Trustworthy Digital Society Hub

UNSW

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**A Global Trust Index for Sovereign & Sub-Sovereign Assessments**

# Introduction

The governing institutions of a country, region, or municipality express their effectiveness through the quality of the public services that they deliver. Institutions translate policy into practice through planning, funding, implementing, and maintaining service operations that fulfil complex social and economic needs. Standards of public services enjoyed by different populations reflect the competence, reliability, adaptability, innovation, and accountability of their governments. The capacity of these governments to deliver necessary services to individuals – both on a general basisand during critical life events – forms a basis for their popular legitimacy. Credit ratings agencies, assessing sovereign and sub-sovereign borrowers, can reasonably consider the quality of government services as an indicator of institutional trustworthiness.

Digital transformation enables increasingly real-time monitoring of institutional performance, through platforms supporting the generation of voluminous data on public service quality: objective metrics for processes and outcomes, and subjective metrics for user experience and trust. Measures of public service quality can proxy as indicators for institutional credibility for governments at national, regional, and local levels. A *global trust index* that tracks and benchmarks the standards of service quality provided by governments could serve as a meaningful input in sovereign and sub-sovereign credit assessments. This index should summarise information across numerous dimensions of service quality, including the maturity of digital systems underlying service provision.[[1]](#footnote-1)

This note will describe the assessment methodologies of the three major credit ratings agencies – Moody’s, Standard & Poor’s, and Fitch – before considering the role that a global trust index could play in supporting credit assessments in the digital age.

# Assessment Frameworks

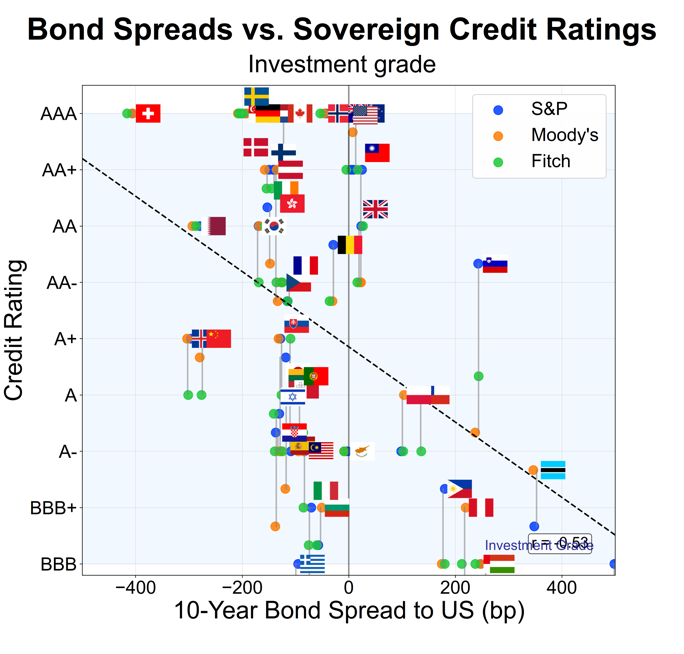
Three major credit ratings account for about 95% of credit ratings industry market share. These agencies categorise long-term debt instruments into *investment* (higher-price, lower-yield) and *speculative* (lower-price, higher-yield) grades (**Table 1**). Major agency ratings significantly affect governments’ financing costs, with prices of bonds and credit default swaps highly sensitive to the potential of major agency upgrades or downgrades. In addition to assigning a rating to government debt-instruments, agencies can also assign a positive or negative *outlook* in their assessments – indicating the direction of an expected future rating change. **Figures 1 and 2** show sovereign ratings currently assigned by the three major agencies and their negative correlation to ten-year sovereign yield spreads. Agency ratings grades have here been converted into to a common scale, with fractional adjustments for *positive* and *negative* outlooks.

