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Passing judgement: credit rating processes as regulatory mechanisms of governance in the emerging world order

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ABSTRACT

This article argues that certain knowledge-producing institutions located in the American financial industry – debt security or bond rating agencies – are significant forces in the creation and extension of the new, open global political economy and therefore deserve the attention of international political economists as mechanisms of 'governance without government'. Rating agencies are hypothesized to possess leverage, based on their unique gate-keeping role with regard to investment funds sought by corporations and governments. The article examines trends in capital markets, the processes leading to bond rating judgements, assesses the form and extent of the agencies' governance powers, and contemplates the implications of these judgements for further extension of the global political economy and the form of the emerging world order.

> Commercial credit is the creation of modern times and belongs in its highest perspective only to the most enlightened and best governed nations. Credit is the vital arm of the system of modern commerce. It has done more – a thousand times more – to enrich nations than all the mines of the world.[1]

INTRODUCTION

This article is about the rise of non-state forms of international authority, and the transformative effects these are having on economic relationships and political processes in the emerging post-Cold War world. Until the erosion of Soviet dominance over eastern Europe in the fall of 1989, and the subsequent collapse of the Soviet Union itself, international political relations were conditioned by an overriding concern with the maintenance of an effective security framework in which possible threats could be contained.[2] With the end of the Cold War, and the obsolescence of many of the relationships undergirding this phenomenon, the atten-

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tion of much of the scholarly international relations community has shifted from these concerns. While this very visible drama has been playing itself out on the nightly television news another has been unfolding behind closed doors. Starting in the early 1960s, offshore capital markets – places where funds are raised by selling debt obligations and equity outside the constraints of government regulation – have rapidly become global in character, stimulated initially by a desire on the part of American financiers to get around the restrictive US banking laws created during the Depression.[3] During the 1970s, and into the first half of the 1980s, the freedom of these non-national money markets was matched by a slackening of regulation within domestic finance industries, led by the United States. Other governments, including those of Britain, Japan and Canada were obliged to follow this path or suffer declines in their own finance sectors, as funds were relocated to more open markets.[4] Accordingly, during the 1980s, 'many of the boundaries between national financial markets dissolved and a truly global capital market began to emerge'.[5]

What questions does the decline of Cold War tensions and the development of a global capital market raise? Among these are: What will be the new organizing principles of the emerging world order? Where will authority be derived in the post-Cold War era of global capital mobility? What new conceptual tools will scholars need to understand these phenomena? This article evaluates these questions through an analysis of debt security rating processes. Debt security rating is portrayed in this article as a significant mechanism of authority in its own right, and as an exemplar of the form of authority that is organizing the emerging world order. Accordingly, the generalizations developed here will have applicability beyond the capital markets. Leading off the article is an evaluation of trends in the division of authority between global civil society and national states.[6] Rosenau's notion of 'governance without government' is then introduced as a way of understanding the new found influence of non-state institutions.[7] Subsequently, the article evaluates specific developments within international finance that have influenced which institutions and processes have gained authority and which have diminished in power. These developments point to the significance of the rating agencies. Some basic background material is then provided on the agencies, followed by a discussion of debt security rating processes. What information goes into a rating and how this material is analysed are examined here. A more theoretical section follows in which the governance 'powers' of the rating institutions are elaborated. This discussion is followed by an appraisal of the implications of rating agency governance for investment, policy and national determination. Finally, the article returns to the broader theme of the future character of the emerging world order in light of the mechanism identified.

GOVERNANCE

The development of the *global political economy* (GPE) has irreparably changed the authority structures that developed with the rise of the Western state system subsequent to Westphalia.[8] 'At the core of the new order', suggests Rosenau, is '. . . a relocation of authority that [has] transformed the capacities of governments'.[9] The 'state-centric system' of the Westphalian order is now being replaced by a 'multicentric system', bifurcated between state and non-state actors.[10] Because of the transnational character of many economic, political and climatic developments, 'national governments are decreasingly competent to address and resolve major issues confronting their societies'.[11] This does not mean that the sovereignty of states has ended, but rather, that the 'exclusivity and scope of their competence' has altered significantly, 'narrowing the range within which their authority and legitimacy are operative'.[12] These developments may also be interpreted as expressive of a political strategy. Gill has labelled this strategy the 'new constitutionalism', which seeks to 'place restraints on the democratic control of public and private economic organization and institutions', premised on neo-liberal assumptions about the efficiency of market forces. He suggests that some states, such as the US, are likely to be less accountable to international market forces than others, based on their divergent positions within the GPE, and thus that 'some states are more sovereign than others in the emerging world order'.[13]

Both Rosenau's and Gill's respective conceptions of the emerging world order problematize the mainstream assumptions about interstate relations and the nature of authority itself. The orthodox, neo-realist understanding of authority in international relations has been one that focuses on the legally binding actions of governments.[14] Ferguson and Mansbach propose that authority be understood instead as a process in which 'law is only one possible source of legitimacy that enhances the capacity of political actors to govern effectively . . .'[15] This implies that authority is socially constructed and based on some measure of voluntary compliance, as was the *auctoritas* of the Roman Senate. *Auctoritas* had the character of 'more than a counsel and less than a command; rather a counsel with which one could not properly avoid compliance'.[16] Based on such a notion of authority, 'a wide range of governmental and non-governmental entities may, in fact, govern effectively and thus be an "authority" or "polity" within their particular domain(s)'.[17]

Following in the conceptual footsteps of Foucault, Rosenau has developed a useful way of thinking about these shifts in the location of authority in the emerging world order. He argues that the crucial category to think about is governance: the 'system of rule'.[18] It only exists when it is accepted by the majority, whereas governments can function

(up to a point) despite opposition. Governance may exist without government where there are 'regulatory mechanisms in a sphere of activity which function effectively even though they are not endowed with formal authority'.[19] Similarly, one can conceive of government without governance. However, essential to identifying a regulatory mechanism is observing 'intentionality'.[20] Governance only exists in self-conscious arrangements, and must be distinguished from arrangements which derive from the 'aggregation of individual decisions'.[21] For example, a market is an aggregation of individual decisions and does not express governance in this sense, whereas market rules or institutions that intervene in markets represent self-conscious arrangements and thus regulatory mechanisms of governance.[22] The following section discusses the context in which the regulatory mechanisms of governance examined in this article have developed.

THE CHANGING FORM OF GLOBAL CAPITAL MARKETS

The argument is that the nature of wholesale financing has changed significantly over the last decade or so, and that this has affected the nature of the authority exercised in the capital markets by regulatory mechanisms. According to Sassen, since the 1980s, the 'marketplace has assumed new strategic and routine economic functions'.[23] Financing has increasingly become *disintermediated,* which has created information problems for those wishing to lend money and for those wishing to borrow. This process has led to the disempowerment of traditional intermediating institutions, notably banks, and the empowerment of others, such as debt security rating agencies.

