International credit rating agencies in Africa: perceptions, trends and challenges

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Abstract: This research examines the perceptions, trends and challenges of the influence of international rating agencies on national economic affairs in African states. A descriptive analysis of independent reports published on international sovereign credit ratings and a survey on the financial bodies of the African Union as well as consultations with the three international credit rating agencies show that there is diminishing confidence in operations rating agencies in Africa. However, despite the criticisms of deficiencies in methodologies, operations and regulation of credit rating agencies, results show that they significantly remain as the best available source of credible of risk information for emerging economies to access international capital. It is therefore concluded that the information manufacturing and opinion-leading role of rating agencies remain critical to capital flow and economic development. Thus, the study recommends that African countries implement a multi-stakeholder approach to engagement rating agencies on reviewing the methodologies, indicators and the rating process as traditional methods and indicators are discounting the potential embedded in emerging economies resulting in poor credit ratings.

Keywords: credit rating agencies; capital flow; Africa; regulation; international capital.

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1   Introduction

The biggest challenge faced by African economies is to fund the growing funding gap to support infrastructure development. As the 'Bretton Woods' institutions are reinventing[1] themselves, migrating from the model that largely relies on member states providing loans for development projects to becoming more of a broker of private capital, have invariably forced African governments to diversify to other funding sources for developmental support. Borrowing from international capital markets through selling sovereign bonds is one of the lucrative options available to emerging economies. To issue international sovereign bonds, financial markets require countries to have a credit rating from at least one or more of the three leading international credit rating agencies (CRAs) – Fitch, Moody's and Standard & Poor's (S&P) – as a minimum requirement for capital market borrowing by market regulators, as adherence to international best practices of information disclosure and to reach out to a wider base of potential investors.

In the quest for either improving or maintaining good credit ratings, studies have argued that African governments have subjected themselves to the fiscal and monetary policy recommendations by the three international CRAs (Mecagni et al., 2014; Mutize, 2019a). Any government that crafts an economic policy that contradicts the recommendations of the three international CRAs consequently suffers the loss of being downgraded. These dynamics have ultimately shifted the regulation of national economies from state governments to the credit rating institutions in which African developing countries do not have control, undermining the role of the state in providing of essential goods and services. In addition to their role in past financial crises, CRAs have been criticised for rating shopping, conflict of interest, pro-cyclicality and methodological deficiencies [Ferri et al., 1999; Amato and Furfine, 2004; United Nations Economic and Social Council (UN ECOSOC), 2014; Cesaroni, 2015; Freitag, 2015; Ahern and Painter, 2016; Mutize, 2019b]. Other criticisms against international CRAs include: selective aggression, political bias, lack of accountability and proof soundness of ratings assigned.

This study makes literature contribution in three folds. First, it adds an exploratory perspective to the credit rating debate by examining the political influence of international CRAs on the economic competitiveness of African states. Second, it examines perception on the paradox that high economic growth level in African countries has not translated into better credit ratings as CRAs dismiss it as fragile growth. Lastly, with evidence from data, this study investigates the assertion that international credit rating agencies (ICRAs) generally have a negative sentiment against African countries, as their downgrade activities far outweigh upgrades, despite the significantly positive average economic growth on the continent. The research paper proceeds as follows. The following Section 2: interrogates prior studies and reports on the influence, dynamics and role of three international rating agencies on the political economy of African countries. Section 3 is description of the data used in conducting this research and the survey methodology applied in the analysis. Thereafter, the findings are discussed in Section 4, and lastly the recommendations and conclusions in Section 5.

2   Literature review

This review of literature provides an analysis of the political and socio-economic influences of international CRAs operations on the African continent and is structured as follows. First, it presents an analysis of past studies on the trend and challenges of CRAs, followed by the trend on sovereign credit ratings (SCRs) in African countries, followed by an analysis of the influence of the three international rating agencies on the political economy of African countries, their governments and industry. Thereafter, an account of the criticisms levelled against them as their criticism in Africa, is explored. The literature review concludes with a critical analysis of the integrity of methodologies used by the three international CRAs and the regulatory frameworks that governs their operations across the globe and in Africa.

Across the globe, SCRs have become one of the most topical subject amongst political leaders, economists, investors and ordinary citizens (Hanusch and Vaaler, 2013). The underlying assumption to financial market participants is that, the change in a country's SCR has a direct impact on the overall economy and the well being of all its citizens (Moosa, 2012). Hanusch and Vaaler (2013) argue that global investors and fund managers magnify the need for constant credit rating updates on African bonds as they classify many African countries as unstable economies. It is from the credit ratings that bond yields are derived, and African bonds are generally ranked below investment grade due to high probability of default (Mu et al., 2013). Mecagni et al. (2014) present evidence that he debt-to-GDP ratio in most African states is above that of other developing regions at 50% and continues to grow as they borrow more for capital projects and infrastructure development. Thus, low credit ratings imply that borrowing countries issue their sovereign bonds at high discounts, at the same time are subject to higher interest rates to compensate investors for the buying sub-investment grade sovereign bonds, also called 'junk bonds' (Mecagni et al., 2014).

