The creation of a new *demos*? The impact of financial institutions on statecraft – the South African experience

Angelo Dube[*]
(Senior Lecturer, Faculty of Law, University of the Western Cape)

Abstract

State sovereignty, democracy and constitutional supremacy underlie the concept of what a state is by today's standards. At the very least, this requires that the people in any nation, assert their collective sovereignty as a people, through the instrumentality of the state. Although there are varying conceptions of sovereignty, it suffices to say that it embodies a continuum ranging from descriptive accounts of the minutiae of the ordering of state powers to considerations of sovereignty as an abstract concept. It is embedded in a national political ethos and serving as its justification. It is from this notion of sovereignty that a state draws the authority to establish democratic processes, institutions and frameworks, such as elections, establishing parliaments and other oversight mechanisms. Indeed, constitutional design and implementation is also an incident of state sovereignty, which often gives birth to a supreme piece of legislation, the constitution. A fully functioning state, whose sovereignty is intact, is one where all institutions are operating efficiently and in line with their enabling legislation, and accountable only to the constitution. The powers of these institutions, however, can be neutered in many ways. One such way is the interference of international institutions in the manner in which states are governed. Quite often this involves self-censorship on the part of states in lieu of their jealously guarded economic interests, in particular sovereign credit rating. The South African case is illustrative in this regard. Faced with threats of a downgrade in its credit ratings, both big business and opposition parties in South Africa put pressure on the government to behave in a particular way in order to prevent such downgrade. For example, the national prosecution authority's intended prosecution of Finance Minister Pravin Gordhan was viewed by opposition parties and corporate South Africa as catalytic elements in the credit downgrade of the country. They urged the government not to go ahead with the arrest and indictment of Minister Gordhan, despite the laws of the land being clear on the powers and duties of the police and the public prosecutor in such cases.

Again, when the President decided to fire former Finance Minister, Nhlanhla Nene, the Rand plummeted amidst calls from the financial and political sector, as well as foreign institutions to restore the minister's appointment. This political development featured when rating agencies to

[*] Angelo Dube LLD (UWC). Senior Lecturer, Department of Public Law and Jurisprudence, Faculty of Law, University of the Western Cape, South Africa. He can be contacted at bdube@uwc.ac.za.

visited South Africa, to conduct a rating review. During the March 2016 review, Moody's affirmed South Africa's investment-grade credit rating, but kept its negative outlook. The rating agency decried the recent political developments (the firing of Finance Minister Nhlanhla Nene) and described them as disruptive.

These concerns are not only limited to South Africa, but are shared by members of the BRICS group. As a result, in its meeting of October 2016 in India, the BRICS group concluded talks on establishing their own BRICS based credit rating agency to counter what was perceived as bias by the Western agencies. This new agency would better cater to developing economies. The concern amongst BRICs nations was that the three traditional rating agencies, Moody's, Standard and Poor's and Fitch Ratings are all western-based and favour those economies.

The power that these agencies hold over states leads to many constitutional and international law questions pertaining to democracy, state sovereignty and economic freedom. The foregoing therefore leads to the following question: To what extent does the intervention of credit rating agencies erode or bolster democratic and constitutional processes of sovereign states? The focus of the paper is on the global south, and centred on South Africa.

Keywords: sovereignty, democracy, governance, transformation, credit rating, global finance

Background

South Africa perceives itself as a constitutional democracy. Section 1 of the South African Constitution of 1996, provides that the Republic is one, sovereign, democratic state. The same section contains several values which are foundational to the existence of the Republic. These include: Human dignity, the achievement of equality and the advancement of human rights and freedoms; non-racialism and non-sexism; supremacy of the constitution and the rule of law. Section 2 further entrenches the supremacy of the constitution. It is this supremacy that has led South African courts to pronounce that the Constitution is a transformative document, one that seeks to move the country from the discriminatory past to a future based on the triplet of human dignity, equality and freedom (*Nyathi v MEC for Health Gauteng* 2008).

