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Are Monarchies More Creditworthy Than Other Types Of Sovereigns?

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Table Of Contents

To Rule Or Just Reign?

The Most-Indebted Rated Monarchs

Comparing The Ratings On Monarchies And Non-Monarchies

The Political Advantage Of Constitutional Monarchies

Absolute Monarchies Generally Have Stronger Balance Sheets

Institutions Matter

Related Criteria And Research

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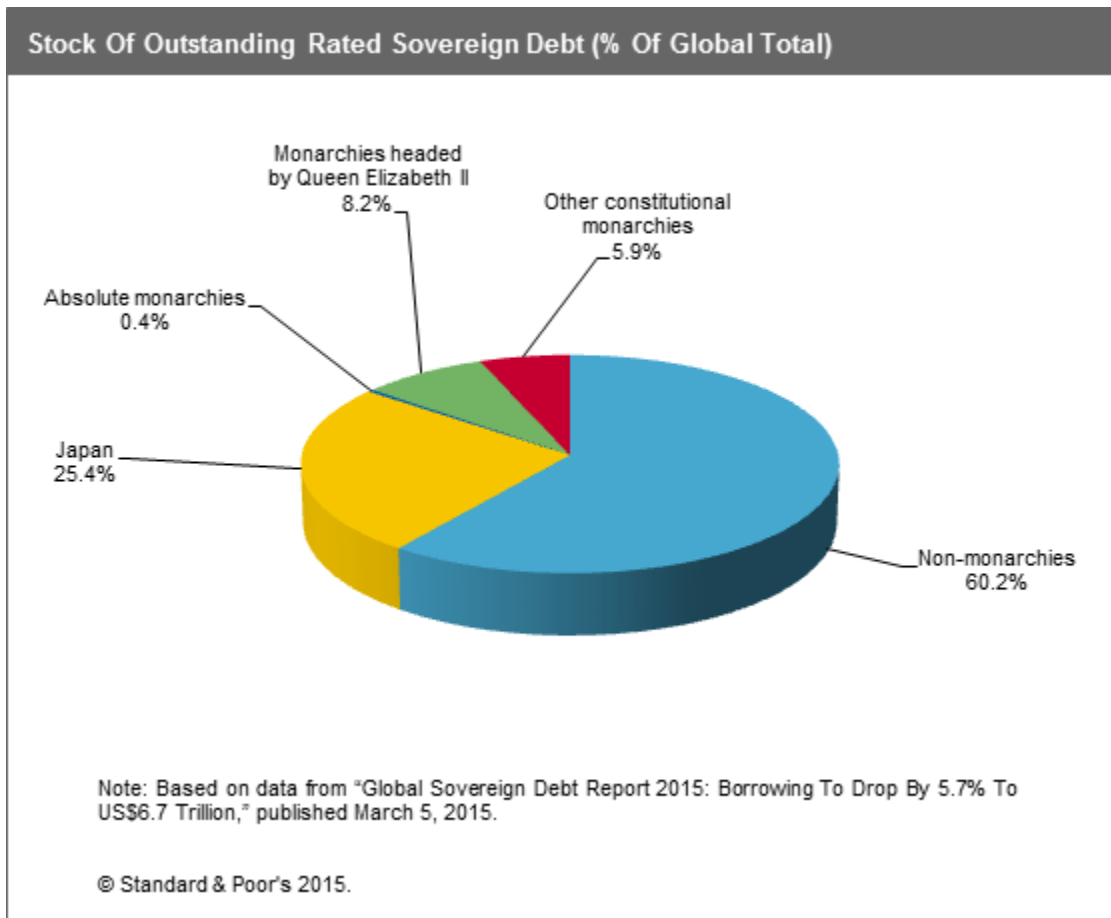
The term "sovereign debt" typically refers to liabilities a country's national government issues. Historically, it referred to debt issued in the name of a head of state in a monarchy. Over time, as much of the world abandoned monarchical government, the term began to refer to debt that a country's national government issued. However, monarchies still account for about 40% of the sovereign debt that Standard & Poor's Ratings Services rates globally (see chart 1).

