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Swimming With The Current:
The Role of Credit Rating Agencies in Contemporary Global Governance

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A thesis submitted in partial fulfilment of the requirements for the degree of Master of Philosophy,
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Statement of Originality

This is to certify that to the best of my knowledge, the content of this thesis is my own work. This thesis has not been submitted for any degree or other purposes.

I certify that the intellectual content of this thesis is the product of my own work and that all the assistance received in preparing this thesis and sources have been acknowledged.

Michael D. Priebe

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Introduction

The 2008 global financial crisis presented scholars with a dramatic demonstration of the extent of global integration of the financial markets and the ramifications of this integration for a range of actors in the international system. States, traditionally viewed as the central players in global governance, scrambled to develop adequate domestic policy responses to mitigate the impact of the crisis on the real economy. A globally coordinated policy response by state actors was discussed, yet ultimately proved unachievable as policy makers came under domestic political pressure to act unilaterally. A number of states were able to pursue similar approaches in responding to the crisis, but the scale of the crisis and the speed of its impact across various markets prevented a fully coordinated policy response. While the global nature of the 2008 global financial crisis was not new, the pivotal role credit rating agencies played both before and after the crisis was. The tumultuous events that engulfed the financial system during 2008 raised serious questions about the rating agencies and triggered tough regulatory responses from state actors in a number of markets, most notably Europe.

For International Political Economy (IPE) scholars, this crisis raised a number of questions regarding the contemporary international system and those actors who influence global governance. While much of the focus has been on how state actors can improve their ability to coordinate their response to challenges whose origins and solutions lie well beyond their jurisdictional responsibility, the role of credit rating agencies warrants greater analysis. These agencies have the important role of rating a range of financial instruments that have an immediate and material impact on the cost

of debt and assessments made by participants in global finance on the creditworthiness of range of state and non-state actors. They also provide a wide range of additional analysis that plays a conspicuous role in the creation of knowledge and the establishment of norms in the modern international system. Their impact on the real economy is substantial.

Despite many policy makers introducing greater regulation and direct public investment in response to the 2008 financial crisis, the credit rating agencies have emerged in an empowered position in some markets, with government rescue packages formalising the role of rating agencies in the financial system. While the failure of the rating agencies to foresee or prevent the crisis remains unresolved, they remain the only actors in the modern international system with the global capacity to assess the creditworthiness of the massive number of entities and financial instruments that exist in the twenty-first century. This institutional capacity was developed during decades of liberalisation in the global economy. These matters gained increased importance following the well-documented retreat of the state from a range of activities, making the flow of private sector investment and the provision of credit the lifeblood of contemporary global governance. This transfer has left state actors largely impotent in their ability to accurately assess the financial strength of many domestic state and non-state entities.

To observers of contemporary global governance, it is evident that most actors over an extended period of time either pursed a liberal approach to governance or are currently seeking to remove state control over economic activities.[1] India and China

[1] Soumyen Sikdar, *Contemporary Issues in Globalization* (Oxford: Oxford University Press, 2003), p.2.

provide poignant examples of the relentless global effort to remove barriers to market forces. The emergence of a consensus around the desirability of a liberal approach to governance has long been promulgated by a range of powerful international institutions including the International Monetary Fund (IMF), the World Bank and the credit rating agencies.[2] While each of these institutions has a role to play in the liberalisation process, the recent role of credit rating agencies such as Standard and Poor's, Moody's and Fitch Ratings deserves more attention from IPE scholars.

In the context of global governance, analysis is often delineated between the developed and developing world. Each is seen as having a unique set of issues, governance structures and challenges. The influence of the IMF and World Bank is typically limited to developing countries that are dependent on their assistance, with non-state actors generally seen as being comparatively more influential in the developed world. However, the credit rating agencies exert influence over an eclectic range of actors across both the developed and developing world. These organisations rate the creditworthiness and policies of states and trans-national corporations (TNCs), benchmarking such actors against a rigid set of criteria, while also providing more qualitative analysis and research. The providers of credit are heavily influenced by the assessments made by rating agencies, empowering their influence in the modern international system. This influence has increased as capital mobility has increased. Timothy Sinclair noted that the impacts of financial issues such as these are

[2] Porter provides a useful definition of an institution as being 'a set of recognized rules that can be informal or formal'. Porter goes on to highlight that an institution uses a combination of specific rules and widely shared expectations and understandings. Tony Porter, *Globalization and Finance* (Cambridge: Polity Press, 2005), p. 25.

profound as ‘policy and democratic life at home and in far away places are increasingly affected by international capital mobility’.[3]

Technological improvements, burgeoning money supply and the removal of regulatory restrictions have liberalised the international money markets and enabled the providers of foreign capital to transfer investments and credit between states and TNCs quickly and cheaply.[4] The growth in scale of the global financial system has increased the importance of knowledge, which plays a key role in guiding the activities of many actors in the modern international system. Within this emerging framework, the credit rating agencies advocate liberal policy settings that augment the free flow of credit.[5] Thomas Friedman described these ratings agencies as the ‘bloodhounds of the electronic herd’, stating that ‘they are supposed to bark loudly when they see a country slipping out of the golden straightjacket’.[6]

The credit rating agencies have secured an integral role in steering credit and Foreign Direct Investment (FDI) through helping the providers of that capital navigate an increasingly complex global investment environment. As Timothy Sinclair has observed, ‘market actors in the new global finance are overwhelmed with news and data about prices, businesses and politics’ and that rating agencies ‘derive epistemic authority from the expert and local forms of knowledge they offer the market’.[7] This

[3] Timothy Sinclair, 'Global Monitor: Bond Rating Agencies', *New Political Economy* 8 no. 1 (2003): 147-61, p. 158.
[4] Timothy Sinclair, 'The Infrastructure of Global Governance: Quasi-Regulatory Mechanisms and the New Global Finance', *Global Governance* 7 no. 4 (2001): 441-51, p. 446.
[5] Ibid., p. 441.
[6] Thomas Friedman, *The Lexus and the Olive Tree* (London: Harper Collins, 2000), p. 108.
[7] Sinclair, 'The Infrastructure of Global Governance: Quasi-Regulatory Mechanisms and the New Global Finance', p. 443. Sinclair also discusses the concept of epistemic authority as it applies to global governance in his article, ‘Reinventing Authority: Embedded Knowledge Networks and the New Global Finance.’ *Environment and Planning C: Government and Policy* 18 no. 4 (2000): 487 – 502: p. 495.

authority derives its legitimacy through recognised knowledge within the context of competing theories. Such authority places agencies such as Standard and Poor's, Moody's and Fitch Ratings at the heart of decision making in global affairs, as state and non-state decision makers endeavour to enhance their financial reputation, obtain credit and attract investment support. Credit rating agencies continue to cultivate an expanded suite of services that create additional opportunities for the provision of analysis well beyond rating scores. Given their important role, a better comprehension of how credit rating agencies make their assessments and interact with rated entities is likely to provide scholars with an improved understanding of how global affairs are being shaped in the twenty-first century.

As an institution, the credit rating agencies have a role, as Sinclair argues, in 'constraining thinking to a specific range of acceptable possibilities' that has guided decision makers around the globe.[8] This process has powerful ramifications for the modern international system. As a large, fast-growing economy that has undergone dramatic liberalisation, India provides scholars with poignant case study of how credit rating agencies influence decision making in developing economies. Indicative of the many public interactions between the rating agencies and Indian decision makers was the April 2006 decision by Standard and Poor's to revise its outlook for India from 'stable' to 'positive' while maintaining a BB+/B rating on the sovereign.[9] According to Standard and Poor's credit analyst, Ping Chew, the reason for the upgrade was 'improved prospects of a stabilizing debt burden based on greater effort across all

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[8] Ibid., p. 443.

[9] 'Standard & Poor's Outlook On India Revised To Positive On Improved Budgetary Prospects; Ratings Affirmed', *Bank Net India*, accessed 04/10/06, http://www.banknetindia.com/banking/sp06a.htm

levels of governments to consolidate their fiscal positions'.[10] The carrot and stick approach employed by the rating agencies was highlighted when Mr Chew went on to say:

> *further liberalization of the economy and infrastructure improvements will help India's trend growth. Such reforms coupled with continued fiscal consolidation will help India achieve investment grade over time. On the other hand, if the fiscal consolidation stalls or the reform agenda derails, the outlook could be revised to stable.*[11]

Just one month later, Moody's upgraded the outlook for India's domestic currency rating from 'negative' to 'stable', due to a perception that there had been an improvement in India's debt scenario.[12] The same report by the ratings agency highlighted the need for Indian decision makers to create a favourable environment for private investment and improve fiscal flexibility.[13] India's policy elite continued to pursue liberalisation, in the hope of attracting more FDI. The correlation between assessments made by credit rating agencies and decisions made by state actors is strong and specific examples will be explored in greater detail in this thesis.

The Indian case study demonstrates that contemporary global governance is dominated by complex interactions between various actors, including the suppliers of credit and FDI. Ongoing growth in money supply and shrinking public sector funding have increased the importance of the role of the provisioning of credit and FDI, leading to heightened sensitivity to the credit rating agencies' recommendations and commentary. However, the 2008 financial crisis raised questions about the objectivity

[10] Idem.
[11] Idem.
[12] Moody's, 'Moody's changes outlook on India's domestic currency debt to stable from negative as debt ratios stabilize', (4 May 2006), accessed 04/10/06, http://www.moodys.com/research/MOODYS-CHANGES-OUTLOOK-ON-INDIAS-DOMESTIC-CURRENCY-DEBT-TO-STABLE--PR_112794
[13] Idem.

of these agencies, with some observers, like Aaron Lucchetti and Serena Ng from *The Wall Street Journal*, claiming that 'rating firms had so much to gain by issuing investment-grade ratings that they let their guard down. They had a 'symbiotic relationship' with the banks and mortgage companies that create these products'.[14]

State actors reacted to the crisis by seeking greater transparency over the credit rating process, with the European Union (EU) announcing in late 2008 the introduction of a regulation of the rating agencies to 'restore market confidence and increase investor protection'.[15] This regulatory response contained a number of punitive measures that prevented credit rating agencies from providing advisory services or rating financial instruments if they do not have sufficient quality information to base their ratings on. The regulations also required credit rating agencies to disclose their methodologies and assumptions, publish annual transparency reports, and ensure that there are at least three independent directors on their boards.

These initiatives reflected a desire amongst many policy makers around the world to reign in the credit rating agencies amidst a perception of opaque decision making and potential conflicts of interest. There is also evidence available that suggests that non-state actors had become doubtful about the role of credit rating agencies. In March and April of 2008, KPMG surveyed 333 senior executives from the global fund and investment management community. The survey found that 86%

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[14] Aaron Lucchetti and Serena Ng, 'How Credit Firms' Calls Fuelled Subprime Mess', *The Wall Street Journal*, 15 August 2007, p. A1.
[15] European Union, 'Commission Adopts a Proposal to Regulate Credit Rating Agencies' (Brussels, 2008), accessed 15/11/08, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1684&format=HTML&aged=0&language=EN&guiLanguage=en

of respondents had concerns regarding conflicts of interest in respect of rating agencies, while 88% thought a lack of understanding of the instruments they rate was a concern.[16] Furthermore, a significant 48% disagreed partially or entirely with the statement: 'rating agencies provide an accurate assessment of whether an instrument will default'.[17] At a time when technical capabilities of credit rating agencies was being questioned by providers of private capital, the role of credit rating agencies in contemporary interactions between state and non-state actors has become a critical juncture in the international system.

This juncture is particularly relevant given the origins of the 2008 financial crisis. Leading up to the credit crunch, credit rating agencies gave positive investment grade ratings to securitised mortgage products that were subsequently sold and purchased through various financial instruments in the financial market. The World Bank noted that 'because many institutional investors and even banks viewed debt with the same credit rating as fungible, even the most complex, innovative or opaque debt instrument could be sold as long as it received an investment-grade rating.'[18] The deterioration in the value of these products and the ensuing crisis has been well documented, with many of these securitised mortgage products being based on low-document mortgage loans to 'at risk' home purchasers in the United States. Once default rates increased, many of the securitised products began to unwind, leading to

[16] KPMG, *Beyond the Credit Crisis: The Impact and Lessons Learned for Fund Mangers* (UK: KPMG Europe LLP, 2008): 1-36, p. 21, accessed 2/7/08, http://www.kpmg.de/docs/Beyond_the_credit_crisis.pdf
[17] Idem.
[18] Jonathan Katz, Emanuel Salinas and Constantinos Stephanou, 'Crisis Response: Credit Rating Agencies, No Easy Regulatory Solutions', *Viewpoint Policy Journal*, Washington D.C.: The World Bank Group, no. 8, October (2009): 1-8, p. 3.

massive losses by a number of banks, other lending institutions and hedge funds, triggering the 2008 global financial crisis.

It is well recognised that credit rating agencies inaccurately assessed the health of a range of financial products, bringing into question both their ability to carry out their stated role and their objectivity, particularly given the evidence that the agencies themselves secured a growing percentage of their income through rating securitised products. The World Bank identified that:

> *lower transparency and greater complexity in this market ensured a heavy reliance by market participants on rating agencies. Partly as a result, the global market for non-traditional debt offerings grew enormously in a short period, dramatically increasing the revenue stream and profitability of rating agencies*.[19]

The World Bank also observed that rating structured products was more profitable than rating corporate bonds, with fees earned for rating corporate debt issues typically between three to four basis points, whereas the fees for structured finance issues can exceed ten basis points. By 2006, structured finance accounted for 54% of the rating business revenues for Moody's.[20]

The 2008 global financial crisis triggered a re-evaluation of the role of credit rating agencies in the modern international system. This is a role that continues to evolve, as the rating agencies expand their service offering beyond simple rating decisions to more subjective observations. In the context of global governance in the twenty-first century, such issues highlight the need for scholars to gain a better

[19] Idem.
[20] Idem.

understanding of how credit rating agencies seek to influence decision making within rated entities.

In modern commentary of global governance issues, the role of the credit rating agencies is often implied or assumed, yet few scholars have attempted to analyse how they exercise influence in global affairs. One exception to this is Timothy Sinclair, who in his book, *The New Masters of Capital* (2005), provides much needed context for the rating agencies and the influence they exert.[21] In order to compliment such research, a sophisticated analysis of how various actors in contemporary global governance interact with international rating agencies is required. Research of this nature would seek to answer questions such as: Why is credit and the flow of private capital so important to global governance in the twenty-first century? What role does knowledge play in the modern international system and who controls knowledge generation? How have state actors altered their policies to placate the rating agencies? How do credit rating agencies interact with state actors and seek to influence their decision making? Given the growing usage of broader service offerings by the credit rating agencies, how do their representatives reach judgements about the likely future actions of decision makers? These issues will have a profound impact on global governance in the twenty-first century and warrant greater analysis by scholars of the international political economy.

This thesis shall seek to contribute to an enhanced comprehension of the role of credit rating agencies in contemporary global governance by sequentially contextualising their prominence in the modern international system and focusing on

[21] Timothy Sinclair, *The New Masters of Capital: The American Bond Rating Agencies and the Politics of Creditworthiness* (New York: Cornell University Press, 2005), passim.

the interaction between rating agencies and state actors. To facilitate this process, Chapter One will explore some of the relevant theories in the current field of scholarship and their application to the contemporary role of credit rating agencies, analysed within the context of overarching governance themes. Of particular focus will be the emergence of credit as the lifeblood of contemporary global governance, which will be observed within the context of the explosive growth in the use of credit products by state and non-state actors, especially derivative products.

Having reviewed much of the current literature on the subject and established a critical methodology for investigating the role of credit in global governance, the thesis will turn to the all important issue of creditworthiness. The statistics set out in Chapter Two will clearly illustrate how important credit has become and why perceptions of creditworthiness are so relevant to cotemporary human affairs. As a continuation of this discussion, Chapter Three will outline the pivotal role of knowledge in that process, as decision makers in a highly complex and interconnected global financial system seek to distil a burgeoning supply of information through globally recognised and consistent knowledge structures.

By way of illustration, Chapters Four and Five will explore two pertinent case studies that demonstrate how contemporary global governance is applied in the modern international system. Experiences in Ireland and Hungary during 2010 provide scholars with relevant and revealing examples of the interaction between state actors and credit rating agencies. Both experiences also demonstrate how credit rating agencies comprehend and use their influence to shape decision making by state-based decision makers. This focus will also clarify how the rating agencies use outlooks and

reviews to make predictive assessments about the future actions of state-based decision makers, effectively enhancing their ability to exert influence and control through knowledge generation and distribution.

The complexity of the modern international system creates challenges for scholars seeking to interpret trends and create meaning. Scholarly theory plays a key role in providing structure around the observations made of a system with many moving parts. The scale of the global financial system and the volume of information available can create an opacity that prevents a clearer understanding of contemporary human affairs. Of particular relevance to this research are those theories that relate to the behaviour of actors in the international system and the allocation and expression of power. Those variables that influence these factors also warrant a greater understanding. By comparing and contrasting alternative scholarly views and applying relevant concepts to contemporary global governance, this thesis aims to enhance the understanding of the role of credit rating agencies in the modern international system.

Chapter One: Literature Review

The aim of this literature review is to compare and contrast different authors' views on contemporary global governance and the role of the credit rating agencies. It is also the aim of this literature review to broadly group those authors depending on their approaches, note areas of disagreement, highlight any gaps in current field of scholarship and demonstrate how this thesis relates to existing research and the literature in general. This literature review will provide definitional boundaries and a theoretical framework for my research. While there has been extensive work carried out by various authors on the evolution of global governance in the contemporary setting, much of the focus of this research has been on the shift of responsibilities away from sovereign governments and their international organisations towards market forces and multilateral organisations such as the World Bank and IMF. These works provide a useful background relating to the diminution of the role of the nation-state in global governance, but the role of other actors in twenty-first century global governance, specifically the role of credit rating agencies, has received comparatively little attention.

The definition of global governance is, in of itself, part of the contemporary dialogue amongst IPE scholars. While there are obvious differences between various actors, the significant increase in trade volumes and the growing interconnectivity of the world's financial markets suggests the presence of an international system that governs the transfer of significant assets across borders on a daily basis. Within any discussion on the definition of global governance lies a cross section of views, from a specific set of identifiable guidelines, as favoured by the United Nations' Commission

for Global Governance, to definitions that acknowledge a more interpretive approach to a subject such as governance on a global scale.

Much of the scholarship recently conducted in the field of global governance has been guided by the work of James Rosenau, who has published several books on the subject, including *Governance Without Government: Order and Change in World Politics* (1992)— a volume of essays that he co-edited with Ernst-Otto Czempiel.[22] In one of two contributing essays, entitled, 'Governance, Order, and Change in World Politics', Rosenau's analysis is shaped by the notion that global governance is a 'biosphere' that is part of 'an organic whole'.[23] The use of such terms suggests a much more elastic interpretation of power flows in the contemporary order. Indeed, Rosenau dismisses the concept that there is one overarching trend in global governance, but rather argues that there are several contradictory trends interplaying at various levels simultaneously.

Furthermore, Rosenau sees global governance on a continuum, with formal rules at one end and a loose set of norms at the other.[24] Along this continuum, various factors combine to create a set of arrangements and regulated patterns that cohere into a global order.[25] Importantly, Rosenau highlights the 'intersubjective consensus' of bottom up consent and the relevance of widespread legitimacy of governance.[26] This concept captures the importance of voluntary participation by global actors in creating

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[22] James Rosenau and Ernst-Otto Czempiel eds., *Governance Without Government: Order and Change in World Politics* (Cambridge: Cambridge University Press, 1992).
[23] James Rosenau, 'Governance, Order, and Change in World Politics', in *Governance Without Government: Order and Change in World Politics*, ed. James Rosenau and Ernst-Otto Czempiel (Cambridge: Cambridge University Press, 1992), pp. 12-14.
[24] Idem. Rosenau's concept of a continuum is further discussed in James N. Rosenau, 'Governance in the Twenty-First Century', *Global Governance* 6 (1995): 13-43.
[25] Rosenau, 'Governance, Order, and Change in World Politics', pp. 12-14.
[26] Ibid., p. 14; For further discussion of Rosenau's concept of intersubjective consensus as it relates to global governance, see Rosenau, 'Governance in the Twenty-First Century', p. 15.

norms that guide decision making, even when there is no identifiable common interest. Moreover, such an interpretation of global governance recognises the complexities at work in contemporary global governance.

Most observers acknowledge that there are a myriad of interests, often competing for influence, that impact on global governance. Rosenau's approach provides a theoretical framework that enables scholars to acknowledge the organic nature of the international system, recognise its dynamism and accommodate its volatility. A key component of Rosenau's approach is his acceptance of conflicting forces in a constant state of interplay. As he has argued in his article 'Governance in the Twenty-First Century', published in the journal *Global Governance* (1995):

> *to anticipate the prospects for global governance in the decades ahead is to discern powerful tensions, profound contradictions, and perplexing paradoxes … it is to look for authorities that are obscure, boundaries that are in flux and systems of rule that are emergent.*[27]

Such a theoretical approach enables scholars to avoid a linear analysis of global governance, which cannot be viewed in the same way that domestic governance is viewed. When assessing traditional domestic governance, scholars are able to identify clear, unambiguous lines of authority that derive that authority through publicly articulated rules or conventions. Yet the genesis of much of the authority that influences global governance is not easily identified. Some of the authority at play in the modern global order is based on rules or conventions, but much of that authority derives its role in the international system through epistemic means that reflect Rosenau's concept of intersubjective consensus. Given this thesis is seeking to

[27] Rosenau, 'Governance in the Twenty-First Century', p. 13.

analyse the role of credit rating agencies on contemporary global governance, Rosenau's conceptual framework provides a valuable structure through which an assessment of that role can be undertaken.

For the purposes of this thesis, credit rating agencies will be defined as those agencies that assign a rating to the providers of debt obligations as well as the debt instruments themselves. Specifically, when referring to these agencies, I will be referring to those rating agencies that have a significant global presence. This definition limits any analysis to the three main credit rating agencies: Moody's, Standards and Poor's and Fitch. When seeking to assess the impact of credit rating agencies on contemporary global governance, I will use O'Brien and Williams' definition of global governance as the 'overarching system which regulates human affairs on a worldwide basis'.[28] The same authors acknowledge that 'the rules of global governance are created by the actions and agreements of key actors in the global system'.[29]

This definitional concept enables scholars to assess the role of credit rating agencies in contemporary global governance in the context of their influence on the overarching system that shapes the way various actors conduct their affairs. Credit rating agencies set out explicit expectations of state and non-state actors that effectively regulate their behaviour through the ratings process. Their assessments are backed up with action, in the form of changes to credit ratings applied to various financial products, that influences how governance is conducted. Technology, communication, disintermediation and scale mean the contemporary global system

[28] Marc Williams and Robert O'Brien, *Global Political Economy* (Basingstoke: Palgrave Macmillan, 2004), p. 316.
[29] Ibid., p. 317.

has a dizzying array of complexity that can create challenges for scholars seeking trends in the international system. Clear definitional foundations provide much needed clarity around key concepts and provide context for analysis of specific actors, regardless of the nature of their formalised role.

Credit rating agencies are not acknowledged in nation-state constitutions, nor are they formally acknowledged in the annual reports of many major financial institutions or central banks. Yet their deliberations have a significant impact on the evaluation of credit, the flow of money and the investment decisions that ensue. These institutions have secured a significant role in the contemporary international system, thanks to the cooperation of traditional actors such as states and international government organisations (IGOs). The emergence of the nation state was marked by easily identifiable events such as the Treaty of Westphalia of 1648. In contrast, the emergence of credit rating agencies on the global scene was not marked by a formal declaration by any actor, but rather it emerged over time based on perceived epistemic authority. Assessing the impact of such actors therefore requires a theoretical framework that acknowledges the fluidity of global governance, the conflicting forces seeking to influence the international system and the lack of clearly definable roles and responsibilities.

Credit rating agencies do not roam the global stage unchallenged. Some nation-states openly defy their guidance on credit issues, as seen in Venezuela, while others query their capacity to execute their stated aims objectively and effectively. In 2008, the EU carried out a review into credit rating agencies in response to the sub-prime crisis. EU Commissioner McGreevy publicly stated that he was:

convinced, like others in Europe, of the need to legislate in this area at EU level. CRAs (credit rating agencies) will have to comply with exacting regulatory requirements to make sure ratings are not tainted by the conflicts of interest inherent to the ratings business. The crisis has shown that self-regulation has not worked.[30]

These challenges to the authority of credit rating agencies were triggered by a significant event, in this case market failure resulting in the 2008 financial crisis. However, the reaction by powerful actors in global governance to the crisis set the stage for a struggle between those advocating tighter regulation and those who acknowledged the need for state actors to appropriately direct their rescue packages with the assistance of rating agencies. This state of conflict, unthinkable in early 2007, raises poignant questions regarding the future of global governance, but also compels scholars to see governance as an organic concept that is a constant state of flux.

Much of the literature relating to contemporary global governance seeks to address how such conflicts play out in terms of governance outcomes. Rosenau highlights the need for participation, because 'governance is a system of rules that works only if it is accepted by the majority, whereas governments can function even in the face of widespread opposition to their policies'.[31] To obtain such acceptance, it is imperative for any system of governance that basic rights and responsibilities are clearly defined. Donahue and Nye draw attention to a hierarchy of governance:

the first level of governance is providing the intellectual and institutional infrastructure of a market system. Property rights must be defined. Rule for

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[30] European Union, 'Consultation by the Commission Services on Credit Rating Agencies (CRAs)', (Brussels, 2008), accessed 31/7/08, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1224&format=HTML&aged=0&language=EN&guiLanguage=fr

[31] Rosenau, 'Governance, Order, and Change in World Politics', p. 5.

private exchange must be put into place. Procedures must be established for enforcing commitments, resolving disputes and sanctioning defaults. These foundation and housekeeping responsibilities ... go little noticed.[32]

If these factors are the basic premise for any system of global governance, it is evident the role of the credit rating agencies is now integral to how the international system operates. They play a key role in calibrating the contemporary rules for provision of credit and the private exchange of capital. The rating agencies also establish procedures for monitoring various actors and instruments and enforce norms through a complex rating system.

Conceptually, any theoretical construct that provides for a dynamic build of rules and responsibilities in global governance provides scholars with an enhanced capacity to assess the role of individual actors. In the case of the rating agencies, who seek to guide other actors on important investment decisions, their role is only relevant when other actors cooperate and engage. Using Rosenau's concept of majority acceptance as a benchmark,[33] it is evident that over recent years, the rating agencies have had significant acceptance of their role amongst major state and non-state actors on the global stage. However, the scope of this acceptance is occasionally tested, raising challenges for observers of the contemporary global system. For example, how do such challenges materially impact on the ability of credit rating agencies to influence the investment decisions of other actors? Do any changes in their role impact the way global governance is conducted in the future? Clearly, there is fluidity around the roles of various actors in the international system and frequently

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[32] John Donahue and Joseph Nye, 'Market Ascendancy and the Challenge of Governance', in *Governance Amid Bigger, Better Markets*, ed. John Donahue and Joseph Nye (Washington D.C.: Brookings Institution Press, 2001), p. 6.

[33] Rosenau, 'Governance, Order, and Change in World Politics', p. 5.

their roles rapidly evolve without formal changes to written guidelines or rules. For observers of the global system, such an acknowledgement increases the importance of frequent observations of the international system and regular reassessments of the changing roles of various actors whose influence ebbs and flows.

Some of the systemic changes in the international system can be traced to changes in the logistics of interaction between various actors. Mark Zacher highlighted the role technology plays in accelerating the demise of sovereignty and accelerating the pace of change within a newly globalised paradigm.[34] Clearly, the technical capability to transfer credit and investment across state boundaries has had a critical enabling function for the rise of a genuinely global financial system. The speed of technological change continues to increase, causing the pace of shifts in authority between various actors in the contemporary international system to accelerate. The challenges scholars face in observing global governance and giving its functionality structure can become significant. The global system at the end of 2008 had altered, even when compared to six months earlier. Dramatic economic and financial shocks lead to dramatic shifts in the policies of a range of actors. The prospect of international political economy scholars keeping pace with these shifts and being able to analyse their implications can be problematic.

For the purposes of this research into the role of the credit rating agencies, the 2008 financial crisis created such challenges. The very real threat of systemic failure in the world's financial system following the collapse of Lehman Brothers saw non-

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[34] Mark Zacher, 'The Decaying Pillars of the Westphalian Temple: Implications for International Order and Governance', in *Governance Without Government: Order and Change in World Politics*, ed. James Rosenau and Ernst-Otto Czempiel (Cambridge: Cambridge University Press, 1992), p. 63.

state actors in the financial markets clamour for state intervention, after vigorously opposing such intervention for decades. This dramatic shift altered the global governance equilibrium, giving state actors, particularly in developed economies, an elevated role in the financial system. However, the ongoing failure of these state actors to develop a coordinated response to the challenge left a vacuum that has been filled once again by the rating agencies. To analyse these seismic changes in the global governance structure, theoretical frameworks that provide for this dynamism are critical.

Rosenau's organic approach to governance issues provides a framework for such analysis. His biospheric approach lies at the juncture of many conflicting issues about the nature of contemporary global governance and differing conclusions can be drawn based on his assessments. Edward Comor, for example, has argued that qualitative analysis directs scholars to acknowledge that power is actually centralising around core governance institutions that are based on information flows.[35] These information flows are based on what Comor calls a 'complex set' of 'conceptual systems and cultures—forged and modified through institutional, organizational and technological mediators—thus constituting key nodal points shaping what is known'.[36] Comor goes on to note that 'information in and of itself is meaningless without the presence of a conceptual system that facilitates particular understandings'.[37] Thus, the control of that information is paradoxically diffused as technological developments empower individuals to create their own conceptual

[35] Edward Comor, 'Governance and the Nation-State in a Knowledge-Based Political Economy', in *Approaches to Global Governance Theory*, ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), pp. 117-135.
[36] Ibid., p 119.
[37] Idem.

systems through which to they process information. In the face of this fracturing, actors are coalescing around reliable and traditional sources of information, namely core governance institutions such as governments and media outlets.[38] While Comor takes a more structured approach to governance issues, his theories help explain the epistemic authority enjoyed by rating agencies in the absence of credible global alternatives.

One trait widely recognised by international political economy scholars is the increase in complexity and the commensurate burgeoning information flows evident in the modern global system. Technological and communication improvements have created an explosion of information, making the distillation of that information a critical component of any governance system. Comor's view that actors focus on trustworthy sources of information when faced with such complexities raises important questions around which modern actors are regarded as authoritative sources of information.[39] At the same time, geographic considerations are being diminished. Tony Porter observed that contemporary information flows have undermined 'territoriality as an organizing principle of the states system'.[40] Porter goes on to argue that this has left states in a weakened position, because their own jurisdictional restrictions prevent them from having carriage of information flows beyond their borders, while global, 'knowledge-producing epistemic communities' have risen to the fore.[41] Credit rating agencies clearly are knowledge producing, global and authoritative epistemic sources of information that are highly valued by many actors

[38] Ibid., p. 118.
[39] Ibid., pp. 118-120.
[40] Tony Porter, 'The Late-Modern Knowledge Structure and World Politics', in *Approaches to Global Governance Theory*, ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), p. 137.
[41] Ibid., p. 137.

in the global system. They have grown in size and strength due to the high demand for their assessments of the creditworthiness of state and non-state actors. Their emergence on the global stage is directly correlated with the undermining of territoriality as an organising principal. Investors in global commodities, TNCs or even currency products no longer think of events in each state as being definitive. Rather, contemporary investors think through a global prism and require regularly updated information from sources they see as reliable. The rating agencies have successfully addressed this need, positioning themselves in a powerful position in the modern global system.