Other studies have argued that rating agencies are procyclical, this means they do not reveal any new information to financial markets rather than just magnifying the current negative underlying economic conditions through following already known economic events (Amato and Furfine, 2004; Cesaroni, 2015; Ferri, 2004; Freitag, 2015). Thus, CRAs downgrade (upgrade) companies and countries during periods of their financial distress (boom). Freitag (2015) further critic the inaccurate optimism through positive ratings and outlooks ratings that ultimately creates asset bubbles that inevitably busts after some time. The bubble busts, followed by abrupt credit downgrades causes massive capital outflows out of a country and destabilising in economies such as in the eurozone and the USA debt crisis of 2008 (Cesaroni, 2015). In support of these studies, Armstrong (2016) adds that these conditions cause financial market distortions to a country's prevailing economic conditions, issuer's financial challenges and probability of defaulting on their debts. Thus, posing that the opinions of CRAs are not necessarily objective.

Barta and Johnston (2017) also critique CRAs for being at the centre of the complex structured financial products that triggered the 2008 global financial crisis (GFC). They present evidence showing that the influence and dominance of CRAs has been used inappropriately to constrain national governments, especially in emerging economies to align to austerity policy philosophy. Their leading role in formation of public policy, combined with threats of downgrades have seen Fabian (2007, p.115) and

Moosa (2012, p.1) calling them: 'organised economic gangs', 'fear-mongering colonialist', 'thieves, liars and cheats'. On political biases, Armstrong (2016) argue that the CRAs rating methodology tend to assign more weights and scores to political variables rather than the potential growth embedded in emerging economies. Barta and Johnston (2017) also contend that the changes in credit ratings do not reflect the average improvement in political, economic and social indicators. Armstrong (2016) and Barta and Johnston (2017) concur on the view that the three ICRAs have displayed political biases by assigning widely distinct sovereign ratings to countries that have relatively similar macroeconomic indicators. They present evidence showing cases where CRAs have assigned better rating to sovereigns with crises conditions whist continue to unreasonably justify their refusal to upgrade countries that are performing well.[2]

Despite claims by rating agencies that their models are objective and fairly applied for uniformity and comparison, The Financial Crisis Inquiry Commission (2011) find that "it is a misconception that credit ratings are derived solely from the application of a mathematical processes, instead it is an exercise of judgement by members of the rating committee", evidence that the CRAs have varied the rankings based on their analysts sentiment. Following the failure of CRAs to either predict or at least reveal events leading to the GFC, even when clear signs of an impending crisis are highly conspicuous, The US Financial Crisis Inquiry report (US Commission, 2011) and The European Commission Economic Crisis report (European Commission, 2009) find that rating agencies do not deal robustly with the sovereigns and companies that pay them well compared to aggressive rating actions – downgrades – displayed against companies and countries that do not pay for ratings.

The European Union Regulation No. 462 of 2013 and the UN ECOSOC (2014) question the issuer-pay model of CRAs in which the borrowers pay for the rating costs whilst the information is published for use by the investment public. Effectively, issuers pay for information that they do not need whilst pension funds, money market funds, insurance companies, retirement funds, retail banks and other asset managers benefits from it more than the issuer that pays for it (Strier, 2008). Strier (2008) argues that, in the issuer-pay model, CRAs may seek to please issuers who pay them more when assigned favourable ratings and who in turn benefit for low cost of borrowing. The inherent conflict of interests arising from this issuer-pay business model has, according to Partnoy (2017),
led to the concealment of material facts from financial markets in an attempt for rating agencies to protect their income, to secure long-standing business relationship and to secure additional work. Thus, Partnoy (2017) assert that, it is most probable that the credit ratings issued under the issuer-pay model may be perceived as the credit ratings that suit the issuer rather than the credit ratings needed by the investor.

2.1   *SCRs trend in Africa*

The credit rating trend in Africa, South Africa was the first African country to receive a sovereign rating in 1994 of BB grade from Fitch and S&P. By the end of 2003, 14 African countries had been assigned a SCR including Ghana, Cameroon, Cape Verde, Malawi and Mozambique with support from the United Nations Development Programme (UNDP) initiative (United Nations, 2015). As at September 2018, 31 African sovereign states had been assigned a credit rating by either (or all) of the three international CRAs. Most African countries were assigned an initial sovereign rating

grade BB (junk status) – save for Botswana, Egypt, Libya, Morocco Mauritius, Namibia and Tunisia who got investment grade – implying that they have high credit risk and the bonds issued by those countries are highly speculative. Of the eight countries that received an investment grade sovereign rating, only three of them – Botswana, Morocco and Mauritius – have managed to maintain it to date. Figure 1 presents the SCR distribution in Africa.

