LOW GEOPOLITICS: CREDIT-RATING AGENCIES, THE PRIVATIZATION OF AUTHORITY AND THE NEW SOVEREIGNTY

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Critical geopolitics can be faulted for an excessive focus on the "high" geopolitics of foreign-policy making and for slighting so-called low geopolitics, both the reproduction of geopolitical images and practices in everyday life and the roles of non-state actors in the making of world politics. The recent global economic meltdown serves as a salutary reminder of the ways in which the world has become hostage to the activities of a range of agents – from bankers and mortgage brokers to transactional lawyers and credit raters – whose activities have rarely figured in discussions about global geopolitics. One of the most controversial aspects of the recent global financial meltdown has been the role of the Big Three credit-rating agencies (Moody's Investors' Services, Standard and Poor's, and Fitch Ratings) in both rating bank credit portfolios and government (sovereign) debt and the bonds servicing that debt. These private organizations are an important aspect of the privatization of authority in the world economy since the 1990s. This paper asks: How did this happen (particularly in relation to sovereign debt), how do these organizations work, and what are the implications for contemporary understandings of state sovereignty and of geopolitics?

Two brief vignettes help to orient the paper to its subject matter: (1) In August 2011 S&P downgraded US long-term debt; the first time this had ever happened. This was a controversial decision, not least because France, for example, in the midst of the Eurozone crisis, was not downgraded until much later, but the downgrade hasn't had much effect. The US economy as a "safe haven" and home of the US$, has other assets beyond its bond ratings. This suggests the limited impact of bond ratings, at least as far as the US is concerned. (2) Elsewhere, however, the story is different. Since the mid-1970s when the whole business of sovereign debt credit rating took off, ratings have been a good indicator of sovereign-default risk. All countries that have defaulted on their bonds since then have had their grade cut to "junk" (highly speculative grade) at least a year before it happened.

Why have ratings agencies become so important in relation to sovereign debt? Briefly, this reflects the demand for private regulation as a result of the massive financial liberalization of the world economy that has occurred since the 1970s. States have had to concur with judgments made by these organizations because they possess information about corporations, banks, and countries that no one else does as stock, money, and bond markets have effectively internationalized with the end of the Bretton Woods era. Thus, in raising funds through bonds governments have become as dependent on rating-agencies as have private businesses. Indeed, the agencies' geographic scope has increased with that of the number of states requiring ratings in order to raise funds to pay for infrastructure and other projects. Banks used to serve this function but increasingly rather than bank loans it is bonds and tradeable securities (mortgage-backed securities, loans, derivatives, etc.) that circulate in capital markets without bank intermediation. Informational leverage, therefore, is the way in which credit-rating agencies have come to exercise authority not simply coercive power within the world economy and over state sovereign debt.

THE RISE OF CREDIT-RATING AGENCIES IN RATING SOVEREIGN DEBT

Rating agencies have grown from beginnings as "market surveillance mechanisms" in the mid-1850s largely in the United States. This is an aspect of the prototype world economy within the borders of the United States that later became the template for the hegemony associated with American "marketplace society" in the world at large (Agnew 2005). In the United States the role of the agencies reflected the lack of a single clustering of banks and businesses around a single center such as characterized most European economies at the time. Information was so diffuse spatially that agencies were needed to collect it and provide it to potential investors. Henry Poor and John Moody were pioneers.

In the 1920s foreign governments sought ratings by the US-based (and other) agencies for their bonds but defaults in the 1930s led to retreat of the agencies into rating the stocks and bonds of municipal and large industrial firms. From the 1930s until the 1960s only a few creditworthy countries had rating coverage. Fees derived from issuers were widely introduced only in the 1960s. Of course, this brings about a conflict of interest when the rating agencies are paid by those whose bonds/stocks they are rating. It is only since the 1970s that the major rating agencies have internationalized on a massive scale with offices now scattered around all of the world's major financial centers and tax havens. This is has reinforced the role of the Big Three (although S&P and Moody's are really the most important globally). Fitch has its most profitable niches in the municipal bond market and in rating banks.

The two US agencies are headquartered in Manhattan with a major overseas presence. Fitch is French owned with about forty offices worldwide. There are over 100 other credit-rating agencies but most have primarily domestic markets. None has the "global reputation" to offer sovereign debt ratings of the Big Three. Moody's and S&P are both parts of larger corporations (Moody's of Moody's Corporation, S&P of McGraw Hill). Those rated by them can thus also own shares in them.

