THE POLITICS OF LOSING THE “AAA” RATING:  
A CRITICAL PERSPECTIVE ON THE SOVEREIGN DOWNGRADES OF THE UNITED STATES, FRANCE, AND AUSTRIA

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ABSTRACT

ZACHARY DUNNAM: The Politics of Losing the “AAA” Rating: A Critical Perspective on the Sovereign Downgrades of the United States, France, and Austria (Under the direction of Erica Edwards)

This article promotes the utility of critical theory to examine instances of private authority in international affairs with a particular focus on the political consequences of a sovereign credit rating downgrade. After historicizing the American roots of credit rating agencies and linking their global expansion to the growth of transnational finance in the neo-liberal era, this article argues that credit rating agencies’ authority is socially constructed and inextricably tied to the United States’ hegemonic position in the current world order. This argument is qualified through case analyses of the politics surrounding the sovereign downgrades of the US, France, and Austria. The results of these case studies shows that following the global financial crisis of 2008 credit rating agencies’ judgments on sovereign debt are much more political than technical, their power to affect the cost of capital is diminished, and their authority is increasingly challenged by bondholders, political leaders, and regulators.
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Introduction

The global financial crisis of 2008 resulted from numerous failures among state and non-state actors to effectively govern the ever-increasing demands of expanding capital in the global economy. Prior to the crisis, governments and other state regulatory institutions increasingly came to rely upon non-state actors to monitor and manage the flow of capital as the speed of financial innovation continued to outstrip the capacity of traditional state apparatuses to effectively govern the global financial system. One of the most important non-state actors with public regulatory responsibility has been the international credit rating agencies (CRAs), whose “relatively standardized, harmonized, easy to understand, independent (third party) assessments of credit quality” (Basel Committee 2009) became an essential element within the global financial governance mechanism (Sinclair 2001). However, the outbreak of the subprime mortgage crisis revealed the CRAs contribution to the US real estate bubble by “over-rating senior tranches in specialty purpose vehicles” (Lanoo 2008). Additionally, their continued role in the assessment of sovereign debt throughout the euro-crisis has helped precipitate the implementation of fiscal austerity and structural reforms in the fledgling economies of the European periphery. With a downgrade by a rating agency having such immediate and powerful consequences for a sovereign state, it is important that their role within the global financial governance mechanism be critically assessed.

While an extensive study of CRAs influence on governments since the 2008 global financial crisis would be highly enlightening, such an endeavor for this article is unfeasible, as changes in the rating of sovereign debt occurred too frequently to permit the appropriate handling of data of this magnitude. However, much insight can be gained by focusing our analysis on the unprecedented event of the downgrade of the United States’ sovereign debt rating by Standard & Poor’s on August 5, 2011. It was the first time in history that the US lost its “AAA” credit rating and the subsequent effects would have global economic and political consequences, especially in Europe. In fact, both
France and Austria would lose their “AAA” rating five months later, making all three the only countries to lose their “AAA” status since the onset of the 2008 global financial crisis. The loss of a “AAA” sovereign rating is a rare incident, with only Japan, Australia, Sweden, and Canada having previously experienced the event. But the downgrade of the world’s most important economy provides a unique opportunity in which to critically examine the political and economic consequences of such an occurrence and contribute to a broader investigation into the evolving role of CRAs as private actors with considerable influence over sovereign states in the global economy. By historicizing the American roots of CRAs and their eventual global expansion following important changes in the global economy in the 1970s, this article will show that sovereign ratings are not merely “expert” or technical opinions on the likelihood of a sovereign default, but are a global governance mechanism that privilege the neo-liberal organization of production and are a representation of the United States’ hegemonic position in the current world order. This assertion will then be qualified by an in-depth case study of the political and economic events surrounding the sovereign downgrade of both France and Austria on January 13, 2012. These cases will show that while the sovereign ratings made by CRAs seem to have lost considerable influence among bondholders since the 2008 global financial crisis, especially in countries high up the ratings scale, the manner in which their opinions are politicized can generate disproportionate consequences on a government’s fiscal policies and political dynamics.

**Critical Theory and Private Authority in International Relations**

As previously discussed, CRAs are an example of private actors wielding authority over sovereign states in the international system and the relationships that exist between states and non-state actors should be given proper theoretical consideration. But examining the development of private authority in international affairs is often a difficult challenge for the traditional, problem-
solving theories of international relations (IR). By viewing the state as the most important unit of analysis, neo-realism and neo-liberal institutionalism not only overlook the relevance of non-state actors in the international system, but they also fail to account for the existence of different kinds of states with a diversity of goals and modes of interaction beyond the concerns of war and peace. While of important practical use for the precise examination of a particular problem area involving a limited number of variables (Cox 1981: 88), problem-solving theories assume the basic features of the international system to be constant and are thus, unable to conceptualize structural change beyond these features (Bieler and Morton 2003). However, critical theory “does not take institutions and social power relations for granted but calls them into question by concerning itself with their origins and how and whether they might be in the process of changing” (Cox 1981: 89). The main purpose of this article is to analyze how the authority of CRAs emerged in the existing world order, how that authority is exercised in the current crisis, and how and whether the nature of that authority is changing. Thus, this article will apply a neo-Gramscian perspective in international political economy (IPE) to the global growth of CRAs. I will then briefly examine Standard & Poor’s downgrade of the United States to set up the political and fiscal responses that surrounded the downgrade of my case studies, France and Austria.

