Russian Sovereign Bond Ratings and the Foreign Policy of the United States, China, and Russia
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Abstract

Russian sovereign bond ratings are examined in order to determine whether or not a relationship exists between nominally independent credit appraisers and the foreign policy of their states of origin towards Russia. The ratings analyzed were produced by Dagong Global Credit Rating Co., Standard & Poor's Financial Services LLC, Fitch Ratings Co., and Moody's Investor Service between 2012 and 2015, a time period that coinciding with the Crimean Crisis. The paper finds that while Western-based raters have lowered their sovereign bond ratings and assumed negative economic outlooks for Russia since the start of the Crimean crisis, the Beijing-based Dagong rating agency has maintained a higher rating of Russian sovereign bonds and a more positive economic outlook for the Russian Federation. This disparity reflects the broader foreign and economic policy aims of the United States government and its allies as compared to those of the Chinese government.

Introduction

This paper focuses on Russian sovereign bond ratings produced by Dagong Global Credit Rating Co., Standard & Poor's Financial Services LLC, Fitch Ratings Co., and Moody's Investor Service between 2012 and 2015. More specifically, it looks at how these ratings changed following the onset of the Crimean crisis, which resulted in the Russian Federation's annexation of the Ukrainian territory of Crimea in March 2014. The aim of the paper is to determine whether or not a relationship exists between the Russian sovereign bond ratings of nominally independent credit appraisers and the Russia-specific foreign policy aims of the states in which they are incorporated—in this case, China and the United States.[1] Any evidence that raters demonstrate a tendency to interpret or reinforce the political and economic policies of their native states increases the potential for global capital markets to operate under the auspice of inconsistent or misconstrued information regarding their principal participants.

The first section of the paper reviews its attendant research methodology. The subsequent section presents an overview of sovereign bonds, their history, the implications of sovereign debt

[1] Fitch Ratings Inc. maintains headquarters in both New York City and London.

on the broader economy, and the influence that interest rates have on bond investments. Section three reviews the historical background of each ratings agency under consideration—Dagong Global Credit Rating Co. and the "Big Three" credit rating agencies (CRAs). Included in each historical background is a description of the organization's process for rating sovereign bonds. Section three closes with an assessment of U.S.-China relations since 2008 and a synopsis of the Crimean crisis. Section four reviews existing literature on CRAs, with a focus on their workflow and role in global governance—the reputation rationale for the repayment of sovereign debt and the social/political components of the ratings industry. Section five reviews Russian sovereign bond ratings produced by the CRAs under consideration between 2012 and 2015. The paper's findings are reviewed in section six and are followed by an outline of policy recommendations in section seven.

Section I: Methodology

This is a qualitative study utilizing an empirical-analytical approach. Through deductive reasoning and analysis of objective knowledge, it seeks to determine what if any relationship exists between the foreign policy of China and the United States toward Russia and ratings of Russian sovereign bonds issued by Dagong Global Credit Rating Co. and the Big Three CRAs—Standard & Poor's Financial Services LLC, Fitch Ratings Co., and Moody's Investor Service. Notably, the investigation of objective knowledge herein includes consideration of publicly available quantitative and qualitative data pertaining to Russian sovereign bond ratings over time. However, no new quantitative data sets specific to this study have been produced. While the history and development of rating behavior is reviewed, the sample size of rater-produced quantitative and qualitative data pertaining to Russia's macroeconomic conditions comprises 2012 to 2015. This time period coincides with the outbreak of the Crimean crisis, a situation that continues to influence political and economic relations between Russia, China, and the United States. Analyzing how rater outputs on Russian sovereign bonds may have changed from before and after the start of the crisis provides a clear context for observations about the larger political, economic, and foreign policy implications at play.

As it pertains to rater-generated data, the paper considers only free, publicly available information—not data sets and reports for which raters charge an access fee. While the amount and availability of information made freely available to the public differs between raters, each makes a regular practice of communicating the most important information related to sovereign bond credit ratings to the financial media and popular press. In addition, each rating agency makes information pertaining to the central elements of its ratings process and the meaning of the ratings it produces publically available online. The fact that raters require payment for access to their full reporting is consistent with their overarching business model—charging a fee in exchange for analysis of market conditions and judgments of creditworthiness across a range of economic sectors and asset classes.[2] Beyond material produced directly by raters themselves, the paper draws on existing analyses of raters and rating. The quantity and scope of such materials has increased in the years following the global financial crisis of 2007–08, which many have suggested was precipitated by the failure of raters to foretell the high credit risks involved in various financial products tied to the American real estate market.[3]

While much is written about the larger foreign policy objectives of the United States, Russia, and China—and the accordant economic policies therein—this paper aims to advance considerations of how ratings agencies—nominally independent, largely unregulated, and hugely influential actors in capital markets—inform and interpret these policies in their work. The question of whether or not raters are influenced by the foreign policy of their countries of origin is consequential to the consideration of the quality and usability of their outputs on the part of global investors.

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[2] Following a web registration process, Standard & Poor's provides free overviews of their ratings. As of April 2015, Moody's charges individual users $300 for full reports of their ratings rationale. Overviews on rating methodologies organized by region and market segment, in addition to press materials ("Ratings News"), are available following a free user registration process. Fitch Ratings provides limited free information upon user registration, while providing full reports via a paid subscription model. Dagong Global Credit Rating Co. provides registered web users English-language overviews of their ratings without charge.

[3] Herwig Langhor and Patricia Langohr. The Rating Agencies and Their Credit Ratings: What They Are, How They Work, and Why They Are Relevant. (New York: Wiley, 2009) 14.

Section II: Sovereign Bonds

What are sovereign bonds?

Reliable access to capital is central to the functioning and survival of countries in the international state system.[4] It is through the consistent inflow and dispersion of money that national governments are able to provide essential services to their citizenry. These services range from the maintenance of national security to the upkeep of trade infrastructure through public/private partnerships and the provision of various government-funded social welfare programs.

There are two ways in which national governments earn revenue—the collection of taxes from the foreign and domestic sale of goods and services and the issuing of securities in the form of bonds. A "security" is defined as a fungible, negotiable financial instrument with monetary value.[5] A bond is a type of debt security, named so because the issuer of the bond incurs a debt to the bond's investor. The basics of a bond transaction involve an investor loaning money to the bond issuer for a defined length of time, during which the investor earns interest on the loaned money. The interest represents the fee afforded to the lender (the debt investor) in exchange for the bond issuer's use of the invested capital.

There are three different types of bonds; corporate bonds, municipal bonds, and government bonds. Corporate bonds are issued by both public and private companies, municipal bonds by state and city governments, and government bonds by national governments. Government bonds, also referred to as sovereign bonds and/or sovereign debt, comprise the

[4] Capital is essential to all states, including those that operate outside of what is understood to be the "international community," whether this exclusion is self-selected or the result of economic sanctions. Examples include North Korea and Zimbabwe.
[5] "Security Definition | Investopedia." Investopedia. 26 Nov. 2003. Web. 5 Apr. 2015. <http://www.investopedia.com/terms/s/security.asp>.

central focus of this paper. Government bonds, most often issued as fixed-income securities, are generally organized into three main categories: bills, notes, and bonds.[6] These categories are based on the security's date of maturity. Bills mature within one year of issuance, some within several days. Notes mature within one to 10 years of issuance. The third category, bonds, are issued with a maturity date of 10 or more years from the date of issuance. Government bonds are often issued with a maturity date of 30 years, while providing the lender interest payments every six months.[7]

Sovereign debt over time

Borrowing by governments in the form of sovereign debt has taken place since antiquity.[8] The origin of the contemporary sovereign debt market is traced to foreign currency markets in the city of Amsterdam during the 1700s. By the early nineteenth century, London served as the centerpiece of an integrated sovereign debt market that extended throughout Europe, Latin America, and the Caribbean.[9] Debt-to-GDP ratio is used as a standard measurement of the sovereign debt of advanced economies in the twentieth century. Between 1900 and 2010, increases in the sovereign debt held by advance economies occur in parallel with years encompassing the First World War and the Great Depression. A massive increase in borrowing on the part of advanced economies also took place during the Second World War. After reaching its lowest levels in decades during the 1970s, the debt-to-GDP ratio of advanced economies has

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[6] The term "fixed-income security" refers to any type of investment agreement in which the borrower (or bond issuer) is obligated to make payments of a set amount in accordance with a set schedule. As an example, a bond issuer may be obliged to make a regular interest payment once annually and to repay the bond's principal on the security's date of maturity.

[7] "Bonds." *Bonds*. U.S. Securities and Exchange Commission. Web. 5 Apr. 2015. Bond values are also effected by security-specific technicalities including interest rates, yield calculations, and the frequency of repayments.

[8] Robert W. Kolb. Sovereign Debt: From Safety to Default. (New York, Wiley: 2011)

[9] Marc Flandreau and Juan H. Flores. "Bonds and Brands: Foundations of Sovereign Debt Markets, 1820-1830." *The Journal of Economic History* 69.3 (2009): 646-84.

increased in every subsequent decade through 2010.[10] In the United States, notes and bond issuances have fallen since reaching a record of over $1.6 trillion in 2010. An estimated $717 billion worth of notes and bonds were sold in 2014. In March 2015, the Bank for International Settlements (BIS), an international organization of central banks established in 1930, estimated the total value of outstanding debt securities to be $76 trillion worldwide, in large part the result of sovereign borrowing efforts aimed at overturning the recessionary impact of the global financial crisis.[11] This figure was down from the 2014 BIS estimate of $100 trillion.[12] According to estimates by the International Monetary Fund (IMF), Japan, Greece, Italy, Portugal and Ireland hold the highest levels of gross government debt as percentage of GDP. Japan's government debt is estimated at nearly 240 percent of its GDP, with Greece's estimated at approximately 159 percent. The IMF estimates the gross government debt of the United States at approximately 107 percent of GDP. China's debt, by contrast, is estimated at 32 percent of GDP, while Russia's is estimated at 12 percent of GDP. The debt held by Russia's government is among the lowest of the world's major economies, the result of huge repayments made in 2006 when the country was benefiting from high global oil prices.[13]

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[10] S.M. Ali Abbas, Laura Blattner, Mark De Broeck, Asmaa El-Ganainy, and Malin Hu. "Sovereign Debt Composition in Advanced Economies: A Historical Perspective." *IMF Working Paper: Fiscal Affairs Department* (2014). International Monetary Fund. See Appendix, Chart 1.

[11] Figure include financial corporations, non-financial corporations, and governments. See: "Table 18: Total Debt Securities - All Issuers." *BIS Quarterly Review* (2015). Bank for International Settlements. Web.