Standard & Poor's sovereign rating criteria do not, on their face, distinguish between a monarchy and other forms of government. Thus, there is no straightforward connection between the sovereign credit rating on a country and its status as a monarchy or a republic. However, our criteria do, in the institutional and governance analysis, focus on factors such as the rule of law and checks and balances, as well as the transparency, predictability, and effectiveness of policymaking. In these areas, distinctions emerge between monarchies and other forms of government. The biggest gap between constitutional and absolute monarchies appears to be the greater institutional strength of constitutional monarchies. Absolute monarchies score higher, on average, in our fiscal and external assessments, reflecting their stronger balance sheets. But, constitutional monarchies have higher credit ratings, on average, than absolute monarchies, indicating the importance of the effectiveness, stability, and predictability of a sovereign's policymaking and political institutions. (Watch the related CreditMatters TV segment titled, "How Monarchies Affect Sovereign Ratings," dated Aug. 5, 2015.)

Overview

- Monarchies have issued about 40% of the sovereign debt that Standard & Poor's rates globally.
- The biggest gap between constitutional and absolute monarchies appears to be the greater institutional strength (as described in our criteria) of the former.
- Absolute monarchies score higher than constitutional monarchies, on average, in our fiscal and external assessments, reflecting their stronger balance sheets.
- But, constitutional monarchies have higher credit ratings, on average, than absolute monarchies, indicating the importance under our criteria of the effectiveness, stability, and predictability of a sovereign's policymaking and political institutions.

Chart 1



To Rule Or Just Reign?

For analytical purposes, it is useful to divide monarchies into two categories: absolute and constitutional monarchies. Absolute monarchies are countries where the monarch exercises great political power over the government. Typically, the absolute monarch's powers are not limited by a law or constitution, or are only slightly limited.

In contrast, constitutional monarchs usually reign but do not rule. The ruler of a constitutional monarchy typically has a symbolic or very limited political role, as British writer Walter Bagehot describes in "The English Constitution" (1867): "To state the matter shortly, the sovereign has, under a constitutional monarchy such as ours, three rights – the right to be consulted, the right to encourage, the right to warn."

We classify commonwealth countries such as Canada, Australia, and The Bahamas, as well as autonomous overseas territories such as Turks and Caicos Islands and Aruba, as constitutional monarchies. We classify Thailand and Kuwait as constitutional monarchies, following general conventions, despite the fact that their monarchs have often played a larger role in domestic politics than is typically the case in most constitutional monarchies.

We rate 129 sovereigns, of which 39 have a monarch (or similar individual) as head of state (see table 1). Of the

monarchies that we rate, 30 are constitutional and nine are absolute monarchies. All nine sovereigns that we classify as absolute monarchies are located in the Arab world, ranging from Morocco in the west to Oman in the east.

Table 1

Rated Sovereign Monarchies	
Long-term foreign currency ratings	
Absolute monarchies	
Abu Dhabi	AA
Qatar	AA
Saudi Arabia	AA-
Ras al Khaimah	A
Sharjah (Emirate of)	A
Oman	A-
Bahrain	BBB-
Morocco	BBB-
Jordan	BB-
Constitutional monarchies – Queen Elizabeth II	
Australia	AAA
Canada	AAA
U.K.	AAA
Guernsey	AA+
Jersey	AA+
New Zealand	AA
Bermuda	A+
Turks and Caicos Islands	BBB+
Bahamas	BBB
Montserrat	BBB-
Cook Islands	B+
Papua New Guinea	B+
Barbados	B
Jamaica	B
Belize	B-
Constitutional monarchies - King Willem-Alexander (Netherlands)	
State of the Netherlands	AA+
Curacao	A-
Aruba	BBB+
Other constitutional monarchies	
Denmark	AAA
Liechtenstein	AAA
Luxembourg	AAA
Norway	AAA
Sweden	AAA
Belgium	AA

Table 1

Rated Sovereign Monarchies (cont.)	
	Long-term foreign currency ratings
Kuwait	AA
Japan	AA-
Malaysia	A-
Thailand	BBB+
Spain	BBB

The universe of rated monarchies is diverse. Japan has the oldest continuing hereditary monarchy in the world, led by Emperor Akihito. On Sept. 9, 2015, Queen Elizabeth II will become the longest-serving monarch in British history, surpassing the 63 years and 216 days record held by Queen Victoria in the 19th century. Malaysia has a "Supreme Head of State," a rotating monarchy elected for five years by the hereditary monarchs of nine of Malaysia's 13 states.