It should be noted that the emergence of informal authority sources has not caused belief in a more structured global governance system to disappear. One challenge to Rosenau's organic approach to global governance emerged in the mid-1990s, with the release of a report by the United Nation's Commission for Global Governance entitled, *Report on Our Global Neighbourhood*. In that document, the Commission outlined a prescriptive set of expectations that should guide global governance, based on the view that 'the world's arrangements for the conduct of its affairs must be underpinned by certain common values'.[42] The Commission set out to establish a system of global governance in the post-cold war environment that had a clear and transparent set of guidelines that were essentially incontestable by various actors, to provide certainty and stability and enhance cooperation and exchange in the international system. *Global Neighbourhood* was provocative, if somewhat ambitious, reflecting the hope that with the demise of global cold war divisions, actors would

[42] Commission on Global Governance, *Report on Our Global Neighborhood* (New York: Oxford University Press, 1995), p. xiv.

embrace a set of mutually agreed guidelines to reduce conflict and enhance governance standards. Global events at both a political and economic level since 1995 suggest that such a prescriptive approach is unlikely to take hold in the contemporary international system.

While such an aspirational view of governance can seem unrealistic, it remains evident that structure is indeed required for the contemporary international system to function. Citing the work of twentieth-century American Sociologist, Talcott Parsons, Robert Latham has observed that in order ‘to achieve the function of governance, ‘rule systems and control mechanisms’ must operate’.[43] How these rule systems and control mechanisms are developed and which actors have carriage over any enforcement mechanisms becomes central to any assessment on the nature of the international system. Given this thesis is seeking to identify the role credit rating agencies have in establishing and maintaining rule systems though the use of powerful control mechanisms, Latham’s recognition of these factors as building blocks to any governance system creates a useful framework for further analysis.

One overriding theme in the literature relating to contemporary global governance is the reduced ability of the sovereign states to establish rule systems and administer binding control mechanisms. This trend is seen by many as critical to allowing actors such as the credit rating agencies to emerge as influential players in the current global system. Since the Treaty of Westphalia in 1648, states have played a pivotal role in global governance. Two key developments have significantly eroded

[43] Robert Latham, 'Politics in a Floating World', in *Approaches to Global Governance Theory*, ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), p. 32. Latham’s reference to Parsonian theory is taken from Talcott Parsons, *The System of Modern Societies* (Englewood Cliffs, N.J: Prentice-Hall, 1971).

that role —the persistent pursuit of liberal policies that have transferred authority away from states and toward market mechanisms and improvements in technology and communications that have made information and authority more transferable over increasingly porous national borders.

At the same time the Commission for Global Governance was seeking a multilateral consensus on governance, Susan Strange was highlighting the weakened position of nation states as large responsibilities shifted from state actors to private and global actors. In *The Retreat of the State: The Diffusion of Power in the World Economy* from 1996, Strange argued that 'where states were once masters of the markets, now it is the markets, which, on many critical issues, are the masters over governments of states'.[44] Strange went on to demonstrate the broad range of policy areas where governments had abrogated responsibility to the financial markets, often in the name of economic liberalisation. This in part reflects the growing capacity of financial markets to absorb such responsibilities. As observed by Donahue and Nye, 'markets have become more extensive, more integrated, and more intricately interwoven into the fabric of life'.[45] Such observations provide a poignant basis for an assessment of the role of rating agencies in the contemporary global system. These organisations have accumulated significant technical capabilities along with epistemic authority, which has facilitated their accumulation of responsibilities from state actors. This institutional capacity has a symbiotic relationship with the decline of state ownership and control over many of the levers of economic management.

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[44] Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (New York: Cambridge University Press, 1996), p. 4.
[45] Donahue and Nye, 'Market Ascendancy and the Challenge of Governance', p. 2.

Much of the literature written on this shift has focused on the environmental changes to the international system that eroded the ability of state actors to maintain control over key components of their economies and societies. This trend can be benchmarked against recognised variables that support state control. Mark Zacher identified six pillars that boosted state autonomy and power that included, ‘low levels of economic interdependence’, ‘low information flows that limit the growth of economic interdependence’, ‘a predominance of authoritarian or non-democratic governments that limit the flow of information’ and ‘a high degree of cultural, political and economic heterogeneity amongst states that makes the coordination of policies difficult’.[46] Clearly, these factors have been increasingly absent from the international system for some decades, enhancing the capacity of non-state actors such as the rating agencies to assume greater responsibilities. Geoffrey Underhill has discussed the growth of international finance in the context of declining state power, noting ‘as capital has become more mobile, firms and markets have become for trans-national, enhancing their power in relation to governments, which remain territorially based’.[47] In a sense, the international system has outgrown national boundaries, leaving states increasingly unable to control the most basic of functions in a market economy such as the provision of credit and the flow of capital.

Much has been written on the implications of the growth of international finance, particularly capital mobility. As Sinclair and Thomas have noted ‘few pressures impinge on the policy choices of nation states to the extent that capital

[46] Zacher, 'The Decaying Pillars of the Westphalian Temple: Implications for International Order and Governance', pp. 62-63.
[47] Geoffrey Underhill, 'Global Money and the Decline of State Power', in *Strange Power: Shaping the Parameters of International Relations and International Political Economy*, ed. James Rosenau Thomas Lawton, and Amy Verdun (Aldershot: Ashgate Publishing, 2000), p. 120.

mobility does'.[48] Similarly, in *States and Markets* (1988), Susan Strange identified the globalisation of the financial markets as having a major effect in shifting authority in the international political economy,[49] while later observing that because of the mobility of capital and the rivalry of states as borrowers, the markets have the authority to reward or punish according to their judgement.[50] Clearly, such dependence by state actors on capital flows has emerged as the ability of the state to control capital has declined. This shift in capital dependence will be a focus of further research.

The second trend that is frequently attributed to the erosion of the authority of state actors in the contemporary global system is the sustained advances in communications and technology. At a basic level, developments such as the expansion of the numerate mode over the literate mode through the use of digital systems and the global spread of the English language have augmented the flow of international communication, which have become cheaper and easier.[51] While much is taken for granted by observers of the contemporary global system, it is critical to remember that such trends have provided the building blocks for today's relatively seamless global network. As Karen Litfin argues, 'technologies of knowledge production…… promote certain actors and discourses as authoritative in the evolution of global governance'.[52] Indeed, scholars have analysed the implications of

[48] Timothy Sinclair and Kenneth Thomas, 'Introduction', in *Structure and Agency in International Capital Mobility*, ed. Timothy Sinclair and Kenneth Thomas (New York: Palgrave, 2001), p. 3.
[49] Roger Tooze and Christopher May, ed., *Authority and Markets: Susan Strange's Writings on International Political Economy* (New York: Palgrave Macmillan, 2002), p. 12.
[50] Ibid., p. 231.
[51] Ibid., p. 75.
[52] Karen Litfin, 'The Global Gaze: Environmental Remote Sensing, Epistemic Authority, and the Territorial State', in *Approaches to Global Governance Theory* ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), p. 73.

technological change to observe its connection to power. For example, J. P. Singh has noted that 'instrumental power focuses on the capacity or capability of power holders to effect particular outcomes. Information technologies…are then forces that enhance these capabilities'.[53]

Technology's role in the emerging landscape of contemporary global governance is hard to overstate. For instance, Rosenau noted that,

> *few dissent from the proposition that advances in transportation and electronic technologies, and especially the internet, have resulted in a transformation, a compression if not a collapse of time and distance, as well as altered conceptions of hierarchy, territory, sovereignty and the state*.[54]

These changes have completely reshaped global governance. State power has simply been unable to keep pace with scope of technological change and the commensurate decline of territory-based authority. As China has discovered, it is becoming increasingly difficult for a state actor to attempt to control access to and information from the Internet. Zacher's six pillars have come under sustained challenge thanks to improvements in technology, permanently altering the power structure within the international system.

For rating agencies, these technological changes have augmented their capacity to influence global affairs. These organisations have been issuing ratings for over one hundred years,[55] yet their influence on global governance has risen significantly in recent times. Technology has not only enabled rating agencies to

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[53] J. P. Singh, 'Introduction', in *Information Technologies and the Changing Scope of Global Power and Governance*, ed. J. P. Singh and James Rosenau (Albany: SUNY Press, 2002), p. 7.
[54] James Rosenau, *Distant Proximities: Dynamics Beyond Globalization* (Princeton: Princeton University Press, 2003), p. 19.
[55] Timothy Sinclair and Michael King, 'Private Actors and Public Policy: A Requiem for the New Basel Capital Accord', *International Political Science Review* 24 no. 3 (2003): 345-62, p. 347.

increase the scope and pace of their activities, but has facilitated the growth of a global market for investment that has become incredibly influential on the international order. The current literature provides important context for how these developments have shifted power and permanently recalibrated the hierarchy of actors in contemporary global governance.

Assessments relating to technological improvements and the declining role of the state can only go part of the way to providing a framework that adequately assesses the current international system from a governance perspective. Such analysis cannot see the relationship between state and non-state actors as a binary. The loss of authority by states is not automatically correlated with an equal gain in responsibility by institutions such as the credit rating agencies. Contemporary global governance is by its very nature fluid, due to the complex web of interrelated interests that shape how the international system operates. Rosenau draws the clear distinction between what a government can control and governance, observing that the latter is 'a system of rule that works only if it is accepted by the majority (or, at least, the most powerful), whereas governments can function even in the face of widespread opposition to their policies'.[56] Such observations bring the notion of authority to the fore of any assessments on how particular actors influence current affairs.

Importantly, much of the literature surrounding the subject of contemporary global governance examines the role of power, discussing who has it, how it is exercised and what its impact is on various global actors. In *States and Markets* (1988), Susan Strange's analysis of power and its interplay with knowledge has

[56] Rosenau, 'Governance, Order, and Change in World Politics', p. 2.

significant implications for any assessment of the role of rating agencies in the contemporary global system. In particular, her dissection of power between structural power and relational power provides context for scholars seeking to place actors within a perceived hierarchy of influence and authority. Strange defines relational power as the power of A to get B to do something they would not otherwise do, whereas structural power is the power to determine how things shall be done, the power to shape frameworks within which states relate to each other, relate to people or relate to corporate enterprises.[57] In a sense, Strange sees structural power as the power to determine the structures of the global political economy.[58] Strange goes on to identify four sources to structural power—'control over security, control over production, control over credit and control over knowledge, beliefs and ideas'.[59] Finance, in particular the control of credit, is highlighted as the facet that has risen in importance in recent times, more rapidly than any other and the facet that has come to have 'decisive importance' due to its 'power to determine outcomes'.[60]

It can be argued that relational power, crudely typified by warfare, has given way to structural power within the contemporary global system. Using Strange's sources of structural power, it is evident that rating agencies have acquired such power through their ability to control credit and knowledge. A wide range of state and non-state actors operate within guidelines explicitly set by rating agencies. These agencies have effectively created the paradigm within which actors operate. As Strange points out, the control of credit flows has risen to prominence, again highlighting the powerful role rating agencies have acquired due to their perceived

[57] Susan Strange, *States and Markets* (London: Blackwell Publishers, 1988), p. 24.
[58] Idem.
[59] Ibid., pp. 26-27.
[60] Ibid., p. 30.

capacity to determine credit worthiness.[61] These agencies do not compel actors to cooperate with their activities. Rather, actors opt in, encouraged to do so because of their recognition of the epistemic authority the rating agencies have. Rosenau's required majority support is clearly at play,[62] with state and non-state actors coalescing around the validity of the edicts of organisations such as Standard and Poor's, Moody's and Fitch Ratings.

Strange's observation about the growing importance of the finance sector reinforces the strong role credit relations have in the international system. Strange defines finance as 'the system by which credit is created, bought and sold and by which the direction and use of capital is determined'.[63] While the scale of finance's role in how human affairs are regulated is new, its presence is not. Andrew, Henning and Pauly draw attention to the old Roman maxim 'money alone set the world in motion' to highlight the timeless importance the flow of money has on the international system.[64] Indeed, there has been much written about the growing importance of international finance, particularly in relation to actors in the system seeking to attract investment by implementing policies that are perceived as market friendly. A growing pool of capital responds to such signals. The rating agencies play a critical role in the process of steering capital through the matrix of contemporary investment options, providing clarity for investors who face a dizzying array of global investment opportunities. The source of this structural power, as identified by Strange, lies in the ability to control credit and knowledge.

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[61] Idem.
[62] Rosenau, 'Governance, Order, and Change in World Politics', p. 5.
[63] Susan Strange, 'Finance, Information and Power', *Review of International Studies* 16 no. 3 (1990): 259-274, p. 259.
[64] David Andrews and Randall Henning and Louis Pauly, eds., *Governing the World's Money* (Ithaca: Cornell University Press, 2002), p. 1.

One of the key factors leading to rating agencies becoming able to assume control of knowledge is disintermediation of communication between the suppliers and users of credit. Historically, such a relationship would have centred on an intermediary such as a bank, but now the borrower and lender can cut through the middleman via the money markets.[65] As Sinclair has noted, disintermediation has seen 'the movement from an institutionalised world of legal authorities towards a decentralised, marketized world' of credit.[66] Furthermore, Sinclair regards the development of epistemic authorities such as rating agencies, who substitute their information and expertise for bank judgements, as an important consequence of disintermediation.[67] This process spurred what Sinclair has called the 'Global Information Economy', which has a tendency to 'homogenize thought', through what he terms 'cognitive centralization'.[68] These observations have important ramifications for how knowledge is distributed, how credit relations develop and where authority lies in the contemporary international system. For scholars seeking to provide context around the growing importance of credit rating agencies, disintermediation and its logical consequences provide structure to the empirical evidence of a fundamental shift in credit relations and ultimately in power flows.

Mark Amen's observations on how knowledge impacts credit relations further clarifies the nature of contemporary global finance. Amen clearly draws the connection between knowledge and power, particularly as the range of options for

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[65] Timothy Sinclair, 'Synchronic Global Governance and the International Political Economy of the Commonplace', in *Approaches to Global Governance Theory*, ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), p. 165.
[66] Ibid., p. 166.
[67] Idem.
[68] Ibid., p. 167.

potential investors has exploded.[69] Beyond this connection, Amen observes that 'knowledge is housed in a hierarchical setting', with various actors ceding responsibility to acquire knowledge to others, in effect creating new sources of authority in the global system.[70] This authority can be observed at its most basic level in the previous financial rescue packages for the currencies of Mexico, Thailand and Indonesia, which prescribed 'these countries adopt liberal economic, fiscal, monetary and trade policies as a condition for receiving the loans'.[71] Examples such as this demonstrate that knowledge does indeed generate authority, which in turn generates or reinforces hierarchies.

Amen's analysis provides the theoretical framework around the role rating agencies play in the current global system. Through their assiduous development of exclusive knowledge capabilities, these agencies have positioned themselves at the top of the knowledge hierarchy, seemingly impervious to the ebbs and flows of authority experienced by other actors. This is illustrated by the fact that Standard and Poor's, Moody's and Fitch Ratings emerged from the 2008 financial crisis in an empowered position. Regardless of any mistakes that they are perceived to have made, no other actor can come close to acquiring the knowledge base so effectively accumulated by rating agencies. While their operating environment may change, their position at the top of the knowledge food chain appears un-contestable.

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[69] M. Mark Amen, 'Borrowing Authority; Eclipsing Government', in *Approaches to Global Governance Theory*, ed. Martin Hewson and Timothy Sinclair (Albany: SUNY Press, 1999), pp. 180-181.
[70] Ibid., p. 181.
[71] Ibid., 189.

Jan Toporowski clarifies the source of this perennial authority, highlighting that modern capital markets are accompanied by a permanent buzz of new information.[72] Toporowski points out that this has a material impact on the markets:

> *Whereas actual prices are principally determined by the net inflow into the capital market and notional prices are principally determined by a conventional interpretation of news and statistics, effective prices are influenced on the demand side by the adjustments that companies make through the capital market to their balance sheet and their liquidity*.[73]

Global news networks such as CNBC and Bloomberg bear testament to the insatiable appetite for information in the contemporary financial markets. In an era where information is plentiful and knowledge is closely linked to authority, the role of rating agencies comes into perspective.

Beyond that research which has a more theoretical base, much of the contemporary analysis conducted on the rating agencies focuses on the functions they carry out within a complex interplay between state and non-state actors across the globe. This research is often conducted from a financial perspective or from the perspective of a participant in the ratings process. One of the earliest detailed reviews of how credit rating agencies operate was a report commissioned by the Twentieth Century Fund Task Force on Municipal Bond Credit Ratings in 1974. The report was entitled *The Rating Game* and included a background paper by John E. Petersen, which outlined how rating agencies assessed the creditworthiness of municipal and state authorities in the United States and highlighted improvements that could be made.

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[72] Jan Toporowski, *The End of Finance: The Theory of Capital Market Inflation, Financial Derivatives, and Pension Fund Capitalism* (London: New York: Routledge, 2000), p. 41.
[73] Idem.

It is noteworthy that the similarities between the issues raised in *The Rating Game* and the issues being discussed by contemporary scholars are numerous. For example, Petersen draws attention to the need for some sort of rating of municipal and state bonds ‘since the investor is unable to detail the creditworthiness of each of the thousands of issues traded daily’, and that the impact of a rating on a particular bond can be dramatic in terms of interest rate differentials of 100 basis points.[74] Petersen highlights that banks and insurance regulatory bodies have been ‘delegating their responsibility to the rating agencies and thereby impose a burden of fiscal dependence upon the private rating agencies’.[75]

The Twentieth Century Fund Task Force recommended greater transparency, so that those being rated and those buying the ratings have a better understanding of how those ratings are developed, including a full disclosure of the criteria used for particular appraisals. Furthermore, to enhance the accountability of the ratings process, the Task Force recommended the establishment of a central data bank that included the reports of the fiscal condition of state and local government borrowers and their debt obligations.[76]

Thirty-four years later, similar recommendations were made by the EU, which announced draft laws that would require rating agencies to ‘register with European regulators and submit to monitoring by national authorities; disclose how they determine risk; and make changes in their corporate governance to prevent conflicts

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[74] John E. Petersen, *The Rating Game* (New York: Twentieth Century Fund, 1974), pp. 1-2.
[75] Ibid., p. 5.
[76] Ibid., pp. 6-14.

of interest'.[77] The EU went further, publicly stating that rating agencies had 'understated the danger' associated with sub prime mortgages in the US and that this 'raised concerns about their competence and their cosy relationship with the financial industry'.[78] Regulators have obviously sought to gain greater control over the operations of rating agencies over many decades, yet to date, these efforts have failed to provide the transparency and comfort that many actors seek. Furthermore, these attempts have failed to fundamentally challenge the authority of credit rating agencies.

Much of the contemporary analysis focuses on the role of the rating agencies because that very basic tenant of analysis is challenging to define due to the opaque nature of their activities. The rating process is complex and relates to a myriad of financial products, some of which are very sophisticated and hard to define. As discussed in the introduction to this thesis, Timothy Sinclair's *The New Masters of Capital* from 2005 provides much needed context for scholars seeking a greater understanding of the rating agencies.[79] Sinclair's work builds a conceptual structure for these organisations using counterfactual analysis to test the strength of the observations being made. This process excludes the most likely cause of a particular response and then enables observers to assess alternative causes.

Sinclair tracks the history of the rating agencies and their meteoric rise, noting that in the 1960s, Standard and Poor's had just three staff.[80] Sinclair admits that rating

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[77] European Commission, 'EU moves to regulate credit rating agencies', (12 November 2008), accessed 17/3/09, http://ec.europa.eu/news/economy/081112_1_en.htm
[78] Idem.
[79] Sinclair, *The New Masters of Capital*, passim.
[80] Ibid., p. 27.

agencies are ‘some of the most obscure institutions in the world of global finance’,[81] but credits them for remaining relevant and keeping up with financial innovation.[82] The important role of knowledge networks is discussed, with Sinclair noting that ‘as banks are displaced as key investment sources, gatekeeper power is concentrated in the hands of the small number of rating agencies. Rating has become a key means of transmitting the policy orthodoxy of managerial best practise’.[83] He notes that rating agencies rate around US$30 trillion in debt obligations and that their activities reflect a store of expertise and intellectual authority.[84] His research also analyses how the ratings are compiled, the implications of the rating judgements and how those judgements shape the international system.

One of the most far reaching observations made by Sinclair is that the ratings produced rating agencies are not formulaic and linear, but rather subjective and based on judgements. These judgements imply gate keeping, which is ‘manifestly political’.[85] Such observations have significant ramifications for scholars seeking a greater understanding of the role of rating agencies in contemporary global governance. The strong correlation between the assessments made by the rating agencies and the cost of debt and flow of investment is well documented. If there are political and subjective components to the rating process, the ratings the agencies produce are more malleable than could otherwise be assumed, creating a reactive interplay between various actors and those who determine their ratings.

[81] Ibid., p. 6.
[82] Ibid., p. 9.
[83] Sinclair, *The New Masters of Capital*, p. 18.
[84] Ibid., pp. 2, 5.
[85] Ibid., p. 62.

Sinclair uses an Australian example to demonstrate this point. In 1993, the new Victorian State Government's dramatic cutbacks announced in the State Budget were defended by then State Treasurer Alan Stockdale, who said at the time there 'was no alternative', and that 'Moody's downgrading of Victoria two rungs on the credit ladder graphically illustrated the consequences of excessive debt'.[86] Demonstrating the subjective nature of their assessments, a Moody's analyst noted that there was a 'large difference' in the policies of the two major parties at the time in the state of Victoria.[87] Like the Indian example provided earlier in the previous chapter, rating agencies use both incentives and disincentives to encourage actors to adhere to their prescribed approach to policy implementation. For state actors, this has become increasingly important. It has also ensured that states are complicit in supporting the structural changes that dilute their influence. As Sinclair has noted, 'resistance to tax increases is also behind the increasing use of innovative financing instruments like derivatives, which offer higher returns'.[88]

Sinclair's assessment is that the most subjective area of rating agency activity is sovereign ratings, which 'incorporates opaque quality of life factors and what seem to be overtly political variables'.[89] Using Moody's own criteria, Sinclair highlights that factors such as 'the degree and nature of political intrusiveness in the cultivation of wealth, the depth and experience of government bureaucrats, political intrusiveness in economic management, political links with foreign partners, past behaviour under stress and regime legitimacy' are all factors that influence sovereign ratings.[90] These

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[86] Ibid., p. 103.
[87] Sinclair, *The New Masters of Capital*, p. 104.
[88] Ibid., p. 95.
[89] Ibid., p. 139.
[90] Idem.

variables are highly susceptible to subjective assessments, particularly in markets with which the agency is not familiar. Sinclair's analysis demonstrates that the rating agencies are not simply applying an objective set of criteria onto each actor or instrument they rate. Rather, they are applying a set of judgements to help them assess the willingness and ability of a receiver of credit to pay that credit back. Such subjectivity stimulates a contested dialogue between those who rate and those who are rated.

The views of the authors discussed in this literature review have created a conceptual framework for further analysis of the rating agencies and their influence on global governance. By taking a more organic approach to governance, it is possible for scholars to observe and assess the rapidly evolving international system and provide structure to the complex relationships that shape contemporary global governance. Broad trends that have facilitated the rise of rating agencies such as the retreat of the state, improvements in technology and disintermediation have been discussed in the context of a hierarchy of knowledge and authority. The contemporary position of the rating agencies has been reviewed, with a particular focus on the subjective and political nature of the rating process. Following this literature review process, it is evident that there is a growing acknowledgement of the important role rating agencies play in the international system. However, for scholars to gain a better understanding of how global governance is influenced by the rating agencies, an improved understanding of the interplay between the rating agencies and those actors susceptible to political or subjective decisions warrants further analysis.

One useful way of focusing such analysis is observing the process of sovereign ratings. While there are many relevant case studies highlighted in the existing analysis, they tend to be observed through the prism of identifying the cause and effect. A typical case study observes that a if country's sovereign debt position deteriorates, its credit rating is lowered by the rating agencies. In turn, that country's currency falls and the cost of borrowing in that market increases as foreign lenders charge more for credit. Policy makers then seek to reverse the negative rating by reeling in debt and reversing the process. Observations of this process do not adequately address the importance of the nature of the interaction between rating agencies and sovereign markets. How that interaction takes place and how rating agency analysts seek to influence the policy formation process are important issues. Given the acknowledged subjectivity at play and the demonstrable bias towards more market-orientated policies, how do states seek to influence rating agencies on their assessments on issues as opaque as what Sinclair described as 'political intrusiveness in economic management'?[91]

It is important to note that non-state actors are also heavily influenced by sovereign ratings. TNCs are impacted by a negative sovereign rating in a particular market due to the ensuing fluctuations in the currency market, changes to domestic interest rates and changes to the cost of foreign debt products. Observers of the international political economy have a relatively clear understanding of how state actors and TNCs interact with themselves and each other on a regular basis, providing an empirical framework for theoretical applications.

[91] Idem.

A deeper understanding of the interaction between sovereign markets and rating agencies will provide scholars with a better understanding of how the inclinations of sovereign decision makers are actually determined and what role each actor has in shaping those determinations. If credit rating agencies acknowledge political factors are central to sovereign ratings, how do the rating agencies make assessments in this area? Do they simply interpret the public decisions of policy makers, or is the process more sophisticated? Do they seek to shape policy before it is made, say before a major budget initiative, or do the simply react to decisions after they are made? Do representatives from sovereign markets actively seek to shape these assessments, or are they more passive? The answer to these questions are particularly relevant in the aftermath of the 2008 financial crisis when the role of rating agencies and state actors has become more topical.

A deeper analysis of the interaction between rating agencies and state actors on sovereign rating issues will compliment existing research and provide a more holistic assessment of rating agencies and their influence on global governance. As scholars observe tectonic shifts in the financial system, sovereign debt levels have risen to historically high levels as government borrowing increases. This dramatic adjustment in policy makes sovereign ratings a key enabler for many state actors. The next chapter will provide context for this important development by demonstrating the massive growth of money supply and the increasing use of debt instruments by state actors to fund spending. While the reduction in tax revenue is well documented, the growth of dependence on the issuance of government bonds has altered behaviour and empowered the rating agencies to influence state actors in a way that was simply unimaginable only thirty years ago. Understanding the relationship between rating

agencies and state actors will provide critical context for those seeking to understand how modern human affairs are regulated on a global scale.

This literature review provides an important theoretical construct for such an analysis. Rosenau's organic interpretation of global governance accommodates for inconsistencies evident in how rating agencies and state actors interact. Similarly, Sinclair's concept of cognitive centralisation and the emergence of homogenous thought becomes more relevant when considered alongside Amen's linkage between knowledge and power. These theories help explain the emergence of the rating agencies as a seminal actor in contemporary global governance. In addition, Strange's concept of structural power adds another layer of theoretical context to the contemporary role rating agencies enjoy. The importance of technology in promoting knowledge production and empowering certain actors, as acknowledged by Litfin, is important in an era when state and non-state actors can struggle to keep up with an ever expanding information flow in the financial markets. As a result, Zacher's pillars of state autonomy continue to be eroded, with the assistance of the rating agencies, further weakening this once dominant player in the international system.

Despite the significance of this shift in contemporary global governance, Rosenau's majority support threshold continues to be surpassed,[92] as increasing numbers of actors look for guidance from the rating agencies and provide or seek credit that has been rated to augment investment. This investment has become the lifeblood of the contemporary international system, making those who steer its path powerful and auspicious actors whose actions and influence warrant greater analysis.

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[92] Rosenau, 'Governance, Order, and Change in World Politics', p. 5.

Chapter Two:

The Emergence of Credit as the Lifeblood of Contemporary Global Governance

Much of the literature on contemporary global governance has focused on the decline of state actors and the emergence of global finance as a major factor in the functioning of the contemporary international system. The pursuit of liberal policy settings by decision makers in many developed and developing countries is identified as a determining variable behind the documented shifts in the global system. While the shift in authority toward non-state actors is well documented, the governance ramifications of the emergence of rating agencies as influential participants in the international system and the corresponding decline of state actors deserves greatly scholarly attention. The scale and pace of the recalibration of the international system have caused a deficit in the understanding of how global governance has changed. Like most changes to the international system, significant global events bring shifts in the power structure to prominence.

The 2008 global financial crisis and the reaction to the crisis by state actors provided a reminder on the hierarchy of power in contemporary global governance. The perceived impotence of state actors in the face of a rapid deterioration in the global financial markets and the corresponding impact on both the broader economy and state finances illustrated the incapacity of state actors to employ governance tools that can keep pace with innovation in the financial markets. The 2008 global financial crisis illuminated the scale of cross-border engagement in global finance and the role technology plays to augment and amplify significant movements in the global financial system.

Against this background, the inadequacy of state-based responses to genuinely global financial crises became apparent. This period also reinforced the reliance of state actors on the financial system. Following the crisis, state actors in many developed markets provided direct and indirect financial assistance to private financial institutions to prevent systemic failure and more broadly to stimulate the economy. To fund these activities, the sale of government bonds increased, fostering the dependence of state actors on credit creation. This credit creation took place through engagement with private actors in global finance. The fact that the rating agencies emerged from the crisis with their power and influence not only intact, but enhanced, demonstrates the fundamental importance of credit for all actors in the modern international system.

Credit creation is a seminal component of the modern international system. This process is supported by a plethora of complex financial products, the nature of which few state-based policy makers understand. Indeed, the role of credit creation is a poignant symbol of the structural, as well as relational power now enjoyed by the rating agencies. Rating agencies are now shaping the global structure in which actors operate and employing specific measures, both direct and indirect, to influence specific actors to take certain actions. Using Susan Strange's four sources of structural power,[93] it is evident that rating agencies have obtained control to a significant extent over knowledge, beliefs and credit.

In the absence of state-based structural power that effectively controls global behaviour, particularly behaviour relating to credit provisioning and the financial

[93] Strange, *States and Markets*, pp. 26-27.

markets, rating agencies are able to exert influence over many facets of contemporary global governance. They have assumed this power by controlling the knowledge that determines credit worthiness while also controlling the conceptual systems, to use Comor's term,[94] that guides various state and non-state actors. This is a determining factor behind the power structures of the modern international system. While it has already been acknowledged by Strange that control over finance has a critical facet of structural power,[95] its importance continues to grow as the use of credit-related instruments to fund activities become more prolific amongst all actors in the modern international system.