***Table 1.*** *Ratings Agency Grades*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Grade | Description | S&P / Fitch | Moody’s | Countries (Averages) |
| Investment | *Prime* | AAA | Aaa | 🇨🇭 🇸🇬 🇳🇴 🇳🇱 🇩🇪 🇦🇺 🇸🇪 🇩🇰 🇨🇦 |
| *High Medium Grade* | AA+ | Aa1 | 🇳🇿 🇺🇸 🇫🇮 🇦🇹 |
| AA | Aa2 | 🇶🇦 🇹🇼 🇮🇪 🇰🇷 🇭🇰 |
| AA- | Aa3 | 🇬🇧 🇧🇪 🇨🇿 🇫🇷 |
| *Upper Medium Grade* | A+ | A1 | 🇮🇸 🇸🇮 🇯🇵 🇨🇳 |
| A | A2 | 🇱🇹 🇲🇹 🇨🇱 🇵🇹 🇸🇰 |
| A- | A3 | 🇵🇱 🇪🇸 🇭🇷 🇨🇾 🇮🇱 🇲🇾 |
| *Lower Medium Grade* | BBB+ | Baa1 | 🇧🇼 🇧🇬 |
| BBB | Baa2 | 🇵🇭 🇮🇹 🇮🇩 🇵🇪 🇰🇿 🇲🇽 |
| BBB- | Baa3 | 🇭🇺 🇬🇷 🇮🇳 🇲🇺 🇷🇴 |
| Speculative | *Speculative* | BB+ | Ba1 | 🇨🇴 🇷🇸 🇲🇦 🇻🇳 |
| BB | Ba2 | 🇧🇷 |
| BB- | Ba3 | 🇿🇦 🇯🇴 🇳🇦 🇹🇷 |
| *Highly Speculative* | B+ | B1 | 🇧🇩 |
| B | B2 | 🇧🇭 |
| B- | B3 | 🇺🇬 🇳🇬 🇪🇬 🇰🇪 |
| *Substantial Risk* | CCC+ | Caa1 | 🇵🇰 |
| CCC | Caa2 |  |
| CCC- | Caa3 | 🇱🇰 |
| *Extremely Speculative* | CC | Ca |  |
| C | 🇿🇲 🇺🇦 |
| *In Default* | D | C |  |
| No Rating |  |  |  | 🇷🇺 |

***Figure 1. Figure 2.***

A graph of different countries/regions

Description automatically generated 

Exact methods used by Moody’s, Standard & Poor’s, and Fitch to determine credit ratings are proprietary and subject to regular change, but varying levels of detail on assessment frameworks have been made public. All three agencies assign ratings according to frameworks that evaluate similar factors. Agencies make extensive use of primary data from established international sources including the International Monetary Fund (IMF), the World Bank, national statistics offices, and central banks.

## Moody’s

Moody's sovereign ratings are the outcome of a committee process that applies qualitative judgement to a quantitative scorecard. The scorecard is based on four factors:

1. **Economic Strength.** Assesses the inherent strength and resilience of the sovereign's economy using Gross Domestic Product (GDP) statistics for *Economic Scale (35%), Income Level (25%), Growth (30%)* and *Volatility (10%).*[[2]](#footnote-2)
2. **Institutions & Governance Strength.** Assesses more qualitative properties of sovereigns:

* the quality of legislative and executive institutions *(20%)*
* the strength of civil society and the judiciary *(20%)*
* the effectiveness of fiscal policy *(30%)*
* the effectiveness of monetary and macroeconomic policy *(30%)*.

Although qualitative, **Institutions & Governance Strength** assessments are based on quantitative external indicators, primarily the **World Bank Worldwide Governance Indicators (WGI).** The WGI include indicators for *Regulatory Quality*, *Government Effectiveness*, *Voice & Accountability, Rule of Law,* and *Control of Corruption*. The World Economic Forum (WEF) Global Competitiveness Index (CGI) has also been referenced for components relating to market efficiency, infrastructure, innovation, and education, and the IMF referenced for information on data adequacy for surveillance and assessments. World Bank Country Policy and Institutional Assessments (CIPA) have also been referenced, along with other independent external sources. Assessments of **Institutions & Governance Strength** are adjusted according to government default history and track record of arrears.

1. **Fiscal Health.** Assesses the sustainability of government finances using g*overnment debt burden (50%)* – the average of debt-to-GDP and debt-to-revenue ratios – and g*overnment debt affordability (50%)* – the average of interest-payments-to-GDP and interest-payments-to-revenue ratios. Adjustments to this factor are made according to expected changes in debt burden, the share of foreign-currency-denominated debt, and the value of public assets (including sovereign wealth funds).
2. **Susceptibility to Event Risk.** Assesses vulnerability to sudden, disruptive events, using four sub-factors:

* ***Political Risk:*** domestic political and geopolitical instability. Assessment refers to World Bank WGIs, along with socioeconomic indicators for unemployment and inequality.
* ***Government Liquidity Risk:***failure of government cash flow.
* ***Banking Sector Risk:***failure of national banking or payments systems.
* ***External Vulnerability Risk:***risks originating from current account position and its financing structure, sustainability of external liabilities and access to hard currency. Risks from environmental factors also included.

Moody’s combines the **Economic Strength** and **Institutions & Governance Strength** factors with equal weights to produce an **Economic Resiliency** score, which is combined with the **Fiscal Health** factor to produce the **Government Financial Strength** assessment. Dynamic weights are used to make **Economic Resiliency** more important for wealthier sovereigns, and **Fiscal Health** more important for less wealthy sovereigns (**Figure 3** shows weights typical for the wealthiest sovereigns).

The **Government Financial Strength** assessment can then be adjusted (*downward only*) according to the **Susceptibility to Event Risk** assessment, which uses a **minimum function** for aggregation letting the weakest of its sub-factors determine its overall score. The final ratings decision is determined by the qualitative judgement of a **ratings committee**, which may consider various factors idiosyncratic to the sovereign.