In any sovereign state, the people are the demos. This means that political power flows from the populace of a democracy as a political unit. Yet in recent years, certain decisions taken by the demos through elected representatives have elicited negative reviews and economic reprisals from financial institutions. Effectively, elected representatives can no longer carry out their mandate, without being subordinated to the demands of financial institutions, credit rating agencies, and big business in general.

The question that begs an answer is if the demos can no longer be in control of their substantive political and economic policy, can they still claim to be enjoying democracy?

To answer the above question in the context of South Africa, it is imperative to assess the behaviour of rating agencies through three key pillars of governance, viz democracy, popular sovereignty and transformation.

Democracy

De Vos and Freedman (2014) assert that the concept of democracy is not easy to define. It defies singular definition. Roux (2013) defines democracy as that idea at the core of which is the understanding that decisions affecting the members of a political community should be taken by the members themselves, or at least by elected representatives whose power to make those decisions ultimately derives from the members.

At the core of the concept, is the notion that public policy is to be governed by the freely expressed will of the people whereby all individuals are to be treated as equals (Saward 1994: 7). In other words, substantive policy, and political and administrative actions performed under substantive policy, must correspond to the express preferences of a majority of citizens. As Butt (2009: 1) puts it, legitimate political authority must derive from the consent of the governed. The same applies to financial policies.

Sovereignty

Like democracy, sovereignty is susceptible to a diversity of meanings. Thomas Hobbes (1588 – 1679) conceived sovereignty as essentially the claim that power should be vested in a single source which was free from external and internal constraints. However, sovereignty has shifted since Hobbes' time, for the internal constraints today are justified as safeguards against despotism or absolutism. Such safeguards take the form of the electorate, the people. Hence today, the concept of popular sovereignty is much more acceptable (Newman 1996: 6). Popular sovereignty offers a better appreciation of the power dynamics between the ruler and the ruled. It ensures that the power which the sovereign exclusively enjoyed in the past now resides with the people (Nootens 2013: 113). Most authors incorrectly perceive popular sovereignty as a western concept. In the African context, however, this was the predominant form of governance prior to colonisation, where the king would not be allowed to take decisions unilaterally. Power lay with the people (Ohaegbulam 1990: 101). Hence the myriad of African maxims such as *morena ke morena ka batho* (Sotho), *inkosi yinkosi ngabantu* (isiZulu, isiNdebele and SiSwati) and *kgosi ke kgosi ka batho* (Tswana). All these philosophical concepts translate to 'a king is a king by his people' (Dube and Nhlabatsi 2016). Within the Basotho, for example, the political power and policy of the king was contingent on his ability to give reasoned justification for his actions, to satisfy popular expectation, and to secure consent through regular consultation (Ohaegbulam 1996: 102).

According to Peonidis (2013: 23), the confluence of democracy and popular sovereignty gives priority to decision-making procedures that engage the totality of citizens. It is only when democracy is used as popular sovereignty that collective self-rule can ideally realise its full potential, when everyone has the power to participate personally and on an equal footing in the administration of any country.

Transformation as an incident of supremacy

When South Africa wrestled free from the clutches of an evil system, apartheid, in 1994, it committed itself to transformative constitutionalism. Butt (2009) argues that the goal here was to heal the wounds of the past and bring about change to many previously excluded South Africans. Two elements were necessary to achieve this.

First, the government had to commit to create a substantively equal society. This involves the recognition of the moral entitlement of persons to what some call positive liberty, the ability to exercise one's rights and pursue one's projects rather than a mere empty entitlement to do so. Secondly, transformation requires a shift from a culture of paternalistic state authoritarianism to a culture of the ongoing and never-ending justification of state power (Butt, 2009: 2).

