What explains the credit ratings in economically advanced democracies?

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

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Sychowiec, M. (2021) Does Media Freedom Benefit Sovereign Credit Ratings in Times of Mass Mobilization?. Unpublished Manuscript.

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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.

Key Words: Credit Ratings, Political Economy, Political Ideology, Corruption, Transparency, Sovereign Debt