Figure 1   Africa's SCR distribution (see online version for colours)
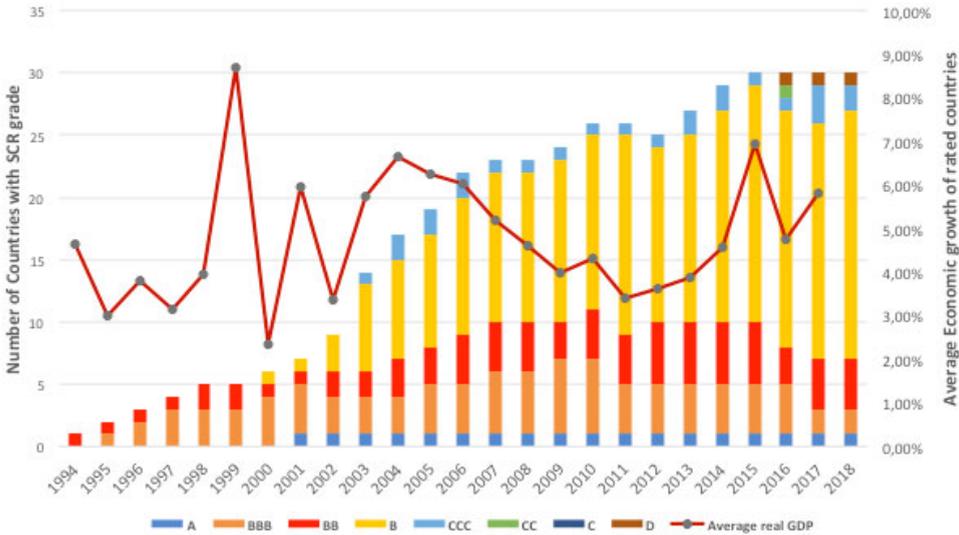
Source: Data from trading economics

Figure 2   Africa's SCR Outlook distribution (see online version for colours)
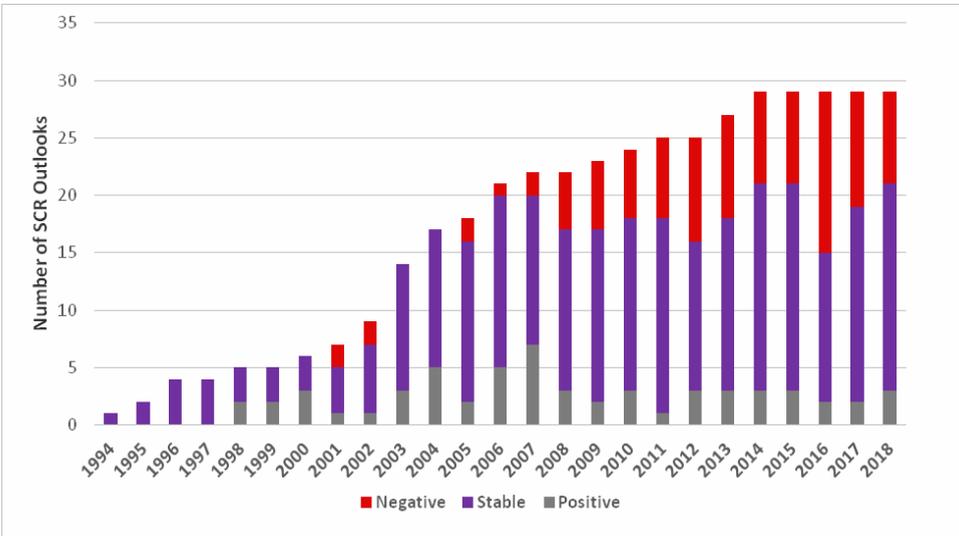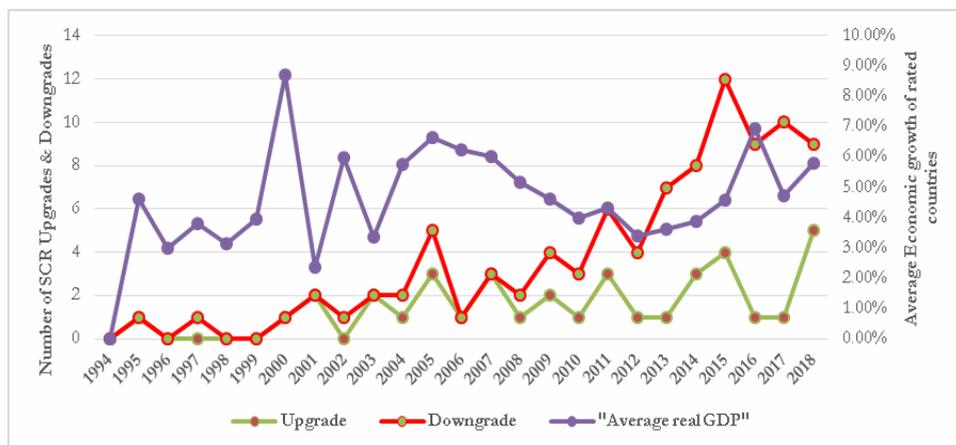

Source: Data from trading economics

The general SCR outlook, which indicates the potential direction of a country's rating over the intermediate term, has been 'stable' for most African countries, indicating that their credit ratings remained unchanged over the period. However, the number of negative outlook has been growing more than positive outlooks, showing that a number of countries were at risk of being downgraded. The distribution of SCR outlooks is shown in Figure 2.