[12] John Glover. "Debt Exceeds $100 Trillion as Governments Binge."*Bloomberg.com*. Bloomberg, 10 Mar. 2014. Web. 1 Apr. 2015

[13] Peter Finn. "Oil Profits Help Russia Pay Off Soviet-Era Debt." *washingtonpost.com*. Washington Post, 22 Aug. 2006. Web. 1 Apr. 2015

The broader implications of sovereign debt

Moderate levels of government debt are thought to enhance overall economic growth by affording countries with spending capital sourced from outside tax revenues. Nonetheless, BIS research suggests that government debt exceeding 85 percent of GDP is the threshold at which countries begin to leave themselves overly exposed to both mild and significant market shocks, increasing the potential for recurring, disruptive financial cycles.[14]

Apart from the macroeconomic health of states, levels of sovereign debt are consequential within the context of the larger global economy. Since the mid-1990s, global markets have undergone a process of disintermediation, wherein "bonds and notes sold on capital markets are displacing traditional bank loans as the primary means of borrowing money." This contrasts starkly with historical precedent, which saw commercial banks as the institutions with which national governments transacted in order to raise capital.[15] Likewise, expansions in communication technology and trade capacity resulting from globalization have resulted in the debt of both developed and emerging market economies becoming more internationalized. The globalization of the financial industry has resulted in "the international integration of previously segmented national credit and capital markets."[16] A continually evolving process of securitization of debt securities has paralleled this expansion, wherein "mortgages, credit card receivables, and bank loans are being transformed into tradable securities that can be bought and sold in capital markets."[17]

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[14] Stephen G. Cecchetti, M.S. Mohanty, and Fabrizio Zampolli. "The Real Effects of Debt." *Bank for International Settlements* (2011). *Bis.org*.

[15] Timothy Sinclair. <u>The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness</u>. New York: Cornell University Press: 2005, 2-5.

[16] Leslie Elliott Armijo, preface to the paperback edition, in Armijo, ed., *Financial Globalization and Democracy in Emerging Markets* (London: Palgrave: 2001), xiii.

[17] Sinclair, 2-5.

The impact of sovereign debt on the global economy has grown more pronounced over recent decades as the total amount of outstanding obligations has increased. BIS Economic Adviser Steven Cecchetti, BIS Macroeconomic Analysis Unit Head M.S. Mohanty, and BIS Senior Economist Fabrizio Zampolli remark that "debt has risen relentlessly across the industrial world over the past 30 years," with total non-financial debt—debt owed by households, government agencies, non-profits, and companies outside the financial sector—increasing by 147 percentage points of total GDP between 1980 and 2010. Public debt, including bonds, represents about a third (49 percentage points) of this total.[18] As of December 2014, the BIS estimates the value of total outstanding general debt securities held by governments worldwide to be approximately $40 trillion. Countries with the highest general government obligations held in debt securities include the United States ($15 trillion), Japan ($9 trillion), and Italy ($2.2 trillion).[19]

While high public debt has the potential to threaten a government's ability to meet its expenses and thus its responsibilities to the public good, changes in the issuance and the value of public debt holdings can have further financial impact on businesses and individuals across the world. This is because bonds are routinely purchased and traded by an array of institutional investors who allocate capital on behalf of larger groups. These institutional investors include banks, retirement funds, hedge funds, mutual funds, and insurance companies. The Securities Industry and Financial Markets Association, a financial industry trade group, maintains that the purchase and sale of bonds by banks and brokerage houses provides investors with opportunities to preserve capital over the long term while earning a predictable return and protecting a portion of

[18] Cecchetti, Mohanty, and Zampolli. "The Real Effects of Debt." *Bank for International Settlements* (2011), 8.
[19] Table 18: Total Debt Securities - All Issuers." *BIS Quarterly Review* (2015). Bank for International Settlements. Web. Web. 10 May 2015. The figure referenced pertains to "General government debt securities."

their assets from the volatility of stock markets.[20] However, bond values can be impacted by changing interest rates, which can in turn effect investment portfolios and threaten the ability of governments to issue bonds in order to raise capital in the short-term.

Sovereign debt and interest rates

Interest rates—the fees afforded to borrowers in exchange for the use of their money—are an elemental part of sovereign debt and capital markets. In both developed and emerging economies, interest rates are determined by central banks. This determination takes place in concurrence with the effort of central banks to regulate the supply of money in the overall economy. It is important to note that the influence of central banks on monetary supply is not exacting. As economists Todd Keister, Antoine Martin, and James McAndrews note in a paper for the Federal Reserve Bank of New York's *Economic Policy Review*, "central banks have in recent decades moved away from a direct focus on measures of the money supply. The primary focus of monetary policy has instead become the value of a short-term interest rate." Thus, "the tools of monetary policy are used to guide the market interest rate toward [a] chosen target."[21] Here, the term "market interest rate" refers to the rate at which retail banks loan money to—and borrow money from—both each other and central banks.

Interest rates directly impact that value of bonds and inform a fundamental tenet of bond investing known as interest rate risk. This term refers to the potential for changing market

[20] "What You Should Know: The Role of Bonds in America." *Investinginbonds.com*. Securities Industry and Financial Markets Association (SIFMA), 1 Jan. 2013. Web. 18 Apr. 2015.
[21] Keister, Todd, Antoine Martin, and James McAndrews. "Divorcing Money from Monetary Policy." *FRBNY Economic Policy Review* (2008). Federal Reserve Bank of New York. Web.

interest rates to impact that value of bonds *in the immediate term*.[22] Essential to understanding the concept of interest rate risk is the idea that bonds are tradable securities. That is, both newly issued bonds and bonds issued in the past are traded on global markets and their values are always in flux and contingent on current interest rates. When market interest rates rise, the prices of fixed-rate bonds fall. Conversely, lower market interest rates result in higher fixed-rate bond prices. The following example is a simplified scenario of how this phenomenon works. If an investor purchases a 10-year bond for $1000 at an interest rate of 5%, the bond will pay the investor $50 in interest over time. If interest rates increase to 6%, *newly issued* 10-year bonds will pay investors $60 in interest over time. Because no investor would be willing to pay (or in the case of bonds, lend) the same amount of money for $10 less in return, the price of the first bond decreases in order for it to maintain market relevance. While maintaining a face value of $1000, the price of the first bond referred to in this example would fall to $833, allowing it to maintain its $50 return in interest over time. Figure #1 demonstrates how the market price of "Bond #1" changes in relation to market interest rate variations over time and the issuance of new debt securities. In the case of Scenario #1, or increased market rates (marked in green), the bond's price falls (marked in red). In the case of Scenario #2, or decreasing interest rates (marked in red), the bond's price increases (marked in green).

[22] At the core of bond investing lies the guarantee that the bond issuer will return the initial investment, with interest, upon the bond's maturity date. However, there have been many cases throughout history in which governments have defaulted on their debt.

FIGURE 1. THE IMPACT OF INTEREST RATES ON BOND PRICES

Higher market interest rates → lower fixed-rate bond prices

Lower market interest rates → higher fixed-rate bond prices

Scenario #1				
	Face Value	Price	Market Interest Rate Increase	Return to Investor
Bond #1	$1,000	$1,000	5%	$50
After time...			*...rates increase*	
Bond #2	$1,000	$1,000	6%	$60
Bond #1	$1,000	$833	6%	$50
Scenario #2				
	Face Value	Price	Market Interest Rate Decrease	Return to Investor
Bond #1	$1,000	$1,000	5%	$50
After time...			*...rates decrease*	
Bond #2	$1,000	$1,000	4%	$40
Bond #1	$1,000	$1,250	4%	$50

Interest rates impact bonds in complex ways. In addition to bond prices, higher and lower market interest rates can have an effect on yields—the amount of interest earned by the investor at the bond's maturity date. The impact of changes in market interest rates on bond prices is also informed by a bond's coupon rate (its stated interest rate upon being issued) and its maturity (the year in which full repayment is required by the issuer). Equally important is the impact of these fluctuations on the total value of bond funds—large collections of capital that invest in groups of debt securities in the pursuit of growth.

The value of bonds (and by extension, bond funds) are influenced by innumerable capital market undulations, but these movements are not the chief arbiter of a bond's recognized worth. The central determinant of a bond's creditworthiness—or the likelihood that a borrower will default on their debt obligation—are credit rating agencies.

Section III: Historical Overview & Background Information

Whereas concepts of creditworthiness dates as far back into prehistory as the origin of trade and the use of currency, the origins of the credit rating industry date to the mid-nineteenth century American railroad industry. In the mid-1850s, lawyer and financial analyst Henry Varnum Poor began publishing compendiums of data pertaining to railroad companies, including track length, investors' share capital, and total profit and loss. Financial analyst John Moody expanded Varnum's concept into other industries. He began publishing the *Manual of Industrial Statistics* in 1800.[23] The 1907 U.S. financial crisis, which resulted from the failure of the United Copper Company, resulted in numerous reforms to the American financial system—including the establishment of the United States Reserve Bank.[24] The crisis also reiterated the need for widely available appraisals of the creditworthiness of market players across business sectors. The first modern credit rating is attributed to the Moody's organization in 1916, followed thereafter by the Standard Statistics Company.[25] The 1933 Glass-Steagall Act legislated the separation of the securities and bank industries in the United States and helped transform ratings activity from a voluntary addendum of industry-specific data collection efforts into a legally required component of capital market transactions. By the mid-1930s, many state governments had implemented rules incorporating rating standards into the evaluation of pension fund investments.[26] Today, small financial institutions often conduct their own creditworthiness research, while investment firms of varying size also depend up the work of in-house fixed-income investment analysts in determining how to allocate capital. As of March 2015, the United

[23] Sinclair, 23.
[24] Chen, Lucy D. "Banking Reform in a Hostile Climate: Paul M. Warburg and the National Citizens' League." *Center for Economics & History* (2009). Harvard University. Web. 24 Apr. 2015.
[25] Sinclair, 24.
[26] Sinclair, 26.

States Securities and Exchange Commission permits the ratings work of 10 organizations for use by the financial industry in meeting its wider regulation requirements. These firms are known as National Recognized Statistical Rating Organizations (NRSRO).[27] Eight of ten NRSROs are based in the United States.

The Big Three credit ratings agencies—so named because they were the first three firms to be recognized by the SEC as NRSROs in 1975—maintain approximately 95 percent of credit rating industry market share.[28] While the Big Three credit ratings agencies operate offices globally, the U.S.-centric nature of the credit rating industry has remain largely unchanged over the past century. The fact that global capital markets rely in large part on credit ratings produced by three U.S.-based for-profit companies has generated criticism and accusations of monopoly.[29] Numerous industry critics have called for increased regulation of the Big Three by international organizations such as the United Nations or IMF. In June 2013, China's Dagong Global Credit Rating Co., the Moscow-based rating agency RusRating, and Egan-Jones Rating Company announced plans to establish a Universal Credit Rating Group (UCRG) based in Hong Kong. It has been reported that UCRG could begin issuing ratings sometime in 2015.[30]

The subsequent material in this section presents background information on Dagong and the Big Three, and reviews each rater's process for evaluating the creditworthiness of sovereign bonds. The Big Three credit rating agencies begin the ratings process upon the request of a state

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[27] United States. Securities and Exchange Commission. *Annual Report on Nationally Recognized Statistical Rating Organizations*. 2014. Web. 25 Apr. 2015. See Appendix, Chart 2.
[28] "The Credit Rating Controversy." *Cfr.org*. Council on Foreign Relations, 19 Feb. 2015. Web. 25 Apr. 2015.
[29] Guzman, Timothy Alexander. "Politics, Financial Fraud and the. 'Big Three' Credit Ratings Agencies." *Global Research*. Centre for Research on Globalization, 31 Jan. 2015. Web. 24 Apr. 2015. S&P and Fitch are a part of large, privately held companies. Moody's is a separate, publicly held organization.
[30] "China and Russia to Launch New Credit Rating Agency in 2015." *RT.com* 13 Jan. 2015. Russia Today. Web. 25 Apr. 2015. *RT* or *Russia Today* is owned in part by the Russian government. See also: Hume, Tim. "Hong Kong-based Credit Rating Agency Launched to Rival 'Big Three" *CNN*. Cable News Network, 25 June 2013. Web. 25 Apr. 2015.

or corporation, after which a contract is agreed to by both the rater and the rated entity. Dagong's process differs, in that it issues sovereign ratings on states in the global economy at their own behest. Whereas the Big Three raters are providing an opinion in exchange for a fee, Dagong's goal is to offer a countervailing opinion on sovereign creditworthiness.[31]

Dagong Global Credit Rating Company, Ltd.

