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Sovereign rating criteria and the climate crisis: How rating agencies hinder climate action in the Global South

Pedro Lange Machado*

October 7, 2025

Abstract: This paper examines how the sovereign rating methodologies of the "Big Three" credit rating agencies – S&P, Moody's, and Fitch – interact with the imperatives of the climate crisis and the low-carbon transition. It argues that these methodologies not only overlook climate objectives but actively constrain their pursuit by narrowing the policy space of states, particularly in the Global South. Two interrelated mechanisms drive this outcome. First, the incorporation of climate factors into rating criteria tends to lower sovereign ratings in vulnerable countries and channel climate action toward market-liberal, investor-oriented approaches. Second, the broader methodological architecture of sovereign ratings systematically penalizes reformist strategies – such as green industrial policy, strategic regulation, and debt-for-climate swaps – that are essential for a just transition. Drawing on a qualitative and interpretive analysis of CRA methodological documents and sovereign rating reports, complemented by a set of illustrative heuristic cases highlighting tensions between rating criteria and reformist climate action, the study shows how fiscal orthodoxy and creditor-centric logics are embedded in rating practices. It concludes that CRA methodologies function as enforcers of a narrow, market-conforming transition, thereby deepening climate injustice and constraining developmental autonomy in the Global South.

Keywords: climate crisis; green finance; rating agencies; sovereign rating; just transition.

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1. Introduction

Despite repeated international pledges, the world remains far from meeting the Paris Agreement and the Sustainable Development Goals (SDGs). The alignment of financial market actors and instruments, often framed as *green finance*, has emerged as a central mechanism proposed to close this gap. Yet green finance is far from neutral: it is a contested arena in which competing political and ideological projects of climate action collide, ranging from market-liberal to reformist approaches oriented toward a just transition (Sharma & Babic, 2025; Gabor & Braun, 2025; Dziwok & Jäger, 2021).

Credit rating agencies (CRAs) are central actors in this dispute and in the broader green finance ecosystem. The "Big Three" – S&P, Moody's, and Fitch – hold an oligopolistic position in global finance, and their assessments strongly shape governments' access to capital. International organisations such as the G20 and the UN have highlighted the potential role of CRAs in enabling the transition to a low-carbon economy (G20, 2024; UN, 2022). Yet this expectation raises a fundamental question: can institutions originally designed to inform investors about creditworthiness be repurposed as effective facilitators of climate goals?

Emerging literature has begun to address this tension, often examining how climate factors influence sovereign ratings (Cevik & Jalles, 2023; Sun et al., 2023; Capiello et al., 2025). Work in International Political Economy (IPE) further shows how CRAs embody and enforce the neoliberal logics of financial globalisation (Sinclair, 2005; Paudyn, 2014; Machado, 2025a), a tendency now refracted through the so-called Wall Street Consensus (Gabor, 2021). Critical contributions on green finance have also developed typologies of state responses and macrofinancial regimes, highlighting alternatives to market-led transitions (Dziwok & Jäger, 2021; Gabor & Braun, 2025). Still, important gaps remain: specifically, we know relatively little about how sovereign rating methodologies – beyond the surface inclusion of climate variables – interact with distinct paradigms of green finance, and what that interaction implies for the policy space of countries in the Global South.

This article addresses that gap by critically analysing the sovereign rating criteria of the Big Three. Sovereign ratings matter because they function as an implicit ceiling for other asset classes: downgrades are often followed by higher borrowing costs, reduced fiscal space, and wide macroeconomic repercussions (Sun et al., 2023; Paudyn, 2014). Countries in the Global South are doubly vulnerable: they face greater exposure to climate impacts while having less fiscal capacity and deeper reliance on international capital markets (IPCC, 2023; Paula, Fritz & Prates, 2017).

The core argument is that current sovereign rating methodologies, as designed and applied by the Big Three, systematically undermine climate and environmental goals, especially in the Global South, through two interrelated mechanisms. First, the growing incorporation of climate factors into rating methodologies tends to lower sovereign ratings in climate-vulnerable countries and channel climate action toward market-liberal and investor-oriented approaches. Second, the broader methodological architecture of sovereign ratings constrains or outright penalises reformist policy strategies – such as green industrial policy, strategic regulation, and debt-for-climate swaps – that the specialised literature and international organisations increasingly identify as essential for a just transition.

To capture this dynamic, the article employs a qualitative, interpretive methodology based on documentary scrutiny of sovereign rating criteria and methodological publications by S&P, Moody's, and Fitch, complemented by a close reading of selected rating reports and actions. The analysis mobilises illustrative heuristic cases drawn from policy debates – on green industrial policy, social protection, debt-for-nature swaps, and regulatory reform – as analytical probes to reveal the structural biases embedded in rating practices. The objective is to trace how methodological choices translate into incentives and constraints for state climate action, particularly in contexts of fiscal vulnerability.

