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AN ORGANIZATIONAL REVIEW OF THE IMPACTS OF SOVEREIGN RATING COMPANIES*

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Abstract

The present study aims to provide a political economy approach to the sovereign rating concept, questioning the influence the sovereign ratings have on economies. The business and economics literature have regarded the rating agencies as significant actors of world economy, while frequently criticizing their failures. These implications suggest, that the impact of sovereign ratings is limited on economies and that the agencies should be considered only within the framework of information provision. In addition, some policy recommendations are presented in this study in line with the criticisms within the relevant literature.

Keywords: *Sovereign rating, Credit rating agencies, Political economy.*

KREDİ DERECELENDİRME KURULUŞLARI VE ETKİLERİ ÜZERİNE BİR ÇALIŞMA

Özet

Bu çalışma, ülke kredi derecelendirmesi kavramına politik ekonomi açısından bir açıklama sağlama amacıyla hazırlanmıştır. Bu bağlamda, kredi notlarının ülke ekonomilerine olan etkileri üzerinde çalışılmıştır. İşletme ve ekonomi literatürleri, kredi derecelendirme kuruluşlarının hatalarını eleştirmekle beraber, bu kuruluşları dünya ekonomisinin önemli aktörleri arasında değerlendirmektedir. Bu eleştiriler de göz önünde bulundurularak, bu çalışma, politik ekonomi açısından, kredi notlarının ülkelere politik ve ekonomik açıdan etkileri üzerinde durmaktadır. Bu incelemelerle, kredi notlarının etkilerinin kısıtlı oluşu ve derecelendirme kuruluşlarının uluslararası ekonomide bilgi sağlama rollerinin dışında değerlendirilmemesi gerektiği sonucuna varılmıştır. Ayrıca, derecelendirme kuruluşlarına yönelik değişiklikler için bazı politika önermelerinde de bulunulmuştur.

Anahtar Kelimeler: *Kredi derecelendirme, Politik ekonomi, Kredi derecelendirme kuruluşları.*

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INTRODUCTION

This study is about one of the significant actors of the globalizing economy, the credit rating agencies. The study aims to analyze specifically the sovereign rating process in Turkey and the implications on both the economic outlook and policy-making following the rating announcements. It will provide an insight to what the sovereign rating is, how the credit rating agencies work and what their ratings' significance for a country's economy is. These questions will contribute to the understanding of the power exercised by the agencies and source of this power.

Having provided the general framework of the sovereign rating issue, it will be questioned how the sovereign rating system works in Turkey, by focusing on the specific sovereign rating changes. This will be a case study including an analysis of the past rating records given by the three major agencies Standard and Poor's, Fitch Ratings and Moody's for Turkey between the years 1993 and 2008 and the related main macroeconomic data, on which those ratings were announced to be based. By doing this, a comparison between the three agencies' decisions on Turkey's sovereign rating will be achieved. This comparison will be useful in order to have a better understanding about the widespread critiques on the rating methodologies, that there is no specific formula for the determination of the credit ratings, leading to a variety in the timing and features of the rating updates and thus questioning the 'attached' power of the rating system in general. In addition, the resulting changes on Turkish economy will be provided by using three most relevant indicators, so that the exercise of this 'power' is better observed. Following the study of the sovereign rating changes for Turkey, it will be investigated whether and, if any, how and to what extent the rating announcements had an effect on the economic conditions and later economic bureaucratic policies in Turkey. This will help us to see whether the role of the rating agencies for the countries is exaggerated or deserves the expectations. The significance of the sovereign rating results and their functioning in general will be questioned in the light of this Turkish case.

What the credit rating agencies serve for is simply to provide information as a basis for economic and financial decisions of major investors and economic actors. They have a grading mechanism with a wide ranging scale, according to which they determine certain grades for both countries and corporations as a result of their calculation processes and decision making analyses. In this way, the rating system is supposed to fulfill the 'guide role' within the international economics for the involving players. They are, in fact, not very recent outcomes of the international financial system. Their history dates back to the late 1880s, yet their significance increased with the early 1930s' economic conditions. It was the major economic turmoils related to the increasing debt problems contributing to the emerging necessity of the credit rating service in general. More detailed information about the CRAs' historical background will be provided in the following chapter. However, at this point, it would be more useful to have a shortcut focus on their definition and their functioning mechanism.

For a proper definition of what the credit rating means, Beers and Cavanaugh from the Standard and Poor's (2004: 1) stated that "[Standard and Poor's] sovereign credit ratings reflect its opinions on the ability and willingness of sovereign governments to service their commercial financial obligations in full and on time." With specific reference to their own company, they claimed that:

"Standard & Poor's appraisal of each sovereign's overall creditworthiness is both quantitative and qualitative. The quantitative aspects of the analysis incorporate a number of measures of economic and financial performance and contingent liabilities, although judging the integrity of the data is a more qualitative matter. The analysis is also qualitative due to the importance of political and policy developments and because Standard & Poor's ratings indicate future debt service capacity" (2004: 2).

Since it is the same what the rating agencies do in common, this definition applies to the whole system of the sovereign rating. In addition, Kucukkocaoglu (a) (2005: 10) clearly listed the main features of how the credit rating agencies (CRAs) function for sovereigns. *Firstly*, CRAs measure the government ruling systems' and their central banks' credit values. This seems to be the main source of power for the agencies within the international arena. *Secondly*, as already mentioned, they calculate and determine the probability of debt repayments by the debtors and the probability of debts, tangible assets, exporting foundations to be repayed. In addition, they evaluate the extent to what these assets can be invested on. These aspects can be applied also to the individual governments

taking their central banks and ministries of finance into account, since this study is mainly focusing on CRAs' situations at the government level, instead of the company basis. CRAs perform these activities periodically and make analyses and final evaluations leading to the credit ratings.

Many investment decisions, determination of credit availabilities and finance opportunities are likely to be the analyzed results of the calculations by the rating agencies, because the economic players usually do not have other alternatives and opportunities to look for information in shorter time. From this perspective, they are recognized as being useful data sources for the business environments and the entities, where the depending investments are assumed to flow. The quality and function of the data remains to be discussed further, as by doing so, it is possible that the agencies provide too much data, which are far from being the final points for the investors to look at for their decisions. However, the investors or financial actors are quite ready to adopt the outcomes provided by the agencies for their strategic choices. For instance, by looking to the rating scores of the relevant country, an investor finds it easy to decide on whether the country he has chosen is safe to be invested in terms of security or whether the credibility of the host government, where the company is located, is sufficient to repay its debts.

At this point, it needs to be ensured that the provided information is appropriate according to the established mechanism of the agencies themselves. The grades and ratings provided by the CRAs are published and provided as official valid information to the international business environment. Yet, many critiques argue that the shape of this guidance has changed with time and turned to be far more effective than being simply a source of information. "Although the credit rating agencies themselves often argue that they are merely in the business of information provision, in practice these informational ratings function as exclusive providers of global regulatory licenses" (Sinclair 1994 cited in Cooley 2003: 678). In this statement, Sinclair referred to the idea that the observed functions of the rating agencies exceed their pre-assumed responsibilities and they have somehow become authorities by publishing ratings, whose attached values have gradually increased. This aspect will be elaborated in the following chapters while discussing whether the CRAs fulfill their responsibilities in the expected manner. By this 'expected manner', the original point of establishment for this mechanism was intended to mean, where the initial responsibility of the rating agencies is to provide the relevant and efficient information for the economic actors and to provide a final evaluation about these actors' economic outlooks for a well functioning world economy.