Background

Dagong Global Credit Rating Company was established in 1994 by the People's Bank of China (PBOC), working in conjunction with China's State Economic and Trade Commission (SETC).[32] The four Mandarin characters used to represent Dagong translate approximately into "selflessness" or "just and fair."[33] Dagong can be considered a subsidiary of the Chinese government and the PBOC. While the connection between its ratings output and China's broader political and economic objectives is understated, it is viable to presuppose that Dagong's opinions are reflective of the wider national policies of the ruling Communist Party.

The PBOC's lack of regular forward guidance regarding its polices and operations has been criticized in the Western financial press.[34] Similarly, Dagong does not release financial information pertaining to its business. According to Dagong's English-language website, its staff of 600 operates thirty-four domestic branches throughout China and two branches outside the country. Dagong Europe opened in Milan, Italy in March 2012. Although Dagong is the sole

[31] Dagong's English-language web properties offer limited information on how the firm's ratings process is initiated. See: "Rating Process." *Rating Standard*. Dagong Global Credit Rating Co. Ltd. Web. 30 Apr. 2015.
[32] "Overview: About Us." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd., 1 Jan. 2012. Web. 26 Apr. 2015. The SETC was made a part of the Ministry of Commerce in 2003.
[33] "大公无私." *Google Translate*. Web. 26 Apr. 2015.
[34] "Covert Operations." *Economist* 22 Nov. 2014. Web. 26 Apr. 2015. See also: "PBOC Uses Hidden Hand as China Seeks to Stem Slowdown: Economy." *Bloomberg.com*. Bloomberg, 23 Dec. 2014. Web. 26 Apr. 2015.

shareholder of its Europe branch, it was founded through a collaboration with Mandarin Capital Partners—a private equity fund.[35] Dagong's second international branch is located in Hong Kong. Among the services the company provides are included professional risk evaluation services, bond credit ratings, and credit ratings on China-based financial institutions, including banks and insurance companies.[36]

Illustrative of its position within a broader government framework, information available on Dagong's website makes clear that one of the organization's central charges is countering the power and influence of Western ratings agencies. The website states that "Dagong is the first agency in the world to study American credit rating theories and methodologies and reveal their short comings," adding that "it is also the first agency to downgrade the U.S. credit rating." "As the initiator and promoter of the reform of the international credit rating system," it continues, "Dagong first pointed out that the existing international credit rating system is the origin of the global credit crisis. It proclaimed that only a new international credit rating system could help the recovery of the world economy."[37]

In 2010, Dagong's application to enter the U.S. marketplace as an officially recognized bond rater was rejected by the SEC on the grounds that the company could not meet federal securities law. The commission also cited its own inability to supervise a credit rater outside of the U.S. Nevertheless, the effort by Dagong to further extend the scope of its operations into America signaled increased confidence on the part of China's economic leaders relative to the overall health and increased global influence of the country's economic system.[38]

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[35] "Company Overview." *Dagong Europe*. Dagong Global Credit Rating Co. Ltd. Web. 26 Apr. 2015.
[36] "Dagong Global Credit Rating Co., Ltd.: Private Company Information." *Bloomberg.com*. Bloomberg. n.d. Web. 26 Apr. 2015.
[37] "Overview: About Us." *En.dagongcredit.com*.
[38] Shaw, Joy C. "Dagong Fires Back at SEC." *WSJ.com*. Wall Street Journal, 27 Sept. 2010. Web. 26 Apr. 2015.

Sovereign bond rating methodology

Dagong's sovereign bond ratings are issued on a letter-grade scale that ranges from AAA (the highest credit rating) to C (the lowest credit rating). Plus/minus differentials are included as deemed necessary to provide relative context (AA-, CCC+, etc.).[39] In adherence to long-accepted standards of credit-worthiness evaluations and sovereign bond ratings, Dagong's sovereign credit ratings are determined through a combination of qualitative and quantitative analyses. An English-language paper published by the company in 2012 presents an overview of its sovereign ratings process, which states that it is comprised of six tenets: income-to-debt ratio, economic growth indicators, the health of a country's broader financial system, macroeconomic stability, levels of existing debt, and repayment ability based on local currency values.[40] The paper also establishes an assortment of other criteria as influential to Dagong's procedures for assessing creditworthiness. For example, considerations pertaining to "National Management Capability" are subdivided into "Country Development Strategy," "Governance of Governmental Agencies," "Security Status," and "International Relations." Details comprising the Country Development Strategy provide insight into Dagong's state-centric approach to the economic and political evaluations necessary to producing assessments of sovereign creditworthiness. The term is defined as "a country's long-term overall plan to employ state power for the achievement of national objectives. In this sense, a country's development strategy is fully capable of reflecting a nation's political-economic development, its position with the existing international system, as

[39] See: "Sovereign Ratings." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd., n.d. Web. 26 Apr. 2015. Letter ratings are issued with +/- stipulations and the term "stable" or "unstable" to denote immediate-term risk (i.e. AA-/stable). See also: Appendix, *Chart 3*

[40] "Sovereign Rating Methodology." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd., 14 Aug. 2012. Web. 26 Apr. 2015.

well as its current governance level."[41] Further evidence of the state-centric nature of Dagong's philosophy of sovereign credit analysis can be found in language pertaining to matters it considers under the rubric of Security Status. A section explaining the importance of maintaining public security in accordance with financial health and economic development states that "rioting is often the result of long-term accumulation of social contradictions, which may happen due to lasting conflicts among different races, ethnic groups, religions, [and] social classes. For small countries with weak fiscal strength, riots usually lead to long-term economic stagnation."[42]

Dagong's methodology overview provides framework for its International Relations parameter by stating that "in the context of globalization, ties among different countries are strengthened." "As a result," it continues, "international factors impose a significant, even decisive impact *[sic]* on a nation's development." This category of analysis is subdivided into three sections: "international strategy, regional relationship *[sic]*, and global relationship *[sic]."* Relative to global relationships, Dagong's methodology maintains that "major power [and] global international organizations are likely to impact the country's political, economic, [and] social affairs in all aspects—especially to provide *[sic]* necessary assistance when the country is in a crisis." It is stipulated that "when considering the impact of world powers [and] international organizations, [Dagong] examines the conditions attached to the assistance offered to a needy country." According to the company, "it has been proved repeatedly *[sic]* that the funding support for international organizations may help the country avoid defaults, but additional reform requirements often do harm to the country's long-term interest *[sic]* [and] may even refuel crises at a later time."[43]

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41 *Ibid*., Section 3.1 ("National Management Capability")
42 *Ibid*, Section 3.1.3.
43 *Ibid,* Section 3.1.4.

After celebrating its twentieth anniversary in 2014, Dagong announced in a January 2015 press release its intention to "build into a world heavyweight in the credit rating industry by 2019."[44] One of the company's main objectives is the establishment of an Asian Credit System—an idea introduced by China's Premier Li Keqiang at the 16th Association of Southeast Asian Nations (ASEAN) Summit in October 2013. Dagong sponsored a summit tied to the Asian Credit System project in June 2014. The goal of the project is to increase capital flows between Asian countries and to established "a regionally recognized credit rating system" to foster development and economic growth.[45] Former French Prime Minister Dominique de Villepin has expressed support for the Asian Credit System scheme. Villepin has been critical of what he refers to as the "hegemony of the U.S. dollar." "The credit system remains dominated by Western models and rules," writes De Villepin, a situation he describes as "dangerously paradoxical" given that Asia has become "the beating heart of the global economy." A new credit system must be developed, De Villepin writes, "based on principals and not on domination."[46] De Villepin's support of the Asian Credit System—and by extension, the work of Dagong—is not widely shared by other Western investors, political figures, or by the Western financial press. A Reuters report on Dagong's lowering of its U.S. credit rating in December 2013 described Dagong's ratings as "barely watched outside of China" in part because "major international credit agencies classify most countries very differently from the Chinese agency."[47]

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[44] "Editorial - 2014: A Great Year for Dagong." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd. Jan. 2015. Web. 2 Feb. 2015.
[45] Guan, Jianzhong. "Construction of Asian Credit System and UCRG." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd., 25 June 2014. Web. 26 Apr. 2015.
[46] De Villepin, Dominique. "The Need to Build a New Asian Credit System." *Beijing Review* 1 July 2014. China.org.cn. Web. 26 Apr. 2015.
[47] Yao, Kevin. "China's Dagong Sees Lower U.S. Rating, No China Local Debt Default." *Reuters*. Thomson Reuters, 2 Dec. 2013. Web. 27 Apr. 2015. Similarly, an October 2013 Reuters report described Dagong's ratings as "hardly followed outside of China." See: Langer, Christopher. "DAGONG DOWNGRADES US TO A- FROM A." *Reuters*. Thomson Reuters, 17 Oct. 2013. Web. 27 Apr. 2015.

Standard & Poor's Financial Services LLC

Background

Standard & Poor's Financial Services LLC (S&P) is a subsidiary of McGraw Hill Financial.[48] It is the largest ratings organization in the world and a SEC-designated NRSRO. Headquartered in New York City, S&P operates twenty-six offices worldwide and employs approximately 10,000 people. According to the company's website, S&P maintains more 1.2 million credit ratings on over $4 trillion of debt securities in the government, corporate, and financial sectors.[49] The present day iteration of the company was founded in 1941, following a merger between Standard Statistics Bureau and Poor's Publishing.[50] S&P was acquired by McGraw Hill Companies in 1966. S&P is perhaps best known for the S&P 500, a stock market index that tracks the market capitalization of 500 major U.S. companies. Introduced in 1957, the S&P 500 is considered the foremost indicator of the U.S. equities market and a bellwether of the American economy because it tracks major U.S. companies across a variety of industries.[51]

The Council on Foreign Relations (CFR) has criticized S&P for "accelerating" the European Debt Crisis—a multi-year debt repayment crisis involving a group of Eurozone states that began in late 2009. CFR connects S&P to the crisis via the rater's downgrading of Greek sovereign bonds to junk status in April 2010. The downgrade, according to CFR, "weakened

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[48] McGraw-Hill Financial reported revenues of $1.24 billion for 2013. See: Egan, Matt. "McGraw Hill Swings to 4Q Profit as S&P Capital IQ Revenue Climbs." *Foxbusiness.com*. Fox Business Network, 14 Feb. 2014. Web. 1 May 2015.

[49] "What We Do | Who We Are | S&P Ratings." *S&P Ratings*. McGraw Hill Financial. Web. 27 Apr. 2015.

[50] "A History of Standard & Poor's." *A History of Standard & Poor's*. Standard & Poor's Financial Services LLP. Web. 27 Apr. 2015.

