Sovereignty and Solvency: Just a material constraint?

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Abstract

The politics of financial markets culminates in the assessment of the creditworthiness of sovereign states—with striking societal implications. This paper examines the structural power exerted through the practice of sovereign ratings in the discursive construction of the solvency of states. I argue that sovereign ratings, understood as an intersubjective practice of power, shape shared understandings, norms and beliefs about the constitutive parts of a state's creditworthiness. Indirectly prescribing the rules of the game, the practice incorporates the potential to shape the economic policy agenda and to ascribe to states which role to play in the economy.

Driven by the problematization of public finances and debt, sovereign rating events could stylize restrictive fiscal policies as an inevitable therapy to overcome the crisis, construct public budget consolidation as an unquestioned overarching aim, and decouple the consequences of the financial crisis from its actual origins—allowing for a redefinition of the financial crisis into a crisis of sovereign debt.

Keywords: sovereign ratings, structural power, public debt, politics of creditworthiness, redefinition of crisis

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1 Introduction

The understanding of markets as a social and political product motivates my inquiry into the implications of a purely economic phenomenon at first sight—judging the creditworthiness of a sovereign state through oligopolistic, transnational non-state actors—the so-called credit rating agencies (CRAs).[1] The argument of this paper is based on the notion that the practice of sovereign ratings plays a codifying role in the process of the market's political opinion formation (Abdelal & Blyth 2013).

What explains the tacit consensus in terms of the subordination to the practice of sovereign ratings at the cost of the democratic deliberative process? If the impossibility of market efficiency, i.e. the perennial existence of information asymmetries, constitutes the raison d'être of the CRAs, how to legitimize the "power" of CRAs to dislike certain economic or political conditions, and to induce markets to punish states accordingly with higher interest rates? Since likewise 'rating failure' suggests hat CRAs are not necessarily the corrective of these inefficiencies, how can the belief in market efficiency, rationality and objectivity persist to provide the normative legitimization for the disciplining function of the market, and implicitly for the sovereign rating practice?

According to a comparative study of the market's 'taste' in the aftermath of the financial crisis of 2008/09 (Armingeon 2012), markets honor political stability, lean government, a dismantling of big government and right governments when determining a country's risk premium—giving obviously away the highly political dimension of the 'disciplinary function of the market.' If the sovereign rating practice shapes the market perception of the creditworthiness of states, then CRAs indirectly steer the direction of the market disciplinary function—thereby playing a crucial, advocating role in the politics of finance.

This paper applies the concept of structural power in the understanding of Strange (1998) to the practice of sovereign ratings.[2] Strange's concept of structural power serves as a theoretical tool for explaining both the origins and the effects of the role of sovereign ratings in the discursive construction of the solvency of states. The underlying idea is that the sovereign rating practice shapes shared understandings, norms, beliefs in terms of the constitutive parts of sovereign creditworthiness. Influencing market perception

[1] This abbreviation refers to the three largest credit rating agencies (also known as the 'Big Three'); namely Fitch Ratings, Moody's Corporation and Standard and Poor's Ratings Services, which hold approximately 95 per cent of market shares (Rügemer 2012).

[2] This article is closely related to a larger research project: Mennillo (forthcoming), "Sovereign ratings and the solvency of states: a case of structural power."

through its codification, allows not only to influence credit spreads materially, but also to set the terms of the fiscal and economic policy agenda ideationally, and thus to ascribe to the state which role it is supposed to play in the economy.[3]

Thus, this article argues that the consequences of sovereign rating deterioration creates the material pressure to pursue austerity policies on the one hand, and delivers the ideational basis on which austerity is legitimated; worse ratings can have a direct impact on the refinancing costs of a country and on banks using the concerned bonds as collaterals.[4] This material pressure translates into a political reaction which is driven by the normative predispositions of the sovereign rating itself. Moreover, as the perception of investors tends to reproduce the "reality" the sovereign rating is supposed to describe, such kind of structural power invalidates independent performance assessment of CRAs.

This argument draws on the seminal works of Timothy Sinclair (Sinclair 1994, 2000, 2001, 2005) who suggests that CRAs influence the way how credit risks are defined and perceived. Other scholars who work in this tradition are e.g. Kerwer (2001, 2005), Strulik (2000) and Willke (2001, p. 165). The latter explicitly categorizes the CRAs as part of the knowledge structure in the vein of Strange (1998). Similarly, Kerwer (2005, p. 8) assigns a "monopoly of expertise" to the CRAs through which influence on actors can be exerted (Rosenbaum 2008, p. 38). In this logic, CRAs are constitutive actors in the discourse of creditworthiness as they provide the "common language of risk." Thus CRAs' opinions can have a crucial impact on the alignment of politics as governments tend to orient themselves towards the measurement criteria in order to get a high rating. Such an understanding goes beyond the functionalist logic of ratings as information-cost-reducing devices, and rather stresses their normative dimension (Lehmkuhl 2011, p. 12).

The article is structured as follows: I briefly introduce the concept of structural power in the understanding of Strange (1998). Secondly, the consequentiality of sovereign rating events is highlighted. In a third step, the core difficulty of the sovereign rating practice, namely the 'mission impossi-

[3]This argument can be developed further: CRAs seem to embark more and more on political occurrences which go beyond fiscal policy, suggesting an intensified "politics of sovereign ratings" in other policy areas too. Empirical evidence for the hyperactivity of CRAs in the sovereign rating business can be found in Gaillard (2014). The overall net effect of this higher visibility of CRAs in terms of their epistemic authority and reputation may be ambiguous.

[4]This 'going hand-in-hand' of coercive material force and normative implications concerning the political sphere is even fortified by an incorporation of ratings into financial regulatory regimes. An analysis into the rationales and legitimacy of the regulatory use of ratings is undertaken in Mennillo & Roy (2014).

ble' of *measuring* sovereign creditworthiness, is discussed. Subsequently, the possible impact of sovereign ratings in the redefinition of the financial crisis to a crisis of sovereign debt is examined, drawing on the concept of 'narrative fallacy.' An illustrative example of a sovereign rating event precedes brief concluding remarks.

2 Structural power: Who chooses the game?

Strange (1998, pp. 24-25) defines structural power as "the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate." Strange (1998, p. 18) assumes that "social, political and economic arrangements affecting the global systems of production, exchange and distribution, and the mix of values reflected therein" are not exogenously given, but are "the result of human decisions taken in the context of man-made institutions and sets of self-set rules and customs."

Structural power confers the authority to the relevant players in the global political economy to decide how things shall be done. The concept tries to address questions such as: What are the constitutive rules of the political economy? Who sets these rules which trigger biases and determine the "competent players and their effective moves" (Guzzini 2010, p. 9)? Who chooses the game? The possessor of structural power can change the range of choices by, for instance, imposing costs. This often occurs without pressurizing others directly to make a specific decision rather than another. Structural power is less visible and more subtle than relational power in a narrow understanding.[5]

Applied to the case of CRAs, this quality of structural power is also mentioned in Sinclair (1999, p. 165):

> [A]n important feature of [...] bond-rating agencies is their epistemic authority and closely related structural power, rather than direct 'power wielding.' The reason for this is that authority and structural power are built upon a certain base of consent. This is a more robust structure upon which the social forces associated with coordination can generate legitimacy for their view

[5] In the Weberian/Dahlian sense of 'A has power over B to the extent that A induces B to do something that (s)he would not otherwise do.' Due to the limited scope of this paper, I abstain from recapitulating the far-reaching power debates in International Relations (IR) and International Political Economy (IPE). A concise account is provided by Baldwin (2002).

