Chapter 9

SEEING LIKE A CREDIT RATING AGENCY: THE CONSTITUTION OF FINANCIAL UNCERTAINTIES DURING THE GREEK SOVEREIGN DEBT CRISIS

Grégoire Mallard and Pierre Pénet

1Department of Sociology, Northwestern University, Evanston, Illinois, US
2Department of Sociology, Northwestern University, Evanston, Illinois, US & SciencesPo Paris/OSC, Paris, France

ABSTRACT

Building on a relatively new literature in the sociology of knowledge and science studies, this paper analyzes how financial actors minimized the uncertainties arising in the recent European sovereign debt crisis by resorting to non-linear practices of risk valuation by which they “constituted” the reality of those same financial uncertainties. Centering on the Greek sovereign debt crisis, we explain why credit rating agencies (CRAs), specifically Moody’s, failed to recognize early signs of trouble in Greece, and displayed rating inertia before issuing multi-notch downgrades. Using ratings reports and press releases published by Moody’s, we first show that CRAs used ratings they had already assigned to constitute the new threats they were tasked with predicting, a technique we call “backward reasoning.” Second, we show that market regulators also made constitutive use of ratings’ forecasting capacities to carry out their tasks of market surveillance and monitoring, forcing CRAs to anticipate the potentially destabilizing effects that further downgrades would have on Greece’s borrowing costs. Such non-linear risk valuation practices created several inconsistencies in CRAs’ predictions about Greece’s ability to meet its financial commitment. We additionally show how these inconsistencies played out in the unfolding Greek sovereign debt crisis.

For many, the 2008 financial crisis demonstrated the colossal failure of credit rating agencies (CRAs) to predict risk events. This was especially true of their ability to predict the prospect that sovereign (country) issuers would default on their debt. Until 2008, investors

* Corresponding author: g-mallard@northwestern.edu and pierrepenet2013@u.northwestern.edu, or to Pierre Pénet, Department of Sociology, Northwestern University, 1810 Chicago Avenue, Evanston 60208 IL, USA.
and CRAs considered the sovereign bond market a safe haven for a wide range of reasons. From the years following World War II until the late-1990s, sovereign debt rescheduling and defaults remained quite low (Reinhart and Rogoff 2009). And, although most advanced economies saw their credit positions erode in the 2000s due to a conjunction of factors (including higher public spending, lower capacity to tax, and low GDP growth), investors assumed the trend of trustworthiness would last. But the European sovereign debt crisis beginning in 2009 proved everyone wrong: sovereign defaults could still trigger devastating financial and economic consequences, even at the heart of the Western world. The 2012 Greek default—the largest sovereign default in recent history and the epicenter of the European debt crisis—spurred controversies about the role of CRAs and led investors, regulators, and public officials to blame CRAs for their lack of foresight in the months leading up to the Greek sovereign crisis.

In financial markets, as in any market environment, competing and often contradictory forms of knowledge circulate. In global credit markets, risk knowledge essentially comes from two sources: (1) Market-based risk information embedded in market prices (yields, spreads), that provides an aggregated snapshot of the millions of risk pricing transactions at any given time, and (2) Expert judgment in a standardized (ratings, rankings), written (reports, policy briefs), or oral (press conferences) form, which reflects the particular risk views of their originators, whether governmental organizations, private agencies or international institutions.

In the months leading up to the Greek sovereign crisis, risk perceptions expressed in market prices and expert assessments significantly diverged. Credit default swap (CDS) and government bond spreads suggested a much higher probability of Greek default than was encoded in the ratings of the three main CRAs, notably Moody’s. Converting CDSs into CDS-implied ratings (CDS-IRs), Gaillard (2012) finds that investors had already begun to price Greek government debt in the speculative-grade category as early as December 2009, well before CRAs aggressively downgraded Greek bonds to junk status after months of rating inertia. As the market’s risk perceptions diverged from those of CRAs, the ratings of the three main CRAs also varied substantially from one another. All three major CRAs had more optimistic risk views than the market-based perceptions embedded in market prices, notably CDS spreads. Standard & Poor's (S&P) and Fitch, however, still perceived Greece as more risky than did Moody’s, until Moody’s finally issued a four-notch downgrade on Greek sovereign ratings in June 2010.