While there are obviously quite enough reasons to attribute expectations and responsibilities to the rating agencies, there are also certain points where the power of rating agencies become questioned. Critiques are raised mainly deriving from the assumption that, unless the system works properly enough, the credit rating activity can easily turn to be an ineffective and inefficient one. Strikingly, the system itself is very likely to deviate from its informative nature, as the grounds on which operates, that are the rating criteria, are keen for this.

Coming to this aspect of rating grounds, there are two types of rating criteria applied by all agencies in general: these are political and economic ones. The economic criteria, which will be detailed in the following chapters, are mainly based on numerical and statistical data, that are chosen from a very large list of economic indicators as a result of a decision making process not likely to be purely apolitical at all. The point is that although the choice of the data to be used for the rating process looks a little biased and political, at the very end, the final outcome is reached as a result of the real data obtained from government officials and mathematical formulas applied to them. The political criteria, on the other hand, are relatively far from being 'neutral' in nature, and exposed to be dependent on the perception of the people interpreting them. The political criteria are only judgments in nature and thus even only this aspect would be sufficient to regard them as being less powerful than the meaning attached to them. In order to clarify this aspect of the political criteria, Sinclair (2005: 137) can be quoted here, arguing that "debt repayment is premised on both *capacity* and *willingness* to repay. Thus, judgments about officials' ability to manage and govern – and likelihood of them being willing to repay – are central." The managerial capacity stated here would be the aggregate whole of different political criteria. Such political criteria are determined taking into account, that the political events indirectly affect the economic decisions susceptible to the regulatory environment of the relevant country. They are mostly determined taking the possible risky political circumstances into consideration.

The risky political factors were listed by Kucukkocaoglu (b) (2005: 3) as: election system and election times, foreign policy developments and the level of democratic consolidation, the changes on the political leadership or agenda, the structure of the coalition, the situation of the opposition party and the degree of central bank independence. In addition, Kucukkocaoglu (c) (2005: 18) listed the political subjects on which the ability and willingness of the country to fulfill its obligations depend on as: the program of the governing political party and the length of their governing period, the character of the political system, the outlook of the political parties within the country, the comparison of the people's expectations from the government and the consequent outcomes of that government's services with regard to the voters' satisfactions, the possible existence of influential external political powers, the activities of the organized religious and ethnic groups in the domestic politics, the legal traditions and regulations in the country, the geopolitical/ strategic importance of the country, the qualifications of the bureaucrats with whom foreign investors would be in contact, the international integration of the country and the relations of the country with its neighbors and trade partners.

Taking these explanations into account, while the relevant economics literature tends to regard the rating agencies (CRAs) mainly as among the major economic/ financial actors in the global system, this study will question their role and investigate to what extent their power has an implication for the countries' economies, taking Turkey as the main case study. From this perspective, this will be an attempt to provide a political economy explanation of the sovereign rating issue. In addition, it will be indirectly elaborated and revealed at the end, that all these efforts of the CRAs as being a major party of the global financial system is only to guarantee the repayment of the debts by the borrower side to the creditor and to provide the most useful information for the investors and other economic actors worldwide. Their power is, and should be, limited to the information and insight provision, and the definition of what constitutes a country's economic well being, and thus they shouldn't have an authority of having the final say about a country's economic outlook. While this proves to be useful and meaningful, that the rating agencies are in favor of the debt repayment, which is in fact their starting point of emergence, there are common critiques towards the system as being concerned with the interests of key players at the expense of the others, who need to be rated the most in order to survive within the international economic system. This was pointed out also by Kerwer (2001: 5), referring to the epistemic authority perception of the rating agencies by Sinclair (2000). "Most importantly, this epistemic authority has a political dimension. It justifies financial markets as neutral and efficient means for allocating resources, even though they in fact favor the financial elite and disfavor redistribution." The striking point in this argument is that the authority of the agencies is transformed, consciously or not, into a biased one and they succeed in making this look as if it is the appropriate one.

This study also aims to provide an insight to the general criticisms, which have gradually increased with the major economic crises starting in the late 1990s by questioning why they whether the agencies do not fulfill their responsibilities towards the international economics they had proclaimed beforehand. This was mostly reflected by the concept of 'pro-cyclical behavior', that is easily observed on the agencies' rating behavior, as they tend to make most of their announcements after the crisis-inclined situations. The major study question, as indicated above, asks whether the rating agencies are in fact so much significant for the countries' economies or their role is exaggerated by the actors of the system exposed to overabundant information and following justifications of economic activities, which prevent them from accessing to the most relevant data for their decisions.

The reason why this topic was specifically chosen is that the credit rating agencies have increasingly become influential actors in the global financial system. The significance of the global economic and specifically financial system and their recently observed failures starting with the twenty first century has brought many questions to be answered. Not necessarily referring to the rating agencies, Porter in his book *Globalization and Finance* discusses the significance of a regulatory mechanism in the global economic and financial system. According to Porter (2005: 25), it would be impossible without governing entities and rules to 'transfer millions of dollars electronically', which is at the heart of today's finance. Only this reason alone would be sufficient to focus on the regulatory governance in the system, leading to the credit rating industry. While how the system operates and how the major actors involve in the scenarios of this system is to be left to the field of the international finance itself, some overlapping issues are considered within the framework of the international political economy. This derives from the very nature of these actors having transactions among each other and thus reflecting

diverse implications for the worldwide economies. Public authorities, financial institutions, multinational or local corporations are among the most popular ones, whose conducts usually have a variety of consequences for the global economic system. Together, they constitute the community within which the rating agencies operate and which they serve for.

It has strikingly become unavoidable to encounter any daily statement by a rating agency, mainly being Standard and Poor's, Moody's and Fitch Ratings, about a country's economic situation especially with regard to the financial stabilities. Under this exposure, major financial players do very carefully follow the statements made by these agencies, so that they keep up with the recent developments in the world economy in a supposedly most efficient way. This derives from the fact that these rating agencies' main motivation is to follow each and every political, economic or financial news, events and speculations to provide the correct explanations for their decisions and announcements. As mentioned before, many investors make their decisions in line with the results obtained from the credit scores, which are accepted to reflect the economic conditions in the country, besides the significant political events and changes. Moreover, the financial borrowing system is also highly based on the information coming from the rating agencies. According to the statistics articulated by Sen (03.07.2008), a debt amount of almost 20 trillion dollars, that is the 40 per cent of the total debts worldwide, was released only according to the rating grades given by the CRAs. This clarifies the inevitable effect of the agencies on the countries' economies, as the number of indebted countries increase every year. Especially for the developing countries, foreign debts constitute a large part of the government financing, such as the import expenses. Furthermore, it is the developing countries, where the political issues are largely intervened in the economic outlook. Thus, it would be significant to focus on these political aspects of the sovereign rating process.

In addition, in this study, the rating agencies' role as political actors will be elaborated with reference to the potential correlation between the rating announcements and the following implications on the economies and the further related economic policy making. By questioning this, the purpose of this study is to review the role of the agencies within the international political economy. While their main function is to provide a fair and efficient basis for the international financial transactions, whether too many responsibilities are loaded far beyond their original designations will be evaluated. A good justification for these questions would be the 1994 economic crisis in Turkey, one reason of which was considered to be in fact the downgrade announcement by the rating agency Moody's. Deriving from this case, it would be expected to assume that the rating announcements are so effective that they can even lead to raise economic crises. On the other hand, as it can be observed, that rating announcement was only one of the other factors causing the 1994 crisis. Thus, this complicated situation needs a clarification in order to have a better insight about the rating agencies and to indirectly allow them to function properly in the way they were designed to be. This study would further contribute to the literature by questioning the efficiency of getting low or high grades for these emerging markets, who try to set their policies in line with these grades in order to obtain better economic conditions.