> of the world, for their approach to problems and their distribution of payoffs to allied social interests. Epistemic authority and structural power are, however, much harder to specify than the variables international political economist are used to. Not only is authority seemingly more intangible, it is also constantly being both constructed and worn away.

Guzzini (2010) argues that "different 'structural power' approaches have demonstrated the need to conceive of more encompassing power concepts so as to capture important, but otherwise neglected facets of international rule."[6] In other words, structural power analysis aims at filling a gap in the social sciences, which could emerge from a blind spot of 'conventional' power approaches. This is typical for "poststructuralist and constructivist approaches [which] focus on power as authority and legitimacy not through the establishment of an open social contract, but in the habitual working of discourses and practices which dis/empower agents" (Guzzini 2010, p. 5). Not for nothing, Guzzini selects explicitly credit ratings as an object of interest for "the analysis of how international standards, which are often established by private actors, are practices of rule once they become accepted convention and interact with the actors and issues they were supposedly only neutrally measuring" (Guzzini 2010, p. 9).

This is not to say that CRAs as non-state actors are powerful per se, or omniscient, when they rate states: If there was nobody who shares the same ideas about the (in)solvency of a sovereign state or about fiscal policy, the application of a structural power concept would not make much sense. Guzzini (2010, p. 15) argues that a shared idea about what counts in world affairs "will strongly influence the status [...] of particular actors." In this perspective, it is not *primarily* the material influence to move markets or the coercive force of finance which empower actors as the CRAs, but rather the shared ideas. If there is an intersubjective consensus about what "sound" fiscal policy means, this consensus legitimates the CRAs' practice when they demand for certain measures, and not for others. At the same time, through the practice of sovereign ratings, exactly these measures are legitimized. Thus, one purpose of the structural power analysis is to look behind the curtain of the sovereign solvency discourse, which is publicly carried out on a hegemony of economic data categories (Prager 2012).

Since Strange's concept of structural power emanates from a non intentional conceptualization, motivations and interests of CRAs are factored out of the analysis. For the same reason, the practice itself is not to be regarded

[6]Other concepts of structural power are 'indirect institutional power,' and 'systematic bias' or 'impersonal power.' An insightful discussion is provided by Guzzini (2010).

as a direct instrument of power, but rather as an *intersubjective practice* of it. Guzzini (2010) suggests that unquestioned practices are the "most effective power relations." If the practice of sovereign ratings is assumed to be widely a practice of "tacit legitimacy," then structural power analysis aims at revealing the "origins of consent" (Guzzini 2010, p. 9). Such an approach suggests that power resources have no intrinsic value, but depend on the actual value systems of the interacting parties such as CRAs, investors, policymakers, media, and the public. This is in line with Sinclair (2005, p. 46) who classifies CRAs as "embedded knowledge networks," in the sense that "rating knowledge" is "very much a social phenomenon."

Strange's concept of structural power implies the diffusion of its origins, namely: the control over security; over production; over credit (finance); and over knowledge, beliefs and ideas. Such a notion of power is primarily defined in a functional, and not in a territorial sense, which implies that power manifests itself (or not) in the control over risks which go beyond immediate political risks, including currency or financial stability risks (Bieling 2010, p. 407). The four resources of structural power (security, production, credit, knowledge), also referred to as power structures, may indicate where social power relations are at play. Yet more important is that they suggest the cause for these power relations. Moreover, "through each structure power is exercised on particular relationships," and these "four separate distinguishable but related structures" interact with one another. These interactions result in a high diffusion of the effects of the power structures.

As *the* distinct characteristic of CRAs, structural power in the form of 'knowledge, beliefs and ideas' is exerted within the finance structure—a case of interweaving structural power sources.[7] This specific conjuncture of the two structural power sources allows, at least theoretically, to suggest a high degree of diffusion of the effects of such kind of power. It explains how CRAs are enabled to exert epistemic consequential power not solely in the *field* of the financial markets, but in the public discourse about sovereign creditworthiness, implicitly shaping common understandings, norms and beliefs about fiscal and economic policy.[8] At the same time, the finance structure provides the monetary leverage which helps the epistemic dimension to materialize;

[7]For reasons of simplicity, in this paper I abstain from analyzing the relationship between knowledge and finance and the two other power structures, security and production.

[8]An alternative classification of CRAs as a case of structural power is done by Prager (2012, p. 30). In particular, Prager applies Bourdieu's concept of symbolic power, which is exclusively based on acceptance and acknowledgment. It rests on the influence exerted on the *field*, i.e. on the financial market—both as tool for overcoming information asymmetries as *habitus*, and through the inclusion of ratings in regulatory regimes as objective constitution of the field.

enabling the perception inherent in the sovereign rating assessment to mold the reality it pretends to describe neutrally.

Structural power in the form of 'knowledge, beliefs and ideas' manifests itself in the control of the channels by which "knowledge respected and sought by others" is communicated (Strange 1998, p. 30). Since the business model of CRAs is based on the processing and making available of relevant market information, CRAs could be categorized as a transnational epistemic community (Haas 1992). Due to their oligopoly position in the finance structure, CRAs can control the channels of communication through which demanded information about sovereign creditworthiness is provided to investors.

The finance structure is the sum of all the arrangements regulating the provision of credit and currency relations. This type of power is exerted by those who are "able to control the supply and distribution of credit" (Strange 1998, p. 26). Not least because of the power to move markets, CRAs have been characterized as capital market's distinct "gatekeepers" (Partnoy 2006) or "global monitors" (Sinclair 2003). Furthermore, "[s]uch control of credit is important because through it, purchasing power can be acquired without either working for it or trading for it, but it is acquired in the last resort on the basis of reputation on the borrower's side and confidence on the lender's" (Strange 1998, p. 26).

Metaphorically speaking, reputation is the currency with which credit is obtained, and the more it depreciates, the more expensive it is to obtaining funding. If sovereign ratings do matter for the reputation of a sovereign borrower, then CRAs have a critical role in determining the budgetary scope for action. Taking influence on the credit risk perception, and thus on the interest rates for newly issued sovereign bonds, translates one-to-one as impacting the government budget. Tightening (and relaxing) the fiscal room to maneuver, implies that sovereign ratings affect fiscal sovereignty.

3 The consequentiality of sovereign ratings

Before analyzing more in detail the consequences of sovereign rating events on the refinancing ability of a sovereign debtor, for the sake of completeness, further effects of sovereign ratings shall be mentioned only briefly. These are, directly or indirectly, related to the "interdependence between banks and sovereigns," and the pervasiveness of sovereign debt in the financial system (Bank for International Settlements 2011). If sovereign ratings deteriorate, implying higher sovereign risk, "adverse effects on banks and financial markets" worsening the refinancing situation of banks are to be expected (Bank for International Settlements 2011). This is usually referred to as the

'sovereign-bank nexus.' A sovereign rating downgrade has a negative effect on the collateral value of a bond, which in the worst case can trigger runs on the repo markets (Gabor & Ban 2014).[9] Sovereign downgrades also translate into "lower ratings for domestic banks, increasing [likewise] their wholesale funding costs, and potentially impairing their market access" (Bank for International Settlements 2011).[10]

Considering the fact that sovereign ratings serve also as 'sovereign ceilings' for corporate bond ratings of a concerned country (Borensztein et al. 2007), a further downward spiral is initiated.[11] Moreover, there is evidence for a positive correlation between sovereign ratings and stock market indexes (Brooks et al. 2004). In the worst case, credit provision to the real economy and to the state itself is curtailed, which makes the vicious circle even deeper.