Despite the generally stable economic outlook in Africa, the dominant international rating agencies have downgraded more countries than they have upgraded over the years and the gap between number of upgrades and downgrades had been widening. Figure 3 shows the trend of credit rating changes compared to average economic growth of rated African countries.

Figure 3   Africa's upgrades and downgrades trend (see online version for colours)

Source: Data from trading economics

2.2   Political economy of CRAs

African governments sought sovereign ratings in pursuit of broader objectives such as fostering deeper local capital markets, raising capital for public infrastructure projects, attracting foreign direct investment and supporting private sector access to the global capital markets [United Nations Economic and Social Council (UN ECOSOC), 2014]. In the post-independence phase, as financial markets began to globalise and liberalise, there was a significant rise in cross-border financial transaction volumes, and an increase in the complexity of financial instruments traded. This development made formal credit ratings to be progressively more relevant and important as a form of validating a country's credit risk profile to avoid manipulations of investors by issuers of debt through information imbalances in the marketplace (Rhee, 2015).

Literature analysis shows that the dominance and market authority of the three international CRAs is largely derived from the following sources. First, CRAs have received investment public imprimatur from the users of securities ratings who recognise a few prominent rating agencies as issuers of 'credible and reliable ratings' (Partnoy, 2017). Second, investment managers usually have mandates in their investment policy statements (IPS) to hold specific rating classes of financial assets depending on the

risk appetite of the supplier of funds (Bolton et al., 2012). Lastly, the international regulatory frameworks[3] for good practices have immensely contributed to the exponential dominance CRAs by making it mandatory for certain institutions to have credit ratings from either of the three international CRAs. Since 1990, until 2003, only the dominant three CRAs were recognised under the nationally recognised statistical rating organisations (NRSROs) in the USA – a designation used by the USA' Government as reference for in several other regulatory areas.

Approximately 38% of the capital flow into African markets has been through sovereign debt, which constitutes debt instruments issued by the national government of a country; usually denominated in a foreign currency (Mu et al., 2013). On the other hand, global investors have been moving their capital into African bond markets in search of high yields compared to the low interest-rate environment in many of the developed markets (averaging 1% per annum in the USA, Australia, France, Canada and the UK, and below 0% per annum in Japan and Germany) which has lured many African governments to issue large bonds to finance their funding deficits, with almost all the bond issues being over-subscribed (Financial Times Africa Summit, 2018). However, African governments are in a weak position to build proper yield curves as the corporate bond markets and local currency domestic debt markets are not yet well-developed, instead they are pushed to issue debt at whichever maturity is cheapest (IMF, 2016).

2.3   Criticism against CRAs

In a quest to either improve or maintain favourable SCRs, governments subject themselves to the fiscal and monetary policy recommendations by the three international CRAs (Armstrong, 2016). Armstrong (2016) argues that a government that crafts an economic policy that contradicts the recommendations of the three international CRAs consequently suffers the loss of being downgraded. For instance, South Africa is facing a high threat of sovereign downgrade partly because of the land expropriation bill (IMF, 2018). Kenya facing downgrade by Moody's following its delay to implement value added tax (VAT) on fuel products and proposal to remove petroleum tax (Irungu and Alushula, 2018). S&P warned[4] South Africa against its R500 million stimulus package aimed at cushioning the economics impact of corona virus, citing that it will result in rising public debt. Barta and Johnston (2017) adds that there is an absence of sound economic logic behind CRA's discouraging certain economic policies in emerging economies, which suggests that SCRs may be prone to being used as punitive measures against states that contradict western interests. Policy recommendations by rating agencies are restrictive and forbid fiscal stimuli through government spending and tax relief, which usually align with emerging economies to increase consumer demand, encourage private investment, create jobs and stimulate economic growth. However, in contrast, extreme forms of these expansionary policies highly denounced in emerging economies are permitted and left unquestioned in the European and American setting under the banner of monetary easing and/or bailouts.

Despite the long-term economic potential in African countries, the credit rating methodologies over-emphasise the political risk in the rating criteria (Ahern and Painter, 2016). These circumstances have taken away the economic freedom of credit rated Africa governments and their sovereignty to freely craft their preferred long-term economic policies without threats of sovereign downgrades. This ultimately shifts the regulation of

national economies from state governments to the credit rating institutions in which African developing countries do not have control. These developments have undermined the role of the state in the provision of essential public goods and services, such as healthcare and education to its population. In line with the 'Washington Consensus' doctrine[5] (Williamson, 2004), SCRs are more inclined towards favouring private capital which advocate for strict inflation controls, high taxation, large-scale privatisations, rapid trade liberalisation and cutting government expenditure on social services.