Arguably, the authority that the Big Three wield over debt markets results from their designation as "nationally recognized" ratings firms (licensed in the US by the SEC since 1975). This gives them quasi-regulatory status when their judgments are seen as elements of the rules governing banks, insurers, funds, and state bond issuers. Since the 1990s ratings have been used in setting capital standards for banks and in central bank collateral eligibility rules. Ratings are also embedded in private contracts for derivatives and pension fund investments. They have become "hard-wired" into the global financial system. In this context, questions have arisen about rating quality in the absence of much competition between agencies, conflicts of interests, and "cliff effects" as sudden rating shifts cause massive disinvestments. The consistency of criteria for judging bonds across the agencies is also problematic. S&P has been far more likely to downgrade sovereign debt than the others (Figure 1). Yet even as it downgraded US federal debt in August

2011, S&P announced that some states and local governments could preserve their top-notch ratings if they showed how they might cope with reduced federal benefits!

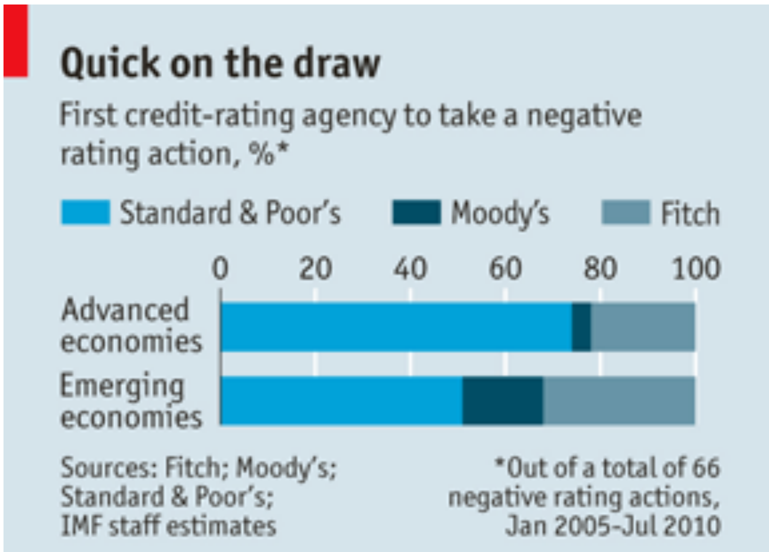

Figure 1: First of the Big Three Credit-Rating Agencies to Take a Negative Rating Action on Sovereign Debt, January 2005-July 2010

HOW ARE RATINGS DONE?

Ratings can be initiated by issuers or by the agencies themselves. This is irrespective of the financial product involved: bonds, stocks, or sovereign debt. Analytical teams undertake research, meet with issuers, and write reports proposing ratings and their rationales. What then happens is shrouded in much mystery. Moody's is infamous as the most conservative agency and until the 1990s did not publish rating criteria. A recent cartoon in the Financial Times shows two men leaving a building named "MOODY'S" with one saying to the other: "I had a bad dream about the UK's credit rating." The other agencies have been more forthcoming about the criteria they use to rate and rank different countries bonds and the relative danger of default in different cases. Typically, financial ratios of revenues/expenditures or debt-burden versus debt-bearing capacity are used to decide which "grades" to award. Rating committees, at S&P typically of eight people, make the final determinations. A major distinction is drawn by all agencies between "investment" and "speculative" grades of bonds, reflecting the language of US securities legislation from the 1930s. AAA for S&P and Aaa for Moody's are the highest investment grades. The move to speculative grades begins at BB+ for S&P and Ba1 for Moody's. For both agencies there are ten levels of investment grade and eleven of speculative grade. D is default for both of them (see Sinclair 2005, Chapter 2; for a full listing of sovereign credit ratings by country and Big Three rating agency see Guardian 2012).

In practice the letter symbol takes on a totemic quality. The clarity it offers also reflects the selection and suppression of various types of information that a more complex narrative or statistical indicator might better avoid. Monitoring of the bond and its context then becomes the next step in the agencies' task. Discipline operates through the possibility of appearing on a "Watchlist" (Moody's) or CreditWatch"(S&P) signaling a possible re-grade is in the works for a country's bond rating.