Standard & Poor's rates 15 entities (12% of all rated sovereigns) that have Queen Elizabeth as their monarch: nine realms (including the U.K.), three overseas territories, and three other entities (Jersey; the Bailiwick of Guernsey, a crown dependency; and the Cook Islands). The Queen is the monarch of 16 member states of the Commonwealth of Nations, plus 14 overseas territories. We rate three of the 14 British overseas territories: Bermuda, Montserrat, and Turks and Caicos Islands.

Until last year, Standard & Poor's had rated two other sovereigns whose head of state is Queen Elizabeth II. We withdrew our sovereign rating on Grenada in October 2014 and the sovereign rating on the Isle of Man in February 2014 at the request of the two governments.

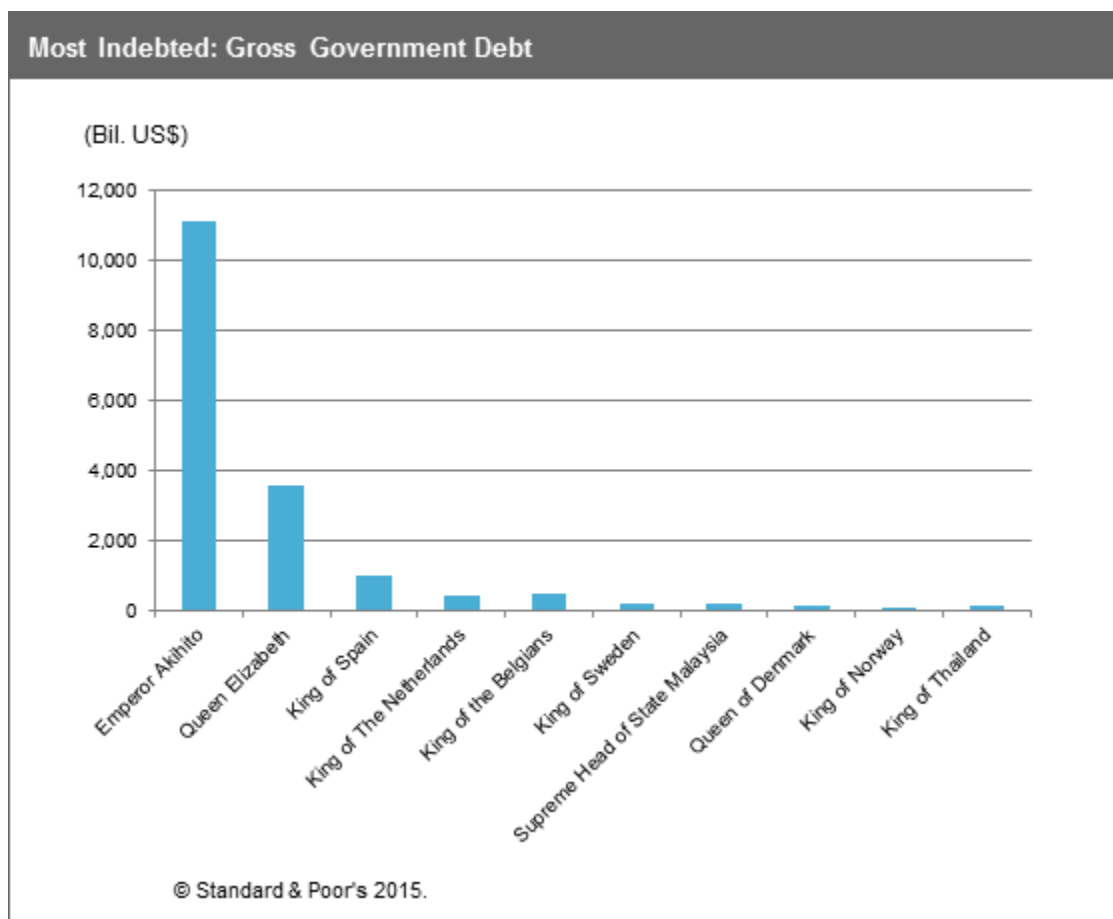
We rate three sovereigns that have King Willem-Alexander as monarch: State of the Netherlands, Aruba, and Curacao. The latter two entities are autonomous states within the Kingdom of the Netherlands.

The Most-Indebted Rated Monarchs

The largest monarchical sovereign debtor is Japan, with more than US\$11 trillion in outstanding rated debt--just over 25% of all such sovereign debt globally (see chart 2). The commercial debt issued by various rated sovereigns with Queen Elizabeth II as monarch amounts to US\$3.6 trillion (or just above 8% of the global amount). The third-largest monarchical debtor is Spain, with nearly US\$1 trillion in outstanding debt, followed by the Kingdom of the Netherlands and the Kingdom of Belgium. There are no absolute monarchies among the top 10 monarchical debtors.