The neo-Gramscian approach rests on a unique conception of hegemony. While neo-realism conceives of hegemony as the military and economic dominance of a powerful state over all other states (Gilpin 1981), the neo-Gramscian perspective broadens the concept’s domain to one “based on a coherent conjunction or fit between a configuration of material power, the prevalent collective image of world order (including certain norms) and a set of institutions which administer the order with a certain semblance of universality” (Cox 1981: 103). Hegemony is thus conceived to extend beyond the coercive actions of a powerful state to include the more consensual aspect of dominance and subordination so that “dominance by a powerful state may be a necessary but not a sufficient condition of hegemony” (1981: 103). Within a historical structure, hegemony is constituted through
three spheres of activity: social relations of production, forms of state, and world orders (Bieler and Morton 2003). These three spheres are interrelated:

Changes in the organization of production generate new social forces which, in turn, bring about changes in the structure of states; and the generalization of changes in the structure of states alters the problematic for world order. For instance, as E.H. Carr argued, the incorporation of the industrial workers (a new social force) as participants within western states from the late nineteenth century accentuated the movement of these states toward economic nationalism and imperialism (a new form of state), which brought about a fragmentation of the world economy and a more conflictual phase of international relations (the new structure of the world order) (Cox 1981: 100).

Using the neo-Gramscian concept of hegemony within a method of historical structure, we can historicize the growth in authority of CRAs by examining the significant economic changes that occurred during the 1970s, which first transformed the structure of the US state, and ultimately gave way to a new world order organized around the interests of transnational capital in a globalized world economy. This historical examination will show that the growth in authority of CRAs is one expression of US neo-liberal hegemony in the current world order. Following this examination, an analysis of the political and fiscal responses to a sovereign downgrade in France and Austria will be conducted to determine whether the authority of CRAs’ judgments are being internalized or resisted, and thus provide some insight into whether the world order is in a process of change.

**Credit Rating Agencies and Global Governance**

Before an in-depth analysis of the various governmental responses to a sovereign debt downgrade can be made, a critical examination of the history of CRAs and their role in global governance is required. The concept of global governance is itself highly contested but much can be gained from a brief discussion of the subject despite the diversity of perspectives that exist. Additionally, such a discussion will provide this article an opportunity to establish the utility of a neo-Gramscian concept of hegemony in assessing the influence and authority of private entities in international affairs as opposed to the limited contributions of traditional theories of international relations (IR) to the subject.
The concept of global governance emerged in the 1970s as decisions over the collective problems confronting states grew in importance. Drastic changes in the global economy after the collapse of the Bretton Woods system, the liberation of capital from national borders, access to new labor in the developing world, growing competition over finite natural resources proceeding the Arab oil embargo, and the emergence of climate change, were among the many new global issues weakening the ability of nation-states to manage independently. Simultaneously, the US-led system of postwar coordination through the concept of international organization, represented most visibly in the growing prestige of the United Nations, began to disintegrate as the assertive emergence of new states in Africa and Asia following the end of colonialism shifted the balance of international concerns towards rectifying the inordinate disparities between the global North and South (Sinclair 2012: 15-17). Following this relative decline in US leadership and Western dominance over the prevailing world order, the broadening scope of global issues throughout the 1970s and 1980s fostered the growth of private, non-state actors’ technical and managerial influence in the creation and enforcement of global governance, particularly over the challenges created by the reemergence of global finance and increased economic interdependence (2012: 20). Even while the profiles of intergovernmental organizations such as the European Union, International Monetary Fund, World Trade Organization, and the World Bank grew, the influence of NGOs, Multinational Corporations (MNCs), social movements, and other private institutions in shaping government policy and regulatory oversight increased dramatically (Cutler, Haufler, and Porter 1999). One such private institution with the authority to “regulate both states and much of transnational economic and social life” is the credit rating agency (Murphy 2000: 793). Therefore, their authority and influence must first be examined by historicizing the character of the economic and political transformations responsible for creating the environment instrumental for their proliferation.

Credit Rating Agencies in the Neo-liberal Era

Partnoy suggests that CRAs originated in the United States’ mercantile past (Partnoy 1999: 636).
During the seventeenth and eighteenth centuries, colonial importers customarily extended up to a year of credit to their retail customers, shopkeepers, and general stores. Payments were often late, and it was difficult for sellers to gather credible information about the reputation of buyers: letters of reference were faked or forged, detailed financial data were not available, and the process was tediously slow. As markets and trade evolved during the nineteenth century, it became clear that there were economies of scale associated with gathering and disseminating credit information in a systematic, organized way.

The railroad boom of the late 19th century provoked the need for greater market surveillance, ultimately fostering the establishment and success of Moody’s, Poor’s Publishing Co., Standard’s Statistical Company, and Fitch Publishing Company in the early 20th century (McVea 2010: 707-708; Partnoy 1999). These CRAs initially focused on railroads, industrial corporations and financial institutions in the US until an important transformation of the global economy in the 1970s and 1980s instituted their global reach (Sinclair 2005: 26).

The last major economic crisis in the 1970s marked the end of the Keynesian, state-led management of national economies and unleashed a new era of “globalized financialization” (Hoogevelt 2010: 52). The economic and political challenges of the 1970s gave rise to the theory of neo-liberalism, which promoted an institutional framework designed to support strong private property rights, free markets, and free trade. The state would be responsible for the creation and preservation of this framework but would keep interventions to a minimum (Harvey 2005: 2). This new era is personified by Ronald Reagan and Margaret Thatcher in the United States and Britain, respectively, but their domestic political achievements were only part of the broader ideological and practical transformation of capitalism instigated by the effects of technological advancements in global logistics and communication, the liberation of capital from national borders, and access to new labour in the developing world. Perhaps the most relevant development to our research agenda in this era was the deregulation of finance and currency markets after the collapse of the Bretton Woods system and subsequent proliferation of short-term speculative capital transfers (Burchill 2009: 74).