[51] The term market capitalization refers to the valuation of a company based on its number of outstanding shares of stock and its current share price. See: "S&P 500: The Gauge of the Market Economy." Standard & Poor's Financial Services LLC. Web. 27 Apr. 2015.

investor confidence, raised the cost of borrowing, and made a [European Union] financial rescue package in May 2010 all but inevitable."[52]

In February 2015, S&P agreed to $1.5 billion in settlement deals with the U.S. Justice Department, nineteen U.S. states, the District of Colombia, and the California Public Employees Retirement System. The settlements ended litigation pertaining to allegations that S&P issued artificially inflated ratings of securities tied to subprime mortgages, helping to precipitate the 2008 financial crisis.[53]

Sovereign bond rating methodology

S&P issues credit ratings on 128 countries and the European Union.[54] The company's credit rating opinions are issued following a letter-grade scale that ranges from AAA to D.[55] Sovereign ratings are codified on the company's website and made available to the public as "Sovereign Risk Indicators" that are updated quarterly. S&P considers a bond to be "investment grade" if it holds a rating of BBB- or higher, although the definition of that term is imprecise and translates essentially into "considered good enough to invest in." Bonds that fall below this rating are considered "speculative" or "junk bonds" and usually offer purchasers higher yields in exchange for the higher level or risk associated with the security. In concurrence with ratings industry practice standard practice, S&P combines quantitative analysis with qualitative analysis in determining its sovereign credit ratings.

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[52] "The Credit Rating Controversy." *Cfr.org*.
[53] Sharf, Samantha. "S&P To Pay $1.5 Billion In Settlements With DOJ, States, CalPERS." *Forbes.com*. Forbes Magazine, 3 Feb. 2015. Web. 29 Apr. 2015.
[54] This figures includes various political entities. S&P produces distinct ratings for two Arab emirates (Ras Al Khaimah and Abu Dhabi), the British Crown dependencies of Guernsey and the Isle of Man, the British Overseas Territory Montserrat, and the Baliwick of Jersey. See: "Sovereign Risk Indicators (2015 Estimates)." *Sovereign Risk Indicators*. Standard & Poor's Financial Services LLC, 30 Mar. 2015. Web. 28 Apr. 2015.
[55] Letter ratings AA to CCC are issued with +/- stipulations to "show relative standing." See: Appendix, Chart 4.

In 2011, S&P undertook an overhaul of its sovereign ratings criteria "to provide market participants with a clearer picture of how we rate sovereigns and to further incorporate the experiences of the 2008-09 global recession and its aftermath."[56] Additional updates to its ratings criteria occurred in in mid-2013 and late 2014. The company maintains that "no rating changes resulted" from the criteria update, which it says also aimed to "improve the transparency of [its] methodologies, capture recent market and credit trends, and produce criteria that support high-quality ratings." S&P's "Sovereign Issuer Credit Rating Framework" is now organized of five considerations, or "scores." Each sovereign is attributed a "political score," "economic score," "external score," "fiscal score," and "monetary score" from which an "indicative rating" is established and juxtaposed with foreign and local currency ratings. S&P documentation states that a country's political score "reflects [its] view of how a government's institutions and policymaking affect credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks." The company's political score also takes stock of "the transparency and reliability of [economic] data."[57] The economic score considers "income levels, growth prospects and volatility." S&P's "external score" category evaluates the performance of a country's currency in the global economy and its "external indebtedness" or the "assets and liabilities of [a country's] residents relative to the rest of the world." The sovereign's fiscal score reflects existing debt burden and funding access, while the monetary score considers a government's ability to "use monetary policy to address economic stresses, particularly through money supply and domestic liquidity."[58] Scores are calculated on a six-point scale, with 1 representing the strongest grade and 6 the weakest.

[56] Dimitrijevic, Alexandra, and Curtis Moulton. "How We Rate Sovereigns." *Standardandpoors.com*. Standard & Poor's Financial Services LLC, 13 Mar. 2012. Web. 1 May 2015.
[57] Dimitrijevic, 4.
[58] *Ibid.*

According to S&P, “a series of quantitative factors and qualitative considerations form the basis for assigning these forward-looking scores.”

S&P’s process of ratings creation involves a series of discussions with representatives of the sovereign issuer. Final ratings are conducted by a committee that “discusses, questions, and debates the [lead] analyst’s conclusions and evaluation of certain risk factors.” The firm’s ratings process allows for an appeal by the issuer “only if the issuer can provide new and significant information to support its point of view.” Issuers are given the option to be provided with the end rating on a confidential basis.

Since 2010, S&P has offered its customers a product known as “The Global Credit Portal,” which it describes as “a dynamic, Web-based, workflow solution that brings together financial intelligence across multiple asset classes and markets allowing financial professionals to perform efficient credit risk-driven analysis.” “The Portal,” according to the company’s description, “provides access to in-depth credit ratings and research, Credit Default Swap (CDS) spreads, Standard & Poor’s Market Derived Signals, [and] credit-adjusted fundamentals.”[59]

Fitch Ratings Co.

Background

Fitch Ratings Co. is a subsidiary of the financial services company Fitch Group, which also includes Fitch Solutions (a credit market analysis firm), BMI Research (an emerging markets analysis firm) and Fitch Learning (a professional development firm). The Fitch Group—which has headquarters in both New York and London—is owned by the Hearst Corporation.[60] The

[59] *Ibid*. Note: Information regarding the cost of a “Global Credit Portal” subscription is not made available on the S&P website, though users are provided with a free trial option.
[60] “About.” *Fitchratings.com*. Fitch Ratings Co. n.d. Web. 29 Apr. 2015.

companies origins date to the founding of the Fitch Publishing Company by John Knowles in 1913. According the company's website, it "introduced the now familiar 'AAA' to 'D' ratings scale" in 1924, in order to "meet the growing demand for independent analysis of financial securities."[61] The SEC first recognized Fitch as an NRSRO in 1975—a designation it continues to maintain. Fitch's ratings and research activity spans the entire financial sector and includes corporate finance, global infrastructure finance, insurance, public finance, sovereigns, and emerging markets.[62]

Sovereign bond rating methodology

Fitch produces ratings on over 100 countries, analyzing "a synthesis of quantitative and qualitative judgments that capture the willingness as well as the capacity of [sovereigns] to meet debt obligations."[63] The four key factors considered in Fitch's sovereign ratings are macroeconomic performance, structural features of the country's economy, public finances, and external finances. Macroeconomic performance variables include "growth prospects, economic stability, and the coherence and credibility of policy." Structural features include "political risk and governance factors," while public finance includes assessments of existing public debt. Fitch's external finance category considers a sovereign's current account balances and capital flows.

Fitch differs somewhat from other major raters in its delineation of how it seeks to separate larger macroeconomic trends from financial fluctuations that are specific to a particular

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[61] See: Appendix, Chart 5.
[62] Fitch reported $982 million in profits for 2013. See: "Our Activities: Fitch Ratings." *Fimalac.com*. Fimalac, S.A. Web. 1 May 2015.
[63] "Sovereign Rating Criteria: Master Criteria." *Fitchratings.com*. Fitch Ratings Co. n.d. Web. 29 Apr. 2015.

sovereign. The company claims that it "distinguishes in its analysis of public and external finances between 'cyclical' and 'structural' developments and trends."[64]

Moody's Investor Service

Background

Moody's Investor Service (MIS) is a subsidiary of the Moody's Corporation. The company specializes in providing financial analysis and credit ratings of corporate and government bonds. John Moody, the organization's founder, is credited as the originator of the bond ratings industry in the United States.[65] The company has provided ratings on the entire U.S. bond market since 1924.[66] The company's website maintains it followed other raters in the practice of charging a fee for its services in the 1970s, deciding that "issuers should pay for the substantial value objective ratings provide in terms of market access" and because "the increasing scope and complexity of the capital markets demanded staffing at higher levels of compensation than could be received from publication subscriptions alone."[67] In February 2015, it was reported that officials from the U.S. Justice Department had begun meeting with Moody's executives. Speculation arose that a formal investigation of the firm was forthcoming, perhaps similar in form to the S&P case—involving allegations of inaccurate ratings of mortgage-related securities

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[64] *Ibid.*
[65] Sylla, Richard. "A Historical Primer on the Business of Credit Ratings." worldbank.org. World Bank. 1 Mar. 2001. Web.1 May 2015.
[66] "Moody's History: A Century of Market Leadership." *Moodys.com*. Moody's Investors Service. Web. 3 May 2015.
[67] *Ibid.*

in the run up to the 2008 financial crisis.[68] As of May 2015, no formal charges have been levied against the firm, which reported year-over-year revenues of $602.3 million.[69]

Sovereign bond rating methodology

Moody's published an updated version of its sovereign ratings methodology in September 2013. This documents stipulates that the company's assessment of sovereign creditworthiness is "based on the interplay of four key factors: economic strength, institutional strength, fiscal strength, and susceptibility to event risk."[70] Variables cited under the heading of economic strength include "growth potential, diversification, competiveness, national income, and [economic] scale." Components included as part of Moody's assessment of institutional strength include "political instability, budget managements" and other "features conducive to supporting [a county's] ability and willingness to repay its debt." Sub-factors referenced in the firm's analysis of institutional strength include the *World Bank Government Effectiveness Index*, the *World Bank Rule of Law Index*, and the *World Bank Control of Corruption Index*. As relates to fiscal strength, Moody's analysis includes considerations of a sovereign's debt burden and total revenues. The category of susceptibility to event risk differentiates the sovereign ratings methodology used by Moody's from those of other raters. The firm describes this area of consideration as an evaluation of "the risk that sudden, extreme events may severely strain public

[68] Martin, Timothy W. "Justice Department Investigating Moody's Investors Service." *WSJ.com*. Wall Street Journal, 1 Feb. 2015. Web. 3 May 2015. It was later reported that "multiple states," including Connecticut and Mississippi, were conducting inquiries into MIS. See: Martin, Timothy W. "Multiple States Probing Moody's Precrisis Business Practices." *WSJ.com*. Wall Street Journal, 6 Feb. 2015. Web. 3 May 2015.

[69] "Moody's (MCO) Beats Q1 Earnings and Revenues Estimates." *Zacks.com*. Zacks Investment Research, 1 May 2015. Web. 3 May 2015. The term "year-over-year" refers to the twelve month period since last quarter end, as opposed to revenues for a specific calendar year.

[70] "Sovereign Bond Ratings." *SOVEREIGN & SUPRANATIONAL* (RATING METHODOLOGY). Moody's Investors Service, 9 Sept. 2013. Web. 1 Feb. 2015.

finances, thus sharply increasing the sovereign's probability of default."[71] Sub-factors of this category include domestic and geopolitical risks and banking sector risk—including the size and strength of a country's banking system. Moody's produces ratings of sovereign issuers on a letter grade system that ranges from Aaa to C.[72]

Prior to looking at how Dagong, S&P, Fitch, and Moody's ratings of Russian sovereign bonds may or may not have been impacted by the Crimean crisis and/or informed by the foreign policies of their countries of origin, the following section reviews the broader context of U.S.-China relations since 2008. This is provided in order to clarify how Dagong's assessment of events in Ukraine might differ from those of U.S.-based raters. It is followed by a brief description of the crisis itself—which touches on how events in Ukraine both reflected and informed the current state of Russia's relations with the international community and its broader foreign policy aims.

U.S.-China Relations Since 2008

There are few regions in the world today that are not at least tangentially impacted by the political and economic influences of the U.S. and China. That said, Asia has played host to the most overt policy disagreements between the two countries since 2008. After two decades of unprecedented economic growth, China has sought to reconstitute its position as a regional political and military power while leveraging its abundant capital reserves globally to ensure that it maintains a robust economy into the near future. Meanwhile, China's policy makers are contending with the challenge of having to reconceptualize and retool traditional approaches to

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[71] *Ibid.*, 20.
[72] See Appendix, Chart 6.

domestic issues ranging from environmental protection, political expression, poverty, healthcare, corruption, and housing.[73] By and large, U.S.-China relations since 2008 have been framed by the global financial crisis, the U.S. foreign policy initiative known as the "pivot to Asia," the ongoing disputes between China and its neighbors in the East and South China Sea, and ongoing negotiations over the trade agreement known as the Trans-Pacific Partnership.