Rating agencies as substitution for the demos

The main role of credit rating agencies is to provide global investors with an informed analysis of the risk associated with debt securities. These securities include government bonds, corporate bonds, certificates of deposit, municipal bonds, preferred stock, and collateralized securities, such as collateralized debt obligations and mortgage-backed securities. The behaviour of the debt issuer is central to determining their creditworthiness. Hence rating agencies determine how risky investing in these securities is by the likelihood that the debt issuer will fail to make timely interest payments on the debt. The debt issuer could be a corporation, bank-created entity, sovereign nation, or local government. A debt issue itself is a financial obligation through which the issuer can raise funds by promising to repay the lender at a future date, and in accordance with the terms of the contract. In the case of South Africa, sovereign debt is issued by the government in a foreign currency in order to finance the country's growth and development. The three dominant rating agencies (the Big Three) Standard and Poor's (S&P), Moody's, and Fitch Ratings are all based in the US. The Big Three are designated as 'Nationally Recognised Statistical Rating Organisations' and are officially endorsed by the US financial watchdog - the Securities and Exchange Commission (SEC).

It is ironic that foreign corporations with tainted financial records can negatively assess dictate to a sovereign state on how it should craft and administer its policies. Moody's has been known to issue false credit ratings, as seen in its role in the 2008 financial crisis. Earlier this year the firm parted with R11.7 billion (nearly $864m) in penalties for its role in that financial crisis. S&P Global's Standard & Poor's entered into a similar accord in 2015 paying out $1.375bn. In the S & P case, resolution was reached after the US filed a $5bn fraud suit.

The power of corporates – stronger than elected governments

When President Zuma fired former Minister of Finance, Nhlanhla Nene in December 2015 and replaced him with Des Van Rooyen, the Rand plummeted. Mr Van Rooyen was potrayed in the media as an unqualified backbencher, ill-suited for the post of Minister of Finance. In reality, he has experience in public management accompanied by various qualifications in that area too.

When Moody's conducted its review in March 2016, it considered the changes within the finance ministry as positive. It also took into account key legislative and judicial developments, such as the Constitutional Court judgment against the president on the misuse of public funds in the Nkandla saga. In Moody's report, the reappointment of Pravin Gordhan, whom Moody's called a respected former finance minister to the post contributed to a positive outlook. The use of such words is concerning, given that the prerogative to appoint ministers lies with elected representatives.

In June 2016, S & P cited rising political tensions which it alleged had intensified since Nhlanhla Nene was fired. It thus gave the country a negative outlook. The company also decried the socioeconomic dynamics of race and skewed income distribution. These, it said, had the potential to shift policy toward intervention and income redistribution, at the cost of headline GDP growth. Again these are sentiments that point towards an attempt to legislate from New York rather than allow the demos to determine their own policy issues as dictated by the needs on the ground. Such sentiments are likely to hamper South Africa's transformative agenda, which is constitutionally mandated.

The relations between states is governed by international law. This branch of law does not accord corporations subjecthood. It is my argument that corporations such as rating agencies do not fall within the list of subjects of international law, and as such their involvement in governance, politics and statecraft is illegitimate. Their actions are no more than those of a western based NGO calling for a third world country to democratise.

As subjects of international law, states criticize each other all the time. This is acceptable conduct as it forms part of the global governance framework and inter-state relations. To prevent wayward and bully states from interfering in the internal affairs of other states, international law has in place several safeguards. For starters the United Nations Charter in Article 2 recognises the sovereign equality of all member states. Article 1 underscores respect for the principle of equal rights and self-determination of peoples in the conduct of international relations. The principle of self-determination is what informs the notion of democratic governance, where the people themselves determine their political future. In relation to these agencies, there is no mechanism for checks and balances to hold them accountable at the global level.

The dangers with arrogating such powers to corporations are manifold. First, as noted above, these agencies are not states, and as such should not be involved in policy issues. In January 2017, it was reported that during a panel discussion, Standard and Poor's managing director Konrad Reuss had said that a cabinet reshuffle in South Africa could hurt the country's assessment by the rating agency (EWN News 2017). This statement was condemned by the ruling party, the ANC. Indeed such actions on the part of a corporation that ought to objectively assess the work done by the government does not reflect well on its impartiality.