When rating downgrades lead to a higher risk premium on newly issued bonds increasing the refunding costs for a sovereign (Bank for International Settlements 2011), as experienced in the euro area, the increased distrust can lead indirectly to a higher probability of default.[12] Ex ante unjustified ratings can therefore be justified ex post, and can be a tool for improving the CRAs' credibility and 'performance.' The perception of investors tends to reproduce the 'reality' the sovereign rating is supposed to describe. In the moment investors act according to the lower sovereign rating, or to the announcement which indicates an outlook change, by demanding higher interest rates (for whatever reason, e.g. regulatory requirements or voluntary investment standards), they unconsciously reproduce exactly the scenario the CRAs predicted; an increase in the probability of default. Whether the influence on investors is intended or not by the 'prophet' is irrelevant for the self-fulfilling prophecy. The self-fulfilling prophecy becomes a tool to confirm and legitimize the epistemic power of CRAs. At the same time, the epistemic power allows the self-fulfilling prophecy to work.[13] Not only do these mechanisms enforce the epistemic authority of CRAs regarding sovereign

[9] Although the existence of the sovereign-bank nexus is hardly deniable, "empirical literature does not provide indications on the *size* of the impact of sovereign risk on the cost of bank funding" (Bank for International Settlements 2011, p. 12, emphasis added).

[10] For a further discussion of transmission channels between sovereign ratings and banking funding, see Bank for International Settlements (2011, pp. 13-29).

[11] In an academic panel discussion (2012), a high ranked CRAs' representative confirmed that especially in the case of "unsolicited sovereign ratings," one rationale for producing sovereign ratings is their use as input for other rating types and for customer service reasons.

[12] For example, Kiff et al. (2012) detect an effect of the CRAs' opinions on the cost of sovereign issuers' funding.

[13] Self-fulfilling prophecies can also be categorized as reflexivity on the macro level (Guzzini 2010).

creditworthiness, they also have "self-generative effects" on CRAs per se; "ratings function as self-validating feedback loops" (Paudyn 2013, p. 14). Self-fulfilling prophecy reduces independent "performance" measurement of ratings ad absurdum, and, ironically helps to build up the CRAs' reputation.

Although CRAs cannot be regarded as executive epistemic authority by definition, they produce "consequential speech" (Sinclair 2005, p. 63)—a usual characteristic of such type of authority. In the broadest sense, this refers to the co-constitution between meaning and materiality, or to the interaction between the social construction of knowledge and the construction of social realities.[14] Applied to the CRAs, the reflexivity between knowledge and social reality constitutes the understanding of a sound fiscal policy on the basis of commonly shared ideas. Consequently, the increased presence of CRAs in the public discourse authorizes decision-makers in their self-understanding to pursue exactly the type of fiscal policy which is authorized through the common understanding. Lincoln (1995), cited in (Sinclair 2005, p. 64), "argues that the consequentiality of authoritative speech actually has little to do with the form or content of what is said. [...] 'Authority is not persuasion. [...] The exercise of authority need not involve argumentation and may rest on the naked assertion that the identity of the speaker warrants acceptance of the speech'."

In a similar vein, Paudyn (2013, p. 12) categorizes sovereign ratings as 'discursive practices' with performative effects. Paudyn (2013, p. 27) endogenizes the performativity as a product of the methodology underlying the ratings. Paudyn (2013, p. 27) claims that the recognition of the "the authoritative capacity of ratings" presupposes an understanding of "how their construction facilitates their performativity." Such discursive practices "help constitute a social facticity which may otherwise not exist." From this perspective, intersubjective meaning is reproduced in the discourse, and not firmly anchored in language. For example, that what is intersubjectively meant by "a fact," can potentially change through the discourse, as discourses are not static, but dynamic. If meaning making is subject to the dynamics of discourses, then also, the things we know about events is discursively constructed. In this logic, there are always more versions about these events–"narratives". Which version prevails, is a question of power (Diez

[14]For example, if the deregulation of financial markets is classified as a constructed social reality, the reflexive relationship with the social construction of knowledge becomes visible by means of the assumption often made in financial economics that financial markets are efficient. This assumption may lead to the normative policy implication that financial deregulation is desirable. In the moment policymakers act according to this 'knowledge,' deregulation becomes a social reality. Concerning the performativity of economics in general, see Callon (2007).

2003, p. 474). CRAs can be regarded as messengers of certain versions of reality, which many actors in the discourse share.

4 *Measuring* sovereign creditworthiness

4.1 The ontology of sovereign ratings

How to detect a political, economic or social occurrence which may affect the sovereign rating of a country? In order to answer this question, let us consider what a sovereign rating actually is. Sovereign ratings deliver *qualitative* information about a "sovereign government's willingness and ability to service its debt on time and in full" (Standard & Poor's 2012, p. 3). A sovereign rating thus represents *not* a quantitative measurement of sovereign default risk, but a qualitative information in a quasi-quantitative dress. The following table taken from the International Monetary Fund (2010, p. 99) lists the main ingredients used by the CRAs for their sovereign creditworthiness assessment:

Table 3.3. Key Factors in Sovereign Credit Rating Assessments

Fitch	Macroeconomic policies, performance, and prospects; structural features of the economy; public finances; external finances
Moody's	Economic strength; institutional strength; financial strength of the government; susceptibility to event risk
Standard & Poor's	Political risk; economic structure; economic growth prospects; fiscal flexibility; general government debt burden; offshore and contingent liabilities; monetary flexibility; external liquidity; external debt burden

Sources: Fitch (2010a); Moody's (2008); and Standard and Poor's (2008).

Through the "*admixture* of quantitative and qualitative data" the rating, inherently, becomes a product resulting from "a process of judgment" (Sinclair 2005, emphasis added). For example, in the case of Standard and Poor's, a "series of quantitative factors and qualitative considerations form the basis for assigning [...] forward-looking scores." The different scores consist of the following (ibid.):

- "Political score" = "Institutional effectiveness and political risks"
- "Economic score" = "Economic structure and growth prospects"
- "External score" = "External liquidity and international investment position"

- “Fiscal score” = “Fiscal performance and flexibility, as well as debt burden”
- “Monetary score” = “Monetary flexibility”

However, in practice, how are these score-ingredients constructed? As an example, let us consider the genesis of the “political score.” The S&P methodology states (p. 3):

> [T]he political score reflects our view of how a government's institutions and policymaking affect a sovereign's credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks.

If an election, for example, leads to “inconclusive” results (Italy, 2013), or a referendum implies risks in terms of growth (Switzerland, 2014), or in terms of public debt (United Kingdom/Scotland, 2014), this may decrease, or not, the “political score” of a country and affect, or not, its outlook. It is hardly possible to detect a methodology-deviating pattern, which could suggest arbitrariness or biasing of information in the evaluation—the CRAs' “view” legitimizes rating action and inaction: the sovereign rating methodology is, to a certain extent, self-immunizing with respect to criticism (Walton 1996).