Between September 2008 and June 2010, CRAs failed to recognize early signs of trouble in Greece and displayed rating inertia before issuing multi-notch downgrades. This pattern of rating migration poses a problem of valuation and begs the question of how CRAs “see” risk and produce risk knowledge. Greece is not an isolated case, as evidenced by the similar problem of valuation of risky credit derivatives in the U.S. subprime market. Upon realizing that they had bestowed generous ratings to debt instruments that were defaulting at a much higher rate than anticipated, CRAs aggressively downgraded the ratings of billions of dollars’ worth of securities. This wave of downgrades prompted global panic across capital markets.

---

44 From 2008 to mid-2010, Moody’s ratings sharply contrasted from the ratings of S&P and Fitch as well as from market indicators: until the first European bailout of Greece in May 2010. Moody’s proceeded to only two rating changes (downgrades) against 4 and 5 for Fitch and S&P, respectively. Moody’s finally issued a four-notch downgrade of Greek bonds on 14 June 2010, almost 2 years after the collapse of Lehman Brothers.
an event widely cited as one of the main causes of the subprime mortgage crisis and the 2008 financial meltdown (Carruthers 2010; Rona-Tas and Hiss 2011).

Such a dramatic rating migration pattern arouses suspicion and seems to indicate that ratings were too high in the first place. In this spirit, economists have pursued studies of rating criteria and ratings' informational content which seek to explain CRAs’ poor predictive performance, thereby lending credence to the notion that CRAs “missed” the crisis (Bhatia 2002; Cantor et al. 1996; Ferri et al. 1999). Their informational approach suggests that CRAs’ poor track record in predicting future outcomes originates in the failure to “discover” market information, which results in inaccurate predictions. However, this purely informational approach to rating failure has limited explanatory value for the sovereign debt market because financial parties (including investors and CRAs) typically rely on similar credit information from public sources or governmental agencies. Therefore, information issues pertaining to access, quality or asymmetry—to pick just a few—cannot alone explain the gap between ratings and market perceptions. Nor can an informational approach explain why CRAs maintained their ratings in spite of conspicuous evidence of a rapidly changing market environment. And finally, such an approach cannot properly explain why Moody’s downgraded Greek government bonds by six notches in just six months between December 2009 and June 2010, a rating pattern unprecedented in the recent history of sovereign ratings.

In this article we argue that CRAs’ failure was not merely informational but also socio-cognitive. We do so by pointing to several inconsistencies at the level of the evaluative practices that CRAs use to produce anticipatory knowledge under high uncertainty. In the face of ambiguous, contradictory or fragmented information—such as in contexts of financial innovation or rapidly changing market environments typical of times of crisis—anticipatory knowledge producers like CRAs do more than simply collect additional information when they are unsure about their ratings. Knowledge producers also engage in a cognitive effort to reengineer evaluative practices so as to minimize uncertainty.

Sociologists of knowledge and science studies scholars have only recently begun to focus on those practical dimensions of anticipatory knowledge which determine its ability to predict likely outcomes. Their work includes studies in banking and high finance (Knorr Cetina 2011; Maniesa and Callon 2007; Stark 2009, MacKenzie 2011), environmental policy (Dalmedico and Guilleminot 2008), and food safety (Borráz and Besançon 2008). No research has yet focused on sovereign ratings, partly because the latter do not mobilize the highly formalized models that CRAs use to rate other classes of assets, most notably structured financial instruments. Indeed, CRAs use more qualitative analytical techniques to formalize sovereign risk and arrive at a judgment about the willingness of a country to repay its debt on time and in full.