The paper makes three contributions. Conceptually, it advances the literature on green finance and IPE by shifting attention from whether climate risks are material for ratings to how rating methodologies actively shape which climate responses are perceived as credit-compatible. Empirically, it documents mechanisms through which credit assessment practices privilege creditor-centric, market-oriented responses and penalise reformist pathways. Finally, it situates these findings within ongoing reform debates: proposals by scholars, international organisations, and vulnerable states to reshape rating practices – whether through new CRAs, resilience-oriented metrics, or climate-resilient debt clauses – are examined for both their promise and their limits.

The article proceeds as follows. Section 2 reviews the relevant literature on green finance and CRAs in IPE, situating them in the broader ecosystem of green finance. Section 3 examines the incorporation of climate factors into sovereign rating methodologies and their implications for the governance of state climate action. Section 4 analyses how rating methodologies more broadly constrain reformist policies, focusing on four sub-domains: public investment and green industrial policy; regulatory sovereignty and uncertainty; social protection and resilience; and debt, fiscal space, and innovative restructuring instruments. Section 5 discusses emerging reform proposals for the rating industry and their implications. The conclusion summarises the argument, discusses policy implications, and indicates avenues for future research.

2. Green finance and rating agencies

The alignment of financial actors and practices with the imperatives of the climate crisis constitutes an arena of political and ideological tension. On one side, the dominant paradigm assumes that this objective should be pursued through market rules and practices, in line with the market-liberal parameters underpinning the global financial order (Gabor, 2021; Dziwok and Jäger, 2021). On the other, a growing body of scholarship highlights the ineffectiveness of purely market-based solutions in addressing the climate crisis, pointing instead to the need for a rupture – whether partial or profound – with the premises of financial globalisation, and for greater state activism to ensure a just transition to a low-carbon global economy (e.g., Vasudevan, 2024; Mazzucato et al., 2024; Feijó, Feil and Pessoa, 2023; Dafermos, 2025).

This tension can be better understood through two complementary perspectives offered by the literature. The first is the approach to green finance as an ecosystem, within which a variety of actors and financial instruments interact (Babic, 2024). Sharma and Babic (2025) argue that this ecosystem can be divided into four interrelated layers. The first two concern providers of green finance and the instruments enabling such financing. The third relates to governance and regulatory aspects of sustainable finance. The fourth – and the most crucial for understanding the political and ideological tensions it entails – concerns its embeddedness in the broader structures of global finance. In other words, green finance is constantly shaped by the political foundations, ideological frameworks, and power relations that underpin the development of global finance.

This means that, although conceived as a response to climate and environmental challenges, green finance operates within an environment marked by financialisation, where the profit motive of investors tends to prevail, reinforcing an institutional architecture designed to safeguard capital mobility and market functioning (Palley, 2013;

Mader, Mertens and Zwan, 2020). The dominant paradigm of green finance, centred on market solutions to climate and environmental crises, reflects this reality. Not by chance, Gabor (2021) refers to this as *green financialisation*, highlighting how the parameters of the "Wall Street Consensus" are projected onto climate governance.

A second perspective for grasping the tensions within green finance comes from typologies developed in recent scholarship. Gabor and Braun (2025), for instance, identify four *green macrofinancial regimes*, defined by how public institutions (monetary, fiscal, financial) allocate credit and money in the low-carbon transition. The first, *weak de-risking*, epitomises the Wall Street Consensus (Gabor, 2021), where fiscally constrained states only slightly adjust risk–return profiles to green existing sectors. The second, *robust de-risking*, involves more active subsidies for clean-tech manufacturing and a limited reshaping of sectoral structures. The third, *carbon shock therapy*, is characterised by high discipline on capital through market competition and heavy reliance on carbon pricing, often generating disorderly transitions. At the opposite end, a *big green state* regime relies on strong state capacity for spending, regulation, and disciplining private capital, enabling planning-based transitions.

Similarly, Dziwok and Jäger (2021) distinguish between three forms of green finance and monetary policy – *neoliberal, reformist, and progressive* – each grounded in distinct assumptions about markets, state intervention, justice, and ecological limits. In their view, neoliberal forms rest on faith in markets to solve environmental problems. Reformist forms are more sceptical of market-only solutions, calling for greater state involvement through taxation and public investment. Progressive forms go further, questioning the systemic foundations of the current economic order and advancing strategies based on international solidarity and de-growth policies.