After the numerical scores have been assigned, “the average of the political score and the economic score” deliver a “sovereign's political and economic profile,” and “the average of the external score, the fiscal score, and the monetary score” deliver “its flexibility and performance profile.” These two profiles are then used to determine an ‘indicative rating level’ ” (Standard & Poor's 2012, p. 4). Assigning scores, calculating averages, combining them in an additive fashion suggests transparency and retraceability of the sovereign rating methodology. However, that many of the inputs of these scores actually escape from quantification, can be interpreted as a preliminary, and legitimizing, step in the creation of a figure that cloaks the degree of debatability of the inputs it consists of.

Finally, the ‘committee meetings’ represent the last piece in the preparation of a sovereign rating decision, in which the “final rating assigned by the committee is primarily determined by applying the rating criteria to the information that the analysts have collected and evaluated” (Standard & Poor's 2012, p. 6). According to Bhatia (2002, pp. 26-27) cited in Bruner & Abdelal (2005, p. 198), the discussions in the committee meetings are focused above all on “intangible issues such as a government's propensity for ‘orthodox’ vs. ‘heterodox’ policy responses when under acute debt-service pressure.” The

attempt to predict conditional reactive policies is thus an essential point of *discussion*, and eludes from being measured quantitatively (Paudyn 2013, p. 22). Precisely because the 'judgmental' element is so preponderant and, probably, decisive in the sovereign rating process, rating decisions can be hardly retraced by an econometric algorithm or quantitative-empirical testing.

In terms of the committee meetings, Standard & Poor's (2012, p. 7) itself stresses:

> However, rather than providing a strictly formulaic assessment, Standard & Poor's factors into its ratings the perceptions and insights of its analysts based on their consideration of all of the information they have obtained. This process helps the committee to form its opinion of an issuer's overall ability to repay obligations in accordance with their terms.

4.2 Mission impossible

Concerning the sovereign rating business, CRAs have been much criticized by professionals, scientists and policymakers for different reasons, above all in the context of the European sovereign debt crisis. However, quite all criticism is directly or indirectly related to the difficulty of quantifying sovereign default risk. One strand of criticism relates to the timeliness of sovereign rating events: changes would occur too late, just reflecting the information which is already known in the market. Simultaneously, CRAs have faced criticism to have downgraded countries after 2008 more severely than was apparently warranted by economic fundamentals (Gärtner et al. 2011, Fuchs & Gehring 2013). This interpretation points to a general procyclical effect of ratings with respect to the markets' risk perception (Ferri et al. 1999). Instead of mitigating and correcting it, ratings would favor herd behavior and cliff effects in bad times, and confer 'false' certainty in good times.

In this article, I argue that the role of sovereign ratings in triggering the distrust-turn and fueling the confidence crisis in sovereign debt is more pronounced in the case of the sovereign debt crisis than in the case of the 2007-08 events, where safety illusion of the structured financial products materialized into the financial crisis. This implies that the latter can be regarded to a greater extent as a correction of rating failure, whereas, in the former, the continuous and permanent interference of sovereign rating actions acted as self-validating feedback loops, or self-fulfilling prophecies in terms of the deterioration of creditworthiness of sovereign entities, thus reenforcing the repo run and deepening the crisis (Paudyn 2013, Kiff et al. 2012, Gärtner & Griesbach 2012, Gärtner et al. 2011).

In other words: My thesis is that a large fraction of the sovereign risk concerns could have been constructed via the sovereign ratings practice, and been less "fundamentally" justified compared to the "sharp downgrades of structured credit products that followed in the wake of the subprime mortgage crisis" (International Monetary Fund 2010). This does not deny the possibility of fundamental reasons to doubt about sovereign creditworthiness. As the risk-free notion of government bonds in the past could be constructed via the CRAs (perhaps more than fundamentals would have justified), the excessive sovereign downgrades by the CRAs could construct the perception of the excessive riskiness of sovereign bonds too.

According to Bruner & Abdelal (2005, pp. 194-195), historically, the CRAs "have depended, perhaps paradoxically, on some instability in sovereign bond markets: Crises and defaults increase the potential value to investors of the agencies' expertise at the same time that they threaten to dry up the market or expose agencies to criticism." For the CRAs, sovereign debt crises in particular represent both a reputational exposure *and* an opportunity to distinguish themselves. For example, this has become prominently visible in the Asian financial crisis, when "rating agencies attached higher weights to their qualitative judgment than they gave to the economic fundamentals" (Ferri et al. 1999, p. 394).

It seems that history has repeated itself also in the course of the European sovereign debt crisis: The crisis was endogenously accompanied by a rise in the frequency of sovereign rating events, and the attention paid to them. Therefore, CRAs faced accusations of arbitrariness by economists, policymakers, market participants and the media (Sinclair 2010, Hiss & Nagel 2014). One possible interpretation for the CRAs' more conservative assessments of sovereign debt is that they have been trying to compensate for past mistakes; a reflex to restore credibility and demonstrate their learning capability, since CRAs are often listed as one of the crucial contributors to the sub-prime mortgage crisis.

Moreover, the issuer-pays business model often does not apply for sovereign ratings, as governments—until now—are not regarded as CRAs' typical customers (unsolicited ratings). The often expressed criticism of the conflict of interest which undermines the credibility of the rating assessments is reversed by the logic of unsolicited ratings. The absence of incentives to underestimate risks does, however, not imply the automatic accuracy of risk assessments and the absence of excessive severity: both underestimation and overestimation can occur.

Until today, econometric research faces difficulties in quantifying, or objectively measuring, sovereign "creditworthiness." On the hand, this can be explained by the fact that the number of sovereign defaults is still limited,

making reliable stochastic calculations virtually impossible. Another argument points to the fact that "unique national contingencies" (Paudyn 2013, p. 19) are characterized by uncertainty and thus "qualitative elements elude being captured through quantitative techniques" (Paudyn 2013, p. 22).

Ironically, this might deliver one reason for the conviction of many scholars that political variables are merely correlates of economic variables and thus have no significant effect on the sovereign rating of a country (Rosenbaum 2008, p. 41). Challenging this conventional wisdom, Armingeon (2012) finds that political conditions do have an independent influence on the assessment of the creditworthiness of a sovereign bond issuer even after economic fundamentals have been controlled for.[15]

In a similar manner, Gärtner et al. (2011) challenge the notion of the irrelevance of other factors than purely economic ones for the assessment of sovereign creditworthiness. They undertake a check for arbitrariness and find a lack of consistency. According to their estimations, during the sovereign debt crisis, sovereign ratings cannot be explained by means of economic fundamentals. Deviating patterns have been found with respect to past assessments. At the same time, certain countries are assessed differently with respect to other countries in the same year despite the same economic fundamentals. This shifts the focus of attention to the qualitative component of the assessment, which seems to make the difference since 2008.

Given these difficulties of measuring the sovereign creditworthiness of a country, it does not surprise that CRAs themselves warn the investors to regard sovereign ratings as an indisputable judgment.

As (Fitch Ratings 2002, pp. 3-4) declares:

> It is important, though, that investors realise the limitations of this [sovereign rating] exercise, which is necessarily far less certain than our ability to analyse either bank or corporate risks of default. The essential problem is that the world of sovereign borrowers is far smaller than the world of large banks or corporations, and that the number of instances of default in the modern period when we have reasonable national accounts is tinier still. [...] So the rating of sovereigns depends more on the art of political economy than on the science of econometrics.

