Concept Note

# Reform of the International Debt Architecture: A Developing Country Perspective of Credit Rating Agencies and Financing for Sustainable Development

FfD4 Side Event Co-Organized by IDEAs and South Centre

2 July 2025, 12:30 – 14:00, Room Side Event 17,
FIBES Sevilla Exhibition & Conference Centre, Seville, Spain

## Background

Global public debt is at the historical high in its record since WWII. Currently, about 60 percent of low-income countries are facing the challenge of debt distress or are at high risk of debt distress. In an environment of slow global economic growth, which remains below its pre-COVID trend, relatively high real interest rates, trade fragmentation and heightened global uncertainties, the concern about sovereign debt vulnerabilities is real and acute for some global South countries. High debt servicing costs haves increased vulnerability to external shocks and diverted an increasing amount of public resources from health, education, and climate action.

The international debt architecture is generally considered outdated and ineffective, plagued with many gaps and deficiencies in the stages that stretch from debt creation to the extreme endpoint of debt crisis resolution. In that process, developing countries face unique challenges in accessing and utilising affordable and high-quality finance at equitable cost for sustainable development or addressing their unsustainable debt burdens.

This side event attempts to address an important building block of the international debt architecture, namely the role and function of credit rating agencies (CRAs) which has drawn particular attention and criticism from developing and least developed countries in recent years for acting as barriers to accessing development finance at a fair price.

## Credit Rating Agencies

Countries need to borrow money for long term investment and also for bridging some financing gaps. While developing countries used to rely more on multilateral and bilateral sources which offer some lending at concessional terms, the trend in the past two decades and more has been a shift to borrowing from the international capital market by both emerging and frontier economies. With borrowing from the private sector becoming more frequent and larger in quantity, a fundamental change in the composition of developing country debt has occurred with private sector debt accounting for a significantly larger share in the developing country debt portfolio.

However, ratings from major credit rating agencies largely continue to determine the access to and costs of borrowing from international capital markets by sovereigns and financial institutions alike. Credit rating scores can also trigger market reactions including capital flow volatility and interest rate adjustments, especially in cases of downgrades when a country is experiencing the "cliff effect". Many studies have shown that CRAs have biases against developing countries. With an increasing number of emerging and developing economies obtaining access to capital markets, credit rating is also like a 'Sword of Damocles' which hinders countries in debt distress to resort to debt crisis resolution arrangements, including the G20 Common Framework and debt restructuring for non-low-income developing countries. It could also discourage resort to time-bound debt relief measures during crises, like the DSSI during the COVID-19 pandemic. Overall, the current credit rating system, its modality of rating and the structure of the market have adverse effects on the ability of developing countries to borrow and invest in sustainable development, and undertake effective debt crisis resolution.

Reform of the CRAs is challenging owing to many reasons. The current credit rating market is monopolized by the three big, private, for-profit agencies which control about 95 percent of the market which has few new entrants and almost no room for competition. The CRAs' failures during the East Asian financial crisis and the 2008-09 Global Financial Crisis have not reduced their oligopolistic structure and control of the market. On top of it, the rating market is far from well-regulated, even though there are ongoing efforts at strengthening the regulation of CRAs, with some incremental improvements. The CRAs are answerable to national regulators, while being guided by the international norms and standards, like those from the Bank of International Settlements (BIS), the International Organization of Securities Commissions and other regulatory bodies. In view of this situation, the United Nations and the IMF have called for "well-crafted" regulations including cross-jurisdictional regulations.

The business model of CRAs, in particular the "issuer-pays" model which gives rise to inherent conflicts of interest, is problematic. The United States had experimented with legal reforms attempting to change that model, but only with partial success owing to resistance from the CRAs. Nevertheless, the most influential CRAs are only subject to U.S. national laws which makes it difficult for international efforts to have any influence.