For the purposes of this analysis, and inspired by these typologies, I suggest grouping climate policies and state actions related to green finance into two main categories. On the one hand, *market-liberal* forms rely on market-based solutions in which global investors' interests prevail, restricting state intervention to the role of safeguarding those interests in the transition. On the other hand, *reformist* approaches recognise the insufficiency of market-only solutions and argue for a more proactive state role in ensuring that environmental imperatives are met, even when this clashes with investor priorities.

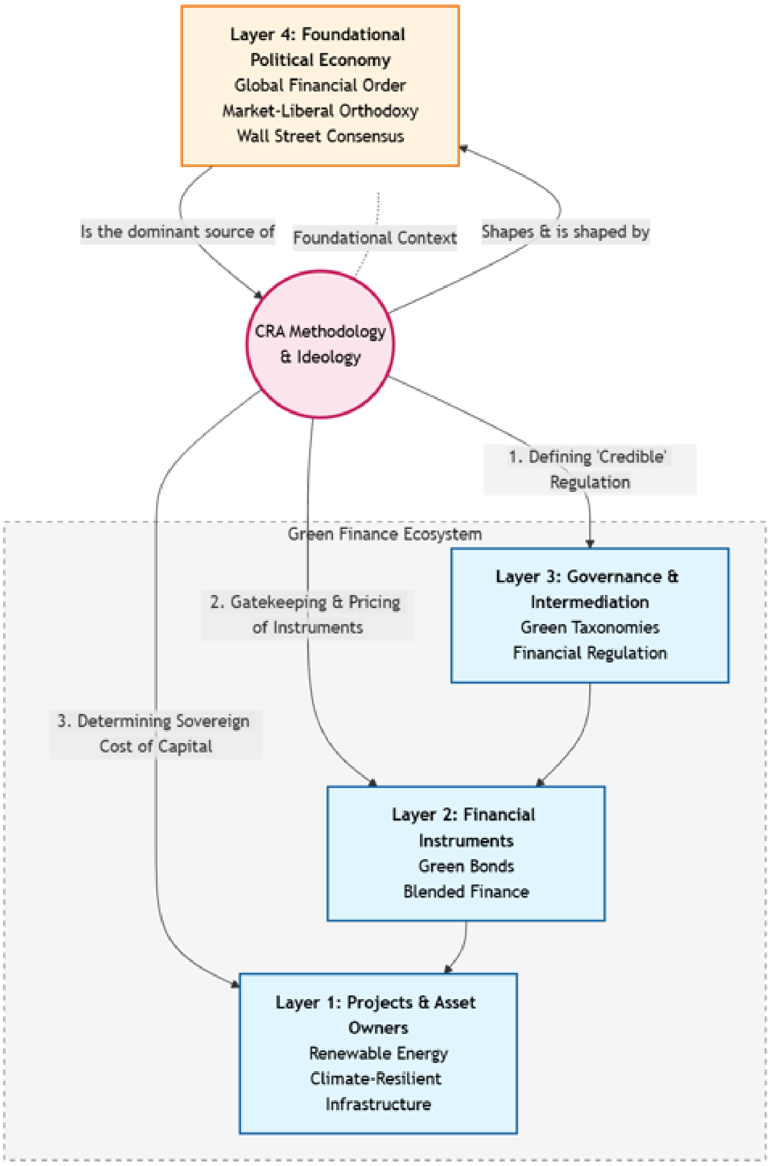
Against this backdrop, the role of CRAs in the green finance ecosystem becomes clearer. IPE scholarship has long examined the political foundations and power relations embedded in financial globalisation (Helleiner, 1994; Strange, 1996). In the case of the Big Three CRAs, their interactions with national governments have been the subject of a consolidated research agenda that has sought to explain the origins of their structural power and the political implications of their *modus operandi* (e.g., Sinclair, 2005, 2021; Paudyn, 2014).

S&P, Moody's, and Fitch emerged in the early 20th century from the needs of U.S. capital markets, and their century-long trajectories span multiple financial orders (Machado, 2025a). Under financial globalisation, the structural power and epistemic authority of the Big Three were projected worldwide, consolidated by institutional embedding and financial market regulation (Sinclair, 2005; Kruck, 2016). This allowed them to become powerful actors in global financial governance and vectors of an economic order designed to protect investor interests (Sinclair, 2005, 2021). In their interactions with national governments, this translates into pressure for fiscal austerity and liberal reforms – which reinforce financialisation and empower the financial sector both politically and economically – as well as the promotion of specific policies meant to improve sovereign creditworthiness (Paudyn, 2014; Barta and Johnston, 2023; Machado, 2025b).