In this chapter, we argue that the specific socio-cognitive problems associated with the calculation of sovereign risks by CRAs originate from the non-linear aspect of anticipatory knowledge practices at play in their valuation processes. Most studies of risk valuation adhere to a conventional—linear—framework in which time flows from the past to the future. From this perspective, producers of anticipatory knowledge analyze past and present information in order to assign a single distribution of probabilities to future outcomes. Moreover, under a linear approach to temporality, producers of anticipatory knowledge work in the isolation of the laboratory, never having to acknowledge the consequences their predictions may bear on a future course of events. Departing from this linear narrative, we suggest a more complex vision of how anticipatory knowledge producers articulate the past, present, and future. In
doing so, we claim that social scientists should study anticipatory knowledge not only for its predictive purpose (whether it produces accurate or inaccurate predictions about the future likelihood of specific events), but also for its “constitutive purpose” (Mallard and Lakoff 2011), e.g. the use of some knowledge of the future (anticipatory knowledge) to constitute present uncertainties. We pay particular attention to the constitutive use of ratings first, by CRAs, and second, by market regulators.

First, as we show in our preliminary investigation of the Greek sovereign debt crisis, CRAs adapted strategically to cognitive inconsistencies and credibility concerns by using ratings they have already assigned to constitute the new threats they were tasked with predicting. In doing so, CRAs used a technique we call “backward reasoning.” This appeal to the future to make sense of present threats also guarantees that new risk threats will acquire meaning in ways that vindicate their previous views, because the terms of meaning are generated by their own previously-assigned ratings. Therefore backward reasoning helps CRAs maintain continuity between ratings, thereby preserving the consistency of opinion that marks CRAs as credible producers of valid anticipatory knowledge. However, while their non-linear technique of rating production mitigated their most immediate concerns about uncertainty and credibility, we show that it also resulted in rating path dependency and informational diminishing returns, two inconsistencies which are highlighted in Moody’s’ unusual pattern of rating migration.

Second, our preliminary investigation of the Greek sovereign debt crisis shows how knowledge producers may have to anticipate the likely consequences of their predictions as they are used in the financial world, especially by market regulators. Indeed, since the 1990s it has become common practice for market regulators to make constitutive use of ratings’ forecasting capacities to carry out their tasks of market surveillance and monitoring (Partnow 1999). When regulators appeal to ratings for “governmenality” purposes (Foucault 2009) such as defining acceptable investing practices, credit standards, and accounting norms, they inevitably alter the rules governing the market reception of ratings. When ratings are extended legal influence, they cease simply to be fluctuating opinions about the future. Instead, they function as fixed market rules, and the mechanisms governing their reception become no longer deliberative but legally binding because investors and other financial parties must comply with the enforceable standards which regulators have developed in reference to ratings. As a result, CRAs no longer produce ratings in isolation from their predicted outcomes. Rather, they must anticipate how their predictions about long-term future risks will affect their environment – what Espeland and Sauder (2007) define as “reactivity.” With specific reference to Moody’s, we will show that CRAs account for the potentially destabilizing consequences of their predictions on issuers when assessing new threats. In light of this evidence, we show that the constitutive use of ratings by market regulators can strongly influence the rating process, as evidenced by Moody’s’ inertia during the Greek debt crisis.

The main data sources for this chapter are ratings reports and press releases published by Moody’s between October 2009 and September 2010 (available on the agency’s website). Since the motivations behind rating actions are not always clear, especially in time of acute

45 Ratings are now routinely used in bank capital requirements and in SEC and Basel prudential regulations in the U.S. and Europe. Rating-based regulations can take many other forms. See: Bank for International Settlements (2009) and Cantor et al. (2007) for an overview.