2Standard’s merged with Poor’s in 1941 to form Standard & Poor’s (S&P).
Timothy Sinclair notes that the level of reliance on CRAs directly coincides with changes in financial markets. Banks are traditionally defined as financial intermediaries that borrow money through the funds of depositors and then lend that money to borrowers at their own risk. But the neo-liberal era helped usher in a new change in banks and borrowers’ behaviour, as depositors discovered new opportunities for their funds (government and private bonds, stocks) while borrowers found new sources for funds (capital markets) other than banks (1999: 154).

Figure 1. Trends in financial assets of institutional investors

By 1994, the percent of American households owning a mutual fund increased to 28 percent, up from 6 percent in 1980. Consequently, the proportion of household assets held in US bank deposits declined from 1980-1990, from 46 to 38 percent (Sinclair 2005: 55). On the borrowing side, commercial lending by American banks declined from 65 percent of total borrowing needs in 1970 to 36 percent by 1992, making up the balance through securities (Economist 1994: 11). At the global

level, bank lending declined from 37 percent of total capital movements in 1977-81 to 14 percent in 1982-86. Portfolio investment, instead of direct investment in physical capital, grew from 36 percent in 1972-76 to 65 percent of total investment in 1982-86 (Sinclair 2005: 55).

The process of disintermediation made it more difficult for a lender to effectively judge the likelihood that a borrower would be able to repay his debt, therefore requiring independent institutions capable of gathering the information needed to make such a judgment. CRAs fulfil this role by making judgments on the “future ability and willingness of an issuer to make timely payments of principal and interest on a security over the life of an instrument.” They provide this service for all issuers of debt, including sovereign governments, through a rating scale from least to most “creditworthy” (Sinclair 1999: 155). It is no surprise that the global growth in disintermediation since the 1970s coincided with the expanding reach of CRAs. By 2007, S&P alone rated approximately US $34 trillion in debt globally in 100 countries (McVea 2010: 708).

Neo-liberalism emphasizes “contractual relations in the marketplace”, which requires the pursuit of information technologies that can “accumulate, store, transfer, analyse, and use massive databases to guide decisions in the marketplace” and maximize the “reach and frequency of market transactions” (Harvey 2005: 3). Given the important changes in global financial markets during the neo-liberal era, especially evident through the referenced trends in disintermediation, we can more clearly understand why the utility of CRAs in coordinating market activities increased as a result of this historical juncture in the global capitalist system. Still necessary for our examination is a discussion over how that increase in utility relates to the existence of power and authority in global governance and it is to this discussion that we now turn.

*Neo-liberal Hegemony – The Structural Power of Capital and Epistemic Authority*

The neo-Gramscian concept of hegemony can be readily applied to the neo-liberal era and its proliferation of market ideology, norms, and standards of behaviour - through which CRAs are just one conduit. In one strand of the concept of hegemony, Gramsci applies it to the “apparatus or
mechanisms of hegemony of the dominant class”. This idea is what led Gramsci to extend his view of hegemony beyond the actions of state institutions but also further into all the political structures of civil society that contribute to the social order (Cox and Sinclair 1996: 126). No doubt this includes the numerous forms of private authority and self-regulation in global governance discussed in detail in Cutler, Haufler, and Porter (1999). In the second strand of the concept of hegemony, Gramsci connects it to the concept of power, which can then be applied to “relations of dominance and subordination” and particularly “relations of world order” (Cox and Sinclair 1996: 127). It is from the concept of hegemony applied to international relations or “world order” that we can more clearly see CRAs as a part of the broader structural changes in capitalism. Cox insists that the end of the Bretton Woods system marked a shift in economic world order from the “Keynesian demand management along with varieties of corporatism” prevalent in the postwar era towards the “subordination of domestic economies to the perceived exigencies of a global economy” in the new neo-liberal era. This shift was characterized by the emergence of several new structures, including the structural power of capital and the role of debt (Cox and Sinclair 1996: 297-298).

Power itself is a controversial concept and enjoys broad usage. In the international relations (IR) field, power is almost exclusively focused on the power of states (Baldwin 2002; Schimmelfennig 1998), and while Comparative and American Politics often discusses the relationship between power and legitimate rule within the state, the lack of a sovereign authority beyond the state in the international arena frequently underestimates the relevance of questions concerning legitimate power and authority (Fuchs and Lederer 2007). In order to analyze the power of non-state actors in global governance a broader conception of power must be employed. Susan Strange defines structural power as “the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises, and (not least) their scientists and other professional people, have to operate” (1988: 24f). In this conceptualization, “the ability to define the norms and terms for the satisfaction of needs in the international system” is an important aspect of power and brings a sociological perspective to power relations (Fuchs and
Lederer 2007). We can then apply this concept of structural power to capital, which defined as a social relation, provides an important insight into the complimentary yet often competitive pursuit of authority between state and non-state actors (Gill and Law 1989). Capital as a social relation perceives a distinction between those with privileged ownership and access to capital and the remainder of society. Thus, “capital as a social relation depends on the power of the state to define, shape, and participate in a regime of accumulation.” Due to the demands of capital and financial innovation spurred by advances in technology and communication during the neo-liberal era, the structural power of transnational capital increased over that of the state (Gill and Law 1989: 479-480). While the state still retains the sole legal authority to determine the extent of free enterprise, its political will and capacity to do so is what is at question in the current environment. Even closer to the issue of this article is the manner in which the structural power of capital is manifested in the authority of CRAs.