This pattern of behaviour is rooted in sovereign rating methodologies informed by neoliberal frameworks, which inherently view as negative any policy or institution not aligned with market primacy (Paudyn, 2014). Methodologies became more transparent after regulatory pressures from bodies such as the United States Securities and Exchange Commission (SEC) and European Securities and Markets Authority (ESMA), following the CRAs' involvement in systemic crises such as the 1997 Asian crisis and the 2008 subprime crisis, which placed them under intense scrutiny (Sinclair, 2021). Despite this, their power remains largely unchallenged: the Big Three continue to guide financial flows and act as gatekeepers of sovereign access to debt markets (Binici et al., 2018; Sinclair, 2021).

This positions them in a privileged place within the green finance ecosystem, where their actions cut across all four of its layers, as Figure 1 shows. For instance, CRAs engage in *green bond* certification (Ehlers & Packer, 2017), and their ratings assess the creditworthiness of instruments connecting investors to green projects. But it is in the fourth layer identified by Sharma and Babic (2025) that their role is most decisive: CRAs act as conduits between the green finance ecosystem and the broader global financial order, transmitting the institutional and ideological imperatives of the latter into the former. In practice, this means translating climate risks into the language of credit risk and, in doing so, imposing a specific financial logic (e.g., short-term profitability, aversion to state intervention) on what counts as "legitimate" or "credit-positive" climate policy. This, in turn, has tangible effects on climate policy and other forms of green finance in countries rated by the Big Three.

Figure 1: CRAs in the green finance ecosystem.



Source: the author.

In other words, consistent with the *modus operandi* already well-documented in IPE scholarship, CRAs insert themselves into green finance as enforcers of *market-liberal* approaches to the climate and environmental crisis. They may deploy the power at their disposal – including gatekeeping (controlling access to debt markets through ratings), epistemic authority (defining what counts as risk and shapes creditworthiness), and enforcement (the threat of downgrade) – to frame as risky, and ultimately punish, green policies that threaten investor interests, even when such policies are backed by robust scientific evidence. This role is particularly consequential for Global South countries, which have less fiscal space and are more vulnerable to financial market pressures (Mosley, 2003; Campello, 2015; Paula, Fritz and Prates, 2017). Ultimately, this perspective allows us to consider CRAs as consequential – and often detrimental – actors for the achievement of the climate goals enshrined in the Paris Agreement and the SDGs. The next sections explore sovereign rating methodologies in greater detail to show how these mechanisms may operate in practice.

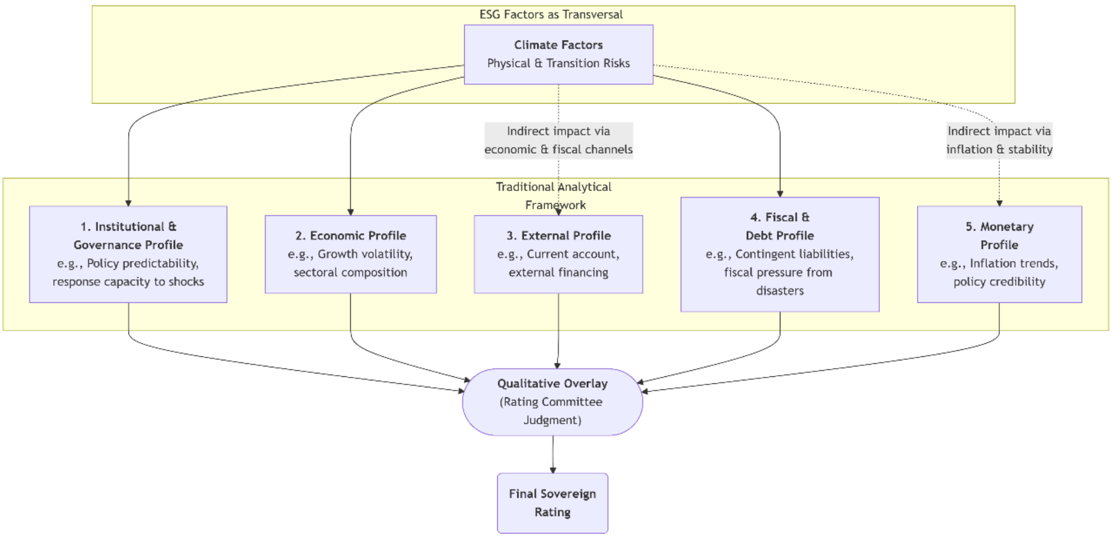
3. Climate factors and sovereign rating criteria

One way to observe the role played by the Big Three within the green finance ecosystem is through the growing prominence that climate factors have acquired in their sovereign rating methodologies. This process, intensified over the past decade and reflecting S&P, Moody's, and Fitch's commitment to the UN Principles for Responsible Investment (PRI), translates the climate crisis into the language of financial risk, thereby connecting the green finance ecosystem to the dominant financial-materiality approach of global finance. Under pressure for legitimacy and transparency, CRAs have sought to provide greater detail on this integration (S&P, 2024a; Moody's, 2025; Fitch, 2025a), yet they do so in ways that reaffirm their historical role as vectors of a market-liberal political economy (Sinclair, 2005), with profound implications for the autonomy of Global South countries.