***Figure 3.***

**Moody’s Sovereign Assessment Framework**

**Susceptibility to Event Risk**

Negative adjustment

(-2 to 0)

***worst of:***

**- political risk**

**- liquidity risk**

**- banking risk**

**- external vulnerability risk**

**Fiscal Health**

**- interest / revenue**

**- interest / gdp**

**- debt / revenue**

**- debt / gdp**

**Government Financial Strength**

*Dynamic weights ranging from* ***25:75*** *to*

***50:50*** *for* ***Fiscal Health : Economic Resiliency***

**Economic Resiliency**

**Institutions & Governance Strength**

**- legislative & executive institutions**

**- civil society & judiciary**

**- fiscal policy effectiveness**

**- monetary & macroeconomic policy effectiveness**

**Economic Strength**

**- scale**

**- income level**

**- growth rate**

**- volatility**

**Ratings Committee**

Qualitative Judgement

Sovereign

Rating

Moody's methodologies for Sub-Sovereign or Regional and Local Government (RLG) ratings are different inside and outside the United States.[[3]](#footnote-3) For RLGs outside the United States, Moody’s begins with a **Baseline Credit Assessment** of the Sub-Sovereign’s intrinsic (standalone) credit strength, based on four **Weighted Factors**:

1. **Economy (25%):** *Regional Income* (15%, regional per capita GDP PPP), *Economic Growth* (5%), and *Economic Diversification* (5%, concentration vs diversification of local / regional economic activity across economic sectors).
2. **Institutional Framework and Governance (30%):**
   * *Institutional Framework (15%):* the extent to which the prevailing framework for government powers and responsibilities is mature, robust, stable, and clearly defined in law; the process to change the framework is transparent and deliberate; and the framework provides for strong revenue-generating and expenditure flexibility.
   * *Governance (15%):* the strength and transparency of fiscal planning and budget management.
3. **Financial Performance (20%):** *Operating margin* (10%), *liquidity ratio (5%), ease of access to funding (5%).*
4. **Leverage (25%):** *Debt burden* (15%) and *interest burden* (10%) as ratios to operating revenue.

The preliminary **Baseline Credit Assessment** is then adjusted according to:

* three **Idiosyncratic Notching Factors:** *Significant Pressures from Material Pension Obligations or Contingent Liabilities* (-2 to 0); *Ample Liquidity that Minimizes Borrowing Needs* (0 to +1) and *Expected Trend in Fiscal Performance* (-2 to +2); and
* a **Macro Operating Assessment**: a factor for the influence of the Sovereign Rating on the Sub-sovereign; and an *Operating Environment* factor that considers the macroeconomic environment, the institutional framework, and the extent of ordinary support from higher tiers of government.

The resulting **Baseline Credit Assessment** is evaluated together with an assessment of **Extraordinary Support** – the willingness and ability of a higher-tier government to support an RLG in financial stress (beyond its ordinary support).[[4]](#footnote-4) Other considerations – including environmental, social, governance, liquidity, financial control, and event risk factors – may also be weighed in the final ratings decision (**Figure 4**).

**Idiosyncratic Notching Factors**

Pension Obligations and Contingent Liabiliies

***Figure 4.***

**Risk** **Matrix**

**Moody’s Sub-Sovereign Assessment Framework**

**Systemic Risk**

**Baseline Credit Assessment**

**Weighted Factors**

**Systemic Risk**

**Ratings Committee**

**Extraordinary Support**

***Expected Emergency Support from Higher Level of Government***

**Sub-Sovereign Rating**

Sovereign Rating

Within the United States, a different framework is used for RLGs.[[5]](#footnote-5) Unlike for sovereign assessments, Moody’s does not report on the use of external indicators for sub-sovereign assessments.

## Standard & Poor’s (S&P’s)

S&P’s sovereign assessment methodology is based on scores assigned for five “pillars”.

1. **Institutional Assessment:** capacity to deliver sustainable public finances and balanced economic growth, and to respond effectively to economic and political shocks.
2. **Economic Assessment:** income levels (GDP per capita at PPP), economic growth prospects, and economic diversity and volatility (based on sectoral composition of production and exports).
3. **External Assessment:** external position and liquidity with the rest of the world; status of sovereign’s currency in international transactions
4. **Fiscal Assessment:** sustainability of a sovereign's fiscal policy, with components *Fiscal Performance and Flexibility* (trends and vulnerabilities) and *Debt Burden* (structure of debt, funding access and contingent liabilities)
5. **Monetary Assessment:** evaluates monetary policy credibility, diversification of financial system and capital markets, and the exchange rate regime and its impact on policy coordination.

