Asian Journal of Management and Commerce

E-ISSN: 2708-4523
P-ISSN: 2708-4515
AJMC 2022; 3(1): 115-117

www.allcommercejournal.com
Received: 09-10-2021
Accepted: 19-11-2021

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A study of international political economy of credit rating agencies

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Abstract
A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance. Credit Rating Agencies have recently come under scanner for their lack of independence, ambiguity in functioning and mechanisms in credit rating processes, their misses in financial crises like the Global Financial Crisis (2008) and associated Euro-zone crisis. Its excessive tilt towards developed countries in terms of ownership is also questioned as seen in the ongoing discourse on setting up a separate BRICS Credit Rating Agency during the 2015 BRICS Summit held in Ufa., Russia. It can be inferred that, against the backdrop of the financial status of the states, what we need to cautiously examine is the tools and methods that ultimately determine the ratings of state government, the public sector and other statutory corporations.

Keywords: Credit rating agencies, credit rating, financial intermediary, benchmark, responsibility and accountability

Introduction
A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance. The proposed study attempts to explain the very entity of Credit Rating Agency (CRA) and its ever increasing influence in the global political economy and the dynamics going within it and outside regarding its regulation and control. CRAS have recently come under scanner for their lack of independence, ambiguity in functioning and mechanisms in credit rating processes, their misses in financial crises like the Global Financial Crisis (2008) and associated Euro-zone crisis. Its excessive tilt towards developed countries in terms of ownership is also questioned as seen in the ongoing discourse on setting up a separate BRICS Credit Rating Agency during the 2015 BRICS Summit held in Ufa., Russia. It can be inferred that, against the backdrop of the financial status of the states, what we need to cautiously examine is the tools and methods that ultimately determine the ratings of state government, the public sector and other statutory corporations. The role of CRAS transcends beyond simply being a financial intermediary to a potent political actors and how it has turned out to be an authoritative entity. One can see the politics of 'neo-liberalism being played out in a clandestine way in case of developing countries. An attempt will be made to elucidate the role of CRAS in the genesis and perpetration of the Eurozone Crisis.

The global financial credit crisis of 2008 abruptly halted the development of financial markets which for the period from 1995to 2005 recorded an increase in capital flows by 166.67%; from 6% to 16% of global GDP (Deeg and O'Sullivan 2009). Within just a few months 14 trillion dollars in bonds, with high evaluation rate, were considered junk. As a result the chaos created in the financial market highlighted the phenomenon of global mistrust against global markets assessment system (Scalet and Kelly 2012). At the same time it was obvious that practically globalization was accompanied by an in parallel burst of economic, financial and credit services as a percentage of the total economic activity. Also their influence was expanded over the rest of political economy, a fact certified by the agenda of the newly established Group of 20 (G20), where for the first time it was so intensively expressed the need of formulating policies and rules of operation for these services. (Helleiner and Pagliari 2011).Bond Credit Rating Agencies have both a dominant role in financial market but also in the debate regarding the causes of global crisis (Papaikonomou 2010). Friedman's publication in New York Times is characteristic by claiming "There are two superpowers in the world today in my opinion. There's the United States and there's Moody's Bond Rating Service. The United States can destroy you by dropping bombs, and Moody's can destroy you by downgrading your bonds. And believe me, it's not clear sometimes who's more powerful ". Especially after the outbreak of the crisis there have been many studies and scientific analyses that deplore the role of bond credit rating agencies in global financial credit crisis (Calomiris and Mason 2009, Pagano and Volpin 2010, Becker and Milbourn 2008, Hunt 2009). They pay special attention in both cases; the bankruptcy of Enron, where all three major bond credit rating agencies have suggested to their clients to invest in Enron bonds, just five days before her bankruptcy; and in the case of Lehman Brothers where she was upgraded shortly before collapsing. This paper aims in determining bond credit rating agencies' role and overall power over international politics and economy by exploiting a multilevel approach, using the toolbox of international political economy, notably through the analysis of effects and empirical investigation. More particular, the analysis focuses on the investigation of the role and function of rating agencies in market organization but also in evaluation models and methods applied. Also it will investigate all factors that transformed rating agencies, in international economical protagonists and the way they apply influence in economic policy and politics in general. Finally we will try to demonstrate the role of bond credit rating agencies during global financial credit crisis

A few literatures can be reviewed in this regard

Credit Rating in India: A Study of Rating Methodology of Rating Agencies (2011; Kuljeet Kaur, Dr. Rajinder Kaur): This paper tells that the rating agencies use consistent methodology while assigning a particular rating grade as there is no significant difference in the values of all the ratios which belong to different sets of similarly rated companies in maximum cases.

In the paper, An Analytical Study on Impact of Credit Rating Agencies in India's Development (G Sunitha and Rinku Sanjeev 2018) it is asserted that the part played by credit rating agencies in the development of a country either directly or indirectly is significant. The paper initially points out that Credit rating helps us to know about the credit capability of individuals in a country. When all the investors are positively rated, then there will be an increase in new startups. Gradually income of the country increases, Employment opportunities expands and Poverty ranks less. When there is development in all the sectors then the GDP increases and country develops.

Role of the credit rating agencies in the financial market crisis (Vandana Gupta; Raj Kumar Mittal; V K Bhalla, August 2010): The objective of this paper is to critically examine the role of credit rating agencies in the sub-prime crisis. The paper traces the development of the sub-prime crisis from its origin till the aftermath. It studies the weaknesses of credit rating agencies in performing their basic function of timely and accurate rating of bond obligations. The paper then scrutinizes the diversification of credit rating agencies into the structuring and rating of complex securitized products. This raises fundamental issue of the independence and accountability of these agencies. The paper comes to the conclusion that appropriate changes in the regulatory framework of credit rating agencies are necessary to help avert similar crises in the future.