The main argument of this study is that the power and significance of the rating agencies are exaggerated and their announcements are considered to be much more significant than it is observed in the real cases by attaching too much meaning to the rating results, taking the current criticisms into account. As stated before, the sovereign rating system was initially established as a guide for the investors and it was not intended to make them the sole authority for the economic players to make their economic decisions and to turn them into rule makers or regulators within the international economy. What was originally planned was a mechanism to provide insight for the international investors, who otherwise would not be able to be that much easily informed about the countries in which they decide to make investments. However, bureaucrats, policy makers, investors and scholars have an increasing tendency to expand the territories of the effects of rating announcements and the critiques are raised when these expectations are not fulfilled. This view also derives from the question of whether the rating agencies influence the worldwide political outcomes by representing certain interests, mainly the U.S' ones. It was also asserted, that the rating scores are used by the agencies and their home countries or indirectly the ones whose interests they are assumed to serve for as a stick to make their preferred policies to be implemented.

1. LITERATURE REVIEW

Despite being a relatively new issue on the agenda of the international economics, many scholars have focused on the credit rating issue from various perspectives. The most part of the literature on this issue belongs to the field of economics and international business, including large numbers of empirical and statistical studies deriving from numerical data and further analyses based on their evaluations. Mainly, they focus on a detailed investigation of rating functions and the significance of the credit rating for the global economy. Yet, what they usually tend to undermine is a critical evaluation of the rating practices in real life with a comparison of the theoretical basis, although there is an increasingly growing critique about a significant existence of such an overlap. An evaluation of such an argument can be achieved after a good analysis of what the rating agencies theoretically are designed for and how they operate in the field. There is a quite large literature on these issues in order to make such a comparison. The relevance of this idea to the study question is that the power of the rating agencies can be better evaluated when having enough information about what they were designed to do at the beginning and what they serve for in practice. The diverse themes within the literature on the credit rating issue can be mainly classified as follows: what the credit rating is, how the agencies work and where their source of power comes, their significance within the economic and financial governance, critiques about how they better should be organized and a broader literature on the financial and economic governance. The data about the rating agencies will be provided separately in the literature review chapter of this study.

There is an additional point to be made when trying to explain the role of the sovereign ratings for a country's economy. Other than referring to the general economic environment of the country as a whole, the sovereign ratings also provide an idea about the single firms operating within the country and their performance affected by the economic conditions. The rating used for this purpose is called as 'country ceiling', different from the sovereign rating, and it implies the limits of the ratings firms can have within definite countries. Accordingly, country ceiling "captures the specific risk of controls being imposed by the sovereign authorities on the conversion of local into foreign currency and on transfer abroad in order to meet external debt service obligations" (Fitch Ratings Criteria Report, 2007: 1). In fact, "they are not ratings, but rather act as the effective 'cap' on the Foreign Currency Rating that can be assigned to any issuer or transaction originating in the country; hence Country Ceilings do not have rating Outlooks. Transactions and entities can only achieve Foreign Currency Ratings above the Country Ceiling if there are specific features that materially reduce the credit vulnerability to Transfer and convertibility risk" (Fitch Ratings Criteria Report, 2007: 4). Thus, the country ceiling enables the issuers within a country to be rated higher than the official rating grade of the sovereign in which they are located. This significance of the credit ratings for governments is well expressed by Audino (1996: 22) as: "A sovereign government's foreign currency debt rating often serves as a cap on the maximum rating for most foreign obligations of issuers domiciled in that nation. This concept reflects the extremely broad range of financial powers and resources available to a sovereign government". The reason why the sovereign countries need these ratings derives mainly from the main premises of the financial globalization.

Financial globalization's effect contributing to the significance of the rating agencies was noted by Bissoondoyal- Bheenick (2005: 252) that "in recent years, the demand for sovereign ratings has increased mainly due to the inevitable globalization of markets. Investors and particularly managed funds are increasingly focused on international diversification. A change in sovereign ratings can be a major input in the re-weighting of international portfolios." A similar view was also held by Sassen (2002: 26), referring to the impact of globalization on the increasing significance of the credit rating agencies. According to Sassen, the agencies contribute to the establishment of transparency and order within the global market and thus exercise a kind of authority. This argument can be explained by connecting the financial globalization to the increasing necessity of transparency within the system, a gap supposed to be filled by the credit rating agencies. Sassen's argument in favor of the rating agencies' important responsibility is among the driving motives behind choosing to evaluate this process. However, to what extent it is appropriate to trust in their explanations is the striking aspect of this evaluation.

The role of the rating agencies within this notion of globalizing economy and the nature of the authority they exercise need to be elaborated. The concept 'embedded knowledge networks' introduced by Sinclair suggests the significant role played by the CRAs in the financial system. What is meant with this concept is that the actors

providing information for the international financial system are interacting and the resulting information is endogenous to the system. (See also Kerwer 2001: 4). They provide the grounds for the key financial organizations to conduct their financial transactions. In addition, they indirectly determine for the economic players what data and information is necessary to look for their activities and decisions.

At this point, CRAs contribute to this system, first by setting the standards about the definition of the necessary information and then by rating the companies and countries based on those standards, so that, for example, the investors would have a significant insight about the investment conditions. According to Sinclair (2005: 15), “the agencies’ views on what is acceptable shape the actions of those seeking their positive response”. In fact, it is this assumption leading to this study’s major concern, as to whether such important information becoming ‘embedded’ in the system is a correct and objective one. In a similar manner, it was stated by King and Sinclair (2003: 358), that “according to S&P’s President, Leo C. O’Neill (1992), the rating agencies see themselves as ‘quasi-regulatory institutions’. They are well placed to defer or modify government challenges to their authority, as the hesitancy with which any new effort (including Basel II) to pull them further into regulation demonstrates.” This possibility of the ‘modification of government challenges’ inevitably leads to questioning them analytically. The same view was held by Barry Hindess (in Larner and Walters 2004: 35), that it is “the use of financial markets (and credit-rating agencies) to regulate the conduct of states...” accepted as one of the main critical behavior of the CRAs. Such a criticism can, however, be supported in the study after analyzing the data in later chapters, because only then it can be understood how the ratings affect a country’s economy.

There is a broad literature of the critiques on the rating agencies from various perspectives. The mostly criticized aspect of the CRAs is related to their decision making process when finalizing the rating scores of certain countries. This is related to a critical evaluation of the predetermined qualitative and quantitative criteria applied by the rating agencies. Bissoondoyal- Bheenick (2005: 279) referred to this criticism, arguing that “qualitative and judgmental aspects of analysis are unavoidable even in the interpretation of quantitative indicators. Every measure of economic performance is the result of a complex interaction of economic, political, and social forces as reflected in the policy formation process within the government and in the reactions of private-sector economic actors to policy parameters.” In fact, the numbers on which the data is based are also the results of choices made by the rating analysts. It is inevitably a choice of including some data and not some others for the finalization of the ratings that leads to the determination of countries’ economic outlooks. Such choices indeed have a qualitative nature contrary to the attached value to them as being numerical side of the criteria. However, the involvement of some qualitative process does not necessarily mean that there is a tendency for the manipulation of the data used by the agencies.