A number of studies have consistency in that the performance of CRAs in the developing countries is not satisfactory (Elkhoury, 2008; Hanusch and Vaaler, 2013; United Nations, 2015). Ferri (2004) suggests that CRAs often devote less staff and resources towards necessary researches for credit ratings in developing countries than they do when rating developed countries. Although it is acknowledged that the EU and US have complex industrialised economies, questions are raised on the adequacy and thoroughness of the researches carried out by analysts in emerging economies. Despite demanding substantial rating fees from African countries, the resources committed to rate them are minimal. Since April 2008 to May 2017, the 31 rated African countries have paid the international CRAs a total of approximately US$186 million African Development Bank (AfDB) (2018); of this amount, US$10.2 million paid by South Africa (South African National Treasury, 2017) and US$7.3 million paid by Nigeria (Nigerian National Budget, 2017) only for SCRs. There are thus concerns on value for money and prohibitive pricing.

The failures of the three dominant international CRAs have been unequivocally exposed during the financial markets collapse of New York city in the mid-1970s that caused the US real GDP growth to fall from 7.2% to –2.1%, the Asian financial crisis of 1997–1998 that costed Asian countries a combined 31.7% loss in nominal GDP, the Enron scandal of 2001 that resulted in shareholders, employees and creditors losing more than US$100 billion, and the global debt financial crisis of 2008 that costed over 10% loss of GDP in all major economies across the world. In its findings on the causes of the 2008 financial crisis in the USA, The Financial Crisis Inquiry Commission (2011) reported that "the financial crisis would not have happened without CRAs as mortgage-related securities that were at the centre of the crisis could not have been marketed and sold without rating seal of approval. Finely honed CRAs' computer models accorded triple-A ratings to complex mortgage-backed securities that almost no one understood and investment banks were paying handsome fees to the rating agencies to obtain the desired ratings. Prior to the crisis, the rating agencies placed market share and profit considerations above the quality and integrity of their ratings by deliberately disseminating inaccurate information about the probability of default of issuers."

The United States Department of State, the Bureau of African Affairs and the UNDP funded the initiative for African countries to be rated between 2002 and 2006. Prieg (2011) has however questioned the sincerity of the credit rating initiative and explored the possibility that CRAs may be the new instruments of imperialism and economic exploitation in Africa.

Out of the 31 African countries assigned a credit rating by the three international CRAs, only four[6] countries are rated investment grade. This implies that most of African countries' bonds are classified as 'junk' status bonds. It can be argued however that, if these countries are absolutely 'junk' and highly risky, their risky sovereign bonds should be difficult to sell. On the contrary, most of Africa's long-term sovereign bonds are usually over-subscribed and international investors are willing to commit their

investments long-term for periods between 20 and 30 years (Mecagni et al., 2014). Furthermore, the report on geographical distribution of financial flows to developing countries by the Organisation for Economic Co-operation and Development (OECD)'s Official Development Assistance (ODA) (2018) shows that there are huge investments flowing into African countries in the form of concessionary loans which are not subject to credit ratings. Thus, these commitments are proof that African countries are not as 'junk' as portrayed by the international CRAs. Although the commitment to repay sovereign debts sorely rests on the current government, the biases in SCR methodologies seem to be inclined on the assumption that African governments are politically vulnerable and inefficient in managing sovereign debts. Thus, SCR analysis makes little to no distinction between political administrative challenges of African countries and their individual ability to repay their sovereign bonds.

The three international CRAs were established[7] in the late 19th and early 20th century before the African states were born. These companies were established to conduct financial research on bonds issued by American commercial and government entities, then later, on Europe, and rank their creditworthiness using a standardised credit rating scale. Although their credit ratings scale continues to improve, the fundamentals of the credit rating methodology remain static and rigid across countries. Considering the development dynamics in the global financial system over the years, the fundamental emphasis of these rating models may be grossly inaccurate due to the passage of time. Applying the same weights in these standard models in African context is gross injustice as it is fundamentally inaccurate to rate both developed and developing nations using the same scale. As the ability to pay is engulfed in the future potential of a sovereign, credit ratings in emerging economies are not forward-looking. The key macro-indicators used in credit ratings such as gross domestic product (GDP), fiscal balance, inflation, exchange rate and interest rate are all historically focused and backward-looking. Hence, in emerging countries macro-indicators are practically invisible according to credit ratings when in real terms the informal sector generates the bulk of economic activity in those countries. The recent consideration of environmental social and governance (ESG) factors still present similar challenges against developing countries assessments (Escrig-Olmedo et al., 2010).

During the credit rating process, a team of analysts is appointed to research about the status of an economy before assigning a credit rating. It is the prerogative of the CRA to decide the composition of the research team which has a direct bearing on the outcome of the rating process. Criticism has been levelled again the regulatory responses following the financial crisis, which have not addressed the challenges in lack of transparency on the allocation of codes on qualitative elements in the rating models. This leaves the rating process prone to human biases, whose accuracy depends on the competence of the analysts (United States Securities and Exchange Commission, 2016). For instance, S&P's methodology has no algorithms applied in generating codes and weights assigned on qualitative characteristics to avert human bias. Above all there is no conclusive proof of the soundness of either the rating methodology or the rating outcomes due to lack of standards for comparison. Although there are known deficiencies in rating methodologies, the basis for judging the fairness of CRAs and the outcomes of their ratings is subjective.

