-Federal convictions for corruption
		-Federal transfers as % of state's GDP
Sample	24 European countries (1998-2019)	50 U.S. States (2001-2015)
Method	Time-series cross-country analysis	Time-series cross-country analysis
Main Findings	-Governments with the leading role of TAN-leaning parties are associated with lower credit ratings	-Corruption is not directly associated with subnational credit ratings
		-Corruption is associated with lower subnational credit ratings only when the level of federal transfers is low
Article number	**Article 3**	**Article 4**
Title	Do Transparent Countries Receive Better Credit Ratings? Domestic Audience Costs in Democracies	Does Media Freedom Benefit Sovereign Credit Ratings in Times of Mass Mobilization?
Hypothesis	-Government transparency leads to better credit ratings	-Media freedom leads to better credit ratings
	-The effect of government transparency on credit ratings is contingent on the strength of interest groups	-Economic protests weaken the relationship between media freedom and credit ratings
Independent variable/variables in interaction	-Government Transparency	-Media freedom
	-Trade Union Density	-Number of economic protests
Sample	25 OECD countries (1998-2010)	66 democratic countries (1990-2014)
Method	Time-series cross-country analysis	Time-series cross-country analysis
Main Findings	-Government transparency is associated with better credit ratings	-Media freedom is associated with higher credit ratings
	-Government transparency appears to be associated with better ratings, but only when trade union density is very low.	-Countries with freer media are associated with better credit ratings, but only when there are no, or a small number of economic protests

6

Article summaries

The overarching goal of this dissertation is to improve our understanding of the variation in credit ratings among democratic governments. In particular, what political factors contribute to a better understanding of differences in credit ratings between economically advanced democracies. The following section summarizes how each of the four articles contributes to answering this question, as well as the empirical investigation and main findings.

Article 1: Does Political Ideology Affect a Government's Credit Rating? The Evidence on Parties' Socio-Cultural Positions in European Countries

This article examines how the socio-cultural dimension of a government's political ideology influences the decisions of credit rating agencies (Sychowiec, 2021). Existing studies that tackle the impact of political ideology have been mainly concerned with the economic left-right dimension (Block & Vaaler, 2004; Vaaler et al., 2006; Breen & McMenamin, 2013; Paudyn, 2014; Brooks et al., 2019). However, some scholars have suggested that there is no significant difference in debt-related policies among left- and right-wing governments (Campello, 2014; Hübscher, 2016; Barta & Johnston, 2018). Moreover, in recent years, populist parties in many European countries have gained in popularity or even entered governments (Mudde, 2014; Rooduijn, 2018).

This study aims to address this gap by investigating the relationship between the socio-cultural dimension of political ideology (GAL-TAN) and credit ratings. In this article, I argue that governments with the dominant TAN-leaning parties are more likely to receive lower credit ratings.

The reason behind this is that TAN-leaning parties are perceived as less predictable both domestically and internationally. On the domestic level, these parties may not adhere to the rule of law and have a lower propensity for cooperation with other parties. On the international level, they may not follow the rules of international organizations. TAN-leaning parties are also likely oppose market liberalization not only for economic but also for cultural reasons related to immigration.

To investigate the relationship between the socio-cultural dimension of political ideology and creditworthiness, I use panel data analysis for the period 1999–2019 for 24 European countries. The results show that the TAN-leaning governments are associated with lower sovereign credit ratings. Based on these findings, governments which are more hesitant toward globalization and international cooperation have less respect for individual rights are more likely to receive a lower rating.

These results indicate that the socio-cultural dimension should not be overlooked in the investigation of the relationship between political ideology and credit ratings. This study also contributes to a better understanding of market constraints on political actions in economically advanced democracies. In addition, this article sheds light on the mechanisms of credit rating assessment by showing that changes in the domestic party politics can infringe on the stability of debt repayment.