Sovereigns typically do not guarantee the debt that their overseas or autonomous territories issue. Hence, a default by a sovereign sharing the same monarch with another rated sovereign does not usually have any rating implications on the latter. For example, recent sovereign defaults in Jamaica and Belize have no rating impact on other sovereigns that also have Queen Elizabeth II as their monarch.

Chart 2



Comparing The Ratings On Monarchies And Non-Monarchies

The average long-term foreign currency rating on the 39 monarchies that we rate is 'A-', which is slightly higher than the average sovereign rating for all 129 sovereigns that we rate, which is around 'BBB' to 'BBB-' (see table 2). Among the rated monarchies, constitutional monarchies have a slightly higher average rating of 'A+', compared with 'A-' for absolute monarchies. The average rating for the 15 rated sovereigns that have Queen Elizabeth II as their monarch is 'BBB+', which is lower than the 'AA-' average rating for all the other 24 rated monarchies.

Institutional and governance effectiveness is an important element of our sovereign rating criteria. However, the criteria do not, on their face, distinguish between a monarchy and other forms of government. Nevertheless, analyzing rated sovereigns based on the five main criteria factors provides more insight into possible connections between monarchies and their ratings.

Table 2

Comparing The Average Ratings On Monarchies	
	Average long-term foreign currency ratings
All monarchies	A-

Table 2

Comparing The Average Ratings On Monarchies (cont.)

	Average long-term foreign currency ratings
All constitutional monarchies	A+
All absolute monarchies	A-
Monarchies of Queen Elizabeth	BBB+
All monarchies excluding Queen Elizabeth	AA-

Our methodology for rating sovereigns is based on an assessment of the following factors: institutional, economic, external, fiscal, and monetary. Each of the five factors is assessed on a six-point numerical scale from '1' (the strongest), to '3' or '4' (neutral), to '6' (the weakest). A series of quantitative factors and qualitative considerations form the basis for these forward-looking assessments. We then combine those five assessments to form a sovereign's institutional and economic profile (the average of the institutional assessment and the economic assessment) and its flexibility and performance profile (the average of the external assessment, the fiscal assessment, and the monetary assessment). These two profiles are then used to determine an "indicative rating level." We expect that our sovereign foreign currency rating would, in most cases, fall within one notch of the indicative rating level. The foreign currency rating could differ from the indicative rating level if certain supplemental adjustment factors apply, as described in the criteria, "Sovereign Rating Methodology," published Dec. 23, 2014.

The Political Advantage Of Constitutional Monarchies

The first rating factor, an assessment of institutional strength, is primarily qualitative. Its main focus is on the effectiveness, stability, and predictability of a sovereign's policymaking and political institutions. Governments are better able to respond to challenges in countries that have stable institutions and policies that are generally predictable over time.

In our assessment of institutional and governance effectiveness, monarchies score higher than all sovereigns on average (see table 3). However, the monarchy average obscures an important distinction: constitutional monarchies score higher, on average, than absolute monarchies.

Table 3

Institutional And Governance Effectiveness Scores

All sovereigns	4
All monarchies	2
All constitutional monarchies	2
All absolute monarchies	4
Monarchies of Queen Elizabeth	2

Note: Scores reflect the median numerical value of the assessment for each category of sovereigns.

The standard deviation of this score is almost equal (about 1.4) for rated monarchies and non-monarchies. However, the standard deviation is a low 0.3 for absolute monarchies, indicating their high concentration toward the lower end of our scale. The standard deviation for monarchies headed by Queen Elizabeth is 1.7, which appears to reflect the wide variety of institutional and governance effectiveness scores in the countries where she reigns.

These results likely reflect that many of today's constitutional monarchies are countries that have managed to democratize their politics (reducing the powers of the monarch) over many years without serious disruptions to the constitutional order (as in the U.K., the Netherlands, Sweden, Norway, and Denmark). Many constitutional monarchies enjoy stable, democratic governments with ample checks and balances, transparency, and predictability in policies and procedures. In some cases, the separation of the role of monarch as titular head of state from the head of government (the prime minister or president) could lend stability to political institutions and ensure continuity while political leadership is changing.