Formally, climate criteria are situated within the Environmental pillar of the Environmental, Social, and Governance (ESG) factors that compose sovereign rating methodologies. However, it is crucial to recognize that these factors do not constitute a standalone analytical pillar. Instead, they are conceptualized as *transversal risks* whose materiality is strictly filtered through their impact on traditional credit categories – such as economic strength, fiscal robustness, and the institutional profile (S&P, 2024a; Moody's, 2025; Fitch, 2023), as illustrated by Figure 2.

This very structure of integration means that the assessment of climate risks is inherently imbued with a conventional credit logic that prioritizes short-term macroeconomic stability and predictability for investors. Consequently, as the critical literature has pointed out, ESG often functions less as a transformative tool than as an organizational framework that re-presents traditional risk factors in a modernized guise, raising concerns about greenwashing and its limited capacity to facilitate a genuine sustainability transition (Fichtner, Jaspert, & Petry, 2023). Reflecting these inherent uncertainties, Moody's (2025) itself acknowledges that "there is no single set of ESG definitions or metrics that is comprehensive, verifiable and universally accepted."

Figure 2: Climate factors and sovereign rating criteria of S&P.



Source: The author, based on S&P (2024c).

In any case, the credit materiality of these factors is inexorably filtered through the traditional lens of CRAs: the sovereign's repayment capacity. As Moody's (2025) makes clear, climate risks within ESG are categorized in two ways. On the one hand, *physical risks*, defined as "the adverse effects of direct environmental trends and hazards, such as pollution, drought, severe natural and human-caused disasters, and climate change." On the other hand, *transition risks*, referring to "the consequences of regulatory or policy initiatives that seek to reduce or prevent environmental trends or hazards or perceived trends or hazards."

Recent scholarship has sought to measure the effects of this integration. Klusak et al. (2021), for example, simulate the impact of climate change on the sovereign ratings of 108 countries, concluding that climate-induced downgrades are set to intensify already in this decade. Other empirical studies corroborate this finding, suggesting that countries more vulnerable to physical risks tend to receive lower ratings (Cevik & Jalles, 2023; Sun et al., 2023). Cappiello et al. (2025), analyzing two decades of data from 124 countries, also find evidence of penalization, while further suggesting that exposure to transition risks may be credit-positive when countries adopt more ambitious emission reduction targets. These conclusions, however, are contested by authors such as Andersen (2025), who highlights methodological problems and questions whether there is robust causality between climate factors and ratings.

Such disagreements may stem from the neglect of two key aspects of CRA operations in these quantitative analyses. First, the role of the *qualitative overlay*, applied opaquely by rating committees, which can decisively affect the issued rating. Second, the omission of *rating reports*, where CRAs justify their actions – documents that recent scholarship (Barta & Johnston, 2023; Machado, 2025b) considers indispensable for understanding rating decisions and broader CRA positioning. For example, recent reports show that CRAs have explicitly linked rating actions to climate events, as in the cases of Pakistan (Fitch, 2022), Sint Maarten (Moody's, 2017), and Namibia (Fitch, 2017), all downgraded in part due to the impacts of extreme weather events.

A further tangible indication of the materiality of climate factors is the development of *Climate Resilient Debt Clauses* (CRDCs) and their inclusion in sovereign rating criteria. These clauses allow debt repayments to be deferred in the aftermath of extreme climate-related disasters without being classified as default – provided certain CRA-defined conditions are met (S&P, 2024b). Far from being a mere concession, CRDCs financialize physical climate risk, effectively turning it into a priced market variable and consolidating the logic that resilience must be managed through market mechanisms. This, in turn, creates new layers of evaluation and potential screening for investors – an illustrative case of how green financialization (Gabor, 2021) operates and is promoted by CRAs within the broader green finance ecosystem.

The aggregate effect is both asymmetric and pernicious. Global South countries – least responsible for global warming but most vulnerable to its impacts (IPCC, 2023; S&P, 2025) – are disproportionately exposed to physical risks. The materialization of these risks places downward pressure on their ratings, increasing sovereign borrowing costs and constraining already limited policy space for climate action. A vicious cycle may emerge: vulnerability leads to downgrades, which raise borrowing costs, which reduce fiscal capacity for resilience investment, which in turn amplifies future vulnerability. As Dafermos (2023) notes, this dynamic undermines the prospects of a just transition to a low-carbon global economy and deepens the debt crisis already facing poorer and developing countries (Volz et al., 2021). Without climate justice, the likelihood of political backlash – leading to reversals or retrenchment in climate commitments – grows stronger (Gaikwad et al., 2022), further jeopardizing global climate goals.