Article 2: Does Corruption Lead to Lower Subnational Credit Ratings? Fiscal Dependence, Market Reputation, and the Cost of Sovereign Debt

The second article is co-authored with Monika Bauhr and Nicholas Charron (Sychowiec et al., 2021). This study examines the relationship between corruption and subnational credit ratings. It is well-established that corruption undermines sovereign credit ratings (Butler et al., 2009; Mellios & Paget-Blanc, 2006; Connolly, 2007; Afonso et al., 2012; Biglaiser & Staats, 2012; Ozturk, 2014). However, this relationship may not be as straightforward at the subnational level as it is on the national one. While

subnational borrowing has become increasingly more important (Ahrend et al., 2013), there have only been a few attempts to address its relationship with corruption (Depken & Lafountain, 2006; Butler et al., 2009; Bastida et al., 2015; Hanniman, 2018; Pérez-Balsalobre & Llano-Verduras, 2020).

This study argues that corruption may not reduce subnational credit rating to an equal extent across the U.S. states. In contrast to previous research, this study accounts for the link between subnational and federal finances. Specifically, this study suggests that the subnational credit ratings are unaffected by high levels of corruption if the state receives higher levels of federal fiscal transfers. Regardless of the misuse of public revenues, fiscal dependence on transfers guarantees states a relatively good and ongoing standing in the credit market. Moreover, federal governments may have the incentive to support corrupt states with federal transfers to keep their credit reputation untouched.

Using data from 2001 to 2015, the results show that, on average, corruption is not associated directly with subnational credit ratings. This relationship appears to depend on the level of federal transfers that the state receives. Empirically, the findings indicate that corruption is only associated with lower credit ratings when there is a low level of federal transfers.

These findings contribute to the debate on subnational creditworthiness by showing that corruption may not always undermine credit ratings. While corruption still has several negative implications for economic performance, some subnational units can remain creditworthy in eyes of credit rating analysts and still have access to the credit market on favorable terms.

Article 3: Do Transparent Countries Receive Better Credit Ratings? Domestic Audience Costs in Democracies

The third article examines the impact of government transparency on credit ratings, which is considered to be an important institutional factor that improves fiscal outcomes and, therefore, plays a crucial role in the credit assessment of sovereign countries. Existing studies attempting to explain the factors that have an impact on credit ratings fall short of accounting for

the ways how interest groups influence credit rating assessment. Organized domestic interest groups that are opposing debt-related policies may be seen as an obstacle to comply with credit commitments. This article combines an institutional approach with domestic audience cost theory. In contrast to the argument of domestic audience cost, I maintain that domestic groups, such as trade unions, can punish policy-makers if debt-related policies undermine their economic well-being, like cuts to public spending. Transparency allows both international actors and the domestic audience to hold governments accountable.

In order to investigate the relationship between government transparency and credit ratings, I use data on credit ratings from Moody's and A. Williams's databases on information transparency for 25 countries between 1998 and 2010. The empirical results reveal that government transparency can be associated with better credit ratings. However, higher levels of government transparency are associated with better credit ratings only when the level of the trade union density is very low. This analysis shows that while credit ratings agencies may be interested in transparent procedures and access to fiscal information, they may also take into account the pattern of the relationship between government and organized domestic interest groups. The results imply that democratic states can face an accountability dilemma that requires governments to strike a balance between domestic audience and external actors in the context of upholding international commitments.

Article 4: Does Media Freedom Benefit Sovereign Credit Ratings in Times of Mass Mobilization?

The fourth article investigates the impact of media freedom on credit ratings. Despite the existing studies on the relationship between transparency and credit ratings (Kopits & Craig, 1998; Hameed, 2005; Arbatli & Escolano, 2015), scholars have paid limited attention to whether a free media environment can contribute to better credit rating assessments. This study aims to fill this gap. I suggest that media freedom are positively associated

with credit ratings due to a reduction in information asymmetries (Hollyer et al., 2011), the provision early warnings (Apergis, 2015), and the enhancement of reputation in the credit market (Alt & Lassen, 2006; Tomz, 2007).

However, media coverage motivates citizens to express their economic grievances in the form of mass protests (Kriesi, 2012; Della Porta, 2017; Bremer et al., 2020; Zhao, 2019). Therefore, I hypothesize that the effect of media freedom on credit ratings can be contingent on the strength of economic protests.