In addition, constitutional monarchs can sometimes help foster loyalty or serve as symbols of national unity, important in countries with ethnic or language divisions (such as Belgium). Constitutional monarchs might, as in Japan, connect people with the country's past. In the words of Walter Bagehot in "The English Constitution" (1867): "The nation is divided into parties, but the Crown is of no party. Its apparent separation from business is that which removes it both from enmities and from desecration, which preserves its mystery, which enables it to combine the affection of conflicting parties – to be a visible symbol of unity to those still so imperfectly educated as to need a symbol."

Same Sovereign But Different Ratings

Countries that have the same individual as monarch do not automatically have the same credit rating. However, the constitutional links between different entities sometimes play a role in our analysis, even if there is no formal guarantee or credit support from one entity to another.

Standard & Poor's analysis of the creditworthiness of several overseas territories explicitly considers the implications of their political and institutional links with the country whose individual monarch they have in common. For example, our ratings on Aruba and Curacao explicitly factor in their institutional links with the Netherlands. In addition to providing a legal and political anchor to the two overseas territories, the Netherlands has intervened in their fiscal policies and created a joint mechanism for fiscal oversight. In the case of Curacao, the Netherlands has given debt relief and access to low cost funding.

Similarly, the U.K. intervened in the Turks and Caicos Islands in 2009 following fiscal mismanagement by the locally elected government. Subsequently, the U.K. provided a loan guarantee on certain locally issued debt and created a new framework for public-sector financial management, with a strong direct role for the British government.

The ratings on Curacao and Aruba are not at the same level as the ratings on the State of the Netherlands, and neither are the ratings on Turks and Caicos Islands the same as those on the U.K. However, the formal links between these entities, as well as sometimes informal mechanisms of support, play a role in our assessment of creditworthiness.

Political opponents of constitutional monarchies often see them as outmoded for modern politics, a vestige of a feudal and un-democratic past. However, opponents often have difficulty in formulating effective alternatives. Some opponents want direct elections for a new head of state while others prefer indirect elections, often through the elected parliament. The detailed workings of such alternatives may have a major impact on the balance of power within an elected government. Anti-monarchy movements in Australia and some parts of the Caribbean have not progressed for these reasons.

In our view, the somewhat lower ranking of absolute monarchies in our institutional assessment typically reflects their weaker institutional checks and balances, highly centralized decision-making, risks of succession, or possible challenges to political institutions due to demands for more political or economic participation by the population. The monarch and a small number of associates, often members of the ruling family, typically make most policy decisions in such countries.

We classify Thailand as a constitutional monarch even though its monarch has played a key role behind the scenes during periods of political stress. Similarly, we classify Kuwait as a constitutional monarchy despite the fact that it has a mixed political system with elections and that its monarch enjoys considerable political powers. Liechtenstein, another constitutional monarchy, recently enhanced its monarch's role in public policy. In 2003, Liechtenstein's voters agreed through a referendum to increase the powers of the monarch to nominate judges, veto laws, and dismiss the legislature.

Absolute Monarchies Generally Have Stronger Balance Sheets

There is no difference between constitutional and absolute monarchies in our assessment of their debt risk (both have a median score of '2'). However, absolute monarchies score higher than constitutional monarchies in external risk and fiscal risk (see table 4), largely reflecting the strong general government balance sheets and high external asset positions of wealthy monarchies in the eastern Arab world (with the exception of Bahrain and Jordan).

Table 4

	External risk score	Fiscal risk score
All sovereigns	3	3
All monarchies	3	2
All constitutional monarchies	4	3
All absolute monarchies	2	1

Note: Scores reflect the median numerical value of the assessment for each category of sovereigns.

The median score for monetary risk is the same for monarchies and non-monarchies. However, constitutional monarchies have, on average, better assessments than absolute monarchies, reflecting the limited monetary flexibility of monarchies in the eastern Arab world, which typically have rigid exchange rates.

Institutions Matter

A country's status as a monarchy or a republic does not affect its rating. However, the data show that absolute monarchies have lower credit ratings, on average, than their constitutional counterparts, indicating the importance under our criteria of the effectiveness, stability, and predictability of a sovereign's policymaking and political institutions.

(Pedro Quintanilla provided valuable research assistance for this commentary.)

Related Criteria And Research

Related Criteria

- Sovereign Rating Methodology, Dec. 23, 2014

Related Research

- Sovereign Risk Indicators, June 30, 2015

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