Key changes to the structure of public and private finance have dramatically expanded the role of credit in the international system and enabled rating agencies to control knowledge and credit. For the purposes of this chapter, I shall focus on the growth in money supply and credit product issuance and the changes in the usage of credit by state actors. These trends have placed greater importance around the role of those who determine the direction of credit provision and the behaviour of credit recipients. Indeed, it is evident that the structural and relational power balance has shifted in favour of the rating agencies due to the growth of credit provisioning. The reorientation of the global economy toward a greater reliance on credit has been augmented by the precipitous growth of scale in the financial markets. Traded financial instruments that vary in complexity, from simple bond notes to highly geared derivatives, are used with increasing frequency to facilitate transactions throughout the modern international system.

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[94] Comor, 'Governance and the Nation State in a Knowledge-Based Political Economy', pp. 118-119.
[95] Strange, *States and Markets*, p. 30.

These developments, when combined with disintermediation, have amplified the unique ability of rating agencies to generate much needed knowledge in the modern international system. This chapter shall provide an overview of the growth of credit in the modern international system and its emergence as a critical enabler of many basic tools of global governance. Such an overview will provide an empirical basis for further analysis of the role of knowledge in this new environment, the importance of structural and relational power shifts and the interactions between state actors and rating agencies in the twenty-first century. By gaining a better understanding of the systemic shifts in credit provisioning that have taken place in recent years, particularly relating to state actors, scholars are better able to assess the modern role of credit rating agencies and analyse the implications of this role on contemporary global governance.

Why credit growth matters

Credit relations have historically been influential on how governance functions. Mark Amen observed that credit is one of the many sites where people govern their social relations and that over time, credit relations have become abstracted and more opaque.[96] In this chapter, I will define credit as the lending of money, or the commitment to lend, to an individual or organisation for a defined period of time. While the scale and scope of international credit provision has grown significantly in recent times, its existence is not confined to modernity. Credit has flowed across geographic barriers to address funding needs over many centuries, as individuals or groups with a defined need have sought funding from external sources.

[96] Amen, 'Borrowing Authority; Eclipsing Government', p.173.

The provisioning of credit has taken place in various societies across many of the cultural and societal barriers that otherwise demonstrate the heterogeneous nature of human affairs. For example, in his paper in the *Journal of the Economic and Social History of the Orient*, Steven J. Garfinkle states that 'credit transactions played an important role in the institutional and non-institutional economies of southern Mesopotamia at the end of the third millennium BC'.[97] Garfinkle goes on to describe the complex credit market that operated in the region at the time, based around a variety of loans and commodities, including interest free loans and customary loans.[98] The credit environment described by Garfinkle is relatively sophisticated and plays a key role for the functioning of the wider economy.

In different cultures at different times in history, the provisioning of credit is not only identifiable as a key activity around which affairs are organised, but also is reflective of the power that accompanies that control. This power has been obtained by a variety of actors, as the providers of credit have taken many forms. For example, R.H.C. Davis observed that until the end of the thirteenth century, the Fairs of Champagne were 'the central clearing house of European trade and finance. Italian bankers sent agents who issued letters of credit that could be cashed in almost any stated currency and in any part of Europe'.[99] Over many centuries, financiers, merchants and bankers have creatively sought ways to overcome political or geographic barriers to identify new recipients of credit. With such transactions came obligations on the part of borrowers. When describing how credit was transacted at

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[97] S. J. Garfinkle, 'Shepherds, Merchants and Credit: Some Observations on Lending Practices in URIII Mesopotamia', *Journal of the Economic and Social History of the Orient*, vol. 47, no. 1 (2004): 1-30, p. 2.

[98] Ibid., p. 11.

[99] R. H. C. Davis, *A History of Medieval Europe: From Constantine to Saint Louis*, 2nd ed., (New York: Longman, 1988), pp. 377-78.

such fairs, R.D. Face noted that ‘every merchant had his agent, or perhaps several, to act in his place, to fulfil obligations, and in many cases to undertake news ones’.[100] The providers of credit at these medieval fairs communicated to borrowers a set of obligations that accompanied loans.

Human interaction has long centred on the notion of engaging in various transactions to obtain items of need. The concept of exchange is embedded in history and built the foundation of exploration and travel that commenced the establishment of a global system. The providers of credit have long been able to attach conditions to loans, obtaining control over the actions of the borrower in the process. Credit’s historic role in the international system can be linked to its enabling function of a range of activities that otherwise may not take place because of inadequate capital. Borrowers fund activities in the near term that generate the requisite returns over the medium and long term to repay the loan and derive a direct commercial benefit. Given this enabling function, the providers of credit have possession of a resource, typically money, for which there is a perceived or real demand. This demand has facilitated authority to the providers of credit, as they are able to attach conditions to the loan and influence the activities of the borrower.

MacDonald and Gastman have discussed the correlation between credit and power, noting ‘the wealth represented by credit augments political power’.[101] They go on to liken credit to water, claiming credit is ‘a key wellspring of life – in this case economic life. Without credit, most businesses would find it difficult to function and

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[100] R. D. Face, ‘Techniques of Business in the Trade between the Fairs of Champagne and the South of Europe in the Twelfth and Thirteenth Centuries’, *The Economic History Review*, vol. 10, no. 3 (1958): 427-438, p. 431.
[101] A. L. Gastmann and S. B. MacDonald, *A History of Credit and Power in the Western World* (New Brunswick: Transaction Publishers, 2001), p. 4.

certainly many governments would be forced to scale down their operations and reduce expenditure'.[102] From a global governance perspective, credit relations become important when they alter human behaviour on a significant scale in an organised and identifiable way.

Credit relations have always provided context for how societies function and how one set of actors obtains and enforces control over another set of actors. These examples of structural and relational power structures have illuminated the state of global governance to varying degrees throughout history. However, what has changed over recent years is the expansion of credit's role in the international system. The importance of credit has grown exponentially as more participants rely on credit to fund activities and its provision is now critical to state and non-state actors in the modern international system. The behaviour of numerous influential actors is now determined to a meaningful degree by the need to obtain credit. Credit relations are now a totemic factor in how human affairs are conducted across the globe. While this importance is not new, the scale of credit provisioning and its widespread usage for activities previously unlinked to credit has changed the scope of the dependence on credit and altered the structure of authority in the international system.

This chapter is focussed on the global governance ramifications of the growth in importance of credit relations. As such, data will be used to illustrate the trend towards an increased reliance on credit by those conspicuous actors who play distinct roles in contemporary global governance. This analysis will not provide an exhaustive statistical overview of the credit growth. Of most relevance here is the growth in scale

[102] Ibid., p. 3.

of credit provisioning and the increased reliance on credit by actors who have previously enjoyed greater autonomy over their own financial affairs, most notably state actors. Changes in financial relationships have altered the global hierarchy by empowering the rating agencies to control the direction of credit, the behaviour of borrowers and the knowledge that creates the paradigm within which most actors now operate. From a global governance perspective, such a shift has profound ramifications on how human affairs are organised and conducted. Providing context to that recalibration of the global order enables scholars to more effectively assess the role of rating agencies in the modern international system.

The scale of credit growth in the modern international system

An important component of any analysis of the modern international system by political economists is the identification and interpretation of relevant economic data that provides evidence of shifts in global governance. In seeking to demonstrate the growth in the importance of credit in the contemporary global system, it is appropriate to sequentially demonstrate the scale and context of this growth by using global and country-specific data that provides an unambiguous illustration of a significant worldwide trend. Therefore, the growth in money supply, the growth in usage of credit products and the growth in usage of state-based credit products are used in this chapter to provide evidence that the contemporary use of credit in the modern international system far exceeds previous experiences. By demonstrating the scale of credit growth in the modern international system, the importance of knowledge and the contemporary role of credit rating agencies have perspective in an analysis of global governance.

One baseline method used to determine the scale of the overall growth of the demand and supply of credit across the international system is through observations of money supply, which is the amount of money in circulation in the global economy. When money supply increases, lending institutions are providing increased amounts of credit to public and private sector borrowers. When assessing money supply, the common benchmarks that are used are the M1 to M3 aggregates, as defined by the Board of Governors of the Federal Reserve Bank of the United States.

M1 is defined as currency and demand deposits at commercial banks. M2 is the equivalent of M1 plus commercial bank savings and small time deposits, and M3 is M2 plus deposits at mutual savings banks, savings and loans, and credit unions.[103] These monetary aggregates are important benchmarks for central bankers, other policy makers and observers of the international system who use the data to track trends in the amount of money in circulation. For scholars, the complexity and size of the modern financial system can create obstacles to obtaining an overview of trends relevant to global governance issues. Money supply provides an important and simple indicator of the prevalence of credit provisioning in the contemporary international system.

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[103] Ben Bernanke, 'Monetary Aggregates and Monetary Policy at the Federal Reserve: A Historical Perspective Federal Reserve' (Address, Fourth ECB Central Banking Conference, Frankfurt, November 10, 2006), accessed 12/12/08, http://www.federalreserve.gov/newsevents/speech/Bernanke20061110a.htm

Data compiled by independent financial data agency *Now and Futures* shows that global M3 plus government debt plus credit grew from US$5 trillion in 1982 to over US$60 trillion in 2008.[104] To provide historical context for this growth in money supply, it took an estimated eighty years for the same number to grow from $US1 trillion to $US5 trillion.[105] Importantly, according to the same source, money supply has essentially stabilised since the 2008 global financial crisis, rather than contracted in any sizable way. Observations of economic growth over a comparative timeframe show that money supply grew with the global economy. According to the IMF, the world's gross domestic product grew from US$10.8 trillion to US$61.2 trillion between 1982 and 2008.[106]

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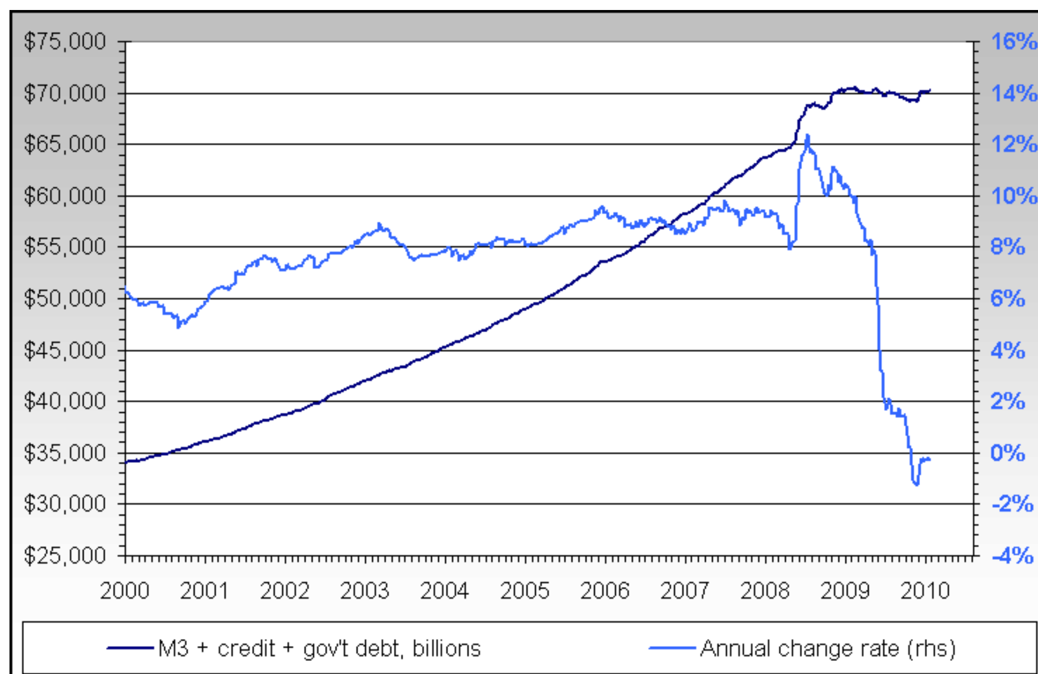
[104] 'Definitions: M1 - Cash/currency, travelers checks and checking account (demand deposits) balances. M2 - M1 plus savings accounts, individual Money market fund (excluding those in IRAs) accounts, and time deposits (such as CDs) under $100,000. MZM - M2 minus the time deposits and adding in all balances in all money market funds. It stands for Money of Zero Maturity, and basically means money that can be spent immediately. M3 - M2 plus large time deposits that are over $100,000, non individual (financial institution or company) money market fund balances, repurchase agreements held by commercial banks in values over $100,000 and that are based on U.S. government securities like Treasury bonds, and most Eurodollars. Monetary base - Currency in circulation plus banks' required and excess deposits at the central bank (reserves).' See Now and Futures, 'Some Key Statistics as Prediction Aids', accessed 10/10/08, http://www.nowandfutures.com/key_stats.html
With topical issues related to global finance, differences in data can be identified. For, the purposes of this paper, the data represented in graphs and tables have been selected to reflect trends of relevance to the topics in this thesis.

[105] Idem.

[106] Data rounded up. See International Monetary Fund, 'World Economic Outlook Database', accessed 30/07/10, http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/download.aspx

Figure One[107]

M3 Plus Credit Plus All Government Debt, Short Term



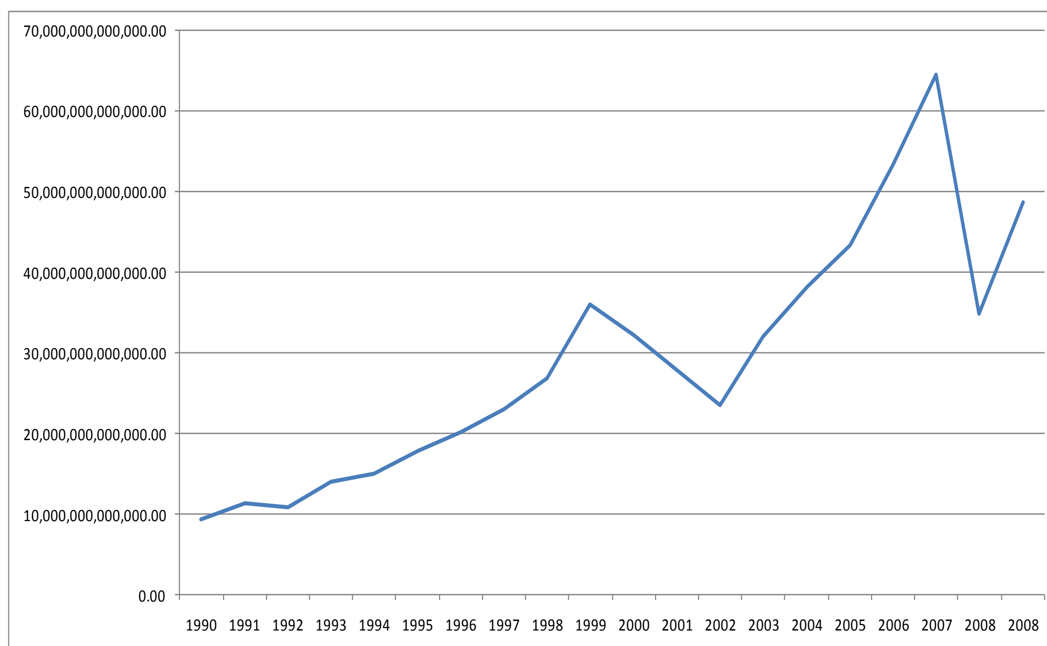
To facilitate this growth in money supply and economic activity, the global financial system expanded its depth, reach, size and complexity over a comparable timeframe. The size of the finance sector has important consequences for how knowledge and power interplay with various actors in the contemporary international system. Most crudely, the increase in the scale of the financial markets can be illustrated in the market capitalisation of the world's stock markets, as seen in Figure Two. Market capitalisation is an estimation of the value of a business that is obtained by multiplying the number of shares outstanding by the current price of a share for those companies listed on the stock exchange. While much of the growth in market capitalisation over this period can attributed to the corresponding bull market that

[107] Now and Futures, 'Some Key Statistics as Prediction Aids', accessed 17/03/10, http://www.nowandfutures.com/key_stats.html

gripped the world's stock markets, the floating on the stock exchange of previously state-owned enterprises in large developed markets also contributed to this sizeable global growth in market capitalisation.

Figure Two[108]

Global Market Capitalisation in Current US$

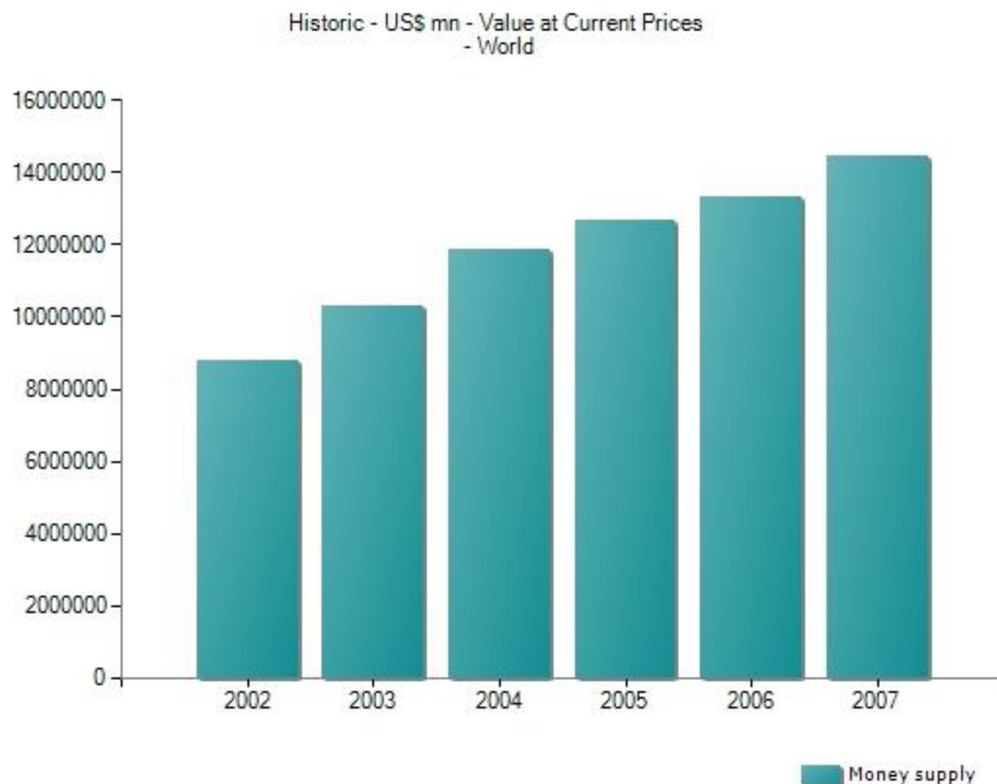


The IMF definition of money supply differs slightly from that of the US Federal Reserve. The International Monetary Fund defines money supply as the total amount of money held by the non-bank public at a point in time. The International Monetary Fund also refers to this data as M1, which equates to physical currency and demand deposits, which are checking accounts. Regardless of the precise definition, M1 is a very liquid measure of the money supply, as it benchmarks the volume of

[108] Data sourced from the World Bank website, accessed 24/02/10, http://www.worldbank.org. Graph created by Michael Priebe on the same date.

cash and assets that can quickly be converted to currency.[109] Figure Three illustrates the growth in M1 over a similar timeframe to that used to track the growth of global share market capitalisation.

Figure Three[110]



Beyond data on money supply and market capitalisation lie a large number of indicators that inform observers of the international system about changes in the scale and complexity of the contemporary financial markets. One such indicator of considerable importance in the contemporary context is the use of credit products in

[109] Idem.
[110] International Monetary Fund, accessed 29/11/08, http://www.imf.org.

the modern international system. Of particular relevance is the emergence of derivatives. The Bank of International Settlements (BIS) defines a derivative as:

> *a financial contract, the value of which depends on the value of one or more underlying reference assets, rates or indices. For analytical purposes, all derivatives contracts can be divided into basic building blocks of forward contracts, options or combinations thereof.*[111]

The contemporary credit market is dominated by the use of over the counter (OTC) derivatives. If a derivative is traded OTC, participants trade directly with each other, via the telephone or computer, rather than via an exchange.[112] Given the identified importance of disintermediation, data relating to the usage of OTC derivatives provide observers with an indicator of the prevalence of credit products in contemporary global financial markets.

The Bank for International Settlements' data shows that the total amount of over the counter (OTC) single-currency interest rate derivatives outstanding (total contracts) on a global basis rose from US$42 trillion in June 1998 to US$458 trillion in the final quarter of 2008.[113] According to the European Commission, this figure increased to $615 trillion by December 2009.[114] Not only is the volume of derivative trading expanding on an extraordinary scale, but the pace of these financial transactions is also becoming more frenetic. The Bank of International Settlements' triennial survey of the foreign exchange and derivatives market is based on data

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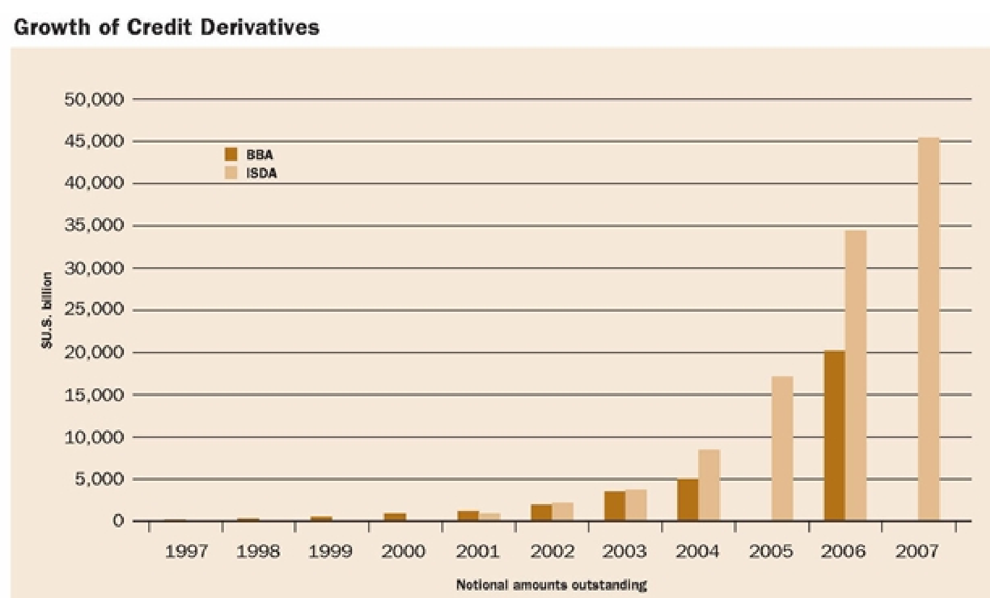
[111] Bank of International Settlements, 'Committee on Payment Settlement and Systems: A Glossary of Terms Used in Payments and Settlement Systems', 2003, p. 18, accessed 08/06/09, http://www.bis.org/publ/cpss00b.pdf
[112] Ibid., p. 37.
[113] Bank of International Settlements, accessed 16/09/08, http://www.bis.org/statistics/otcder/dt21a21b.csv
[114] European Commission Press Release, 'Commission Proposal on OTC Derivatives and Market Infrastructures - Frequently Asked Questions' accessed 16/09/10, http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/410&format=HTML&aged=0&language=EN&guiLanguage=en

provided by fifty-four central banks and monetary authorities. The April 2007 survey showed that the average daily turnover of OTC interest rate and non-traditional foreign exchange derivatives contracts had reached US$2.1 trillion, which was 71% higher than the previous survey in 2004.[115] The BIS survey shows the sizeable growth in the scale and frequency of usage of derivate credit products in the contemporary global financial system.

David Mengle, head of research at the International Swaps and Derivatives Association (ISDA), sources the growth demand for credit derivatives to financial institutions seeking to diversify risk and those seeking a low cost means of taking on credit exposure.[116] As illustrated in Figure Four the growth in outstanding credit derivatives expanded dramatically between 2004 and 2007.

Figure Four[117]



[115] Bank of International Settlements, accessed 08/06/10, http://www.bis.org/publ/rpfx07.pdf
[116] David Mengle, 'Credit Derivatives: An Overview' *Economic Review*, (Federal Reserve of Atlanta, Fourth Quarter, 2007): 1-24, p. 1.
[117] Fred Rix and Clark Boyd, 'Dogs Tags for Virtual Sniffing', *Technology Review* 110.4 (July 2007), p. 16, accessed 14/12/07, http://search.ebscohost.com/login.aspx?direct=true&db=aph&AN=25887648&site=ehost-live

Figure Four demonstrates the growth of credit derivatives according to two sources: the British Bankers Association (BBA) and the International Swaps and Derivatives Association (ISDA). While there is evidence that demand for some credit derivatives slowed in 2008 and 2009 as the global financial crisis took hold,[118] any slowdown was only temporary. According to the ISDA, the growth in trade of OTC credit derivatives resumed in 2010.[119]

Indeed, these instruments are now an integral component of the contemporary international system. For scholars seeking to gain a better understanding of the governance ramifications of this consequential surge in the use of credit products, securing a better understanding of the motives and underlying needs driving this growth is important. In his testimony to the US Senate Committee on Agriculture, Nutrition and Forestry, the former Chairman of the Federal Reserve observed that:

> *over-the-counter (OTC) derivatives have come to play an exceptionally important role in our financial system and in our economy. These instruments allow users to unbundle risks and allocate them to the investors most willing and able to assume them. A growing number of financial and non-financial institutions have embraced derivatives as an integral part of their risk capital allocation and profit maximization.*[120]

This observation, from one of the global financial system's informed observers, demonstrates that credit products are now a critical tools for various actors in the modern international system seeking to manage risk and improve returns. Both of

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[118] International Swaps and Derivatives Association, accessed 11/01/10, http://www.isda.org

[119] International Swaps and Derivatives Association, 'ISDA Provides Concentration Statistics on OTC Derivatives Activity and Publishes Mid-Year 2010 Market Survey Results' (Press Release, October 25, 2010), accessed 26/10/10, http://www.isda.org/media/press/2010/press102510.html

[120] Alan Greenspan, 'Testimony of Chairman Alan Greenspan: Over-the-counter derivatives', *Statement Before the Committee on Agriculture, Nutrition and Forestry, United States Senate* (US Federal Reserve, February 10, 2000), accessed 17/09/08, http://www.federalreserve.gov/boarddocs/testimony/2000/20000210.htm

these outcomes are essential to the ability of state and non-state actors to effectively function.

Derivatives enjoy their contemporary status due in part to their ability to provide a universal value on various financial products. Dick Bryan and Michael Rafferty propose that 'derivatives provide a means to compare all different sorts of capital' and that 'the need for a universal measure of value … is what derivatives are enacting'.[121] They go on to highlight their seminal role, based on the fact that 'they are crucial to the link between money, price and fundamental value not because they *actually* determine fundamental values (for there are no truths here) but because they are the way in which the market judges or perceives fundamental value'.[122] The scale of cross border capital flows and the size and complexity of the contemporary global financial markets places durable relevance on derivatives. Derivatives provide an immediate reflection of market sentiment and in doing so enable market participants to manage risk and optimise commercial returns. From a global governance perspective, the pace at which derivatives have transformed the modern financial system and the broader modern economy has fostered a deficit of understanding of the governance ramifications of this new paradigm.

It is clear that modern credit provisioning has quickly moved away from a simple lender/borrower paradigm towards a larger number of largely anonymous actors using complex financial instruments on a much broader scale. Such instruments enable participants in the modern international system to customise each transaction to suit each specific set of commercial needs. This ability to tailor each product and

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[121] D. Bryan and M. Rafferty, *Capitalism with Derivatives* (New York: Palgrave 2006), p. 35.
[122] Ibid., p. 37.

transaction to a specific set of commercial and risk variables creates a highly complex financial structure that lacks transparency. While derivatives help actors assign value, their trade over-the-counter does not help actors identify important trends in the financial system.

Indeed, the ability of many actors to understand and influence global finance and the broader economic order is mitigated by the emergence of derivatives. Contemporary financial engineering creates challenges for traditional actors, particularly for states. The ability of traditional, state-based regulatory regimes to influence the operating environment for global credit provisioning has been undermined by the multilayered labyrinth that is the burgeoning international derivatives market. Because of the nature of many of the cross-border transactions undertaken in the modern credit market, state actors have limited capacity to monitor those credit transactions taking place partially or fully within their jurisdiction.

This challenge for state actors is particularly acute for OTC derivatives. Bloomberg notes that the OTC market is 'a decentralised market where geographically dispersed traders are linked by telephones and computer screens'.[123] Similarly, the European Commission has observed:

> *Currently, there is little reliable information on what is going on in the OTC derivatives market. There are no public prices available, no public information as to who is entering deals with whom, over what period of time, relating to what underlying asset or for which amounts.*[124]

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[123] Bloomberg, 'Financial Glossary', accessed 19/08/09, http://noir.bloomberg.com/invest/glossary/bfgloso.htm - o.t.c.

The Commission goes on to note that 90% of the derivatives market is comprised of OTC derivatives.[125] Given the volumes of derivative products being traded on a daily basis, the ability of state actors to even observe the scale of trading going on within their boundaries is now fundamentally compromised.

From a global governance perspective, this shift is profound. Prior to the explosion of OTC derivatives in the global financial system, financial transactions were more concentrated in specific exchanges, providing greater transparency for state actors and international government organizations. With transparency came the ability to attempt to influence outcomes in specific markets. As highlighted by Comor, control over information flows is a determining factor behind any given authority structure in the global system.[126] The European Commission has acknowledged that state actors have very limited capacity to obtain reliable information flows, yet alone control them, creating a governance vacuum that has been filled by credit rating agencies.

At the same time as OTC derivatives have become an omnipresent force, both state and non-state actors have increased their usage of other, more traditional credit instruments. One such instrument is a Collateralised Debt Obligation (CDO), which Bloomberg defines as a 'general inclusive term which covers Collateralised Bond Obligations, Collateralised Loan Obligations and Collateralised Mortgage

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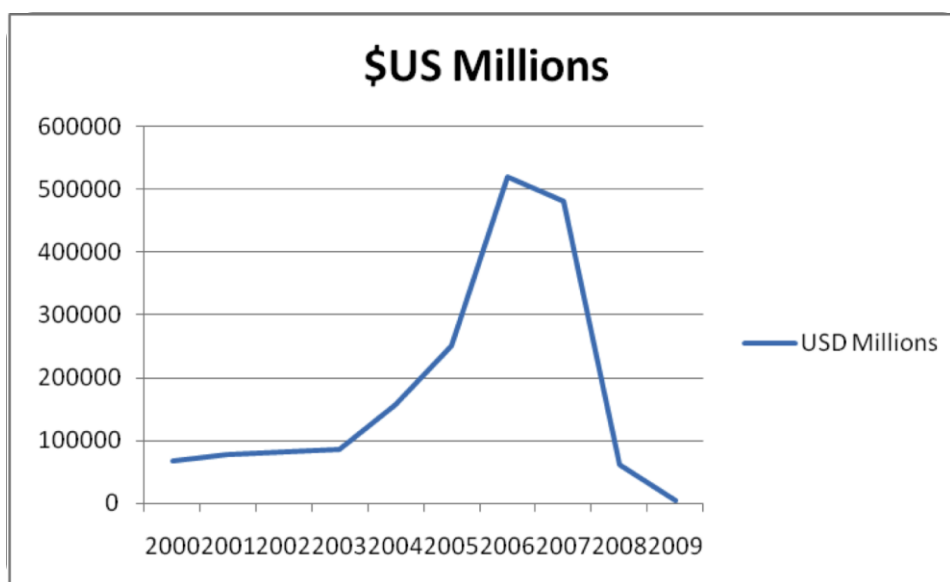
[124] European Commission Press Release, 'Commission Proposal on OTC Derivatives and Market infrastructures – Frequently Asked Questions', accessed 16/09/10, http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/410&format=HTML&aged=0&language=EN&guiLanguage=en
[125] Idem.
[126] Comor, 'Governance and the Nation-State in a Knowledge-Based Political Economy', p. 118.

