S&P Downgrade Sets Off Alarm Bells in Europe

The S&P downgrade of the U.S. government's credit rating from AAA to AA+ set off alarm bells in foreign markets as well, as the news coincided with increased concerns over the economic crisis in Europe. Finance ministers of both the Group of 7 and Group of 20 nations were conferring by phone, Reuters reported, while the governing council of the European Central Bank was also holding an emergency conference call late Sunday. The central bank was reported to be considering buying Spanish and Italian bonds to keep the cost of borrowing for those two counties manageable.

"They just can't allow the Italian economy to go down the tubes. It would be a Lehman-type situation," Uri Dadush, a senior associate at the Carnegie Endowment for International Peace, told the *New York Times* on Sunday, referring to the collapse of the Lehman Brothers investment bank in 2008 that started a global financial crisis and led to U.S. government bailout of many of the leading financial firms in this country. An international bailout of Italy and Spain would be a huge political as well as financial challenge, Dadush acknowledged. "There is no precedent. It would be extraordinarily fraught," he told the *Times*. But he insisted world leaders "cannot stand by and watch the biggest default in history unfold."

{modulepos inner_text_ad}

Standard and Poor's rated the U.S. fiscal situation "negative," indicating there might be another downgrade in the near future. In a Saturday conference call with reporters, senior officials at the ratings agency defended the emphasis in its analysis on the politics of the battle over raising the debt ceiling as well as the fiscal policies that created the crisis. "The debacle over the debt ceiling continued until almost the midnight hour," said John B. Chambers, chairman of S.& P.'s sovereign ratings committee. But administration officials emphasized that the other two of the "big three" ratings agencies, Moody's and Fitch, have thus far maintained the government's AAA rating, though both are closely monitoring events. Acting Assistant Secretary of the Treasury John Bellows questioned both the analysis and the timing of Standard and Poor's report. Shortly before it was released, officials pointed to what they said was an erroneous assumption that the nation's debt would reach 93 percent of GDP by 2021, eight percentage points higher than the administration's figures. The $2 trillion discrepancy was the result of different assumptions about what spending and revenues will total over the next decade. The ratings agency accepted the administration's numbers, but said the difference would not affect its downgrade decision.

"S&P did not believe a mistake of this magnitude was significant enough to warrant reconsidering their judgment or even significant enough to warrant another day to carefully re-evaluate their analysis," Bellows wrote in a Treasury Department blog, adding that the downgrade raised "fundamental questions about the credibility and integrity of S&P's ratings action." The ratings agencies were criticized during the 2008 financial crisis for not warning about the dangers associated with subprime mortgages during the last years of the George W. Bush administration. "I find it interesting to see S&P so vigilant now in downgrading the U.S. credit rating," Senator Bernie Sanders (I-Vt.) said Saturday. "Where were they four years ago?"

The political fallout continued over the weekend, with Speaker of the House John Boehner (R-Ohio) and several of the GOP presidential candidates placing the blame for the nation's fiscal crisis primarily on the Obama administration and Democrats in Congress.

"Unfortunately, decades of reckless spending cannot be reversed immediately, especially when the Democrats who run Washington remain unwilling to make the tough choices required to put America on solid ground," Boehner said. Former Sen. Rick Santorum of Pennsylvania, a presidential hopeful, said the downgrade "happened on the president's watch.... The markets are scared and the credit downgrade has happened because the president and this Congress continue to address the symptoms and not the disease."

"President Obama is destroying the foundations of the U.S. economy one beam at a time," said Rep. Michele Bachmann of Minnesota, a presidential candidate who called for the resignation of Treasury Secretary Timothy Geithner. Texas Congressman Ron Paul, making his second bid for the Republican presidential nomination, blamed "the old crowd of elites" in both parties for offering "fake" budget cuts and tricks instead of taking "bold actions to reduce out-of-control government spending, and get the federal government out of the way of small business and entrepreneurs so that they can start hiring again."

Photo: AP Images