This statement can be understood as a concession to the limits of the positivist stance CRAs usually adopt, but also as an invocation thereof: The in-

[15] As the dependent variable, Armingeon (2012) uses the spread between the national and the German nominal interest rate on long term government bonds. His cross sectional data set of EU-27 members and mature OECD democracies covers the time span from 1960 to 2011.

feasibility of calculation in the special case of sovereign ratings is attributed to the 'not enough n' problem. Put it differently, the inherent judgmental nature of the rating is excused by 'small n.' Consequently, the Fitch warning suggests that if there were sufficient 'n,' indication of the probability of sovereign default would be based "more" on econometric calculations; the opinion, would become, so to speak, less opinion, and more "scientific."

Since CRAs do not reveal in their methodology how "quantitative and qualitative parameters are accommodated and synthesized" (Paudyn 2013, p. 21), in practice, the differentiation on whether the rating judgment is based on the "art of political economy" or "science of econometrics" is obsolete. The impression of computation is conveyed, be it with small or large 'n,' as the rating format suggests the application of a quasi-scientific method. Even though CRAs may not explicitly claim to be fully objective as they insist to regard their ratings as 'opinions,' their endeavor to objectification is not least visible in the usage of the letter-grade scaling system, which implicitly stylizes ratings as quasi-scientific technical products: Instead of using cumbersome text to reproduce what a sovereign rating actually is, namely a 'qualitative information,' the 'easy to understand' letters convey the impression of 'objectively' computed probabilities—relative measures of sovereign credit risk on an ordinal scale. As Carruthers (2013, p. 544) puts it, the "distinctively portable format and scientific appearance" of a rating conceals its actual nature as judgment.[16] The disguise seduces to conceive of ratings as the product of 'unambiguous' calculation.

According to Sinclair (2005, p. 46), the "agencies assert that rating determinations are opinions but simultaneously seek to objectify and offer their views as facts." That such a balancing act leads to tensions concerning the CRAs' self-understandings, may not be surprising.[17] The tacit acceptance by market participants, including CRAs themselves, towards the inherent contradiction between signifier (AAA) and significant (opinion) in rating may

[16]The actual nature of ratings as judgments, as opposed to objective measures of credit risk, also holds for ratings in general (Lehmkuhl 2011, p. 12): "[R]atings of rating agencies implicitly transport a model of how to transform their interpretation of creditworthiness into practice. This transformation may include specific forms of organization or operation. But always is the underlying idea a subjective one, deriving from specific assumptions on chains of causal relationship between factors, on an inclination towards specific policy models or on a specific socialization and education background of actors."

[17]In the context of an academic panel discussion in 2012, a CRAs' managing director of European sovereign ratings affirmed that conceiving of ratings as 'technical products' and 'opinions' at the same time, implies no compatibility problems, underlying the CRAs' self-conception as epistemic authorities. Furthermore, empirical evidence suggests that the CRAs' self-perception in terms of the nature of their work, is not homogeneous across the staff (Besedovsky 2012, p. 228).

inform the core of the CRAs' epistemic authority.

4.3 The black box

The strength of the CRAs' authority seems to rest on the taken-for granted acceptance of their professional integrity. The transparency narrative in the CRAs' communication strategy with respect to methodology and rating criteria may contribute to the general treatment of ratings as objective measures. At the same time, for civil liability reasons, e.g. Standard and Poor's declares that "credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact" (Standard & Poor's 2012). Sovereign ratings are, approvingly, accepted as opinions and technical products at the same time. Although the media and the public may be conscious, upon reflection, that these assessments are discretionary to a certain degree, this ambivalence is silently overlooked. Unconsciously, this lends validity to the ratings and lays the ground for the "power base."

Under the circumstances of a methodological 'black box,' Paudyn (2012) questions the possibility of "methodological rigorousness." Such a black box, ultimately, is able to open the flood gates to "ambiguous and superficial conclusions." Paradoxically, a methodological black box can even fortify the CRAs' executive epistemic authority and its consequential capacity (Bon 1896). CRAs are never tired to assure the traceability and transparency of their decisions in order to invalidate criticism against their "methodology." Such a communication strategy may be necessary to ward off reputation-damaging offenses of their authority; the published methodologies can be understood as a protective shield.

As discussed above, a degree of opacity is incorporated within the methodology itself; for example, the minutes of the 'committee meetings,' which precede sovereign rating decisions, are not available to the public. As Bruner & Abdelal (2005, p. 198) assert citing Bhatia (2002, p. 26 et seq.): "[The] actual committee discussion remains the 'invisible ingredient in the ratings process' across the agencies, though reportedly it often center[s] around intangible issues such as a government's propensity for 'orthodox' vs. 'heterodox' policy responses when under acute debt-service pressure'."

Also with respect to the access policy, CRAs do not seem to meet their own requirements with respect to 'transparency.' For example, S&P's press releases are not publicly available. Even in the internal area, only the press releases of the "last seven days" are on-line. Notwithstanding verbal declarations, the rationales of sovereign rating decisions older than one week cannot be retrieved—neither by the public nor by (normal) subscribers. Such a de-

viation of communication strategy and factual accession policy suggests the impression of mock-transparency (in German: *Scheintransparenz*). As a declaration of conformity, transparency as a value is cherished. For the purpose of meeting certain expectations, the seemingly unutterable is legitimately disguised as apparent transparency.

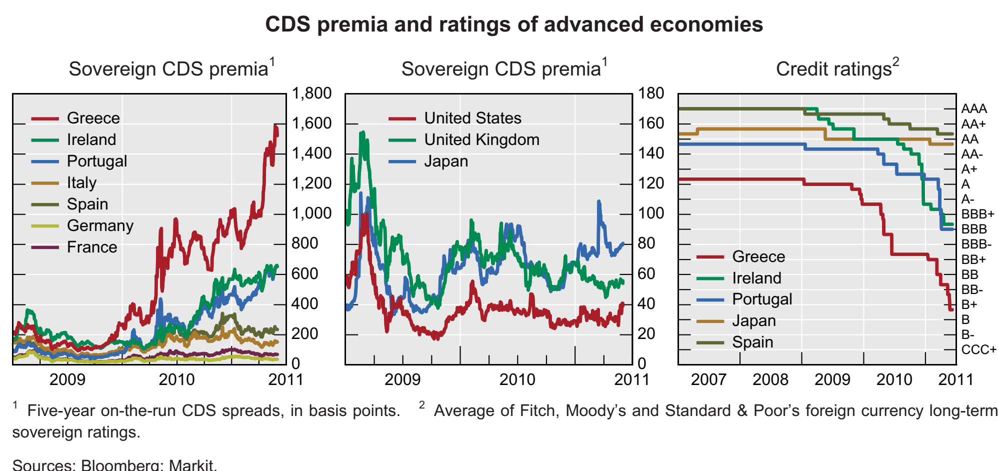
4.4 Who follows who? Inter-subjectivity!

Whether CRAs influence the market's perception of sovereign creditworthiness, and thus, the interest rates of sovereign bonds, is not to grasp easily in econometric terms, as it is so often the case with econometrics and causality. That leads us to the simple question of 'who follows who.' For example, the Bank for International Settlements (2011) uses the terms 'sovereign risk' and 'sovereign ratings' as equivalents, escaping the 'who follows who' question. It does neither explicitly claim that investors' concerns about sovereign risk are subject to the CRA assessments, nor that investors form an opinion on their own. In the context of the beginning of the euro crisis in the EU, the International Monetary Fund (2010, p. 103) commented on the market reactions to the CRA events slightly in a more explicit way: "some of these negative rating changes appear to have surprised markets, particularly the scale of the change."

