

agreement and NAFTA, which enjoyed strong although not universal support in the west, implicitly urged Canadians to refocus their attention and energies away from the national community to the continental and international economies. Western Canadians have accepted this message with enthusiasm and, as a result, are simply less interested in the evolution of the Canadian federal state.

The survival of Canada, and Quebec's strategic threat to that survival, will not generate the same intense, visceral reaction this time around in the national unity debate. This does not mean that western Canadians do not care, but it also does not mean that they are unlikely to go out of their way to provide a positive or comforting message to Quebec. The danger is that regional indifference may be interpreted as hostility by Quebecers.

Thus, the challenge for the supporters of the federalist option in Quebec will not be to ward off regional hostility from the west, but to penetrate a growing regional indifference. More specifically, the task will be to bring western Canadians into the debate, and to do so in a positive manner. Neither task will be easy in a region whose mind and heart is increasingly to be found elsewhere.

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ECONOMIC REPORT

THE ATTACK OF THE BOND RATING SERVICES

by Fred Lazar

DOWNGRADING OF GOVERNMENT DEBT ACROSS CANADA

Part of the federal government's foreign debt was recently downgraded. Last fall, Ontario's debt rating was downgraded. Indeed, most governments across Canada have been subjected to the same experience during the past few years. Unfortunately, it appears that the federal and provincial governments have become totally intimidated by bond rating services, and, as a result, they seem to be willing to consider whatever measures they believe are necessary to control their deficits and maintain their credit ratings.

To preserve credit ratings, and governments are not always successful, during the past year, provincial governments' cumulative deficit reduction strategies have removed about 2 percent from the spending stream in Canada and have contributed significantly to slowing the rate of economic recovery. Slower growth exacerbates the deficit problem by reducing revenue growth and increasing the number of UI and other social assistance recipients.

The "financial" community now seems to dictate the policy course for governments in Canada. Panic overwhelms policy makers when the financial community warns of credit downgrading. Rapid declines in the value of the dollar create equally

outrageous panic since such moves are interpreted by the same financial community as confirmation of their dire concerns with government deficits and debt.

Governments no longer appear to respond to the electorate, but rather to the dictates of the bond rating services and "faceless" international investors—a complete reversal of democracy. Standard & Poor's is not even a Canadian company, yet it wields more influence than millions of Canadians. The Bank of Canada, by acquiescing to higher interest rates in order to support the dollar and drawing arbitrary lines in the sand around the dollar, encourages speculation, adds unwarranted credibility to the Cassandras of government fiscal irresponsibility, and makes deficit reduction more difficult.

DEBUNKING THE CREDIT RATING AGENCIES

But perhaps it is time for governments in this country to challenge the credit rating agencies and their followers in the financial community. Saskatchewan and Newfoundland have the lowest credit ratings among the provinces and, as a result, are extorted into paying a substantial interest rate premium in order to borrow. The downgrading of Ontario's credit rating is expected to cost Ontario taxpayers up to \$25 million more a year in interest payments. The unnecessary upward spike in Canadian interest rates, as a result of the latest and assuredly not the last "currency crisis," may cost Canadian governments collectively \$5 to \$15 billion, depending on how long rates remain at the "post-crisis" levels.

Are these risk premiums stemming from downgrading of debt warranted or are they just a form of blackmail? Does anyone really ex-

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pect the federal government to allow either Saskatchewan or Newfoundland to default on their debt? Is Ontario any more likely to default in the future because it has been running \$10 billion deficits for a few years? Anyone who truly believes that Ontario, Saskatchewan, Newfoundland, or even the Canadian government, is more likely to default in the future is in serious need of therapy.

The higher risk premiums imposed on governments in Canada are a case of theft on a grand scale against Canadians. The resulting policies demanded by the financial community to avoid further blackmail have imposed even greater costs on Canada. Savings and loans institutions in the United States, and trust companies in Canada, were run by crooks or were just poorly managed, and were operating on or beyond the brink of insolvency for several years before they collapsed. It is amazing that they were able to attract billions of dollars in deposits by offering a slight interest premium over the interest rates paid by larger, more stable, and better managed deposit-taking institutions, just because of the availability of government guarantees (in the form of deposit insurance). The financial community, especially the brokers who arranged for massive infusions of deposits, were quite happy to participate in the charade. Fees are fees and one should not look too closely at how the moneys are used.

CHALLENGING THE AGENCIES

Governments in Canada should challenge the bond rating agencies and call the bluffs of the financial community. I am sure that there is a waiting list of companies who would eagerly step forward to replace any institution foolish enough to give up

a lucrative position in issuing and/or acting as a market-maker in Canadian governments' bonds.

The rating agencies supposedly predict the default probabilities on various types of debt. But are they capable of performing this task well? Michael Milken, the former junk bond king, proved them wrong. He made billions because of the inadequacies of these agencies in rating the debt of smaller or lesser known corporations. It would be interesting to examine how successful these agencies have been in predicting defaults at the time of new issues of debt, not after the fact, when the financial problems of companies or countries are widely known.

Despite the appearance of a thorough and scientific approach to evaluating risks (spreadsheets and financial software can fool a lot of people), these agencies are not capable of accurately assessing risks. They do not have the ability to properly understand and evaluate corporate strategies and competitive behaviour. Indeed, anyone who is good at this can make much more money working for one of the major consulting firms or other companies. Moreover, these agencies underestimate the intelligence and ability of the electorate to control wasteful government initiatives and budget deficits. But only the electorate should have the opportunity to dictate the trade-offs governments should make.

THE FOIBLES OF THE BANKS

The problem with the rating agencies is more pervasive. By offering a solution to the free-rider problem faced by investors in assessing credit risks, they also provide financial institutions with an excuse for not doing what the public implicitly expects of them: namely, objectively and thoroughly examining all lending opportunities and estimating their respective risks. The credit rating

agencies provide the way out from fulfilling these responsibilities. It is much cheaper not to build up the credit rating functions within a financial institution and follow the leader into the financial gimmick of the day—the herd instinct run rampant.

Once again, fees are fees and the taxpayer will end up picking up 40 to 50 percent of the losses anyway. How else can one explain the third-world loans in the 1970s, the oil-patch loans in the 1970s and 1980s, the real estate loans in the 1980s, and so on? Senior executives in financial institutions are paid a lot of money to mess up continually on these scales.

Thus, not only should governments challenge the reliability and usefulness of the services provided by the credit rating agencies, they should also challenge the financial institutions in this country to fulfill their responsibilities. Maybe the federal government should consider removing the right of these companies to write off their losses on a wide array of loans against their other taxable income. It's bad enough that taxpayers have to be hit with higher interest costs because of the "job" done by outsiders. It's even worse, when we have to pick up the billion dollar tab for bad real estate loans and other mistakes that contribute nothing to the prosperity of Canada.

I suspect that debt downgrading, the absurd interest rate policies of John Crow, and the tax write-offs for massive loan losses by Canadian financial institutions have probably added \$150 billion more to the aggregate debt of governments in Canada during the past six years.

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