Japan's Downgrading Fans Criticism of U.S. Rating Agencies

By Sakamoto Sakae

Moody's Investors Service Inc., a major U.S. credit-rating agency, downgraded Japanese government bonds by one notch from the top rank of Aaa (triple A) on November 17, 1998, the day after Tokyo unveiled an emergency pump-priming package of nearly ¥24 trillion. Until then, it was only Canada and Italy among the Group of Seven (G-7) economic powers that had sovereign-risk ratings below the top rank. The cut in Japan's debt rating put the country into the secondary group with the two other G-7 nations in terms of national credit standing.

What the government of Prime Minister Obuchi Keizo did (unsparing public works spending and massive national bond offerings for financing major corporate and individual tax cuts) in the belief they would boost economic activity turned out to be a negative factor in the cool eyes of a rating agency.

Finance Minister Miyazawa Kiichi reportedly expressed a strong feeling of displeasure after he was asked to comment on the Moody's action. "Japan's government bonds are the most trustworthy in the world," Miyazawa was quoted as saying. The downgrading, which leads to a higher cost of borrowing for Japan, should be far from pleasant for the chief executive officer of the Finance Ministry, which issues government bonds. His top aide for international finance, Sakakibara Eisuke, was also critical of the Moody's rating cut. "If things like this continued, market confidence in Moody's might decline," he reportedly said. Sakakibara's official title is vice finance minister for international affairs. The remark can be taken as an expression of distrust against Moody's, which is regarded as one of the world's top rating agencies along with another U.S. firm, Standard & Poor's Corp,.in terms of credit influence with investors around the globe.


Photo: The Mainichi Newspapers

Finance Minister Miyazawa Kiichi expressed a strong feeling of displeasure about Moody's downgrading of Japanese government bonds

World's largest reserves

If a sovereign-debt rating is to symbolize national strength, which is difficult to measure objectively, the Moody's action poses a number of serious questions.

As critics taking issue with the Moody's judgment have said, Japan's gold/foreign currency reserves ($220 billion) eclipse those of any other G-7 member (ranging from $30 to $70 billion). Japan has almost enough external credits to finance the external liabilities of the U.S. When it comes to the balance of goods and services trade, which may be called the outcome of international competitiveness of industry, Japan is chalking up a huge surplus while the U.S. is suffering an enormous deficit. It is unreasonable indeed to judge national power on the basis of a few specific factors like the fiscal deficit (the ratio of general government debt to gross domestic product (GDP) is almost 100% for Japan as against the 50%-70% levels for the other G-7 nations with the exception of Italy), uncertainty over the financial system, and prevailing economic activity.

On the other hand, the grounds on which the Moody's rating cut is based have many convincing points that make one feel the judgment is "reasonable." For example, Moody's says "it may be difficult for the present government or possible future governments to balance conflicting policy objectives over the long run to achieve a durable recovery in economic growth, to relieve the fiscal burden of the government, and to restore solvency and vitality to the financial sector." Moody's also points out that "the structure of the bureaucracy and regulatory system may not be as effective as they were in the past in handling the challenges facing the Japanese economy over the long term."

Behind the Moody's downgrading of Japan's debt rating lies strong distrust of the nation's political leadership and bureaucratic system. Anti-Moody's critics may have no choice but to admit this point.

Businesses unhappy about unsolicited ratings

The earnings structure of rating agencies, which may be called information service companies in a broad sense, is unique. This is because their main source of income is not subscription fees collected from information buyers (investors who need information for their investment decisions), but rating fees earned from companies planning to issue bonds (those companies are comparable to news sources for the mass media).

Several years ago rating agencies began to rate credit standings of companies without their requests. The Moody's downgrading of Japan was such an "unsolicited rating." "I suspect unsolicited ratings are part of the business tactics adopted by rating agencies to win requests for ratings," says a top executive of a certain company. "They may be considered a kind of intimidation," he adds.

According to an international economist who is familiar with the workings of Moody's, the chief analyst who was responsible for the decision to downgrade Japan's debt rating is known to be tough with the country. Calmness and fairness are required of analysts who are in charge of ratings, particularly government debt ratings that effectively mean "sovereign evaluation." It is questionable if those who have a type of bias against certain countries are to be asked to decide on their ratings.

Moody's refutes such criticism. "Our rating work is always done by two or more analysts who organize a rating committee, which makes a decision by majority," says a spokesman for the rating agency's Japanese unit. "In no way is it the kind of conclusion drawn by a single analyst."

The international economist mentioned before also questions if rating agencies adequately control information associated with their ratings. "There is a possibility of rating decisions being leaked to U.S. securities houses before U.S. rating agencies announce them, although it is difficult to come up with evidence," says the economist. "This would allow a brokerage knowing a decision in advance to use such inside information to trade in shares of the rated company. If this is true, it means insider trading."

The Moody's spokesman denies such allegations. "They are not true. Rating companies cannot operate without keeping confidential information secret. We have strict rules about keeping secrets, and all company staff observe them by signing contracts when they enter and quit the company."

Focus rating decisions on solvency

Japanese parliamentarians are casting increasingly suspicious eyes at the activities of U.S. rating agencies, with some lawmakers wanting to summon their CEOs to the Diet for grilling.

A House of Representatives committee on government accounting and administration held a hearing on the rating issue in mid-December. A senior official of the government-funded Japan Center for International Finance told the hearing that he cannot agree with Japan's downgrading in view of the nation's foreign reserves, trade surplus and savings levels. "Rating standards should be limited to a country's capability of redeeming government bonds," said Masunaga Rei, deputy president of the center, who testified as an unsworn witness.

Yanagisawa Hakuo, the state minister in charge of financial reconstruction, pointed out at the hearing that rating agencies themselves would be forced out of the market if they failed to give convincing reasons for their rating decisions. The remark is similar to the comment made by Sakakibara after the downgrading was announced. At the hearing, an academic proposed ignoring Moody's downgrading. Foreign rating agencies "do credit ratings on the basis of their home standards," said Kurosawa Yoshitaka, professor of Nihon University in Tokyo. All the Japanese government has to do is to "just focus on economic policy without reacting excessively" to ratings, he said.

For Japanese people who traditionally trust "the authorities," it is hard to understand the value of rating agencies, which are peculiarly American organizations. The Japanese media once mistook rating agencies as public-sector or neutral entities, describing them as rating "organizations." Noticing them as private companies, they have changed the description. Deconstructing the myth of rating agencies is a precondition for Japan to implement "Big Bang" financial market deregulation.

APEC to check rating system

The question of ratings was also taken up at a series of meetings of the Asia-Pacific Economic Cooperation (APEC) forum held in Malaysia in November. In a statement, APEC leaders called for a review of the practices of international rating agencies "to promote greater effectiveness and to contribute to sustainable capital flows." This may be regarded as one of the moves to check global capitalism advocated by the U.S. Treasury Department. If rating agencies involved themselves in the so-called "plot" of the "Wall Street-Washington complex" (meaning the criticism that the U.S. government, together with financial companies, is acting on behalf of their interests), it would then lead to the self-denial of the rating business. JJTI

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