Using panel data for democratic countries during the period 1990 - 2014, the empirical results reveal that media freedom and credit ratings is indeed associated with better credit ratings. However, countries with freer media are associated with better credit ratings only when there are no, or a small number of economic protests.

This article contributes to better understanding how various channels of information dissemination can have implications for credit rating assessment. The findings show that institutional quality, such as transparency via media coverage, can benefit international assessments, like credit ratings, as it can also have positive implications for the perception of political stability in the eyes of credit rating analysts. This article also contributes to the discussion on the role of domestic pressures in the credit rating assessment by showing how domestic pressures against debt-related policies can be perceived in the eyes of credit rating analysts.

7

Conclusions

This dissertation presents a comprehensive collection of studies that investigates the variation of credit ratings among democratic countries. The overarching question that links all four studies together is as follows: What explains the variation in credit ratings among democracies? While economic factors are typically seen as the most central determinants of credit ratings, this dissertation focus on political factors that may contribute to a better understanding of differences in credit ratings between economically advanced democracies. The point of the departure in this dissertation is the democratic advantage argument, which emphasizes that democratic countries receive favorable treatment in the credit market due to their ability to make more credible commitments. The growing differences in credit ratings between economically advanced democracies demonstrate that this group of countries is not free from negative credit assessment. Therefore, the focus on democracy per se may not be sufficient to explain the variation in credit ratings. Moreover, there is also a significant variation in credit ratings within individual countries, and thus it is insufficient to focus only on the national level.

The main argument of this dissertation is that one needs to investigate political ideology and institutional quality in order to better understand the differences between credit ratings of economically advanced democracies. These factors may have implications for CRAs' perceptions of political stability. Stability can signal to credit rating analysts that political incumbents do not diverge from norms that are commonly accepted in the credit market. In contrast, governments that exercise their power in an unpredictable manner may have difficulties in maintaining favorable access to the credit market. One needs to account for elite actions that shape day-to-day politics. For this reason, I investigate the impact of the

government's political ideology on credit ratings, by focusing specifically on the socio-cultural dimension of political ideology. In the first article, I find that the presence of TAN-leaning parties (Traditionalists, Authoritarians, Nationalists) in governments raises concerns among credit rating analysts about the predictability of debt repayment. Accordingly, TAN-leaning governments are associated with lower credit ratings. Based on the results of the second article, corruption, on average, does not always is negatively associated with credit ratings as this has been suggested by previous studies (Mellios & Paget-Blanc, 2006; Connolly, 2007; Afonso et al., 2012). On the subnational level, federal transfers can compensate for corrupt practices in the eyes of rating analysts. Results show that corruption is only negatively associated with subnational credit ratings when there is a low level of federal transfers. Furthermore, I investigate the effect of interactions between transparency and domestic responses on credit ratings. The third article investigates the relationship between government transparency and credit ratings. Based on the findings, the higher levels of government transparency are associated with better credit ratings. However, countries with a greater level of government transparency are only associated with better credit ratings when the level of trade union density was very low. According to the findings of the fourth article, media freedom is associated with better credit ratings. However, based on the empirical evidence, this study also suggests that countries with freer media are associated with better credit ratings, but only when there are no, or a small number of economic protests. Despite the fact that results are associational, I believe that they make an important contribution to our understanding of credit ratings and why they vary between economically advanced democracies.

The findings in the dissertation provide a relevant contribution to the sovereign debt literature. In the context of the relationship between democracy and economic performance, this dissertation shows that democracies are not a coherent block that is more creditworthy on the ground of its political regime (Breen & McMeniamin, 2013; Barta & Johnston, 2018). While the creditworthiness of economically advanced democracies is often taken for granted (Brooks et al., 2019), changes in slow-moving

political factors like corruption or transparency can be crucial for the perceived political stability in the eyes of credit rating analysts. Institutional qualities like corruption or transparency can vary across economically advanced democracies and can contribute towards better understanding of the differences in credit ratings between them.