The rating decision making process, as observed above, consists of different components with various aspects. It requires, as mentioned before, both analytical data and the interpretation of it what makes meaning of the grades. “Sovereign risk analysis is an interdisciplinary activity in which the quantitative analytical skills of the analysts must be combined with sensitivity to historical, political, and cultural factors that do not easily lend themselves to quantification” (Bissoondoyal- Bheenick 2005: 279). At this point, whether a CRA official can successfully manage the quantitative data, which has an unquestionable nature, with the qualitative skills in its correct way is important for the accuracy of the rating behavior. This is critical, because, as also mentioned by Bissoondoyal- Bheenick (2005: 251), the political and cultural factors are quite likely to influence the outcome of the decision by intervening as a bias-generating effect. He further strengthens his argument, claiming that purely economic and financial criteria are not sufficient to determine the rating scores and that these same criteria do not apply to several countries in the same way. Furthermore, as Cantor and Packer (1996: 39) have argued, another problem related to the applied criteria is the ambiguity in the relative weight given by the different agencies to each single factor. The decision of what criteria plays a more important role in the final rating score can also be regarded as a political act, far from being objective at all. This indirectly implies the critical assumption, that the agencies can have certain foreign policies with regards to the sovereign ratings.

Kerwer refers to this critical notion from a different perspective, viewing the rating behavior as a ‘voluntary’ action exercised within the globalizing finance inevitably. The reason why it is regarded as being ‘inevitable’ derives from the increasing significance of the credit rating in the global credit transactions and investment

patterns, where a third actor is necessary to set the rules and provide the effective functioning of the system. According to Kerwer (2001: 20), “third party enforcement can cause an accountability gap whenever voluntary expertise based standards are converted into coercive rules” What he argues is, that the system itself created this ‘accountability gap’ by establishing a newly arranged mechanism as the regulatory standard. However, in contrast to what Kerwer criticized, Larner and Le Heron (2004: 216) argued that the results of these third-party involvement lead to the establishment of the standards, which are necessary for further comparative evaluation in the system, possibly deriving from the huge international market and information problems.

Giselle Datz is a scholar whose works were specifically focused on as a guide of this study’s arguments and questions. A related point in the literature like the abovementioned ideas is made by Datz about the source of power of the rating agencies, which is a necessary aspect for evaluating their behavior. Datz (2004: 311) refers to Sinclair’s argument regarding the CRAs as part of these ‘embedded knowledge networks’, having become authorities in terms of specific problem solving experiences. Their power derives from the limitations they put on the investment behavior and the changes they lead on the financial markets by using the available information and expert knowledge. Datz further explains that the risk assessment and sovereign rating are part of the embedded neo-liberal strategy of development, leading to the financial liberalization. This newly emerging system, as can be obtained from this view, contributed to the increasing power of CRAs. Indeed, building on Datz’s argument, it can be claimed that the source of rating agencies’ authority derives also from their identification of economic wellbeing for a country and what may constitute problems for any country’s economy. In fact, this problem definition can be highly interpreted as a judgment of the analysts working for the agencies. On the other hand, there is an argument put by Datz (2004: 304) that “the power of credit ratings agencies has little to do with the efficiency of their work, or the accuracy of their estimations. It has a lot more to do with what they represent: a business of self-validation that plays with a panic-prone environment where the word ‘risk’ resonates loudly, and where ‘development policies’ are held hostage by the standards set by these agencies and their clients.” A very good point in this statement is that the CRAs are assumed to ‘represent’ a system of ‘self validation’, where the agencies serve for the interests of these represented entities and they do this indeed in a standardized mechanism.

A significantly differing criticism related to the accountability problem was also made by Kerwer (2001: 25) from the neo- institutionalist perspective, arguing that “rating agencies have to be observed with a dose of skepticism because their standard-setting activities largely go unchecked. Thus, the reason to be critical is not because they engage in 'ideological uncertainty transformation' which provides legitimacy for organizing the financial world in a way that favors the interests of a capitalist class. It is because rating agencies may not adapt their standard of credit-worthiness fast enough to avoid harm to borrowers and lenders.” There is, in fact, a mechanism checking the works of the CRAs. Yet, the problematic point is that this mechanism is also a U.S - based institution, called as Security Exchange Commission. This control mechanism does not satisfy some of the major critiques, arguing that these agencies simply reflect the interests of certain parties, as mentioned before, and mostly these parties are U.S. ones. This issue is in fact a part of a larger literature as in the case of many other global institutions mainly as the IMF or the World Bank, arguing that there is a need for a further mechanism ‘to rate the raters’ and to control the inspection responsibilities of the relevant institutions.

Apart from the specifically focused literature on credit rating, there is a broader literature on financial and economic governance, of which the rating agencies themselves are a part. The mostly articulated aspect of this economic governance concept for the rating agencies is their regulatory nature within the system. Their power deriving from their unique mission in the globalizing economy attributes them an additional and indirect regulatory feature. Their decisions become so embedded, that they have inevitably started to create their own regulatory framework, within which the actors behave accordingly. “Although the credit rating agencies themselves often argue that they are merely in the business of information provision, in practice these informational ratings function as exclusive providers of global regulatory licenses” (Sinclair 1994 cited in Cooley 2003: 678). What is intended to mean here with the ‘licenses’ is the rating records given for the countries as indicators of debt repayment capacities and broader economic outlooks. This grading mechanism makes them powerful actors within the system, where there is no other alternative institution serving solely for this purpose.

Although studies that focus on the credit rating system are rich in number, there are few works that include a further analysis supporting the criticisms taking both the political and economic aspects of the ratings agency power into consideration. So far, the economics literature has large number of statistical analyses on the economic data and information, yet mostly neglecting impact of the rating agencies on the policy making by the bureaucracies or only slightly mentioning it. On the other hand, political science works and articles have had a tendency to focus on the power relations aspect of the agencies and assuming that they had already taken place in the global capitalist system. Yet, for the evaluation of this power, it would be necessary to focus on a real case and compare this theoretical ground with the data provided by the agencies. This is what will be explained in the next section 'methodology' as an attempt to humbly fulfill such a gap in the literature.

1.1. Definition of Credit Rating Agencies

There is a limited literature by a relatively small number of scholar works on the definition of the credit rating system, as the remaining part mostly focuses on the criticisms and the evaluation of the rating methodology, taking different countries as case studies. Basically, credit rating agencies are firms responsible for calculating and determining the credit rating scores of both the companies and countries for economic purposes. The rating given for countries is called as 'sovereign rating', while the other type is called as corporate rating. There is also 'country rating' other than the 'sovereign rating' designed for the countries. Sovereign ratings mainly reflect the economic outlook of countries with respect to their ability to repay their debts, so that they can borrow easily further or attract more foreign investors to invest within their boundaries. In other words, according to Afonso et al. (2007: 9), sovereign ratings indicate the evaluations of default likelihoods. The ratings are determined as a result of various factors reflecting the ability and willingness of the sovereign to repay debt. (see also Lehmann 2004: 255).

The difference between the sovereign rating and country rating should be noted here, as this study will focus on the concept of 'sovereign rating' deriving from the political economic approach, and not the 'country rating', yet the country rating is also important when the corporations are the case. "Sovereign ratings are not 'country ratings', an important and often misunderstood distinction. Sovereign ratings address the credit risks of national governments, but not the specific default risks of other issuers. A rating assigned to a non-sovereign entity is, most frequently, the same as or lower than that assigned to the sovereign in the main country of domicile, but may be higher" (Beers and Cavanaugh, 2004: 1). For this reason, as mentioned before, the concept of 'country ceiling' was designed recently to give the corporations the chance to be rated higher than the government, when necessary. Since this study is about the countries' general economies and it is an attempt to make a political economic explanation of the rating system, the data chosen here is based on the 'sovereign ratings' provided by the agencies.