Scores for *Institutional* and *Economic* Assessments are averaged to derive an **Institutional and Economic Profile**, with *External*, *Fiscal*, and *Monetary* Assessment averaged to derive a **Flexibility and Performance Profile**. Those profiles are combined using a **risk matrix** to determine an i*ndicative rating level*, which may then be modified according to *supplemental adjustment factors* (such as liquidity positions or significant event risk) to determine the final rating. [[6]](#footnote-6) Unlike Moody’s, S&P does not report on the use of specific external indicators used for sovereign assessments, although their explanatory documentation implies that similar sources are likely to be referenced.

Like Moody’s, S&P has different methodologies for Sub-Sovereign assessments inside and outside the United States. Outside the United States, components of LRG assessments include:

1. **Institutional Framework Assessment:** a composite of three sub-factors:
   1. ***Predictability (25%):***stability and predictability of institutional framework; frequency and impact of changes in laws, regulations, and intergovernmental fiscal arrangements.
   2. ***Revenue and Expenditure Balance (50%):***adequacy of revenue sources to cover mandated services, flexibility to adjust revenues and expenditures and overall fiscal discipline.
   3. ***Transparency and Accountability (25%):***quality of financial statements, level of disclosure, effectiveness of oversight mechanisms.
2. **Individual Credit Profile Assessment:** a composite of five equally-weighted factors: *Economy* (socioeconomic profile, economic diversification and growth prospects); *Financial Management* (managerial quality and political impact on willingness and ability to service debt); *Budgetary Performance* (level and volatility of cash flows for debt service); *Liquidity* (adequacy of internal and external liquidity sources relative to servicing needs); *Debt burden* (debt and interest relative to consolidated operating revenues).

*Institutional Framework Assessment* and *Individual Credit Profile Assessment* are combined using a risk matrix to create an *Anchor rating*, which is then subject to various judgement-based supplemental adjustment factors to arrive at the final credit rating.[[7]](#footnote-7)

## Fitch

Fitch’s framework involves a quantitative Sovereign Rating Model (SRM) incorporating four categories of features. There are not predetermined weights for the four categories, but refined by a Qualitative Overlay (QO). The SRM feature categories are:

1. **Structural Features:** the economy’s institutional and political environment, governance standards, and overall structural characteristics, incorporating “governance indicators” sourced from the World Bank WGI.
2. **Macroeconomic Performance, Policies and Prospects:** the sovereign’s economic performance and the credibility and flexibility of its macroeconomic policies; indicators such as GDP growth and Consumer Price Inflation.
3. **Public Finances:** the financing flexibility and sustainability of the sovereign’s fiscal position; factors include gross general government debt to GDP, fiscal balance to GDP, interest to revenue, foreign currency debt as a proportion of total debt.
4. **External Finances:** the sovereign’s external positions, including net foreign assets, foreign exchange reserves, external interest service burden, and commodity dependence.

Fitch’s SRM is computed on the basis of its component features to generate a Predicted Rating, which is then refined by a Qualitative Overlay (QO), which allows adjustments to be made on the basis of

# Incorporating a Global Trust Index in Credit Assessments

Largely based on official statistics

fff

Sovereign credit rating methodologies are largely based on official statistics: GDP (nominal and per capita, growth, and volatility) similar weightingst to … . These statistics compute component element of assessment methodologies capturing economic and budgetary performance.

However a large part of credit assessments is applying qualitiative judgements to .

Considerations include transparency and accountability of data, processes, and institutions; sovereign’s debt repayment culture; and potential security risks.

These include indicators for *Regulatory Quality*, *Government Effectiveness*, *Voice & Accountability, Rule of Law,* and *Control of Corruption*.

**Quality of Legislative and Executive Institutions**

Policy is legistlated and implemented with the support of a highly professional, well-staffed and highly capable public admisnitration with exceptionally deep bench strength

These institutison have demonstrated the fexibiltiy to deal with changing circumstances and can absibr shocks while maintaining financial and economic stability.

Law making occurs under a well developed constitutional framework that is transparent and predictable.

Data sets are timely, stabkle, comprehensive, and are provided for all levels of government (central, regional, local, and social security).

Political independent government bodies, such as fiscal councils, have a strong voice in the policymaking process

The enforcement of laws is highly predictable and consistent, including as they apply to the government itself

An effective balance of power and separation of powers is consistnely and dependently maintained between rnacnhes of government and judicial independence is maintained nad respected

There are few instances of corruption that act to the detriment of the sovereigns credit profile

Judicial proceeses are imparticla, contracts are encorced, and legal cass are resolved in atimely manner

Instiutions in civil society consistenly act as an effective check on the ecercise of vovernmetn power

*Fiscal and Monetary POliocy effectiveness*

Domestic Political and Geopolitical Risk

Unemployment is typically low and distribution of wealth and incomes is relatively unifmr with ittle or not adverse impact on policy outcomes

There are no significant sources of social conflict that pose a material risk to economic or political outcomes

General consensuis on credit-positive policy outcomes that endure through changes in government

Key aspects include the transparency and accountability of data, processes, and institutions, the sovereign\_s debt repayment culture, and potential security risks (both external and domestic).