The opacity of the rating process has become a major political issue since the US bond downgrade of August 2011. The companies defend themselves by saying that the process remains secret to "maintain analytical independence" (Creswell et al. 2011). From available sources, it seems that three people were the most involved of all employees in the S&P decision to downgrade US federal bonds from AAA to AA+: David Beers, head of the company's entire sovereign ratings division, his deputy John Chambers, and Nikola Swann, an analyst responsible for the ratings of the US, Canada, and Bermuda. All have spent most of their careers at S&P rating countries around the world. Rumor has it that "being first" in a re-rating has been important to Mr. Beers. He declines to comment. S&P certainly is usually the quickest of the agencies in downgrading. The US Treasury noted that S&P made a $2 billion error in its draft report on the downgrading. Moody's and Fitch left well alone. In September 2011, the SEC reported that S&P's pending downgrade had been leaked and the information traded on before the official announcement (Wyatt 2011). But the SEC failed to do anything about this. This has been par for the course. Regulation of the credit rating agencies has been notoriously loose. All of them rated the sub-prime mortgage-backed securities that were the immediate cause of the 2008 great recession at the highest grade until the markets actually said otherwise. In the same report, the SEC failed to say anything very specific about any credit-rating agency in particular while criticizing them en masse for giving priority to their revenues over analysis, feeble controls over employee ownership of rated products, and conflicts of interest.

There is little then except some gossip from former analysts and defenses of the agencies by PR spokespersons to go on about how the agencies actually work. The possibility of a "fly-on-the-wall" sort of ethnography within the corridors and officers of the Big Three is beyond the realm of possibility. Trading in information is their business. They don't share it with outsiders. What we await is the sort of personal/institutional biography of Stephen Axilrod (2009) describing his years working at the Fed. Until then, there's not much to go on.

In part because of the opaqueness of the process, the entire rating process is now under a cloud. Reliance on ratings for a wide range of financial products including sovereign bonds is now under attack. The agencies are fighting back by lobbying hard in Washington to keep their various roles (Eggen 2011). The Dodd-Frank Act has made it illegal for US regulators to use ratings for regulatory purposes. The problem is that the simplicity of the ratings for potential investors makes them hard to replace. Having more raters is one alternative, particularly ones less tied into the Washington-Wall Street axis. The other side of the problem is that sovereign bond ratings have come to be treated as an "emblem of national virility" (Stephens 2012). This is what happened to President Sarkozy in 2012 when he said that a downgrade of France's AAA rating by S&P would kill his presidency. Belief in the magical powers of the ratings has become part of their power … and a major problem.

PRIVATE AUTHORITY AND STATE SOVEREIGNTY

Arguably, the Big Three credit-rating agencies represent the emergence of transnational actors whose practices have fundamental effects on the well being of people within the borders of self-defined sovereign states. They exercise “fields” of power, and I would claim, authority, acceptance of their decisions as at least quasi-legitimate in the eyes of investors, political elites, and segments of mass publics, that can be seen as displacing the authority of public agencies with democratic or governmental accountability. The “game” of sovereignty has changed and thus has the “practical” basis on which it rests (Bigo 2011). From this viewpoint, it is not that globalization or some other supranational process is eroding state sovereignty but states have outsourced authority to a variety of other agencies including private as well as supranational and global interstate ones. This is what Sakellaropoulos (2007) has interestingly termed the “rise of the headquarters state.” Many existing state functions are delegated and potential new ones accrue to novel private and public but not single-state centered ones.

Credit-rating agencies are one among a range of new transnational actors exercising such authority today. They may not be “The New Global Rulers” that Büthe and Mattli (2011) write of. That study focuses on standard setting organizations in high tech product standards and accounting rules such as the International Accounting Standards Board (IASB) and the International Electrotechnical Commission (IEC). Some transnational organizations, however, can sometimes lay claim to emerging democratic bona fides particularly in the areas of human rights and law (Erman and Uhlin 2010). Most, however, conform to one of four “types” of regulatory organizations that are technocratic or expert and representative of industry groups rather than based on transparent democratic rule making in the interest of people(s). First are public rule making but non-market agencies such as the Universal Postal Union, the Kyoto Protocol, the IMF, and the Basel Committee on Banking Supervision. The second group covers public but market-based organizations such as the US Federal Trade Commission and the EU Directorate General Competition. Third are private non-market bodies such as those establishing accounting and electronic product rules mentioned previously,. Fourth, and finally, are private market-based entities such as the Forest Stewardship Council and Microsoft (an international standard setter with the Windows computer operating system). The credit-rating agencies fit best into the private market based category of transnational organizations. They are privately owned and claim to base their judgments on market criteria rather than technical standards as such. But they are arguably much more influential in relation to conventional notions of state sovereignty than all of the other so-called new global rulers put together.

Crucial to the entire question of private authority and its relation to state sovereignty is what we understand authority to mean. As Katsikas (2010, 116) has usefully pointed out, we need to distinguish between "non-state governance schemes that generate formal legal results and those that do not, since the former are clearly associated with institutional, political, and symbolic transformations that the latter do not necessarily invoke." In this regard, credit-rating agencies of the scope of the Big Three have exactly the sort of legitimate power to be "in authority" rather being "authorities" in the sense of simply having knowledge, private power, or influence. This distinction suggests that we can no longer (if we ever *should have* is a different question) pretend empirically that states monopolize sovereign authority without engaging and enrolling other private and public actors of various types and vintages (Agnew 2009).