46 Pierre Penet has conducted the analysis of the primary material.
financial stress, these materials deserve careful attention. In the event of a rating action, CRAs typically issue a rating report to subscribers via a press release. In these, they establish a dialogue with investors and provide explanatory guidance that can be difficult to pass along in ratings alone. Weaving together various threads of meaning and context, these reports thus provide insight into the considerations CRAs undertake and the choices they make when reflecting on the relevance of a rating action. If reports give prime access to the rationale behind rating actions, they also reflect on the messy and highly ambiguous nature of the rating process by displaying the doubts, hesitations, and occasional contradictions that rating activity invariably entails. Overall, these documents offer a key perspective on the processes of risk assessment and reality construction that underwrite any rating process.

In the first section, we cover CRAs’ views on the Greek economy during the period of September 2008 through December 2009. We show that their initially contrarian risk predictions were not inaccurate but instead reflected a highly plausible rating scenario among other equally plausible scenarios. However, as our inspection of rating reports reveals, Moody’s continued to use investment-grade ratings they had previously assigned while the Greek crisis amplified, simultaneously making sense of Greece’s developing threats and “constituting” the list of events to which they assigned probabilities. By doing so, Moody’s sought to minimize the uncertainties which the European sovereign debt crisis posed to their valuation of risk while maximizing the continuity between ratings and thereby appease concerns about their credibility. In the second section, and focusing on the period of January through June 2010, we investigate how the ECB’s constitutive use of ratings in defining market regulations changed the market reception of ratings and forced Moody’s to anticipate the potentially destabilizing consequences that further downgrades would have on Greece’s borrowing costs. In both cases, we argue, the constitutive use of ratings by regulators and CRAs themselves greatly affected the rating process and contributed strongly to the problem of valuation described above.

1. Backward Reasoning and Rating Inertia

Backward reasoning is a non-linear process by which a producer of anticipatory knowledge infers the meaning of new information in a way that vindicates former views, which are themselves embedded in the producer’s present anticipations of a future outcome. We suggest that Moody’s employed backward reasoning as an adaptive strategy, on the one hand, to minimize the political uncertainties that emerged from the valuation of new risk threats in the Eurozone sovereign debt market, and, on the other, to maximize stability between ratings in order to maintain their overall rating credibility.

Our examination of the press release (Moody’s 2008) and two rating reports (Moody’s 2009a; Moody’s 2009b) published by Moody’s between September 2008 and October 2009 suggests four persistent and complementary views supporting Moody’s initial “A” investment-grade rating for Greek government bonds.
Greek fundamentals and government resolve and credibility: Moody’s emphasize the potentially destabilizing effect of Greece’s poor economic performance, weakening competitiveness, and growing debt levels in both the public and private sectors. At the same time, however, they note their intention to monitor deteriorating fundamentals in relation to other risk factors, including political ones. At the national level, Moody’s state their plan to assess the Greek government’s resolve to shore up creditworthiness, as well as its margin for maneuver and capacity to implement efficient reform.

External support: The prospect of a sovereign debt crisis involving a Eurozone member had little precedent and did not lend itself to easy calculation. A member of the European currency zone, Greece did not control exchange rate or monetary policy. The ECB’s decision to extend external support was thus crucial, especially given Greece’s soon-to-be non-existent access to capital markets. Since the legal rules and procedures contained in the European Stability and Growth Pact had made external support from the ECB conditional (see: section 2), Moody’s had to issue a judgment about the Greek government’s willingness to repay its debt in time and in full, but they also had to imagine and evaluate the probability of another element in this scenario: the willingness of the ECB to assume its role of lender of last resort, should Greece need them to do so. For CRAs and specifically Moody’s, the prevailing belief that the ECB would not let a member default made the prospect of a Greek default highly unlikely. According to Moody’s rationale, liquidity risk could only materialize if the ECB refused to approve external support for a Eurozone member, a possibility Moody’s considered extremely unlikely.