Obligations'.[127] According to the Securities Industry and Financial Markets Association (SIFMA), private sector bond issuance increased dramatically in the 2000's before the 2008 financial crisis, as seen in Figure Five.

Figure Five[128]

Global CDO Issuance



The significant growth in Collateralised Debt Obligation (CDO) issuance in the 2000's provides another important indicator of quickly significant structural change can occur in the modern international system. It is evident that money supply and the use of credit products can now shift on an extraordinary scale over a short time period. Other indicators show that the impact of the global financial crisis on the broader growth of credit was only ephemeral. As illustrated in Figure Six, SIFMA's data on US Corporate Bond Issuance shows activity soon recovered after a decline in

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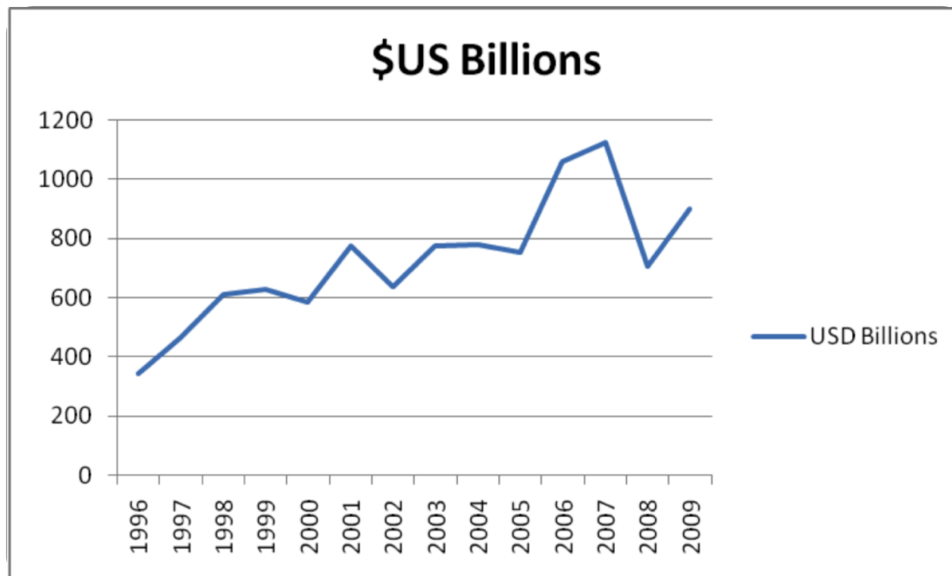
[127] Bloomberg, 'Financial Glossary', accessed 18/05/10, http://noir.bloomberg.com/invest/glossary/bfglosc.htm

[128] Securities Industry and Financial Markets Association, accessed 18/01/09, http://www.sifma.org/research/statistics/global-sector-statistics.shtml (Statistics only – graph created by Michael Priebe).

2008. More contemporary data shows that YTD, 2010 US Corporate Bond Issuance has grown by over 11% when compared to 2009.[129]

Figure Six[130]

US Corporate Bond Issuance



The increasingly reliance on credit products by private actors is well documented. However, the breadth of this reliance across the modern international system is an important development for political economists. The trend towards a greater reliance on credit is also pervasive amongst state actors, who traditionally have been influential and relatively autonomous from other actors in the global system. For observers of the modern international system, any evidence that state actors have fundamentally altered their usage of credit products would provide important context on the role credit plays in enabling global governance and the ensuing trends in knowledge and power. State actors around the world have had a growing dependence on the use of government bonds and the issuance of other

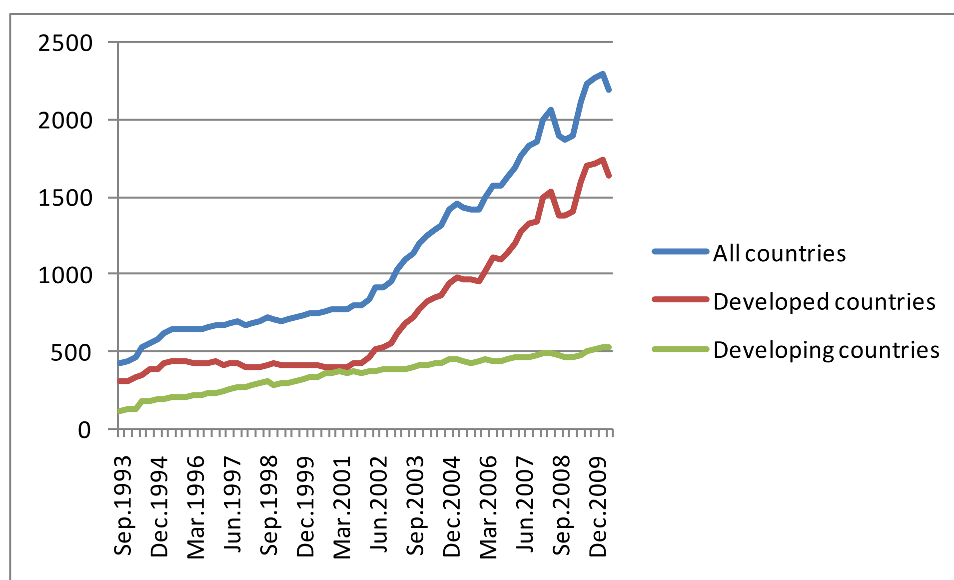
[129] Idem.
[130] Idem.

securities to fund their operations. As shown in Figure Seven, according to the Bank of International Settlements, the use of international debt securities by governments in both the developed and developing world has expanded significantly over recent years.

Figure Seven[131]

International Debt Securities Issued by Governments in $USB

– Global, Developed, Developing



Between June 1995 and June 2010, the global amount of international debt securities issued by governments grew by 321%. In developed countries, debt security issuance rose over the same period by 367%, compared to 208% in developing countries. Tellingly, the growth in bond issuance by state actors continued during and after the 2008 global financial crisis. This growth in bond issuance reflects the growth of total central government debt. According to the OECD, total central government debt grew in member states grew from US$1.78 trillion in 1980 to $24.8 trillion in

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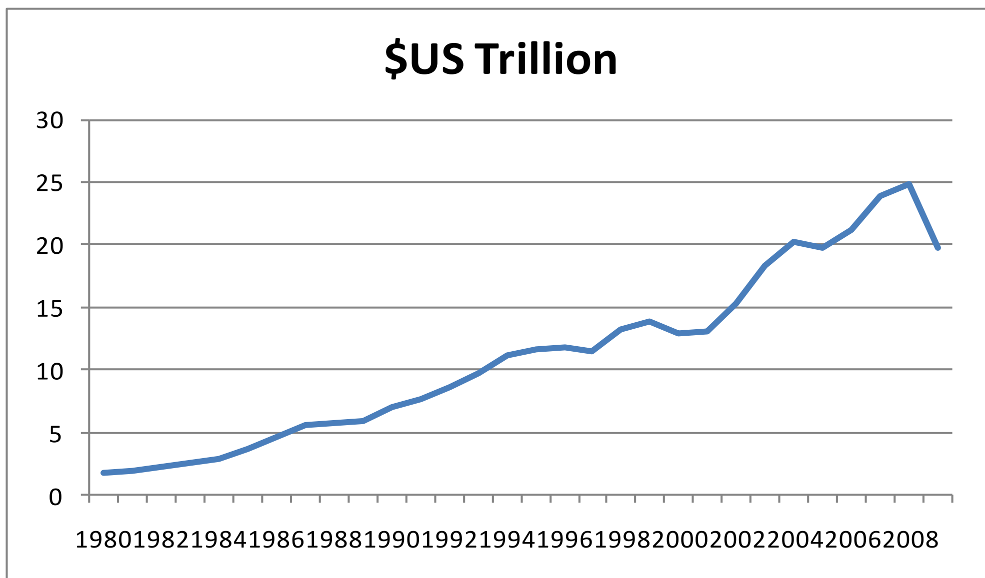
[131] Bank of International Settlements, accessed 09/09/10, http://www.bis.org/statistics/qcsv/anx12d.csv

2008, before easing back to $19.8 trillion in 2009.[132] Represented graphically in Figure Eight, the scale of government debt becomes more apparent. OECD data also shows that central government debt, as a percentage of GDP, has remained relatively stable.

Figure Eight

Total Central Government Debt – OECD Nations 1980 - 2009



State actors have become more reliant on debt instruments because of a shortfall that has emerged in their revenue streams. This shortfall is due to the well documented pursuit of liberal policy settings, particularly since the 1980's, that have seen tax rates fall. State actors have become increasingly reticent to address revenue shortfalls through taxation. Data from twenty-five developed nations shows that total tax receipts as a percentage of GDP averaged 50.8% in 1997 and this figure fell to

[132] OECD, 'Central Government Debt', accessed 19/03/10, http://stats.oecd.org/Index.aspx?datasetcode=GOV_DEBT

47.2% in 2007.[133] The same data source shows that total government expenditure as a percentage of GDP across twenty-seven developed nations fell over the same period from an average of 45.5% to 42.7%.[134] The shortfall arises in the lag between tax receipts and state expenditure. Tax receipts generally occur in arrears, whereas expenditure is immediate. In 2006, for example, the average financial assets of general government across the same twenty-seven developed nations sat at 44% of GDP, while average liabilities for the general governments of these nations in the same year was 63.5%.[135] The negative net worth of governments across the developed world was exacerbated by the 2008 global financial crisis. In response to the crisis, a large number of developed nations increased outgoing expenditure to prevent economic collapse.

The measures pursued by policy makers in developed markets at this time included both rescue packages for specific private actors and stimulus measures for domestic economies, which experienced slowing growth in the face of financial uncertainty. In early 2010, the Board of the IMF noted that:

> *on current trends, general government debt in advanced countries was expected to rise 36 percentage points of gross domestic product (GDP) during 2007–2014 and that age-related (health and pension) expenditures would rise*

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[133] OECD, *National Accounts at a Glance 2009* (Paris, 2010), p. 65. Calculations of averages conducted by Michael Priebe. Nations included in calculation: Australia, Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom, United States.

[134] Ibid., p. 63. Calculations of averages conducted by Michael Priebe. Nations included in calculation: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom, United States.

[135] Ibid., p. 71. Calculations of averages conducted by Michael Priebe. Nations included in calculation: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom, United States.

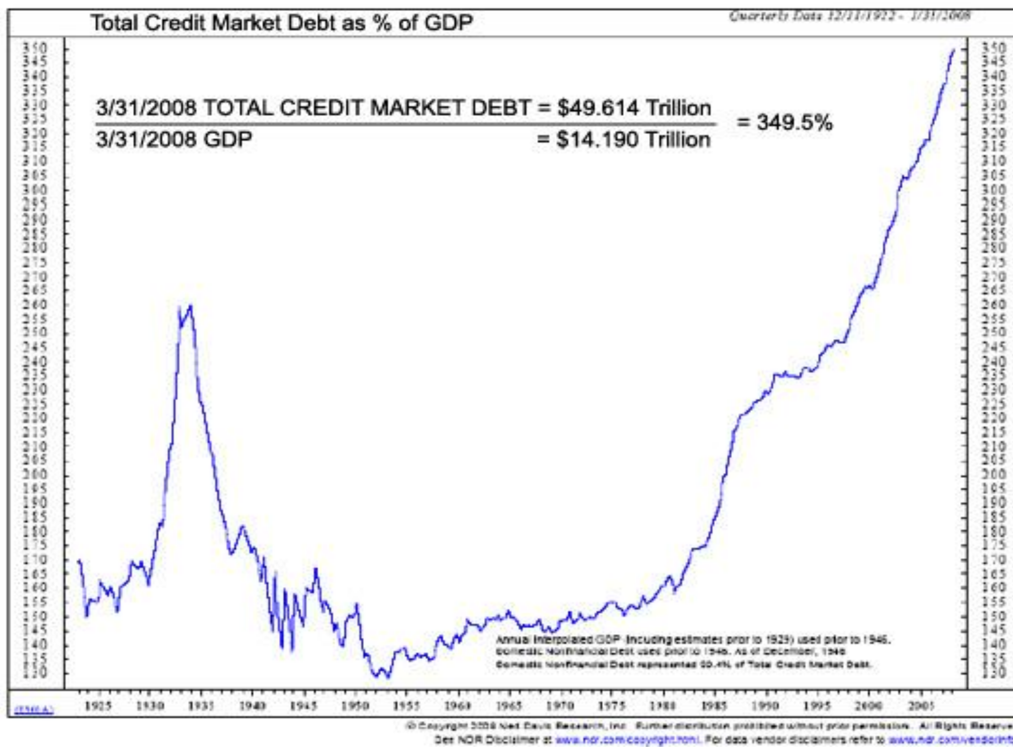
by about 4-5 percentage points of GDP over the next 20 years, requiring a large adjustment to restore fiscal positions to more sustainable levels. In emerging economies, the outlook was more favourable, but adjustment would be needed here too.[136]

Such an increase in general government debt is statistically significant and will ensure that state actors become even more dependent on utilising credit instruments to fund their activities.

The growth in money supply, the growth in derivatives and the growth in usage of credit instruments by state actors have combined to dramatically increase the importance of credit in the international system. That growth is difficult to overstate. Figure Nine provides some historic perspective that is particularly relevant for political economists. The previous occasion credit experienced comparable growth was in the aftermath of the Great Depression, a time that saw significant shifts in global governance.

[136] International Monetary Fund, accessed 16/05/10, http://www.imf.org/external/np/sec/pn/2010/pn1059.htm

Figure Nine[137]

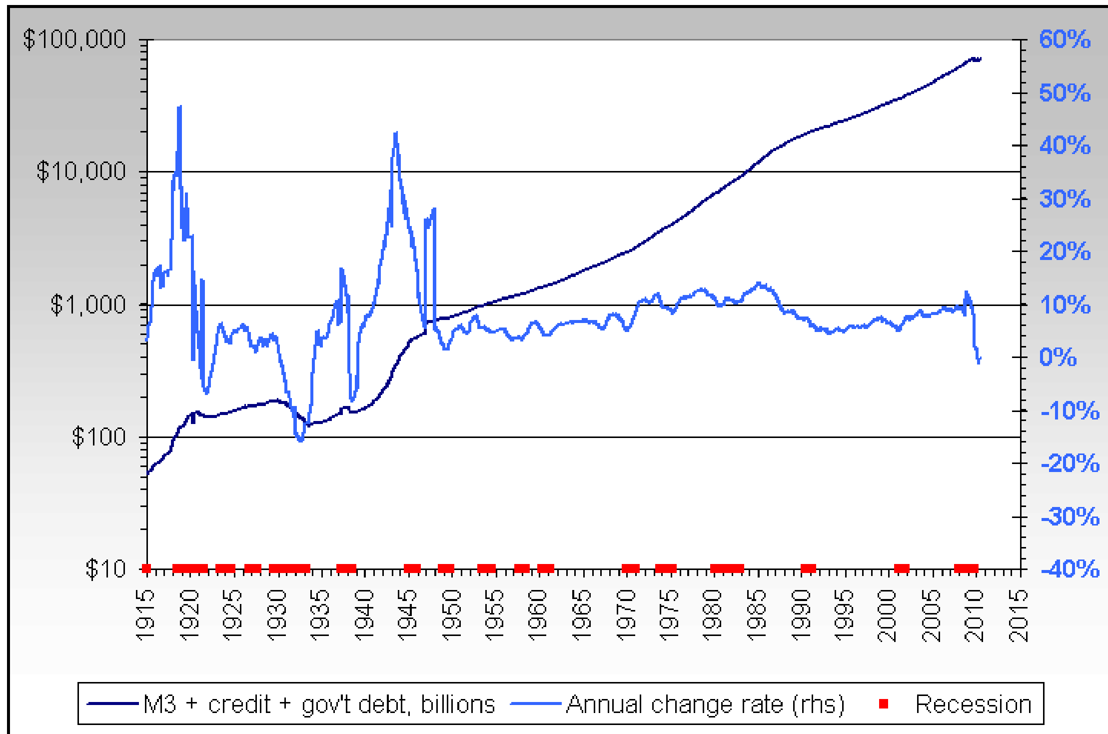


The correlation between explosive credit growth and fundamental alterations to the international system is strong. While the changes experienced in the 1930s were more easily identified and monitored, the changes experienced in recent years are no less dramatic, despite their more opaque nature. Data is rarely presented in a way that so clearly illustrates systemic shifts in global finance. From the perspective of state actors, the trend to greater indebtedness is not new, although its scope and impact on the autonomy of state actors is. When viewed over a longer time period, the growth of money supply and government debt can be placed into a genuinely historic context.

[137] Ned David Research, 2007, accessed 18/06/10, http://www.ndr.com

Figure Ten[138]

M3 Plus Credit Plus All Government Debt, Longer Term Charts



As previously shown, the trend towards greater indebtedness is not restricted to developed states. State actors in emerging markets are also using debt instruments to fund activities with increasing frequency. For example, a Banque de France analysis of the of the West African Economic and Monetary Union (comprising of Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo) showed there was a sixfold increase in the issuance of government securities between 2001 and 2006.[139] The need to obtain credit is now prevalent amongst state actors of varying degrees of development. While the data suggests that developed states are

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[138] Idem.

[139] Banque de France, 'The Rapid Growth of the Government Securities Markets in Sub-Saharan Africa: The Case of WAEMU', accessed 18/12/09, http://www.banque-france.fr/fileadmin/user_upload/banque_de_france/Eurosysteme_et_international/RAZF-2006-study.pdf

more reliant on credit than developing states, the trend towards greater reliance is ubiquitous.

The data presented in this chapter demonstrates clearly that both state and non-state actors in the international system are increasingly dependent on the issuance of credit related products to fund their activities. Furthermore, the growing importance of credit provisioning has been accentuated in the aftermath of the 2008 global financial crisis. While credit has always played a role in influencing the activities of numerous actors in the international system, that role has evolved to the point where credit is now a critical enabler of global governance. Derivative products play a totemic role in assigning value to a wide range of products that are central to the functioning of the modern international system. Furthermore, state actors have lost their autonomy and are now reliant on the ebbs and flows of the international credit market to fund their activities.

This chapter has also demonstrated that money supply and the broader global financial system has grown in size and complexity, diminishing the ability of state actors to accurately observe and control the financial markets. Within such an environment, those who are able to make sense of the exponential amount of data and other information available to market participants are destined to accumulate significant influence over those providing credit and those seeking credit to fund their activities in the international system. For political economists, observations on knowledge in the international system assist in understanding contemporary global governance. Both Strange and Comor, for example, have highlighted the importance

of the connection between knowledge and structural and relational power.[140] This connection has more potency when that knowledge is determinant to the activities of most state and non-state actors in the international system.

Given the genuinely global nature of the modern financial system, state and non-state actors require consistent, global sources of information on credit. The next chapter will demonstrate that credit rating agencies have comprehensively addressed this need. These agencies determine the behaviour of key actors in a prescriptive and unforgiving fashion. Indeed, a recalibration of structural power has taken place, with states losing control over credit, knowledge and beliefs, which combine to determine how the modern international system functions. From an IPE perspective, the shift in control of knowledge is of particular relevance. The scale and complexity of the global financial markets has dramatically increased the options available to the global investors who guide ever-growing pools of capital across state boundaries. As the scale of the global financial system has grown and technology evolved, the volume of information available has grown exponentially. In this highly competitive, highly complex and fast moving investment environment, demand for knowledge that is internationally recognised and respected has risen.

Into this breach have marched the credit rating agencies. By assuming control over knowledge and creating consistent and easily recognisable global benchmarks, credit rating agencies have effectively harmonised their offering to the needs of the emerging paradigm. A new intersubjective consensus, to use Rosenau's term, has

[140] Strange, *States and Markets*, p. 24 and passim; Comor, 'Governance and the Nation-State in a Knowledge-Based Political Economy', p. 118-120.

emerged.[141] State and non-state actors are now guided in their investment activities to varying degrees by the knowledge controlled and communicated by credit rating agencies. Indeed, the new proclivity to rely on credit rating agencies to obtain and distribute knowledge has fundamentally altered contemporary global governance. Tony Porter's observations on the rise of knowledge-producing epistemic communities provide a poignant reference point for contemporary political economists seeking to gain a better understanding of the modern power structure.[142]

The shift in power is effectively illustrated through the development and distribution of knowledge on the creditworthiness of state actors by credit rating agencies. In the modern international system, these agencies are empowered to determine how investors view state actors and therefore influence to a significant extent the ability of state actors to fund their activities. State actors are no longer able to accumulate and distribute knowledge on their own creditworthiness in a credible way in the global investment community. Investors now question the objectivity and reliability of state-based knowledge. The Greek debt crisis provides scholars with a relevant example of this evolving dynamic. The role of knowledge and the ability of credit rating agencies to obtain and distribute knowledge to influence a broad range of actors shall be explored in the next chapter.

[141] On Rosenau's theory of intersubjective consensus, see Chapter One of this thesis.
[142] Porter, 'The Late-Modern Knowledge Structure and World Politics', p. 137.

Chapter Three:

The Role of Knowledge in Contemporary Financial Markets

In the modern international system, the financial markets play a seminal role in global governance. As outlined in the previous chapter, the growth in scale of the global financial system in recent years has been dramatic. This growth has seen the development of a global financial infrastructure that can accommodate the explosion in money supply and the associated growth in the usage of complicated credit products, particularly derivatives. At the same, technological advances and the removal of barriers to cross border financial transactions have accelerated the emergence of a genuinely globalised financial system. With this new scale comes more complexity. The number of financial products available across porous state borders has significantly increased the options for would-be-borrowers and would-be-lenders.

A corollary of this development is a shift in the way actors seek knowledge to inform decision making, including investment decisions. The modern international system is a dynamic, interconnected and multifarious organism that has fundamentally new characteristics. The explosion of available information within that system is one such characteristic, permeating the activities and decisions of many actors, due largely to its scale. While many scholars and commentators acknowledge this development, it is a change in the global system that is challenging to quantify. However, research conducted by Lyman and Varian (fig. 11) effectively illustrates the pace and scope of the growth of information on a global scale.

Figure Eleven

Worldwide Production of Original Information, if Stored Digitally, in Terabytes circa 2002.[143]

Storage Medium	2002 Terabytes Upper Estimate	1999-2000 Upper Estimate	% Change Upper Estimates
Paper	1,634	1,200	36%
Film	420,254	431,690	-3%
Magnetic	4,999,230	2,779,760	80%
Optical	103	81	28%
TOTAL	**5,421,221**	**3,212,731**	**69%**

Clearly, a profound growth in information is taking place in the modern international system. With so much information readily available, it is incumbent upon IPE scholars to consider the ramifications of this pervasive trend, particularly for global governance. Within the context of the global financial system, knowledge has become a powerful compass, guiding actors as they make decisions that regulate human affairs. In the twenty-first century, knowledge guides huge waves of capital to state and non-state actors via a range of financial instruments, including credit products. These waves of capital are the lifeblood of the contemporary global system, placing knowledge in a powerful and totemic role.

[143] Peter Lyman and Hal. R. Varian, *How Much Information? 2003* (Berkeley: University of California, 2003), p. 4. Note: a terabyte is the equivalent of 1,000,000,000 kilobytes.

How knowledge is conceptualised is therefore important. This chapter will seek to highlight relevant theoretical concepts regarding the importance of knowledge and its use in contemporary global governance. This chapter will also seek to explore the accumulation of knowledge by the credit rating agencies and how these agencies use knowledge to influence the behaviour of a broad range of actors in the modern global system. These observations will provide the foundation for an analysis of specific examples of the influence of credit rating agencies on contemporary global governance in the following chapters. Knowledge plays a pivotal role in the influence exerted by credit rating agencies. A deliberate evaluation of the theoretical and practical positioning of knowledge in the modern system augments an enhanced understanding of the role of credit rating agencies in contemporary global governance.

Knowledge is different to information. Knowledge effectively distils information and provides widely accepted contextual frameworks around which participants in the global system can interpret information and make choices. This process engenders authority for the originator, who is able to claim access to knowledge that is to some degree exclusive. This process can also be subjective. Such authority can be amplified when there is broad acceptance of contextual frameworks created by knowledge. Information by itself has limited capacity to influence the behaviour of actors in the contemporary global system. Rather, it is the frameworks and structures provided by knowledge that shape human affairs on a global basis.

The distinction between information and knowledge represents a logical starting point for an assessment of the positioning of knowledge in the modern international system. Edward Comor has observed that knowledge is represented by

‘how human beings sort and process information into what is known’ through a ‘complex set of conceptual systems’. [144] As outlined in Chapter One, Comor has argued that ‘information in and of itself is meaningless with the presence of conceptual systems that facilitate particular understandings and applications’.[145] Indeed, the volume of information available in the modern international system elevates the importance of such conceptual systems. As previously noted, Jan Toporowski has made similar observations relating to the importance of knowledge structures in global finance due to the permanent buzz of new information.[146]

James Rosenau has described the emergence of information technology as an ‘information revolution’ that is both ‘powerful and neutral’.[147] Rosenau draws a clear distinction between information and information technology, noting that ‘information is perforce subjective and anything but neutral. It can be skewed and designed to distort. This is not the case, however, with information technologies’.[148] Indeed, using Rosenau’s distinction, information technology provides a powerful platform that enables those who create and enforce knowledge structures to quickly distil enormous volumes of information into relatable and usable constructs. Information technology has facilitated the emergence of a highly responsive global financial system that can react quickly to research and assessments generated by globally recognised providers of knowledge such as credit rating agencies.

Participants in the modern global financial system have access to extraordinary volume of information generated by a broad range of actors including

[144] Comor, ‘Governance and the Nation State in a Knowledge-Based Economy’, p. 118.
[145] Ibid., p. 119.
[146] See Chapter One of this thesis.
[147] James Rosenau, *Distant Proximities* (Princeton: Princeton University Press, 2003), p. 256.
[148] Ibid., p. 257.

companies, analysts, financial and industry media and states. Information relating to variables such as earnings, forecasts, industry peers, regulatory changes, sectoral and macroeconomic trends flood the twenty-first century financial system through information technology platforms. For observers of contemporary global governance, the complexity of conceptual systems described by Comor are evident in the knowledge generated by the ratings agencies. These actors produce a plethora of globally recognised rating measures, as illustrated in Figure Twelve.

Figure Twelve[149]

Rating number (fine)	Rating no. (broad)	S&P	Moody's	Fitch
21 (Highest credit rating)	8	AAA	Aaa	AAA
20	7	AA+	Aa1	AA+
19	7	AA	Aa2	AA
18	7	AA−	Aa3	AA−
17	6	A+	A1	A+
16	6	A	A2	A
15	6	A−	A3	A−
14	5	BBB+	Baa1	BBB+
13	5	BBB	Baa2	BBB
12	5	BBB−	Baa3	BBB−
11	4	BB+	Ba1	BB+
10	4	BB	Ba2	BB
9	4	BB−	Ba3	BB−
8	3	B+	B1	B+
7	3	B	B2	B
6	3	B−	B3	B−
5	2	CCC+	Caa1	CCC+
4	2	CCC	Caa2	CCC
3	2	CCC−	Caa3	CCC−
2	1	CC	Ca	CC
1	1	C	C	C
Default	Default	SD/D		DDD/DD/D

These ratings have become synonymous with the financial health of state and non-state actors and are a veritable proxy for global market consensus. However, the

[149] Robert Brooks, Robert Faff and Paula Hill, 'Variations in Sovereign Credit Quality Assessments Across Rating Agencies', *Journal of Banking and Finance* 34 (2010): 1327-1343, p. 1329.

contemporary conceptual systems created by the rating agencies now extend well beyond rating assessments. Christina Bannier and Christian Hirsch have noted that:

> *the widespread use of credit ratings has been accompanied by a rise in the complexity of the rating information. Most credit rating agencies not only offer a rating ...but supplement their service by providing additional information via rating outlooks and rating reviews (watchlists) that give indications of future credit rating changes*.[150]

Timothy Sinclair has also drawn attention to this growth in innovation by the credit rating agencies, observing that 'derivatives and structured financing, among other things, have stressed existing analytical systems and outputs, and the agencies have been developing new rating scales and expertise in response'.[151]

By deepening their offering beyond ratings, credit rating agencies are able to further differentiate the knowledge they generate from the financial information that is available to market participants and observers. The broader offering also enables the credit rating agencies to engage with increased frequency with both the entities they are rating and those who acquire the knowledge they produce. The technical attributes of the ratings process are well documented. However, for scholars with an interest in contemporary global governance, an understanding of how credit rating agencies accumulate and use knowledge to exert influence over a range of actors has significant value. The integration of linear ratings with more subjective analysis, outlooks and reviews, as described by Bannier and Hirsch, is conducive to the establishment of conceptual systems that help generate pervasive norms in the modern

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[150] Christina E. Bannier and Christian W. Hirsch, 'The Economic Function of Credit Rating Agencies – What does the Watchlist Tell Us?' *Journal of Banking and Finance* 34 (2010): 3037-3049, p 3037.
[151] Sinclair, The New Masters of Capital, p. 27.

international system. These norms help actors quickly sift through voluminous information and reach a consensus on what is known and what that means.

As outlined in the previous chapter, the volume of financial transactions and financial instruments has grown markedly over a relatively short period of time. However, the challenges facing participants in the global financial system extend well beyond scale. James Crotty has noted that ‘financial innovation has proceeded to the point where important structured financial products are so complex that they are inherently non-transparent’.[152] The intricacies of modern finance are not only multiplied by the complexities of the financial products themselves, but also by the increasingly convoluted commercial relationships that transact their exchange. In a Bank of International Settlements (BIS) working paper, Hyun Song Shin observed ‘a characteristic feature of financial intermediation based on the US-securitisation system is the long chains financial intermediaries involved in channelling funds from the ultimate creditors to the ultimate borrowers’.[153] Shin draws attention to the trend in contemporary finance away from a short intermediation chain, where a borrower lends from a bank which derives its funding from depositors, towards long intermediation chains. These long intermediation chains include several financial institutions and products between the borrower and the depositor.[154]

Longer intermediation chains, combined with disintermediation and increasing complexity, create opacity for participants and observers in global finance, who are seeking greater clarity on investment choices. As highlighted in Chapter One,

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[152] James Crotty, ‘Structural Causes of the Global Financial Crisis: A Critical Assessment of the ‘New Financial Infrastructure’,’ *Cambridge Journal of Economics* 33 (2009): 563-580, p. 566.
[153] Hyun Song Shin, ‘Financial Intermediation and the Post-Crisis Financial System’, *Bank of International Settlements Working Paper* 304 (2010): 1-38, p. 2.
[154] Idem.

