Will Climate Change Lead to a 'Fiscal Tsunami'?

As extreme weather increasingly wreaks havoc, credit rating agencies want more information about how vulnerable each state and local government's economy is to climate change.

Moody's isn't waiting for them to give it up.

Moody's Corporation, which owns one of the largest U.S. credit rating agencies, recently purchased a major stake in Four Twenty Seven, a company that analyzes climate risks, such as sea level rise, heat stress and storms, to companies and governments. The acquisition "will help us go deeper into and refine how we assess physical risks caused by environmental factors," Michael Mulvagh, head of communications for Moody's, told Inside Climate News.

The move comes as rating agencies have increasingly commented on climate change and credit risk.

Both Moody's and S&P have released online tools to gauge which areas and what industries face the most exposure to extreme weather and long-term climate change. All three rating agencies have developed guidelines for evaluating the environmental, social and governance investments, some which include certain government bonds. But the purchase by Moody's is widely regarded as a clear signal the ratings agency will be incorporating climate risk into future assessments of governments as a whole.

Calling Out Coal

While hurricanes and wildfires can do a lot of damage in a short amount of time, a more subtle climate risk is having an economy that's reliant on an industry that's harmful to the environment — like coal.

After robust growth between the early 1960s and 2000s, total coal production in the U.S. declined by 32 percent between 2007 and 2017, in large part because of the cheaper cost of natural gas. Much of the decline affected coal mines east of the Mississippi River in Appalachia and in the Powder River Basin in Wyoming and Montana.

According to new research from Columbia University's Center on Global Energy Policy, local governments in these regions — some of which rely on coal for up to half of their annual revenue — face "a fiscal tsunami."

"We've seen this with other industry collapses," Adele C. Morris, one of the report's authors, said in a presentation of the paper last month at the Brookings Institution. "In most cases what you see is this fiscal death spiral where public services decline, property values decline, other revenue declines, outmigration produces blight."

In Mingo County, W.V., coal mine employment fell from more than 1,400 people in 2011 to just 500 at the end of 2016. Nationwide, coal production is expected to drop by another 15 percent over the next decade — by even more if governments continue pursuing climate policies to reduce emissions and incentivize renewable energy.

Moving forward, the Center on Global Energy Policy suggests investors and other stakeholders ask these governments "for budget data that appropriately reveals the coal reliance of the local economy, and they should expect the information to appear in official statements in bond issuances."

Exaggerating the Financial Risk?

But some bond investors and analysts argue that any savvy bond buyer is already looking at climate risk, especially as it pertains to fossil fuels.

It's not necessary for governments to discuss their own climate risk at length, says Joseph Krist, a partner at the municipal finance firm Court Street Group.

"We've seen this before," he says, noting the collapse of the textile industry in South Carolina and the steel industry in Pennsylvania. "It's not a great thing if you live there but it also hasn't led to a whole lot of defaults. It's not a reason for bondholders to freak out."

Asking governments to disclose more about their how the environment could pose financial risks is also tougher for smaller cities and counties, many of which are most vulnerable to the changing climate.

"Reporting is an issue, and it is a struggle for municipalities," Tim Coffin, director of sustainability for Breckinridge Capital Advisors, said at the Brookings event. "We engage with companies and municipalities and we've discovered that even though we carry a pretty big stick in the muni market, it's hard to engage with some of them because they just don't have the bandwidth."

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