Two ways of organizing the allocation of investment funds have been in competition with each other since the rise of the GPE. The primary way in which funds have been loaned and borrowed has been through banks. Banks act as financial intermediaries in that they bring together the suppliers of funds and the users of funds. They borrow money, in the form of deposits, and lend at their own risk to borrowers. Those who deposit money in banks and those who borrow from them do not establish a contractual relationship with each other, but only with the bank.[24] Banks cover the costs of intermediation and make a return on their investment by charging the users or borrowers of funds more than they pay to the suppliers or lenders of funds. This structure is threatened by the trend toward disintermediation. In this process, flows of funds between borrowers and lenders avoid the direct use of financial intermediaries, for instance, in cases in which companies withdraw their funds from banks and lend them directly to each other, or when corporations issue commercial paper that may merely be underwritten by a bank or investment bank.[25] Globally, bank lending decreased from 37 per cent

of total capital movements in the 1977–81 period to 14 per cent in 1982–6. Portfolio, as opposed to direct forms of investment grew during the same period from 36 per cent in 1972–6, to 65 per cent of total investment in 1982-6. Most of this was funded through securities offerings.[26] Commercial banks increasingly take on the characteristics of investment or merchant banks, organizing issues, underwriting them, buying and selling debt in the secondary market, but not carrying these obligations on their own balance sheets.[27]

Why has this trend toward disintermediation developed? Part of this story clearly has to do with the locus of control evident in securities issues versus either equity or bank debt.[28] Banks typically want covenants that limit the application of funds by the borrower so that their interest stream is covered first. They might also place limits on the leveraging of the corporation that prevent it from raising its debt load, hindering management's plans for new plant and equipment. Moreover, '[b]ank lending is inherently more expensive than securitisation' because of the high overhead costs generated by the credit monitoring function of intermediation.[29] The high interest rates and elevated loan defaults of the 1980s made these differentials very significant. In the case of equity finance, stock holders may expect some involvement in the major decisions of the corporation, as is their right as owners of the enterprise.

What are the implications of this trend? Has the authority that used to reside in banks dissipated, or has it taken a new form? Disintermediation creates an information problem for suppliers and users of funds.[30] In an intermediated environment a lender can depend on the prudential behaviour of the bank, which is regulated and required to maintain a certain liquidity under the Basle standards. There is relatively low risk to the supplier of funds where intermediation is the norm. However, in a securitized funds environment in which no institution stands between the supplier of funds and the user, the supplier must make a judgement about the likelihood of repayment by the user. Given the high transaction costs of gathering this information for individual funds suppliers it is not surprising that institutions have developed to provide judgements on the creditworthiness of security issuers.[31] Because there is no merchant relationship between providers of these judgements and the users of this knowledge with regard to the funds themselves, this is not the same form of relationship that banks have had with their customers. The providers of the judgement risk only their credibility, not their balance sheet when they conduct this business. This interest is in making an accurate rating, not in determining which are reliable credits for the purpose of furthering their own balance sheet. However, in a disintermediated GPE, in which the creation and sale of knowledge seems to be displacing more traditional financial relationships from centre stage, these institutions of

capital market judgement may have become regulatory mechanisms of governance. It is to these mechanisms – the debt security rating agencies – that this article now turns.

DEBT SECURITY RATING

Debt security rating agencies had their beginnings in the early part of this century as a result of failed railroads, Florida land schemes and other property deals in the far West of the United States.[32] Two major agencies dominate the market in ratings, listing around US$3 trillion each.[33] A host of smaller agencies compete for market niches. The two major agencies are Moody's Investors Service (Moody's) and Standard & Poor's Ratings Group (S&P). Both are headquartered in New York. Moody's is owned by Dun and Bradstreet, the information concern, while S&P is a subsidiary of McGraw-Hill, the publishing company. S&P is split into two major groups, one that deals with debt rating, and the other with equity analysis. A demarcation line separates the two parts of the corporation. Moody's concern themselves exclusively with debt, although parts of their parent corporation conduct equity research.[34] Both agencies have branches in London, Paris, Frankfurt, Tokyo and Sydney. Two American agencies dominate the second tier. These are Fitch Investors Service and Duff & Phelps. Fitch is mainly in the business of municipal and corporate rating, while Chicago-based Duff & Phelps exclusively rates industrial corporations. Neither has any presence outside the USA, although Fitch did have a European presence at one time. IBCA, a London-based agency that has its roots in rating banks, has in recent years expanded its business into the corporate area. It now has offices in New York, Paris, Madrid and Tokyo. It recently merged with Euronotation of France, in what may be the first step toward the creation of a 'true European rating agency'.[35] In addition, there are a host of domestically focused agencies in a number of countries, including Japan, France, Canada, Israel, Brazil, Mexico, South Africa, and most recently, the Czech Republic.[36] Rumours constantly circulate in the financial press about the creation of a German rating agency.[37]

What do bond raters actually do? Bond raters make judgements on the 'future ability and willingness of an issuer to make timely payments of principal and interest on a security over the life of the instrument'. [38] The more likely 'the borrower will repay both the principal and interest, in accordance with the time schedule in the borrowing agreement, the higher will be the rating assigned to the debt security'.[39] Ratings are made on corporations, financial institutions, municipalities, and sovereign governments in terms of long-term obligations such as bonds or short-term obligations such as commercial paper. The processes that lead to a rating will be discussed below. The product the bond raters produce is a

letter symbol reflecting a relative ranking on a scale from most to least creditworthy. The agencies are adamant that a debt rating is 'not a recommendation to purchase, sell, or hold a security, inasmuch as it does not comment as to market price or suitability for a particular investor', because investors' risk/return trade-offs vary.[40] What bond raters do must be distinguished from equity analysis, where a buy/sell recommendation is fundamental. It has become a convention in the industry to distinguish between investment and speculative grade credits as a result of US state laws enacted during the interwar period which limited the investment opportunities of pension funds to those above a certain benchmark.[41] S&P provide four categories of investment grade, from AAA to BBB and seven of speculative grade, from BB to D (for default). Moody's rank from Aaa to Baa3, and Ba1 to C respectively.[42] Both agencies have other scales for short-term debt obligations such as commercial paper. Bond raters maintain surveillance over the issues they rate and will warn investors when they consider that developments may lead to a revision to an existing rating in either an upward or downward direction. The following section of this article investigates the elements of the rating process.

RATING METHODOLOGY

Most securities issuers approach the rating agencies themselves to initiate the rating determination, although the bond raters do on occasion approach the issuer when they become aware that a major issue is about to be offered for sale. Recently, Securities and Exchange Commission (SEC) Rule 415 has allowed issuers to file in advance in order to sell a given value of securities in the US when market conditions are agreeable. This has meant that corporations have been able to bring a new issue to market at very short notice. As a consequence, 'it has become common practice for issuers' managements to meet with S&P analysts on a regular, reasonably frequent basis, regardless of whether a new issue is imminent'.[43] Three types of information flow into the rating process. The first type of information is the publicly available kind. This includes quantitative information such as audited financial statements and qualitative information such as media reports on the state of the industry, municipality or country. The second type is the information disclosed by the issuer themselves. This includes up-to-date financial information on the operating position of the entity. But it also includes qualitative information on accounting policy, management experience and skill, competitive position and corporate strategy. The third type of information is provided by competitors of disgruntled former employees of the issuer, amongst others. The bond raters claim this sort of information is uncommon and is treated sceptically, but they exhibit no qualms about asking

questions of the issuer based on these anonymous tips.[44] These information flows are always supplemented with extensive meetings between issuer and rater. The actual rating is made by vote in a rating committee, sometimes disparagingly referred to as the 'Star Chamber', on the recommendation of the analytical team.[45] The composition of the rating committees and the internal deliberations within the rating agencies on any particular issue are kept strictly confidential. The judgement that is made by the committee weighs the quantitative and qualitative factors in each case because 'there is no formula for combining these scores to arrive at a rating conclusion'. Accordingly, 'such judgements are highly subjective. Yet that is at the heart of every rating.'[46] The rating is generally subject to appeal by the issuer. But there is no regulatory requirement for this: rating opinions are defendable as free speech within the terms of the First Amendment to the Constitution of the United States.[47]