The hesitation in claiming causality relates, again, to the difficulty of falsifying that CRAs do *not* influence the sovereign risk premia on a meaningful statistical significance level. Because CRAs and the market would process the same information, a simultaneity problem would arise. For solicited ratings, the added value of the rating consists in the insider information the issuer provides to the CRA in the context of the issuer-pays business model. Since sovereign ratings are usually unsolicited, and thus based on publicly available information, the CRAs are sometimes criticized for being too late in their judgments, just reflecting the risk perception of the market: CRAs do not matter for risk perception, they can be seen as "delayed weathermen," so the argument.

Such a logic disregards contingency and the judgmental dimension of the rating process and assumes homogeneity and repeatability of perception. Moreover, it disregards the mechanistic market responses to CRA ratings resulting, for example, from the regulatory incorporation of ratings and from market practice which voluntarily incorporates ratings as investment guidelines. Turning the tables, precisely because CRAs only use public information as their basic data for unsolicited ratings, the "judgmental" dimension constitutes the "added value" of sovereign ratings. Thus the source of the CRAs' authority and influence goes beyond the question of the *informational* added

value.



CDS premia and ratings of advanced economies

[1] Five-year on-the-run CDS spreads, in basis points. [2] Average of Fitch, Moody's and Standard & Poor's foreign currency long-term sovereign ratings.

Sources: Bloomberg; Markit.

As the graph taken from the Bank for International Settlements (2011, p. 3) illustrates, by just comparing the concomitant deterioration of sovereign ratings with the increasing credit default swap (CDS) spreads, the 'who follows who' question cannot be answered satisfactorily. Usually, CDS spreads are seen as metaphorical 'clinical thermometers' for investor concerns about sovereign credit risk. If these increase before a credit rating event, this may be taken as evidence that CRAs follow the market, and not the other way round.[18]

Apart from the fact that the appropriateness of CDS spreads as proxy for sovereign creditworthiness concerns may be debatable, such a comparison neglects the fact that moves by the CRAs—beginning from announcements, on watches, insider information, rumors, and outlook changes—flow "discursively" into the market's credit risk perception. Therefore, even if CDS spreads are regarded as a valid proxy for sovereign risk, the fact that a widening of these spreads precedes the actual rating change cannot be taken as a falsification of the CRAs' influence. Discursive elements may be captured empirically via measurable changes in the risk premia—their origins are not.

If the sovereign rating practice can be regarded as the codification of the market's perception of sovereign credit risk, then sovereign ratings do not only reflect sovereign risk, but co-constitute it. It is exactly the "intersubjective reflexivity" which brings about the circularity in creditors' and CRAs' "world views" or "market beliefs and sentiments." These are reflected in the ratings "which are themselves demanded by the agents affected by the

[18] In a panel discussion in 2012, a senior CRA manager used this argument in order to neutralize allegations that CRA would drive markets by fueling investors' concerns about sovereign creditworthiness.

ratings" (Abdelal & Blyth 2013, p. 3).

The successful "codifying" of these views constitutes *one* distinct feature of the CRAs' influence. Hence, the question 'who follows who' misses the fundamental point: Even if the market knew everything in advance, CRAs still affect the market by "codifying" certain norms and values in the discourse. Such a codification function conditions and fortifies the unanimity of the CRA oligopoly, which is reflected by the high correlation coefficients between the ratings of the three agencies (Gaillard 2012). Again, the source of influence goes beyond the question of the informational added value of CRAs, and, beyond the inclusion of ratings in regulatory regimes.

What are these norms and values? Since the economic policies of countries which enjoy the highest ratings are often described as "cautious, flexible, and market-oriented," Bruner & Abdelal (2005, p. 199) note concerning the rating methodologies that "little in the way of substance is provided beyond affirmation of the liberalist commitment to openness." If "orthodoxy" is equal to best practice, then it "appears simply to be a positive term describing the absence of 'policy errors'." Bruner & Abdelal (2005) call this "the implied litmus test—that countries that have gotten this right will be identifiable because they will not make 'policy errors'." The orthodoxy follows a tautological logic: the triple A countries are lacking in policy errors by definition, and because they are lacking in policy errors, they are the triple A countries.

But then, how to detect a policy error without an objective 'policy error' screening tool, e.g. explicit thresholds? As the rating is usually disclaimed as an opinion or judgment, which per se cannot be 'accurate' or 'inaccurate,' the very lack of an objective 'policy error' screening tool cannot be used as an accusation against the CRAs. Instead, I suggest that the CRAs' supplement of such a screening tool consists in the successful reproduction and redefinition of the intersubjective terms of orthodox policy-making.

However, to a certain extent, there are certain limits to the shaping of such a consensus: Since sovereign ratings are a *relative* measure, by definition, there has to be always a role model, a benchmark, i.e., a sovereign that does 'everything right,' constituting and reflecting the orthodox mindset. This implies that if there are deviations between a triple A country and the current orthodox mindset, this can give rise to 'home bias' or inconsistency accusations against the CRAs (Fuchs & Gehring 2013). At the same time, if the market sticks to a role model e.g. because it may anticipate the impossibility of not having such a model, the CRA opinion to downgrade the concerned country may not be 'believed,' and respective bond values may rise as in the case of the US downgrade by S&P's August 5, 2011 (Reuters 2011, CNN money 2011). To sum up, the hermeneutic space for the diagnosis procedure for sovereign ratings changes is determined by the degree of

flexibility of orthodoxy and the incumbent "number ones."

It is quite predictable that in times of exogenous shock as a financial crisis, the "business as usual" of the sovereign rating practice is challenged. As stated above, also the sovereign rating methodology does not help as a 'road-map' in this regard. Methodology-deviating and -conforming patterns are hardly to detect via the political score, or the committee deliberation: the CRAs' view legitimizes sovereign rating action or inaction. It lies in the CRAs' interpretation to decide upon whether and which occurrences are to be regarded as critical for the rating—be it, for example, either the causes or rather the consequences of a global financial crisis, which led to the deepest recession since the Great Depression.

5 The redefinition of the crisis

As a quote of German chancellor Angela Merkel at the EU summit in December 2011 suggests: "it is decisive to fight against the causes of the crisis, the lack of fiscal discipline and the lack of competitiveness."[19] The apparent taken-for-grantedness of her causal analysis may lay bare the re-formulation in the semantics of the crisis. As a consequence of this redefinition, a wide consensus seems to have emerged that fiscal homework has to be prioritized over questions the global financial crisis posed to the international community. Put it differently, the primacy of the austerity imperative (Blyth 2013), which can be regarded as a result of the problematization of public debt, may have favored the decreasing political pressure to implement the macro-prudential financial market reforms formulated by the G20 in 2008 (Blyth & Shenai 2010).[20]

In the past century, economic crises have served as base-ground to supersede existing paradigms of economic thought; be it the Keynesian turn in the 30s/40s or the neoliberal turn in the 70s/80s (Helleiner 1994, pp. 15-16). As Schmidt (2014, p. 197) puts it, at the pike or in the midst of the financial crisis, "ideas seem in flux, new policy ideas are being tried, and the dominant 'paradigm' is under attack." In this article, I argue that 'this time *is* different,' since there is reason to suggest that the predominant pre-crisis paradigm "is emerging from the financial collapse more politically powerful than ever"

[19] Own translation from German. Source: Newsticker, December 9, 2011, 17:57 CET.