Although CRAs provide their services for all issuers of debt, from corporations to municipalities, it is the rating of sovereign debt that yields the highest potential for affecting the actions of sovereign governments and represents an instance of the structural power of capital over that of the state. Until the 1980s, sovereign rating represented a very small fraction of the rating agencies’ work, with only US $14 billion in foreign sovereign bonds sold in New York between 1945 and 1963. This was largely due to the fact that sovereign debt was once unavailable for sale outside the country (Sinclair 2005: 138). But due to the financial globalization of the 1970s and onwards, local currencies became a more attractive purchase for investors and by the end of 2011 over US $31 trillion worth of government bonds were in issue (Economist, February 11, 2012). Cox observes that governments are increasingly relying on debt financing, particularly foreign debt, instead of equity investments or taxation in the neo-liberal era. As states use a higher and higher proportion of their revenue to service debt, their accountability to bond markets takes precedent over their own public (Cox and Sinclair 1996: 299). Because the interest rate to be paid on a bond is in effect determined by a state’s international credit rating, a sovereign credit downgrade by a credit rating agency will likely further
undermine market confidence in a state’s ability to service its debt, driving up interest rates even more and increasing the amount of state revenue directed towards debt servicing. Nowhere is this scenario more visible than in the peripheral countries of the euro area (Greece, Portugal, and Ireland) as a result of the European sovereign debt crisis. The downgrading of these countries’ sovereign debt to “junk status” led to a jump in interest rates on bonds to an unsustainable level that inevitably required a bailout from the troika of international lenders – International Monetary Fund, European Central Bank, and the European Commission – who provided the necessary liquidity in exchange for the implementation of specific structural reforms comprised of tax hikes and spending cuts to government services that much of the public relies upon. While CRAs themselves do not directly dictate fiscal policy to the sovereign states whose debt they rate, their ratings publications have an enormous effect on investor decisions and market price (Sinclair 1999: 156), thus creating a potential for calamitous ramifications when rating sovereign debt.

While CRAs, as well as other non-state actors, do not possess the legal authority often associated with government, their authority is instead “based upon and operative through claims to specialized knowledge. Epistemic authority supplies advice, expertise, and the like to executive authority, while the latter retains financial decision-making power” (Lincoln 1994: 168; Sinclair 1999: 159). CRAs have epistemic authority, rather than influence, because their judgments determine a corporation, municipality, or state’s level of access to capital markets (Sinclair 1999: 159). Although the work of CRAs is often viewed as depoliticized and technical, the epistemic authority of their judgments should not be disentangled from the world order from which it arose. The American rating agencies, Moody’s and Standard & Poor’s, dominate the global credit issuer market with the much smaller French-owned Fitch Ratings in a very distant third (Sinclair 2005: 1). Whether credit rating is viewed as a specifically American process or a transnational phenomenon, either scenario creates pressure for policy convergence that “privilege a system of values and knowledge tied to particular social forces” (Sinclair 1999: 158; 2005: 120). Thus, the oligopolistic control of the rating market, the “issuer pays”
model\textsuperscript{3}, and the incorporation of ratings into the regulations and investment mandates of the Basel I capital requirements, has cemented the institution as a “quasi-regulatory” mechanism of global governance (McVea 2010: 708) and an expression of US neo-liberal hegemony in the current world order. Whether this current order is in a process of change will now be determined through the careful consideration of the methodology employed and the results of our subsequent case analysis.

**Methodology**

As indicated earlier, this article will employ a case-oriented analysis of the political and fiscal policy effects of the sovereign downgrades in France and Austria. I am using a case-oriented design instead of a positivist or variable-oriented design because I am attempting to explore the interactions between a constellation of variables within a variety of state-society complexes and their subsequent effect on the current world order, instead of trying to establish generalized relationships between variables. Using this strategy will allow me to account for and make effective use of the observation that our unit of analysis is not a static object but a fluid entity continually pressured by “forces from above (world order) and from below (civil-society)” (Cox and Sinclair 1996: 3). I selected my cases because at the time of this research they were the first and only “AAA” rated countries to be downgraded following the US downgrade in August 2011. These cases also happen to be members of the European Union, and perhaps more importantly, utilize the common euro currency. This is an especially important consideration as the political prerogatives associated with the European Union, as well as the political and monetary constraints of the common currency, situates France and Austria’s response to the downgrade within a unique global governance power structure that cannot be ignored. Of all the countries previously downgraded from “AAA” (Australia, Canada, Japan, Sweden, US), only France and Austria faced the sovereign limitations of a supranational free trade regime bound by a common currency. Therefore, their respective responses to the downgrade must

\textsuperscript{3}For a detailed explanation of the “issuer pays” model, see McVea, H. (2010). ‘Credit Rating Agencies, the Subprime Mortgage Debacle and Global Governance: The EU Strikes Back,’ *International and Comparative Law Quarterly* vol 59, July 2010, pp 701–730.
be placed within the context of the euro area and its current crisis when conducting an in-depth empirical investigation of the several variables I will now present.

The first variable to take into consideration is the issue of time. The global financial crisis and the S&P downgrade of the US in August 2011 will act as an instance of what Sewell (1996) calls *eventful temporality*, or those particular events that are defined as a “relatively rare subclass of happenings that significantly transform structure” (della Porta 2008: 220). Therefore, the analyses of our cases cannot be removed from the narrative of the era of globalization and European integration that preceded their downgrade. More importantly, due to the transnational character of the global economy and the United States economy’s large role in it, the timing of its downgrade must be a consideration when analyzing the simultaneous downgrade of France and Austria five months later.