Rating methodology varies by the nature of the credit. In the case of industrial debt, it is important to understand that ratings do not reflect merely the accounting or financial position of the enterprise. While that is considered fundamental to the likelihood of successful repayment of obligations, understanding financial risk is not sufficient. Financial considerations such as debt/equity ratios of various kinds are considered alongside business risk factors that influence the probability of a sufficient stream of funds flowing into the business to meet obligations.[48] In the case of municipalities, the bond raters make judgements about the future prospects for the tax base and the professionalism of local government, amongst other variables.[49] This led to controversy when Moody's downgraded the City of Detroit in November 1992. City officials considered that they had met the stringent quantitative criteria for greater confidence, which had to do with the City budget, while Moody's based its negative view of the City on 'extraordinarily weak credit fundamentals' in Detroit itself, such as depopulation (the City is expected to shrink to 400,000 by 2012, from around one million people in 1992, which is already down 44 per cent on 1950), maximal tax rates and unemployment at twice the US average. Moreover, the vast majority of the City residents are poor. Raymon L. Flynn, the Mayor of Boston and past president of the United States Conference of Mayors, is critical of the inclusion of factors such as these by the bond raters because he believes these are the sort of issues that should be judged by the electorate and do not impact directly on creditworthiness.[50] In the case of sovereign credits, a judgement has to be made by the agencies not just about the capacity to repay but also the willingness to repay. This is an important consideration because 'the enforceability of a legal claim against a sovereign government by a foreign investor is limited at best'.[51]

Creditworthiness is a dynamic condition and the quality of the rating output immediately starts to deteriorate as new events occur which

impact on the liquidity and solvency of the debtor. Accordingly, the agencies place a great deal of emphasis on monitoring the condition of issuers on a continuous basis. This allows them to react to events more readily and give appropriate signals to the market about the condition of an issuer. This is important, because one of the major criticisms of the agencies has been the backward or historical focus of much of their credit analysis.[52] Attention to surveillance presumably improves the quality of analysis, based on a much deeper institutional knowledge of their credits by rating analysts, and consequently heightened awareness of likely risks. The willingness of firms to subject themselves to this monitoring has been heightened by the aforementioned SEC Rule 415, as taking advantage of 'shelf registration' in the market requires up-to-date ratings.[53] The surveillance relationship can readily be characterized in terms of an instituted system of rule, in which information is gathered as a prelude to possible discipline, should that information reveal a break in the understanding – or rating – that underpinned the relationship.[54] That discipline may take the form of a rating review and rating change, or a listing on Moody's 'Watchlist' and S&P's 'Credit Watch' lists which signal positive and negative rating implications of events or trends. Importantly, S&P place emphasis on the fact that credibility is gained when the 'record demonstrates' that an issuer's actions are consistent with its plans. This credibility may carry an issuer over a rough patch, because, 'Once earned, credibility can support the continuity of a particular credit rating' despite, say, short-term liquidity problems.[55] The next section of this article evaluates the extent to which the rating agencies can be considered mechanisms of governance.

RATING AGENCIES AS REGULATORY MECHANISMS OF GOVERNANCE

> The Masters of the Universe were a set of lurid, rapacious plastic dolls. . . . They were unusually vulgar, even for plastic toys. Yet one fine day, in a fit of euphoria, after [Sherman McCoy] had picked up the telephone and taken an order for zero-coupon bonds that had brought him a $50,000 commission, *just like that*, this very phrase had bubbled up into his brain. On Wall Street he and a few others – how many? – three hundred, four hundred, five hundred? – had become precisely that. . . Masters of the Universe. There was . . . no limit whatsoever![56]

Three developments have contributed to the growth of the regulatory authority of debt security rating during the era of the GPE. These are the structural power of disintermediated debt finance, the knowledge structure that has developed around economic and financial analysis in the GPE, and the coordinative position of rating agencies with regard to

economic and financial behaviour. The first development has been discussed above. Disintermediation has led to the growth of the structural power of securitized finance, in which structural power is understood as the capacity to condition the context in which events occur, as opposed to the behavioural power over the course of events themselves, by shaping the conceptual frameworks that market actors use to understand situations and the subsequent range of choices they consider to be within the acceptable range.[57] The same process has reduced the structural power of banks and public authorities. An article in *The Wall Street Journal* just prior to the 1992 US presidential election ruminated on this power. The report posed the question of whether the debt security market 'may now hold unprecedented power – perhaps even veto power – over US economic policy'.[58] US federal debt, it reported, stood at around $3 trillion, with interest costs of approximately $200 billion per year. If President Clinton was thought likely to pursue a strategy perceived to be inflationary (and therefore reduces the yield on fixed income securities such as US Treasury bonds) the reaction, according to the *Journal*, is likely to be 'swift and painful' in the electronically-linked secondary market. This would in turn raise the price or interest rate the Treasury would have to offer to clear the market in new US Treasury bonds. Because 'many other long-term rates, such as mortgage rates are keyed to the Treasury debt, rising long-term rates can stagger the economy'. This power has led the players in the debt security market to be labelled 'bond vigilantes', because when inflation threatens their earnings 'they act as vigilantes to restore law and order to the market and the economy'. According to the *Journal*, Clinton's plans at the time of the election seemed to imply a $20 billion net increase in federal spending in the 1994 fiscal year. If bond buyers were to react with even modest anxiety to this prospect and send long-term rates up by, possibly, one percentage point, the US deficit would increase by $20 billion, effectively doubling to $40 billion the net cost of President Clinton's new policies. But this is an unlikely scenario, concluded the *Journal* reporters at the time because, according to Edward Yardeni of C.J. Lawrence Inc., the bond vigilantes are 'forcing Clinton to recognize that they will be *voting* every day the bond market is open', and if Clinton ignores them, he will find out very quickly who is in the 'driver's seat'. Makers of public policy, like corporate executives who want access to cheap finance, must acknowledge the structural power of disintermediated finance and incorporate debt security markets into their policy agendas and market plans at the earliest stages, and not as an afterthought. This precognition must in turn expand the authority of rating agencies as these institutions are a primary vehicle through which the actions of issuers are examined and judged.