For the rating process, the agencies have predetermined political and economic criteria, according to which they make their calculations in line with the most recent developments about the rated entities and their capacities for debt repayment or credibility for doing business with/ within or investment. These criteria help them to provide information for further investment decisions of other actors. Most of all, the rating outcomes serve for the investment decisions in case of both lack of information and excessive information experienced by the investors. As Sinclair (1994: 452) remarked, "rating agencies can be considered endogenous solutions to the uncertainty that exists when a lender does not know the reputation of a borrower, due to the lack of community in capital markets (Taylor and Singleton, 1993: 198). Rating agencies operate as the agents of investors in these situations (Pratt and Zeckhauser, 1985)." Yet, it can also be argued that the information already available to the international economic community may be too confusing to make decisions for the players. This may also derive from the fact, that with the increasing technological improvements, the world economy is exposed to more data and information than what is necessary. Under these circumstances, a mechanism becomes necessary to separate the relevant and useful information from the irrelevant ones. Of course, as previously mentioned, in this case, the determination of the relevant information is a result of individual judgments of rating analysts. This aspect will be elaborated later.

There is a large literature on the main premises of the credit rating system and what they are supposed to be responsible for. It would be wrong to argue, that there is a convergence in the literature on that issue, as many scholars view the rating agencies from different perspectives. This eventually leads to a debate, as will be detailed in a separate discussion in this study, about the power and capability of the rating agencies as to whether they provide strict information about the rated entity's economic situation or only a foresight or opinion about the possible repercussions of certain economic or political indicators. Partnoy (2006: 83) stated, that the credit rating agencies regard their work as being simply a financial publishing. The Nationally Recognized Sovereign Rating Organizations have always claimed their business to be only about publishing purposes. Accordingly, their job consists of collecting relevant data, analyzing and evaluating them and then making the results of the analysis publicly available with their final opinions. From this point of view, what they produce as a result of their long processes is nothing more than an opinion based on obvious data which are already publicly available. Supporting this argument, "in July 1995, Leo O'Neill, S&P's president, stressed that ratings are opinions issued to inform investors rather than to protect them. Moody's emphasized in August 1999: "Because it involves a look into the future, credit rating is by nature subjective" (Kunczik 2001: 26). This 'forward looking' nature of the agencies was also articulated by Bissoondoyal- Bheenick (2005: 279) as being a feature specifically of the sovereign ratings. It is important to note here, that such 'defensive' statement made by Moody's simply refers to the very commonly addressed criticism about the rating agencies on making 'subjective' decisions.

Apart from the commonly known credit rating agencies, "there are further actors in the risk rating business. The Business Environment Risk Intelligence (BERI Institute in Geneva) was developed about 1975. "Foreland" (Forecast for Country Risk for International Lenders) is according to Peter Hoffmann (1991, 87) reliable, because the index predicted the problems of countries like Poland, Mexico, Hungary and Brazil years before their financial system got into troubles. Another important evaluation of country risks is done by Institutional Investor (a banking and investment journal; cf. Feder and Ross 1982). Since 1979 the American magazine has been publishing the risk-evaluation of countries by about 100 leading banks, investment firms and brokers twice a year (March and September)" (Kunczik 2001: 17). Such an overall insight on the definition of the credit rating enabled the basis upon which the next section will be built. The next section provides more details about the functioning mechanism of the rating system.

1.2.How do the Rating Agencies Operate

The criticisms within the literature mostly refer to the deficiencies on the working process of the rating agencies. Thus, it would be appropriate firstly to focus on this aspect and analyze the details provided by the literature. As briefly aforementioned, the rating behavior is based on two types of criteria: economic and political ones. The Fitch IBCA Sovereign Rating Methodology Report 2008 clearly listed their criteria under certain topics, which are similarly used by other rating agencies as well. These are mainly: *demographic, educational and structural factors, labor market analysis, structure of output and trade, dynamism of the private sector, balance of supply and demand, balance of payments, analysis of medium-term growth constraints, macroeconomic policy, trade and foreign investment policy, banking and finance, external liabilities, politics and the state and the international position.*

As it can be observed, there are multiple categories for the criteria to be applied. This can be explained with reference to Mitchell (1998: 91), that "the emergence of the economy, then, should not be examined merely as a conceptual innovation within the discipline of economics or in general social theory. These intellectual developments accompanied and interacted with a broader discursive change in which political and social practice constructed a new object." The assessments made by the rating agencies depend on multivariate types of indicators and it is an interdisciplinary work. This can be explained based on the motivations behind the credit rating mechanism, which was established mainly for the foreign investors and creditors. Since these actors have multiple interests in different areas, the rating process should correspond to the indicators beneficial for their final analyses. In other words, the points upon which the rating criteria are built on are the results of the needs of the investors and creditors for their decision making.

“A quick glance at common rating methodologies reveals that sovereign ratings are designed for a very different class of investors than those that are currently invested in low-income countries. The rating process evaluates countries on a broad range of criteria, including for instance structural factors impeding the functioning of markets, political stability, resilience to external shocks, prospects for economic growth and the health of the financial system. However, there is a clear emphasis on the liquidity of public finances through the assessment of budgetary flexibility, of public sector debt, and of any outstanding contingent liabilities, for instance due to guaranteed debt to state-owned enterprises of potential banking sector recapitalization requirements (Bhatia, 2002)” (Lehmann 2004: 256).

As also observed here, it is inevitable that the majority of the criteria consist of the economic and financial aspects. UI Haque, Mathieson and Mark (1997: 10) similarly argued, that the ratings are the results of a comprehensive analysis reflecting different types of indicators such as rate of economic growth, current account balance and other ratios, mainly to GDP. Vulnerability to external shocks is usually measured by the extent to which the country depends on foreign trade or investment. In addition, the political criteria were listed generally as the government’s capacity to implement the economic policies, policies towards the foreign investors and creditors and the possible political instabilities. “For example, S&P determines the rating by evaluating the country’s performance in each of the following areas: political risk, income and economic structure, economic growth and prospects, fiscal flexibility, general government debt burden, off-shore and contingent liabilities, monetary flexibility, external liquidity, public-sector external debt burden and private sector external debt burden” (Afonso et al. 2007: 9). Here also, the dominance of the economy-related factors is interesting to observe. On the other hand, Kunczik (2001: 25) laid out the significance of the political criteria by detailing its components.

A parallel argument was made by Sinclair (1994: 457) referring to the rating agency Moody’s, that some countries such as Argentina, South Africa, the Philippines and Poland have defaulted on their foreign debts for some other reasons, rather than simply economic or financial ones. Among those factors, political, social and cultural concerns such as existence of radical uprisings, lack of public confidence in central authorities and inability to impose austerity were counted for a country’s liquidity problems. On the other hand, there are still arguments suggesting that the political events may not be that much effective for the sovereign rating process and indeed going beyond that, some claim, that at the end, it is purely economic indicators leading to the final credit ratings. One of the leading arguments in this line was made by UI Haque et al. (1998: 12) with a related study. At the end of their work, they claimed:

“Our significant finding is that creditworthiness appears to be determined primarily through the observation and analysis of economic events. Political events and variables do not add any additional information once economic factors have been accounted for. There could be two explanations for this. First, the raters are primarily concerned with the “ability to service debt” and hence are concerned with political events only when they affect this variable. However, coups, crises, law and order problems may not affect this ability and hence raters do not react significantly to these. Second, while country economic performance is affected by political events, it offers a more continuous barometer of the evolving economic situation. It is not surprising then, to find that the raters attach more weight to the economic variables. The few discreet events such as coups, crises and revolutions and strikes may contribute some information to the extent that they have not already been reflected in economic variables.”