The Causes of International Expansion and Operation of Credit Rating Agencies

Credit rating agencies had for decade only national dimension, operating just within the U.S. Their appearance on the international stage and development of international power and influence occurred during the last 20 years. The question that arises relates to the factors that contributed to this international emergence. In summary, the key factors of internationalization and strengthening of rating agencies were:

- The debt crisis in Latin America and the banking-currency-financial crises in Southeast Asia in 1997/8.
- The internationalization of financial markets. The interdependence of national money and capital markets, the development of relations between institutions of all countries, the international expansion of commercial banks', investment banks' and hedge funds' activities and networks, the international allocation of national financial products, etc. triggered the creation of an international regime of transparency and information among market participants. This role was assigned to the experienced and incorporated in the market of U.S. credit rating agencies.
- The need for public and private borrowing in U.S. markets: The international trend of public and private sector to issue bonds and other securities in U.S. dollars, along with their willingness to be funded by U.S. credit institutions due to the largest and deepest capital market worldwide, demanded for institutional and practical reasons, the initial evaluation of certified U.S. agencies.
- The growth of securitization and financialization of international capital markets. The turn from traditional financing through bank loans to finance by issuing new complex structured securities increased the need for evaluating the creditworthiness of issuers and of securities themselves. The creation of structured products and derivatives such as CDS, CDOs and the expansion of covered financing (asset-backed finance, 40% of a purchase of $ 30 trillion) through securities (collaterals) caused a dramatic increase in international financial market and expanded credit rating agencies' activities.
- Institutional arrangements. For decades only U.S. authorities demanded previous assessment of both securities and issuers by certified bond credit rating agencies in order to approve certain methods of financing. Subsequently, similar institutional arrangements were introduced in other countries including EU. In parallel in international level, taking as an example "Basel 2", the evaluation obligation for determining the necessary reserves and banks' risks was established. Therefore, it was the states and the international organizations themselves that contributed in the expansion of international presence and activities

of credit rating agencies. After the international financial crisis and Eurozone's debt crisis a significant effort is applied for reducing the importance of external evaluation and promoting internal evaluation procedures of financial institutions.

- The political factor: It is of great intense the criticism often practiced by leading politicians to credit rating agencies that has resulted in an increased effect of their point of view in public opinion. These practices reveal the importance that politicians are giving to credit rating agencies blaming them (rightly or wrongly;) for the economic problems their countries experience. Therefore, it is suspected that credit rating agencies often play the role of a scapegoat. On the other hand, despite intense criticism, in practice, policy makers seem to be decisively influenced by the reviews. It's a characteristic example the peculiar economic diplomacy that is developed in Eurozone, where a group of four countries with AAA rating, meet and consult as a group outside the established procedures of the Euro group.

The Role of Credit Rating Agencies in the International Financial Crises

Many academics, researchers, politicians, journalists, etc. believe that credit rating agencies have an enormous responsibility in causing the global financial crisis. According to U.S. Congress, credit rating agencies, including investment banks, have the primary responsibility for the real estate bubble and the following collapse of financial markets causing a widespread global recession. Specifically, credit rating agencies are not blamed that much for their inability to foresee the coming crisis, but rather for their extremely favorable (inflationary) gradations of many investment banks, derivatives and toxic products. Although S&Ps and Moody's on 2003 warned the public for malfunctions in the property market, continued to give high ranks to involved companies and securities, thus contributing to the continuation and expansion of the speculative bubble and as a result it contributed in the fraudulent of end-investors. Benmelech and Dlugosh (2009) examined 4,000 Collateralized debt obligations-CLOs and found that 4/5of these were assessed by AAA, despite the fact that the average assessment of collaterals was B +. Not surprisingly, their value fell by 70% between 2007-8 (Pagano / Volpin 2010). A number of researchers estimates that this is due to the fact that rating reports are been paid by investment banks and other issuers of securities (http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf., Partnoy 2009). Also, credit rating agencies failed in properly rating mortgage market issues, since their reviews didn't link individual investment bank cases with the possibility of a general decline in the U.S. financial market. In other words, the evaluations focused only on microeconomic data, without studying their interactions with the macroeconomic ones. For example this was the case of Lehman Brothers, AIG, Washington Mutual's etc.

Conclusion

During the last few decades the influence of markets was boosted over politics. The liberalization of financial markets, the deregulation and reduction of control and supervision of financial institutions, the creation of new complex financial products, the exponential growth of the derivatives market, the international interconnection of markets, the increased speed of disseminating information and international capital transactions, the decrease of state influence in modern mixed economies in favor of markets and the acceptance of markets as the primary mechanism to exercise discipline against policy (market discipline), limited the interventionist role of the state and largely subdued economic policy, and up to a certain point democracy, functioning according to markets' desires (Rodrik 2011). Furthermore, increased competition among national systems e.g. national fiscal, social, environmental, regulatory, etc. based on the criterion of which system is more favourable for financial markets. Therefore, it is overlooked the fact that for most countries markets were at first chosen as a mean for more efficient allocation of resources and increase of economic performance of their economic system, and not as an end in itself or as a general and absolute component of socio-political organization.

From all those mentioned above it is obvious that there is a fragmented regulatory framework, with little efficacy. Also, many regulations appear to have contradictory effects. Furthermore, there is not a uniform international approach to a global phenomenon affecting all countries. Therefore, the need for a thorough evaluation of the previously introduced legislation is recognized. Finally, the possibility of establishing a common international regime that will regulate the issue of credit rating and the agencies and businesses that carry them out should be investigated. Also, from the legal and ethical point of view, it is of great importance the question over agencies' civil liability and financial compensation, in case of misleading the investing public.

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