A second variable will be to examine changes in fiscal policies before and after the rating downgrade in each country as well as a comparison between any fiscal changes with the recommendations provided in the rating statement. This will involve some quantifiable measurements of fiscal austerity or stimulus but also a qualitative assessment of how fiscal policy decisions are directly affected by the downgrade, if at all. Another quantifiable variable will be the market reaction to the downgrade, namely the fluctuations in borrowing costs (we will use 10-year bond yields) and stock markets. An additional variable will be an in-depth examination of the rhetorical framing of the country’s credit rating, before and after the downgrade, from governments and their political leaders (executives, finance ministers, central bank presidents, etc.). A final variable will involve an examination of proposals introduced within sovereign government institutions, as well as those in international/supranational organizations or other institutions of global governance to reform the credit rating industry.

Exploring all of these variables in our respective cases will allow us to observe the emergence of important changes, if any, within the “limited totality” of credit rating agencies as an historical structure. In this sense, we should be able to observe any change in the ideas and judgments central to the rating process, evaluate changes in the material capabilities of the process through their
relationship with the effect of a credit downgrade on the cost of capital, and a change in the position of credit rating agencies as an institution among many, competing for authority over the allocation of capital (Cox and Sinclair 1996: 10-11), following the global financial crisis. An informed discussion on the extent of private authority as it relates to credit rating agencies in the world order can then conclude our analysis.

**The Downgrade of US Sovereign Debt by Standard & Poor’s**

When Standard & Poor’s downgraded the United States from “AAA” to “AA+” on August 5, 2011, it cited three main reasons for the rating adjustment: (1) the rising public debt burden, (2) the inadequacy of the fiscal consolidation plan to stabilize the country’s medium-term debt dynamics that the Congress and Administration agreed to, and (3) the likely continuation of the policy uncertainty and political brinkmanship exhibited in the debt ceiling controversy (S&P 2011). Briefly examining the market response and political rhetoric following the S&P downgrade will help provide some important insight into the role and position of CRAs’ private authority during the global financial crisis.

*Figure 2. Yields on U.S. 10-yr government bonds (4/2011 – 1/2012)*

In the graph above, US government bond yields began a steady decline in April of 2011 until the
announcement of the downgrade in early August, in which a sharp decline from 3 percent down to 2 percent occurred. The downgrade in no way negatively affected the US government’s ability to borrow and actually reduced borrowing costs by a significant amount.

*Figure 3. U.S. Stock Market – Dow Jones (4/2011 – 1/2012)*

The US Stock Market (Dow Jones) on the other hand, registered an approximate 2,000-point drop after the announcement of the downgrade. But this decline is likely an indication of a panicked sell-off among short-term investors following the unprecedented event of a US sovereign downgrade. The significant decline in Treasury yields gives a much greater weight to the view that investors still perceive US debt to be extremely safe. The political response was unsurprising, however, with the Obama Administration and Congressional Democrats placing the blame on the Republican opposition and vice versa (Goldfarb 2011). Furthermore, the downgrade seemed to have almost no effect on fiscal policy. S&P said the $2.5 trillion deal reached to raise the debt ceiling “fell short” of the $4 trillion reduction to the deficit in the next ten years that was needed (S&P 2011). $1.5 trillion of the original deal was supposed to be determined by a “supercommittee” of twelve lawmakers but the downgrade did not appear to create much impetus for further deficit reduction as the “supercommittee” dissolved only months later with no agreement. More significant was the response from the US Treasury, which commented on what they called a $2 trillion math error in an early draft
of S&P’s report, indicating that their methodology was “flawed” (Goldfarb 2011). Treasury Secretary Timothy Geithner is quoted as saying, “I think S&P has shown really terrible judgment and they’ve handled themselves very poorly. They’ve shown a stunning lack of knowledge about basic US fiscal budget math. And I think that they drew exactly the wrong conclusion from this budget agreement” (Cox 2011). Taken together, the various market and political responses provides an important insight into the political and economic dynamics surrounding sovereign ratings in the current environment.

As evidenced by sales and yields in the US bond market, the downgrade actually increased demand in the same government bonds that S&P’s rating implied were now riskier. Since bondholders seemed to overwhelmingly ignore the implied judgment of S&P, the logical deduction not only suggests a significant decline in the company’s credibility but also confirms our characterization of the US as the proverbial Gramscian hegemon relatively free from the exigencies typically placed on a state further down the hierarchy of the world order following such an event. Furthermore, the paradoxical outcome of the downgrade suggests that S&P’s opinion was not solely an “expert” or “technical” judgment of the likelihood of a default on US government debt, but ultimately a political intervention by a private entity into sovereign governmental affairs. But while the downgrade in the United States may have proved relatively inconsequential, both economically and politically, the effects of the event would find their way across the Atlantic into the dynamics of the European economic crisis.

**Case Analysis: France and Austria**

On January 13, 2012 Standard & Poor’s downgraded nine euro area countries, including the “AAA” rated economies of France and Austria. In its rating statements, S&P said that insufficient resources and lack of operational flexibility provided by EU policy-makers to address the political, financial, and monetary challenges of the euro area of which France and Austria is closely integrated, including the misguided focus on austerity as the center of the reform process to address rising
external imbalances and divergences in competitiveness, was one of the reasons for the downgrade (S&P 2012). Although S&P published rating statements with country specific reasons for each respective downgrade, one common judgment in all of them refers to the current state of European governance in the ongoing crisis. Therefore, it is important that France and Austria’s situation is placed in the European context when proceeding with the detailed case analyses.