Their study is interesting, because in the same article, they had declared, that according to the rating agencies themselves, political factors are significant for the final rating of a country and that sudden political events can have unanticipated effects on a country’s rating (1998: 4). In addition, UI Haque (1997: 13) stated that a country’s ratings are affected by international factors independent of the developments inside. For example, both some regional considerations and export profiles can strongly affect the ratings. Thus, ratings do not specifically focus on one of the theoretical explanations, rather incorporate both aspects. As can be observed here, there is no clear-cut consensus on the factors influencing the rating process at most. This also explains why that the rating officials very carefully try to refrain themselves from disclosing single details about the rating determination. There is no publicly available information about the exact rating procedures and this prevents the system from

being evaluated with regard to the weights of the rating criteria, either economic or political or also social. While these statements very clearly express the main rating methodology, there are certain details, where critical points are hidden.

The rating process, on which there is not enough information, takes a long time, since it is an outcome of long lasting study, data collection and calculations. "Sovereign rating, according to IMF (1999, 193), begins with meetings between the agency's staff and government officials in order to evaluate the sovereign's creditworthiness. This information is used to prepare a presentation for the rating committee. After the initial rating the agencies continue to monitor the economic developments of a sovereign. In recent years e.g. Duff & Phelps, Moody's and S&P have supplemented their ratings with watches and outlooks. The rating process includes three steps: 1. identification of risk factors; 2. prognosis of future developments and 3. determination of risk-weight. The main problem of the rating process is that the agencies don't give full information about the rating process, which is regarded as a kind of trade secret" (Kunczik 2001: 19). As mentioned above, this hidden nature of the rating process brings more questions into line. Parallel to this point, Sinclair (2001: 444) asks how the rating works, which Kunczik (2001: 27) believes to be belonging to the field of the sociology of knowledge. Bhatia (2002: 51) provides a further perspective to the issue of rating process:

"In essence, sovereign ratings are a product of a one-size-fits-all ranking process. The analysis is disaggregated into a number of categories, each of which is assessed in relation to the strengths and weaknesses of other rated sovereigns. Analytical categories cover political stability, the real economy, and the fiscal, monetary, and external sectors. The interface between the corporate and financial sectors and the sovereign balance sheet is institutionalized via a careful process of contingent liabilities estimation. The interface between market developments and sovereign vulnerabilities is institutionalized via detailed scrutiny of international liquidity factors. In an effort to protect the process from business related pressures and to preserve an element of discretion, all ratings decisions are taken by committee vote." These rating committees analyze the obtained information and finalize the rating results.

When turning to the technical aspect of the rating process, the rating committees are in charge of data collection and decision making. Since the major rating agencies have many branches in different countries in order to conduct both sovereign and corporate ratings more effectively, there is an inevitable coordination issue between the headquarters and the local branches. Whether there is a real necessity for such a coordination and consensus concerns is open to discussion, because it is mostly believed that the final ratings are determined by the authorities other than the local officials. As of the main critique towards the rating system of being under the influence of the U.S headquarters and indirectly the government policies, Sinclair (1994: 453) clarifies that there is generally no complete independence for these branches from their headquarters. "Although both agencies endeavor to hire mainly local officials in order to establish regional specialization, training and important rating committees, where rating determinations are actually made, are routed through New York. The objective in the case of both agencies is globally comparable ratings (so that an AA on a steel company in South Korea is equivalent in credit risk terms to an AA on a pulp mill in British Columbia, or a similar rating on a software company in California). New York remains the analytical core, where rating expertise is defined and reinforced." So, the headquarters are inevitably the ones who finalize the rating reports. However, the rating agency officials usually have a tendency to reject this aspect. Bruner and Abdelal (2005: 198) explain the process with specific reference to the Standard and Poor's' rating process, calling it as 'broadly representative'. Accordingly, "once a sovereign seeking a rating has entered a formal agreement with Standard & Poor's and forwarded preliminary economic and financial data, a team of two or more analysts visits the country for three to four days to meet with finance ministry and central bank representatives (including top officials), as well as a range of constituencies outside the government thought to be knowledgeable on politics and economic policy. The analysts then prepare for the rating committee a report including a suggested rating and rationale, which the committee assesses through a number of quantitative and qualitative lenses representative of 'economic risk' (the sovereign's ability to repay) and 'political risk' (the sovereign's willingness to repay). There is 'no exact formula' through which such considerations factor into the eventual rating (see Abdelal and Bruner 2005b)."

Marie Cavanaugh from Standard and Poor's explained that the governments invite the agencies and a team is sent to the country to collect economic and political data both from the government and the organizations. They talk to different economists of the country visited and then the committee consisting of specialists finalizes the rating¹. "The coordination effect of EKNs (embedded knowledge networks), as exemplified by rating agencies, is to narrow the expectations of creditors and debtors to a well-understood or transparent scope of thought, comprising a set of norms shared among all parties. Accordingly, the agencies do not merely constrain the capital markets but actually provide significant pressures on market participants themselves, contributing to their internal constitution as agents. This transformation of the merit infrastructure operating in markets is key to understanding the quasi-regulatory significance of rating agencies" (Sinclair 2001: 448).

Another significant point about the credit rating industry is about the employed staff in these agencies responsible for calculating and determining the rating scores. It is important to have information about this aspect, because most critiques are focused on the rating agencies' competencies and assume that they have certain connections with bureaucracies or large corporations which they are responsible to rate. "IMF (1999, 149) reports that in terms of educational work and background, most sovereign analysts have a master's degree, and on average they have 10-12 years of work experience in country risk analysis. This implies that with a high probability the analysts have a homogeneous view of the world" (Kunczik 2001: 27).

Such information about the rating analysts is significant also because "the judgment of the rating analysts plays an important role, both in evaluating economic and political variables (e.g., drawing conclusions about the degree of political stability) and in determining how much weight should be attached to different variables within each group of factors. Thus, a fair amount of subjective judgment goes into the final evaluation" (Ul Haque et al.: 11). While the interpretation of the collected data is left in the hands of these analysts, the possibility of a potential manipulation of these data by them is articulated very often. In a defensive manner and pointing out specifically this aspect, "S&P emphasizes that the agency operates with no government mandate and is independent of any investment banking firm, bank or similar organization" (Kunczik 2001: 16). One point should be made clear, yet, that it is inevitable for a credit rating outcome to include some subjective interpretation of the rating committee, as in many other social sciences conducted by personal determinations. "Qualitative and judgmental aspects of analysis are unavoidable even in the interpretation of quantitative indicators. Every measure of economic performance is the result of a complex interaction of economic, political, and social forces as reflected in the policy formation process within the government and in the reactions of private-sector economic actors to policy parameters. Consequently, sovereign risk analysis is an interdisciplinary activity in which the quantitative analytical skills of the analysts must be combined with sensitivity to historical, political, and cultural factors that do not easily lend themselves to quantification" (Bissoondoyal-Bheenick 2005: 279). At the end, according to Kunczik (2001: 27), "all use a qualitative approach based on quantitative indicators and qualitative factors." The credit rating staff has a different and unique language used in the rating process and specifically during the finalization meetings. This is reflected on how they use certain criteria and incorporate them so that a final analysis is obtained. Since it is a work simply done by a committee as a result of long meetings, it requires a specific framework, according to which every data and observation is properly communicated. "With certain institutions, effective communication may require voluntary compliance with distinctive rules of language, mathematics, or science" (Porter 2005: 25). Sinclair (2001: 449) similarly adds to that, that "regulation, as achieved by these quasi-regulatory mechanisms, results from coordination. Coordination, as accomplished by the agencies, consists of adjustment to the scope of thought, a narrowing in expectations among different social interests." In addition, Kunczik (2001: 41) argues, that "Ann Swidler and Jorge Ardití (1994, 313) point out, that scattered evidence suggests that those who must regularly deal with an impersonal, distant cultural world organized by abstract principles such as individualism or rationality construct knowledge differently than do those located socially and intellectually in more parochial settings."