In examining the agency of African states in monetary and fiscal policy management as a factor in credit rating, it is worth noting that, until recently, West and Central African

Francophone[8] countries were still using the France-managed Communauté financière d'Afrique (CFA franc) currency in their economic planning. France national treasury guarantees the convertibility of the CFA franc at a fixed rate with the euro whose monetary policy is controlled by the European Central Bank and provides foreign currency liquidity support for member countries that face temporary shortages of foreign currency receipts (Sylla, 2017). These arrangements have been justified as a form of helping the West and Central African countries to facilitate the flow of exports and imports amongst the Franc Zone member countries and to stabilise their economies as well as their national currencies. However, there is still a huge gap between the SCR of France (rated AA status) and Francophone Africa (rated 'junk' – B status). The variation in SCRs between France and Africa franc zone raises questions about either the objectivity of the CRAs or it is evident that the benefits from monetary and economic integration within the CFA franc zone is insignificant.

2.4   *Regulatory framework of CRAs*

Before the 2008 financial crisis, international CRAs were not subject to any form of regulation. For a long time, critics have raised questions on 'who guards the guardian angels'. The CRA Reform Act was only passed in the US Congress in 2006, mandating its Securities and Exchanges Commission to regulate the business practices of rating agencies, their record keeping and internal operational processes. Following the financial crisis of 2008, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 further expanded the regulatory power of the Securities and Exchanges Commission to enforce full disclosure of the rating methodologies. In the European Union, there is the Regulation No. 462/2013, which precede Regulation 361/2009 and several directives such as the Capital Requirements Directive of 2006 and Directive 2013/14. Only the European Securities and Markets Authority is responsible for monitoring the business practices and disclosure requirements rating institutions registered in Europe.

In Africa and many other developing countries across the world, the international rating agencies have operated unregulated although the need for them to be regulated has become apparent. Constitutional legislations in African countries do not account for the operations of CRAs, hence there is no any form of accountability on their operations in these developing countries. In each African country, there is lack of a 'central coordination mechanism' in CRAs operations as no single institution is responsible for either administering their regulations or managing them, instead there may be several institutions interacting and involved in the dealings of CRAs. It is usually the mainstream Ministry of Finance and at times the central banks that work hand in hand with rating agencies and liaise on issues relating to a sovereign's rating profile. Only a few countries such as South Africa has assigned its Financial Services Board to administer the Credit Rating Services Act and to oversee the operation of international rating agencies the same way it regulates capital markets.

Furthermore, besides the international supervisory standards set primarily by the International Organisation of Securities Commissions (IOSCO), there is no international regulatory authority that regulates the operations of the dominant three rating agencies, which are operating across the world. Countries have also raised concerns on the lack of a specific mechanism for arbitration in the event of dispute between the parties to a credit rating arrangement. Although many investors across the world lost their investments during the 2008 financial crisis due to inaccurate ratings by the three international rating

organisations, it was only in the USA and Europe where the credit rating institutions were tried through the court processes and paid approximately US$270 billion and US$3.44 million, respectively, in admission of guilty. None of these funds were paid to those who made losses outside the jurisdiction of the USA. This is as such because outside the USA and the European Union, CRAs do not subscribe to any international regime or governance body. Thus, their misconduct or failure to abide by universal principles of the conduct of international transnational actors remains unchecked. Without any periodic reports on the operations of rating agencies, there are high chances that prudential practices by these institutions solely rests upon their own discretion.

With very minimal regulation in some developed countries and almost none in emerging economies, there is high chances that rating announcements are used for insider trading. The developed economies are essentially establishing their own CRAs regulatory reform agenda inevitably focus on the impact only on developed countries whilst their impact on developing countries is completely overlooked.

3 Data and methodology

The analysis conducts a comprehensive examination of key secondary data sources of reports published on international SCRs; government reports, credit rating reports and data on macro indicators of African states. The following key literature sources were also examined. It also utilise primary data collected using a survey questionnaire. A purposive sampling technique was applied for the selection of the 15 financial bodies of the African Union. The purposive sampling was most appropriate as this study took a policy approach to the operations of CRAs, hence the financial bodies of the AU were selected assuming that they have a fair understanding of the credit rating issues on the continent and abroad.

Other continental Pan-African institutions were also purposively selected because they are key African oriented financial institutions. These financial organisations are assumed to have specialised knowledge on the implementation of economic integration in African and on the globe, hence they would understand the dynamics in the credit rating industry better than the general financial bodies of the AU. Other key national institutions were consulted for countries that have more than ten credit rating events in the past five years. International bodies were also consulted on questions relating to the development initiative between 2002 and 2006 which resulted in African countries being rated by international CRAs. To have a balanced view, rating agencies were also consulted on questions that relates to their operations in the African continent, criticisms, regulation and methodology were posed to the team of analysts that represent the international CRAs.