The role of CRAs is to reduce information asymmetry for investors and borrowers. However, the criteria and methodologies for ratings do not seem to support the assumption that ratings can transmit accurate and objective information and assessments. Rating variables rely on both quantitative data and qualitative assessments. Qualitative variables are prone to subjective interpretation of the economic situation. Sovereign ratings in particular, would be affected by sentiment, perception and ideology. Therefore, lack of full grasp of the economic situation, incomplete data, weak analytical skills and the presence of negative or over-positive sentiments can lead to suboptimal ratings, not warranted by real world conditions. Moreover, ratings do not take into due consideration of long-term factors like climate change and demographic trends, introducing short-termism in the rating exercise. During the COVID-19 pandemic, while EMDEs had less economic contraction than advanced economies, they accounted for a 95 percent share of the world's credit downgrades.

The failures of CRAs during the East Asian Financial Crisis and the Global Financial Crisis as well as during the COVID-19 pandemic have demonstrated clearly the pro-cyclical nature of their ratings. CRAs issue “excessive” downgrades during crises and economic downturns, exacerbating crises. While the economies are experiencing bubbles, the CRAs issue good ratings without recognising the possibility that those bubbles can burst. When market stress appears in developing countries, CRAs hand out downgrades, which leads to reduced investor confidence and higher cost of capital, as well as spillover to other emerging markets; the higher debt servicing cost increases the risk of a potential default and further worsens market distress. The procyclical behaviour of CRAs, coupled with their biases against developing countries, have made these countries go through a vicious cycle of successive downgrades.

Despite the failures and structural problems of the CRAs, many investors take credit ratings as a key benchmark for making their decisions on investing in emerging and frontier economies. The criticism against mechanical overreliance on ratings has been there for many years. The lack of competition and absence of strong alternative views in the market have made reducing this overreliance difficult to avoid.

Nevertheless, efforts to reform the CRAs have shown some preliminary results. The international pressure for including long term factors in rating methodologies and models have made CRAs include climate change policies as a variable. As the creation of new private, national, regional or international publicly owned CRAs could encourage competition in the rating market and minimize the conflict of interest, there have been efforts to launch new CRAs. For instance, the African Union and UNECA have supported the establishment of the African Credit Rating Agency (AfCRA) with the objective of providing more objective and transparent ratings and support the development of domestic financial markets. The AfCRA was launched on the sidelines of the 38th Assembly of the African Union on 14 February 2025.

Despite incremental progress, the reform of the credit rating agencies has proved to be difficult to implement owing to the oligopolistic nature of the market. In addition, it takes time and financial capability to for new CRAs to establish networks, develop technical skills and prove credibility.

**Objective**

This panel discussion is being held on the sidelines of the 4th International Conference on Financing for Development (FfD4) to leverage the global focus towards reforming international financial systems and addressing inequities in financing for development for addressing the urgent needs and priorities of developing and least developed countries. In this context, it is important to discuss reforming of the international debt architecture, in particular the role and impact of CRAs and the broader development financing landscape for generating equitable outcomes for global South nations.

**Questions to be discussed**

1. How are the practices of credit rating agencies impacting on market access and financing costs for developing countries?

2. Can public regional or national credit rating agencies be an option for more accurate and objective rating, offering an alternative to countries, especially those without a rating?
3. How can mechanistic reliance on ratings be reduced and consistent regulatory regimes be implemented for rating agencies?
4. What can be done to reduce the fear of credit rating downgrades among developing countries and allow timely debt restructuring?

**Agenda**

- Introductory Remarks: Welcoming the participants and introducing the panel;
- Opening Remarks: Context-setting by facilitator;
- Panel Discussion: Insights from experts in international development finance, representatives of developing countries, and civil society organisations;
- Q&A Session: Engagement with the audience to foster dialogue and knowledge sharing;
- Concluding Remarks: Summarisation of key takeaways and a call to action.

**Target Audience**

Policymakers and government officials from developing countries, representatives of international organisations, academics, researchers, and civil society organisations, especially from the global South.

**Date and Venue**

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