A NEW PARADIGM FOR THE RATING MARKET – A GEOPOLITICAL PERSPECTIVE ON RATING

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The oligopolistic structure of the global rating market formed by the "Big Three" and doubled by their incapacity to solve problems related to correctly evaluating some of the world's largest economic entities have both set a serious challenge on the rating industry after the onset of the contemporary economic crisis. If both in the E.U. and the U.S. rating agencies are subject to public debate and reform acts, China has defined a particular position by setting up its own rating agency, Dagong Global Credit Rating Co. This article reveals evidence of a geopolitical behavior in a quasi-official domain, which is more a necessity under the current paradigm of the world's economy.

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Dagong is a rating agency controlled to some extent by the Chinese government. Its purpose emphasizes an alternative for the "Big 3" global rating agencies. The reason for creating such an organization was primarily triggered by the need of having a clear investment rating processes. However, China's economic ascend over the last years has determined a powerful recalibration of this hypothesis to fit geopolitical issues. The pronounced economical growth rates, based upon China's export oriented economic model, have brought the Asian economy to rank three in the world and have imposed the need for a major rating agency. This latter aspect is common between powerful nations as most developed countries are homes for the most important rating entities. Therefore, the world can be divided into regions associated to different dominant players which come to complete the gap left by the "Big Three" on the markets. Most of those local players are controlled by governments whose influence sphere is located in that particular region.

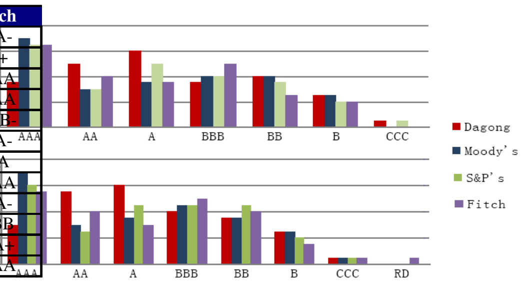
China has not had a rating agency until 1994, when Dagong wad founded. At first Dagong's main purpose was to represent Chinese economic interests in other parts of the Globe and to make sure that the Chinese investments were safe. China's vocation as a major player on the global economy and its aspiration towards a superpower status are the elements which have mobilized the need for such an institution. A rating agency has the advantage of converting general public data into information that can be used both for economic and political purposes. The contemporary context proved that rating agencies are absolutely necessary for international investments, as they are nothing but a common language to deal when assessing business opportunities. Beyond these technical perspectives, the rating activity brings significant returns and holds a stable market. Both arguments are strong incentives towards the formation of a Chinese rating agency. Through basic rating activity Dagong has managed to ensure amounts of money for China that, in the absence of an own agency, would have left the country, respecting in the same time the international rules of evaluating securities. Even though the reasons that determined China to establish a rating agency were mobilized by the intentions of country investors to benefit from local ratings, Dagong's core activity propels it into the interest area of the government as a way to express a Chinese position on certain international issues.

Suspicions on sovereign risk assessments

A statement made in the mid-2010, accompanying the publication of results of a sovereign risk evaluation for 50 countries, described Dagongs's action as being "the first sovereign credit risk assessment in the world conducted by a non-Western agency". On those premises Dagong started to offer an explanation to why it had lowered the ratings of some Western countries, whilst others were increased. Even though there is a clear propagandistic orientation in Dagong's claim, there is also a possibility that the rating agency could have objectively evaluated the environments of the 50 states. Dagong's analysis covered 90% of the total world economy. The geographical distribution of the assessment focused on 20 European, 17 Asian, 2 North American, 6 South American, 3 African, and 2 Pacific countries. The shock associated caused by the release of the report resides in the fact that it has attracted considerable attention in various political and economic circles. Dagong had degraded many Western countries in relation to the position they normally would occupy in the evaluations of Moody's, S&P's or Fitch. The 50 countries analysis report was published in June 2010 and reflected 18 more pessimistic views over sovereign risk than the ones indicated by the "Big Three". The Chinese report had downgraded USA, UK, France, Germany, Italy, Canada, Netherlands, Belgium, Spain, Israel, UAE, Thailand, Mexico, Romania, Iceland, Greece, Philippines, and Ecuador. However, there were certain countries, which according to the situation perceived by Dagong, benefited of improved grades compared to the ones provided by the Western agencies. This situation was reflected in the ratings of China, Saudi Arabia, Russia, Brazil, India, Indonesia, Venezuela, Nigeria and Argentina.