Market prices: Moody’s also acknowledged the significance of market price fluctuation on Greek government borrowing costs. Moody’s did not expect a direct causal relationship between higher borrowing costs and liquidity crisis, as long as the Greek government sustained credibility and foreign support remained plausible. This is why, despite soaring prices and increasing risk fears expressed in CDS spreads, Moody’s did not downgrade Greek sovereign bonds in the fall of 2008.

Equivalent ratings: Finally, rating all 16 country members of the Eurozone, Moody’s sought to contextualize the Greek economic situation relative to countries with comparable fundamentals. They did so for the purpose of commensuration, in order to ensure that they applied similar ratings to equivalent levels of trustworthiness. Until October 2009, Moody’s justified its “A” investment-grade rating for Greece by arguing that its financial situation was not materially different from that faced by other equivalent European countries.

After the collapse of Lehman Brothers in September 2008, fears that the American financial meltdown would spill over into Europe began to damage market perceptions of Greek economic trustworthiness. Although sovereign CDS and bond spreads were on the rise, CRAs did not change their ratings of Greek government bonds until the end of 2009, with the exception of S&P, who downgraded Greek bonds by one notch in January 2009. For instance, Moody’s maintained its “A1” rating for Greece from November 2002 until December 2009. Until October 2009, Moody’s’ projected scenario was eminently plausible and, in fact, accurate: market fears had eased and Greek bond and CDS spreads declined to almost pre-crisis levels, thus confirming the relatively optimistic scenarios CRAs had predicted. For
weeks, Greek officials used Moody’s contrarian views to convince financial parties to invest more heavily in its debt. Their appeal was predicated on the logic that Moody’s countercyclical perception of future events was more rewarding for all parties than the “consensual” market perception reflected in sovereign bond and CDS spreads.

However, Greece’s unexpected revision of its 2009 deficit projection from 3.7% of GDP to 12.5% on October 20 stunned markets. As a result, Greek sovereign CDS and government bond spreads began to widen again in October 2009, signaling deteriorating perceptions of Greece’s creditworthiness. By December, markets were already pricing Greek sovereign bonds in the speculative-grade debt category and Greek sovereign CDS spreads had risen well above those of Ireland, Portugal, and Spain (Gaillard 2012). The deficit revision significantly undermined the risk scenario that Moody’s had predicted for Greece: only one item of Moody’s rationale (external support) could be said to remain unchanged.

In spite of these developments, Moody’s did not downgrade Greek government bonds, but continued, instead, to use their existing rationale for investment grade rating to make sense of the uncertainties arising from increasingly negative perceptions of Greek sovereign risk. In the rest of this section we show how they did so, even as the limits of plausibility of their investment-grade rating were being tested from October 2009 onward.

Moody’s press releases published in December 2009 (2009c; 2009d) justify (albeit somewhat warily) an investment-rating for Greece that challenges market fears that Greece’s deteriorating economic situation could materialize in a significant liquidity risk. In the note, “Investor Fears of Liquidity Risks in Greece are Overdone,” Moody’s reaffirms its prevailing confidence in the ECB and calls the prospect of a Greek default “extremely unlikely.” Only in the highly remote case that Greek government debt became ineligible as collateral, the note claims, would liquidity risk become a possibility.

Moody’s deep-seated expectation of ECB support constituted their evaluation of Greece’s new risks. Beginning in October 2009, Moody’s relied on this expectation as a cognitive antecedent that conferred meaning on any new risk information pertaining to Greece’s deteriorating economic situation. Thus, despite Greek government’s weakening fundamentals, declining financial maneuver, lowered credibility, and borrowing costs that had risen above those of any other European country they had previously deemed comparable, Moody’s reaffirmed its investment-grade rating. The single-notch downgrade issued by Moody’s on December 22 still maintained Greece in the “A” investment-grade range and was widely viewed by market actors as “softer” than expected.