Global financial crisis: Impact on U.S.-China relations

The American and Chinese economies suffered significantly as a result of the global financial crisis of 2008. Total losses to the U.S. economy have been estimated to be as high as $7.6 trillion.[74] Growth in China had begun to slow somewhat in late 2007 and the onset of the crisis exacerbated this trend.[75] The country's total export levels decreased due to lower global consumer spending. Household consumption in China also decreased, which left the economy more dependent on investment from the government. China announced a $586 billion domestic stimulus package in November 2008.[76] Its economy rebounded from the crisis more quickly than the U.S., but the crisis had the effect of convincing the country's policy makers that solidifying its domestic consumer base and regional export markets were central to protecting it from any comparable future shocks. Wen Jiabao, who served as Chinese premier until March 2014, stated in a September 2009 speech that boosting domestic demand "is a long-term strategic policy for

[73] See: Osnos, Evan. Age of Ambition: Chasing Fortune, Truth, and Faith in the New China. (New York: Farrar, Straus, and Giroux, 2014)
[74] Khimm, Suzy. "How Much Did the Financial Crisis Cost Us? $12.8 Trillion, One Group Says." *Washington Post*. Washington Post, 16 Sept. 2012. Web. 10 May 2015.
[75] Bulman, David Janof. "China and the Financial Crisis." Stanford Journal of East Asian Affairs Summer 2010 (2010). Stanford University. Web. 9 May 2015.
[76] Morrison, Wayne M. "China and the Global Financial Crisis: Implications for the United States." Congressional Research Service. United States Congress, 3 June 2009. Web. 10 May 2015.

China's economic growth and the way for us to tackle the financial crisis and stave off external risk."[77]

One significant consequence of the global financial crisis relative to U.S.-China relations has been concurrent accusations of blame among each country's popular press, policy makers, and academics over who was responsible for engendering it. Writing in *Foreign Policy* in January 2012, Helen Mees of Tilburg University, argues that the global financial crisis occurred as a result of China's prospering from "American's spending binge." Mees argues that China moved billions in profits from exports to the U.S. into savings in the form of "U.S. Treasury bonds and other supposedly risk-free securities, driving up the price of bonds and driving down interest rates." While exotic mortgage-based financial products played a small role in fomenting the crisis, Mees says it was in fact "low long-term interest rates that were the most important factor in enlarging the housing bubble."[78] Speaking to the World Economic Forum in January 2009, Wen Jiabao laid blame for the crisis on American policy makers. Without referencing the U.S. by name, Wen stated that the crisis was the result of "[the] inappropriate macroeconomic policies of some economies and their unsustainable model of development characterized by prolonged low savings and high consumption." Wen also criticized the "excessive expansion of financial institutions in blind pursuit of profit" and the "lack of self-discipline among financial institutions and ratings agencies."[79]

[77] Bulman, 20.
[78] Mees, Helen. "How China's Boom Caused the Financial Crisis." *Foreign Policy*. FP Group, 17 Jan. 2012. Web. 9 May 2015. Often attendant to this argument is the idea that China has continued to keep the value of its currency artificially low in order to maintain robust exports—low-priced goods for the world market.
[79] Seager, Ashley, "China Puts Blame for Financial Crisis on America." *Guardian*. Guardian, 28 Jan. 2009. Web. 3 May 2015.

The U.S. "pivot" to Asia

The U.S. foreign policy initiative known as the "pivot" to Asia was unveiled in November 2011, when *Foreign Policy* published an article by Secretary of State Hillary Clinton entitled "America's Pacific Century." "As the war in Iraq winds down and America begins to withdraw its forces from Afghanistan," wrote Clinton, "the United States stands at a pivot point."[80] Clinton solicits the adverbs "diplomatic, economic, strategic, and otherwise" to describe America's planned regional investments and is careful to reference America's military presence in the region as existing in conjunction with its allies. This presence, writes Clinton, has "underwritten [Asian] security for decades and helped create conditions for growth." In a 2010 article for the journal *Geopolitics* entitled "American Dual Containment in Asia," Robert Edwin Kelly is more frank about America's interest in Asia and explains how the U.S. rebalancing addresses significant components of a wider global agenda. According to Kelly, "the post-9/11 U.S. security discussion turns on two Asian challengers over the next few decades—a clear if weak Islamic fundamentalist threat, and a gathering Chinese challenge."[81] Kelly submits that it remains uncertain whether China intends on using its growing economic power to fundamentally alter the existing world order or to elevate its prestige and position within it.[82] Nonetheless, he argues that if the U.S. were to ignore "the new round of emerging Asian competition," including China, it "would jeopardize interests long considered central to [its] values and/or security—Israeli security, Pakistani stability, reliable oil flows from the Persian Gulf, and deeply affective alliances with South Korea and Japan."

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[80] Clinton, Hillary. "America's Pacific Century." *Foreign Policy*. Nov. 2011: n.p. Web. 10 May. 2015. <http://www.foreignpolicy.com/articles/2011/10/11/americas_pacific_century>
[81] Kelly, Robert Edwin. "American Dual Containment In Asia." Geopolitics 15.4 (2010): 705-725. Academic Search Complete. Web. 5 May. 2015.
[82] *Ibid*, 706.

China's Disputes in the East and South China Seas

A third major component of U.S.-China relations since 2008 has been increasing tension between China and its neighbors in the East and South China Sea—many of which are long-time U.S. allies. Disputes over the control of maritime borders and small islands in the East and South China Sea have taken place for centuries. Beyond informing regional influence over fishing grounds and shipping routes, many of the disputed areas are thought to harbor potentially vast stores of natural resources, including untapped supplies of oil and minerals beneath the sea.[83] In total, China is active in at least seven maritime and territorial disagreements in the region, pitting it against a range of neighboring states—including Brunei, Malaysia, the Philippines, Taiwan, Singapore, Vietnam, and Cambodia.[84] Regional disputes have also taken the form of disagreements and policy maneuvering over airspace. In one of the more dramatic episodes of military positioning to date, U.S. President Barack Obama ordered two B-12s to fly through an Air Defense Identification Zone (ADIZ) established by China in late November 2012. Although the American aircraft were unarmed, it did not comply with the ADIZ notification protocols established by China.[85] China's establishment of the ADIZ—which occurred not long after the conclusion of the Chinese Communist Party's Third Plenum of the 18th Central Committee—has been criticized in the West as a Cold War-era maneuver that is contrary to the concept of the "peaceful rise." Espoused by Chinese officials throughout the early 2000s, the "peaceful rise" theory dictates that China's reemergence as a great power will occur subtly and in accordance

[83] "Q&A: South China Sea Dispute." *bbc.co.uk*. British Broadcasting Company, 17 Apr. 2015. Web. 10 May 2015.
[84] "South China Sea." *globalsecurity.org*. Global Security. n.d. Web 10 May 2015.
[85] Whitlock , Craig. "U.S. Flies Two Warplanes Over East China Sea, Ignoring New Chinese Air Defense Zone." Washington Post. 26 Nov 2013: n.p. Web. 8 May. 2015.

with accepted international norms of behavior.[86] Some foreign policy analysts have compared China's rise and its American rejoinder to early twentieth century Europe, or "a clash between a rising and an established power."[87]

The Trans-Pacific Partnership

Described by the Office of the U.S. Trade Representative as "the cornerstone of the Obama administration's economic policy in the Asia Pacific,"[88] the Trans-Pacific Partnership (TPP) is a proposed trade regulation and investment treaty between twelve nations—including the United States, Japan, Canada, Australia, New Zealand, Mexico, Chile, Vietnam, Peru, Brunei, Singapore, and Malaysia. China is conspicuously absent from the countries involved in TPP talks, which have been widely criticized for their lack of transparency.[89] Proponents of the deal say it will create lasting trade relationships between countries comprising 40% of global GDP, boosting world output by $220 billion annually.[90] Yet, TPP supporters are less explicit about the fact that the deal would standardize Western trade regulations throughout Asia. As the *Economist* described in April 2015, if the twelve countries in the deal agree to "common trade standards [such as] mutual recognition of regulatory approval processes in medical services, then those rules—not China's—function in effect as global ones."[91] A key component of China's TPP counterstrategy is the Asian Infrastructure Investment Bank (AIIB). As of April 2015, fifty-seven countries—not including the U.S.—have agreed to be charter members of the bank, which will

[86] "Banyan — Crossing A Line In The Sky." *Economist*. 30 Nov. 2013: n. p. Web. 9 May. 2015.
[87] "Face-Off." *Economist*. Economist Group, 30 Nov 2013: n.p. Web. 8 May. 2015.
[88] "Trans-Pacific Partnership (TPP)." *ustr.gov*. Office of the United States Trade Representative, n.d. Web. 10 May 2015.
[89] Kaminski, Margot E. "Don't Keep the Trans-Pacific Partnership Talks Secret." *New York Times*. New York Times, 14 Apr. 2015. Web. 10 May 2015.
[90] "Don't treat trade as a weapon." *Economist*. Economist Group, 25 Apr. 2015. Web. 5 May 2015.
[91] "Fighting the secret plot to make the world richer." *Economist*. Economist Group, 25 Apr. 2015. Web. 5 May 2015.

fund development projects throughout Asia from initial estimated reserves of $50 billion. While World Bank and International Monetary Fund (IMF) officials have stated they expect to work in cooperation with the AIIB in the region, some Western officials, including former Treasury Secretary Larry Summers, have been more critical. Summers has described the AIIB as "a major institution in which the United States has no role [and] that the United States make substantial efforts to stop—and failed."[92]

The creation of the AIIB is thought to be a direct result of the failure of U.S. legislators to approve funding changes for the IMF that would allow China and other emerging markets a greater say in the organization's operations. Chinese Foreign Ministry spokesman Hong Lei described the reforms—which would increase voting power and board representation for Brazil, Russia, India, China, and South Africa—as essential to the IMF's "reputation, electiveness, and legality."[93] Implementation of these reforms is the purview of the U.S. Congress because the United States is IMF's controlling shareholder—the reforms were omitted from the spending bill approved by U.S. legislators in December 2014.[94]

The following overview of the Crimean crisis is followed by a review of current literature on the topic rating and raters, which is proceeded by an analysis of how Russian sovereign bond ratings changed over the time period that encompassed the event.