The second factor which contributes to the regulatory capacity of rating agencies is their provision of knowledge to the increasingly de-

centralized financial markets. Strange has argued that knowledge structures exist which have the effect of valuing or devaluing different forms of knowledge.[59] She considers that a knowledge structure 'determines what knowledge is discovered, how it is stored, and who communicates it by what means to whom and on what terms'.[60] This structure, created by the dominant social forces and their major concerns, comprises a certain pattern of incentives and constraints on the development of forms of knowledge. The structural empowerment of the capital markets has been matched by a new valuation of certain forms of knowledge. The creation of the Euromarkets and the deregulation of capital movements characteristic of the past 20 years have greatly increased the mobility of money within the global economy.[61] Walter B. Wriston, the former Chair of Citicorp, has concluded from these developments that an 'information standard' now exists in which the mobility of investment funds is maximized through the rapid information transfers possible with contemporary communications technology.[62] This standard acts as a constraint on forces that would seek to create, for example, more narrowly regulated environments for investment, as the owners and managers of those funds will seek to circumvent possible controls on the freedom to maximize. However, raw information is not the most important consideration. What is crucial is the valuation placed on analytic frameworks having to do with economic and financial advice. This valuation has grown because of the increased uncertainty resulting from the greater volatility of international financial transfers. Corporations and governments want to reduce or at least specify the amount of risk they are assuming.[63] However, the increasing demand for this form of information and the consequent growth in its authoritativeness belies the processes of judgement which are central to it. These processes are based on certain assumptions tied to dominant interests in society, as Strange's conception of a knowledge structure implies. What is characteristic of this framework is the domination of narrow assumptions about market efficiency, in which undistorted price signals are the objective and state intervention is generally considered meddlesome.[64] Typically, 'transition costs' (such as unemployment) are not factored into the advice but assumed to be outweighed by the new environment created. However, this is merely an 'article of faith' of this framework, as Granovetter has pointed out.[65]

Foucault argued that 'particular technical devices' or 'intellectual technology' such as writing, listing, and numbering render a realm knowable and therefore potentially controllable. These procedures of inscription of 'objects' such as the economy, the corporation and so on are 'rendered in a particular conceptual form', which have implications for governance.[66] Rather than a series of ideas which exist in a political vacuum, knowledge is, in fact, as Smith has argued, a form of social organization with

dominating and subordinating dimensions.[67] Her argument is that knowledge, once produced, loses its connection with those who have created it. It becomes 'externalized' and debates, findings and opinions come to stand alone and acquire 'facticity'.[68] Illustrating this phenomenon, Leo C. O'Neill observed that [*sic*] 'what makes our ratings such a strong factor in the market is that they take into account all the factors that surround a debt obligation and *reduce it to a letter symbol which is easily understood*'.[69] This process, which limits the conceptual universe of social actors involved, can be seen in the salience that ratings have acquired, for example, in the corporate planning process in the US.[70] Ratings are also ubiquitous in advertising. Both the Union Bank of Switzerland and Credit Suisse used ratings in print advertisements during 1992, most notably in *The Economist*. One of these advertisements, for Union Bank, began with the line, 'There are three standards for measuring banks: Moody's, S&P's and our clients.' Ratings have also been used in television commercials, most recently for Canada Trust.[71]

The final factor which has contributed to the regulatory capacity of rating agencies is the fact that they are institutions in what is an increasingly deinstitutionalized context, where traditional forms of authority and organization are less and less evident. Banks are no longer the sources of authority they once were, and governments have increasingly become (*sic*) 'nightwatchmen' over their capital markets rather than allocators or managers of capital investment. This leaves few institutions left with oversight and knowledge of the market, other than market participants. This must increase the structural power of debt rating agencies. That rating agency judgements are increasingly the subject of media analyses probably reflects the understanding that the 'bean counters' have become important sources of coordination within an increasingly decentralized system. A 'steering mechanism' seems to have developed,[72] albeit imperfectly, to contain some of the contradictions generated by the liberalization of markets and provide a 'degree of orderliness' to corporate behaviour.[73] According to Mintz and Schwartz, this 'orderliness' has two aspects. The first aspect relates to situations where the agencies 'directly intervene in the affairs of a corporation' and in 'certain circumstances . . . dictate corporate policy'.[74] The other dimension captures the broader sense of rating agency power as mechanisms of regulatory governance, through the exercise of structural power. In this dimension, the agencies can be seen to in part create a 'set of de facto rules' which 'responsible corporate citizens' must honour or 'risk financial disfavour'.[75] According to Mintz and Schwartz, this has created a situation of hegemonic control in which corporate activity is conditioned by the desire to appeal to the preferences of the rating agencies so as to gain access to cheap capital, or conversely, not to lose such competitively advantageous access.[76] It seems that the 'internationalized policy pro-

cess', which provides some measure of coordination within the GPE, occurs not just at the level of relations between states, but within transnational capital itself. Two considerations are important with regard to these transnational regulatory institutions. The first of these is the inadequacy of the existing interstate framework for macroeconomic coordination. Group of Seven or European Union structures have not proven themselves adequate to meet these challenges, as the global exchange crisis in the fall of 1992 has indicated. Yet the process of articulating and reinforcing the knowledge structure of economic and financial analysis through non-state institutions seems to have produced considerable change at the microeconomic policy level, as exemplified by some Latin American countries. The second consideration is that these forms of governance are, of course, private in nature, not subject to the usual forms of public accountability. Governance of the type identified here may reflect and in turn help to constitute a world order in which the demands of investment maximization are increasingly unchallenged. The following section explores the implications of rating agencies considered as regulatory mechanisms of governance.

IMPLICATIONS OF AGENCY GOVERNANCE

> What you consumed over your lifetime was in part borrowed, and even today it still is . . . but at the end of the day if people don't believe it, then someone will pull the plug . . . the only difference between an African Third World state and a Canada or New Zealand is that they actually hit the end of their credit limit very quickly; we're given much more rope to hang ourselves with . . . but when your credit rating is on the line, that focuses the mind.[77]

Growth in the structural power of debt security rating can be assessed in three broad categories. The first set of implications is for investment, the second is for policy choice and the third is for national determination. What are the implications for investment? The investigation of rating agency governance for investment is broken down into three sets of questions. First, the question of cost of capital. Do ratings make a difference to the cost of debt? Second, there is the important issue of the perception of the role of ratings. What tells us that people in the market think that ratings are crucial? Finally, there is the question of the perception of rating agencies as powerful. Are bond raters acknowledged as quasi-public authorities? Is it a widespread view that bond raters are part of the context of the market, although there may be criticism of them at the margins?

The primary influence on the new issue and secondary corporate bond markets as a whole are shifts in interest rates.[78] These determine the price that issuers as a collective must offer to attract funds into their market and

away from other investment opportunities such as banks, the stock market and real estate. Beyond these general influences there are the particular circumstances of the debt instrument itself. For example, whether the bond is backed by a sinking fund, in which the issuing company sets aside revenue for the purpose of debt repayment.[79] Other things being equal, the primary factor that distinguishes between different bonds is the creditworthiness of the borrower. However, as Foster observes: 'There is a dispute in the literature over whether debt-security ratings convey new information to capital market participants (that is, beyond that already in the public domain from other sources).'[80] It may be the case that the market has made its own assessment of the creditworthiness of the issuer. Quantitative analysis has not progressed sufficiently to attribute causation. This controversy is even more pronounced with regard to the impact of downgrades on yield spreads in the secondary market, as one rater observed.[81]

Despite the confusion in the quantitative literature, ratings are certainly perceived to have a major influence on the cost of capital by market participants.[82] It is these perceptions, rather than an inherent reality, that ultimately shapes the impact that ratings have on economic and financial policy. If issuers believe that ratings and the gradations between them are very important this will shape their commercial behaviour. If bond holders believe ratings to be important information this will influence their decisions to buy and sell debt. There are two levels on which market actors and others perceive ratings to be important. The first of these has to do with what Gill and Law have called the behavioural form of power.[83] At this level the actions of rating agencies are perceived to have a direct effect upon market perception and thus upon the views of debt issuers and their behaviour. As Mintz and Schwartz comment, at this level the agencies reveal their capacity to 'directly intervene in the affairs of a corporation'.[84] The clearest instance of this form of leverage is the impact of rating downgrades on the US auto industry. The history of rating actions goes back to the early 1970s, in the case of the Chrysler corporation. However, the most prominent recent example of the perceived behavioural leverage of rating agencies is General Motors (GM).