Apart from the quality issue, a further point made related to the rating agency staff is about the quantity. "S&P has about 700 analysts and produces more than a third of the earnings of McGraw Hill. Governments of countries belonging to the category of emerging markets, e.g., have to pay between \$100,000 and \$150,000 for a rating." (Kunczik 2001: 16) At this point, however, "it is worth remembering that before the 1970s, the

¹ *Radikal* Newspaper, "Marie'nin Not Defteri", 25.01.1999

agencies' business model was radically different from what it is today. Before the 1970s, when the Securities and Exchange Commission created the NRSRO designation and various regulations began to depend on NRSRO ratings, credit rating agencies made money by charging subscription fees to investors, not ratings fees to issuers. In contrast, today roughly 90 percent of credit rating agencies' revenues are from issuer fees" (Partnoy 2006: 62). While these huge amounts are earned from the sovereign rating alone, there is the view, also held by the IMF, that more qualified and larger number of human resource should be employed by the rating agencies. Kunczik (2001: 27) expressed this, that "concerning the resources devoted to analysis it was found that 70 Sovereign ratings were done by only 12 country analysts and 5 study assistants. IMF (1999, 149) sums up: 'On average, each rating agency analysts is responsible for seven sovereigns.' IMF (1999, 150) argued that 'the number of countries followed by agency analysts is excessive in the light of the challenges associated with analyzing sovereigns.' IMF's proposal to solve this dilemma is quite naive from a social scientist's point of view. IMF recommends to increase the number of analysts (1999, 150: "The issue is that more of them are needed.")" On the other hand, the issue of payment has sometimes created ethical concerns for the scholars on credit rating field. "In the 1970s rating agencies began charging fees to those companies whose debt they rated. Tom McGuire, an executive vice-president of Moody's, argued: 'The pressure from fee-paying issuers for higher ratings must always be in delicate balance with the agencies' need to retain credibility among investors.' IMF (1999, 191f) sees the danger that 'issuers and intermediaries could be encouraged to engage in rating shopping – a process in which the issuer searches for the least expensive and/or least demanding rating. Such rating shopping can be particular dangerous when the ratings are used as a substitute for adequate disclosure requirements.'" (Kunczik 2001: 38).

There is a further dimension about the mentality of the rating process. Sinclair (1994: 457) clearly expressed that "the analysis of sovereign rating methodology presented in *Global Credit Analysis* suggests that Moody's favors what Gill has called the 'new constitutionalism' (Gill, 1993: p. 10). New constitutionalism is a doctrine and associated set of social forces which seek to place restraints on the democratic control of public and private economic organization and institutions... The new constitutionalism is intended to guarantee the freedom of entry and exit of internationally mobile capital with regard to different socio-economic spaces...The scope of these constraints in an era of substantial mobility of capital mean that political leaders will need to be perhaps as accountable to international market forces as they are to electorates (Gill, 1993: pp. 10-11)." It is related to the concern of the credit rating system in that it aims to serve for the freedom of movement of capital, goods and services.

1.3. Power of Credit Rating Agencies

One of the significant aspects of the rating agency power comes from the data they base their calculations on and the knowledge they produce at the end of the rating process. Sinclair (1994: 460) stated that "there is a transformation occurring in the knowledge structure in which economic and financial analysis takes place outside the US. Strange introduced the notion of knowledge structures (Strange, 1988: pp. 115-134). She considers that a knowledge structure 'determines what knowledge is discovered, how it is stored, and who communicates it by what means to whom and on what terms' (Strange, 1988: p. 117). The structure consists of a certain pattern of incentives and constraints on the development of forms of knowledge, determined by the dominant social forces in terms of their major interests." "Knowledge is key to understanding where the authority of EKNs [Embedded Knowledge Networks] is derived. Market actors in the new global finance are overwhelmed with data. EKNs supplement and organize readily available aggregate information through expert and local knowledge" (King and Sinclair 2003: 4). Sinclair (2001: 443) himself declared that "EKNs derive epistemic authority from the expert and local forms of knowledge they offer the market. The second form of knowledge—of "particular circumstances of time and place"—is not systematic but remains vital to the authority claims of the agencies." Soederberg (2003: 14) very clearly expressed the knowledge aspect of the CRA power.

In addition, there is a further dimension, that the rating announcements are accepted usually without being questioned. Since they are the sole source of information within the sector in which they function, usually their opinions are taken for granted, although there are increasing criticisms about their produced outcomes. "Rating agencies almost never have to justify their decisions, let alone provide compensation to others for the adverse consequences of their mistakes" (Kerwer 2001: 3). This derives from the fact, that there is no

substitute institution that can produce relevant information to the world finance, which is in great necessity for a reliable source. "There are a number of processes in which the personage of the expert, embodying neutrality, authority and skill in a wise figure, operating according to an ethical code 'beyond good and evil' has become so significant in our society. In our argument the rise of expertise is linked to a transformation in the rationalities and technologies of government. Expertise emerged as a possible solution to a problem that confronted liberal mentalities of government" (Rose and Miller 1992: 187). Bruner and Abdelal (2005: 207) add to that, that "the various roles that ' networks of knowledge based experts', sometimes called 'epistemic communities', have played in policymaking, particularly with respect to conditioning ' the manner in which problems are understood by the policymakers or are represented by those to whom they turn for advice under conditions of uncertainty' (Haas 1992, 2- 3). The 'epistemic' concept has been employed to explain 'the authority exercised by [rating] agencies and its relationship to knowledge', the point being, as Timothy Sinclair (1999) puts it, that 'they do not seek to persuade, but to make judgments'." This knowledge- based authority has another dimension that is the act of standard setting. "Whenever standards are made mandatory the legitimacy pattern should shift to the hierarchical model. However, often this is not the case, because third party enforcement is also justified by the legitimacy of expertise. In this case, the standard setter acquires power by third-party enforcement, which is not checked by corresponding accountability: "Even if standardizers bear relatively little responsibility, they may have great power. In such cases standardization may become a form of fairly strong organization, with concentrated power but diluted responsibility and little room for complaints" (Brunsson 1999: 124)" (Kerwer 2001: 7-8).