[20] I do not regard the argument presented here in conflict with other explanations of the transnational regulatory response to the financial crisis, but complementary. For example, Porter (2014) finds that "its overly technical and incremental character, the persistence of tensions between transnational processes and state-centered politics, and the ongoing power of private actors, have made the regulatory response fall short of what is needed." Or, Rethel (2014, p. 72) concludes that "the record of reform has at best been mixed."

(Crouch 2011). Implicitly, this article relates the non-establishment of a "Post Washington Consensus" to the redefinition of the financial crisis to a crisis of sovereign debt—a process Blyth (2013) labels the "greatest bait-and-switch in human history." The financial crisis has been "politically constructed as a crisis of excessive spending [...] which it never was" (Blyth 2013); "whereas the financial crisis concerned banks and their behavior, resolution of the crisis has been redefined in many countries as a need to cut back, once and for all, the welfare state and public spending" (Crouch 2011).

As a result of this redefinition, both crises seem to have an own raison d'être with its own causes, cutting subtly out off the radar interlinkages and contradictions about what actually led us into the crisis and about how to solve it. Not only the bail-outs for banks, but also the spill-overs from the financial sector to the real economy, requiring increases in current government expenditures in form of stimuli and recovery packages, are hardly used as arguments to question the prescribed panacea against the crisis.[21]

6 The narrative fallacy of sovereign ratings

How could this redefinition take place? How could the imperative of the former head of the IMF and former German president Horst Köhler about the "monster" that "must be put back in its place" fall behind to such an extent (Bertrand & Wilson 2008)? I argue that one necessary mechanism in bringing about this redefinition, is the practice of sovereign ratings. Due to its narrative fallacy, the financial and sovereign debt crises could have been treated increasingly separately from each other, as I try to substantiate.

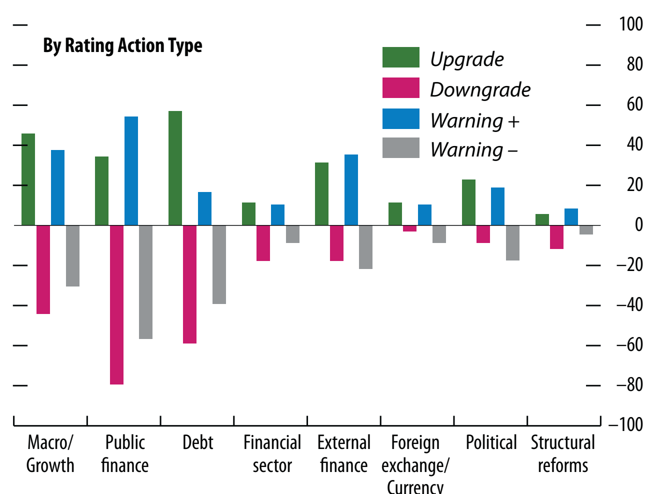
Taleb (2010) describes as a "narrative fallacy" the ex post creation of a narrative with the purpose to give an event a plausible cause or explanation. In other words, discursive strategies are capable to trigger and legitimize a shift in problem identification; they redefine the problems, its causes, and with this, their solution. The common cause-effect chain constructed in order to rationalize the increased investors' concerns about sovereign risk, is usually done by means of the "deterioration of the public finances." That this, in turn, can be regarded as a consequence of the financial crisis and of the subsequent recession, has faded with the ongoing of the crisis (Bank for International Settlements 2011).

The self-reinforcing questioning of sovereign creditworthiness became visible in continuous sharp downgrades of European sovereigns. For example,

[21] An illustrative example is the case of Ireland which had a debt to GDP ratio of 25 per cent in 2007. In 2012, it still recorded a ratio of 115 per cent. Source: Eurostat. For a detailed analysis of Ireland's crisis experience, see Gärtner et al. (2013).

in April 2010 Standard & Poor's downgraded Greece (to BB+), Portugal (to A-) and Spain (to AA) within two subsequent days. One month later, Fitch downgraded Spain to AA+. [22] As can be derived from the following graph of the International Monetary Fund (2010, p. 103), main rating drivers, or rationales, for the downgrades in the time period between May 2007 and June 2010, were the public finances (deficit), gross public debt, and the general macroeconomic situation and growth:

Figure 3.4. Rating Drivers, May 2007–June 2010
(In percent of total rating actions)



As outlined above, the "committee deliberation" represents the "invisible ingredient" of the rating process (Bhatia 2002, p. 26): it is in these meetings in which political, economic or social occurrence which may affect the sovereign rating of a country are discussed and detected. In these occasions, the last word is spoken with respect to "willingness—as distinct from capacity—to honor debt," but also with respect to the "quality and timeliness of policy responses in stress scenarios." These dimensions of assessment, which are, in the real sense of the word, "worthy of discussion" are based on a reactive logic with an inherent blind spot to detect, for example, the origins of a given stress scenario. This blind spot may constitute the hermeneutic space for the CRAs' definition power of problem identification. For example, S&P lowered the British *outlook* to negative in May 2009 (Reuters 2009) with the following rationale:

> The rating could be lowered if we conclude that, following the election, the next government's fiscal consolidation plans are un-

[22]For a timeline of key sovereign debt events, see Bank for International Settlements (2011, Annex 3, p. 46).

> likely to put the UK debt burden on a secure downward trajectory over the medium term [...] Conversely, the outlook could be revised back to stable if comprehensive measures are implemented to place the public finances on a sustainable footing, or if fiscal outturns are more benign than we currently anticipate.

Although according to the Bank for International Settlements (2011, p. 46) this step occurred "owing to concerns about the cost of supporting the UK banking system," long-term financial system reforms are not at the media coverage's center of attention, but (medium-term) deficit reduction.

If epistemic power allows the CRAs to diagnose credibly where the shoe pinches and where not, this enables them to proclaim certain medicine as 'conditio sine qua non' for overcoming the crisis. If this medicine is widely accepted as a social fact, it can interpreted as a material, or factual, constraint (in German: *Sachzwang*), the therapy becomes apparently unavoidable, and gains priority status. Measures become compulsory against the pressure, making policies homogeneous across states. As empirical evidence suggests, Armingeon (2012) finds out that "nearly all democratic countries seemed to converge programmatically on the path of fiscal consolidation" since 2010.

Therefore, if CRAs wield power in the construction of credible cause-effect chains, they can establish necessary conditions to overcome the crisis: "austerity" becomes desirable as austerity is *supposed* to please market sentiments. Thus, CRAs can help to construct "austerity" as a way to come out of the crisis, as a solution. The construction of the "problem of the public budget" delivers the rationale for the justification of exactly these austerity policies. By rewarding those states which comply with the market demands with lower interest rates lends the final validity to the redefinition.[23]

The possibility of a crisis redefinition is not a completely novel phenomenon in the sovereign rating business. The historic experience with the Asian financial crisis, in which "sovereign governments [...] have seen their policy making discretion curtailed," induced Moody's to the following admission: "if the true causes of the crisis have been misdiagnosed, then the prescriptions for remediation may be wrong as well," cited in Bruner & Abdelal (2005, p. 211). The European sovereign debt crisis may lend itself to a re-application of this logic. A misdiagnose may have influenced the prescription for remediation as well.