At the end of 1991, GM announced it had made a 'disastrous $4.5 billion loss' on operations.[85] Subsequently, the corporation declared that it would close 21 plants and cut 74,000 jobs.[86] According to Cox, this 'was intended, by appearing as a token of the corporation's intention to increase competitiveness, to deter a down-grading of its bond rating which would have increased the corporation's cost of borrowing'.[87] The perceived threat of a downgrade was reinforced by *The Wall Street Journal*, which noted that the threat of a rating reduction had 'hung heavily' over Robert C. Stempel, GM's chairman at the time, and had 'pushed' him to speed up the announcement of restructuring plans.[88] However, Stempel's

strategy did not work and the huge corporation was downgraded by Moody's in January 1992, and by Standard & Poor's in March of that year.[89] In justifying their action Moody's officials said that they considered the auto maker's restructuring plans were unlikely to solve its competitive problems.[90] Pressure on GM from the agencies did not end with these downgradings. According to Judith H. Dobrzynski of *Business Week*, 'the prospect of sinking credit ratings that would deny it access to equity and commercial paper, eventually prompted independent directors' to pressure GM's 'old guard', as personified by Chairman Stempel, the 'deliberative engineer', to quit in late October 1992.[91] Subsequently, further warnings of possible downgrades in the form of rating reviews came from the agencies, including the possibility of the relegation of GM debt to junk bond status.[92] Although the agencies subsequently acknowledged some improvement in operating performance at GM, what seems to have tipped the agencies into the further downgrades of late November 1992 and February 1993 were unfunded pension costs and escalating medical benefit liabilities which threatened to substantially degrade GM's balance sheet.[93] As S&P commented,

> Servicing its massive benefits obligations will be a substantial drain on the company's financial resources – and a significant competitive disadvantage – for the foreseeable future. . . . GM's unfunded pension liability increased to $14.0 billion at year-end 1992, from $8.4 billion one year earlier . . . the company has reported a retiree medical liability of $24 billion . . . reflecting not only assumption revisions, but the failure to negotiate with the United Auto Workers an agreement to cap future benefits. Adjusting for these liabilities effectively eliminates GM's consolidated net worth, in contrast to GM's reported equity of $6.2 billion at year-end 1992.[94]

Fearing this sort of judgement, which has hampered General Motors Acceptance Corporation (GM's finance company subsidiary) by raising the cost of commercial paper sales, GM has been forced to raise bank lines of credit instead, 'completing the largest bank credit package ever', with the attendant costs of intermediation, as discussed elsewhere in this article.[95] GM has also been raising relatively high-cost equity capital in response to the impact of reduced credit ratings on the cost of debt finance.[96]

The second type of leverage the agencies possess is structural power. Because it has to do with frameworks of thought, structural power is much harder to detail empirically and disentangle from other influences on the way managers think and act. However, it is also probably the more significant aspect of the relationship between rating agencies and the capital markets. A flavour of this structural power can be picked up from trade journals such as *Institutional Investor* and *Euromoney*, which act as

mouthpieces for industry concerns about rating proficiency. These help to spread the understanding amongst pension fund managers – the lenders of funds – and corporate CFOs (chief finance officers) and their public sector equivalents – the borrowers of funds – that rating agencies expect more than just getting the numbers right from credits, that credits are expected to show foresight in management and business acumen, as well as financial prudence.[97] A measure of the structural power of the rating agencies can be gained from Glen Yago's observation that 'In some of my discussions in Washington [relating to the junk bond phenomenon], I found Congressional leaders who mistakenly thought that rating and credit analysis of bonds was done by government agencies and federally mandated.'[98] Another indication of the structural power of rating agencies is that US corporations often write ratings targets into their corporate plans for the coming financial year.[99] As Emmer commented, those corporations that failed to follow this path learnt in 1991, during a time of stringent bank credit rationing, the costs of not adopting this standard. Indeed, interviews in London confirmed the fact that recessionary conditions have heightened the structural leverage of rating agencies, as alternative sources of credit, such as bank loans, dry up and as difficult operating conditions induce a desire to play a more cautious commercial game.[100] These factors place a greater emphasis on taking the views of rating agencies into account prior to rating determinations.

If rating agencies have behavioural and structural leverage over corporations it becomes a question of whether rating agencies are a new form of financial intermediation? Has the old type of intermediation by banks simply given way to a new intermediary in the form of a rating agency? The answer to this question seems to be no. Rating agencies do not have the same relationship to borrowers and lenders as banks do. They neither lend nor borrow like banks, and thus have entirely different legal obligations. Nor do they place their balance sheets directly on the line when they issue a rating. While their credibility is at stake (and the importance of this cannot be understated) this does not establish the same incentives on behaviour as entering into a financial transaction. There is no pecuniary advantage to the rating agency from any particular rating determination, whereas this is the case with financial transactions between banks and their customers. Thus, the nature of the contract in either case places different incentives on banks and rating agencies which lead to different roles in the market and distinguishable effects on capital allocation. Bond raters simply want to issue a rating which reflects the probability of repayment at the contracted rate of interest at the right time. Banks want to minimize their cost of borrowing and maximize their real return from lending, within the context of competing suppliers of capital. The different incentives on bond raters and suppliers of capital is reflected in the common criticism of bond raters made within the

financial markets, that they look at creditworthiness in historical terms, once removed from what is happening in the market.[101]

A further implication for investment could be that the international growth of ratings through the creation of agencies modelled on American lines and through the establishment of foreign subsidiaries by the American agencies will export US models of financial orthodoxy. An element of this orthodoxy would appear to be a characteristically short-term investment horizon. This tendency reveals itself in the concern of pension fund managers with the quarterly performance of their assets and their readiness to dump a security in the secondary market when it is not performing at an acceptable yield.[102] As Ronald D. Peyton, of Callan Associates, a pension fund consulting firm, commented to *Business Week*, 'I doubt there's an investment manager in America whose contract doesn't have a 30-day cancellation clause.'[103] These time horizons, which raise the risks and therefore the cost of capital in the US, seem to exist because of the relatively distant relationship between suppliers and users of capital.[104] A major element of this antagonism is the lack of information investors have on the businesses they invest in. Only the 'outward manifestations' given in quarterly earnings data are considered fundamental in investment decision making.[105] The high cost of capital has business investment and management consequences which inhibit long-term planning for competitiveness, as seems to have been the case in differences between Japan and the United States.[106] Debt security rating agencies contribute to the divorce between suppliers and users of capital to the extent that their analysis merely reflects orthodox US theories of finance, and perhaps to the extent that they seek a uniform comparative system of rating world wide. Moreover, ratings themselves, as expressions of a 'neutral' judgement about a corporation, can often take on a life of their own and 'crowd out' analysis by the investor. This may be especially the case with large institutional investors such as pension funds.[107] Ratings may also have the effect of making some corporations overly prudent in their business activities. Ratings may become objectives in themselves, enshrined in corporate plans even where this raises the cost of capital for the concern in question and lowers long-term profitability.[108] This mark of esteem seems to have been of special concern to the Swiss banks who, as discussed, use their AAA ratings in advertising. It would be ironic if the international growth ratings based on US methodology and assumptions led to this sort of outcome overseas, just as US business leaders are calling for a greater role for the equity investor in corporate governance, so as to create the sort of 'patient capital' that has existed in countries with a more 'relational investing' system.[109]