Fig. 1: Comparison table between the grades associated to sovereign debt denominated in local currency and foreign currency

Stat/Perioada	Dagong	Moody's	S&P	Fitch
Saudi Arabia	AA	AA3	AA-	AA-
China	AA+	A1	A+	A+
France	AA-	AAA	AAA	AAA
Germany	AA+	AAA	AAA	AAA
Greece	BB	BA1	BB+	BBB-
Italy	A-	AA2	A+	AA-
Japan	AA-	AA2	AA	AA
UK	AA-	AAA	AAA	AAA
Portugal	A-	AA2	A-	AA-
Russia	A	BAA1	BBB+	BBB
Spain	A	AAA	AA+	AA+
USA	AA	AAA	AAA	AAA



Source: DAGONG, Moody's, S&P, Fitch Ratings

The problem associated with Dagong's assessment, which reverses about 50% of the commonly known global ratings, is that it has a profound geopolitical orientation. Because of this the assessment report seems to support theories that accuse the government in Beijing of pursuing its own interests and resulting in less accurate rating suspicions on data published by an rating agency "whose ownership was not made public [...] but has undeniable links with the government."

The countries that Dagong has downgraded are either declared U.S. allies (Canada, UK, Greece, Philippines, Romania, Israel, etc.) or countries that have important competitive roles along Chinese products (France, Germany). By downgrading the ratings of these countries Dagong has raised some questions about the honesty of its rating processes, as large budgetary deficits theories under which most decisions were based upon are not uniformly applied to all countries. For example, Japan, a country with a deficit of 225% of GDP (y. 2009) was not classified at a lower level to U.K. which have received the same leniency despite the deficit amounted to 50% of GDP (y. 2009). Israel is another example of a country opposing to some of China's current allies. This could explain the somehow surprising presence of Israel on the list of declining ratings. When discussing about economic arguments for lowering ratings, Israel's case is

interesting to observe as the same motivations were not extrapolated to its Egyptian, Syrian or Jordanian neighbors, each facing their own challenges in political and social environments.
It is not difficult to notice that the better appreciated countries are non-Western and, moreover, they are countries witch China seeks to cultivate strategic alliances with in order to counterbalance the power of the U.S. hegemony. If not the case, they are for sure key suppliers of raw materials that support China's constant growth. For the countries whose grades had an upward perspective, a possible interference in the assessment of geopolitical strategies can also be easily noted. For example Russia is in a close cooperative relationship with China on several fields, while regional powers like India and Brazil are fundamental variables in China's international plans. In addition to this, both Brazil and Russia are suppliers of raw materials particularly for Chinese agricultural and energetic products. China's interest in these three states is explained by their geographical and demographic sizes, each having the capacity to become a very large outlet market for Chinese products. The best evidence to support such an idea is based on investments made by China in recent years in South America, which are designed to give Brazil an opening to the Pacific Ocean and a direct trade route to China via Peru. Other countries are important suppliers of energetic resources, like Saudi Arabia, Indonesia, Venezuela, Nigeria, or food, like Argentina. There are also other geopolitical ideas that are equally important when considering this group. Nigeria, for example, lies in the heart of the Chinese colonized Africa, which holds around $100 billion in foreign investments, while Venezuela is a strong critic of the U.S. administration and therefore plays an important role in China's ascending to an important global superpower status.

Dagong's statement: between a sensitive truth and political demagoguery

While issuing its own rating report, the head of China's largest rating agency challenged the Western institutions by blaming them for their contribution to the onset and deepening of the global financial crisis. During a nationalist speech, Dagong's CEO emphasized that the largest nation in the world and the most important lender should have a greater influence on how governments' and nations' liabilities are valued. "Western credit rating agencies are highly ideological, politicized and do not adhere to objective standards. All this is fully supported by evidence which show that the big Western agencies are too close to their customers". Indeed, the phenomenon of "rating bidding", whereby a client provides the valuation of its titles to rating agency that offers the most favorable assessment, is not a new practice. The U.S. subprime crises has been generated and fueled by major rating companies, who competed in giving higher grades to risky investments.
Dagong's methodology was developed in the last five years and reflects an assessment of the economic sector of a state where the main concerns are directed towards the tax position of authorities, the ability to govern, the economic strength, the financial reserves, the debt burden and the ability to make profitable investments. Although, from the methodological point of view there is no difference from what other agencies have already developed, Dagong uses laudatory words to describe its rating model. Dagong worked until 1999 in cooperation with Moody's to form all necessary skills in the assessment processes. As a consequence, Dagong's methodology does not differ as much as it denounces versus its Western counterparts. Beyond this idea of methodology similarity, there is no marking difference in terms of competition, as Dagong has a privileged position in the Chinese market. The "Big Three" control about 75% of China's rating market, while Dagong holds almost the entire 25% left. Tripartite domination of the market was changed to one that involves four major competitors. There is little doubt that Dagong's statements are meant to please Chinese authorities, who are also the main client of the agency as management reports reveal. Cataloguing the U.S. as "a bankrupt nation into insolvency, willing to conquer the world by force" is but one example of a speech designed to meet China's allies and serve the country's geopolitical interests.

