A Global Trust Index for Sovereign & Sub-Sovereign Assessments

Introduction

- Governing institutions of a country, region, or municipality express their effectiveness through the quality of public services they deliver.
- Credit ratings agencies can use government service quality is a proxy indicator for institutional credibility and trustworthiness.
- Digital public service platforms support the generation of voluminous data on service quality, enabling increasingly real-time monitoring of institutional performance
- A benchmarking indicator that standardizes the measurement of government service quality could be designed for use as an input in sovereign and sub-sovereign credit assessments.
- This global trust index would summarize quality and performance metrics across public-service portfolios of debt-issuing governments.

Current Assessment Frameworks

All three agencies assign sovereign ratings based on similar sets of factors, making extensive use of primary data from established international sources, supplemented using secondary data sources, which provide indicative metrics for qualitative institutional characteristics. All agencies have distinct methodologies for sub-sovereigns in the United States and internationally.

Moody's

Economic Strength

GDP statistics for scale, income level, growth and volatility

Institutions & Governance Strength

Quality of legislative and executive institutions, strength of civil society, fiscal and monetary policy

Fiscal Health

Debt burden and affordability metrics

Susceptibility to Event Risk

Political, liquidity, banking sector, and external vulnerability risks

Standard & Poor's

Institutional & Economic Profile

- ***Institutional Assessment:*** capacity to deliver sustainable public finances and balanced growth, and to respond effectively to economic and political shocks.
- ***Economic Assessment:*** income levels, economic growth prospects, and economic diversity and volatility

Flexibility & Performance Profile

- ***External Assessment:*** external position and liquidity with the rest of the world
- ***Fiscal Assessment:*** sustainability of a sovereign's fiscal policy
- ***Monetary Assessment:*** evaluation of monetary policy credibility, the exchange-rate regime diversification of financial system and capital markets.

Fitch

Structural Features

Composite governance indicator

Macroeconomic Performance

GDP and CPI statistics

Public Finances

Budget and interest metrics

External Finances

Net international position, reserves, commodity dependnece

Institutional Quality in Sovereign Ratings

Moody's

Institutions & Governance Strength represents 20-30% of initial sovereign assessment, with influence extended through Political Risk component.

- Legislative & Executive Institutions (35%)
- Civil Society & Judiciary Strength (20%)
- Fiscal Policy Effectiveness (30%)
- Monetary Policy Effectiveness (30%)
- Plus Political Risk within Event Risk assessment

Primarily based on World Bank Worldwide Governance Indicators (WGI): *Regulatory Quality*, *Government Effectiveness*, *Voice & Accountability*, *Rule of Law*, and *Control of Corruption*

S&P's

Institutional Assessment effectively represents around 25% of preliminary rating calculation. While specific external indicators aren't prescribed, World Bank WGIs are likely referenced.

- Policy effectiveness and predictability
- Transparency and accountability
- Debt payment culture
- Security risks assessment

Specific indicators not publicly disclosed but documentation suggests similar sources to other agencies

Fitch's

Composite Governance Indicator (an average of four WGIs) is the single most significant feature in the Sovereign Rating Model at 22% of overall explanatory power before Qualitative Overlays.

Single composite score incorporating:

- Governance quality
- Rule of law
- Political stability
- Corruption control

Limitations of Current Approaches

- Credit ratings of sovereigns are principally based on official economic and financial indicators.
- Agencies recognize that these objective indicators cannot capture the full range of factors affecting creditworthiness.
- The quality of institutions and governance is highly relevant, with stable systems for law-making, reliable data, judicial integrity, and professional public administrations being key indicators of credible borrowers.

National-Level Focus

The World Bank Worldwide Governance Indicators are national levels indicators, providing limited granular insight into regional and local institutional variations that impact sub-sovereign creditworthiness.

This constraint partly explains why institutional factors receive lower explicit weightings in sub-sovereign methodologies.

Service Reduction Bias

Current approaches emphasize governmental flexibility to reduce expenditures during fiscal stress, treating service-cutting capacity as a positive institutional attribute.

This perspective may misunderstand the relationship between service quality and economic sustainability, as aggressive service reductions can accelerate economic decline.

Perception vs. Outcomes

Existing (WGI) indicators rely heavily on perception-based surveys rather than observable outcomes.

This creates potential for bias and makes it difficult to track improvements in institutional quality in real-time, especially at the sub-national level.

Observable Measures of Institutional Quality

A reliable measure of government service quality—incorporating both service delivery effectiveness and user trust—could potentially provide a more accurate proxy for institutional quality than current methodologies allow, capturing institutional effectiveness through observable outcomes rather than external perceptions.

Service Quality Metrics

Measure ease and transparency of administrative procedures, reliability of utilities and digital infrastructure, outcome-oriented social services, and public-finance interfaces.

Statistical Validation

Test the link between service quality and credit outcomes through panel data analysis, controlling for macro fundamentals and income effects.

Ratings Framework Integration

Embed the index in existing frameworks, such as Moody's "Institutions & Governance Strength" factor or as an early-warning overlay for political risk.

Expected Benefits

More timely updates than governance surveys, greater granularity for pinpointing institutional weaknesses, and reduced perception bias through hard service metrics.

- An index of government service quality can serve as a direct, observable proxy for institutional credibility, competence, and predictability.
- Studies confirm that observable service-delivery performance shows up in credit ratings, CDS spreads, and bond pricing.
- Countries in the top quartile of Government Effectiveness pay significantly lower interest rates than peers with similar debt ratios but weaker public-service delivery.