Through the narrative fallacy of sovereign ratings, prodigal fiscal policy has been redefined as the source of the crisis, taking the place of the expensive

[23]See Thomas theorem (Thomas & Thomas 1928, p. 572): "If men define situations as real, they are real in their consequences."

rescue of the financial sector. By defining the symptoms for the cause, not only do mechanisms fall into oblivion which had led into a certain situation, but also narratives are (re-)activated which legitimize this obliviousness—this is done, most easily, with ‘problems,’ which had always existed.

7 An illustrative sovereign rating event

For Cutler (2014), CRAs, among other players in global finance, shape crucially “common sense understandings about the governance of global capitalism.” They are part of the “dominant knowledge structures that [condition] belief systems about the nature and function of finance and credit, as well as about the acceptable means of governing them and the proper role of the state therein” (ibid., p. 4). Thus when it comes to the rating of sovereign bonds, CRAs play a crucial role in the “diffusion of norms and common understandings” of sovereign creditworthiness, and implicitly of fiscal and economic policy.

This article suggests that sovereign ratings contributed to the idea of austerity as solution to the crisis. According to Armingeon (2012), the “only broadly accepted idea [in the public discourse] is that public policy should be based on fiscal prudence.” If CRAs wield structural power in the construction of the solvency of states, then the practice of sovereign ratings (including announcements, warnings, and comments) may have contributed decisively to the understanding of public budget consolidation as panacea against the crisis. Through the practice of sovereign rating “austerity” is legitimated, and austerity as an intersubjective consensus about the sound fiscal policy legitimates the CRAs’ practice.

Every sovereign rating event is usually accompanied by a list of necessary conditions a state is supposed to comply with in the future if it aims at being regraded differently. Paudyn (2013) refers to this as “prescriptive normativity.” In the following, as an exemplary case, I consider the Fitch Ratings downgrade of Italy on March 8, 2013 to “BBB+, Outlook Negative”. Key occasion of the downgrade were “inconclusive” election results, following Monti’s resignation in December 2012. This seems to be in line with the claim raised by Paudyn (2013, p. 14) that “technocratic governments are seen by CRAs as typically superior in implementing the structural reforms necessary to manage the crisis.” In this vein, sovereign ratings would act as depoliticizing socio-technical device, promoting “a [fictitious] bifurcation between politics and economics.” This suggests that if election would have unambiguously confirmed Monti’s coalition, a downgrade, perhaps, would not have happened.

The press release states that "future developments that may, individually or collectively, lead to a revision of the Outlook to Stable include":

- "Sustained economic recovery that supports ongoing fiscal consolidation."
- "Confidence that the public debt to GDP ratio is on a firm downward path."
- "Further structural reforms that enhance the competitiveness and growth potential of the Italian economy."

Such claims suggest that fiscal consolidation, or austerity, is a taken-for-granted, overarching aim. Although Italy is amidst a deep recession, and a future GDP growth may not be in sight in the short and medium run (ceteris paribus), the soundness of a restrictive fiscal policy is assumed. The role the state has to fulfill is the one of restraining itself and cutting back. Public investment in education, research and infrastructure drop out as options for boosting growth and competitiveness. Rather, it is insinuated (although not explicit) that this shall happen differently. This example might support Paudyn (2013, p. 26), who characterizes sovereign ratings as an "internal form of governmentality aligned with self-systemic, disinflationary logics of neoliberalism."

However, especially in the last bullet point listed above, it becomes clear that the concepts a CRA uses for its claims are quite abstract. What kind of structural reforms are meant? Probably those, which do not represent a 'burden' for the public account. Higher taxation? Labor market reforms and privatizations of public enterprises? It is not explicitly specified how to boost growth, or to what kind of growth potential Fitch refers to, or how to enhance competitiveness. In other words, the communication ventures on hermeneutics, making it possible that shared beliefs and values are implicitly reproduced. This can also be understood as a way of immunization with respect to critique. Abstractness helps as a tactics and preserves credibility. Ultimately, abstract notions represent a way to exert structural power via a subtle pressure which does not directly force a state to do this or that. For example, cutting back the welfare state is not explicitly asked in the press release.

Another channel through which the therapy is prescribed is the set of key assumptions underlying a certain sovereign rating action. These key assumptions can function as implicit warnings. In particular, when the assumptions reflect an optimistic view of the course of events, subtle pressure is potentially exerted. Ex post, these assumptions can serve as justifiers for future

rating actions. Since this is anticipated by all participants in the discourse, governments are already alerted to comply with these assumptions in order to prevent a worsening of the rating.

In this concrete case, assumptions included were, for example, “that Italy will retain market access and, if needed, EU intervention would be requested and provided to avoid unnecessary strains on sovereign liquidity” (Fitch Ratings 2013). So the political solidarity between EU(!) member states is quasi called for in case that the markets punish Italy prohibitively. Moreover, “Fitch assumes there will be progress in deepening fiscal and financial integration at the eurozone level.” If realized, this can translate politically into either “a two-speed Europe” or in a fragmentation of the euro area. Since Fitch assumes that the risk for the latter “remains low,” it rather claims the former.

8 Concluding remarks

In the whole discussion of the redefinition of crisis and the social powers behind, it may appear severely reductionist to consider exclusively the practice of sovereign ratings. That simplistic debates such as ‘more or less state’ have become one of the dominant issues after the financial crisis, is certainly not only due to the CRAs. They did not invent these controversies, but I have tried to argue that their structural power conferred them the capacity to put this old debate in the pole position of the economic policy agenda. This is not to say that politics does not instrumentalize the crisis (and its rhetoric) for the realization of certain ends, which may be difficult to implement in normal times (‘politics of crisis’). It requires certainly further research to analyze this ‘other side of the coin.’

In this article, I have tried to argue that the prescriptive normativity of sovereign ratings delivers the ex post rationale to identify an alternative cause of the crisis. Through the narrative fallacy of sovereign ratings, fiscal policy has been redefined as the source of the crisis, taking the place of the financial sector. By defining the symptoms for the cause, not only do mechanisms fall into oblivion which had led into a certain situation, but also narratives are (re-)activated which legitimize this obliviousness—this is done, most convincingly, with ‘problems’ which may already existed in the past.

Furthermore, the infeasibility to capture “fiscal temperaments” in a “probability distribution” due to idiosyncrasy and contingencies (Paudyn 2012) reveals the mission impossible of an ‘objective’ predictability of sovereign default risk. I would extend this argument further: If this probability distribution—admittedly in the case of sovereign ratings—does not even exist, the whole

sovereign rating exercise becomes a pleasant fallacy of precision, as it suggests a positivist epistemology without entirely following it. In other words, if the differentiation between risk and uncertainty (Katzenstein & Nelson 2013) is fully taken into account in the rating language, would mean, in the end, to abandon the relative, ordinal letter-grade figures when it comes to the assessment of sovereign creditworthiness. It is very unlikely that this will happen in the near future, given the pervasiveness and popularity of the 'common language of credit risk,' for which CRAs can claim authorship.[24]

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[24] The format "credit ratings" has taken an own dynamic, going beyond the 'external' ratings provided by the CRAs: The advanced internal ratings based approach (A-IRB) within the Basel framework, in which ratings are generated by banks themselves in order to undertake risk differentiation for the calculation of capital requirements, is another example for the pervasiveness of ratings as general language of credit risk.

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