Dagong: a possible key to China's geopolitical aspirations

Although the U.S. are currently the only global superpower, China's goals are so high that many voices are already referring to it as the second pole of world power. China fully assumes this role and tries to create its own influence group in this competition with the U.S. and their allies. During past decades the Asian country was converted into a global power, while further replicas are expected to be seen more often as part of the competition between East and West. The analyses performed by the Chinese agency on different countries' sovereign risk are mainly based on geopolitical interests. The fact that the Chinese agency has failed to identify the problems that occurred in Egypt, Tunisia and Libya in 2011 merely have strengthen such an opinion. It appears that the agency does not use any different methodology compared to other institutions for its ratings, the differences being simply the result of an emotional approach directed by ideological interests of those who control it.

Dagong's uncontested merit is that it provides an alternative to Western views over ratings and this can only bring a reinforcement of a troubled area. The influence of the Chinese government is undeniable and can affect the rating agency's role in shaping long-term market trends. If Chinese companies would pay more attention to Dagong than to Moody's, S & P or Fitch, this agency would certainly have a major impact on the world's economic future. However, an unexpected strengthening of Dagong is implausible at this point because there is an extremely low possibility that Western companies would abandon the "Big Three" too soon. Also, given the fact that Chinese companies will certainly want to invest in Western countries, Dagong will probably be reluctant to cut too much of their ratings only based on political considerations. The sum of these elements indicates that Dagong's position will at some point be aligned with that of Western agencies, even though a distinct speech will be detected.

Dagong's perspectives: the option of servitude versus correct ratings

Despite the critical tone, Dagong aims to internationalize its business by penetrating foreign markets, especially the U.S. The pretext invoked by the agency is that it must protect the interests of Chinese investors no matter of their location. This argument is justified by the exposure that Chinese investors have on the world's largest economy. U.S. Treasury Department data indicate an amount of $ 1.1547 trillion worth of government bonds held by Chinese residents only at federal government level, on the date of the issuing the report. The challenges faced by Dagong are to overcome the possible skepticism coming from the U.S. regulatory authorities and the issues related to its rating objectivity. Those two major issues are due to the fact that Dagong uses a nationalist speech and because of suspicions related to the accuracy of its ratings.

The future of the Chinese rating agency seems to be marked by country and sovereign risk analyses as the "Big Three" have focused more on corporate securities ratings, because they are better paid and abundant on the market. This leaves an unexplored niche on sovereign assessments. Channeling its attention towards sovereign debt evaluation, the only Chinese owned rating agency has become a central element in China's global ambitions.

Dagong tried to enter the U.S. market in 2010, but SEC declined its accreditation under the pretext that the Chinese agency "does not meet the standards [...] required by federal law". This refusal received by Dagong for its registration as a NRSRO was the first time SEC rejected any rating institution after the implementation of the new rules regarding the approval and control over rating agencies. This decision has increased the tensions between the parties and even between the two countries. The invalidation received by Dagong was treated by China as a discriminatory treatment towards its most important rating agency. In a similar manner, Dagong's press release criticized SEC's decision through attacks directed towards the American regulatory organism.

Dagong's frustrations are explainable as the credit rating services in China are far from the growth process that were defined for other sectors. The paradox of the Chinese rating services is that this domain has not benefited from the worldwide expansion as energy, mining, and banking did. From this perspective, the Chinese authorities are eager to obtain an advantage in the area of risk assessment and Dagong is the only domestic agency through which this can be achieved. The future of China's largest agency depends on the actions of the "Big Three" and the country risk evolution. A confirmation of such radical assumptions can only bring a fearsome reputation and open the institution's path to an international rating player, even though they are based on geopolitical premises. Meanwhile, the perspective of a failure would have little impact on the institution, based upon the already tested cases of "Big Three", whose errors have little been sanctioned by the markets.

Dagong's case reveals a new paradigm for rating agencies and possibly a different future evolution for such institutions. Being so powerful that they can project trends and determine evolutions, rating agencies have become a central focal and support point in government actions. The challenge for such institutions is to choose a path between correct ratings and geopolitical interest of their owners. The success or failure of such an agency is strictly correlated to its capacity to provide accurate analyses.

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