The second set of implications of debt security rating governance have to do with policy choice in the liberal democracies. Governments have

increasingly financed their deficits with foreign debt during the 1980s. They 'now have to care about their international credit ratings' because they have to borrow in foreign currencies or have obligations to foreign investors.[110] In 1991, for example, non-resident investors held C$149.2 billion of Government of Canada and provincial bonds, an 84 per cent increase from the C$81.3 billion they held in 1985.[111] Governments are now much more effectively accountable to the 'bond vigilantes' and 'Masters of the Universe' and their agents than previously. Local policy decisions will be judged from the perspective of these external interests, within the context of assumptions about a liberal trade order and the free movement of capital within the GPE. Their debt exposures mean that governments are constrained to respond to this perspective. As Cox notes, among the very first acts of the new provincial government of Ontario in 1990 was for the recently installed Premier to visit New York to discuss credit issues with the rating agencies and other debt market players.[112] Even where the actual magnitude of a downgrade is minor, as was the case when Standard & Poor's reduced the rating on the Government of Canada's C$9 billion debt denominated in foreign currency, the impact on the credibility of the issuer can be immense. As *The Globe and Mail* (Toronto) commented at the time,

> While the downgrade is expected to increase the federal government's borrowing costs only marginally in the near future, [private] investment officials said the action sent alarms throughout international markets that Canada's financial health is eroding. 'It's a warning bell that the country's finances are deteriorating. This will only add to investor worries about Canada,' a New York investment executive said.[113]

For the developing countries, ratings provide perhaps the supreme seal of approval in their struggle to obtain development funds at a less than exorbitant cost, and with less risk than the recycled petrodollars they obtained from banks on floating interest rate contracts during the 1970s. Accordingly, in a recent *Euromoney* supplement on Mexico, there is a lengthy discussion of the probability of that country acquiring an investment grade rating from Moody's and S&P.[114]

Finally, there is the question of national determination and response to the growth of the US agencies' extra-US activities. Ten years ago Moody's and S&P had no analysts outside the USA. In 1993, they each had around 100 employees altogether in Europe, Japan and Australia. S&P opened a new branch in Toronto during the spring of 1993. Questions arise then, especially in times of tension and transformation in European–American and Japanese–American relations, about the aspirations of the major United States rating agencies. Will countries find that the regulation of their financial systems, ways of reporting financial information, industry

practices and financial cultures change in accord with an American agenda? Who is likely to resist the spread of the American agencies? Is the internationalization of rating simply another step toward greater global financial integration, or do the American agencies represent a more parochial interest in financial organization? There is growing resentment toward the US agencies in Europe which seems to have crystallized around the 1991 downgrading of Credit Suisse, the early 1992 downgrading of Swiss Bank Corporation and the longer-term problem that foreign agencies have had in getting SEC recognition in the USA as Nationally Recognized Statistical Rating Organizations (NRSROs).[115] NRSRO status is important because under many state laws US pension funds may not purchase bonds that have not been given an investment grade rating by an NRSRO, but only agencies rating US issues have been given this status by the SEC.[116] These are all US agencies with the exception of IBCA, which has established a branch in New York, seemingly in order to qualify. Regulation is much less significant in Europe, although this is a developing situation. These tensions have led to private discussions in London, Paris and Frankfurt about the establishment of a possible Europe-wide agency to compete with the major US-based agencies.[117] In addition to this concern, which reflects the cross-national significance of the SEC, Europeans complain that 'being based in the US, the two global agencies simply don't understand non-US businesses'.[118]

CONCLUSIONS

The argument of this article is that debt security rating agencies are exemplars of the new location and form of authority that is shaping international relations in the emerging world order. There are three aspects to this authority. The first has to do with the division of authority between state and non-state institutions, the second concerns the distribution of power among non-state institutions, and finally, the third has to do with conflict between rising and declining sectors of finance. The rise of the GPE and the decline of exogenous threats has changed the balance of authority between institutions of government and institutions of global civil society. Global civil society has become relatively empowered while state institutions have become less significant in the way things get done. Although both elected authority and what might be called 'manifest authority' are bound together in many ways in terms of the reproduction of political order, the argument here is that the shift in authority, as exemplified by debt security rating, has changed the character of that order in significant ways.

The second aspect of authority in the emerging world order to consider is its sectoral character. Although a shift from 'high' to 'low' politics, and

from state to non-state institutions within the GPE has been identified, a relocation of authority within the GPE itself is observed. This transformation has involved the erosion of the control formerly exercised by some of the great industrial concerns, and a corresponding increase in the leverage available to financial forces and those industries in which information is the raw material and knowledge the product. The downgrading of General Motors by the rating agencies reflects this shift. Accordingly, finance may, to use Robert Cox's words, have increasingly 'become decoupled from production to become an independent power, an autocrat over the real economy'.[119]

The final aspect of the relocation of authority to consider are the transformations within the financial realm itself. International political economy has expended a great deal of its initial research effort on studying the activities of the major international banks and their regulation. This made a lot of sense when the LDC debt crisis threatened to overwhelm the international credit system. However, that risk did not materialize and banks have subsequently become the preserve of the most marginal users of funds in the United States, and increasingly elsewhere. In global capital markets, banks have been exposed to much greater competition by their governments and have come under pressure to play the markets like any other investor. The increased cost of this activity has been passed along to funds users, raising the cost of capital to them, reducing their demand and spurring the drive to securitization. With the growth of alternative mechanisms for gathering information about credits and producing saleable knowledge about them, the rationale for banking intermediation of credit allocation is threatened. Banks will – in the medium term at least – continue to be major pools of funds because of their retail activities. But they will become less like lenders and more like portfolio managers, and consequently less like sources of authority in the market and more like just another part of the market itself.[120] The creation of knowledge and the passing of judgement, based on a strategic position in the production of financial, economic and policy information, will increasingly fall to debt security rating agencies.