In the organisations selected, individuals that have been directly involve in the work of CRAs were selected as they would have knowledge about the trends and challenges African countries raise on the subject. The questionnaires were distributed through e-mails and responses were also returned through the same mode. A total of 55 questionnaires were distributed, with 28 completed and returned. The names of institutions and individuals respondents were not mentioned to maintain anonymity of responses. Data was analysed using descriptive statistical method. Some of the key questions asked in the questionnaire include; respondents' perception on the political

influence of CRAs on the economic competitiveness of African states, opinion on why high economic growth level in African countries has not led to improvement in credit ratings, and where negative sentiments about Africa risk dynamics could have led to the dominant rating downgrades. Respondents' views were also sought on whether performance of CRAs in the African countries has been satisfactory, and also whether the influence of the CRA negatively impacted their organisations.

4   Findings

From the survey conducted, only seven of the continental financial bodies responded to the questionnaire whilst no responses were received from the two specialised African development financial institutions. There was consensus in the responses from the continental financial bodies on that the trend of performance of the three international CRAs in Africa have not been satisfactory, although the influences of the rating agencies have not directly impacted their organisations either negatively or positively. These organs expressed that the trend of demand for African sovereign bonds proves that they are not bad investments. They therefore suggest that the reason for high cost of bonds is that, issuing countries may in a weak position to either negotiate better credit ratings or favourable bond covenants, possibly because of the following reasons:

1   the excessively high appetite to diversity away from the conditionalities typically associated with the multilateral loans

2   woeful inadequacy of official assistance and concessional lending for meeting Africa's developmental needs

3   limited options to attractive alternative sources of financing

4   non-existence of an alternative African-oriented ratings as a standard for comparison.

The AU financial organs significantly question the issuer-pay model of CRAs which is susceptible to manipulation by the borrowers who pay for the rating costs whilst the information is published for use by the investment public.

Responses further point out that there are vulnerability challenges in the position of issuing countries is exposing them to the exploitative nature of speculative global investors who are only after profit rather than the welfare of the continent. AU financial bodies also agree on the perception that, to a larger extent that the international CRAs are pro-western countries due to the nature of the indicators they consider and the methodology they apply, which from the onset puts Africa at a disadvantage. They were however neutral on that the institutions are political tools being manipulated for political reasons, as their contribution to the development of local financial markets and access to global capital is substantial. Their responses commend how CRAs have helped African countries as well as companies to be competitive at global scale. There was also consensus in responses that the rating agencies have encroached too much into the political space, becoming more dictatorial to sovereign policy trajectories. On whether an African rating agency would solve the rating challenges, there was optimism in the response that in the long-term the comparative analysis of all credit rating announcements will ultimately make an African rating agency relevant.

None of the two African specialised financial institutions responded to the survey. However, responses from the other key African institutions show dissatisfaction on the relationship between countries and the international CRAs especially concerning the circumstance in which their countries are downgraded. Responses point out that the rating downgrades has contributed significantly in weakening their government's position in the international bond market. These organisations also agree that the fear of rating downgrade limits governments' independence in defining policy trajectory as policy signals emanate from CRAs especially for countries at the verge of rating downgrade. Responses further agree that the credit rating methodologies are objective except that no country is aware of the actual risk ratings assigned to each weighted risk component. Given this predicament, African countries might be disadvantaged as variables such as susceptibility to event risk (usually political risk) and economic environment (often not business friendly), might be allocated weights that have a negative impact on their sovereign ratings. They further express that the historical focus of rating models that have constantly emphasised low debt-to-GDP levels as desirable and credit positive, is partially applied to African countries as many developed countries have debt-to-GDP of more than 100%, yet they have 'AAA' credit ratings whilst African countries are harshly penalised if they accumulate such high levels. They however noted that African countries accumulate debt to refinance their old debts and for operational motives compared to developed countries that accumulate debt for infrastructure development purposes.

Responses pointed out the CRAs' biases in assessments against most kinds of government interventions in Africa. A point in case cited is the intervention of central banks in the USA and Europe where they introduced quantitative easing in order to bolster the economy. They argue that if African central banks embark on a similar approach, rating agencies are likely to react differently than they do with developed countries. In addition, they pointed out that CRAs often associate labour market 'rigidities' with output underperformance, and a high degree of central bank independence as having a positive impact on debt sustainability. It is thus revealed that CRAs' sovereign ratings are based more on subjective assumptions and prejudices that government intervention in emerging economies reduces economic growth and efficiency rather than on the actual 'fundamental' variables related to debt sustainability. Hence, they also suggest that CRA methodologies are driven by their credit ratings ideology and biases which might be unfair to most African countries. There was optimism in responses that an African rating agency would be a good basis for comparing fairness in the international rating scale and local investors would consider its rating announcements. All the responses received agree on that the international CRAs are not adequately regulated in Africa, suggesting that through the AU, strict regulations and laws should be put in place to contain their influence.