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | aaa | aa | a | baa | ba | b | caa | ca |
| Quality of legislative & executive institutions : WGI scores for regulatory quality & government effectiveness (35%) | 1.5 | 1.5-1.0 | 0.5-1.0 | 0-0.5 | -0.5-0.0 | -0.5-  -1 | -1-1-.5 | -1.5 |
| Civil‑society & judiciary strength : WGI Rule of Law, Control of Corruption, Voice & Accountability (20%) | 1.5 | 1.5-1.0 | 0.5-1.0 | 0-0.5 | -0.5-0.0 | -0.5-  -1 | -1-1-.5 | -1.5 |
| Domestic Political and Geopolitical Risk : WGI for coive and accountability, political stability | 1.5 | 1.5-1.0 | 0.5-1.0 | 0-0.5 | -0.5-0.0 | -0.5-  -1 | -1-1-.5 | -1.5 |
|  |  |  |  |  |  |  |  |  |

Institutional strength is both a stand‑alone pillar and the glue that holds the rest of the model together. In Moody’s calibration a highly effective legislature, credible policy making and an independent judiciary are worth as much, numerically, as long‑run GDP growth. Strong institutions also dampen debt dynamics (by containing fiscal slippage) and make sudden crises less likely (by boosting policy predictability and social cohesion). Conversely, when trust in institutions erodes, the scorecard simultaneously penalises Economic Resiliency, raises the weight on Fiscal Strength (because high‑trust economies tend to be richer and therefore shoulder less fiscal weight in the dynamic algorithm), and widens the scope for Event‑Risk notches. In practice, therefore, institutional resilience can be the single biggest differentiator between two countries that look similar on raw macro‑fiscal numbers.

Taken together, the disclosed metric weights give outside observers a transparent map of Moody’s quantitative starting point. What ultimately matters, however, is how those numbers interact with qualitative judgments about a government’s willingness and capacity to keep its promises—an idea that, in Moody’s own words, “is inseparable from the quality of institutions that sustain the trust of citizens, investors and the international community.”

Studocu

About the Worldwide Governance Indicators

Moody’s accounts for about 40% market share…

# The World Bank Governance Indicators (WGI) are comprehensive measures used to assess various dimensions of governance quality across countries, directly informing sovereign credit rating methodologies. The WGI consists of six critical aspects:

# Rule of Law: Measures confidence in the legal framework, enforcement quality, judicial impartiality, and contract enforcement. Strong rule of law ensures judicial processes are impartial, laws consistently enforced, and legal disputes resolved efficiently, which is crucial for sovereign creditworthiness.

# Control of Corruption: Evaluates the extent to which public power is exercised transparently, limiting corruption's detrimental impact. Lower corruption levels indicate stronger governance structures and reduced financial and policy risk.

# Government Effectiveness: Reflects the quality of public services, civil service capacity, policy formulation, and implementation efficacy. High scores demonstrate a professional and competent public administration capable of maintaining stability and absorbing economic shocks.

# Political Stability and Absence of Violence/Terrorism: Assesses perceptions of government stability, likelihood of political unrest, and violence impacting governance continuity. Stable political environments underpin consistent policy outcomes and predictable governance, significantly benefiting sovereign credit assessments.

# Voice and Accountability: Represents the degree to which citizens can participate in governance, exercise freedom of expression, and hold governments accountable. Robust accountability mechanisms strengthen institutional resilience and policy predictability.

# Regulatory Quality: Examines the government's capacity to establish and implement sound policies and regulations promoting private-sector development. Effective regulatory frameworks foster economic resilience and investment attractiveness, positively influencing sovereign ratings.

# These WGI dimensions form a substantial foundation for sovereign credit rating assessments, as agencies like Moody’s emphasize qualitative judgments alongside traditional economic metrics. While official statistics such as GDP metrics (nominal, per capita, growth, volatility) carry significant weight, qualitative evaluations of institutional quality are pivotal.

# Institutional quality considerations in sovereign credit ratings particularly focus on:

# Legislative and executive strength: Transparent law-making within stable constitutional frameworks and proficient public administration are essential. Sovereigns with professional institutions adept at responding flexibly to economic shocks score highly.

# Civil society and judiciary effectiveness: Independent judiciary systems, consistent law enforcement, and effective civil-society oversight mitigate risks and enhance credit profiles.

# Political and geopolitical stability: Stable domestic political conditions and low geopolitical risk contribute positively, aligning closely with WGI's political stability and accountability indicators.