In order to concretely examine the political and fiscal effect of the downgrade in France and Austria, we must first consider the existing economic policies surrounding the euro area and the political dynamics of the ongoing economic crisis. Euro area members are already required to adhere to the Maastricht convergence criteria, which calls for a 3 percent limit on budget deficits and a 60 percent ceiling on total overall debt (European Commission n.d.). The effects of the euro-crisis in 2010 caused many members to exceed both of these limits, especially in the periphery, where international bailouts were provided in exchange for structural adjustment policies that would bring these countries’ fiscal situations back in line with the Maastricht criteria. Although neither France nor Austria were ever under a bailout-imposed fiscal adjustment, their fiscal policy still operates under existing EU and domestic constraints, meaning the goal is to determine whether the downgrade altered or intensified the previous fiscal trajectory.

It is also important to consider the tumultuous month of July 2011, in which concerns about a Greek exit from the euro led EU leaders to agree to a second bailout for the country and yields on government bonds from Spain and Italy rose sharply. Below are some indicators of the market reaction in France and Austria in the summer of 2011:

*Figure 4. France Stock Market – CAC 40 (5/2011 – 9/2011)*
The stock market in each respective country experienced a very sharp decline in July 2011 as concerns about the future of the euro currency grew. We will return to an examination of the stock market in France and Austria again following their downgrade. The graphs below are yields on ten-year government bonds in France and Austria during the summer of 2011:

*Figure 6. Yields on France 10-yr government bond (5/2011 – 9/2011)*
Even with the euro area locked in market turmoil, yields in France and Austria actually began steadily declining in July 2011, signaling the safe-haven status provided by a “AAA” rating. Maintaining that status would become an increasing concern for France and Austria in the following months as any further downgrades of euro area members would affect the European Financial Stability Facility (EFSF), Europe’s previous bailout fund, which had just been granted the power to purchase bonds on the secondary market and recapitalize banks in an emergency (Economist, August 28, 2011). European sovereign ratings would have a direct effect on the cost of purchasing such bonds and maintaining the EFSF’s own “AAA” rating, creating an extra pressure on European governments to avoid potential downgrades.
The French Case

The events surrounding the downgrade of France by S&P on January 13, 2012 are particularly unique given the dramatic narrative of the presidential election that framed them. Then president, Nicolas Sarkozy, had been experiencing consistently low levels of support since the onset of the euro-crisis and was searching for a way to craft a political legacy that would prove to voters his resolve in leading France through the crisis. Soon after the US lost its “AAA” rating on August 5, attention was then diverted to the economies of the euro area, where European leaders were returning from their summer holiday to negotiate a second international bailout for Greece. On August 10, Nicolas Sarkozy announced that his government would unveil new austerity measures to slash the country’s public debt and preserve its “AAA” credit rating (Phillips 2011). The statement came after shop drops in the shares of France’s largest banks – Societe Generale, BNP Paribas, and Credit Agricole – began the circulation of rumors that France’s “AAA” rating was at risk (Gill 2011). On August 24, a EUR 11 billion austerity budget was announced, consisting solely of various tax increases on high incomes, capital gains, and property investments, as well as taxes on cigarettes and alcohol. The measures also limited tax breaks given to companies incurring losses and a reduction in benefits for companies of tax-free overtime (Hollinger and Boxell 2011). It is also important to note that the austerity package was also designed to help bring France’s budget deficit back to the 3 percent limit required by the Maastricht Criteria. But by late October the worsening crisis in the euro area forced the French government to lower its growth forecast for 2012 from 1.75 percent to 1 percent and Moody’s put France on “negative” watch (Clark 2011). In a televised statement Sarkozy said that the anticipated decline in tax revenues would need to be compensated with another program of budget cuts between EUR 8.5 – 11.3 billion: “It’s because of this debt crisis that we find ourselves in a position of having to defend France’s triple-A” credit rating, and added that a downgrade would only increase the interest burden on France’s debt (Clark 2011). Thus, on November 7 the government unveiled its second austerity package in three months, promising to save EUR 7 billion with three-
fourths comprised of various tax increases, in addition to limited short-term cuts and a rise in the retirement age to 62 in 2017 (Economist, November 12, 2011). Sarkozy was reported saying in private, “if we lose the triple-A, I’m dead” (Chrisafis 2011).

On January 13, 2012 S&P published its downgrade of France from “AAA” to “AA+”. Interestingly, the overall market response was minimal:

*Figure 8. Yields on France 10-yr government bonds (12/2011 – 3/2012)*

As indicated by the graph above, a brief spike in yields occurred in early January upon expectation of the downgrade but this was followed by a steady decline in rates over the next two months. The downgrade actually proved relatively inconsequential in negatively impacting France’s debt servicing ability and like the US, France’s borrowing capabilities actually improved after the downgrade.

*Figure 9. France Stock Market – CAC 40 (12/2011 – 3/2012)*
The French Stock Market (CAC 40) also performed relatively well in the months following the downgrade, although a relatively sharp decline did occur in early January upon expectation of the downgrade. Much like the situation in the US, though, the market reaction remained small, indicating that bondholders continued to overwhelmingly ignore the implied judgments of S&P. Given these indicators, the downgrade did not produce any short-term external market pressures that would create a need for significant or substantive fiscal measures.