Beyond the materialization of physical risks, climate factors also shape the *governance of transition risks*. CRAs do not merely assess exposure; they evaluate and prescribe the "quality" of climate policies. As Moody's (2025) explains: "We seek to assess regulatory frameworks and the likely impacts that regulations will have on rated issuers and their sectors." At this point, risk analysis explicitly converges with a political project of framing the transition (Gabor, 2021).

Here, the logic of the Wall Street Consensus becomes inescapable. The "quality" of a policy is judged according to its adherence to market-liberal principles. S&P (2025) is unambiguous in prescribing solutions: "Blended finance solutions – which use development finance to mobilize additional capital from the private sector..." are deemed ideal. The road to creditworthiness is thus paved through the creation of a "pro-private sector investment framework." Conversely, reformist climate policies – such as large-scale public investment in green infrastructure or taxation of carbon-intensive sectors – are implicitly categorized as "weak institutional settings," a risk factor that can justify negative assessments and potential downgrades.

From the perspective of incorporating both physical and transition risks into sovereign rating criteria, the insertion of CRAs into the green finance ecosystem is thus characterized by a *contradictory dual pressure* that defines their role as enforcers of a market-liberal approach to state climate action. On the one hand, there is *pressure to act*, as the integration of climate criteria pushes countries to mitigate risks or face downgrades. On the other hand, there is *pressure to converge*, whereby CRAs signal that acceptable –

and thus credit-positive – climate action must conform to strict market-liberal parameters, privileging blended finance, public-private partnerships (PPPs), and private capital mobilization. Any deviation toward reformist policies risks being framed as institutional weakness and political risk, carrying the threat of downgrades with tangible economic and political consequences for rated countries.

In other words, the integration of climate factors by the Big Three is far from neutral. It is an active mechanism of governing through finance which, even while acknowledging climate urgency, drastically narrows the range of policy options available to states – especially in the Global South. By penalizing reformist pathways and promoting a market-led transition, sovereign rating methodologies do not merely reflect the "Wall Street Consensus"; they actively implement it, entrenching structural obstacles to an equitable and effective resolution of the climate crisis.

4. Sovereign Rating Methodologies and the Constraint of Reformist Climate Policies

The incorporation of climate risks into sovereign rating methodologies, and their influence on the governance of state climate action in favor of market-liberal policies, represents only the most visible dimension of how CRAs are embedded in the green finance ecosystem. Less visible, but arguably far more consequential, is the way in which sovereign rating methodologies as a whole tend to foreclose the adoption of reformist measures frequently highlighted in the literature as necessary for achieving a just transition to a low-carbon global economy. Here, the *modus operandi* of the Big Three exposes a central paradox of the climate emergency: achieving climate goals requires stronger states, yet CRAs consistently favor leaner ones.

This tension is closely tied to the variables that compose sovereign rating methodologies and the way they are measured. For example, S&P emphasizes fiscal performance, debt dynamics, and institutional credibility; Moody's gives particular weight to fiscal strength, external vulnerability, and institutional capacity; Fitch similarly stresses public finance indicators, governance quality, and macroeconomic stability. Such variables are operationalized through metrics – including debt-to-GDP ratios, fiscal balances, current account performance, and inflation targets – that inherently privilege fiscal discipline, market openness, and policy predictability. This diagnostic resonates with the IPE literature, which consistently frames CRAs as political actors endowed with structural power and epistemic authority – resources they deploy to privilege investor interests and safeguard the ideological and institutional parameters of financial globalization (Sinclair, 2005, 2021; Paudyn, 2014; Machado, 2025b).

Against this background, the following subsections examine four selected conflicts between reformist proposals discussed in the literature and international policy debates aimed at addressing the climate crisis, and the methodologies employed by S&P, Moody's, and Fitch in sovereign ratings (Fitch, 2025a; Moody's, 2022; S&P, 2024c) – without any claim to exhaust all the tensions between them. Since many of these measures are relatively recent and have rarely been implemented by governments in the Global South, the analysis also draws on comparable policies or analogous situations where CRA reactions can be observed. By engaging with concrete examples of sovereign experiences, the section demonstrates how the methodological framework of sovereign ratings operates in practice and how it can potentially constrain reformist climate action.