# Moody’s explicitly integrates these qualitative factors numerically into their rating methodology. For instance, WGI scores significantly influence ratings, with benchmarks defined explicitly for categories (AAA to C ratings):

# Legislative & Executive Institutions (35%): Ratings range from scores of 1.5 (AAA) to -1.5 (CA).

# Civil Society & Judiciary Strength (20%): Similarly weighted, reflecting the rule of law, corruption control, and accountability.

# Domestic & Geopolitical Risk: Accounts significantly through WGI’s political stability and voice/accountability metrics.

# In Moody’s calibration, strong institutional frameworks are not only independent factors but vital to overall model integrity. Effective governance institutions moderate debt risks, enhance policy predictability, and strengthen economic resilience. Conversely, institutional weaknesses can exacerbate economic risks and significantly worsen sovereign credit ratings.

# Ultimately, sovereign credit ratings blend quantitative metrics and qualitative judgments on institutional robustness, debt repayment culture, and transparency, emphasizing governance quality as a crucial determinant of a country's creditworthiness.

**Sovereign creditworthiness = institutionalised trust**

1. **What investors must trust**  
   *Credit risk is ultimately the risk that a government will* ***choose or be forced*** *to break its promises.* Rating agencies formalise two intertwined kinds of trust:
   * **Capacity trust** – confidence that the state can marshal resources (tax base, seigniorage, external liquidity).
   * **Willingness trust** – confidence that political and legal institutions will keep leaders from opportunistic default or policy lurches. S&P’s very first lines make this explicit: sovereign ratings gauge a government’s *“ability* ***and willingness*** *to service obligations”*.[S&P Global](https://www.spglobal.com/ratings/_division-assets/pdfs/021519_howweratesovereigns.pdf)
2. **How the big agencies quantify “willingness trust”**

| **Agency** | **Trust proxy inside the model** | **Where it sits in the rating mechanics** | **Why it matters** |
| --- | --- | --- | --- |
| **S&P Global** | *Institutional assessment* (rule‑of‑law, policy credibility, transparency) | One of five pillars; averaged with “Economic” pillar to form the **Institutional & Economic Profile** that sets the top half of the indicative rating matrix. A one‑score swing here typically shifts the final rating 1–2 notches.[S&P Global](https://www.spglobal.com/ratings/_division-assets/pdfs/021519_howweratesovereigns.pdf) | Directly captures how trusted the policy framework is to deliver “sustainable public finances” and respond to shocks. |
| **Moody’s** | *Institutions & Governance Strength* factor (four sub‑factors on legislative quality, judiciary, fiscal‑policy and monetary‑policy credibility) | Combined with economic data to create **Economic Resilience**; carries ≈ 25 % of the numeric scorecard weight before committee overlay.[Moody's Ratings](https://ratings.moodys.com/api/rmc-documents/395821) | Acts as both a ceiling (persistent arrears/defaults yank it down) and an early‑upgrade lever when governance reforms gain traction. |
| **Fitch** | Composite of the **World Bank Governance Indicators (WBGI)** | WBGI has the **single‑largest variable weight (20 %)** in Fitch’s Sovereign Rating Model—the heaviest of any input driving the initial SRM score.[Fitch Ratings](https://www.fitchratings.com/research/sovereigns/esg-remains-key-rating-driver-for-sovereigns-08-04-2019?utm_source=chatgpt.com) | Gives governance the decisive vote when macro numbers are similar across peers. |

 **Why trust shifts move markets—and ratings**

* Investor risk premia rise the moment the *narrative of trust* frays, even if debt ratios have not yet changed (e.g., Greek spreads in 2010, UK gilt sell‑off in 2022).
* Rating committees can act pre‑emptively: Scope has warned that sustained erosion of *trust in the US dollar’s “exceptional status”* would trigger a U.S. downgrade despite strong fiscal capacity—purely a trust (willingness) problem.[Reuters](https://www.reuters.com/markets/european-rating-agency-scope-sends-us-downgrade-warning-2025-04-15/)

 **Channels through which institutional trust translates into credit outcomes**

| **Channel** | **Trust‑rich sovereigns** | **Trust‑poor sovereigns** |
| --- | --- | --- |
| **Policy predictability** | Clear fiscal rules, independent central bank, transparent statistics. | Ad‑hoc budgets, politicised central bank, data opacity. |
| **Crisis response** | Rapid counter‑cyclical spending, credible debt‑management agency; markets accept higher temporary deficits. | Forced austerity or arrears; sudden‑stop in market access. |
| **Legal enforceability** | Strong courts and creditor rights deter unilateral restructuring. | History of selective default or retroactive legislation increases “willingness risk”. |
| **Social contract** | High domestic compliance with taxes; low default stigma if population trusts government stewardship. | Low compliance, populist backlash against external creditors. |

Credit analysts treat “institutional quality” as shorthand for the credibility, competence and predictability of a state’s policymaking apparatus. A well-constructed **Government-Service-Quality Index (GSQI)** can serve as a direct, observable proxy for those attributes and therefore slot naturally into existing ratings frameworks that already reward effective institutions. Here is how that would work in practice.