Moody’s decision to maintain its investment-grade rating for Greece even when its initial rationale was no longer (as a whole) valid has several implications. First, by calling investor fears over Greek government liquidity “misplaced” and “exaggerated,” Moody’s seemed to hope it could once again shape investors’ perceptions about the Greek government’s ability to repay its debt and encourage market parties to bring about the conditions that would justify an “A” investment-grade scenario. After all, between January and October 2009, CRAs’ (and specifically Moody’s) rating inertia seemed to have achieved precisely that goal, with CDS and sovereign bond spreads returning to their pre-crisis levels after a temporary surge in the fall of 2008. Until 2009, the initial gap between CRAs’ perception of Greece’s trustworthiness and the more conservative views embedded in market prices essentially

---

expressed a conflict between equally plausible risk scenarios that had been resolved in favor of CRAs.

Second, after Greece’s October deficit revision announcement and its destabilizing consequences for the Greek government’s fundamentals, borrowing costs, and overall credibility, Moody’s rationale for its investment-grade became significantly more contrarian and the possibility that market actors would bring their predictions to pass more remote. That Moody’s refrained from downgrading Greece to the “B” range suggests a path dependency of ratings we interpret as a manifestation of backward reasoning. Moody’s consistently made constitutive use of the prospect of external ECB support to restrict the range of meaning that information could acquire, even under markedly different conditions. Moody’s were embroiled in a dynamic cognitive process whereby constitutive use of rating models created diminishing informational returns for every piece of new information collected. Thus, rating inertia appears to be the path-dependent outcome of a non-linear process of knowledge production and credibility assurance: so long as CRAs can use existing risk rationales, in whole or in part, to make sense of new risk information, CRAs have an incentive to uphold ratings. Therefore, non-linear rating practices and backward reasoning creates an interesting paradox where, over time, the predictive capacities of existing rating scenarios increase the uncertainties of present threats.

Moody’s expectation that the ECB—or, for that matter, the Eurozone stakeholders—would assume of the responsibilities of lender of last resort was considerably challenged in January. This political decision brought about the considerable amount of uncertainty to which we turn in the following section.

2. MARKET MONITORING AND RATING STANDOFF

Since the creation of the European and Monetary Union in 1994, European financial institutions have routinely used ratings to define the risk weight of their financial exposure. Under the Capital Requirement Directive, the ECB applies a rating threshold to define the acceptable quality of collateral for refinancing purposes. In October 2008, the ECB lowered the normal “A3/A-” threshold to a more relaxed “Baa3/BBB-” to enhance provisions of liquidity to the Eurozone. However, the ECB announced in January 2011 that they would revert to their usual, tighter collateral framework. As explained above, financial parties (most notably CRAs) expected the ECB to provide strong institutional commitment and to agree to step in as lender of last resort, should the need arise. Therefore, financial parties, and especially Moody’s, anticipated further amendments to the ECB’s collateral framework rating threshold, to accommodate the rapidly changing Greek economic situation. Instead, the contrary happened: on January 14, 2010, the ECB President Jean-Claude Trichet reaffirmed its intention to let its “Baa3/BBB-” threshold expire in January 2011.49 This decision increased fears that liquidity risk could materialize if CRAs lowered ratings, which would bring Greek bonds closer to ineligibility for refunding purposes. The ECB’s decision thus changed the meaning that further downgrades would have on Greece’s ability to borrow.

49 “We will not change our collateral framework for the sake of any particular country. Our collateral framework applies to all countries concerned. And that has been said already by the Vice-President, by me and by colleagues. That is crystal clear.” (ECB 2010a).
Indeed, having faced prohibitive borrowing costs since January 2010, the Greek government was left with little means to propose a financial support package of its own and was effectively squeezed out of capital markets. It was therefore critical to Greece’s ability to fund itself that its sovereign bonds remain eligible as collateral in exchange for low-interest loans from the ECB.

