



## Standard and Poors Extends, Defends and Explains Its Downgrade

Most municipal bond issues are not pre-funded with U.S. Treasury securities, and so they aren't likely to be affected, especially as they rely on local and regional sources of revenues, with little reliance on the federal government to back them up. And, at the moment at least, S&P continues to rate 13 states as AAA.

These downgrades have set off a firestorm of protest, mostly from the White House and the Treasury Department. Secretary Timothy Geithner [angrily expressed his views](#) to NBC/CNBC News:

I mean, I think S&P has shown really terrible judgment and they've handled themselves very poorly. And they've shown a stunning lack of knowledge about basic U.S. fiscal budget math. And I think they drew exactly the wrong conclusion from this budget agreement.

Equally vitriolic was Obama's economic advisor Gene Sperling: "The magnitude of their error combined with their willingness to simply change on the spot their lead rationale in their press release once the error [in calculating future U.S. debt] was pointed out was breathtaking. It smacked of an institution starting with a conclusion and shaping any arguments to fit it."

David Beers, head of global sovereign ratings for S&P, [responded](#): "This idea that we made a \$2 trillion error is simply a smoke screen for the[ir] unhappiness, in our view, about our decision. So it seems that the Treasury isn't challenging the analysis both on the political side and on the fiscal side. They're just unhappy with the downgrade, but we stand by our decision." He added that "The underlying debt burden of the U.S. government is rising and will continue to rise [in spite of the budget agreement]. That means that we think the risks currently on the rating are to the downside."

John Chambers, the managing director for S&P, [added](#).

There really is, well, as President Obama — who characterized the political system as "dysfunctional" — I think that's a good word. We got to a position where we were with ten hours of having a major cash flow problem.

[The country needs a] medium-term fiscal consolidation plan ... and for that you need policy makers who can take a pro-active stance to put public finances on a sustainable footing.

A careful reading of the six-page [explanation](#) of the decision reveals much more about their concerns that the budget bill just passed will have little if any impact on the country's fiscal trajectory: "The plan envisions only minor policy changes on Medicare and little change in other entitlements, the containment of which we and most other independent observers regard as key to long-term sustainability." The report added:

A new political consensus might ... emerge after the 2012 elections, but we believe that by then, the government debt burden will likely be higher, the needed ... fiscal adjustment ... greater, and the inflection point on the U.S.'s population's demographics ... [will be] closer at hand....

Even assuming that at least \$2.1 trillion of the spending reductions the act envisages are implemented, we maintain our view that the U.S. ... government debt burden will likely continue to grow. [And the] projected 2015 ratio of sovereign indebtedness is high in relation to those of peer credits and, as noted, would continue to rise....



Written by [Bob Adelman](#) on August 8, 2011

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When comparing the U.S. to sovereigns with 'AAA' long-term ratings that we view as relevant peers — Canada, France, Germany and the U.K. — we also observe, based on our base case scenarios for each, that the trajectory of the U.S.'s net public debt is diverging from the others.

In the grand scheme of things, the downgrade by Standard & Poor's is a case of way too little, way too late. As shown [elsewhere](#), the government of the United States has been living beyond its means for years. And the fact that the slightest diminishment of its precious AAA debt rating has drawn such ferocious attacks from those responsible merely indicates how closely the downgrade from Standard & Poor's has come to hitting its target.



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