### 1 What the index would measure

A GSQI should capture the citizen’s experience of core public services that only the sovereign can deliver or regulate:

* **Ease, speed and transparency of administrative procedures** (e.g., time to register a business, obtain a passport, clear customs).
* **Reliability of critical utilities and digital infrastructure** (electricity-grid uptime, broadband coverage, cyber-resilience of public portals).
* **Outcome-oriented social services** (primary-health coverage, basic-education completion, vaccination logistics).
* **Public-finance interfaces** (online tax filing, open-budget portals, accuracy and punctuality of fiscal statistics).
* **Citizen-feedback or complaints-resolution systems** (percentage of grievances resolved within statutory deadlines).

Collected across countries on a consistent methodology, these indicators yield an annual composite score that rises when states modernise workflows, digitise back offices and embed service charters, and falls when capacity or probity deteriorates.

### 2 Why a service-quality gauge is a valid stand-in for institutional strength

Good service quality is impossible without clear rules, professional civil services, data-driven monitoring and political accountability—all of which underpin a sovereign’s willingness and ability to repay. Empirically, countries with high scores on the World Bank’s **Government Effectiveness** index or the OECD’s **Government at a Glance** metrics tend to enjoy lower bond spreads and higher credit ratings. A purpose-built GSQI refines that signal by focusing on deliverables the average citizen (and investor) can verify, thereby strengthening the behavioural link between day-to-day governance and macro-level repayment culture.

### 3 Embedding the GSQI in a ratings scorecard

| **Existing Moody’s factor** | **Where GSQI could fit** | **Practical integration step** |
| --- | --- | --- |
| **Institutions & Governance Strength** | Under the “quality of legislative & executive institutions” sub-factor | Re-scale GSQI to the same 0–100 percentile universe used for Worldwide Governance Indicators, map percentile bands to Moody’s six-point scale (“aaa” to “caa”), and weight alongside Government Effectiveness/Regulatory Quality. |
| **Susceptibility to Event Risk – political** | Early-warning overlay | A one- or two-year deterioration of ≥ 15 percentile points could trigger a committee discussion of heightened social-unrest or policy-reversal risk. |
| **Fiscal Strength – expenditure efficiency** | Qualitative notch | If GSQI shows sustained improvement at constant spending ratios, analysts could grant a +1 fiscal-management notch to reflect better value for money. |

For an investor’s proprietary model the same logic applies: regress historical GSQI levels (or changes) against subsequent bond-spread movements and default episodes, choose the coefficient that maximises out-of-sample predictive power, and translate the result into a basis-point adjustment.

### 4 Testing the link: data analytics blueprint

1. **Assemble a panel** of annual GSQI scores, sovereign credit ratings and control variables (debt-to-GDP, GDP growth, inflation, terms-of-trade shocks) for at least two decades.
2. **Run fixed-effects regressions** of rating notches (or EMBI spreads) on lagged GSQI, controlling for macro fundamentals. A materially negative coefficient on GSQI → spread indicates that better service delivery lowers perceived risk.
3. **Stress-test** by dropping high-income OECD members to ensure the relationship is not driven solely by income.
4. **Validate stability** across crises—e.g., does GSQI deterioration precede downgrades during the Arab Spring or COVID-19?
5. **Translate** the coefficient into a weight: if a 10-point GSQI gain historically tightens spreads by the same amount that a one-notch Moody’s upgrade does, then the GSQI deserves roughly a one-notch equivalence in the model.

### 5 Benefits and caveats

* **Timeliness**: Service-delivery data, especially when scraped from digital-government dashboards, update faster than multi-year governance surveys.
* **Granularity**: Because each component is observable, analysts can pinpoint which branch of the state is eroding trust.
* **Mitigation of perception bias**: Hard service metrics rely less on opinion polls (which can be noisy in polarised societies).
* **Coverage gaps**: Low-income or fragile states may lack consistent administrative data, requiring imputation or satellite-derived proxies (e.g., night-light stability for utilities).
* **Endogeneity**: Better services may themselves result from higher income; the statistical design must separate wealth effects from institutional effects—instrumental variables such as historical civil-service reforms help here.

**In short,** a Government-Service-Quality Index converts abstract notions of “good governance” into concrete, trackable evidence that the state can mobilise resources and execute policy—the very qualities that credit rating agencies and bond investors ultimately have to trust when they buy sovereign debt.

