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Too Much Attention To Moody's Swing

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Tax Deal: The media are touting a rating agency's schizophrenic claim that keeping the Bush tax rates helps the economy, but hurts the country's credit standing. Are ratings firms even relevant anymore?

Manhattan Institute senior fellow Nicole Gelinas, in her richly detailed analysis of the roots of the financial crisis, "After the Fall: Saving Capitalism from Wall Street — and Washington," pulls back the curtain and exposes the ugly reality of the once all-powerful credit ratings agencies Moody's, Fitch and Standard & Poor's.

"Reliance on ratings agencies contravenes market principles," Gelinas warns. "The ratings-agency world is small and homogeneous, populated by a few thousand people with similar educations filling in similar boxes of financial-ratio calculations and going out for drinks with one another afterward."

She points out that "each ratings agency operates by consensus. The agencies have no system for rewarding a person who speaks out against the conventional wisdom, writing a report contrary to his colleagues' opinion" and have historically demanded "a unanimous verdict on every security."

So no wonder the ratings agencies were instrumental in allowing toxic mortgages to be sliced and diced, baked into securities, and spread all over the world.

As Cato Institute senior fellow Johan Norberg points out in his book, "Financial Fiasco," "The agencies' generous use of their A stamp is what made investors across the world believe in alchemy and scramble for" securities filled with rotten mortgages.

Norberg goes further, wondering if Moody's and its doppelgangers are guilty of collusion-based fraud. "They will deny it adamantly," Norberg writes, "but many people in the industry claim that the agencies' involvement" in the actual design of debt instruments "amounts to full-fledged negotiations about what would be required for an instrument to get the highest rating."

Ludwig von Mises Institute senior fellow Thomas E. Woods Jr. calls the rating agencies a government-created "cartel," with their judgments impervious to competition thanks to their being shielded by federal regulations.

Considering how much these ratings agencies are to blame for the worst global economic calamity since the Great Depression, why should we be listening to their analysis of how to fix the economy they helped wreck?

CNN and other news sources have been talking up a Moody's analysis released this week warning that the agreement to prevent the Bush tax rates from expiring imperils the U.S.' AAA credit rating.

At the same time, the Moody's report concedes that the tax deal between Congress and President Obama is likely to expand economic growth over the next two years. The deal, which passed by 81-to-19 in the Senate on Wednesday and may come to a vote on Thursday in the House, keeps the tax cuts for two years, cuts the payroll tax and extends jobless benefits for 13 months.

According to Moody's: "From a credit perspective, the negative effects on government finance are likely to outweigh the positive effects of higher economic growth."

What exactly do these cabals of wheeler-dealers know about "the positive effects of higher economic growth" anyway? The U.S. is flirting with 10% unemployment right now. Who can deny that what we need more than anything right now is a boost for the private sector?

That doesn't come from anywhere other than letting investors continue to keep more of their own wealth — so they can invest more of it and generate jobs. The "offsetting measures" Moody's wants to see added to the tax deal are the kind of green-eyeshade items that give thrills to accountants as they examine balance sheets. In the real world, it's capital that fuels the engines of economic activity.

Stopping the huge impending tax increase is the top priority for combating the recession that Moody's and the other ratings agencies helped get us into. Listening to them on economic policy is like taking hygiene advice from Typhoid Mary.