Timothy Sinclair see disintermediation as an important precursor to the emergence of epistemic authorities such as ratings agencies, who homogenise belief systems through a process they describe as cognitive centralisation.[155] Mark Amen has also noted that 'abstract credit relations increase the likelihood that the hierarchical setting in which knowledge is exchanged will itself affect the distribution of power'.[156] This abstraction has increased as the size and scale of global finance have increased.

The challenges associated with navigating the global financial system foster the growing reliance on the interpretations and assessments of recognised knowledge providers. Indeed, the many participants involved in the long intermediation chains described by Shin, including money market funds, commercial banks, securities firms, issuer and mortgage pool funds, are all potential suppliers of information regarding a typical financial transaction.[157] For actors seeking clarity and consistency across sectors and markets, the need for a homogenous, recognisable and accepted set of conceptual systems is acute. As Timothy Sinclair has noted, 'the authority of rating agencies has expanded with the growth of capital markets and the decline of banks as major allocators of resources'.[158]

In the absence of the conceptual systems described by Comor,[159] the global financial markets' ability to interpret information would likely drown in a sea of seemingly unrelated data. State and non-state actors are now highly reactive to the global financial markets, which themselves are effectively structured around the distillation of information. As Langohr and Langohr have observed, 'it is a truism that

[155] Sinclair, 'Synchronic Global Governance and International Political Economy', pp. 166-167.
[156] Amen, 'Borrowing Authority; Eclipsing Government', p. 181.
[157] Shin, 'Financial Intermediation and the Post-Crisis Financial System', p. 2.
[158] Sinclair, The New Masters of Capital, p. 65.
[159] Comor, Governance and the Nation-State in a Knowledge-Based Political Economy, pp. 118-119.

securities markets are actually information markets' and that 'one of the most critical impediments to investor rights is their ignorance of what goes on in a company, i.e., the information asymmetry between outside investors and insiders who control company operations'.[160] This information asymmetry is present at a broader scale in financial instruments relating to currencies, sovereign debt and commodities. The driving need to distil information empowers those actors who are able to credibly claim an ability to illuminate the commercial and financial realities that are so relevant to the decision making of participants in the financial markets.

Given the critical role knowledge plays in influencing the actions of various actors, any changes to the access to and demand for that knowledge will have significant implications on the international system. This demand brings Susan Strange's delineation between relational and structural power into focus. Strange observed that structural power 'confers the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people or corporate enterprises'.[161] Numerous participants in global finance scattered across disparate locations influence the behaviour of actors through the assessments and decisions they make. The credit rating agencies codify their assessments of the credit-worthiness of actors through their ratings, which provide globally recognised and accepted benchmarks that guide a range of important decisions by state and non-state actors alike. Collectively, this influence constructs the overarching system that regulates human affairs on a global basis. Such power therefore is not relational, but structural.

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[160] Herwig M. Langohr and Patricia T. Langohr, *The Rating Agencies and their Credit Ratings* (Chichester: Wiley 2008), p. 9.
[161] Susan Strange, *States and Markets*, p. 25.

Strange cites the control of knowledge and control of credit as being two integral sources of structural power. In particular, she attributes the ability to influence the activities of actors through less visible means as being a critical component to the importance of knowledge in the global system.[162] Indeed, Strange observes that control of knowledge provides a 'very special kind of structural power'.[163] This power is derived from the structure of knowledge itself. According to Strange, 'a knowledge structure determines what knowledge is discovered, how it is stored, and who communicates it by what means to whom and on what terms'.[164] Importantly, Strange also noted that 'power and authority are conferred on those occupying key decision-making positions in the knowledge structure' and 'those who are acknowledged by society to be possessed of the 'right', desirable knowledge and engaged in the acquisition of more of it, and on those entrusted with its storage, and those controlling in any way the channels by which knowledge, or information, is communicated'.[165] In a modern setting, such authority requires the acknowledgement and acceptance of a significant number of disparate actors.

The epistemic nature of the structural power, as described by Strange, provides a useful context for an analysis of the role of credit rating agencies in contemporary global governance. Using the criteria above, it is clear that in the modern international system the credit rating agencies, perhaps more than any other actor, exhibit the traits highlighted by Strange attributable to the creation of a knowledge structure. These organisations are able to determine to a significant extent what knowledge is discovered, how it is processed, how it is communicated and most importantly, to

[162] Ibid., p. 30.
[163] Idem.
[164] Strange, *States and Markets*, p. 117.
[165] Idem.

whom it is communicated to. In an era when the scale and complexity of the global financial markets extends well beyond the institutional capacity of any single state actor, the credit rating agencies effectively control the rules that guide the conspicuous and inconspicuous decisions that guide human affairs. The recognition and authority they carry enables credit rating agencies to employ structural power on an impressive scale.

In *The New Masters of Capital* (2005), Timothy Sinclair draws attention to the role of state-based financial regulation in the reinforcement of the epistemic authority of credit rating agencies. For example, Sinclair documents a plethora of regulatory measures in OECD and APEC countries that force market participants to use the credit ratings system.[166] In New Zealand, for instance, a registered bank is required by legislation to disclose ratings in its quarterly disclosure statement, while in Argentina, banks and financial companies must seek a rating from an authorised rating agency.[167] In Malaysia, no private debt securities can be issued unless they are rated BBB or higher for long term debt.[168]

Such state-based regulatory reinforcement is supplemented by international financial regulation. As previously discussed, the third of the Basel Accords, known as Basel III, represent the Basel Committee on Banking Supervision's response to the 2008 global financial crisis. Basel III is emerging as the new global regulatory standard on bank capital adequacy and liquidity through which the Basel Committee have sought to address the reliance on ratings generated by the credit rating agencies

[166] Sinclair, *The New Masters of Capital*, 'Table 4', pp. 47-49.
[167] Ibid., p. 47 & p. 49.
[168] Ibid., p. 48.

in Basel II.[169] Basel III explicitly recognises the global banking system's 'reliance on external credit ratings', yet seeks to explore ways to compel banks to more transparently assess the credit risks associated with exposures.[170]

The answer, according to the Basel Committee, is the incorporation of the International Organisation of Securities Commission's (IOSCO) *Code of Conduct Fundamentals* for credit rating agencies. Basel III recommends changing the text of Basel II, paragraph ninety to read 'national supervisors are responsible for determining on a continuous basis whether an external credit assessment institution (ECAI) meets the criteria ... national supervisors should refer to the IOSCO's *Code of Conduct Fundamentals* for credit rating agencies when determining ECAI eligibility'.[171]

Basel III is likely to reinforce the role of the credit rating agencies in the global banking system, albeit with additional scrutiny courtesy of IOSCO's *Code of Conduct Fundamentals*. Other international organisations with an oversight of the global financial system also recognise the importance of credit rating agencies in the provision of knowledge. The International Monetary Fund's (IMF) *Global Financial Stability Report: Sovereigns, Funding, and Systemic Liquidity* (2010), acknowledged the need for aggregating information about the credit quality of various actors in the global financial system, noting that credit rating agencies allow 'borrowers to access global and domestic markets and attract investment funds, thereby adding liquidity to

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[169] Bank of International Settlements, Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems, December (2010), p. 51.
[170] Ibid., pp. 51-52.
[171] Idem.

markets that would otherwise be illiquid'.[172] International financial regulation echoes the importance placed on the credit ratings system by state regulators in developed and developing markets. Such regulatory measures legitimise the claims by the credit rating agencies that they have a percipient ability to create the knowledge structures that are needed in the global financial system.

The location of such structural power may not be easily recognised by many due to the less visible means used to exert influence, as described by Strange in *States and Markets* (1988).[173] Where knowledge is derived and communicated is critical to the construct of power structures and how influence is exerted. Mark Amen notes that 'although knowledge is finite, it is also firmly in place at sites of governance to which people come…people can submit to a process of learning, conform to what is expected of them, and even change their activities to comply with the norms'.[174] In a modern context, global finance is an important site of governance to which various actors come as they seek funding for their activities. The compliance by state and non-state actors to the ratings system reflects a powerful conformity to the norms, as prescribed by the credit rating agencies. The process of learning described by Amen is illustrated in the analysis the credit rating agencies use to accompany ratings decisions. Indeed, the broadened offering from the rating agencies has a distinctly educative quality, with rating agency analysts happy to narrate their decisions via the media, as discussed in Chapter One, to ensure actors understand the rationale behind decisions. The acceptance by so many actors of the credence of the ratings system creates a powerful enforcement mechanism.

[172] International Monetary Fund, 'The Uses and Abuses of Sovereign Credit Ratings', in *Global Financial Stability Report*: *Sovereigns, Funding, and Systemic Liquidity* October (2010): 1-148, p. 85.
[173] Strange, States and Markets, p. 24.
[174] Amen, 'Borrowing Authority; Eclipsing Government', p. 178.

Another enforcement mechanism that strengthens the positioning of the knowledge structure generated by judgements around credit is the market reaction to decisions and statements from the credit ratings agencies. The financial markets swiftly react to new knowledge, in the form of a ratings decision, analysis or commentary from a ratings agency, repeatedly reinforcing the market consensus that the ratings agencies are the source of accurate assessments on the financial health of various actors and the likely moves of key decision makers. There are a plethora of examples of this dynamic. In March 2011, Standard and Poor's cut its credit rating of Japanese motoring giant Toyota from AA to AA-, triggering a swift reaction by investors. Toyota shares fell 1.3% within hours of the credit rating decision.[175] Standard and Poor's analyst Chizuko Satsukawa explained the decision by saying, 'the company's profitability is still weak, its pace of recovery is slower than those of Japanese peers, and its profitability might remain under pressure from higher raw material prices and gasoline prices as well as the strong yen'.[176] Toyota spokesperson Mike Michels said 'the downgrade by S&P is regrettable and we do not take this rating change lightly'.[177] Mr Michels went on to say 'we aim to improve our rating by making the best management decisions we can, while continuing to take care of our customers as our top priority. This will help us improve our profitability over the long term'.[178]

The Toyota example provides a good case study of the enforcement mechanism at play with credit rating agencies. A credit rating agency downgrades a

[175] Shawn Langlois, 'Toyota Stung by S&P Downgrade', *Market Watch*, (4 March 2011), accessed 09/03/11, http://www.marketwatch.com/story/toyotas-profit-path-trips-sp-downgrade-2011-03-04
[176] Idem.
[177] Idem.
[178] Idem.

company's rating and publicly releases a statement that provides both the rationale for the decision and outlines the steps for possible improvement by the rated entity. The market reacts negatively, wiping significant value from the rated entity in response. The rated entity subsequently releases a contrite statement, pledging to address the issues raised by the rating agency.

Examples of credit rating news trumping operational or commercial fundamentals are also commonplace. The intraday volatility of BP's share price during the 2010 oil spill in the Gulf of Mexico represents a poignant example of this dynamic. On 3 June 2010, BP's share price rallied '3.7 per cent on news that robot submarines attempting to curb the spill made some progress'.[179] However, later that day, Fitch announced it had lowered BP's credit rating from AA+ to AA. In a statement, Fitch said 'The downgrade of BP's ratings reflects Fitch's opinion that risks to both BP's business and financial profile continue to increase following the Deepwater Horizon accident in the US Gulf of Mexico'.[180] BP shares fell dramatically on news of the credit rating downgrade, ending the day down 0.7%.[181] Investors, who were originally bullish on operational progress being made by the company as it sought to manage the oil spill, clearly prioritised the assessment of a credit rating agency over BP's own analysis.

A unique component to the enforcement mechanism attached to credit rating assessments is its scale. Changes to sovereign ratings can have a broad market impact. For example, in May 2010, Fitch downgraded Spain's sovereign debt one notch from

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[179] 'BP's Credit Rating Downgraded After Rally', *The Times Online*, (3 June 2010), accessed 08/06/10, http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article7143119.ece
[180] Idem.
[181] Idem.

triple-A to AA+ due to its economic growth outlook, triggering a remarkable chain of events on the global financial markets. The downgrade saw the euro fall precipitously against the US dollar, with the European currency falling almost a cent in the minutes after the announcement, while in New York, the S&P dropped 1.1% on the news. [182] The response to that particular credit rating decision in the financial markets was fast, global and decisive. This case study again demonstrates the supremacy of credit rating assessments over other developments in the minds of investors. The day before the Fitch downgrade, Spain's Socialist government won parliamentary approval for a tough austerity plan, involving €15bn of budget cuts through a 5% cut in public sector pay, a freeze on pensions and other cuts to government spending.[183] Such significant state-specific political news was unable to inoculate various markets from the fallout of a credit rating downgrade the next day.

Cognitive learning means that participants in the global financial markets are highly responsive to knowledge generated by the credit rating agencies. The complexity of the contemporary rating system described by Bannier and Hirsch means there is an almost continuous stream of information emanating from the rating agencies that potentially influence the markets. In addition, speculation about future changes to rating agency assessments is commonplace, particularly amongst those involved in market research. The growing prevalence of rating watches fosters such speculation and helps to sustain the knowledge structure rating agencies provide. Indeed, the statements released by credit rating agencies do little to dispel market ruminations, creating a symbiotic cycle of dependence.

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[182] Jennifer Hughes and Victor Mallet, 'Fitch Downgrades Spain's Credit Rating', *Financial Times* (28 May 2010), accessed 08/01/11, http://www.ft.com/intl/cms/s/0/979f8314-6a81-11df-b282-00144feab49a.html#axzz1XzexZYLU
[183] Idem.

For example, in December 2010, Moody's announced a two-notch downgrade of Hungary's sovereign rating to Baa3, one notch above junk, with a negative outlook.[184] Dietmar Hornung, Vice President and Senior Credit Officer at Moody's Sovereign Risk Group told reporters that the negative outlook 'speaks to the next 12-18 months ... we are monitoring the situation but negative outlooks (don't mean) an imminent rating action to be expected'.[185] The market interpretation of the ramifications of the Moody's announcement was less ambiguous. Timothy Ash, Head of Global Emerging Markets Research at the Royal Bank of Scotland said that following the downgrade, there was 'a clear risk' that at some time in the next year, Hungary would lose its investment grade status.[186] Emerging market analysts at TD Securities, a significant global financial and investment consultancy, asserted that 'the risk for further downgrades should trigger a risk-off reaction adverse to Hungarian assets'.[187] This example demonstrates the reinforcement mechanisms in-built in the credit rating process. Credit rating agencies use mechanisms like credit outlooks and credit watches to tantalise market participants through the spectre of future action within a broad time horizon that could have a material impact on prices. Such mechanisms sustain ongoing interest in the deliberations of the credit rating agencies, creating a never ending process of assessment with little prospect for closure or long term certainty.

The interplay between the rating agencies and the financial markets represent a unique and omnipresent reinforcement mechanism for the knowledge structure

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[184] MTI Hungarian News Agency, 'Hungary at Risk of Losing Investment Grade', *Newswire* (6 December 2010): 1-2, p. 1.
[185] Idem.
[186] Idem.
[187] Idem.

assiduously built by the credit rating agencies. The reinforcement mechanism is unique because a broad range of actors can be materially impacted on the global financial markets within minutes of new knowledge being created by the credit rating agencies. It is challenging to identify a contemporary knowledge structure that can boast a reinforcement mechanism that has comparable potency. This knowledge structure occupies the entire length of Rosenau's continuum of global governance,[188] with formal rules one end in the form of credit rating decisions and a less formal set of norms at the other in the form of market expectations and reactions.

The atypical nature of this structural power is material to the impactful capabilities of this select group of influencers. As outlined in the previous chapter, state and non-state actors need to interact with global finance to facilitate access to the capital required to fund their activities. Importantly, the globalised nature of the contemporary international system has compromised the ability of state actors to exclusively obtain and disseminate knowledge that will establish expectations and guide behaviour. There is now a fundamental dislocation, as noted by Rodrik, 'in a world where national markets are fully integrated yet politics remains organised nationally'.[189] State actors no longer have the capacity to control the modern knowledge generation process.

The exclusivity of the rating agencies' knowledge offering is no accident. These entities have carefully cultivated their monopoly over knowledge generation and dissemination in the modern international system. Exclusivity of knowledge is a key claim of the rating agencies. Rating agencies unambiguously promote the concept

[188] Rosenau, 'Governance, Order, and Change in World Politics', pp. 12-14.
[189] Dani Rodrik, 'Governance of Economic Globalization', in *Governance in a Globalising World*, eds. J. Donahue and J. Nye (Washington DC: Brookings Institution Press, 2000), p. 354.

that they are uniquely positioned to provide the structural knowledge that participants in the global financial system need. Indeed, they clearly distinguish the knowledge they generate from the less valuable information available from other sources.

These themes are consistently highlighted through the promotional activities of each of the three major credit rating agencies. For example, Standard and Poor's claims to 'provide investors who want to make better informed investment decisions with market intelligence in the form of credit ratings, indices, investment research and risk evaluations and solutions'.[190] Moody's describe themselves as 'an essential component of the global capital markets',[191] and go on to claim, 'our independent and objective opinions contribute to transparent financial markets and provide an insightful view on credit quality to investors and issuers worldwide'.[192] Meanwhile, Fitch's definition of its services reveal the exclusivity positioning that is so central to the contemporary global power structure. As their website states: 'Offering a world of knowledge and experience behind every opinion, we transform information to deliver meaning and utility to investors, issuers and other market participants….the additional context, perspective and insights we provide help investors make important credit judgments with confidence'.[193]

Rosenau's concept of intersubjective consensus becomes more relevant when one considers that the process of knowledge generation at credit rating agencies brings together skills that are not ostensibly unique. In testimony to the United States

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[190] Standard and Poor's, 'About Us', accessed 23/3/11, http://www.standardandpoors.com/about-sp/main/en/au
[191] Moody's, 'About Us', accessed 23/03/11, http://www.moodys.com/Pages/atc.aspx
[192] Moody's, *Annual Report* (New York: Moody's Corporation, 2010), p. 2.
[193] Fitch Ratings, 'About Us', accessed 23/03/11, http://www.fitchratings.com/jsp/creditdesk/AboutFitch.faces?context=1&detail=1

(US) Senate Committee on Homeland Security and Governmental Affairs' Permanent Subcommittee on Investigations, Frank Raiter, Managing Director at Standard and Poor's between 1995 and 2005, provided US Senators with an overview of how rating agencies develop their ratings for corporate entities. His testimony included the following observation:

> *Traditional credit analysis looks at financial ratios, business practices, products, markets and management and a myriad of other factors. In rating corporate bonds a committee, made up of analysts from the same industry as well as analyst from associated industries, reviews the rating proposal and analysis and the committee vote is a significant factor in establishing a published rating.*[194]

Other entities, such as accounting firms, advisory firms, banks, investment banks, brokerage houses and regulators have analysts who compile information on issues like products, markets, management, financial ratios and business practices.

It is the establishment of globally recognised benchmarks that have empowered credit rating agencies and differentiated their offering from that of other entities. The internationalisation of finance has created an acute need for globally understood standards that enable borrowers, lenders and traders to make assessments based on universally acknowledged benchmarks. The credit rating agencies were ahead of the curve, establishing a homogenous, global set of benchmarks well before globalization reshaped international finance. Standard and Poor's traces its history back to 1860,[195] while Moody's was established in 1900.[196] Even the youngest of the big three credit

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[194] Frank Raiter, 'Written Statement to the United States Senate Committee on Homeland Security and Governmental Affairs' (23 April 2010): 1-5, p. 3.

[195] Standard and Poor's, 'About Us', accessed 08/01/11, http://www.standardandpoors.com/about-sp/main/en/au

[196] Moody's, 'About Us', accessed 08/01/11, http://www.moodys.com/Pages/atc001.aspx

rating agencies, Fitch Ratings, was established in 1913.[197] This first mover advantage enabled them to assume a central position in the emerging global system. The knowledge structure they have established has provided the standardisation of financial assessments that is in demand amongst borrowers and lenders alike. As Langohr and Langohr note, ‘credit ratings shorten the distance between lenders and borrowers because they satisfy needs on both sides’.[198]

From a finance perspective, standardisation has important ramifications. In a working paper for the Bank of International Settlements, Claudio Borio observed that ‘what can be measured, can be priced. And what can be priced, if sufficiently standardised, can also be traded’.[199] Indeed, the ratings agencies actively promote the consistency of the ratings they produce. In a *Federal Reserve Bank of New York Staff Report*, Adam Ashcraft and Til Schuermann highlight a Moody’s presentation given by Frederic Drevon in May 2004 which states that ‘the comparability of these opinions holds regardless of the country of the issuer, is industry, asset class, or type of fixed-income debt’.[200] By way of further illustration, Ashcraft and Schuermann draw attention to a Standard and Poor’s document from May 2007 which argues that ‘our ratings represent a uniform measure of credit quality globally and across all types of debt instruments. In other words, an ‘AAA’ rated corporate bond should exhibit

[197] Fitch Ratings, ‘About Us’, accessed 08/01/11, http://www.fitchratings.com/jsp/creditdesk/AboutFitch.faces?context=1&detail=3
[198] Langohr and Langohr, The Rating Agencies and their Credit Ratings, p. 89.
[199] E. V. Claudio Borio, ‘Change and Constancy in the Financial System: Implications for Financial Distress and Policy’, *Bank of International Settlements Working Papers* 237 (2007), p. 3.
[200] Adam Ashcraft and Til Schuermann, ‘Understanding the Securitization of Subprime Mortgage Credit’, *Federal Reserve Bank of New York Staff Reports*, 318, March (2008), p. 37; Frederic Drevon, *Introduction to Moody’s Structured Finance Analysis and Modeling* (Moody’s Investor Services, May 13 2004).

the same degree of credit quality as an 'AAA' rated securitized debt issue'.[201] The desire of credit rating agencies to highlight the standardised nature of the knowledge they produce is unambiguous.

The credit rating agencies clearly understand the link between consistent global benchmarks, the knowledge structure and authority in the modern international system. This understanding is reflected in Moody's articulation of their mission as 'to be the world's most respected authority serving credit-sensitive markets'.[202] The selection of the word 'authority' as part of its core mission is revealing. *The Concise Oxford English Dictionary* defines 'authority' as '(1) the power or right to give orders and enforce obedience (2) a person or organisation exerting control in a political or administrative sphere (3) the power to influence others based on recognised knowledge or expertise'.[203] The use of the word 'authority' is a deliberate attempt by Moody's to position its offering as a source of direction for the modern international system, based on recognised knowledge and capabilities. Such lofty aspirations emphatically link knowledge with structural power in contemporary global governance.

In the early years of the twenty-first century, the volume of information available to actors has exceeded the ability of most actors to comprehend its meaning and make informed judgments. Lengthening intermediation chains and disintermediation are accentuating the growth in complexity of the global financial

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[201] Adam Ashcraft and Til Schuermann, 'Understanding the Securitization of Subprime Mortgage Credit', p. 37; Calvin R. Wong, Thomas G. Gillis and Fabienne Michaux, *Principles-Based Rating Methodology for Global Structured Finance Securities* (New York: Standard and Poor's Ratings Direct Research, 29 May 2007): 1-7, p. 5.
[202] Moody's, *Annual Report* (New York: Moody's Corporation, 2010), p. 11.
[203] C. Soanes and A. Stevenson, eds., *Concise Oxford English Dictionary* (Oxford: Oxford University Press, 2008), p. 88.

markets that invariably accompanies the growth in scale. In this environment, knowledge, as Williams and O'Brien have argued, plays a seminal role in 'the overarching system which regulates human affairs on a global basis'.[204] It is knowledge that enables actors to navigate the modern international system. It is knowledge that creates the frameworks around which actors structure their affairs. Moreover, it is knowledge that guides the massive flows of credit around the world. Thus, Susan Strange's attribution of 'a very special kind of structural power' to knowledge and 'power and authority' to 'those occupying key decision-making positions in the knowledge structure', provides scholars with a relevant theoretical vantage point from which the contemporary role of credit rating agencies is clarified.[205]

Credit rating agencies are globally recognised as authoritative sources of knowledge. These actors actively leverage this recognition to affirm their positioning within the global system. Contemporary global governance is determined, to a large degree, by the interplay between the credit rating agencies and other actors, including private corporations and states. This interplay is centered on the way credit rating agencies use knowledge to influence behavior. The historical importance of state actors in global governance makes the exchange of knowledge between states and credit rating agencies a particularly poignant juncture to explore the shifting power structure that shapes human affairs on a global scale.

While the relationship between credit rating agencies and state actors has been explored, such analysis has typically focused on linear, cause and effect observations.

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[204] Williams and O'Brien, *Global Political Economy*, p. 316.
[205] Strange, *States and Markets*, p. 30.

The plethora of ancillary services being offered above and beyond credit ratings provides greater scope for interpretation, analysis and subjectivity of the part of the credit rating agencies. When analysing a knowledge structure, Susan Strange has highlighted the importance of 'what knowledge is discovered, how it is stored, and who communicates it by what means to whom and on what terms'.[206] Given the scope for how credit rating agencies reach conclusions, make assessments and influence actors beyond of the parameters of the credit rating scores, it is incumbent upon modern IPE scholars to seek a greater understanding of the interplay between credit rating agencies and state actors. Beyond the assessment-reaction dynamic lies an opaque layer of formal and informal engagement that is material to the actions of both states and credit rating agencies. This engagement is not between two equal parties. As outlined in this chapter, credit rating agencies have carefully cultivated their unique role in the provision of knowledge, with powerful in-built reinforcement mechanisms established through the global financial markets.

Such interactions ricochet down both ends of Rosenau's continuum of global governance, with formal, rules-based engagement and informal, normative discussions creating a challenging dynamic to observe. Many of these interactions take place away from the glare of voter or investor scrutiny. Yet these interactions are critical to contemporary global governance. The first decade of the twenty-first century has seen numerous examples of states shifting policy settings to accommodate the overt or implied expectations of credit rating agencies. The accumulation and decimation of knowledge plays a critical role in that process. For scholars seeking a greater understanding of the role of credit rating agencies in contemporary global

[206] Ibid., p. 117.

governance, exploring the interactions between state actors and credit rating agencies will provide improved comprehension of the modern international system.

Chapter Four: A One-Sided Conversation

The process of knowledge generation lies at the epicentre of contemporary global governance. Edward Comor identified the generation of knowledge as being the processing of information into what is 'known' through a 'complex set of conceptual systems'.[207] The generation of knowledge around the creditworthiness of state actors provides a powerful demonstration of the location of authority in the modern international system. States, credit rating agencies and market participants are all actively seeking to create knowledge relating to this sensitive and heavily scrutinised component of the financial system. The creditworthiness of state actors is increasingly a contested subject. As external observers, credit rating agencies typically need to engage with states to obtain information and feedback to assist in their own deliberations. For IPE scholars, understanding how states and credit rating agencies engage amidst a contested knowledge generation environment provide signposts on how credit rating agencies influence contemporary global governance.

The unique nature of sovereign actors means that assessments on their creditworthiness require a process of discovery by the credit rating agencies. The nature of sovereign entities makes that discovery process and the ensuing assignment of credit ratings challenging. Unlike corporate actors, it is difficult for states to be grouped according to key characteristics, reducing the effectiveness of peer comparators. Whereas every listed entity adheres to a predictable reporting calendar according to the listing rules of the relevant stock exchange, the disclosure requirements of state actors differ markedly, depending on unpredictable variables such as domestic budgetary processes, the freedom of the media, political disclosure

[207] Comor, 'Governance and the Nation State in a Knowledge-Based Economy', p. 118.

conventions and regulatory scrutiny over the decision making process. Many of these variables are also susceptible to cultural subjectivity.

Another complicating factor is that the actions of state actors are guided by political, as well as economic considerations, creating complex and at times byzantine policy making environments. For knowledge providers who pride themselves on establishing globally consistent benchmarks, this heterogeneous class of actors can present formidable opacity. Langohr and Langohr note that 'the nature of sovereign ratings involves the use of a whole range of qualitative factors added to a variety of quantitative indicators'.[208] It is the use of these qualitative factors that provoke these authors to observe that 'sovereign ratings are even less of an exact science than a corporate bond rating'.[209]

The unique nature of sovereign entities differentiates the discovery process undertaken by credit rating agencies. While these knowledge providers use rating committees to determine the creditworthiness of sovereign actors through assessments, scores and ultimately ratings, there are important distinguishing features to this influential process. All three credit rating agencies publicly acknowledge the need for a different approach via the unique methodology they deploy to undertake sovereign credit ratings. According to Standard and Poor's, five key areas form the foundation for their sovereign credit analysis: political, economic, external, fiscal and monetary considerations.[210] Standard and Poor's breaks down these areas as follows:

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[208] Langohr and Langohr, The Rating Agencies and their Credit Ratings, p. 287.
[209] Idem.
[210] Standard and Poor's, 'Sovereigns: Sovereign Government Rating Methodology and Assumptions', (30 June 2011), accessed 07/07/11,

Figure Thirteen[211]

Area	Factors Captured
The Political Score	• The effectiveness, stability, and predictability of the sovereign's policymaking and political institutions (primary factor). • The transparency and accountability of institutions, data, and processes, as well as the coverage and reliability of statistical information (secondary factor). • The government's payment culture (potential adjustment factor). • External security risks (potential adjustment factor). • The potential effect of external organisations on policy settings (potential adjustment factor).
The Economic Score	• Income levels. • Growth prospects. • Economic diversity and volatility.
The External Score	• The status of a sovereign's currency in international transactions. • The country's external liquidity, which provides an indication of the economy's ability to generate the foreign exchange necessary to meet its public-and private-sector obligations to non-residents. • The country's external indebtedness, which shows resident's assets and liabilities (in both foreign and local currency) relative to the rest of the world.
The Fiscal Score	• Sustainability of a sovereign's deficits and debt burden, considering fiscal flexibility, long-term fiscal trends and vulnerabilities, debt structure and funding access, and potential risks arising from contingent liabilities.
The Monetary Score	• The sovereign's ability to use monetary policy to address domestic economic stresses, particularly through its control of money supply and domestic liquidity conditions. • The credibility of monetary policy, as measured by inflation trends. • The effectiveness of mechanisms for transmitting the effect of monetary policy decision to the real economy, largely a function of the depth and diversification of the domestic financial system and capital markets.

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http://www.standardandpoors.com/prot/ratings/articles/en/au/?articleType=HTML&assetID=1245319311240

[211] Idem.