What will be the effect of all this upon the emerging world order? Two probable scenarios come to mind. On one hand, the regulatory mechanisms of governance identified in this article could engender a much more thoroughgoing hegemony than has been seen before. During the Cold War, the coherence of transnational relations was maintained by exogenous threats from the Soviet Union. The regulatory mechanism identified, and perhaps others like it, have the character of endogenous forces, at least as far as the advanced industrial societies are concerned. This will probably mute opposition, or as seems to be the case in Europe, channel that opposition into rating competition. For the developing countries, it seems that they are now playing a game with a very different

referee. Rating agencies, as mechanisms of governance without government do not invoke quite the same nationalist hostility that interstate regulation seems to, especially for elites in these countries, infused with a neo-liberal business ethos. The medium-term effect could be to further the strategy of new constitutionalism by removing many areas of domestic policy debate from the political arena, and to undermine radical intellectual elites as a new form of intellectual orthodoxy – economic and financial analysis – becomes the dominant framework in which policy issues are cast. On the other hand, this form of governance may be fragile. An order characterized by governance based in global civil society could conceivably be less dynamic than one with an active political executive. This could reduce the adaptive capacity of the global system, just as threats from transboundary problems like global warming become much more of a concern. It will certainly be the case that this order will be less inclusive than in the past. This may mean that the trend to urban decay typified by the City of Detroit may accelerate and spread to other areas of the world as they too come to be judged by this regulatory mechanism.

NOTES

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1 This quotation, from a speech by Daniel Webster in the United States Senate, 18 March 1834, appears on a plaque above the main entrance to Moody's Investors Service, New York City.
2 John J. Mearsheimer, 'Back to the Future: instability in Europe after the Cold War', *International Security* 15, no. 1 (summer 1990), pp. 5–56.
3 Susan Strange, *States and Markets: An Introduction to International Political Economy* (New York: Basil Blackwell, 1988), p. 104.
4 Ibid., p. 108.
5 'Fear of finance: a survey of the world economy', *The Economist*, 19 September 1992, p. 5.
6 By global civil society, I include the ideas, non-state institutions and social forces that have developed in concert with the global political economy. I am not referring here to a participatory conception of society as a counterhegemonic force, say, that developed in eastern Europe at the time of the

1989 revolutions. Instead, I use civil society as an analytical category in the ideal-typical sense, as discussed by John Keane. See his 'Introduction' in John Keane (ed.) *Civil Society and the State: New European Perspectives* (London: Verso, 1988). I thank Barry Gills and Ronen Palan for pointing out the potential confusion in my previous use of this term.

7 I am grateful to Susan Strange for pointing out the salience of non-governmental authorities such as these in private correspondence with the author, 14 January 1992.

8 Two major processes are evident in the development of the GPE. The first of these, the internationalization or globalization of capital, is the growth in the mobility and fungibility of investment in both its direct and portfolio forms. The second process has to do with changes in the policy outputs of governments, which, taken together, give rise to the transnationalization of state authority. On the global political economy, see Stephen Gill, *American Hegemony and the Trilateral Commission* (Cambridge: Cambridge University Press, 1990), p. 243, and Stephen Gill and David Law, *The Global Political Economy: Perspectives, Problems, and Policies* (Baltimore, MD: The Johns Hopkins University Press, 1988), pp. xvii–xxiii.

9 James N. Rosenau, 'The relocation of authority in a shrinking world'. *Comparative Politics* 24, no. 3, April 1992, p. 256.

10 Ibid.

11 Ibid.

12 Ibid. On this theme see also David N. Gibbs, 'Taking the state back out: business power and the fallacies of statism', paper presented to the annual meeting of the American Political Science Association, Chicago, September 1992.

13 Stephen Gill, 'Gramsci and global politics: towards a post-hegemonic research agenda' in Stephen Gill (ed.) *Gramsci, Historical Materialism and International Relations* (Cambridge: Cambridge University Press, 1993), pp. 10–11.

14 Yale H. Ferguson and Richard W. Mansbach, 'Between celebration and despair: constructive suggestions for future international theory', *International Studies Quarterly* 35, no. 4, December 1991, p. 376.

15 Ibid.

16 Theodor Mommsen, cited by Leonard Krieger, 'Authority' in Philip P. Wiener (ed.) *Dictionary of the History of Ideas: Studies in Selected Pivotal Ideas*, vol. I (New York: Charles Scribner's Sons, 1973), p. 143.

17 Ferguson and Mansbach, op. cit. note 14, p. 376.

18 James N. Rosenau, 'Governance, order, and change in world politics' in James N. Rosenau and Ernst-Otto Czempiel (eds) *Governance without Government: Order and Change in World Politics* (Cambridge: Cambridge University Press, 1992), p. 4. On Foucault, see Peter Miller and Nikolas Rose, 'Governing the economy', *Economy and Society* 19, no. 1, February 1990, pp. 1–31.

19 Rosenau, op. cit. note 18, p. 5.

20 Ibid.

21 Ibid.

22 Ibid., p. 6.

23 Saskia Sassen, *The Global City: New York, London, Tokyo* (Princeton, NJ: Princeton University Press, 1991), p. 6.

24 Graham Bannock and William Manser, *International Dictionary of Finance* (London: Hutchinson/*The Economist*, 1989), p. 86.

25 On disintermediation, see Bannock and Manser, ibid. p. 66. Also see David Stimpson (ed.) *Global Credit Analysis* (London/New York: IFR

Publishing/Moody's Investors Service, 1991), pp. 4–11. Commercial paper is an unsecured, short-term debt obligation, which matures within one year of issue. On commercial paper, see John Downes and Jordan Elliot Goodman, *Dictionary of Finance and Investment Terms*, 3rd edn (New York: Barron's, 1991), p. 76.

26 These figures are taken from the *Balance of Payments Yearbook* (Washington: International Monetary Fund, various years) as cited in Randall Germain, 'From money to finance: the international organization of credit', paper presented to the 1992 annual meeting of the Canadian Political Science Association, Prince Edward Island, June 1992, p. 14. Further evidence of the disintermediation trend can be found in Stimpson, op. cit. note 25, pp. 4–11.

27 Bannock and Manser, op. cit. note 24, p. 34.

28 Germain, op. cit. note 26, p. 14.

29 'Time to leave: a survey of world banking'. *The Economist*, 2 May 1992, p. 9.

30 On the impact of communications technology on this information problem in the securities markets, see Richard O'Brien, *Global Financial Integration: The End of Geography* (London: The Royal Institute of International Affairs/Pinter Publishers, 1992), p. 10.

31 I am grateful to Chris Robinson for pointing out the transaction cost argument to me. Further elaboration of this approach can be found in Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985).

32 Interview with Leo C. O'Neill, President, Standard & Poor's Ratings Group, New York City, 18 August 1992.

33 Interview with Edward Z. Emmer, Executive Managing Director, Corporate Finance, Standard & Poor's Ratings Group, New York City, 17 August 1992.

34 Interview with Joanne W. Rose, Vice President and General Counsel, Standard & Poor's Ratings Group, New York City, 16 February 1993.

35 Rupert Bruce, 'Debt-rating agencies fill the gap'. *The International Herald Tribune*, 14–15 November 1992, p. 11.

36 Susan Greenberg, 'New rating agency causes a stir', *The Guardian*, 13 February 1993.

37 Richard Waters, 'Rating agencies complete merger', *The Financial Times*, 21 October 1992.

38 *Moody's Investors Service: Consistency, Reliability, Integrity* (New York: Moody's Investors Service, ND), p. 3.

39 George Foster, *Financial Statement Analysis*, 2nd edn (Englewood Cliffs, NJ: Prentice-Hall, 1986), p. 498.

40 Standard & Poor's Ratings Group, *Ratings Handbook*, vol. 1, no. 5, August 1992, p. 183.

41 Interview with Leo C. O'Neill.

42 For a complete breakdown of these scales for S&P, see the S&P *Ratings Handbook*, August 1992, pp. 183–7. For Moody's scales, see Stimpson, op. cit. note 25, pp. 71–86.