[92] Zarroli, Jim. "New Asian Development Bank Seen As Sign of China's Growing Influence." *npr.org*. National Public Radio, 16 Apr. 2015. Web. 10 May 2015.
[93] "China expresses regret at U.S. failure to pass IMF reforms." *reuters.com*. Reuters, 12 Dec. 2015. Web. 10 May 2015.
[94] *Ibid.*

Russia and the Crimean Crisis

In late February and early March 2014, the Russian Federation undertook an annexation of the Crimean peninsula from Ukraine. The reaction of the international community to Russia's action was swift. Officials from numerous global governance bodies—including the European Union (EU), the Organization for Economic Cooperation and Development (OECD), the North Atlantic Treaty Organization (NATO), and the UN criticized Russia's behavior as a violation of international laws pertaining to state sovereignty and territorial integrity, expressing concerns over the annexation's implications for global security.[95]

Russia's motivations in Crimea and Ukraine

In public statements regarding Russia's action in Crimea, President Vladimir Putin cited a range of historical, cultural, and political motives—all of which reflect his belief that the peninsula was unjustly appropriated from Russia and made an independent sovereign state following the collapse of the Soviet Union.[96] According to Susan Richards, founding editor of the website *Open Democracy Russia*, "Russia and the Russian-speaking majority in Crimea never stopped believing that the split was an appalling mistake that had to be corrected." Beyond historical rancor, Putin's effort to justify the annexation involved officials from the Russian Orthodox Church, who tacitly validated the action by supporting the narrative that Crimea is linked to the origin story the Russia state—serving as the setting of the baptism of Vladimir the Great, the Grand Prince of Kiev and a grandfather of Russian-Ukrainian political history, in 988.[97] Putin's

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[95] "The International Reaction: Sixes and Sevens." *Economist*. Economist Group, Mar. 8, 2014. Web. 1 May 2015.
[96] Richards, Susan. "Crimea in Context: Life in Russia's Backyard." *Foreign Affairs*. Foreign Affairs, 16 Mar. 2014. Web. 2 May 2015. <https://www.foreignaffairs.com/articles/russian-federation/2014-03-16/crimea-context>
[97] Baczynska, Gabriela. "Russian Orthodox Church Sings from Putin Hymn Sheet on Ukraine." *Reuters.com*. Reuters, 7 Mar. 2014. Web. 10 May 2015. Putin's conceptualization of Crimea as "Russia's Holy Land" has been

ideological impetus for annexing the Crimean peninsula coincided with what he viewed as a more immediate and pressing need for immediate Russian military involvement in the territory—that the lives of thousands of "Russia speakers" in Ukraine were at risk, imperiled by the Western-leaning, pro-democracy militias that had organized massive anti-government protests in Kiev and forced the resignation of former Ukrainian president and Kremlin ally Viktor Yanukovych.[98]

Although absent from any official statements related to the crisis, Russia's trade relations with Ukraine were a central component of its Crimea action—particularly as they pertain to Russian influence on European energy markets. Over half of Russia's gas exports to Europe pass through Ukrainian pipelines, while approximately one quarter of Europe's natural gas is purchased from Russia. Furthermore, Russia supplies 60 percent of Ukraine's natural gas imports, affording it a position of economic dominance that has translated historically into significant influence within Ukrainian domestic politics.[99] Existing regional influence and energy distribution infrastructure notwithstanding, Russia's action in Crimea earned it control over 36,000 additional square miles of the Black Sea and with it primary control over future projects aimed at extracting what are estimated to be significant underwater oil resources.[100] Following a referendum in which over 96 percent of participants elected to join Russia, Crimean officials signed a treaty of accession in March 2014. For Putin and many of his Russian-speaking supporters in eastern Ukraine, the occasion was celebrated for answering once and for all the

disputed by some Russian historians. See: Arkhipov, Ilya and Stephan Kravchenko. "Putin's Crimea-as-Jerusalem Myth Baffles Russian Historias." *Bloomberg.com*. Bloomberg, 5 Dec. 2014. Web. 10 May 2015.

[98] Mankoff, Jeffrey. "Russia's Latest Land Grab." *Foreign Affairs*. Foreign Affairs, May/June 2014. Web. 10 May 2015.

[99] Erlanger, Steven. "Russia Ratchets Up Ukraine's Gas Bills In Shift To An Economic Battlefield." *New York Times*. New York Times, 11 May 2014. Web. 10 May 2015.

[100] Broad, William J. "In Taking Crimea, Putin Gains a Sea of Fuel Reserves." *New York Times*. New York Times, 17 May 2014. Web. 10 May 2015.

question of ownership and control of the Crimean peninsula. Still, the referendum and the treaty are not officially recognized by Ukraine, the United States, or the majority of the international community.

Understanding how or why the creditworthiness of Russian sovereign bonds was impacted by Russia's actions in Crimea can be served by a more dynamic analysis of the conceptual and qualitative components of ratings behavior. The following literature review considers existing research on elements of rating and creditworthiness that exist outside the ambit of more objective, quantitative components of the ratings process.

Section IV: Literature Review

Reputation and credit ratings

A central question posed by researchers of sovereign lending centers around the idea of why, in an international system that international relations theorist Kenneth Waltz argues is inherently anarchical,[101] would any state feel compelled to return payment on a loan—either to another state or to a domestic or foreign constituency? That is—what is the motivation of states to comply to the statues of lending in a world in which the capabilities of other states to enforce compliance is limited and imperfect? Reputation provides one answer. Robert Kolb of Loyola University describes this rationale as "the argument that sovereign governments want to maintain a reputation as a good credit risk to assure future access to international funds." In order to ensure future access to capital, writes Kolb, "[states] repay the debts they own now."[102]

Yet Kolb amends this description with a counterargument on the theoretical failure of the rationale that reputation alone is the driving force behind sovereign lending. Simply put, he points out how the theory is only applicable in an environment of perpetual lending and borrowing. "If the borrower knows that the current year is a terminal year, after which there will be no lending, the borrower would refuse to repay," writes Kolb, "for the simple reason that there is no fear of exclusion from future borrowing." Following this logic, lenders—knowing they would not be repaid—would not lend money in Kolb's "terminal year," shifting to the prior year the very same circumstances in which the lender would have no incentive to repay and the lender no desire to lend, continuing in a series of backward inductions that leads to a situation in

[101] Waltz, Kenneth. A Theory of International Politics. New York: McGraw-Hill (1979). Print, 88.
[102] Kolb, 4.

which no lending is taking place at all. To solve for this theoretical failure, Kolb modifies the reputation rationale. No state can be certain that the cycle of lending and repayment will continue indefinitely—thus, as Kolb states, "it is uncertainty about the future that makes reputation valuable in sustaining lending. A borrower's reputation for paying as promised possess value because of the prospect of securing a loan or expanding borrowing in the future."[103]

Jeremy Bulow of Stanford University and Kenneth Rogoff of Harvard University further modify the reputation rationale, citing the example of a small country that holds a variety of debts from several creditors, but nonetheless has yet to fully develop a reputation for high creditworthiness.[104] Maintaining a reputation as a good credit risk, argue Bulow and Rogoff, is not an option in the cases involving sovereign states for which none exists.

Harold Cole of the University of Pennsylvania and Patrick Kehoe of the University of Minnesota add to the reputation rationale the concept of "reputational spillovers"—where the inability of a borrower to make good on debts "[affects] trust relationships more broadly," meaning the threat of "collateral damage" in other realms of interstate relations helps to define the repayment motivations of borrowers.[105]

Rating agencies and global governance

Existing research on the role and influence of rating agencies in global governance is varied and ranges from theories portending that they are highly impactful, if unseen, powers in the universe of capital markets—to theories more in line with how raters themselves self-identify: as

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103 *Ibid,* 5.
104 Bulow, Jeremy and Kenneth Rogoff. "Sovereign Debt: Is to Forgive to Forget?" *American Economic Review*. 79.1. (1989). Web. 10 May 2015.
105 Kolb, 11. See also: Cole, Harold L. and Patrick J. Kehone. "Reviving Reputation Models of International Debt. *Federal Reserve Bank of Minneapolis Quarterly Review.* (1997) 21.1, 21–30. Web. 10 May 2015.

organizations that provide an educated opinion on markets and market actors in exchange for a fee. Sinclair describes raters as "second superpowers." "Their arsenal is an occult one," he argues, "largely invisible to all but a few most of the time." For Sinclair, "market and government actors take account of rating agencies not because the agencies are right but because they are thought to be an authoritative source of judgments, thereby making the agencies key organizations controlling capital markets."[106] He argues that, relative to global governance, "rating agency surveillance shapes the thinking and action of debt issuers."[107] A central piece of Sinclair's "second superpower" theory is the issue of regulation and the idea that the work of raters "is not regulated seriously anywhere in the developed world." "Indeed," adds Sinclair, "regulation would potentially destroy the key thing agencies have to sell: their independent opinion on market matters."[108] He submits that in market parlance, sovereign bond ratings produced by credit rating agencies represent the a benchmark—or the most widely accepted standard of what is and is not worthy of investment. Sinclair holds CRAs as representative of the increased power and influence of non-state actors in a world economy that continues to experience the wake of financial globalization. "Non-state actors have always been important," he writes, "but financial globalization has made these institutions more central to capitalism."[109]

By contrast, Langohr and Langohr describe Sinclair's conception of rating agency power as sensational.[110] They suggest that the central value of rating agency output is not quantitative, but qualitative—CRAs provide robust business analysis of organizations working in an inherently competitive environment. "One of the most critical impediments to investors writes,"

[106] Sinclair, 2.
[107] *Ibid*, 8.
[108] *Ibid,* 9.
[109] *Ibid*., 67.
[110] Langohr and Langohr, xiii.

argue Langohr and Langhor, is “the information asymmetry between outside investors and insiders who control [organizational] operations.” This, the authors argue, “is the context in which CRAs operate and where they add economic value. With ratings, CRAs aim to remedy the information shortage for fixed income investors.”[111] Langohr and Langohr counter Sinclair’s “occult arsenal” argument by pointing to the fact that ratings activities “require the full and honest participation of the debt issuer.”[112] Furthermore, argue Langhor and Langhor, while regulation of credit rating activity has increased since the global financial crisis, the importance of their work in capital markets has arguably increased. The author’s suggest that criticism of CRA outputs is often engendered by false expectations that they will be 100 percent right 100 percent of the time—an impossible standard. “Sometimes [regulators] are afraid that downgrades are too prompt [and] make things worse for the debtor [and] investor. Sometimes regulators complain that agencies are too slow in downgrading, particularly so when hindsight makes it easy to predict a default that has already occurred.”[113]

Beyond numbers: The social/political components of rating behavior

Much of Sinclair’s work on CRAs focuses on the idea that, despite the best intentions of both sovereign debt issuers, creditors, regulators and raters—markets have always been, and will continue to be, influenced significantly by less precise factors of human nature. “Much that is written about financial markets,” writes Sinclair, “misses the fundamentally social character of what happens inside [them] and their institutions.” According to Sinclair, “financial markets are more social—and less spontaneous, individual, or ‘natural’—than we tend to believe.” He argues

[111] *Ibid.*, 9.
[112] *Ibid.*, 14.
[113] *Ibid.*, 15.

that the same is true for CRA outputs.[114] Implicit in this idea is the influence of politics on rater outputs. For Sinclair, ratings agencies help to transmit Western policy and managerial orthodoxy to governments worldwide.[115] "They are promoters of an American-derived mental framework," that holds that "knowledge is objective," "markets are natural, not social phenomena" and that ratings are not "judgments" but the result of "rational professional processes." Thus, Sinclair argues that raters and their outputs play a principal role in the maintenance of what Philip McMichael terms "the globalization project"—"a Washington-based consensus among global managers [and] policymakers favoring market-based rather than state-managed development strategies" and the "centralized management of global market rules by the Group of Seven (G7) states"—namely, the United States, Canada, France, Germany, Italy, the United Kingdom, and Japan.[116] "The globalization project," writes McMichael, "did not begin on any particular date, but emerged in the 1970s and 1980s as Bretton Woods institutions [including the World Bank and IMF] made explicit claims about managing a global economy." For states with developing economies, involvement in this project became symbiotic with "successful participation in the world economy."[117] Theories of Western dominance in the realm of capital markets maintain significance in today's global economy, where Asian countries—led by China—have established themselves as major factors in both trade and finance. The founding of Dagong and the advancement of Asia-centric financial projects such as the Asian Credit System can be viewed as part of a regional reaction to the legacy of Western dominance in the investment and development space.

