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The importance of corporate climate disclosure and measuring financial costs of environmental impacts

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Under the Biden administration, there has been an effort to do a better job of measuring public and private environmental impacts. The federal government is trying to develop ways of improving the measurement of environmental costs and benefits of public investments and is also trying to stimulate the development of measures of private sector environmental impacts and risks.

The emphasis on private sector sustainability metrics is seen in the rulemaking of the U.S. Securities and Exchange Commission (SEC). The enhancement of public sector sustainability metrics is happening in the Department of Commerce's Bureau of Economic Analysis in collaboration with other federal agencies.

While the SEC is now delaying its climate disclosure rules until April 2024, California and the European Union have moved ahead with their own disclosure requirements. This means that U.S. corporations doing business in California and Europe will need to disclose their carbon emissions, regardless of the SEC's action or inaction. As recently noted by CNN business reporter Samantha Delouya:

"The SEC's delay hasn't stopped other regulators from taking pollution disclosures into their own hands. In October, California Governor Gavin Newsom signed a climate disclosure bill requiring private and public companies that do business in California to disclose scope 1, 2 and 3 emissions beginning in 2026. California's bill comes after Europe passed its own rule, called the Corporate Sustainability Reporting Directive. It forces certain companies that do business in Europe to publish information on environmental and social matters. That rule took effect in January 2023. The combination of those two rules means that many large U.S. companies will likely disclose climate emissions, with or without the SEC's rule…"

The political calendar may well finally force the SEC to act because if it waits too much longer, the rule could be reversed in 2025, depending on the presidential and congressional elections this November. While some form of carbon disclosure is supported by most investors and businesses, the opposition to the SEC's rules focuses on scope 3 disclosure requirements that would require companies to disclose carbon emissions from their supply chains. The SEC's delay seems to be focused on what to do about that issue. According to Bloomberg Law's Senior Reporter Andrew Ramonas:

"The U.S. Chamber of Commerce, West Virginia Attorney General Patrick Morrisey (R) and others have been particularly troubled by the SEC's plans to require big companies to report emissions from their supply chains and other indirect sources. Democratic Sens. Jon Tester of Montana and Joe Manchin of West Virginia also have raised concerns about the Scope 3 emissions. The SEC and other agencies have until early-to-mid 2024 to adopt rules and avoid the possibility of easily losing them in early 2025. A Republican-controlled House and Senate in the next Congress could quickly revoke regulations issued after the first few months or so of 2024 under the Congressional Review Act unless the president stops them with a veto. The exact timing of when the Congressional Review Act will come into play is unclear because it is based on the number of legislative days Congress will be in session. But if the act is imposed, it's expected to affect rules issued as early as April."

The political temporizing of SEC Chair Gary Gensler will need to come to an end, or the political calendar will remove his decision-making power. The importance of the SEC as a rule maker is that, just as with financial reporting, they have the power to define terminology and specify metrics. Their power comes from their control of access to public capital markets. The conservative opposition to these rules as some form of "woke management" misses the point entirely.

If the SEC's nationwide carbon disclosure rules are issued, the U.S. can define these metrics and simplify corporate reporting requirements. If they do not act, the European Union, California, and scores of other jurisdictions will require corporate sustainability reports—each with its own reporting requirements and definitions of measures. While it was useful for the SEC to take the 16,000 plus comments they received seriously and modify their rules in response to those comments, it should not take two years from draft to final rulemaking.

Those who argue that disclosure of environmental risk is not authorized by the SEC's enabling legislation have probably not read the Securities Act of 1933 or the Securities Exchange Act of 1934. These laws were enacted to ensure that investors had factual and detailed information about corporate operations and empowered the SEC to compel publicly traded companies to disclose "material" or relevant facts.

While the initial focus was on financial accounting, the SEC also regulates corporate behavior, including governance, conflicts of interest, and management. In the modern world, environmental risk is now a central element of financial risk. Investors are demanding information on environmental liabilities due to pollutant impact on surrounding communities or the impact of environmental regulation on corporate operations and revenues. The current unregulated versions of corporate sustainability reporting allow companies to cherry-pick indicators and greenwash operations and results.

Even without federal guidance, corporations are building the capacity to measure and manage environmental impacts due to:

- Internal organizational pressure, particularly from talented young staffers.
- Consumers, who are asking about the environmental impact of their purchases and;
- Investors, who are seeking to understand and minimize the financial costs of environmental risks.

The information base needed to meet the demands for corporate sustainability requires the development of generally accepted sustainability metrics. The SEC's carbon disclosure rules will be a critical step in developing widely accepted and utilized metrics.

Initially, I had thought these metrics could be developed in the Department of Commerce as part of the work of its Bureau of Economic Analysis. While work on corporate sustainability metrics is happening in the SEC, there is also work in the Bureau of Economic Analysis now underway as part of a multi-agency effort to develop better measures of the costs of environmental damage and the benefits of environmental investments. In early 2023, the Biden Administration released America's first National Strategy to Develop Statistics for Environmental-Economic Decisions. According to that strategy:

"Natural assets, like land and water, underpin businesses, enhance quality of life, and act as a stabilizing force for economic prosperity and opportunity. They also help counteract the destabilizing risks to our environment and markets caused by climate change and nature loss. Yet the connections between nature and the economy are not currently reflected in our national economic statistics. When the government spends a dollar to restore a coral reef or a forest that will attract tourism, supply water, or clean the air, our current system does not capture the economic value of this investment.

"The National Strategy gives us a path to change that. Clearly measuring the quantity and value of natural capital will enable more accurate economic growth forecasts and facilitate a more complete picture of economic progress to inform how we prioritize investments. Our understanding of the American economy keeps evolving, and our approach to measuring and tracking economic inputs and outputs must evolve too. In the wake of the Great Depression, the U.S. government developed innovative ways to better measure our economy, giving

Americans an overall picture of the state of the nation's economy for the first time.

"That pioneering work fundamentally changed how we talk about the economy, conduct economic policy, and measure progress. Over the years, that system for measuring our economy has continued to evolve and our view of the economy must evolve with it, so we may enable policymakers, investors, business, and communities to make evidence-based decisions. Tackling climate change, restoring nature, cleaning our air, lakes, rivers, and the ocean, and regenerating degraded lands often are economic activities—they are investments in our economy and future, and thus need to be captured in our economic accounts."

These measures would influence public policymaking and more accurately measure the financial value of public goods. They would also help refine the measures used in environmental impact statements. This would impact both public and private development projects. Improved natural capital accounting is important and valuable work.

However, since the size of America's private economy dwarfs the size of government spending, the SEC rule may well be more important to maintaining and improving environmental quality. About 13.7% of the Nominal GDP is public spending. Still, public spending is often directed toward fragile ecosystems or natural resources that are critical to human well-being, so both sets of metrics are critically important.

While the public is not aware of the Biden Administration's low-key efforts to develop sustainability metrics, this work is critically important if we are to address the crisis of environmental sustainability. To understand and manage a problem, it must be measured. Decision-making cannot include environmental impacts if they are not measured. The long-term impact of these efforts to measure and report environmental impacts will be even greater than the massive financial investments of the Inflation Reduction Act and the infrastructure bill. It will embed environmental considerations in corporate and government decision-making.

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