By discussing the socio-cultural dimension of political ideology, this dissertation also illustrates how current domestic debates can influence credit rating assessment. Previous studies have shown that a growing gap between the efforts of a government to deliver policy outputs and domestic preferences causes the growth of populist and far-right parties (Kriesi, 2014; Streeck, 2011; Rico et al., 2017). Such parties may not be willing to become involved in international commitments, and in turn, can undermine the predictability of debt repayment and thus raise the perception of political instability in the eyes of credit rating analysts. While previous research shows that the economic dimension of political ideology matters for CRAs (Block & Vaaler, 2004; Vaaler et al., 2006; Breen & McMenamin, 2013; Barta & Johnston, 2018), I investigate the impact of the socio-cultural dimension of political ideology on credit ratings. According to the results, TAN-leaning governments are associated with lower credit ratings. These findings are particularly useful since current socio-cultural issues, like migration or human rights, tend to dominate public discussion and may also shape economic performance (Bagwell & Hall, 2020).

In addition, this dissertation contributes to a better understanding of the determinants of credit ratings by investigating the relationship between institutional qualities and domestic responses. This interaction may influence how CRAs perceive their commitment to debt repayment. Domestic responses can provide analysts with both guarantees and early warnings on the threats to debt repayment. Firstly, The second article investigates the determinants of credit ratings at the subnational level. While the academic discussion is mostly concentrated on sovereign governments, the credit rating of subnational units provides additional insights into analysts' credit assessment. In the context of the subnational level, corruption is associated with low credit ratings only when the level of federal transfers is

low. In two other articles, I account for mass mobilization and pressures from organized interest groups as means of expressing the opposition of a domestic audience to debt-related policies. The findings of the thrid and fourth articles correspond with each other and provide a more complex account of the role of domestic pressures in credit rating assessment by suggesting that the impact of government transparency and media freedom on credit ratings may depend on if information pressure fuels domestic pressures from interest groups or mass protests.

The final contribution accounts for the perception of political stability in credit rating assessment. Despite receiving a lot of criticism for their limited predictive power and the opaqueness of their assessment process (Stiglitz, 2002; Bruner & Abdelal, 2005; Veranzza & Nielsen, 2015), CRAs remain an important player in the financial market rather than engaging in just a statistical exercise (Cavallo et al., 2013; Afonso et al., 2012). Credit ratings are social constructs that provide a centralized interpretation of credit risk, and since markets react to changes in ratings, they also become social facts (Mennillo & Sinclair, 2019). In this dissertation, I emphasize the fact that credit rating assessments are often not only the effect of analyses based on a large sum of various types of data, but also subjective measures, like cognitive shortcuts taken in categorization of countries (Brooks et al., 2015). From this perspective, the perception of political stability is consequential to maintaining a good credit rating and thus provides favorable terms of access to the credit market. Sudden institutional changes or unexpected domestic responses can have a profound implications on the ways in which credit rating analysts perceive political stability in such a country.

Despite these contributions, this dissertation also has some limitations. One could argue that in order to assess whether institutional quality has an impact on credit ratings, the sample should also include not only less developed economically democracies but also autocratic countries. In fact, countries like Singapore or Kuwait enjoy high credit ratings. Nevertheless, due to strong electoral accountability, the conflict between commitment to debt repayment and domestic responses may be the most salient in economically advanced democracies. In addition, since some scholars have

argued that credit rating assessment is biased in favor of economically advanced democracies (Gültekin-Karakaş et al., 2011, De Moor et al., 2018), one could worry that there is not enough of variation in this group of countries. However, democracies among advanced economies can also be negatively scrutinized by credit rating analysts. Creditors need to be assured that a government sustains debt repayment and that the likelihood of domestic events that fuel instability is reduced to a minimum (Barta & Johnston, 2020).

Overall, this dissertation underscores that institutional quality and political ideology matter for credit ratings, since these factors can have implications for credit rating analysts' perceptions of political stability in economically advance democracies. This group of countries is not a coherent block that can maintain good credit ratings by default, and their commitment to debt repayment can be assessed by CRAs based on the perception of stability. While the role of political factors in credit rating assessment can still can be studied from different angles, this dissertation offers an understanding of how CRAs can react to institutional quality and political ideology. However, this dissertation also opens avenues for future research on the impact of the interaction between institutional quality and domestic preferences in developing countries or autocracies.

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