The Politics and Pragmatism of Sovereign Credit Ratings

Mains: *GS Paper | Economy*

Why in News?

Following Union Commerce Minister Piyush Goyal's recent address at a business conference in London, India's historical friction with global credit rating agencies has once again stepped into the spotlight.

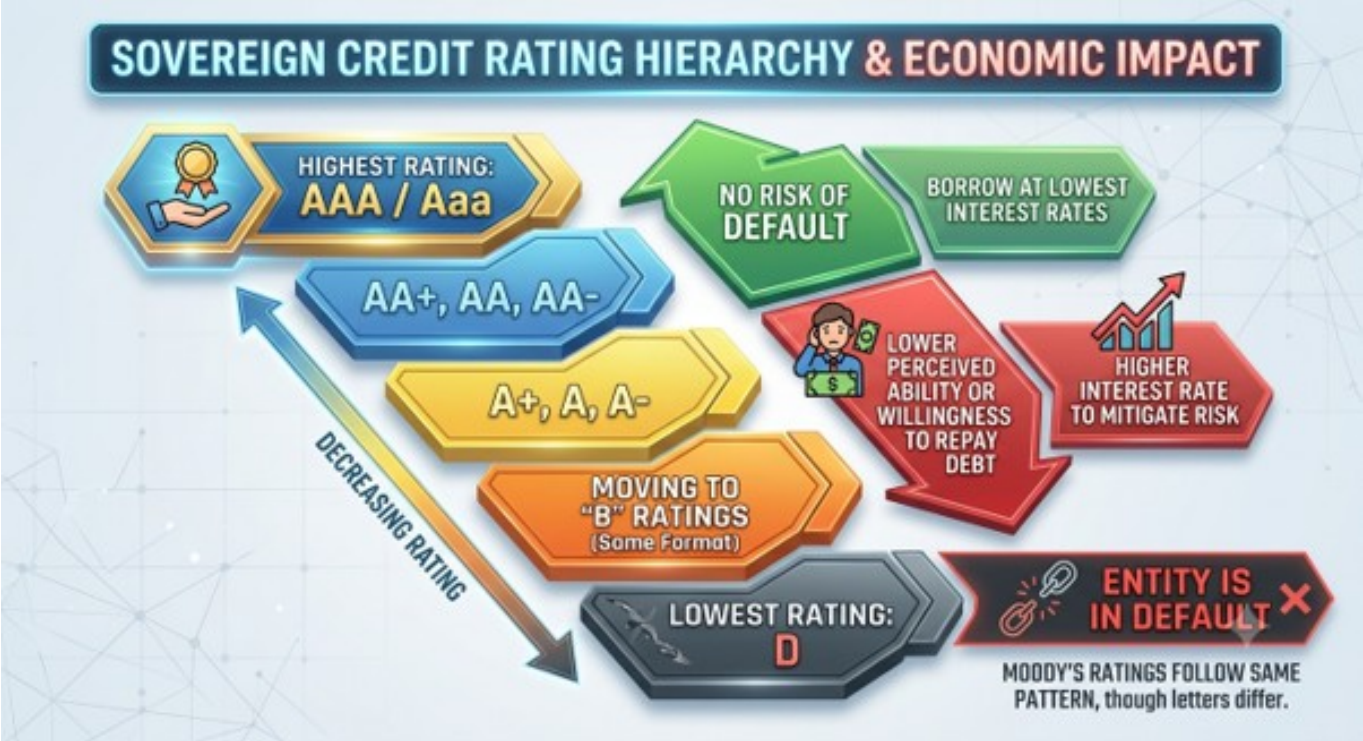
What do credit rating agencies measure?

- Sovereign Credit Rating Agencies (CRAs) ***evaluate a country's economic and political environment*** to determine its creditworthiness.
- **Core role -** To measure the ability and willingness of an entity to repay its debt.
- These entities can be companies, municipal corporations, states, and, in the case of sovereign ratings, Central or Union governments.
- **Components**
  - **Ability to Repay-** A highly quantitative metric.
  - It evaluates hard economic data such as Gross Domestic Product (GDP) growth, fiscal deficit, foreign exchange reserves, and external debt obligations.
  - **Willingness to Repay-** A heavily qualitative metric.
  - It gauges a government's political commitment, institutional robustness, and historical track record in honoring debt obligations during economic distress.
- **Regulation -** Credit rating agencies (CRAs) are regulated by national and regional authorities to ensure the accuracy, transparency, and objectivity of their financial evaluations.
  - **In India -** Regulated primarily by the Securities and Exchange Board of India (SEBI) under the SEBI (Credit Rating Agencies) Regulations.