Following the downgrade on January 13, 2012, Sarkozy gave his first public comments on the downgrade by stating, “in the final analysis, this doesn’t change anything” (Jolly 2012). Finance minister Francois Baroin declared that the event was “not a catastrophe” and urged for calm (Alderman 2012). While Sarkozy and members of his UMP government downplayed the significance of the downgrade, opposition leaders took full advantage of the event to place the blame on Sarkozy. Socialist Party secretary Martine Aubry declared Sarkozy to be the “president of the degradation of France” (Alderman 2012). Socialist presidential candidate Francois Hollande remarked that Sarkozy had made the preservation of France’s top rating “an obligation for his government” and that it was Sarkozy’s policies, not France, that was downgraded (Erlanger 2012). Sarkozy would eventually lose his reelection bid to Francois Hollande in June 2012.

Reform of the credit rating industry continues to be an important legislative issue within EU
institutions, especially since the global financial crisis of 2008, and France is an avid supporter for reform. The French EU Commissioner for Internal Market and Services, Michel Barnier, has been at the head of much of the reform efforts concerning credit rating agencies. He introduced the proposal that eventually created the European Securities and Markets Authority (ESMA) in 2011, with one of its major tasks to institute new rules for credit rating agencies in Europe (BBC, June 2, 2010). One of the major initiatives he proposed to curb the power of CRAs is a proposal to force issuers to regularly change the agencies that rate their bonds. One of the main criticisms of CRAs has been that because issuers pay an agency to rate their debt, this creates a conflict of interest between the issuer and the rating agency (McVea 2010). France was only one of three or four EU member states supporting the idea to require the rotation of agencies every three to six years, with the perception that such a measure would diminish the reliance on Moody’s, Standard and Poor’s, and Fitch. However, the measure faced heavy opposition from several interest groups, many in Germany, the United Kingdom, in France itself, as well the European Securities and Markets Authority, which was created to supervise CRAs. Additionally, almost every initial reform to constrain the power of CRAs introduced in 2009 has been significantly watered down (Barker 2012). The most recent legislation passed in late November of 2012 included new rules that will require agencies to set up a calendar indicating when they will rate EU member states and that ratings can only be published after the close of business and before the stock market reopens in order to avoid sudden market disruptions. Furthermore, rating agencies will have to provide greater transparency of their underlying facts and assumptions to investors and EU countries when rating sovereign states. However, several experts and EU officials admitted that while the legislation provides better supervision of credit rating agencies, the reform does little to alter their behavior. Furthermore, a draft report concerning the creation of a European credit rating agency has been pushed back to 2016 (O’Donnell 2012).

The Austrian Case

Just like France, Austria’s downgrade was tied to its situation in the ongoing euro-crisis and
warnings of an Austrian downgrade also occurred following the S&P downgrade of the US in August 2011. In the fall of 2011, a fiscal austerity package as well as a proposed constitutional limit on future borrowing (commonly referred to as a “debt brake”) were already under consideration before the news of the downgrade and supported by the grand coalition between the social democrats (SPO) and conservatives (OVP). Germany passed its constitutional debt brake in 2009 and in December 2011, German chancellor Angela Merkel and French president Nicolas Sarkozy announced their support for adding the debt brake into the constitutions of the 17 euro area countries (Economist, December 10, 2011).

In November 2011, the SPO-OVP coalition government introduced its proposal to create a debt brake that would constitutionally limit future borrowing and bring the overall debt level back to 60 percent by 2020. While the two coalition parties disagreed over the exact measures to achieve that goal, Austria’s chancellor and member of the SPO, Werner Faymann, said that “we want a top credit rating, the lowest unemployment rate – and we do not want to spend money on interest rates of the public debt” (Austrian Times, November 16, 2011). Head of the State Debt Commission, Bernhard Felderer, also expressed his support for the debt brake while warning that Austria’s credit rating could be lowered from “AAA” if the economic situation in Italy, an important import and export market for Austria, significantly deteriorated (Austrian Times, December 30, 2011). Although Moody’s affirmed its “AAA” rating of Austria in December 2011, it cited concerns over the country’s health care sector and debts and also warned its rating was at risk should the economic climate in Eastern Europe worsen in the future, prompting vice chancellor and OVP member Michael Spindelegger to state that the government “will not sit back and relax” because of Moody’s confirmation (Austrian Times, December 30, 2011). Even in the month before the downgrade by S&P we can clearly see that top government leaders were using Austria’s “AAA” rating as a justification for the pursuit of their specific fiscal agenda.

On January 13, 2012, S&P published its downgrade from Austria from “AAA” to “AA+” and much like France; the overall market response was minimal:
Figure 10. Yields on Austria 10-yr government bonds (12/2011 – 3/2012)

Although a brief spike in yields occurred in early January upon expectation of the downgrade, their consistent decline in the month following the downgrade reaffirms a muted market reaction, as well as signifies limited pressure on the governments’ ability to borrow. In fact, the decline in the 10-year interest rate made the cost of debt servicing lower than it was prior to the downgrade.

Figure 11. Austria Stock Market – WBI (12/2011 – 3/2012)

Again, we see that the downgrade had limited effect on the Austria Stock Market (WBI) and actually began returning to levels seen before the tumultuous summer of 2011. While market indicators suggest minimal external pressures exist to require a significant or substantive change in
fiscal policy, the news of the downgrade would be highly politicized and create conditions conducive for fiscal adjustment, and it is to this examination that we now turn.