Even while licensed to operate without any consciousness of the effects they could have on the sovereignty of states, it seems to me that the Big Three, if not other credit-rating agencies, currently have an authority remarkably akin to what we conventionally label as sovereignty or sovereign power. Of course, whether we should want this to be the case is one of the big political questions of the moment.

GEOPOLITICAL CONSEQUENCES

In what ways does a focus on and analysis of the Big Three credit-rating agencies lead to a reconstituting of understandings of contemporary global geopolitics? For one thing, it leads to seeing the contemporary world as not one of *states as single unified actors*. While that image was always problematic it is now utterly misleading. Increasingly, in the same epoch in which the Big Three have come to exercise such authority as they do, central banks, for example, have become independent of their respective governments. Regulation of money and finance has become increasingly driven by private and quasi-private actors rather than by states per se. Governance has been reconstructed to meet the needs of increasingly globalized private actors such as banks and industrial corporations rather the needs of the territorialized populations of states. State bonds underwrite this system and socialize risk onto domestic populations in return for back stopping the speculative activities of private banks, hedge funds, and other investors. "Technocrat-guardians," as Roberts (2010) terms them, in the central banks and credit rating agencies, shielded from democratic influences thereby guard the marketplace and defend its stakeholders from fiscal and monetary policies of a socially redistributive or nationally oriented quality. Governance as the exercise of technocratic control has in fact become the modus operandi not just globally but at all spatial levels including the national, the regional, and the municipal (Marazzi, 2011, 121). Beyond all of them loom the differentials of bond revenues determined in the international financial markets and evaluated by the credit-rating agencies.

Second, *the meanings of such key terms in political and geopolitical discourse as private versus public and markets versus states have undergone revision*. No longer can the political be seen as uniquely deriving from states or from societies defined in national-state forms. Rather, the spatial boundaries governing states themselves are no longer the national ones. They are profoundly the boundaries defined by the investment and regulatory activities of private/public businesses, pension funds, banks, international law firms, standard setting, and credit-rating agencies. Even as the economic crisis of 2008 could be seen as calling the roles of all of these into question, they have, if anything, emerged from the crisis more strongly entrenched than they entered it. Too much money was spent bailing out those "too big to fail" for the influence of the giant banks and industrial corporations that are the prime movers behind this heavily financialized system to suddenly dissipate (Crouch 2011). Indeed, their interests are increasingly the ones at stake as governments compete with one another to acquire their largesse. The inability to demarcate where the public ends and the private begins is exactly what produces the inability to address how to move beyond the Scylla of undemocratic transnational regulation and the Charybdis of increasingly globalized investment and monetary flows and their legal empowerment.

Third, and finally, in this context *the expropriation of land that has lain at the heart of conventional geopolitical thought is thrown into doubt as a transcendental signifier.* If classically, sovereignty was intimately associated first with the body of the monarch and then with a people occupying a territory, the Manichean them-versus-us logic which this entails no longer makes sense when the very basis to sovereign decision lies in the interstices between states in the capacities and identities of non-state actors rather than in states banging up against one another. This suggests, inter alia, that we have little to learn from excavating theorists such as Schmitt and Mackinder whose logic relies precisely on the expropriation of land/territory (e.g. Legg 2011; Kearns 2009). In a world in which authority is increasingly outsourced by states and in which states "instrumentalize" sovereignty to serve given ends but increasingly thus come under the dominion of transnational actors whose goals thus become theirs, sovereignty has not ended but has been transformed into a new "game" quite different from those old fashioned geopolitical thought insists on constantly reproducing as somehow "essential" to understanding how the world works (Adler-Nissen and Gammeltoft-Hansen 2008).

CONCLUSION

I have used the important role of credit-rating agencies, private transnational organizations with recognized authority, to make the case for a vitally different understanding of geopolitics in the contemporary world. This perspective on "low" geopolitics draws attention to the differences between the present and the past by being attentive to the vital roles of new non-state actors. Little is known about how credit-rating agencies operate. What is known is that they have been heavily involved in the ranking and management of the financial products that are at the center of the world's financial economy today. They represent a specifically privatized source of authority. Yet, they also illuminate several aspects of an emerging geopolitical order in which states can no longer be seriously regarded as single unified actors (the United States does this, etc.), key concepts such as market and state, private and public have taken on distinctively novel meanings, and the expropriation of land no longer lies at the center of geopolitical relations but is being replaced by control over financial products and flows. As the world changes so should our attempts to account for its geopolitics.

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