4.1 The Public Investment Conflict: Green Industrial Policy vs. Fiscal Orthodoxy

Literature posits that the transition to a low-carbon economy requires massive and coordinated investments in infrastructure, research and development, and industrial upgrading. Because of their scale, risk, and low short-term profitability, such investments are unlikely to be led by the private sector alone (Mazzucato, 2013). The state thus becomes an indispensable actor in financing, steering, and assuming the risks of this transition – particularly in the Global South, where capital markets are shallower and less capable of mobilizing long-term funding (Feijó, Feil and Pessoa, 2023; UNCTAD, 2023). Strengthening state capacity and building institutional arrangements for a state-led green industrial policy are increasingly seen not only as desirable, but as necessary conditions for achieving a just transition (Vasudevan, 2024; Anzolin & Lebdioui, 2021; Rodrik, 2015).

Yet, it is precisely this kind of robust state action that traditional sovereign rating methodologies interpret as a credit-negative signal. This logic operates through two distinct but complementary biases.

First, there is what may be termed a *Short-Term Fiscal Bias*: sovereign rating methodologies privilege short-term cash-flow indicators such as fiscal deficits and debt-to-GDP trajectories. By definition, a large green investment program requires higher public spending. Even if such investments generate long-term returns through greater resilience and lower disaster-related losses, they appear in the CRAs' spreadsheets as near-term fiscal deterioration. As highlighted by UNCTAD (2023), this reflects a broader limitation of financial markets and their metrics, which often fail to distinguish between debt used for current consumption and debt that finances productive and resilient future assets – the distinction between "bad debt" and "good debt." The inability to differentiate between current expenditures and long-term strategic investments means that essential climate policies are penalized through the simplified lens of rating models.

Second, there is what can be framed as an *Anti-State Intervention Bias*: in the CRAs' orthodoxy, state intervention in the economy is by definition a source of inefficiency and market distortion. Industrial policies that identify and promote "winners" (such as hydrogen, battery manufacturing, or renewable energy industries) are viewed with suspicion, under the assumption that markets allocate resources more efficiently. Similarly, state-owned enterprises, which are often vehicles for long-term investment, tend to be treated as contingent liabilities and governance risks, regardless of their strategic role in enabling climate transition.

Although explicit downgrades due solely to green investment remain rare – partly because few Global South countries have had the fiscal space to launch programs of sufficient magnitude – the evaluative logic is deeply entrenched and becomes activated against any significant expansion of the "investor state."

Brazil offers an illustrative case. After the 2008 global financial crisis, the government launched a stimulus package that included major public investments, particularly in infrastructure. While that package was not "green," the reaction of CRAs is revealing. Fitch (2009), for instance, issued strong warnings about fiscal deterioration, noting that expenditures would expose Brazil's public finances to risk and emphasizing concerns about fiscal credibility under the stimulus. At the same time, however, Brazil was upgraded to investment grade for the first time in its history, highlighting a disjunction between the rhetoric of credit risk warnings and the CRAs' rating decisions. This case serves as a proxy: any expansion of state-led investment, regardless of its objective or economic effects, tends to be read *a priori* as credit-negative.

As a counterpoint, the solution prescribed by CRAs is blended finance (S&P, 2025). In this model, the state does not act as a direct investor but uses public funds to absorb risks and "catalyze" or "crowd in" private capital. This approach aligns neatly with a market-liberal logic, as it avoids the expansion of the state as an economic actor while creating new profit opportunities for financial investors. The implicit message is clear: climate policy is credit-positive when it opens space for financial markets, but credit-negative when carried out directly by the state.

In sum, the methodology of CRAs generates a paradox for the Global South: the climate transition requires an active investor state, yet the credit rating system punishes both fiscally and ideologically any state that assumes this role. The result is a structural constraint that pushes countries toward slower, underfunded, and less ambitious transition pathways – ones that prioritize market approval over climate effectiveness.

4.2 The Regulation and Sovereignty Conflict: Structural Policies vs. "Regulatory Uncertainty"

Beyond direct investment, literature often posits that a deep and rapid climate transition requires a reconfiguration of the regulatory framework governing the economy. This "re-regulation" spans from imposing strict emission standards on productive sectors and regulating climate-related risks in the financial system (e.g., "brown assets") to strategic policies that protect the environment and foster national green value chains (Brühl, 2021; Cigu et al, 2020; UNCTAD, 2019). Critical political economy scholarship sees such measures as essential for overcoming market inertia, preventing greenwashing, and systematically redirecting capital flows and economic activity toward decarbonization.

However, this sovereign regulatory push collides head-on with the core philosophy of CRAs, which prioritize predictability and maximum freedom of action for private investors. Policies that alter the "rules of the game" or "distort" the supposedly neutral allocation of markets are flagged as a credit risk. Two interlinked mechanisms are at play here.

First, there is what can be described as the *trap of regulatory uncertainty*. This concept is a key operational category in the CRAs' lexicon. Crucially, it does not evaluate the quality, necessity, or legitimacy of regulation, but its stability and familiarity to investors. A new, comprehensive, and ambitious climate regulation – however urgent or well-designed – would likely be framed as a source of "uncertainty." CRAs would assume that such uncertainty discourages private investment, slows economic growth, and thus undermines sovereign repayment capacity. The rapid experimentation and adaptation that effective climate policy requires would be thereby penalized in the name of stability.