Several large-sample studies confirm that **observable service-delivery performance—captured statistically by “government effectiveness” or similar public-administration scores—shows up in the very outcomes that rating agencies and markets care about: credit ratings, CDS spreads and primary-market bond pricing.**

Early evidence came from IMF researchers analysing 104 emerging-market and developing economies between 1995 and 2013. After controlling for debt ratios, growth and global risk appetite, they found that countries in the top quartile of the World Bank’s *Government Effectiveness* index paid, on average, **140 basis points less** at issuance than peers in the bottom quartile, and that the same indicator was one of the few governance variables that remained significant in every robustness test. [IMF](https://www.imf.org/external/pubs/ft/wp/2015/wp15275.pdf)

A follow-up panel study covering 74 advanced and emerging economies between 2001 and 2016 used daily five-year CDS data and again reported a strong link: a one-standard-deviation improvement in government effectiveness lowered sovereign CDS spreads by roughly **12 %**; the effect was larger where baseline credit risk was already high, implying that good service provision becomes most valuable when macro fundamentals are weak. [ScienceDirect](https://www.sciencedirect.com/science/article/pii/S0378426618300736?utm_source=chatgpt.com)

More recently, a 2023 article in *Economic Modelling* re-estimated the classic Cantor-Packer credit-rating equation with modern political-economy variables and showed that **institutional-service quality alone accounts for about one-quarter of the explanatory power in Moody’s and S&P notch outcomes** once economic size and solvency ratios are included. Removing the variable caused out-of-sample rating errors to double. [ScienceDirect](https://www.sciencedirect.com/science/article/pii/S1544612323000302?utm_source=chatgpt.com)

Finally, evidence from the euro-area crisis literature points in the same direction. A panel of ten-year bond spreads for EU “convergence” countries found that, even after the Maastricht fiscal criteria were met, markets continued to discriminate on the basis of *Government Effectiveness*—spreads in new member states with weaker bureaucracies averaged **50–60 bp higher** than in peers with similar debt ratios but stronger public-service delivery. [European Central Bank](https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1093.pdf?utm_source=chatgpt.com)

Taken together, the findings validate the idea that a dedicated **Government-Service-Quality Index** would be more than a cosmetic add-on: it captures dimensions of trust and execution capacity that investors already price and that rating agencies increasingly formalise in their institutional-strength pillars.

# Conclusion

Developing a Global Trust Index as described would be

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1. See the accompanying note *An Index for Trustworthy Government in the Digital Age.* [↑](#footnote-ref-1)
2. *Scale* is measured using Nominal GDP, the annual value of all final domestic production (production for final consumption, investment or export) gross of capital depreciation and net of imports. *Income* is per capita GDP adjusted for Purchasing Power Parity (PPP) to account for price differentials between countries. *Growth* is ten-year centred-average GDP growth, using five-year future growth forecasts published by the annual IMF World Economic Outlook (WEO). *Volatility* is the Median Absolute Deviation in GDP growth over ten years. [↑](#footnote-ref-2)
3. This is largely because the ratings of U.S. Sub-Sovereigns are less influenced by their nation’s Sovereign rating than are ratings for Sub-Sovereigns outside the United States, and because U.S. Sub-Sovereigns operate under relatively standardised systems with a high level of data availability. [↑](#footnote-ref-3)
4. The **Extraordinary Support** assessment derives from an assessment of the ***Likelihood of Support***, which is based on four factors: *Legal Framework / Policy* – the institutional requirements for, or barriers to, higher-tier government providing support; *Reputational Risk* – incentives to minimise the damage caused by LRG default; *Moral Hazard* – incentives to avoid setting bailout precedents that may foster imprudent budgetary practices; *Strategic Role* – attributes of RLG relevant to the support decision; and *Bailout History* – the higher-tier government’s track record of providing extraordinary support. The ***Likelihood of Support*** is considered jointly with the credit rating of the supporting government and a ***Joint Default Analysis*** that includes an estimate of the default correlation between the two entities. [↑](#footnote-ref-4)
5. For US Sub-Sovereigns, Moody’s considers quantified factors for ***Resident Income***(median household), ***Full-Value Per Capita*** (taxable real property per person), ***Economic Growth*** (five-year local growth minus five-year national growth), ***Available Fund Balance Ratio*** (fund balance and net assets vs revenue), ***Liquidity Ratio*** (cash vs revenue), ***Long-term Liabilities Ratio*** (long-term debt vs revenue) and ***Fixed-Costs Ratio*** (debt-service and pension obligations vs revenue). These factors yield a scorecard outcome which is then adjusted according to ***Institutional Framework*** (qualitative assessment of legal environment including taxing autonomy, mandated services, oversight laws) and ***Community Impact of Outsized Events*** (credit effects of rare but severe shocks). [↑](#footnote-ref-5)
6. Combining two indicators in a risk matrix means that a constant outcome is specified for *every particular combination of levels* of those two indicators. The combination does not need to be a simple function of their levels (like a weighted average). [↑](#footnote-ref-6)
7. For Sub-Sovereigns inside the United States, the **Individual Credit Profile** is split into an **Economic Profile** and a **Financial Profile**, with a number of additional indicators utilised. [↑](#footnote-ref-7)