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August 7, 2011: Downgrading the Downgraders

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Title: Downgrading the Downgraders

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8/7/2011—Although a little outside the usual topics on this blog, I cannot help but comment on the bitter irony of the downgrade in the credit rating of the United States by Standard & Poor's. On the one hand, the decision seems reasonable and inevitable. Not only is the deficit large by historical standards, but it is clear from the debt negotiations that a default might have been allowed to happen. Some Republicans spoke as if default on the obligations to pay interest on debt instruments would not be such a big deal. Clearly some Democrats were outraged that this recklessness worked and were willing to call this bluff by not giving in on cuts to spending without some tax increases. The point is not that anyone wanted a default or that our problems are such that a default is likely—actually our problems are not that difficult to deal with by a combination of cuts and increases in taxes—but that a default could have happened by accident and miscalculation. The rating really should reflect that political reality, which is what S&P said. But on the other hand, there is a bitter irony in the downgrade. S&P is largely responsible for the mess we are in. Here is how the New York Times describes the role of the rating agencies in the mortgage crisis: Standard and Poor's is one of the three central credit rating companies in the United States, along with Moody's and Fitch Ratings. Their job it is to provide an objective analysis of the risk posed to investors by bonds, companies and countries. During the housing boom, the system broke down, as hundreds of billions of dollars of assets later shown to be worthless received high ratings from one of the agencies. A Congressional panel called them "essential cogs in the wheel of financial destruction." Without the false ratings of subprime instruments, the crisis would probably have been manageable and there would be no debt problem today in the US. S&P made a lot of money out of being wrong. No one was fired. No one went to jail. And now we have to listen to their self-righteous preening about getting our house in order. It really makes you sick.