What is the Scale and Impact?

- **International Rating Agencies -** India is rated by 7 international

sovereign credit rating agencies
    - Standard and Poor’s (S&P),
    - Moody’s Investors Service,
    - Morningstar DBRS,
    - Fitch Ratings,
    - Japanese Credit Rating Agency (JCRA) and
    - Rating and Investment Information (R&I), and
    - CareEdge Ratings.
- **The "Big 3" agencies**
    - Standard & Poor's (S&P),
    - Fitch, and
    - Moody's, dominate the global market.
- The rating spectrum determines a nation's borrowing costs in international markets.
- Ratings are assigned on an alphabet scale, with Fitch and S&P assigning ***AAA*** to their highest rating and Moody’s assigning Aaa to it.
- The next lower scales are AA+, AA, AA-, A+, A, and A-, before moving on to the ‘B’ ratings in the same format.
- The lowest rating is D, implying the entity is in default. Moody’s ratings follow the same pattern, though its letters differ.
- If an entity is rated AAA, then that means there is no risk of a default and so that entity can borrow at the lowest interest rates.
- However, the lower the rating, the lower the perceived ability or willingness to repay debt, and so higher the interest rate to mitigate that risk.



Where does India Stands in Credit Rating?

- Historically, India has been anchored at the absolute *lowest tier of "investment grade"* just a notch or two above speculative or junk status.
- While India's economic fundamentals surged over the last two decades, rating adjustments remained stagnant, prompting immense domestic frustration.

What are India's issues with the ratings?

- Despite the recent upgrades, India’s ratings still remain just above junk grade.
- The structural disconnect in global methodologies centers on 3 primary arguments
- **Size vs. Rating Anomalies -** India is the fifth-largest economy in the world, yet it holds ratings usually shared by significantly smaller economies with far weaker macroeconomic indicators.
- **Underestimated "Willingness" -** India holds a flawless sovereign repayment track record.
- Despite severe balance-of-payments crises in the past (such as in 1991), India has never defaulted on its external debt.
- The government argues this concrete history should render any "willingness to pay" concerns void.
- **The Subjectivity of the "Expert Consensus" -** Global CRAs weigh qualitative institutional indicators heavily such as perceived governance quality, political stability, and institutional efficacy.
- The Indian government argues these parameters rely on the subjective opinions of a small pool of Western-centric experts, resulting in a systemic bias that fails to capture ground realities.

What is the CareEdge Alternative?

- The appreciation of CareEdge Ratings by Indian policy leaders stems directly from its revised, transparent approach to emerging market realities.
- As the first global sovereign rating agency headquartered in India, its framework directly addresses the flaws New Delhi has highlighted for years.

Evaluation Pillar	Primary Nature	Methodological Alignment
1. Economic Structure & Resilience	Quantitative	Combined with Fiscal Strength, these two pillars command 50% of the total rating weightage.
2. Fiscal Strength	Quantitative	Focuses heavily on hard data indicators rather than subjective perceptions.
3. External Position & Linkages	Quantitative/Analytical	Evaluates forex reserves, trade structures, and debt-to-GDP ratios.

4. Monetary & Financial Stability	Quantitative/Policy	Monitors inflation control, banking health, and central bank efficacy.
5. Institutions & Quality of Governance	Qualitative	Used primarily as a secondary enhancement layer rather than the driving force of the rating.

What is the way forward?

- By shifting the foundational 50% weightage entirely onto objective, quantitative metrics (Pillars 1 and 2), frameworks like CareEdge minimize the impact of qualitative biases.
- For a country like India boasting robust growth rates, controlled inflation, and a flawless default record this methodology yields a far more accurate reflection of modern economic sovereign capability.

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Reference

The Hindu | Credit ratings agencies