INTRODUCTION

This chapter presents results from our ongoing project for evaluating the commercially available, developing-country creditworthiness indicators. Commercial creditworthiness ratings have long been used for the measurement of corporate risk. More recently, country credit ratings compiled by commercial sources have attempted to estimate country-specific risks, particularly the probability that a country will default on its debt servicing obligations. This default risk is measured using country-specific information about political and economic developments that have been identified in theoretical analyses as influencing the ability and willingness to service external debt obligation.

These indicators, or risk ratings, have played a critical role in determining both the volume and the spread over London Interbank Offered Rate (LIBOR), of syndicated commercial bank loans to developing countries over the last two decades. Although the mechanisms for providing private capital to developing countries have evolved significantly beyond the syndicated loans in recent years, the concept of country risk or creditworthiness remains both valid and important. This is not only so for the resumed voluntary bank lending to developing countries, but also for the other forms of private capital flows, including portfolio equity and bond flows, which have increased dramatically over the past four to five years. Indeed, many institutional investors from industrial countries can often only invest in instruments that meet or exceed a minimum credit rating standard.

In general terms, the indicators of developing-country creditworthiness were affected very adversely by the onset of the international debt crisis in August 1982, when Mexico announced that it could no longer service its external debt.1 While these ratings remained depressed throughout the rest of...
the 1980s, they began to improve in the early 1990s in response both to the announcement of the Brady Plan to 'writedown' external debt in March 1989 and to significant policy reforms in many developing countries, particularly in Latin America and Asia. Nevertheless, on average, the current risk ratings of developing countries still remain below those before the onset of the debt crisis, although there is a significantly greater variation in ratings across countries than a decade or so ago.

As indicated in Figures 2.1 and 2.2, the recovery of creditworthiness ratings in the 1990s was associated with a sharp expansion in portfolio investment flows to developing countries in Asia and Latin America. Interestingly,

Figure 2.1 Capital flows and ratings