The Impact of International Credit Rating Institutions on Africa's Fiscal and Monetary Policy: A Critical Analysis

Introduction

In recent years, a growing sentiment among African Leaders in less developed and developing countries, particularly in Africa, is that credit rating institutions wield significant influence over their fiscal and monetary policies. The credit rating industry in the globe is dominated by the three international agencies: Moody's, S&P and Fitch. Together they control an estimated 95% of the credit rating business globally. Most African Leaders argue that these institutions, often based in developed countries, inadvertently contribute to limiting the policy space available to African nations. Policy makers in Africa are increasingly dissatisfied with the approach and methodology adopted by these three (3) credit rating giants. Following the 1998 Asian Crisis and the 2007-08 financial crisis, there have been calls to examine the influence of credit rating agencies (CRAs) in how African countries access private funding and their fiscal feasibility, including their behaviors and methodology. Credit Rating Agencies are quick to downgrade African countries but slow when upgrades are due; they fail to accurately account for risk perception; they do not consult adequately with stakeholders; and they lack independence and objectivity. The subjective biases in credit ratings by these agencies costed African countries a combined US$74.5 billion.

A report by the African Peer Review Mechanism (2021) showed that 11 African countries were downgraded to negative in the first half of 2020 and 2021. Countries such as Ethiopia and Cameroon were specifically downgraded after announcing their intentions to utilize the G20 Common Framework for Debt Treatment under the Debt Service Suspension Initiative (DSSI), with the rationale that the Framework imposes a risk of losses on private-sector creditors, despite multilateral debt being classified as official debt in rating criteria which does not lead to default. Although qualified

for DSSI, up to 27 countries, did not participate in the initiative, due to the fear of being downgraded and alienated from international capital markets which left them with the difficult decision to choose between spending its already scarce financial resources to tackle Covid-19 and their economic needs or service their debts. This article explores this assertion, drawing on examples and references to shed light on the complex relationship between credit rating agencies and Africa's economic policies.

The Influence of Credit Rating Institutions on Africa's Growth

Credit rating agencies play a pivotal role in assessing the creditworthiness of countries. Although rating agencies insist that their ratings are opinions and not recommendations, their ratings have an impact on the conditions under which African Countries access debt markets. Poor credit ratings signal higher risk and tend to result in higher costs of borrowing from international capital markets. To date, the interest rates for borrowing from international financial markets are much higher for African countries than for economies in other regions of the world. Thus, for many African economies, interest repayments constitute the highest and fastest growing portion of their government expenditure with interest rates between 5% and 16% on 10-year government bonds, compared to near-zero to negative rates in Europe and USA. The high interest rates that African countries pay to borrow from international financial markets can be attributed partly to poor credit ratings but also to a mismatch between the instrument's duration and what it is being used to fund, which may be long-term infrastructure projects. Overall, African countries have little control over their market borrowing costs.

African countries often find themselves grappling with challenges such as economic volatility, infrastructural gaps, and social development needs. Despite these challenges, credit rating agencies, predominantly based in developed economies, tend to assess African Countries using criteria that may not adequately capture the unique dynamics of their economies. This standardized approach can lead to disproportionately lower credit ratings for African countries, limiting their access to affordable financing and constraining their policy choices.

African countries facing credit downgrades often find themselves entangled in a cyclic pattern of diminishing creditworthiness, particularly exacerbated by elevated levels of external debt and constrained fiscal space. This downward spiral can significantly impact their ability to secure affordable

financing, leading to challenges in allocating resources for vital development projects, including infrastructure, healthcare, and education. Moreover, concerns linger regarding potential biases embedded in the methodologies employed by global credit rating agencies. These methodologies may inadequately consider the unique economic conditions and challenges specific to African countries, thereby influencing credit assessments. In response to such challenges, some scholars advocate for alternative measures of creditworthiness, encompassing factors like a commitment to economic reforms, political stability, and governance indicators. These alternative metrics are posited to offer a more comprehensive evaluation of the creditworthiness of African nations in a global context.

Way Forward – A Call for an African Credit Rating Agency

The surge in efforts towards intra-continental integration in Africa underscores the transformative significance attributed to this pursuit. Central to this integration is the proposed establishment of an African Union (AU) credit rating agency, a move hailed not just for fostering regional cohesion but also for providing member states with a strategic avenue to access capital and seamlessly connect the continent with global financial markets. The critical need for comprehensive rating services in African nations is evident, given that the absence of credit ratings poses a hindrance to the growth of domestic financial markets. A Pan-African Credit Rating Agency, focusing on reliable credit assessments, emerges as a solution that could play a pivotal role in overcoming these barriers and promoting financial development across the continent.

In the current landscape where global credit rating agencies face scrutiny for potential biases, the establishment of an African credit rating agency takes on added significance. A Pan-African CRA, governed by robust regulatory frameworks, has the potential to serve as a credible alternative, instilling trust and confidence in the accuracy of credit assessments. This becomes particularly relevant as the credibility of international agencies comes under questioning. Crafted through multi-stakeholder initiatives, a Pan-African CRA could tailor methodologies, indicators, and rating processes to suit the unique economic conditions of African countries, initiating a journey that not only enables access to financing for economic growth but also enhances the overall well-being of their citizens.

Conclusion

While credit rating agencies play a crucial role in the global financial system, it is imperative to conduct a thorough evaluation of their impact on the fiscal and monetary policies of less developed and developing nations, particularly within the African context. Addressing these concerns raised by African Leaders becomes pivotal in nurturing economic autonomy and sustainable development in the region. Consequently, the establishment of a Pan-African Credit Rating Agency emerges as a strategic imperative for the continent, aligning with broader objectives of intra-continental integration. This initiative not only offers member states an avenue to access capital and engage with global financial markets but also addresses the pressing need for rating services and the existing gaps in credit ratings for numerous African countries. The credibility concerns surrounding international agencies further emphasize the timely nature of this Call. A Pan-African CRA, shaped by collaborative efforts and regulatory precision, has the potential to pave the way for a future where African nations possess the means to stimulate economic growth and ensure the prosperity of their citizens.