

# Spain, the sovereign debt crisis, and the sociology of finance: some comments

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## Credit-Default Swaps for Sovereign Debt

The cost of insuring Greek government bonds against default rose sharply Thursday. To insure \$10 million of Greek sovereign debt for five years, an investor would now have to pay \$2 million a year.



Source: Markit

THE NEW YORK TIMES

# Sovereign Debts

- Old problem of enforceability (cannot sue the King, inconvenient to send in the gun-boats).
- Reputational mechanism (Tomz 2007): don't lend to sovereigns that default, but could repay.
- Credible promises: North and Weingast (1989) analysis of Glorious Revolution.
- Willingness and ability to pay.
- Foreign vs. domestic creditors.
- Debtor/creditor balance of power: if I owe my bank £100 and can't repay, I'm in trouble. If I owe my bank £1 million, my bank is in trouble (J M Keynes).

# Sovereign Debt Crisis

- Can Leviathan repay? Rating agencies judge.
- Political and fiscal stakeholders of capitalist democracies: unpopularity of fiscal rectitude; presumption that bond holders don't have voice.
- Autonomous central banks prioritize price stability, so inflation isn't an option.
- So a debt crisis poses a distributional problem: how to share the losses?
- Political negotiations shaped by issues of fairness, perceptions of equity, attributions of guilt, and complex financial interdependencies (direct and indirect).

# Modern Bond Rating Categories

Moody's		S&P		Fitch		
Long term	Short term	Long term	Short term	Long term	Short term	
Aaa	P-1	AAA	A-1+	AAA	A1+	Prime
Aa1		AA+		AA+		High Grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1		A+	A+	A1	Upper Medium Grade	
A2	A	A				
A3	P-2	A-	A-2	A-	A2	Lower Medium Grade
Baa1		BBB+		BBB+		
Baa2	P-3	BBB	A-3	BBB	A3	
Baa3		BBB-		BBB-		
Ba1	Not Prime	BB+	B	BB+	B	Non Investment Grade Speculative
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+	B+	Highly speculative		
B2		B	B			
B3		B-	B-			
Caa		CCC+	C	CCC	C	Substantial risks
Ca		CCC				Extremely speculative
C		CCC-				In default, with little prospect for recovery
/		D	/	DDD	/	In default
/	DD					
/	D					

# U.S. Rating Agencies

- Rating sovereigns since 1920s.
- Ratings help channel and price capital flows.
- Now panoptic in scope.
- Downgrades are big news for multiple audiences.
- Ratings are hardwired into national and international regulations, and private contracts.
- Legally are mere “opinions.”
- CRAs are private, for-profit organizations.
- Despite notable failures (Asian Financial Crisis, Enron, CDOs in 2007/2008) they remain central to governance of global capital markets and sovereign borrowing.