43 Standard & Poor's Ratings Group, *S&P's Corporate Finance Criteria* (New York: Standard & Poor's Corporation, 1992), p. 9.

44 Interview with Brian I. Neysmith, President, Canadian Bond Rating Service, Montreal, 16 June 1992.

45 Vivian Lewis, 'Too big for their boots?', *The Banker*, October 1990, p. 12.

46 *S&P's Corporate Finance Criteria*, op. cit. note 43, p. 15.

47 Interview with Joanne W. Rose.

48 With regard to ratio analysis, S&P have developed and published sectoral criteria for debt leverage positions that influence their judgement of any

particular issuer's balance sheet. See *S&P's Corporate Finance Criteria*, op. cit. note 43, p. 9.

49 The search for the relative weighting of these factors in determining ratings has fostered an extensive literature of its own. Although this work emphasizes the significance of administrative and political variables, these have proven stubbornly resistant to the application of quantitative analytical tools. See, for example, George S. Cluff and Paul G. Farnham, 'A problem of discrete choice: Moody's Municipal Bond Ratings', *Journal of Economics and Business*, vol. 37, December 1985, pp. 277–302.

50 Barbara Presley Noble, 'A downgraded Detroit cries foul', *The New York Times*, Tuesday 3 November 1992, p. C1.

51 Standard & Poor's Ratings Group, *Standard & Poor's Ratings Guide* (New York: McGraw-Hill, 1979), p. 231.

52 On this concern, see Margaret A. Elliott, 'Rating the debt raters', *Institutional Investor* 22, no. 14, December 1988, pp. 109–12 and Fran Hawthorne, 'Rating the raters', *Institutional Investor* 24, no. 9, July 1990, pp. 121–7. See also 'OK, so what is quality?', *Euromoney* supplement, September 1991, pp. 36–44 (especially p. 40).

53 *S&P's Corporate Finance Criteria*, op. cit. note 43, p. 9.

54 For a discussion of surveillance in these terms, see Christopher Dandeker, *Surveillance, Power and Modernity: Bureaucracy and Discipline from 1700 to the Present Day* (New York: St Martin's Press, 1990), pp. 39–40. See also Anthony Giddens, *The Nation-State and Violence* (Berkeley and Los Angeles, CA: University of California Press, 1987).

55 Standard & Poor's Ratings Group, *S&P's Structured Finance Criteria* (New York: Standard & Poor's Corporation, 1988), pp. 16–17.

56 Tom Wolfe, *The Bonfire of the Vanities* (New York: Bantam, 1988), p. 12.

57 On behavioural and structural power see Hugh Ward, 'Structural power – a contradiction in terms?', *Political Studies* 35, no. 4, December 1987, pp. 593–610; Strange, op. cit. note 3, pp. 24–9; Gill and Law, op. cit. note 8, pp. 71–5; Stephen Gill and David Law, 'Global hegemony and the structural power of capital', *International Studies Quarterly* 33, no. 4, December 1989, pp. 475–99.

58 Douglas R. Sease and Constance Mitchell, 'The vigilantes: world's bond buyers gain huge influence over US fiscal plans', *The Wall Street Journal*, 6 November 1992, p. A1. Italics applied for emphasis. For a subsequent treatment of this issue once Clinton was inaugurated, see Thomas T. Vogel, Jr and Terrence Donnelly, 'Treasury bond prices surge on strong buying at 30-year sale and Clinton deficit remarks', *The Wall Street Journal*, 12 February 1993, p. C16.

59 Strange, op. cit. note 3, pp. 115–34.

60 Ibid., p. 117.

61 Ibid., pp. 102–4.

62 Jeffry A. Frieden, *Banking on the World: The Politics of American International Finance* (New York: Harper & Row, 1987), p. 114. See also Walter B. Wriston, *The Twilight of Sovereignty: How the Information Revolution is Transforming Our World* (New York: Charles Scribner's Sons, 1992), pp. 55–73.

63 It may also be the case that this form of knowledge has gained new salience because of the development of what Castells has termed the 'informational mode of development', in which, as in foreign exchange or stock speculation, 'knowledge intervenes upon knowledge itself in order to generate higher productivity'. Manuel Castells, *The Informational City: Information Technology, Economic Restructuring, and the Urban–Regional Process* (Oxford: Basil Blackwell, 1989), p. 10.

64 Stephen Gill, 'The emerging world order and European change', in Ralph Miliband and Leo Panitch (eds) *New World Order? Socialist Register 1992* (London: Merlin, 1992), p. 177.
65 Mark Granovetter, 'Economic action and social structure: the problem of embeddedness', in Mark Granovetter and Richard Swedberg (eds) *The Sociology of Economic Life* (Boulder, CO: Westview, 1992), p. 73.
66 Miller and Rose, op. cit. note 18, pp. 6–7. On this theme, see also William H. Melody, 'The information society: implications for economic institutions and market theory', *Journal of Economic Issues* 19, no. 2, June 1985, pp. 523–39.
67 Dorothy E. Smith, *The Conceptual Practices of Power: A Feminist Sociology of Knowledge* (Toronto: University of Toronto Press, 1990), p. 61.
68 Ibid., p. 66.
69 Interview with Leo C. O'Neill. Italics have been applied for emphasis.
70 Interview with Edward Z. Emmer.
71 'Independent bond rating agencies judge Canada Trust as safe as the major banks', broadcast on Canadian Broadcasting Corporation, station CBLT Toronto, January–March 1992.
72 Gill, op. cit. note 8, p. 214.
73 Beth Mintz and Michael Schwartz, 'Sources of intercorporate unity', in Michael Schwartz (ed.) *The Structure of Power in America: The Corporate Elite as a Ruling Class* (New York: Holmes & Meier, 1987), p. 22.
74 Ibid., p. 30.
75 Ibid., p. 22.
76 Ibid., p. 30.
77 Comments by Simon Upton, New Zealand Associate Minister of Finance, *W5 with Eric Malling*, CTV television network, Toronto, 28 February 1993.
78 Staff of the New York Institute of Finance, *How the Bond Market Works* (New York: New York Institute of Finance, 1988), p. 10.
79 Ibid., pp. 175–6.
80 Foster, op. cit. note 39, pp. 515–16.
81 Interview with Brian I. Neysmith.
82 It was precisely this constraint, and the high interest rates charged by banks, that led to the issuance of high-yield or junk bonds starting in the late 1970s, based on arguments made by Michael Milken, formerly of Drexel Burnham Lambert. As a result of research he had conducted at business school, Milken argued that non-investment grade credits were a lot less likely to default than rating agencies had maintained, and that they were therefore deserving of better ratings, or at least better access to non-bank finance at discounted prices. On Milken and his arguments for high-yield financing, see Glen Yago, *Junk Bonds: How High Yield Securities Restructured Corporate America* (New York: Oxford University Press, 1991), pp. 14–27, and Alvin Toffler, *Power Shift: Knowledge, Wealth, and Violence at the Edge of the 21st Century* (New York: Bantam, 1990), pp. 43–57. I thank Stephen Gill for pointing this out to me.
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