The rating agencies recognise that their credit rating business on the African continent is significantly booming as more countries are seeking sovereign rating and the appetite for African sovereign bonds is growing. They all disagreed to the suggestion that they are less committed to rating African countries judging by the size of resources they allocate when rating African countries, insisting that they are equally committed across the globe for uniformity of ratings. They attribute the fewer resources towards researches in African countries to the smaller size of their economies, the depth of their markets and the complexity of the securities traded. With regard to policy influence and political interference, CRAs defend their recommendations stance as a mere standard guidelines

and suggestions that countries have a choice of either following or not. On non-disclosure and lack of transparency, they dismiss the claims citing that they publicly disseminate any material information to the best of their analyses through their websites. In their responses, the rating agencies justify their methodologies as a product many years of tried and tested objective models that exhaustively account for all available information before assigning a credit rating. They ruled out the possibility of applying a customised model of rating to African countries due to their active participation in the Eurobond market which needs a globally standardised mode of analysis. Even though they are considering artificial intelligence in the future ratings, ruled out the possibility that an element of human judgement in ratings can be completely eliminated but rather minimised.

On the view that the rating agencies make no distinction between individual countries in the African continent, they highlighted the significance of the continental geopolitics of African countries which they claim are highly contagious and can fluidly spill-over to other regions and compromise their individual ability to repay their sovereign bonds. Regarding the conflict of interest in the issuer-pay model, they acknowledge the inherent weaknesses in the model but emphasised the strengths in the credit rating process which eliminate the possibilities of system manipulation. They all had consensus in that they are registered businesses in the US and EU therefore abide by them, and are adequately regulated as they operate within the framework of the laws and regulations in each country where they do business. They however rejected the assertion that they monopolise and cartel the credit rating market as any business is allowed to operate in the industry.

5   Conclusions and recommendations

This study analyses the trends and challenges in the development of the SCR industry on the African continent since the first sovereign rating was assign to South Africa in 1994 to date when 31 African countries have a sovereign rating from one or more of the three dominant international rating agencies. In examining the trends in the credit rating industry in Africa, findings show that there is dissatisfaction from most of the market players on the operations, regulation and response mechanism to the three international market watchdogs. The following four implications can be drawn from findings. First, it is imperative to recognise that, since the participation of both international and local investors is largely dependent on credit ratings, it is difficult for a sovereign to increase or broaden its investor base with SCRs. Hence, the role of CRAs is crucial in unlocking competitive global capital which can effectively tackle poverty, promote good governance, peace and security. By accessing sovereign ratings, it implies that a country's policy thrust is to promote self-reliance, build capacity to enable self-sustenance in economic development.

Second, international capital continues to utilise credit rating information despite the known weaknesses in it. It therefore implies that, as long as there is no alternative manufacturers of more credible sovereign credit information than the current rating agencies, then the influence of the international rating agencies on the African continent will remain and continue to expand. Their opinions will thus continue to influence national policies on democratically elected governments against public interest. Third, without a comprehensive system of accountability on sovereign ratings, African state governments will remain constrained from either promoting or protecting economic,

social, cultural, civil and political independence and sovereignty. Last, the dictatorial signals in the CRAs' policy recommendation poses threats to peace and constitutional democracy which highlight the importance of having a response mechanism to the operations and regulation of the credit rating business in Africa.

Based on the findings from the analysis in this paper, the following recommendations are made. First, the African Union should develop a continental policy framework to manage international CRAs and providing technical support to governments in their engagements with ICRAs. Second, establish an African Financial Regulatory Authority for regulating activities of international CRAs on the continent. Third, establish an African Research and Advisory Bureau to facilitate the articulation of an architecture for preparing African governments for credit rating, managing the rating exercise, implementation of admissible recommendations, and to evaluate the accuracy and fairness ratings assigned to African countries. Fourth, AU to establish a Pan-African CRA under its monitoring organs as a basis for comparing African standards to international standards. Lastly, implement a multi-stakeholder programme to engagement on reviewing the methodologies, indicators and the rating process as traditional methods and indicators are discounting the potential embedded in emerging economies resulting in poor credit ratings.

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Notes

1 https://theconversation.com/the-world-bank-reinvents-itself-and-puts-poverty-reduction-at-risk-79403.

2 Japan is rated A+ with a debt-to-GDP rate of 235% and economic growth of 1.7%, higher than India, which is rated BBB– with debt-to-GDP rate of 69% and economic growth of 6.6%. Greece, a country in debt crisis with unemployment rate at 19.5%, debt-to-GDP ratio of 178%, economic growth of 1.4% is rated higher (BB–) than Tanzania (B), Rwanda (B+) and Ivory Coast (B+) which have a GDP of more than 5%.

3 Institutions like banks are required to incorporate credit rating in setting weights under Basel III code toward compliance.

4 https://www.iol.co.za/business-report/economy/s-and-p-warns-sa-over-its-r500bn-coronavirus-stimulus-package-48478384.

5 A set of ten point economic policy recommendations by John Williamson in 1989 that were strongly market-based approaches (sometimes described as market fundamentalism or neoliberalism). Prominent economists and international organisations, such as the IMF, the World Bank, the EU and the US, support the Washington Consensus.

6 Botswana with an A rating and Morocco, Mauritius and South Africa with a BBB rating.

7 Moody's, Standard and Poor's and Fitch were established in 1909, 1890 and 1914 respectively.

8 Where French is the common language: Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Congo, Equatorial Guinea, France, Gabon, Cote d'Ivoire, Mali, Niger, Senegal, and Togo.