Following the news of the downgrade, Werner Faymann declared the move from S&P to be “wrong and incomprehensible”. Faymann cited the country’s reasonable level of overall debt (74 percent of GDP), lowest unemployment rate in the EU (4 percent), and low budget deficit (estimated to be 3.2-3.4 percent at the time) as reasons for why the downgrade was unwarranted (Scally 2012). Furthermore, Faymann made sure to mention Austria’s “AAA” rating from Moody’s and Fitch, as well as the current debt reduction bill still being negotiated in parliament. The social democratic Central Bank governor, Ewald Nowotny, also described the rating downgrade as “politically motivated” (Lister 2012) and called the decision “an aggressive political action by Standard & Poor’s to downgrade quasi all of Europe in one blow” (Scally 2012). However, reactions varied along party lines with conservative members of the coalition (OVP) avoiding any downplay of the downgrade. Finance Minister and OVP member, Maria Fektar, said the downgrade was a “wake up call” to take notice of the country’s “Damocles sword of debt”, most visible in Austria’s bank exposures to Central and Eastern Europe (Scally 2012). Austrian banks’ total international exposure in the first quarter of 2011 was EUR 380 billion, or 134 percent of GDP, with two thirds of that concentrated in Central and Eastern Europe (Stratfor, January 17, 2012). Austria’s biggest bank, Erste Bank, had already announced its plans to reduce the workforce level of its Hungarian affiliate by 400-450, as well as start a “restructuring and re-dimensioning procedure” at Erste Bank Hungary (Austrian Times, January 19, 2012). Fektar made sure to reiterate that the downgrade is “a matter of debt and deficits, not primarily of the economy”, a marked distinction from her colleagues on the opposite side of the coalition and a sign of enthusiasm for her party’s support of debt reduction and a proposed constitutional limit on future borrowing (Scally 2012). Opposition leader Heinz-Christian Strache of the right-wing populist FPO claimed the downgrade was a vote of no confidence in the government and stated “if nothing better occurs to them than ‘incomprehensible’, it’s high time to send these gentlemen into the desert” and called for a general election (Scally 2012). President of the Federal
Trade Union (OGB), Erich Foglar, focused his response to the downgrade on the S&P statements regarding austerity across the EU. He warned of the negative effects on the European economy if all member states did nothing but make cuts at the same time and expressed his support for the inclusion of balanced tax hikes or new taxation measures that would not significantly “affect the masses” nor negatively affect the economy or unemployment rates. The conservative OVP party claimed that the budget deficit could be restored without tax hikes or new taxation measures (*Austrian Times*, January 19, 2012).

In February 2012, the governing coalition introduced a five-year EUR 26.7 billion-austerity package to help bring Austria back within the fiscal limits imposed by the Maastricht criteria. However, after passing the “debt brake” law in December, the governing coalition was unable to obtain the two-thirds majority needed to make the law a constitutional measure, lacking support from the FPO and Green party. After further negotiations within the governing coalition, the austerity package was increased to EUR 27.9 billion and included EUR 17.3 billion in cuts to the pension system, civil service, and state-run companies like Austrian Rail (OeBB) and sector subsidies, as well as EUR 9.2 billion in increased tax revenues. Additional reforms to the social service system would bring EUR 1.4 billion in savings as well (*Times of Malta*, March 6, 2012). One month later in April, Fitch maintained Austria’s “AAA” rating, prompting Finance Minister Maria Fektar to claim Fitch might have downgrade Austria had the austerity measures not passed last month. She further stated that she was “certain that when the next evaluation comes from Standard and Poor’s, they will recognize that we have triple-A status” (*AFP*, April 18, 2012).

**Discussion**

The events following the S&P downgrade of the United States from “AAA” allow this article to observe the emergence of several important changes in the role of credit rating agencies as a “limited totality”, in addition to discussing general observations concerning the nature of private authority in international affairs. The effects of a sovereign downgrade in a country experiencing a true fiscal
crisis are well known, with the struggling peripheral euro area members and their subsequent bailouts and austerity programs providing the most recent examples in daily newspaper headlines around the world. The structural power and authority of CRAs reaches its pinnacle in those countries resting further down the rating scale but my analysis of a downgrade in “AAA” countries allows for a more complete picture on the extent of that authority, particularly following the rare event of a global financial crisis in which CRAs helped precipitate.

The downgrade of the US is especially revealing due to the paradoxical response exhibited by bondholders. After stock markets fluctuated wildly over questions concerning the economic and political uncertainties that such an event might create, bondholders quickly and emphatically provided an answer: nothing. At least, this was the case in the United States. The fact that bondholders overwhelmingly ignored S&Ps implied judgment on the likelihood of a US sovereign default suggests that S&P provided little more than well-established commentary on the political partisanship exhibited in Congressional negotiations over the debt ceiling. It also lends support to the utility of a critical perspective in analyzing the evolution of an instance of private authority. S&P’s downgrade proves that a technical view of credit ratings is incomplete and that those who accept their opinions socially construct their authority. In the case of the US, the extent of that authority seems very much in doubt.

A similar conclusion can be reached in the cases of France and Austria. Once again, bondholders seemed to ignore S&P’s assessment on the risk of default in these countries and the reduction of S&P’s judgment to political commentary on the euro-crisis is reestablished. But the politicization of the “AAA” rating that occurred, both before and after the downgrade, allowed S&P’s judgments the opportunity to generate a much more visible effect on the eventual political and fiscal outcomes, especially in France. When comparing the French and Austrian narrative with that of the United States, a neo-Gramscian conception of hegemony proves useful in interpreting the disparity.

In all cases, all the appropriate conclusions can be reached on CRAs as a “limited totality” within an historical structure. Following the crisis, the judgments of the sovereign rating process are shown
to be significantly more political than technical; their material capabilities in affecting the cost of capital is diminished; and their highly held position as an institution among many competing for authority over the allocation of capital is increasingly questioned by the ongoing reform efforts in both the United States and Europe. Despite these important changes, the utility of credit ratings will likely remain a vital part in coordinating the activities of the global capitalist economy and their role should continue to be critically assessed.
REFERENCES


