Comments on "Sovereign Credit Ratings and the Transnationalization of Finance – Evidence from a Gravity Model of Portfolio Investment"

The authors examine the relationship between sovereign credit ratings and the transnationalization of finance. According to this paper, sovereign ratings are among the variables that affect financial market frictions and, particularly, information frictions. The channel is as follows: Grade changes in sovereign ratings can reduce the informational friction for foreigners who rely on them more than domestic investors. Results provide evidence that credit ratings contribute to reducing information asymmetries between domestic and foreign financial investors.

This is a promising line of research; however, it might be argued that there is an omitted variables bias. For example, previous studies that use a bilateral country panel to analyse the role of International Financial Reporting Standards (IFRS) have already proven that increasing comparability and transparency of financial accounting standards fosters cross-borders investments in a gravity framework. Specifically, the time framework in this paper covers the period in which IFRS were adopted in a considerable number of countries and then, the change from national GAAP to IFRS occurred. In sum, IFRS use (or adoption) is an omitted variable, which, in fact, might be correlated with the variables of interest.

Additionally, although there is some opacity that characterizes the way in which credit rating agencies construct the sovereign credit ratings, criteria such as per capita income, inflation, external debt, economic development, default history, GDP growth, fiscal balance, terms of trade, payment credibility, investment decisions or external balance might be among the indicators used for the construction of the ratings. Is reverse causality an issue? Are the better ratings leading to higher investments or are particular investment decisions leading to higher credit ratings?

The effect might differ for developing and developed countries, as well as by the type of instrument used for making the investment. Although the authors already point out the lack of available data, these two issues might be, at least, discussed. A review of the existing related literature, if it not exists not for the case of CRAs it might exist for other instruments that reduce information asymmetries such as IFRS, would be highly desirable.

Finally, two minor comments are that the name of the variables could be more intuitive in the tables of results and that it seems that there is a problem in the last row of Table 4.