Tellingly, Standard and Poor's provide a glossary of key indicators used in their sovereign rating methodology, covering off each area of scoring, with the important exceptions of the political and monetary scores. The above table exhibits the combination of qualitative and quantitative factors highlighted by Langohr and Langohr that places significant importance on the subjective judgements made by credit rating agencies during their assessments of sovereign entities. Moody's openly acknowledges the importance of such subjective judgements, pointing out that 'by the very nature of sovereignty, a government may decide not to repay its debt despite having the resources to do so'.[212] Such an observation goes to the very heart of the sovereign credit rating assessment process. The data alone will not tell the story. To adequately assess a sovereign's credit rating, knowledge providers must gain an understanding of the intent motivating a sovereign's decision makers.

Herein lies the challenge for both the assessor and the assessed. Discovering the rationale motivating decision makers in any given state can be difficult for experienced domestic political observers, yet alone credit analysts. Each state has its own unique policy formation structure, with distinguishing features that render a formulaic approach redundant. For example, issues relating to political competition and its ramifications can vary greatly, depending on the nature of political party structures that determine how inter-party and intra-party rivalry is accommodated. The relationship between elected politicians and unelected officials can substantially differ between states and these relationships have a material impact on the decision making process. It is perhaps for these reasons that Fitch acknowledges that 'political

[212] Moody's, 'Global Sovereign Rating Methodology', (September 2008), p. 1, accessed 09/07/11, www.moodys.com

and social tensions can have an important bearing on sovereign creditworthiness'.[213] This acknowledgement forms the basis for the admission by Fitch that when seeking to assess the creditworthiness of a sovereign entity, 'account is also taken of powerful vested interests that may block essential structural reforms'.[214]

Each of the major credit rating agencies provides a credit rating for a large and growing number of sovereigns. Standard and Poor's rates 126 sovereign entities,[215] as does Moody's,[216] while Fitch covers 111 issuers.[217] The lists of sovereign entities subjected to scrutiny by credit rating agencies reveal state actors from all geographies, varying stages of development and a myriad of political systems. Indeed, each has its own unique cultural overlay that shapes the decision making process. Publicly available information alone is simply inadequate if the credit rating agencies are to provide insightful and accurate assessments on the political risks and policy choices associated with the creditworthiness of sovereign actors. Moody's have acknowledged that numbers alone will not allow them to determine the likely course of action pursued by key decision makers in any given state. It is for this reason that each of the major credit rating agencies interacts with state actors to seek a greater understanding of the rationale guiding the policies pursued by state actors.

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[213] Fitch, 'Sovereign Rating Methodology', (15 August 2011), p. 10, accessed 19/08/11, www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648978
[214] Idem.
[215] Standard and Poor's, accessed 08/05/11, http://www.standardandpoors.com/ratings/sovereigns/ratings-list/en/au/?subSectorCode=39&start=100&range=50
[216] Moody's, accessed 04/09/11, http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_124089
[217] Fitch Ratings, accessed 08/05/11, http://www.fitchratings.com/jsp/sector/Sector.faces?selectedTab=AllContent&Ne=4293330737+11&N=4293330737

For IPE scholars, the fusion between the political and economic factors behind the assessments of the creditworthiness of state actors provides a poignant example of the growing relevance of IPE in the modern international system. The combination of these two sets of factors creates a multifarious dynamic that, until recently, has not been subject to the scholarly scrutiny it deserves. Historically, both have been viewed as silos, independent of the other. The traditional approach to analysis of finance-related issues ignores the reality of modern decision making. Indeed, the melding of the political and economic spheres in contemporary global governance lacks the theoretical clarity typically associated with each field. Policy making by state actors can often be messy and surprisingly difficult to predict. Yet it is here, at the juncture of two key fields of scholarship, that credit rating agencies and state actors collide, with substantial ramifications for global governance.

This collision is not a collision between two equals. The modern global financial system accentuates the reliance of participants in that system on the knowledge structure created by credit rating agencies to inform investment decisions. This reliance also relates to those financial products that are linked to state actors, such as the sovereign bond market. In the September 2011 *Global Financial Stability Report*, the IMF observed that 'investors are more risk conscious, including regarding the risks associated with liquidity and sovereign credit'.[218] This observation is reinforced by the IMF's 'Survey on Global and Asset Allocation', which showed that sovereign or country risk was the fourth highest factor considered by asset managers

[218] International Monetary Fund, 'Long-Term Investors and Their Asset Allocation: Where Are They Now?' *Global Financial Stability Report* (September 2011), p. 1, accessed 04/10/11, http://www.imf.org/external/pubs/ft/gfsr/2011/02/pdf/ch2.pdf

when considering cross border investment.[219] A year earlier, at the launch of the September 2010 *Global Financial Stability Report*, the IMF's Financial Counsellor and Director of the IMF's Monetary and Capital Markets (MCM) Department, Jose Vinals, provided commentary on the contents of the *Report* and its ramifications for global finance. Vinals observed that 'over the years, credit ratings have become hard-wired in various rules, regulations ... rating downgrades can lead to destabilising spill over effects as investors rush to sell securities, in particular when downgrades go through investment quality thresholds. These are the so-called cliff effects'.[220]

For sovereigns, the prospect of a credit rating triggering a 'cliff effect' provides a powerful incentive to cooperate with credit rating agencies when they seek information. The ramifications on the global financial markets of a negative announcement from a credit rating agency can be immediate, as seen in the previous chapter. The IMF's Senior Financial Expert, John Kiff observed at the same *Report* launch that 'ratings play a significant certification role...downgrades from investment to speculative grade led to statistically significant widening of credit spreads of the downgraded sovereign'.[221] This development can dramatically increase the borrowing costs of state actors. With over 100 sovereigns being constantly assessed by all three of the major credit rating agencies, few can afford to ignore these powerful knowledge providers. As observed in *The Economist*, 'the rules of the financial system make ratings impossible to ignore ...politicians fetishise ratings, too'.[222] The

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[219] Ibid., p. 24.
[220] IMF, 'Transcript', accessed 08/10/10, http://www.imf.org/external/np/tr/2010/tr092910.htm
[221] Idem.
[222] 'The Grim Rater: Countries don't like bad news about their creditworthiness', *The Economist*, (4 March 2010), accessed 07/03/10 http://www.economist.com/node/15606329

same article quoted an un-named ratings agency executive who claimed that 'countries can go bust in a matter of weeks if the markets close to them'.[223]

This dynamic puts the credit rating agencies in a far more powerful position than the sovereigns they are seeking to assess. The uneven distribution of authority has profound consequences on the credit rating process for sovereign actors. An improved understanding of those components of the sovereign rating process that are not based on data collation, such as assessments around the risks associated with political decision making, will reward observers with enhanced comprehension of how credit rating agencies influence state actors in the modern international system. Given the centrality of state actors in traditional IPE analysis, improved comprehension of the relationship between credit rating agencies and sovereign actors will also enable a better understanding of contemporary global governance.

The challenge for scholars lies in the fact that this component of credit risk analysis is, by its nature, more subjective and open to interpretation than analysis regarding, for example, fiscal or monetary policy. Indeed, as previously observed, Timothy Sinclair has identified sovereign rating as the most political of all the ratings.[224] The opacity surrounding this process generates additional obstacles. Understanding where decision makers actually lie within complex organisational structures and who exerts influence on these individuals can be difficult. However, the credit rating agencies are frequently reaching determinations about how decision makers in states are likely to behave. These determinations are not based on data.

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[223] Idem.
[224] Sinclair, *The New Masters of Capital*, passim. For a more detailed discussion on Sinclair's observations of the credit rating agencies, see Chapter One of this thesis.

Rather, they are based on judgements. How these judgements evolve into knowledge that guides investment choices is highly relevant to contemporary global governance.

As outlined in previous chapters, the growth in the volume of information available and the expanding scale of the global financial system empower those who help shape the conceptual systems that are so central to knowledge generation and distribution. One of the key tests in the modern international system can be observed when the knowledge generation capabilities of credit rating agencies are in direct conflict with the knowledge generation capabilities of state actors. The outcome of such conflicts exposes the conceptual systems that underlie the contemporary knowledge hierarchy and the location of structural and relational power in the modern international system. The nature of communication between various actors engaged with the global financial system frequently creates a dynamic where conflicts over knowledge generation are conducted through highly visible mediums such as the financial or political media. For observers of contemporary global governance, the direct and indirect interactions between competing knowledge generators can provide valuable context for assessments about the location and exercise of authority and power in the modern international system.

To achieve such an outcome, there are benefits in identifying those sovereigns who have particularly strong sensitivities to the assessments of credit rating agencies. Such state actors are more likely to publicly engage with credit rating agencies and dispute their judgements, providing scholars with greater visibility over the interaction process and contested knowledge generation. An increasingly topical source of high profile interaction and disputation between sovereigns and credit rating agencies is the

EU. Key structural issues in the EU create a financial dynamic that is conducive to a contested knowledge generation process between state actors and credit rating agencies.

On 13 December 2007, twenty-seven EU Member States signed the Lisbon Treaty, which officially came into force on 1 December 2009.[225] The Lisbon Treaty ostensibly sought to contemporise the EU's two treaties, the Treaty on European Union and the Treaty on the Functioning of the European Community, to reform Europe's legal framework to ensure it better reflected modern governance challenges.[226] This process saw the EU's prescriptive governance frameworks amended across a broad range of policy areas, including finance. According to Article 123 of the amended Treaty on the Functioning of the European Union, overdraft facilities or any type of credit facility with the European Central Bank (ECB) or national central banks in favour of public authorities, including central governments, are prohibited.[227] The ECB and national central banks therefore cannot purchase standard government bonds, in contrast to many other developed states where central banks are free to do so. Such arrangements render sovereign members of the EU more reliant than many of their contemporaries on securing investment for government bonds via private capital markets.

As outlined previously, many state actors are reliant on the issuance of government bonds to help fund their activities. The knowledge that influences the

[225] European Union, 'The Treaty of Lisbon', accessed 12/03/11, http://europa.eu/lisbon_treaty/take/index_en.htm
[226] Idem.
[227] European Union, 'Consolidated Version of the Treaty on the Functioning of the European Union', *Official Journal of the European Union*, (30 March 2010), p. 83, accessed 07/04/10, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:en:PDF

views of non-government investors will therefore have a direct impact on the costs of borrowing for EU states through the yields paid on government bonds. Sovereigns are therefore motivated to positively shape the perceptions of financial market participants and challenge negative commentary wherever possible. Smaller sovereigns within the EU have a particularly acute need to seek to create knowledge and actively shape the perceptions of investors, given they typically issue smaller volumes of government bonds, reducing familiarity amongst bond traders and making their bond markets susceptible to rapid shifts in market sentiment. The difference in volumes can be seen in Figure Fourteen, which provides indicative data on the variations in volumes of long term government bond and note issuances between select EU sovereigns.

Figure Fourteen[228]

Volume of Long Term Government Bond and Note Issuance, Q3 2010 ($USm)

Sovereign	**Volume**
Germany	$1,291,616
France	$1,109,359
Ireland	$103,752
Poland	$1,100
Hungary	$455

A poignant example of the unbalanced nature of the knowledge generation dynamic, and its consequences for contemporary global governance, can be found in the Irish experience of 2010. A small, developed country with a robust and pluralistic

[228] Joint BIS-IMF-OECD-WB Debt Hub, accessed 22/02/11, http://www.jedh.org/jedh_instrument.html

domestic political system, Ireland faced enormous challenges following the global financial crisis. Ireland's economy limped weakly out of technical recession in the first quarter of 2010 after being the first euro-zone country to fall into recession in 2008.[229] Falling house prices and rising unemployment had forced the Irish Government to raise taxes to protect the sovereign's financial position.[230] The deteriorating state of public finances in Ireland drew the attention of all major credit rating agencies and international bond investors. In the aftermath of the global financial crisis, Ireland's position was not unique. However, the very public nature of the interactions between the Irish Government and the credit rating agencies provides a particularly revealing insight into the process that is so pivotal to contemporary global governance.

As the Irish Government's financial position deteriorated during 2010, the role of the Irish National Treasury Management Agency (NTMA) gained global prominence. In his opening statement to the House of the Oireachtas (National Parliament) Committee of Public Accounts hearing in April 2010, NTMA Chief Executive John Corrigan described the Agency's role as:

> *firstly to lead discussions with the covered credit institutions to determine their likely capital requirements, secondly to negotiate the terms and conditions on which any capital support provided by the State will be invested and, thirdly, to manage any Ministerial shareholdings in these institutions.*[231]

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[229] Central Statistics Office, Government of Ireland, 'Quarterly National Accounts', accessed 18/19/10, http://www.cso.ie/releasespublications/documents/economy/current/qna.pdf

[230] Quentin Fottrell, 'Irish Economy is Still on Life Support', *The Wall Street Journal*, accessed 18/09/10, http://blogs.wsj.com/source/2010/07/05/the-irish-economy-is-still-on-life-support/

[231] House of the Oireachtas, 'Public Accounts Committee Debate, National Treasury Management Agency Annual Report and Accounts', accessed 22/01/11, http://www.oireachtas.ie/ViewDoc.asp?fn=/documents/livewebast/Web-Live.htm&CatID=83&m=o

Mr Corrigan went on to note that NTMA offered the state, 'market facing expertise and experience with dealing with capital markets on a day to day basis' and observed that the Agency's role had 'evolved from a single function organisation to one that provides a range of risk management and financial services to the State'.[232]

These roles saw the NTMA act as the primary conduit between the Irish Government and the credit rating agencies during a tumultuous period for Irish public finances. The Irish sovereign's decision making environment is relatively transparent and therefore easier for the credit rating agencies to observe. When describing the NTMA's activities to Irish Parliamentarians, CEO John Corrigan said 'these functions are being carried out in close consultation with the Minister and his Department'.[233] Theoretically, this role also made the NTMA an influential source of knowledge for international bond investors.

After overseeing the auction of 10.764 billion euros worth of Irish Government Bonds in 2009,[234] the NTMA was compelled to raise 14.883 billion euros on the bond market in the first nine months of 2010 to meet the financing needs of the Irish Government.[235] For the NTMA, 2009 had indeed proved difficult, with Mr Corrigan noting 'the challenges which Ireland faced in the international bond markets coming into 2009 were exceptional in terms of the level of our funding requirement,

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[232] Idem.
[233] House of the Oierachtas, 'NAMA and the NTMA: Discussion with Chief Executives', *Joint Committee on Finance and Public Service Debate*, 2010, accessed 19/09/10, http://debates.oireachtas.ie/FIJ/2010/04/13/00003.asp
[234] National Treasury Management Agency, accessed 22/01/11, http://www.ntma.ie/Publications/2009/Auctions_2009.pdf
[235] National Treasury Management Agency, accessed 22/01/11, http://www.ntma.ie/Publications/2010/Auctions2010.pdf

investor sentiment, competition for available funds and market volatility'.[236] Like other sovereigns seeking to borrow via the international bond market, the cost of borrowing grew as the yields payable grew. The basic market forces at work were relatively straightforward. The safer the investment was perceived by investors, the lower the bond yield. If necessary, sovereigns are forced to pay investors higher interest payments to stimulate demand. Under cross examination by Parliamentarians during the House of the Oireachtas Committee of Public Accounts hearing, Mr Corrigan noted that for Ireland, 'the cost of debt is generally measured on the basis of the spread to Germany. In other words, it is measured on how much we pay for ten-year bonds, which is a benchmark maturity. In an auction held yesterday, we paid a spread of 158 basis points or 1.58% over Germany'.[237]

In such an environment, with multiple sovereigns regularly seeking to borrow through access to the international bond market, market perceptions play a critical role in the borrowing costs of state actors, best illustrated in bond spreads. Those perceptions are shaped by knowledge. The source of that knowledge and the way it is created can have immediate and drastic ramifications for state actors. The Irish experience of 2010 provides scholars with an informative snapshot of how knowledge is created and who is recognised as being the authoritative source of knowledge in the modern international system.

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[236] House of the Oireachtas, 'Public Accounts Committee Debate, National Treasury Management Agency Annual Report and Accounts', accessed 22/01/11, http://www.oireachtas.ie/ViewDoc.asp?fn=/documents/livewebast/Web-Live.htm&CatID=83&m=o

[237] House of the Oireachtas, 'Public Accounts Committee Debate, National Treasury Management Agency Annual Report and Accounts', accessed 22/01/11, http://debates.oirachtas.ie/ACC/2010/04/22/00003.asp

This process can be challenging to identify. Indeed, Edward Comor's notion of a 'complex process of conceptual systems' that refine information into what is 'known', provides a poignant theoretical signpost to the contemporary sovereign rating process.[238] Over the course of 2010, as numerous sovereigns sought to shape what was 'known' about their creditworthiness amongst financial market participants, both the Irish Government and the credit rating agencies were potentially key influences over the conceptual systems described by Comor.

At this time, Ireland's deteriorating economic position put the Irish sovereign's lead financial agency, the NTMA, in a challenging position. Bond market volatility and risk aversion were continuing, as other European countries like Greece strained under their ballooning public debt burden and diminishing revenue base. How the NTMA sought to appease market participants and simultaneously engage with the credit rating agencies provides strong evidence of the subordinated role of state actors in the knowledge generation process embedded in the modern international system. How the credit rating agencies made determinations on Irish public finances during 2010 illustrates the central role of the subjective judgements they make and the role of political as well as economic factors that are considered in that process.

As the primary Irish interlocutor with international bond investors, the NTMA was in regular dialogue with market participants. As we have seen, the organisation was in contact with capital markets on a daily basis. According to the NTMA's 2010 Annual Report:

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[238] Comor, 'Governance and the Nation State in a Knowledge-Based Economy', p. 118.

the Funding and Debt Management team continues to work hard to maintain strong, supportive relationships with key international investors in Irish Government debt and to identify and develop relationships with prospective new investors. Those relationships will be a key element in positioning Ireland to return to the international bond markets as soon as market conditions permit.[239]

The Irish Government sought to engage in frequent and meaningful discussions with international bond investors to help provide information and shape opinions regarding Irish public finances. In essence, the Irish Government attempted to create knowledge about the attractiveness of Irish sovereign bonds.

At the same time, the Irish Government also engaged with the credit rating agencies. Given each of the major three agencies actively monitor the Irish sovereign, the existence of such dialogue is unsurprising. In April 2010, NTMA Chief Executive Officer (CEO) John Corrigan informed Irish Parliamentarians that the NTMA had 'a very open relationship with the credit rating agencies' and that 'we are talking regularly that is, at least once a month, to the rating agencies which are continually reviewing Ireland's fiscal and banking position'.[240] Deputy Brian Lenihan, then Minister for Finance, informed a Parliamentary colleague that 'all the rating agencies are in regular contact with my officials, along with officials of the NTMA, the Central Bank and many other public and private bodies in Ireland. While the rating

[239] NTMA, '2010 Annual Report', p. 5, accessed 18/03/11, http://www.ntma.ie/Publications/2011/NTMA_Annual_Report_2010_English.pdf

[240] House of the Oireachtas, 'Public Accounts Committee Debate, National Treasury Management Agency Annual Report and Accounts', accessed 22/01/11, http://www.oireachtas.ie/ViewDoc.asp?fn=/documents/livewebast/Web-Live.htm&CatID=83&m=o

methodology is public, the agencies do not set targets or criteria for individual countries'.[241]

In a separate Parliamentary interaction, Deputy Lenihan revealed that 'as part of my function as Minister for Finance, I meet with a wide variety of organisations, including on occasion, credit rating agencies. In the past six months I have only met with representatives of Standard and Poor's on 18 February 2009 to discuss the budgetary and economic outlook for Ireland'.[242] The rationale behind this dialogue is also relatively easy to identify. When credit rating agencies disclose their assessments to market participants, they play a critical role in shaping market perceptions. By engaging with the credit rating agencies directly and via entities such as the NTMA, the Irish Government was clearly attempting to influence both the credit rating process and market perceptions.

In his April 2010 evidence to the House of the Oireachtas Committee of Public Accounts hearing, Mr Corrigan provided no indication of any acrimony or fundamental disagreements between the NTMA and the credit rating agencies. He indicated that dialogue was relatively frequent, that the relationship was 'very open' and saw no clouds on Ireland's immediate ratings horizon. At this time, Mr Corrigan went so far as to tell Irish Parliamentarians that 'sentiment towards Ireland, as reflected in the bond spreads, has improved and we believe there is a reasonable

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[241] House of the Oierachtas, 'Written Answers – Credit Ratings', accessed 18/02/10, http://debates.oireachtas.ie/dail/2009/04/07/00055.asp
[242] House of the Oierachtas, 'Written Answers – Fiscal Policy', accessed 18/02/10, http://debates.oireachtas.ie/dail/2009/03/26/00071.asp

prospect of the negative outlook moving to a stable outlook'.[243] Tellingly, at this juncture, the Irish Government was in regular dialogue with the credit rating agencies and had a relatively bullish expectation on the outlook provided by these agencies being improved. On the same day that the NTMA was presenting evidence to the Irish Parliament, Moody's released a statement that announced there would be no rating impact from that day's announcement by Eurostat that Ireland's budget deficit was worse than expected.[244]

The following eight months betrayed the optimistic outlook of the NTMA's views in April 2010. Between April and December 2010, every major credit rating agency downgraded the Irish Government's rating, as seen in Figure Fifteen. Such frequent and substantial actions by the credit rating agencies appear incongruous with the relatively upbeat assessment provided by the NTMA in April 2010.

[243] House of the Oireachtas, 'Public Accounts Committee Debate, National Treasury Management Agency Annual Report and Accounts', accessed 22/01/11, http://www.oireachtas.ie/ViewDoc.asp?fn=/documents/livewebast/Web-Live.htm&CatID=83&m=o
[244] Moody's, 'Announcement', (22 April 2010), accessed 19/10/10, www.moodys.com/research/moodys-no-ratings-impact-from-increase-in-ireleands-2009-budget-deficit

Figure Fifteen[245]

Irish Sovereign Credit Rating Downgrades

April 2010 – December 2010

Date	Rating Agency	Action
29 July 2010	Moody's	Downgrade Irish Government bond ratings from Aa1 to Aa2.
24 August 2010	Standard and Poor's	Downgrade long term Irish Government bonds one notch to from AA to AA-.
5 October 2010	Moody's	Place Irish Government bond ratings on review for possible downgrade.
6 October 2010	Fitch Ratings	Downgrade Irish Government bond ratings from A+ to AA-.
23 November 2010	Standard and Poor's	Downgrade long term Irish Government bonds from AA- to A and short term Irish Government bonds from A-1 to A-1+.
9 December 2010	Fitch Ratings	Downgrade long term Irish Government three notches from A+ to BBB+.
17 December 2010	Moody's	Downgrade Irish Government bonds by five notches from Aa2 to Baa1.

[245] All information sourced by relevant rating agency websites.

The rationale of the credit rating agencies for the above decisions were centred on the deteriorating position of the Irish Government's finances, the weakening growth outlook for the Irish economy and assessments around the contingent liabilities from the Irish banking system. For example, when explaining the rationale for the 19 July downgrade, Moody's Vice President and Senior Credit Officer for Ireland, Dietmar Hornung said, 'today's downgrade is primarily driven by the Irish Government's gradual but significant loss of financial strength, as reflected by its deteriorating debt affordability'.[246] When narrating Fitch Ratings' October downgrade, Fitch's Director of Sovereign Ratings Chris Pryce said, the move 'reflects the … greater-than-expected fiscal costs associated with the government's recapitalisation of the Irish banks, especially Anglo Irish Bank'.[247]

It is clear that in April 2010, fully cognisant of the Irish Government's financial position, the growth outlook and the contingent liabilities from the Irish banking system, that the NTMA was not expecting the unanimous and precipitous deterioration in its credit rating that was seen over the remainder of 2010. Based on the above quote from a Fitch Ratings representative, the deterioration in public finances was greater than the ratings agencies had expected. What was once a relatively benign rating environment became incredibly challenging for the Irish Government in a very short period of time. Indeed, *The Irish Times* noted that 'the auction of a rich country's bonds was, until the very recent past, barely newsworthy. Raising money from investors was to governments what withdrawing a small sum

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[246] Moody's, accessed 22/12/10, www.moodys.com/research/moodys-downgrades-ireland-to-aa2-stable-outlook

[247] David Jolly, 'Fitch Downgrades Ireland', *The New York Times*, (6 October 2010), accessed 07/10/10, http://www.nytimes.com/2010/10/07/business/global/07punt.html

from an ATM is to most people. Now it's different. Each time a fiscally weak euro zone country seeks to tap the market, there is a collective holding of breath for fear that investors will turn their noses up at the bonds'.[248]

Critically, there is evidence that the working relationship between the NTMA and the credit rating agencies fractured during this period. Given the identifiable differences of opinion on Ireland's fiscal outlook, this is not surprising. Perhaps the best example was the Irish Government's reaction to Standard and Poor's August ratings downgrade. When announcing the downgrade, Trevor Cullinan, credit analyst at Standard and Poor's said, 'the downgrade reflects our opinion that the rising budgetary costs of supporting the Irish financial sector will further weaken the government's fiscal flexibility over the medium term'.[249] Mr Cullinan went on to offer the familiar carrot and stick analysis regarding Ireland's outlook: 'The negative outlook reflects our view that the rating could be lowered again if ...the government's fiscal performance improves more slowly than we currently assume. Conversely, the outlook could be revised to stable if the Irish government looks more likely to achieve its fiscal target ...or if the banking sector stabilises more quickly and at a lower fiscal cost to the government than we know think likely'.[250]

The market reaction to the announcement was swift, with Irish borrowing costs jumping immediately following the Standard and Poor's announcement. The yield on ten-year bonds rose twenty-two basis points on the same day.[251] Participants

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[248] Dan O'Brien, 'Cost of borrowing is the most pressing concern for NTMA', *The Irish Times* (20 July 2010), p. 17.
[249] Angela Monaghan, 'Ireland spurns 'flawed' S&P downgrade', *The Daily Telegraph,* London (26 August 2010), p. 5.
[250] Idem.
[251] Idem.

in the financial markets expressed little surprise at the announcement. Greg Peters, Global Head of Fixed Income and Economic Research at Morgan Stanley said the downgrade was ‘not a surprise by any stretch’.[252] Sarah Johnson, Senior Research Director (Global Economics) at IHS Global Insight said the Standard and Poor’s announcement ‘simply brought the rating agency’s analysis into line with her own’.[253] Lee Markowitz, Partner at Continental Capital Advisors, a New York-based hedge fund, was quoted as saying in relation to the downgrade, ‘I don’t see any light on the horizon’.[254] The unanimity with which the credit rating agencies and participants in the global financial markets reached a relatively bearish position on the Irish sovereign’s position lay in stark contrast to the position of the Irish Government and its reaction to the Standard and Poor’s downgrade.

In a statement on the downgrade, the NTMA said, ‘in terms of the specific analysis by S&P, this is largely predicated upon an extreme estimate of bank recapitalisation costs of up to fifty billion euros. We believe this approach is flawed’.[255] NTMA Chief Executive John Corrigan was more colourful in his analysis of the Standard and Poor’s decision, when he told *The Independent* newspaper that ‘it’s a bit like waking up the patient in the middle of an operation to tell him he’s not feeling well. We know the situation is pretty painful but we have to get to the end of the operation, which will be in December’.[256] Four months after telling Irish Parliamentarians that the Irish Government had a close working relationship with the

[252] ‘Mixed views from abroad on debt downgrade’, *The Irish Times* (27 August 2010), p. 3.
[253] Idem.
[254] Idem.
[255] Angela Monaghan, ‘Ireland spurns ‘flawed’ S&P downgrade’, *The Daily Telegraph,* London (26 August 2010), p. 5.
[256] Sean O'Grady, ‘Irish debt downgrade raises fears of international deflation spiral’, *The Independent*, London, (26 August 2010) p. 32.

credit rating agencies and that he envisaged no significant clouds on the ratings horizon, Mr Corrigan was openly lashing out at both the analysis driving ratings decisions and the timing of those rating decisions. Others associated with the Irish Government's budgetary position were also critical of the market reaction, with the Governor of the Irish Central Bank, Patrick Honohan, describing the widening of spreads to 320 basis points above German bunds in response to the Standard and Poor's announcement as 'ridiculous'.[257]

Tellingly, the Irish Government received sympathy from other state actors. In the immediate aftermath of the Standard and Poor's August 2010 announcement, the Canadian Finance Minister told *The Irish Times*, 'quite frankly, some of the work done by ratings agencies did not assist and contributed to what became a serious global crisis, so they are part of the story. It is not as if they can stand on high and look down and start now being critical of others who are tying to sort their way out of a crisis that they contributed to'.[258] Such comments reflected unease amongst sovereign policy makers about the role of the credit rating agencies in sovereign credit rating and their influence over international bond markets.

Over the course of the second half of 2010, the actions of credit rating agencies relating to Irish Government bonds became more instructive. For example, on 5 October 2010, Moody's placed Ireland's Aa2 local and foreign currency government bonds on review for possible downgrade.[259] Dietmar Hornung, a Moody's Vice President-Senior Credit Officer and lead sovereign analyst for Ireland

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[257] John Walsh, 'Bond markets: Bond market vigilantes', *Business and Finance* (September 2010), accessed 19/09/10, http://www.businessandfinance.ie/index.jsp?p=847&n=819&a=3911
[258] Simon Carswell, 'Canada says Irish finance policies brave', *The Irish Times* (27 August 2010), p. 2.
[259] Moody's, 'Announcement: Moody's places Ireland's Aa2 rating on review for possible downgrade', (5 October 2010), p. 1.

announced that ‘a key element of the review is Ireland’s revised four-year fiscal plan, which the Government will present in early November. The plan will identify measures to stabilise public finances and bring the deficit below 3% of GDP by 2013’.[260] Such overt and highly prescriptive observations by the credit rating agencies were designed to influence the Irish Government’s decision making processes. The announcement of a review also revealed an acknowledgement that Moody’s was uncertain of how Irish decision makers would respond to the need for budget cuts. By expressing confidence in the likely outcome of Ireland’s fiscal review while simultaneously placing Irish Government bonds on review for possible downgrade, Moody’s was amplifying pressure on the Irish Government to adhere to recommended policy initiatives and whetting the appetite of investors for the outcome of their deliberations. Given the timing of the Irish electoral cycle, with a general election due early in 2011, any rating product that addressed perceived uncertainty around Irish decision making would likely be well received by bond market investors.