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[114] Sinclair, 5.
[115] Sinclair, 71.
[116] McMichael, Philip. Development and Social Change: A Global Perspective, 4th ed. Los Angeles: Pine Forge Press. 2008. Print, 151.
[117] *Ibid*.

Bearing in mind the context reviewed above, the following sections presents a review of CRA outputs on Russia sovereign bonds ratings since 2012.

Section V: Russian Sovereign Bond Ratings Since 2012

Overview

Figure #2 delineates the sovereign credit ratings for Russian sovereign bonds issued by the Big Three raters and Dagong between January 2012 and February 2015. The prefix "n/a" or "not applicable" is used to denote periods in which no rating activity took place. Ratings colored in both green and brown represent "investment" grade ratings—with green-shaded ratings representing a higher-level of creditworthiness than brown-shaded ratings. The yellow bar marking February 2014 indicates the time period in which Russia undertook military operations on the Crimean Peninsula. As is evident in the chart, Russian sovereign bond ratings issued by the Big Three raters trended downward in the months following Russia's military action in Crimea, with two agencies relegating Russia debt to "junk" status by February 2015. This trend is contrasted by ratings issued by Dagong, which rated Russia debt as being highly creditworthy—in conjunction with a positive economic outlook for the larger Russia economy—in both November 2013 and January 2015. The subsequent paragraphs of this section review rater output regarding Russia in more detail.

FIGURE 2. RUSSIAN SOVEREIGN BOND RATINGS SINCE JANUARY 2012

MONTH/YEAR	Dagong	S&P	Fitch	Moody's
January 2012	A (Stable)	n/a	BBB (Stable)	n/a
November 2013	A (Stable)	n/a	n/a	Baa1 (Stable)
January 2014	n/a	n/a	BBB (Stable)	n/a
February 2014				
March 2014	n/a	n/a	BBB (Negative)	n/a
April 2014	n/a	BBB- (Negative)	n/a	n/a
October 2014	n/a	n/a	n/a	Baa2 (Negative)
January 2015	A (Stable)	BB+ ("Junk") (Negative)	BBB- (Negative)	Baa3 (Negative)
February 2015	n/a	n/a	n/a	Ba1 ("Junk)(Negative)

Source: Dagong, Fitch, S&P, and Moody's (May 2015)

Dagong's Russian sovereign credit ratings and economic outlook

Dagong's 2012 rating of Russian sovereign bonds and outlook for the Russian economy (A/Stable) was based primarily on high global oil prices. "Oil export prices fluctuating at the high level *[sic]*," reads Dagong's report, "will lead to a steady growth of the Russian economy while fiscal balance and the balance of payment surplus maintain the government's solvency."[118] While generally positive, Dagong's 2012 rating report is critical of the "severe rigidity" in Russia's broader economy—a reference to its lack of diversification—and describes the country's private sector as "inactive." The agency's 2012 report also makes vague reference to the political unrest surrounding the 2012 Russia presidential election, stating that "the expanding tendency" of political opposition "limits policy implementation and [the] political stabilization of

[118] "Dagong Maintains Russia's A Rating and Stable Outlook." Dagong Global Credit Rating Agency. 30 Oct. 2012. Web. 1 Mar. 2015.

the president."[119] In 2013, Dagong's credit rating maintains the agency's A/stable rating for Russia, but not without referencing the downward trend in global oil prices then influencing global markets. "[The] Russian government sustains a stable debt repayment environment," the report states, "but economic growth is slowing down because of sluggish external demands."[120]

Despite the social and political turmoil engendered by Russia's military action in Crimea—which included the Western-led imposition of an economic sanctions regime, Dagong did not abdicate its A/stable rating of Russian sovereign credit in its January 2015 rating report. While acknowledging that the country's economy had become "mired in deteriorating external circumstances," it reasoned that "a certain scale of fiscal and foreign exchange reserves provides necessary buffers, securing a basically stable debt repayment capability." Russia's foreign exchange and fiscal reserves continues to serve as the backbone of Dagong's reasoning that its creditworthiness will remain strong despite strong market headwinds related to oil prices and the continued impact of international sanctions. Markedly, Dagong maintained its strong outlook for Russia despite the fact that the Russian ruble lost over 20 percent of its value against the dollar between September and November 2014.[121]

Standard & Poor's Russian sovereign credit ratings and economic outlook

S&P downgraded its Russian sovereign credit rating in April 2014—to BBB- with a negative economic outlook. "In our view," the company stated, "the tense geopolitical situation between Russia and Ukraine could see additional significant outflows of both foreign and domestic

[119] *Ibid*.
[120] "Dagong Maintains the Sovereign Credit Ratings of Russian Federation." Dagong Global Credit Rating Agency. 1 Nov. 2013. Web. 1 Mar. 2015.
[121] Llobet, Anais. "Expats Are Looking to Flee Russia After the Plunge of the Ruble." businessinsider.com. 25 Dec. 2014. Web. 16 May 2015.

capital from the Russian economy."[122] Russian Economy Minister Alexei Ulyukayev criticized S&P's downgrade as "a politically motivated decision" made in concurrence with the sanctions regime imparted on Russia as punishment for its actions in Crimea.[123]

S&P downgraded its credit rating of Russia to "junk" in January 2015. Speaking to the *Wall Street Journal*, Standard Bank market strategist Tim Ash described the move as "expected" and reflective of "a combination of lower oil prices, sanctions, and the conflict in Ukraine" and the fact that "the difficult geopolitical tussle with the West shows no signs of easing." "These factors," according to Ash, "have and are expected to continue to weigh on Russia's balance sheet and overall credit matrix."[124]

Fitch's Russian sovereign credit rating and economic outlook

In March 2015, Fitch ratings changed its outlook for Russia to negative while maintaining the investment-grade BBB rating of the country's creditworthiness in January. The company justified the change in outlook as reflecting "the potential impact of sanctions on Russia's economy and business environment." "Since U.S. and European Union banks and investors may well be reluctant to lend to Russia under the current circumstances," Fitch's report stated, "the economy may slow further and the private sector may require officials support." Fitch's outlook report cites the Crimean crisis specifically, stating that "the incorporation of Crimea into the

[122] "Russia's credit rating downgraded by S&P." *bbc.co.uk*. British Broadcasting Corp. 25 Apr. 2015. Web. 15 May 2015.
[123] *Ibid*.
[124] Albanese, Chiara and Maria Armental. "S&P Downgrades Russia Foreign Currency Rating to Junk." *wsj.com*. Wall Street Journal. 26 Jan. 2015. Web. 15 May 2015.

Russian Federation will likely lead to the European Union and U.S. to extend sanctions further."[125]

In January 2015, Fitch changed its Russian sovereign credit rating to near-junk status—releasing a rating downgrade to BBB-/Negative. In a statement regarding the rating change, Fitch noted that "Western sanctions first imposed in March 2014 continue to weigh on the [Russian] economy by blocking banks' access to external capital markets."[126] Surmising the impact of the downgrade, a Barclay's analyst commented that a total loss Russia's of investment grade status would exclude it from global benchmark indices—essentially removing the country's bonds from consideration in the eyes of global investors.[127]

Moody's Russian sovereign credit rating and economic outlook

In November 2013, Moody's credit rating of Russian sovereign bonds stood at investment grade (Baa1) and included a stable outlook for the country's broader economy. The company had affirmed this stance in a supplementary analysis published in July, which cited Russia's commodity exports, current account surpluses, and low gross debt.[128] The company announced subsequent rating action in January 2015, downgrading its Russian rating to Baa2 with a negative economic outlook. A statement from the company on the rating action stated that the downgrade was a result of "Russia's increasingly subdued medium-term growth prospects, exacerbated by the prolongation of the Ukraine crisis" and "the gradual but ongoing erosion of

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[125] "Fitch Revises Russia's Outlook to Negative; Affirms at 'BBB.'" *reuters.com*. Reuters. 21 Mar. 2015. Web. 16 May 2015.
[126] Albanese, Chiara and Lauren Pollock. "Fitch Cuts Ratings on Russia to Brink of Junk." *wsj.com*. Wall Street Journal. 9 Jan. 2015. Web. 16 May 2015.
[127] *Ibid*.
[128] "Supplementary Analysis: Russian Federation." *moodys.com*. Moody's. 8 July 2013. Web. 16 May 2015.

the country's foreign-exchange buffers due to capital flight."[129] The company further degraded its Russia rating in January 2015, moving from Baa2 to Baa3, with a negative outlook. In its report, Moody's cited "the risk of further decline in oil prices at a time when international market access is restricted for Russian borrowers due to sanctions."[130]

Moody's announced that its Russian sovereign rating had been lowered to junk status in February 2015, stating that "the continuing crisis in Ukraine and the recent oil price and exchange rate shocks will further undermine Russia's economic strength and medium-term growth prospects, despite [its] fiscal and monetary policy responses." "The assignment of the negative outlook," reasoned the report, "reflects the potential for more severe political or economic shocks to emerge, related either to the military conflict in Ukraine or a renewed decline in oil prices, which would further impair Russia's public and external finances."[131]

Russia's reaction

Russian officials have been highly critical of the Big Three's collective downgrade of its creditworthiness. In January 2015, officials at the Russian Central Bank (RCB) announced that the institution would no longer use credit ratings from S&P, Fitch, or Moody's generated after March 2014. Writing in support of the RCB's decision, *Moscow Times* columnist Ben Ari, wrote "[Raters] are private companies, so we assume they're completely independent and not subject to political pressure. However, the do exist in an American context and are subject there to the international media's reporting, which tends to give a single narrative—a very negative

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[129] "Rating Action: Moody's Downgrades Russia's Ratings to Baa2; Outlook Negative." *moodys.com*. Moody's. 7 Oct. 2015. Web. 16 May 2015.
[130] "Rating Action: Moody's Downgrades Russia's Ratings to Baa3; on review for further downgrade." *moodys.com*. Moody's. 16 Jan. 2015. Web. 16 May 2015.
[131] "Rating Action: Moody's Downgrades Russia's Ratings to Ba1 from Baa3; outlook negative." *moodys.com*. Moody's. 20 Feb. 2015. Web. 16 May 2015.

narrative— when it comes to reporting the Russia story."[132] The RCB's mandate regarding the Big Three was revised in April 2015, when Russia's state Duma approved legislation introducing accreditation requirements for their activity in the country. The law stipulates that "non-accredited rating agencies would not be forbidden from operation in Russia, but only ratings by accredited agencies could be quoted for regulatory purposes."[133]

Section VI: Findings

It is clear that a relationship exist between the work of U.S. and China-based credit rating agencies and the foreign policy of China and the United States towards Russia. Analysis of their rating activity through the context of the Crimean Crisis demonstrates that U.S.-based raters downgraded Russia's credit rating in the months following the country's military action on the Crimean peninsula, while the China-based rater maintained its robust credit rating and positive economic outlook. This disparity is indicative of a larger schism in the economic and political philosophies of the U.S., China, and Russia. Russia's action in Crimea was penalized by U.S.-led economic sanctions regime, as a penalty its violation of international norms pertaining to state sovereignty. U.S.-based raters—acting both in accordance to their established rating methodologies and in congruence with their role as norms-enforcers of the global economic order—punished Russia accordingly.