Deriving from the last point, it can be argued that their power also comes from the community to whom they serve for. Their business happens usually with the transnational financial and economic community, who in a sense are regarded as forming a transnational elite group. "In this sense, rating agencies have epistemic authority (Sinclair 2000, see also Strulik 2000). Most importantly, this epistemic authority has a political dimension. It justifies financial markets as neutral and efficient means for allocating resources, even though they in fact favor the financial elite and disfavor redistribution" (Kerwer 2001: 5). This situation attaches to them a different notion and empowers them with new capabilities, while changing the nature of their authority. "Bond rating agencies are being transformed into private makers of public policy, as rating institutions acquire power and authority within a context of a global economy of mobile financial resources. Rating agencies, like national states, are an example of what Cox has termed a 'transmission belt' in the process of globalization (Cox, 1992: p. 31)." (Sinclair 1994: 448) At a further stage, it can be claimed, that their formation of this transnational group gives them a sense of public nature. Bruner and Abdelal argued (2005: 208), that "governments - particularly the U.S. government, but also the G12 representatives meeting in Basel - have deputized the rating agencies. Public authority has not been privatized. Indeed, it is just the reverse: Private authority that emerged spontaneously, and which previously had no public counterpart, has been given public standing through laws and codes." Sinclair (1994: 453) relevantly sees the authority of the rating agencies as a hybrid form between the state and the market. In another work, Sinclair (2001: 443) stated that "EKNs exercise authority in market transactions in two senses. First, they control, by constraining thinking to a specific range of acceptable possibilities, and as a consequence shape what market actors do." However, this mentality can sometimes turn out to be prone to be abused and exceed the initial intentions, such as "that there are potentially unexpected consequences from using private rating agencies as a substitute for state-based regulation, due to the organizational incentives that shape the ratings industry. Cementing these organizational incentives into the emerging financial architecture will give rise to negative social and economic consequences" (King and Sinclair 2001: 2).

In this way, the rating agencies automatically construct their own framework and adjust the data they collect to fit within this framework, so that they can make their analyses and produce the rating scores. "Analysts live in a 'world of literary images' and get their information about a certain country mostly from the news media – even if they are specialized on certain countries. The news media on the other side publish the ratings – and so a system of self-references (in German: selbstreferentielles System) develops. The result is a perpetuation of stereotypes of certain countries. Furthermore it can be hypothesized (empirical studies still missing) that analysts/raters adhere to a common ideology – which they don't call ideology, because they even don't know that it is an ideology" (Kunczik 2001: 31). Thus, it can be argued, that the rating agencies determine their own ideology

and operate within this framework, which they believe to be encompassing the best indicators of countries' or corporations' performance. This is, in fact, the identification of what is the best for countries and corporations. As Löwenheim (2008: 256) stated, "these examinations not only reflect certain knowledge and ideas about 'good governance' but are also imbued with power, and they aim to shape and guide examined states' conduct. That is to say, it is materially powerful economic and political actors who carry out examinations of governance."

2. FINANCIAL REGULATION AND GOVERNANCE

As aforementioned, the credit rating industry belongs to the field of financial regulation and economic governance, being one of the actors of them. Thus, their literature has a tendency to see the place of the agencies within the broader framework of the governance and evaluate the agencies on this basis. The need for the rating also derived from the governance issue, as the worldwide economics has transformed into a disintermediation nature, which makes it harder to communicate between the actors. The rating agencies enable here the language. "The capital market moves from intermediation to regulation of firm and household behavior" (Porter 2005: 23).

From another perspective, the rating agencies can be considered as forming a part of the financial regime. "Although the regime concept has most often been used to refer to the rules created by states to govern their interactions, it has also been expanded to include the rules created by private-sector actors. (Porter, 1993; Cutler, Haufler, and Porter, 1999)" (Porter 2005: 27). "Institutions exist within the data gathering processes of investors which have the effect of coordinating capital allocation behavior by structuring information and subsequent decisions in particular ways. These institutions affect the thought and action of those trying to borrow funds, and can be understood as governance mechanisms; that is, as non-state means through which authority is exercised in markets and a form of policy created (Miller and Rose, 1990; Ferguson and Mansbach, 1991; Rosenau, 1992; Sinclair, 1994). In a context of dynamic economic activity, this structuring of information is giving rise to changes in the ways major features of economic and political life are arranged, with implications for the maintenance of hegemonic forces" (Sinclair 1994: 447).

In terms of the rating behavior, in line with the famous accountability problem, there is a debate over the nature of this accountability which is a very significant component of 'governance'. It is commonly argued, that the agencies' responsibility and being aware of the fact that they are usually the most important information providers makes them cautious about their calculations and thus there is no necessity for a separate audit mechanism. "According to the perspective of standard economic theory, there is no accountability gap since the agencies are adequately controlled by reputation. By contrast, critical political economy identifies the accountability problem as a major problem for analysis" (Kerwer 2001: 4) Furthermore, "the 'private' authority of the rating agencies is not so private after all. Governments have both valorized and codified their authority. Indeed, governments define the market for ratings and help to determine their influence. As John Ruggie observes, the scholarly literature has overstated the process of regulatory privatization, "obscuring the fundamental fact that in many instances of 'private governance' there has been no actual shift away from public to private sectors" (Bruner and Abdelal 2005: 193). "Global finance has a number of characteristics that make professional associations important in its governance. First, it is highly knowledge-intensive, and professional associations devote much effort to ensuring that their members are adequately trained. Second, it relies to a very important degree on trust, because of the large, intangible complex transactions involved, where the purchaser often has difficulty understanding or controlling the risks associated with the transaction.

Professional associations can function to certify their members as trustworthy. Third, as global financial markets have expanded, professionalization, accreditation, and licensing have become more important relative to alternative forms of organizing knowledge or to risk-management activities such as relying on old-boys' networks or the informal in-house knowledge that many large banks possess" (Porter 2005: 105).

3. ACTOR – NETWORK THEORY: How these Networks Create their own Power

Since these rating agencies work within a network in order to obtain the relevant data and then communicate it among themselves as a committee, the theory of actor network is relevant to study in order to understand this aspect of their work better. In addition, in the light of the actor- network theory, the criticisms can be evaluated

from a different perspective. Mainly, actor- network theory is about “the multiple and delicate networks that connect the lives of individuals, groups and organizations to the aspirations of authorities in the advanced liberal democracies of the present” (Rose and Miller 1992: 176). “The study of collective action problems and principal-agent relationships is increasingly displacing purely functional neoclassical assumptions about institutions (March and Olsen, 1984; Yarbrough and Yarbrough, 1990; Pratt and Zeckhauser, 1985; White, 1985; Ostrom, 1990; Taylor and Singleton, 1993)” (Sinclair 1994: 452). The agencies need to get the information for the sovereign ratings from the countries themselves, and thus establish regular connections specifically with the economic bureaucracies within the country rated. “Leading financial firms may work closely with their governments, especially in the USA, in aggressively pushing international rules and ideas that help these firms profitably expand their activities around the world, such as rules and ideas supporting unrestrained cross-border capital mobility and requiring debtor countries to adjust to the demands of global financial markets” (Porter 2005: 22).

CONCLUSION

Credit rating agencies serve to provide information as a basis for economic and financial decisions of major investors and economic actors. The initial concern of this study was an evaluation of the rating agencies in light of their announcements and how these announcements affect countries’ economies. This idea had emerged out of the concerns of the critiques held so far within the literature.

Credit rating agencies have a tendency to not make full declarations of the reasons underlying the rating changes. It is usually kept within the agencies which factors are more important in determining certain rating changes, but this further complicates an assessment of what elements of the economy would be affected the most by the rating announcements. Relevant to this problem, a further difficulty can be encountered when analyzing the political events in Turkey corresponding to the rating changes. Since the rating agencies do not make further explanations about the political issues and cannot give numerical measurements to the certain political aspects other than simply calling ‘political instability’ in general when necessary. Only an evaluation can be made based on the general ideology of the sovereign rating system, that any political uprisings or problematic elections, including the early ones, are considered as an impediment towards the country’s political and relevant economic stability.

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