The response to such edicts from the Irish Government reveals the relational power enjoyed by the credit rating agencies, particularly relating to smaller EU sovereign borrowers. Despite the obvious possibility of an electoral backlash, decision makers, inured to the impact of repeated and unexpected credit rating downgrades, duly responded to the demands of the credit rating agencies. In November 2010, the Irish Government released *The National Recovery Plan: 2011-2014*, which broadly adhered to the parameters articulated by Moody’s the previous month.[261] In the introduction of the document, the Irish Government explicitly acknowledged that

[260] Idem.
[261] Irish Treasury, *The National Recovery Plan: 2011-2014*, accessed 02/12/10, http://www.budget.gov.ie/The%20National%20Recovery%20Plan%202011-2014.pdf

lower growth and higher debt interest costs 'have required us to revise our budgetary targets. To achieve a deficit of 3% of GDP by 2014, the Government has concluded that an overall saving of 15 billion euro is required'.[262] While the deficit reduction target was one year later than the date mooted in Moody's October 2010 review, the scale of the budgetary measures contained in the *Recovery Plan* were significant. Welfare expenditure was cut by 2.8 billion euro, over 24,000 public service jobs cut, pensions reduced, minimum wages cut by one euro to 7.65 euro and several taxes were increased.[263]

Such actions by a sovereign government only months before a general election reflect the overwhelming imperative on state actors to appease the credit rating agencies and the global financial markets. They also attest to the relational, as well as structural power exercised by the credit rating agencies, as defined by Susan Strange.[264] In a contested knowledge generation process, the Irish Government in the second half of 2010 was caught in a vicious spiral. As credit rating agencies became more bearish on the creditworthiness of the Irish sovereign, the markets reacted by widening the yield spread between Irish ten-year bonds and German ten- year bonds, increasing the Irish Government's borrowing costs. Despite the best efforts of the Irish Government to communicate a more bullish outlook through direct and indirect dialogue with market participants, key Irish decision makers ultimately acquiesced to the market consensus, implementing an extraordinarily tough *National Recovery Plan*.

This process also corroded confidence in the Irish economy. In early October 2010, the Chief Economist at KBC Ireland told Bloomberg that 'Ireland has

[262] Idem.
[263] Idem.
[264] Strange, *States and Markets*, p. 24 and passim.

experienced a great panic' and that there is a 'risk that a sense of apocalyptic gloom may trigger a freeze in spending'.[265] Such views were supported by the statistics. According to the OECD, the Irish economy shrank by 1.4% in the fourth quarter of 2010, after growing by 1.5% in the first quarter of the same year.[266] Irish producers and consumers were not immune from the torrent of negative coverage generated by the successive downgrades of the Irish sovereign by the credit rating agencies. Indeed, the impact of the knowledge generation process on the real economy only compounded the challenges faced by the Irish Government and in effect increased sensitivity to the ongoing deliberations of the credit rating agencies.

The reaction by both the global financial markets and the broader Irish economy to the credit rating downgrades in the second half of 2010 reinforces the relevance of Rosenau's theory of intersubjective consensus.[267] Different actors with different interests acted in similar ways, due to their submission to a process of learning. Despite the best efforts of the Irish Government to communicate confidence, the consensus amongst a wide range of disparate stakeholders clearly demonstrated where authority in the modern international system lies. The Irish Government simply was not viewed as a reliable source of knowledge on its own creditworthiness. Even when Irish decision makers openly and aggressively challenged the rationale for certain rating downgrades, the market response synchronised with the assessments of the credit rating agencies. This obdurate response rendered the Irish sovereign unable

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[265] 'Fitch Downgrades Ireland's Rating on Cost of Banking Bailout', *Bloomberg*, (6 October 2010), accessed 07/10/10, http://www.bloomberg.com/news/2010-10-06/ireland-sovereign-debt-rating-cut-one-level-by-fitch-outlook-is-negative.html

[266] OECD, accessed 23/02/11, http://stats.oecd.org/index.aspx?queryid=350

[267] For a more detailed discussion of Rosenau's theory of intersubjective consensus, see Chapter One of this thesis.

to do anything but comply with the explicit pathway set out by the credit rating agencies, and pursue difficult and electorally damaging reforms.

During this time, the enforcement mechanisms associated with knowledge provision and the enforcement of norms, as described by Mark Amen,[268] were on graphic display. Yield spreads on Irish Government bonds widened in tandem with credit rating agency announcements as investors predictably responded to increasingly cautious assessments. Increased borrowing costs and deteriorating economic confidence punished the Irish sovereign, providing a powerful incentive for Irish decision makers to adhere to prescriptive measures suggested by the credit rating agencies in the commentary that surrounding their assessments. The political price for the severity of the *National Recovery Plan* was high. The governing Fianna Fail Party called a general election for 25 February 2011. At that election Fianna Fail suffered an enormous 24.2% drop in its support, losing fifty-eight seats in the Irish Dail to be left with only twenty seats out of 166.[269]

The results of the 2011 Irish General Election reflected another enforcement mechanism associated with knowledge generation. The consensus amongst Irish voters at the end of a tumultuous period for the Irish economy was clear. The incumbent decision makers, those who had so robustly defended the Irish outlook over the course of 2010, were severely punished at the ballot box. This enforcement mechanism was distinctly political, providing another layer of motivation to elected sovereign decision makers. Contemporaries in other jurisdictions would have

[268] Amen, 'Borrowing Authority; Eclipsing Government', pp. 157-194.
[269] Elections Ireland, accessed 18/04/11, http://electionsireland.org/

observed with interest the financial, economic and political fallout for state actors who openly reject the validity of the knowledge generated by credit rating agencies.

The Irish experience of 2010 crystallises the power of knowledge in the modern international system and who has the authority in that system to generate knowledge. The Irish Government, directly and through the NTMA, regularly engaged with the credit rating agencies to help shape their assessments. The same government sought to influence market participants through direct dialogue and public statements. It proved to be a one sided conversation. When differences emerged, as seen in the middle of that year, the consensus by various actors in the modern international system quickly coalesced around the position of the credit rating agencies, leaving a relatively defenceless state actor impotent. The Irish experience is particularly noteworthy given the transparent decision making processes at play. For sovereign risk analysts at credit rating agencies, there was little of the opacity experienced in many other states. Yet, when opinions diverged, there was only one clear winner.

The interactions between state actors and credit rating agencies are formal and informal, frequent and intermittent, collaborative and hostile. Yet these interactions, which have such resonance for contemporary global governance, are distinctly one sided. State actors are clearly not seen as objective and reliable sources of knowledge regarding their own financial health. The authority in the modern international system unambiguously lies with credit rating agencies, who enjoy the support of an intersubjective consensus between a broad range of actors, particularly within the global financial markets. The enforcement mechanisms that reinforce contemporary

norms are both powerful and immediate. Credit rating agencies are able to employ both structural and relational power to heavily influence sovereign actors. Within this context, the hierarchy of knowledge is all too clear. States play a subordinated role in knowledge generation. This role can be further compromised when political factors come to the fore and the credit rating agencies use political as well as economic considerations to determine a sovereign's creditworthiness.

Chapter Five: A Tightened Straightjacket

The subordinated role of state actors in the critical process of knowledge generation has a broad range of important ramifications on their decision making processes. Repeated attempts by sovereign decision makers to appease the credit rating agencies illustrate the broad acceptance by this once authoritative group of actors of the hierarchy of knowledge that exists in the modern international system. The Irish experience from 2010 clearly demonstrates a dynamic that is distinctly one sided. The Irish example saw a government about to face an election willingly implement potentially unpopular reforms to pacify the credit rating agencies. That government subsequently lost its bid for re-election, with elected officials paying a significant price for their accommodation of the edicts of credit rating agencies. As seen in the previous chapter, sovereign decision makers may complain in public and robust terms, but they frequently acquiesce to the needs and desires of credit rating agencies. While this appeasement is well recognised, the process behind it is not adequately understood.

As outlined previously, the credit rating agencies deliberately apply political as well as economic considerations when assessing a sovereign's creditworthiness. At times, political considerations can become paramount to the conclusions they reach. For IPE scholars, analysis of the interaction between sovereign actors and credit rating agencies must extend well beyond cause and effect in order to obtain a more comprehensive understanding of this influential process.

Actors with authority are typically adroit at exerting influence over subordinated actors. Credit rating agencies are now adept at cajoling sovereigns,

particularly those with an acute sensitivity to their determinations, to pursue certain courses of action that they deem are in the best interests of enhanced creditworthiness. How credit rating agencies use their position at the top of the knowledge generation hierarchy shapes contemporary global governance. This influence extends well beyond straightforward recommendations on economic policy that would in their view improve the creditworthiness of sovereigns. In the twenty-first century, credit rating agencies are leveraging their knowledge generation capabilities to carefully and effectively influence domestic decision making in a number of sovereigns. This influence extends up and down Rosenau's continuum of global governance,[270] shaping both formal policies and informal norms.

For scholars seeking an enhanced understanding of this process, the beginning and end of electoral cycles within rated sovereigns can be revealing. At the end of electoral cycles, sovereign decision makers, aware they are about to face their voters, often have a heightened sensitivity to the sorts of negative media coverage that typically surrounds sovereign rating downgrades or negative commentary from the credit rating agencies. At the same time, they must be seen as decisive and serving the national interest. Election promises are made by political parties in and out of power, some of which are costly. At the beginning of electoral cycles, governments with new mandates are often eager to clearly demonstrate early signs of the implementation of their policy agenda and stamp their authority over decision making processes. This period also enables those sovereign decision makers elected to government from opposition to receive updated information from public sector agencies and departments that can impact the assessments they make.

[270] On Rosenau's theory of the continuum, see Chapter One of this thesis.

After carefully observing state actors over decades, including those from pluralistic democracies, the credit rating agencies are aware that political risks can become amplified in certain stages of the electoral cycle. Using Standard and Poor's own explanation of its sovereign ratings methodology, 'the effectiveness, stability, and predictability of the sovereign's policymaking and political institutions' are a primary factor driving the political score received by state actors.[271] These political scores influence the ratings generated by the credit rating agencies. The Irish example demonstrates that as part of their sovereign rating process, credit rating agencies directly engage with both elected and unelected government officials to obtain information on a country's policy settings. These officials understand the motivation behind the engagement and are cognisant of the ramifications of any adverse conclusions reach by the credit rating agencies. These interactions, which take many forms, lie at the very heart of contemporary global governance.

Another sovereign that provides a poignant example of the contemporary interplay between state actors and credit rating agencies can be found in Hungary during 2010. As a member of the EU, the successful sale of Hungarian Government bonds is reliant on interest by investors in the private capital markets. Hungary is an emerging market from Eastern Europe and particularly susceptible to rapid changes in market sentiment. As outlined in the previous chapter, Hungarian bond sales are typically much smaller in scale than other EU states, reducing the familiarity amongst prospective private bond investors with the Hungarian bond market.

[271] Standard and Poor's 'About Us', accessed 07/08/09, http://www.standardandpoors.com/home/en/us

Hungary's experience during 2010 was to a very large extent contextualised by the events of 2008, when the sovereign's securities market came under significant stress and the Hungarian Government was forced to turn to the International Monetary Fund (IMF) for a US$15.7 billion loan.[272] For a country with a strong nationalist element, such overt international involvement in Hungarian affairs was a bitter pill to swallow. The stand-by arrangement with the Hungarian sovereign was designed by the IMF to 'facilitate the rapid reduction of financial market stress in Hungary, while supporting the country's longer-run economic goals by creating conditions necessary to facilitate appropriate reforms in government finances'.[273] The IMF's loan came with highly prescriptive and very public set of policy recommendations. When announcing the loan, the IMF declared that 'given the structure of the Hungarian budget, among other areas, adjustment will need to include revisions of wages and pensions ...expenditure restraint will be achieved in part through reductions in the overall government wage and pension bill'.[274]

For the then Socialist Prime Minister, Ferenc Gyurcsany, the conditions attached to the loan by the IMF presented significant political challenges, with harsh spending cuts impacting public sector workers and pensioners. *The New York Times* noted that the agreement Hungary had signed with IMF had put the country 'in an awful vice' and having 'mandated to squeeze its budget deficit below 3 percent of gross domestic product, the government is in no position to stimulate the economy

[272] IMF, 'IMF Agrees $15.7 Billion Loan to Bolster Hungary's Finances', (6 November 2008), accessed 14/2/11, http://www.imf.org/external/pubs/ft/survey/so/2008/car110608a.htm
[273] IMF, 'IMF Executive Board Approves €12.3 Billion Stand-By Arrangement for Hungary', (6 November 2008), accessed 14/2/11, http://www.imf.org/external/np/sec/pr/2008/pr08275.htm
[274] IMF, 'IMF Agrees $15.7 Billion Loan to Bolster Hungary's Finances', (6 November 2008), accessed 14/2/11, http://www.imf.org/external/pubs/ft/survey/so/2008/car110608a.htm

...there is no painless path to recovery'.[275] The pain inflicted by the IMF's conditions was exacerbated by earlier comments by Prime Minister Gyurcsany that a security reserve 'hopefully never has to be used'.[276] However traumatic the process, Prime Minister Gyurcsany's Government had made significant progress in reducing Hungary's crippling debt. *The Financial Times* noted that 'faced with a near-unmanageable level of public debt', Hungary had succeeded in narrowing it budget deficit from 9.2% in 2006 to a projected 3.9% by 2009.[277] The newspaper went on to observe that 'the achievement is all the more remarkable because structural reform of pensions and social welfare programmes was until recently thought nigh-on impossible in Hungary', thanks to a generous social welfare system.[278]

The political fallout from the IMF bailout and the resultant budgetary straight jacket echoed through the 2010 Hungarian electoral cycle. Leading up to the elections, the main opposition party, the centre-right Fidesz Party, heavily criticised the governing Socialist administration's approach to economy policy. In February 2010, Fidesz Party Chairman and candidate for Prime Minister Viktor Orban told German business leaders that 'the era of a hectic, unpredictable and irresponsible government and decisions is over, the time of partnership is coming'.[279] In the same month, Fidesz Party Vice Chairman Mihaly Varga accused the Socialist Government of misleading a number of important interlocutors including the Commissioner for

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[275] Landon Thomas Jr., 'Anxiety Rules Hungary's Economy and Politics', *The New York Times* (2 April 2009), p. B.1.
[276] 'Hungary Drawing International Financial Aid at Rapid Rate', *Magyar Nemzet*, (27 March 2009), p. 11. *Magyar Nemzet* is a privately owned conservative Hungarian newspaper. Translation provided by BBC Worldwide Monitoring, (1 April 2009).
[277] Chris Bryant, 'Crisis Exposes Cracks in Former Communists', *The Financial Times*, (11 March 2010), accessed 18/11/10, http://www.ft.com/intl/cms/s/78af4a88-2cac-11df-8abb-00144feabdc0,dwp
[278] Idem.
[279] Fidesz Party, 'Viktor Orbán's Talks in Frankfurt', (9 February 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=145608&menu=nyomtathato

Economic and Monetary Affairs of the EU, the President of Hungary and international institutions.[280] Mr Varga also indicated that greater economic integration would be a key priority for Fidesz if it won the election, saying 'I do hope that by 2015 the Euro will be the currency in Hungary'.[281]

In the build up to the April 2010 elections, Fidesz simultaneously sought to stoke public concerns about Hungary's loss of face as a result of the IMF bailout. Mr Orban told a meeting of the European People's Party parliamentary group leaders in Budapest that 'Fidesz is ready to restore Hungary's respect and prestige abroad, which has been lost in recent years'.[282] As a centre-right Party, Fidesz's platform unsurprisingly focused on tax cuts, job creation and supporting small businesses.[283] However, Fidesz resisted frequent demands for greater detail on its policy platform ahead of the elections, claiming the Party would be unable to accurately cost policies until it had assumed office, due to its lack of faith in the numbers being provided by the incumbent Socialist Government.[284]

Two rounds of elections in April 2010 delivered an emphatic victory for Fidesz, which comprehensively swept the Socialists from power for the first time in eight years.[285] The scale of their victory provided Fidesz with a two thirds majority in the Hungarian Parliament, enough to secure changes to the Hungarian constitution.[286]

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[280] Fidesz Party, 'Economic Recovery First', (19/ February 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=146187&meu=nyomtathato
[281] Idem.
[282] Fidesz Party, 'EPP Group Bureau Meeting, 4-5 March 2010 Budapest', (6 March 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=146973&menu=nyomtathato
[283] *Reuters*, (11 April 2010), accessed 08/09/10, http://www.reuters.com/assets/print?aid=USTRE63A1GE20200412
[284] Idem.
[285] 'Landslide Victory for Hungary's Conservative Opposition', *BBC*, (25 April 2010), accessed 08/09/10, http://news.bbc.co.uk/2/hi/8642456.stm
[286] Idem.

Given Hungary's significant and high profile financial challenges in the years immediately preceding the April 2010 elections, the results were closely observed by both international institutions such as the IMF and the global financial markets. After the first round of voting, media reports on the election addressed speculation on the financial market reaction to Fidesz's strong showing. When the results became clear, Gergely Suppan, an analyst from Hungarian central bank Takarekbank, told international news agency Reuters that he expected 'moderate strengthening of the Forint and a drop in government bond yields tomorrow' based on the Fidesz win.[287]

Given that the conditions attached to the IMF loan in 2008 required ongoing fiscal commitments by the Hungarian Government, Fidesz's electoral success cast doubt over the consistency of the sovereign's budgetary position. The logical extension of a comprehensive change in both the composition of key policy makers and the political ideology of those policy makers is changes to budgetary priorities. Given the importance credit rating agencies place on consistent and predictable decision making, a dramatic change in the approach of elected officials could impact Hungary's political scores and ultimately its credit ratings.[288] External expectations of significant changes to Hungary's policy positions had grown as Fidesz's campaign progressed. Viktor Orban's statement that the elections would allow the Hungarian

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[287] *Reuters*, (11 April 2010), accessed 08/09/10, http://www.reuters.com/assets/print?aid=USTRE63A1GE20200412

[288] Standard and Poor's, 'Sovereigns: Sovereign Government Rating Methodology and Assumptions', (30 June 2011), accessed 07/07/11 http://www.standardandpoors.com/prot/ratings/articles/en/au/?articleType=HTML&assetID=1245319311240

people to 'carry out our own revolution', clearly communicated to domestic voters and offshore investors the potential for significant change.[289]

Indeed, the change of government in Hungary introduced a new, volatile and less predictable decision making environment that triggered negative reactions from both the global financial markets and the credit rating agencies. Within weeks of their election to office, the Fidesz Party realised that many of their policy commitments may not be deliverable if Hungary was to meet the stringent policy goals set out by the IMF as part of its loan agreement. In a clumsy attempt to manage expectations and blame the previous government for not fully disclosing the real state of Hungary's public finances, Fidesz Vice Chairman, Lajos Kosa said in early June 2010 that Hungary had a slim chance of avoiding 'the Greek situation'.[290] The next day, Peter Szijjarto, Prime Minister Orban's spokesman, observed that Hungary's economy was in a 'grave situation' and added that it was 'not an exaggeration at all' to discuss a Hungarian default.[291] Given the sensitivities associated with links to Greece's sovereign debt crisis, the response from the global financial markets to these comments was swift. The euro sank to a four year low on news of the comments, the forint plunged 6% against the euro, while the cost to insure sovereign debt against default surged across the euro zone.[292]

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[289] Fidesz Party, '11 April 2010 is Our Revolution', (16 March 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=147467

[290] Neil Buckley, 'Hungary Gives Second Warning of Default Risk', *The Financial Times*, (5 June 2010), accessed 22/12/10, http://www.ft.com/intl/cms/s/0/0316416a-703a-11df-8698-00144feabdc0.html - axzz1fXGdjOKD

[291] Idem.

[292] Charles Forelle, Veronika Gulyas and Margit Feher, 'Hungary's Economic Woes Punish Euro, Roil Markets', *The Wall Street Journal*, (5 June 2010), accessed 22/12/10, http://online.wsj.com/article/SB10001424052748704764404575286283092092988.html?KEYWORDS=hungary&mg=com-wsj

Condemnation of these infelicities was widespread, particularly in the global financial press. Timothy Ash, Head of Emerging Market Research at the Royal Bank of Scotland told *The Wall Street Journal* that 'you simply cannot talk like this in these markets'.[293] Deficient apprehension of the rationale behind the comments further confused market observers. Otis Casey from *Markit* wrote in *The Financial Times* that 'market observers are struggling with trying to determine the extent to which the announcement may be a result of political manoeuvring to back away from campaign pledges to reduce taxes all the way to concerns that there may be a similar credibility gap to Greece regarding past budget numbers'.[294] Clearly, understanding the motives behind public statements by elected decision makers is a priority for participants in the international bond markets.

In the absence of clarity, speculation abounded. Josh Noble observed in *The Financial Times* that 'when Hungary's new government was elected with a clear mandate – markets cheered. Now, just a few days on from prime minister Viktor Orban taking office, the party's over and investors are looking for the exit'.[295] Preston Keat from the Eurasia Group observed in *The Financial Times* that 'Fidesz does not have a coherent strategy for fiscal consolidation, and markets are now punishing them as a result. In the coming weeks they will need to piece together a credible outline of a plan, or the pain will worsen'.[296] The condemnation of the new administration's

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[293] Idem.
[294] Otis Casey, 'CDS Report: Investors Discover Hungary', *The Financial Times*, (4 June 2010), accessed 22/12/10, http://ftalphaville.ft.com/blog/2010/06/04/252561/cds-report-investors-discover-hungary/
[295] Josh Noble, 'Hungary – Not Drowning, But Wavering', *The Financial Times* (4 June 2010), accessed 22/12/10, http://blogs.ft.com/beyond-brics/2010/06/04/hungary-not-drowning-but-wavering/ - axzz1fbkPregO
[296] Idem.

comments amongst global financial market participants and observers were remarkably consistent in both its sentiment and its stridency.

Amidst the significant gyrations caused on the global financial markets by the comments, Fidesz sought to backtrack in an effort to calm market participants. Mihaly Varga, a senior Cabinet official, publicly committed Fidesz to delivering a budget deficit 'as small as possible', while describing the previous comments about a possible default as 'unfortunate', adding that 'Hungary is not among the countries that face a default'.[297] For a newly elected sovereign government, such conflicting commentary from senior elected and unelected officials at a time of heightened market sensitivity caused significant reputational damage. The new administration was about to embark on negotiations with the IMF and EU over an extension of the 2008 rescue package.[298] Tellingly, both institutions overtly contradicted the Hungarian scare mongering on a possible default. Former IMF Director Dominique Strauss-Khan observed 'there seems to be no particular element of concern', while Eurogroup Chairman Jean-Claude Juncker told the BBC that 'I do not see any problem at all with Hungary. I only see the problem that politicians from Hungary talk too much'.[299]

Observations in the global financial media were highly critical and sought to define Hungary's new government as inept. *The Economist* observed that Fidesz had 'blundered badly …by casually comparing the country's economic woes to

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[297] Margit Feher, 'Hungary Rushes to Calm Markets', *The Wall Street Journal*, (5 June 2010), accessed 22/12/10, http://online.wsj.com/article/SB10001424052748704183204575288172664600674.html?KEYWORDS=Hungary
[298] 'Hungary government clarifies Greek crisis comments', *BBC*, (7 June 2010), accessed 22/12/10, http://www.bbc.co.uk/news/10254462
[299] Idem.

Greece's'.[300] The newspaper went on to focus its criticism around Prime Minister Orban:

> *Despite winning a stonking mandate in April, the government lacks sureness of touch. Mr Orban has picked unnecessary fights, publicly demanding the sacking of the well-regarded and hawkish central-bank chief, Andras Simor. He has stoked a long-running ethnic dispute with neighbouring Slovakia. That looks reckless. Yet on serious issues, such as reforms of the bloated public sector and pension system, he is strangely timid.*[301]

For a heavily scrutinised sovereign government, it was not an auspicious start.

The reaction of the global financial markets and the commentary by analysts and international institutions demonstrated that initial concerns about a potential default were soon followed by scepticism regarding the alarmist comments from the new Fidesz Government. The observations of key sovereign decision makers were ultimately dismissed by observers and the global financial markets as political posturing. Those observations simply did not fit within the conceptual system apparent in the global financial system. A pervasive market consensus prioritised the views of the IMF, EU and credit rating agencies over the views of elected sovereign decision makers.

A newly elected government from an emerging market within the EU had attempted to create new knowledge regarding its budgetary position, only to quickly backflip in the face of a negative reaction. Comments that were primarily designed for a domestic political audience triggered highly negative international reactions within the global financial markets. The powerful enforcement mechanism embedded within

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[300] 'Hungary Wobbles: Careless Talk', *The Economist*, (10 June 2010), p. 1, accessed 22/12/10, http://www.economist.com/node/16322740
[301] Idem.

that system ensured a hasty clarification on the part of the new government. Indeed, the reaction by the markets and the subsequent backflip by Hungarian decision makers reinforced the conceptual system at play by providing a proof point to the subordinated role of elected sovereign officials in the knowledge generation process. The hasty change of heart by the Hungarian Government was indicative of the power the financial markets and their echo chamber in the financial press have over a number of state actors in the modern international system.

The reputational damage amongst global market participants was particularly impactful for Hungary, given the emerging country's strong reliance on the investment from the private capital markets in government bonds. This reliance is further accentuated by the fact that bank lending within the sovereign is primarily denominated in foreign currency, increasing the susceptibility of the Hungarian private sector to exchange rate fluctuations.[302] The interplay between the Hungarian Government and the global financial markets during 2010 would continue to illustrate the subservient role a number of state actors play in the modern international system and the influence exerted by the credit rating agencies. These events would also place the distinctly political considerations used by credit rating agencies to determine a sovereign's creditworthiness into perspective.

In an attempt to rebuild the government's economic credibility, Prime Minister Orban addressed the Hungarian National Assembly on 8 June to announce a package of economic measures designed to stabilize Hungary's economy and restore investor

[302] IMF, 'Hungary: Markets Have Stabilized, but Long Road Ahead', (12 June 2009), accessed 19/03/11, http://www.imf.org/external/pubs/ft/survey/so/2009/int011209a.htm

confidence.[303] The package, described by the Prime Minister as an 'Action Plan', included a number of tax reform measures designed to reduce and simplify the tax burden for most Hungarian taxpayers through the introduction of a 16% flat tax, while committing to the introduction of a bank tax.[304] The speech contained messages that were clearly designed to reassure the global financial markets. The Prime Minister told the National Assembly that 'we would like to make it clear that the Government is convinced no modern economy can be competitive without a well functioning system of credit institutions'.[305] Such public deference to the importance of the credit markets provided another demonstration of the pervasive pragmatism at play in contemporary global governance and the relational power domiciled in the enforcement mechanisms of the global financial system.

The speech included initiatives that sought to demonstrate the Fidesz Government's commitment to austerity measures, including, for example, a freeze on telephone, furniture and vehicle purchasing within the public sector.[306] However, the speech also contained seemingly contradictory statements about the reliability of the budget data, something that had spooked the markets just days earlier. The Prime Minister said, 'everyone knows the size of the problems before us. There is no room for guessing. Everyone could see the May budget data …unfortunately I must say that the figures in the budget are still rather ambiguous. We had suspected this for a long time'.[307]

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[303] Fidesz Party, 'Package of Economic Measures Announced by Dr. Victor Orbán', (9 June 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=151660&menu=nyomtathato
[304] Idem.
[305] Idem.
[306] Idem.
[307] Idem.

The statement to the Hungarian National Assembly was the first major policy address by Prime Minister Orban. It sought to commit the new Government to implementing the tax pledges made in the lead up to the April elections while addressing the perception that Fidesz lacked a comprehensive economic plan. In a sense the speech, which contained no fewer than twenty-nine specific commitments, had two distinct audiences. The first audience was domestic – those voters who had switched from the Socialists to Fidesz, particularly those who were attracted by the Fidesz election promise to reduce and simplify taxation. The second audience was international – those in the global financial markets, the credit rating agencies and at international institutions like the IMF and EU who were seeking reassurance that the new Government would continue with austerity measures designed to bring Hungary's large public debt burden back to within what were deemed to be acceptable levels.

The response from the first audience was broadly positive, as was demonstrated by the results of the local government elections later that year.[308] The response from the second audience was fundamentally different and quickly forthcoming. *The Economist* observed that 'Hungary is the most debt-ridden country in eastern Europe … cuts in public spending will have to go far beyond the gimmicky blitz on top salaries, official cars and mobile phones mentioned so far'.[309] As an emerging economy in direct receipt of IMF and EU financial assistance, the new sovereign Government's attempts to reassure the global financial markets were off to

[308] Edith Balazs, 'Orban Boosts Power in Local-Government Election, Faces Budget Test', *Bloomberg*, (4 October 2010), accessed 22/12/10, http://www.bloomberg.com/news/2010-10-03/orban-boosts-power-in-hungary-local-government-election-faces-budget-test.html
[309] 'Hungary Wobbles: Careless Talk', *The Economist*, (10 June 2010), p. 1, accessed 22/12/10, http://www.economist.com/node/16322740

a rocky start. While global financial market participants and observers had provided commentary on components of the Fidesz Government's economic and budgetary policies, there was a limited amount of holistic analysis made public in the first weeks of the new administration. The absence of such analysis increased uncertainty amongst market participants, who were seeking greater clarity on the evolving investment environment in Hungary amidst confusing signals from domestic politicians.

Credit rating agencies had closely observed the new Government's early days and their assessments helped define the Orban administration for investors. On 9 June 2010, just days after the conflicting comments had emanated out of the Hungarian Government, Fitch Ratings issued a statement setting out the pathway to greater financial stability for the sovereign. David Heslam, Head of Fitch's Sovereign Team said that the announced commitment to budget deficit targets were 'moderately encouraging', while observing there was 'little room for policy slippage'. Mr Heslam went on to provide very specific commentary on the default bungle, describing the comments from the Fidesz Government as 'a dangerous misjudgement which has dented its credibility …therefore the government needs to improve its communication strategy and avoid other own-goals that undermine confidence'.[310] Two days later, following an undersold Hungarian Government debt auction, Fitch observed the result highlighted 'Hungary's ongoing vulnerability to global investor risk aversion, sharpened recently by misjudged comments by the new Hungarian Government and post-election uncertainty over the outlook for public finances in the context of an

[310] Fitch Ratings, 'Tight Fiscal Policy Need to Stabilise Hungary's Ratings', (9 June 2010).

already high gross government debt burden'.[311] Here, a key credit rating agency used a predictable financial market response to reinforce its own earlier observations and signpost the pathway to a restored position for the Hungarian sovereign.

Shortly after the release of the Fitch statement, the IMF sent a mission to Budapest working in parallel with a mission from the European Union (EU).[312] The purpose of the mission was to hold discussions with Hungarian authorities regarding the sixth and seventh reviews of the country's loan arrangement with the IMF.[313] At the conclusion of their visit, IMF mission leader, Stuart Rosenberg, released a statement outlining unambiguous feedback to Hungarian policy makers:

> *In an environment of heightened market scrutiny of government deficits and debt levels, the fiscal deficit targets previously announced—3.8 percent of GDP in 2010 and below 3 percent of GDP in 2011—remain an appropriate anchor for the necessary consolidation process and debt sustainability, and should be adhered to, but additional measures will need to be taken to achieve these objectives. Sustainable consolidation will require durable, non-distortive measures, which the authorities need more time to develop. Difficult decisions will be needed....*[314]

The clear message for the Orban Government was that extensive fiscal adjustments were still needed and, furthermore, the adjustments would need to be sustained over the medium to long term. Given the importance of the IMF loan to Hungary's ongoing financial recovery, Mr Rosenberg's comments carried enormous weight for international investors.