Secondly, the level at which they are currently trying to intervene in the South African situation can only be reserved for states, which are sovereign equals of the state of South Africa. Rating agencies are financial entities with no political constituency, they are not representatives of the people. They are not elected into office by the people, and they do not have a mandate from the demos. They cannot therefore claim to have neither the moral high ground nor the legal basis to direct the political paths of governments such as the South African Government.

Thirdly, this type of intervention is a peer to peer kind of intervention reserved only for states. Again this is influenced by the fact that states are sovereign and equal. The mechanism to operationalize such peer to peer monitoring is diplomacy, which only states can engage in. Rating agencies are not equipped to engage in diplomacy, their main goal is profit making and pleasing their shareholders. They do not have the best interests of the South African people at heart.

For instance, when approached for a R2.5 Billion loan by the state of Swaziland in 2011, South Africa decided to attach certain conditions for political and economic reform to the loan. This did not sit well with the Swaziland authorities, and they rejected the loan offer. This relationship was managed well through the use of diplomatic channels, where two equal sovereigns agreed to disagree (South African Government, 2013).

These negative interventions have led to calls for the creation of independent alternative rating agencies. The BRICS countries for instance recently started talks on a BRICS rating agency to undercut the negative impact of the US-based agencies. These feelings are also shared by certain member states of the EU. For instance, similar calls were made in the EU after the Big Three relegated to junk status the sovereign debt ratings of Greece, Portugal and Ireland, and downgraded the credit worthiness of France, Austria and other major economies (Council on Foreign Relations 2015). Needless to say, this external influence has negative effects on the skilful management of state affairs, also known as statecraft (Solingen 2012: 299).

Conclusion

It is clear from the foregoing that the growing power of rating agencies has created a parallel demos, whose interventions are slowly chipping away at the authority of elected representatives to carry out their mandate. This is stifling, instead of advancing the constitutional project, especially transformation in the South African context.

References

Butt D ‘Transformative constitutionalism and socio-economic rights (2009) The Foundation for Law, Justice and Society, Oxford.

Dube Angelo and Nhlabatsi Sibusiso, ‘The King can do no wrong: The impact of *The Law Society of Swaziland v Simelane N.O. and Others* on constitutionalism’ (2016) 16 *African Human Rights Law Journal* 265 – 282.

EWN News 31 January 2017 *We don’t work for ratings agencies, we work for the country* available at http://ewn.co.za/2017/01/30/we-don-t-work-for-ratings-agencies-we-work-for-the-country (accessed 29 January 2017).

Newman M *Democracy, sovereignty and the European Union* (1996) Hurst and Co Publishers, London.

Nootens G *Popular sovereignty in the West: Polities, contention, and ideas* (2013) Routlege, New York

Nyathi v MEC for Health Gauteng [2008] ZACC 8

Ohaegbulam FU *Towards an understanding of the African experience from historical and contemporary perspectives* (1990) University of America Press, New York.

Peonidis F *Democracy as popular sovereignty* (2013) Lexington Books, Maryland.

Saward M 'Democratic theory and indices of democratization' in Beetham D (ed) *Defining and Measuring Democracy* (1994)

Securities and Exchange Commission *Current NRSORs* available at https://www.sec.gov/ocr/ocr-current-nrsros.html (accessed 3 February 2017).

South African Government News Agency 3 August 2012 *SA grants Swaziland 2.5bn loan*, available at http://www.sanews.gov.za/south-africa/sa-grants-swaziland-r25bn-loan (accessed 3 February 2017).

The Guardian 22 August 2011 *Ratings agencies suffer 'conflict of interest', says former Moody's boss*, available at https://www.theguardian.com/business/2011/aug/22/ratings-agencies-conflict-of-interest (accessed 1 January 2017).

Solingen E *Sanctions, statecraft, and nuclear proliferation* (2012) Cambridge University Press, Cambridge.