The ECB’s constitutive use of ratings in defining its threshold for collateral eligibility produced a rating standoff in which a downgrade was as undesirable for Moody’s as it was for Greece. Fitch and S&P issued multi-notch downgrades in March and April 2010 respectively, with S&P relegating Greece to junk-bond status on April 22. With its rating well-anchored in the investment grade category, Moody’s remained the only strong holdout, effectively serving with Fitch as a buffer against the prospect of Greek speculative status. Because the ECB determines the eligibility of collateral by applying the higher of the lowest two ratings, the ECB thus used Fitch’s “BBB-” rating, the lowest within the investment-grade category, only because Moody’s were still rating Greece in the investment-grade category.

Moody’s were thus operating under a strong and ever-increasing incentive not to translate its pessimism about Greece’s financial future into a downgraded rating. Had it matched S&P’s speculative rating, Moody’s would have rendered Greek government bonds ineligible as ECB collateral. A downgrade into the junk status would almost certainly catalyze a significant liquidity crisis, which in turn would force Moody’s—and other CRAs—to issue another downgrade (which itself would have to take into account the consequences of its own downgrade on Greek finances). Like a receding horizon, rating accuracy became moved ever-more out of reach; no matter what considerations Moody’s took, the prospect of downgrading Greek sovereign bonds in an orderly fashion was no longer a possibility.

The ECB’s May 3rd announcement to suspend its minimum credit rating threshold for Greece (ECB 2010b) was widely interpreted as a strategic attempt to diffuse the risk of a potential Moody’s downgrade. Crucially and ironically, however, the decision also removed the incentive for Moody’s not to downgrade. A month later on June 14, Moody’s issued the most severe downgrade of sovereign bonds in recent history, knocking it down four-notches, to speculative status. Ultimately, the timing of Moody’s multi-notch downgrade was not motivated by a change in Greek fundamentals, but by the ECB’s modification of its collateral framework, a change that essentially “liberated” Moody’s to downgrade Greece’s government without jeopardizing the country’s ability to qualify for low-interest loans. Past studies have concluded that regulatory reliance on CRA predictions favors high ratings (Gaillard 2012). We propose that this is the case because high ratings create incentives for ratings inertia. They can only do so temporarily, however, ultimately giving way to more dramatic patterns of rating change.

CONCLUSION

This chapter yields several findings. First, we challenge the common view that CRAs merely “misread” the Greek crisis. The examination of rating reports shows that Moody’s’ rationale for its investment-grade rating of Greece was initially highly plausible. We then

---

50 See Committee of European Banking Supervisors (2006), (clause 178) p. 35.
show that CRAs adapted strategically to cognitive inconsistencies and credibility concerns by making constitutive use of the ratings they had already assigned to constitute the new threats they were tasked with predicting. As such, CRAs resorted to a technique we call “backward reasoning” that mitigated their most immediate concerns about uncertainty and credibility but also resulted in rating path dependency and informational diminishing returns: so long as CRAs could use existing risk rationales, in whole or in part, to make sense of new risk information, CRAs had an incentive to uphold ratings. Our preliminary study of the Greek debt crisis shows that backward reasoning creates an interesting paradox where, over time, the predictive capacities of existing rating scenarios increase the uncertainties of present threats. Finally, we indicate that the ECB’s constitutive use of ratings in defining market regulations also greatly affected the rating process by forcing CRAs to anticipate the potentially destabilizing consequences that further downgrades would have on Greece’s borrowing costs.

We believe that this analysis of the non-linear dimensions of risk evaluation practices opens interesting avenues for the sociology of knowledge and social studies of finance. Our preliminary analysis of the Greek sovereign debt crisis points to a non-linear, complex web of cognitive, legal, and political transactions, that complicate previous understandings of the market infusion of ratings (most notably those produced by theories of performativity). A future article will provide analyses of additional concrete cases and develop more refined typologies of these forms of anticipatory knowledge. In this chapter and future work, we aim to develop a better understanding of how constitutive knowledge is used and produced in financial worlds.

REFERENCES