While U.S. foreign policy remains focused on countering the influence of China relative to its allies in Asia and maintaining its position as key arbiter and benefactor of the globalization project initiated in the years following the end of World War II, China and Russia are seeking a

[132] "Russian Central Bank voids Standard & Poor's, Moody's, Fitch ratings." *rt.com*. Russia Today. 19 Jan. 2015. Web. 16 May 2015.
[133] "Russian Government Approves Bill on Credit Rating Agencies with Minor Changes." rapsinews.com. Russian Legal Information Agency. 24 Apr. 2015. Web. 16 May 2015.

new paradigm of world order. China wants to leverage its unprecedented capital reserves to position itself as the main conciliator of the Asian economic engine while acting concurrently to protect its regional interests in the East and South China Seas. While business relations between the U.S. and China comprise one of the central ecosystems of global economics, the U.S. and its allies have been unhurried at best in accepting a greater role for China and other developing economies in the venues of global governance that specialize in finance and trade. Although China and Russia face their own unique set of challenges related to their bilateral relations, Russia shares China's enmity over the idea that it must accept a globalized economy whose governance is decidedly not global, but relegated to the same countries who have overseen control of the world economic order for over seventy years. Moreover, although Cold War power dynamics are often considered bygone phenomena in the West, they remain acutely pertinent in the mind of Russia's president, who views modern Russia as a state weakened by its defeat in that conflict and remains determined to spearhead a return to Russian greatness in Europe and in the world at large. Thus, Dagong's high rating of Russian creditworthiness and its attendant positive economic outlook can be viewed as evidence of the antipathy shared by Russia and China relative to the West's continued stewarding of the world economy—a stewardship those countries agree was sullied by the global financial crisis.

Section VII: Policy Recommendations

- Developing economies should be afforded a greater role in the organizational governance and policy regimes of the World Bank and the International Monetary Fund. The boards of these organizations should more accurately reflect decades of economic development that has taken place worldwide, including the rise of China as an economic superpower.
- The United States should continue to work to maintain functional relations with Russia in order to address challenges such as nuclear non-proliferation and Middle East security. Coordination in these areas increases the chances that agreements can be reached on the political and geographic questions pertaining to Ukraine.
- The Russian government should work to implement economic reforms so that its economy becomes more diversified and less reliant on commodities and energy exports to Europe. A more diverse economic base will lessen the country need to maintain strict control over regional trade infrastructure vis-à-vis curt, tone deaf political and economic relations with most its immediate neighbors.
- The Russia government should work to improve the transparency of the country's political system, including the implementation of reforms aimed at curbing corruption. The dominance of a single person or party over Russian political and cultural life is a threat to the health and prosperity of the greater population and the country's economic future.
- Ratings agencies should work to counter their reputation for being Western-dominated practitioners of research, analysis, and ratings output. They should do more to publicize their working relationships with governments around the global in order to pro-actively counter perceptions of bias regarding their work.

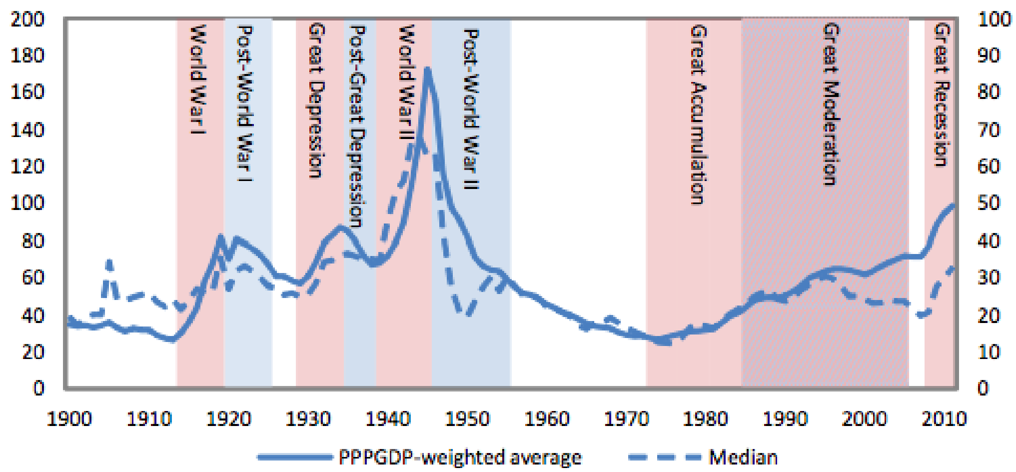
Section VIII: Conclusion

Following the conclusion of World War II, the U.S. and its allies—through the globalization project—sought to establish a system of economic order that, in addition to aiding in the reconstruction of post-war European economies, would offer pathways for the development of impoverished nations worldwide. The moral, political and social implications of this effort aside, it can be argued that the globalization project has in many was succeeded, as measured by global economic growth and the wholly enmeshed nature of world capital flows and trade. This expansion of influential participants in the world economic order since the mid-twentieth century should be paralleled by an increase in the number of states who participate in that system's ongoing maintenance and governance. Whatever the next iteration of the globalized economy—its success is contingent upon the full cooperation and involvement of all—not some—of its major participants.

Section IX: Appendix

<u>Chart 1</u>

Figure 1. Debt-to-GDP Ratio in Advanced Economies, 1900-2011[1]



Source: Authors' calculations.

Excerpted from: Ali Abbas, S.M., Laura Blattner, Mark De Broeck, Asmaa El-Ganainy, and Malin Hu. "Sovereign Debt Composition in Advanced Economies: A Historical Perspective." *IMF Working Paper: Fiscal Affairs Department* (2014). International Monetary Fund. Web. 6 Apr. 2015.

Chart 2

List of Nationally Recognized Statistical Rating Organizations (NRSROs) as of May 1, 2015

ORGANIZATION	REGISTERED WITH SEC	PRINCIPAL OFFICE
AM Best Company Inc.	September 24, 2007	United States
DBRS Inc.	September 24, 2007	United States
Egan-Jones Ratings Co.	December 21, 2007	United States
Fitch	September 24, 2007	United States
HR Ratings de Mexico	November 5, 2012	Mexico
Japan Credit Rating Agency	September 24, 2007	Japan
KBRA	February 11, 2008	United States
Moody's	September 24, 2007	United States
Morningstar	June 23, 2008	United States
Standard & Poor's	September 24, 2007	United States
		Source: SEC (Dec. 2014)

Chart 3

Dagong Global Credit Rating Co. Ltd. — Sovereign Bond Ratings System

Rating Grade	Dagong's Description
AAA	"Strongest management capacity," "prosperous and diversified economy," "Strong capability to resist any crises," "low debt burden"
AA	"Long-term sustainable economic growth," "ability to prevent systemic risks of the financial system is relatively strong," "debt scale is moderate, "the fiscal balance is in good shape," "small sized foreign debts," "the nation can guarantee debt repayment in the medium/long-term"
A	"Policies are consistent/stable, but there exist some factors that might threaten domestic security." "The economic system has structural issues [that] are being improved gradually." "Modest debt, but the fiscal balance is not stable."
BBB	"Although the economic system has potential, it is vulnerable to external impacts. During the process of rapid development of the financial system, the possibilities that financial system risks cause by both internal and external factors are larger *[sic]*. Debts increase at a fast speed than fiscal revenues."
BB	"Unstable political situation, relatively obvious geographical political risks [and] social tensions are visible. The economy is not developed in a diversified way. The economic growth is restricted by its economic structure *[sic]*."
B	"Policies are inconsistent in case of a change in the administration of the nation. National economic management capacity is restricted. Obvious geographical/political risks [and social conflict. The economy is small in size, with weak ability to resist internal/external shock."
CCC	"Weak management capacity in terms of economy and society. The domestic situation/geographical [and] political status are intense *[sic]*. The macro-economy operates in an unstable way. High inflation. Highly risky that adequate fund *[sic]* can be raised to repay its current financial commitments."
CC	"High risk of default. The nation is strongly urged to raise funds to meet its financial commitments due soon."
C	"The highest risk of default. Indicates incapacity to repay its debts. *[sic]*"

Note: Ratings can include plus/minus (+/-) stipulations (i.e. B+, CC-) *Source:* "Sovereign Rating Methodology." *En.dagongcredit.com*. Dagong Global Credit Rating Co. Ltd.

Chart 4

Standard & Poor's Financial Services LLC – Sovereign Bond Rating System

RATING	DESCRIPTION
AAA	"Extremely strong capacity to meet financial commitments. Highest Rating."
AA	"Very strong capacity to meet financial commitments."
A	"Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances."
BBB	"Adequate capacity to meet financial commitments, but more subject to adverse economic conditions."
BBB-	"Considered lowest investment grade by market participants."
BB+	"Considered highest speculative grade by market participants."
BB	"Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions."
B	"More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments."
CCC	"Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments."
CC	"Currently highly vulnerable."
C	"Currently highly vulnerable obligations and other defined circumstances."
D	"Payment default on financial commitments."
	"Note: Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories." Source: "Credit Ratings Definitions & FAQs." *S&P*. Web. 28 Apr. 2015. <http://www.standardandpoors.com/ratings/definitions-and-faqs/en/us>.

Chart 5

Fitch Ratings – Sovereign Bond Rating System

RATING	DESCRIPTION
AAA	Highest credit quality
AA	Very high credit quality
A	High credit quality
BBB	Good credit quality
BB	Speculative
B	Highly speculative
CCC	Substantial credit risk
CC	Very high levels of credit risk
C	Exceptionally high levels of credit risk
RD	Restricted default
D	Default
	Source: "A.1 International Issuer and Credit Rating Scales." Fitchratings.com. Fitch Ratings Co. Web. 1 May 2015. <https://www.fitchratings.com/web_content/ratings/fitch_ratings_definitions_and_scales.pdf>.

Chart 6

Moody's Investors Services Ratings – Sovereign Bond Rating System

National Scale Long-Term Ratings

The rating definitions are as follows, with an "n" modifier signifying the relevant country, for example, Aaa.br for Brazil, or Aaa.tw for Taiwan. Each national scale rating category (e.g. Aaa.n, Aa1.n, etc.) may represent a wide range of creditworthiness and may map to several different notches on Moody's standard global rating scale.

Aaa.n	Issuers or issues rated Aaa.n demonstrate the strongest creditworthiness relative to other domestic issuers.
Aa.n	Issuers or issues rated Aa.n demonstrate very strong creditworthiness relative to other domestic issuers.
A.n	Issuers or issues rated A.n present above-average creditworthiness relative to other domestic issuers.
Baa.n	Issuers or issues rated Baa.n represent average creditworthiness relative to other domestic issuers.
Ba.n	Issuers or issues rated Ba.n demonstrate below-average creditworthiness relative to other domestic issuers.
B.n	Issuers or issues rated B.n demonstrate weak creditworthiness relative to other domestic issuers.
Caa.n	Issuers or issues rated Caa.n are speculative and demonstrate very weak creditworthiness relative to other domestic issuers.
Ca.n	Issuers or issues rated Ca.n are highly speculative and demonstrate extremely weak creditworthiness relative to other domestic issuers.
C.n	Issuers or issues rated C.n are extremely speculative and demonstrate the weakest creditworthiness relative to other domestic issuers.

Note: *Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category. National scale long-term ratings of D.ar and E.ar may also be applied to Argentinian obligations.*

Excerpted from: "Sovereign Bond Ratings." *SOVEREIGN & SUPRANATIONAL* (RATING METHODOLOGY). Moody's Investors Service, 9 Sept. 2013. Web. 1 Feb. 2015.

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