[311] Fitch Ratings, 'Hungary's Budget Liquidity Supported by IMF Programme', (11 June 2010).
[312] IMF, 'Statement by the IMF Mission to Hungary', (17 October 2010), accessed 21/12/10, http://www.imf.org/external/np/sec/pr/2010/pr10295.htm
[313] Idem.
[314] Idem.

Despite extensive discussions over a two week period, the missions left Budapest without reaching an agreement with the Hungarian Government. The IMF noted that ‘while there is much common ground, a range of issues remain open. The mission will therefore return to Washington, D.C. The IMF will continue to actively engage with the authorities with a view to bridging remaining differences’.[315] Within the context of the disastrous use of the Greek analogy and the clumsy attempts to correct the record, the breakdown of talks with the IMF hardened negative perceptions about the Orban Government amongst many external observers. Peter Attard Montalto, an economist from Nomura, described breakdown of talks as a ‘very rare event, countries usually go out of their way to satisfy these missions’.[316] Similarly, Timothy Ash from the Royal Bank of Scotland observed, ‘it seems the new government has not learnt its lessons from the previous gaffe, while the market is in no mood to overlook any fiscal laxity’.[317] Indeed, the ongoing actions of the Hungarian sovereign were outside the norms at play in the modern international system.

The inconclusive outcome of the talks between the IMF, EU and the Orban Government further diminished the credibility of Fidesz. *The Economist* newspaper noted that the ramifications triggered by the breakdown could be widespread, observing that ‘in a world where a misspoken word by a formerly obscure town mayor in a provincial city in eastern Hungary can wipe out trillions in global asset values, it is likely the impact of this weekend’s events will make itself felt in

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[315] Idem.
[316] Margit Feher, ‘Economists React to Breakdown of Hungary Debt Talks’, *The Wall Street Journal,* (20 July 2010), accessed 17/9/10, http://blogs.wsj.com/emergingeurope/2010/07/20/imfeu-walks-out-on-hungary-debt-talks
[317] Idem.

emerging markets from Malaysia to Argentina'.[318] *The Financial Times* editorial pages declared that 'Mr Orban should now scramble to recover' the confidence of lenders and warned of the dangers associated with being 'tempted to flirt with indiscipline'.[319] The continued erosion of confidence in the new Hungarian administration amongst participants in the global financial markets was soon to evolve from event-driven observations and market reactions to far more tangible consequences for global lenders.

In July 2010, Moody's placed Hungary's local and foreign currency government bond rating under review for a possible downgrade.[320] Moody's stated their decision was triggered by the 'increased uncertainty regarding Hungary's fiscal outlook', before specifically highlighting the breakdown in talks between the sovereign and the IMF and EU as a concern.[321] Moody's also identified Fidesz's proposed bank levy as representing a 'further potential drag on economic activity as it could negatively affect banks' credit provisioning and the country's investment climate'.[322] When describing the factors that would be considered in the review, Moody's highlighted the Orban Government's 'ability and willingness … to formulate a coherent reform agenda that could stabilize economic strength generally, and the government's financial strength specifically'.[323] The prescriptive measures were yet another demonstration of the relational, as well as structural power employed by credit rating agencies to influence the activities of sovereign actors.

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[318] 'Fund to Hungary: Drop Dead (Maybe)', *The Economist*, (18 July 2010), accessed 17/09/10, http://www.economist.com/blogs/easternapproaches/2010/07/hungary_and_imf
[319] 'Hungary Blunders', *The Financial Times*, (19 July 2010), accessed 17/09/10, http://www.ft.com/intl/cms/s/0/65b9bf9e-9363-11df-bb9a-00144feab49a.html#axzz1oU5pHLxG
[320] Moody's, 'Rating Action: Moody's Places Hungary's Baa1 Sovereign Rating Under Review for Possible Downgrade', (23 July 2010).
[321] Idem.
[322] Idem.
[323] Idem.

The specific reference by Moody's to the Orban Government's 'willingness' to deliver potentially contentious spending restraints brought the domestic Hungarian political environment into focus. In the April 2010 Hungarian elections, the far-right Jobbik Party had surprised many domestic and international observers when it received 15% of the vote to come in third behind Fidesz and the Socialists.[324] Jobbik had taken a decidedly nationalistic tone in the lead up to the elections and were highly critical of the IMF/EU rescue package of 2008.[325] When talks between the Orban Government, IMF and EU broke down, the Party was highly critical of the global financial markets and their attempt to influence Hungarian decision making. In a statement, Jobbik said, 'we can guess at the choreography that will follow from Monday: politicians, analysts and journalists serving the global financial powers will lay into the government for not giving into foreign pressure … the discussions with the IMF and the EU are a key front in the fight for economic independence'.[326] With such overt economic nationalism stoking isolationist sentiment on Fidesz's right flank, the Orban Government was under pressure to demonstrate its own ability to stand up for Hungarian interests. Dietmar Hornun, a Moody's Vice President and lead analyst for Hungary, clearly factored in such domestic political considerations, stating, 'Moody's expects the Hungarian government and the EU and IMG to come to an agreement following the local elections (scheduled for 3 October)'.[327]

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[324] Pablo Gorondi, 'Center-right Fidesz wins big in Hungary elections', *The Guardian*, (12 April 2010), accessed 29/08/10, http://www.guardian.co.uk/world/feedarticle/9027152
[325] Idem.
[326] 'Fund to Hungary: Drop Dead (Maybe)', *The Economist*, (18 July 2010), accessed 17/09/10, http://www.economist.com/blogs/easternapproaches/2010/07/hungary_and_imf
[327] Moody's, 'Rating Action: Moody's Places Hungary's Baa1 Sovereign Rating Under Review for Possible Downgrade', (23 July 2010).

Moody's had reached the conclusion that the Orban Government would not be in a position to agree to the tough measures being advocated by the IMF and EU while Fidesz was focused on domestic political considerations. This assessment was made in July, some three months before local elections were due. Given the tumultuous gyrations on global financial markets over the weeks leading up to the Moody's statement and their potential impact on Hungary's economy, such an assessment reflects a significant judgment of the priorities of Hungarian decision makers by a credit rating agency. This assessment also represents a judgement about the willingness of Hungarian policy makers to make certain budgetary decisions. Determinations about an actor's willingness to pursue a certain course of action, particularly an actor as multifarious as a state actor, ultimately reflect a judgement call on the part of credit rating agencies. While economists will typically let the statistics guide their judgements, credit rating agencies seeking to make observations about state actors are compelled to ascertain something far more nebulous and difficult to define – willingness. This potentially pivotal factor takes many forms, as seen by the actions of another credit rating agency, namely, Standard and Poor's.

On the same day that Moody's announcement of a review, Standard and Poor's revised its outlook for Hungary's sovereign credit rating from stable to negative.[328] Like Moody's, Standard and Poor's highlighted the collapse of talks with the IMF as being an important factor, stating that 'we believe that without an EU/IMF program to anchor policy, Hungary is likely to face high and more volatile funding costs, which in our view could weigh on financial sector balance sheets, the public

[328] Standard and Poor's, 'S&P Revises Hungary Outlook to Negative on IMF Talks Collapse', Reproduced by *Zero Hedge*, (23 July 2010), accessed 29/08/10, http://www.zerohedge.com/article/sp-revises-hungary-outlook-negative-imf-talks-collapse

finances and economic growth'.[329] Standard and Poor's was also highly critical of the Orban Government's proposed bank levy, stating, 'we believe a tax on financial system assets at the levels proposed could impeded the function of the financial system over the medium term by impairing the banking sector's ability to raise capital and therefore its ability to lend'.[330] The profile of political considerations amongst the credit rating agencies was reinforced when Standard and Poor's ominously stated that 'we could lower the rating … if the political commitment to pursue growth-supportive policies weakens'.[331]

While Moody's referred to 'willingness', Standard and Poor's referred to 'political commitment'. Needless to say both rating agencies were referring to the same thing. The process for reaching determinations on such a variable is far from transparent, nor is it well understood in the modern international system. Yet, beyond the definitional clarity of statistics lies an important layer of judgements by the credit rating agencies that are highly influential to contemporary global governance.

The chronology of developments around the Hungarian sovereign's policy making processes and the response by credit rating agencies attests to the totemic role political considerations played during 2010. As predicted by Moody's, the focus of the Orban Government between July and early October was the local government elections, in which Fidesz performed strongly, winning twenty-two of twenty-three races in Hungary's largest cities.[332] Edith Balazs reported on Bloomberg that the

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[329] Idem.
[330] Idem.
[331] Idem.
[332] Edith Balazs, 'Orban Boosts Power in Local-Government Election, Faces Budget Test', *Bloomberg*, (4 October 2010), accessed 22/12/10, http://www.bloomberg.com/news/2010-10-03/orban-boosts-power-in-hungary-local-government-election-faces-budget-test.html

results boosted Orban's grip on power, 'freeing him of electoral pressures until 2014'.[333] Ms Balasz went on to note that 'investors are betting the results will give Orban, 47, the freedom to unveil the concrete economic policies and budget cuts they've waited for'.[334] Much of the commentary in the financial media following the local government elections echoed the sentiments expressed by the credit rating agencies in the preceding months. There was an expectation that Fidesz's political commitment, or willingness, to focus on economic and budgetary issues would increase once a key event on the domestic political calendar had passed.

As expected by external observers, the Orban Government quickly moved to address concerns about the budget deficit following Fidesz's strong showing in the local government elections. Within days of the results, the Orban Government announced a raft of potentially contentious measures designed to boost the Hungarian sovereign's revenues, including most notably a series of 'crisis taxes' on the energy, retail and telecoms sectors.[335] Prime Minister Orban told the Hungarian Parliament that 'until we are out of the ditch, it's only fair that the strongest participants of the economy help those who are still in distress', while acknowledging the measures sent 'bad messages' to international investors.[336] The post-local government election policy package also contained cuts in government contributions to non-government pension plans and cuts in personal taxation rates.[337]

[333] Idem.
[334] Idem.
[335] Chris Bryant, 'Hungary Unveils "Crisis" Taxes on Business', *The Financial Times*, (18 October 2010), accessed 22/12/10, http://www.ft.com/intl/cms/s/0/c6c86b1e-dac1-11df-81b0-00144feabdc0.html - axzz1fuIzfaHB
[336] Idem.
[337] Stefan Wagstyl, 'Hungary: Chilling Times for Business', *The Financial Times*, (15 October 2010), accessed 22/12/10, http://blogs.ft.com/beyond-brics/2010/10/15/hungarys-new-taxes-shouldnt-comfort-investors-tmuch/ - axzz1fuMsNZaB

While most international analysts welcomed the measures for increasing the likelihood of Hungary meeting its deficit targets, many also voiced concerns about the consequences of the 'crisis taxes' on business confidence and investment, while others questioned the impact of the package on Hungary's budget. For example, Capital Economics also voiced concern at the scale of the revenue measures announced by Prime Minister Orban, noting that 'efforts remain reliant on temporary measures and a failure to tackle contingent risks elsewhere in the public sector means that the country is still walking a fiscal tightrope'.[338] The link between the Orban Government's announcement and future rating agency announcements was also top of mind for many in the global financial markets, with widespread speculation on how they would react to the measures. Market participants feared the package would fall short of expectations, particularly given the downgrade of the outlook for the Hungarian sovereign a few months earlier. As Daniel Bebesy from Budapest Fund Management had previously told *Reuters* in the context of mooted reforms; 'I don't know whether it will be enough to avoid further downgrades to Hungary's ratings'. [339]

Financial market participants like Mr Bebesy did not need to wait long for a response. On 6 December 2010, Moody's announced it was downgrading Hungary's government bonds by two notches, from Baa3 to Baa1.[340] Moody's spokesperson Dietmar Hornung announced the downgrade was, 'primarily driven by the Hungarian government's gradual but significant loss of financial strength, as the government's

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[338] Idem.

[339] Henry Mance, 'CEE Markets Wrap: Breathing Space for Hungary', *The Financial Times*, (8 September 2010), accessed 22/12/10, http://blogs.ft.com/beyond-brics/2010/09/08/cee-markets-wrap-3/- axzz1fuMsNZaB

[340] Moody's, 'Moody's downgrades Hungary's government bond ratings to Baa3 from Baa1; outlook negative', (6 December 2010), accessed 22/12/10, http://www.moodys.com/research/Moodys-downgrades-Hungarys-government-bond-ratings-to-Baa3-from-Baa1--PR_210257

strategy relies on temporary measures rather than sustainable fiscal consolidation policies. As a result, the country's structural budget deficit is set to deteriorate'.[341] The future outlook did not auger well for the Hungarian sovereign, with the credit rating agency highlighting that 'Moody's may again downgrade the ratings if the government fails to stabilise its financial strength. The stabilisation of the government's financial strength may be complicated by increased risk aversion from investors, reflected in exchange-rate pressures or rising financing costs'.[342] The market reaction to the Moody's announcement was unambiguous, with the forint falling 1%, bond yields jumping by ten basis points and the Hungarian stock market falling nearly 1% on the news.[343]

The political reaction was no less emphatic. Fidesz released a statement on 14 December entitled 'Moody's Downgrade Does Not Matter', which highlighted comments by an analyst in a report in a German newspaper that credit rating agencies were becoming 'less credible' who 'always pull the emergency brake when the facts are obvious'.[344] At a press conference, Prime Minister Orban said that Hungary was not planning on responding to the Moody's downgrade by re-negotiating a deal with the IMF, noting it was 'always better to rely on the money market instead of international organisations'.[345] Despite their disagreement with the Moody's decision, the Hungarian sovereign appeared unable to disavow the credit rating agency of its assessments prior to the announcement. Moody's, as part of its disclosure obligations,

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[341] Idem.
[342] Idem.
[343] Stefan Wagstyl, 'Hungary Edging Towards Junk', *The Financial Times*, (6 December 2010). Accessed 22/12/10, http://blogs.ft.com/beyond-brics/2010/12/06/hungary-edging-towards-junk/ -axzz1fuMsNZaB
[344] Fidesz Party, 'Moody's Downgrade Does Not Matter', (14 December 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=1516606&menu=nyomtathato
[345] Fidesz Party, 'Hungry is on the right way', (16 December 2010), accessed 19/03/11, http://www.fidesz.hu/index.php?Cikk=156734&menu=nyomtathato

indicated that 'the rating has been disclosed to the rated entity or its designated agents and issued with no amendment resulting from that disclosure'.[346]

While the Prime Minister sought to downplay the significance of the Moody's downgrade, he was overseeing the finalisation of the 2011 Budget Act, which was subsequently passed by the Hungarian Parliament on 23 December 2010.[347] The Budget contained a number of previously announced measures, designed to bring the budget deficit down to 2.94% of GDP.[348] On the same day, Fitch Ratings downgraded Hungary's long term foreign currency Issuer Default Rating (IDR) one notch from BBB to BBB-. Fitch justified the decision in highly political terms, noting:

> *the new Fidesz government, which won a two-thirds majority in parliamentary elections in April 2010, has set out fiscal plans that go in the wrong direction for further fiscal consolidation. The reversal of pension reforms, populist tax measures that fall mainly on foreign banks and companies, changes to the independent fiscal council and government moves that appear to interfere with the independence of the central bank are concerning signals*.[349]

Again, a credit rating agency referred to judgements that are distinctly interpretative when justifying a ratings action. Fitch's reference to Fidesz's thumping Parliamentary majority was a deliberate attempt to highlight the absence of domestic political obstacles for the sorts of measures Fitch saw as optimal to restoring Hungary's creditworthiness.

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[346] Moody's, 'Moody's downgrades Hungary's government bond ratings to Baa3 from Baa1; outlook negative', (6 December 2010), accessed 22/12/10, http://www.moodys.com/research/Moodys-downgrades-Hungarys-government-bond-ratings-to-Baa3-from-Baa1--PR_210257
[347] 'Parliament Approves 2011 Budget', *Realdeal.hu*, (24 December 2010), accessed 17/01/11, http://www.realdeal.hu/20101224/parliament-approves-2011-budget/
[348] Idem.
[349] Fitch Ratings, 'Press Release' (23 December 2010), accessed 08/01/11, http://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=670145

In the period between June and December, Fitch had gone from viewing the Hungarian budget deficit targets as 'moderately encouraging',[350] to concluding that the Orban Government's fiscal plans 'go in the wrong direction'.[351] The description of tax measures as populist reveals the rating agency's concern that Fidesz was still too preoccupied by domestic political considerations to make the tough budgetary decisions it deemed necessary for fiscal consolidation. Such decisions again revolve around assessments of the rationale of policy makers and their willingness to pursue a particular policy setting. The timing of the Fitch announcements suggests the credit rating agency did not expect anything new to emerge as a result of the Parliamentary approval of the 2011 Budget Act. The markets responded in a predictable fashion, with the forint falling against the euro while the cost of insuring Hungary's sovereign debt against default rose.[352] *Wall Street Journal* journalists Clare Connaghan and Veronika Gulyas observed the market reaction was, 'a sign that investors are becoming increasingly concerned about Hungary's outlook'.[353]

The Hungarian sovereign limped into 2011 with its reputation amongst global investors badly damaged. The experience of Hungary's Fidesz Government between April and December 2010 attests to what Rosenau termed the 'intersubjective consensus' at play in the modern international system.[354] Indeed, in its first eight months, a newly elected government attempted to create knowledge about its own finances and its own financial outlook, only to be dismissed out of hand by

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[350] Fitch Ratings, 'Tight Fiscal Policy Need to Stabilise Hungary's Ratings', (9 June 2010).
[351] Fitch Ratings, 'Press Release' (23 December 2010), accessed 08/01/11, http://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=670145
[352] Clare Connaghan and Veronika Gulyas, 'Fitch Cuts Hungary's Debt Rating', *The Wall Street Journal,* (23 December 2010), accessed 17/01/11, http://online.wsj.com/article/SB10001424052748704278404576037321019041958.html?KEYWORDS=hungary
[353] Idem.
[354] On Rosenau's theory of intersubjective consensus, see Chapter One of this thesis.

international institutions like the IMF and EU, global investors, international financial media and, importantly, the credit rating agencies. Powerful enforcement mechanisms in the form of movements in currency markets, bond yields and equity prices affirmed the hierarchy of contemporary global governance. Fidesz's rapid attempts to correct the clumsy Greek comparison affirm the relational power of the global financial markets and those who shape their perceptions.

Amidst a surge of nationalistic sentiment, the Orban Government had clear aspirations for a more autarkic Hungary. Indeed, Hungary was by no means the first state actor to overtly shun international norms. However, Hungary's overwhelming susceptibility to shifts in sentiment amongst private capital market investors ensured that elected policy makers sought to at least partially accommodate the aspirations of key external stakeholders by demonstrating some willingness to address identified fiscal issues. The rapid recalibration of political attention towards fiscal matters following the local government elections in October 2010 directly mirrored the predictions made by Moody's three months earlier. The credit rating agencies have clearly become adept at interpreting electoral cycles and how they effect the behaviour of elected officials, even in relatively new democracies.

Assessments by the credit rating agencies on the willingness or political commitment of Hungarian politicians played a key role in creating the narrative that shaped perceptions within the global financial markets about the new Fidesz Government. Despite the myriad of opaque influences that shape decision making by domestic politicians, credit rating agencies overtly referenced the intent of elected decision makers as being integral to the rating outlook of the Hungarian sovereign.

Once conclusions about such matters were reached, elected officials were quickly defined by them in the eyes of the global financial markets. In effect, these determinations represent Comor's 'conceptual systems' that 'facilitate particular understandings and applications'.[355] Such systems also represent the structural power bestowed upon occupants at the top of Strange's knowledge structure.[356]

The ratings actions relating to the Hungarian sovereign during 2010 also reflected the classic carrot and stick approach that has become so familiar in the twenty-first century. In June and July, Fitch, Moody's and Standard and Poor's all issued warning cards, placing the Hungarian sovereign on review and publicly stating with great clarity their expectations on how policy makers should act. The strictures were hard to misinterpret and a clear signal to market participants about what policy settings were expected. Such messaging synchronised with the publicly acknowledged assessments of participants in the financial markets. This signalling increased the pressure on the Hungarian sovereign, which hardened its commitment to fiscal consolidation over the course of 2010. In their mid-year statements, the credit rating agencies clearly enunciated how the sovereign could avoid future rating downgrades, while ominously sounding warning bells. True to their word, all three major credit rating agencies withheld judgement until the October 2010 local government elections had been completed and when political considerations were expected to ebb away amongst Hungarian decision makers. By December, their patience had run out, and overt enforcement mechanisms were deployed in the form of rating downgrades and the resulting market reactions.

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[355] Comor, 'Governance and the Nation State in a Knowledge-Based Economy', p. 118.
[356] Strange, *States and Markets*, p. 24 & p. 117.

The Hungarian experience from 2010 provides scholars with a powerful demonstration of the calibration of the contemporary knowledge hierarchy and the subordinated role of state actors within the modern international system. The inherently international nature of that system necessitates conceptual systems that provide unambiguous, globally recognised standards against which actors can be assessed. Even when states seek to directly shape perceptions about their own financial position, they are trumped by the intersubjective consensus at play amongst recognised knowledge generators. While many actors play a role in generating this consensus, including market participants and observers, the global financial media and international institutions like the IMF, it is the credit rating agencies that explicitly communicate expectations to states and leverage their ability to influence a country's credit rating to influence behaviour. This communication is often very public, accentuating its impact on the broader market consensus.

While EU member states have a particularly strong susceptibility to the assessments of credit rating agencies, other large, ostensibly powerful state actors contort their decision making processes to pacify the credit rating agencies. The prominence of assessments about a sovereign's intentions attests to the importance of subjective judgements about policy makers by the credit rating agencies. How these organisations make such judgements remains opaque, to the detriment of a greater understanding of contemporary global governance. State actors, once dominant players in the international system, now find themselves confined to tightened straightjackets, with little room for error. The costs associated with erring from globally accepted norms are significant and administered swiftly by the global financial markets. Not only do state actors need to adhere to an entrenched and

powerful set of norms, they must seek to demonstrate their intent to continue to do so into the future. In reality, sovereign decision makers have remarkably little room to manoeuvre in the modern international system, significantly impacting human affairs on a global scale.

Conclusion: Understanding the Current

The nature, scale and complexity of the modern international system has outgrown the state-based order and replaced it with something less tangible, but more dynamic and more impactful. Human affairs are no longer regulated on a worldwide basis exclusively by state actors and their associated organisations. Rather, credit rating agencies play a pivotal role in determining global governance in the twenty-first century. While their role is gaining increasing recognition amongst IPE scholars, a greater understanding of how credit rating agencies acquire and exercise authority will reward observers of the modern international system with an enhanced comprehension of how that system operates.

The credit rating agencies' ability to craft a pervasive cognitive centralisation amongst a broad range of actors in the international system has been carefully cultivated over decades of rating activity. This cognitive centralisation is reinforced by swift, efficacious enforcement mechanisms driven by the global financial markets, whose role has become elevated in tandem with the extraordinary growth in the usage of credit and knowledge in the modern international system. A powerful current shapes contemporary global governance. State and not-state actors alike can rise or fall on the assessments made by the credit rating agencies and the associated response from the global financial markets. How these assessments are made and communicated lies at the very heart of contemporary global governance. Yet such assessments are, as described by Sinclair, 'manifestly political' and inherently subjective.[357]

[357] Sinclair, The New Masters of Capital, p. 62.

The case studies explored in this thesis demonstrate that relatively indefinable factors such as political commitment and willingness were central to the assessments made by credit rating agencies about the creditworthiness of two European state actors. Often, these conclusions were reached by the credit rating agencies in direct contradiction to the views held by key decision makers from the rated sovereigns, the very people whose political commitment or willingness was being assessed. To make such distinctions, the credit rating agencies must be in a position to distil messaging from decision makers and make judgements in the context of political, economic and international considerations. Standard and Poor’s criteria for sovereign credit risk assessments highlight that overarching factors like stability and predictability are primary considerations used when assigning a political score to a rated state actor. In the absence of such attributes, the judgements made by credit rating agencies relating to state actors are particularly influential in crafting the views and ultimately the decisions of financial market participants.

A unique confluence of events has assisted the credit rating agencies assume their authoritative role in the contemporary global order. The growth in the importance of credit in the contemporary global system, the associated increase in the scale of the global financial system, the interconnectedness of that system across state borders, disintermediation, longer intermediation chains and the indubitable demand for globally recognised knowledge related to creditworthiness, have combined to empower credit rating agencies and neuter the ability of other actors to shape human affairs. Amidst extraordinary growth in the volume and availability of information, credit rating agencies have exploited a first mover advantage and have been able to

provide globally recognised and consistent knowledge structures that deliver much needed parameters around which investors can make decisions.

This unique capability is backed by a myriad of enforcement mechanisms, including market reactions that synchronise with announcements by credit rating agencies. Of particular relevance are the examples outlined in this thesis of the supremacy of determinations by credit rating agencies over announcements of states and corporations. As seen with frequency in the modern international system, participants in the financial markets ultimately prioritised the assessments made by credit rating agencies, even when those assessments directly contradicted announcements and messaging being generated by the rated entity. In the Hungarian case study, the market reaction to comments deemed outside the acceptable paradigm saw sovereign decision makers scramble to correct their mistake, providing a powerful example of the relational power capabilities of the intersubjective consensus that Rosenau has argued so assiduously pervades contemporary global governance.

The historic importance of state actors in global governance makes their relationship with credit rating agencies a highly relevant intersection of the competing interests that craft the modern international system. This intersection sheds light on how credit rating agencies develop knowledge relating to state actors and use that knowledge to directly and indirectly influence their behaviour. It also reveals the subordinated role of state actors in the knowledge generation process. In an era when gyrations on the global financial markets can trigger massive political and policy changes in developed and developing states with extraordinary speed, those who

shape the conceptual systems that anchor such decision making sit atop the knowledge hierarchy.

The composition of the modern knowledge hierarchy was on graphic display in Ireland during 2010. The Irish experience of 2010 provides scholars with a powerful example of the impotence of state actors once the intersubjective consensus shifts. Irish decision makers, through direct interaction with bond investors and the credit rating agencies, sought to shape perceptions about the creditworthiness of the Irish sovereign. After expressing confidence in that process in April of that year, Ireland was rocked by seven negative rating actions by the credit rating agencies between July and December 2010. Despite overt protestations by Irish decision makers, this example displayed the futility of attempting to swim against the current in the modern international system.

The Irish case study also demonstrates how quickly that consensus can shift and the leading role credit rating agencies play in shaping the consensus through cognitive centralisation. This overt display of structural power was reinforced by a similarly identifiable display of relational power, when the governing Fianna Fail Party implemented harsh budgetary measures as prescribed the credit rating agencies, even though the Government was at the end of the Irish electoral cycle and due to face imminent elections. The predictable election loss represented a palpable demonstration of the political consequences that can be associated with negative credit rating actions.

The Hungarian experience in the same year illustrates the synchronicity at play between observers and participants in the global financial system and the credit rating

agencies. Hungary represents a particularly relevant case study because of the sovereigns' sensitivity to market responses goes beyond that of many other European states. Hungary's reliance on private capital investment is accentuated by the fact that its bank lending is primarily denominated in foreign currency. This reliance was highly visible during that tumultuous year. The response from a range of global actors was unanimously negative when, in June 2010, decision makers from a new Fidesz Government significantly erred outside the acceptable norms when Hungary's debt crisis was compared to that of Greece. The failure of the talks between the Hungarian Government, the IMF and the EU was also atypical and interpreted as a damaging sign of inexperience, instability and a lack of political commitment to adhere to the preferred policy setting.

The modern intersubjective consensus offers very little room for error, particularly given the speed at which comments uttered in one state can quickly reverberate around the globe and impact the price movements of various financial instruments. The rapid response by Fidesz decision makers represented a demonstration of the sensitivity of many state actors to the powerful enforcement mechanisms at play in contemporary global governance. The chorus of criticism and the tangible negative response of global financial markets left this state actor with little choice but to fall into line and downplay any link with the Greek situation. In contemporary global governance, perceived sedition can be punished with extraordinary speed.

The Hungarian experience of 2010 also provides evidence of how critical domestic political considerations are when credit rating agencies assess the

willingness of state actors to implement explicitly prescribed policy settings. In July 2010, credit rating agencies clearly communicated their anticipation that the Orban Government would be not focus on budgetary issues until the conclusion of local government elections, which were due in October. The accuracy of such predictions regarding the behaviour of state decision makers attests to the focus credit rating agencies place on these assessments as part of their remit to determine the creditworthiness of state actors.

To accommodate their predictions on such matters, the credit rating agencies are continuing to broaden their offering beyond rating actions to incorporate opportunities for predictive analysis such as credit watches and outlooks. Such offerings help shape the perceptions of many global financial market participants relating to more amorphous qualities of a sovereign's creditworthiness such as the current and future willingness of key decision makers to implement particular policy measures. Indeed, a cognitive centralisation is being applied about the intentions of sovereign decision makers, not just the decisions they make. This development has profound consequences for contemporary global governance. State actors seeking to pacify knowledge generators must seek to demonstrate a preparedness to pursue certain courses of action in the future, not just demonstrate an ability to deliver the prescribed policy settings in the present.

For credit rating agencies, speculation on such matters helps generate additional demand for the knowledge they provide. By broadening their offering well beyond simple rating scores, credit rating agencies have strengthened their place atop the knowledge hierarchy and deepened the current that shapes contemporary global

governance. These assessments are subjective, inherently political and ultimately represent judgement calls by organisations who have observed thousands of sovereign decision makers around the globe. These assessments also lend themselves to judgements on personalities and character traits. The perception that the Orban Government was dominated by bombastic, nationalist and aggressive decision makers clearly shaped how developments such as the breakdown in talks with the IMF and EU were interpreted by the credit rating agencies and the global financial markets.

The case studies explored in this thesis demonstrate that the decisions reached by credit agencies about intentions can often contravene the messages communicated by the decision makers whose intentions are being assessed. Such conflicting perspectives at the intersection between state actors and credit rating agencies could create opacity, if not for the clarity of the modern knowledge hierarchy. Assessments around intentions and willingness are a far cry from assessments relating to economic or budgetary data. For many participants in the global financial markets, a sovereigns' intentions are best assessed by a credit rating agency, rather than the sovereign itself.

The modern international system lends itself to authority being transferred to those global actors who can claim an ability to apply consistent benchmarks around the multifarious factors that shape creditworthiness. State actors lack the perceived objectivity to be taken as seriously as those who rate state actors on a global scale. This standing weakens the ability of sovereign decision makers to shape external perceptions around their intentions and actions. Despite the 2008 global financial crisis and the subsequent development of Basel III, the knowledge hierarchy sits intact within an immovable intersubjective consensus.

The current that shapes contemporary global governance remains too strong, too deep and too broad for state actors to resist. Any efforts to swim their own course will be unsuccessful. Backed by powerful enforcement mechanisms that deliver unprecedented rapid responses on a global scale, the cognitive centralisation at play in the modern international system continues to adapt to changing economic and political times. The judgements made by credit rating agencies craft cotemporary global governance, placing enormous importance to their assessment processes. This thesis has sought to shed light on these processes to enhance our understanding of how human affairs are regulated in the twenty-first century.

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