Second, there is a more explicit *rejection of interventionism*. Policies involving strategic price controls (e.g., in renewable energy), local content mandates, restrictions on fossil fuel exploration or exports, or strong sectoral regulation are systematically labeled "interventionist." In CRA methodologies and reports, the term carries a distinctly negative connotation, associated with inefficiency, political capture (corruption), and resource misallocation – all treated as clear detriments to creditworthiness. The underlying presumption is that markets are always more efficient allocators of resources than deliberate state action.

The application of this logic became evident in Ecuador's decision to preserve the Yasuní National Park and halt oil and mining activities in the Andean Chocó region. Following the 2023 referendum in which Ecuadorians voted overwhelmingly to end oil drilling in Yasuní – one of the most biodiverse areas on the planet – the government committed to implementing the popular mandate. Shortly thereafter, Moody's publicly warned that these decisions could negatively affect Ecuador's credit rating, arguing that the move would reduce export revenues and fiscal flexibility (Amazon Watch, 2025; Expreso, 2023; Latindadd, 2023). The agency characterized the policy as fiscally shortsighted and economically costly, framing environmental preservation as a credit risk rather than a legitimate expression of national sovereignty and long-term climate responsibility. Civil society organizations, such as Latindadd and Amazon Watch, criticized Moody's stance, emphasizing that it penalized a democratically approved climate policy and discouraged other countries from pursuing similar actions. This episode illustrates how CRA methodologies transform ambitious environmental regulation into a signal of instability and risk, thereby constraining sovereign regulatory autonomy in the name of investor confidence.

A similar dynamic appeared in South Africa's Mining Charter. When the government introduced new requirements to increase Black ownership and local content in the mining sector, Moody's immediately described the proposal as "credit negative," arguing that it "introduces significant regulatory uncertainty and could deter investment" (Moody's, 2016). The measure was designed to redress historical inequalities and foster long-term industrial development, yet CRAs framed it primarily as a source of instability and risk. By extension, climate measures with similar features – such as local content mandates for solar panels or wind turbines – would likely be treated with the same suspicion, as they "distort" markets in favor of domestic producers over perceived global efficiency. Indeed, past experiences in countries such as Argentina and India reveal the CRAs' aversion to regulatory shifts, energy price controls, and export restrictions, which are often framed as "interventionist" measures that weaken predictability and undermine investor confidence (S&P, 2013, 2014; Moody's, 2012, 2018).

In sum, the regulatory bias of CRAs against "uncertainty" and "interventionism" creates a hostile environment for the adoption of structural climate policies. By penalizing necessary regulatory change and the strategic use of state power to steer the economy, rating methodologies privilege a market-led, incremental transition – potentially foreclosing the faster and more transformative pathways required by the scale of the climate crisis. This conflict places the regulatory sovereignty of Global South states under constant tension, subordinating it to the predictability demanded by international financial investors.

4.3 The Social Protection Conflict: Climate Resilience vs. Fiscal Rigidity

The climate crisis manifests not only as an environmental disruption but also as a profound social emergency. Extreme events devastate communities and livelihoods, while the transition to green industries may generate large-scale displacements of workers in sunset sectors. Building systemic resilience therefore depends critically on robust social protection systems – including unemployment insurance, disaster assistance, universal healthcare, and retraining programs (Nenning et al., 2023; Silchenko & Murray, 2023). The IPCC (2023) underscores that the social dimension is inseparable from climate adaptation, serving as a pillar of a just transition that leaves no one behind.

The CRAs' perspective on social spending, however, diverges sharply from this view. Within rating orthodoxy, such expenditures are often treated as rigid, recurrent fiscal liabilities rather than strategic investments in human capital, social cohesion, or resilience. This narrow perspective sustains a twofold constraint.

First, there is an *austerity bias*: social spending, because it tends to be permanent and indexed, is seen as reducing governments' fiscal flexibility to respond to shocks. CRA reports frequently emphasize containment, "efficiency," and "fiscal balance," while seldom recognizing social protection's role as a buffer against climate and social shocks that could incur much greater long-term economic costs.

Second, CRAs often interpret *social conflict as political risk*. When policies such as fossil fuel subsidy reform provoke predictable unrest, CRAs tend to focus on instability, business environment disruption, or economic unpredictability, rather than evaluating whether compensatory mechanisms or protection systems could mitigate these concerns.

This logic is evident in the case of Ecuador in 2019, when the government's removal of fuel subsidies (Decreto 883) triggered mass protests and was ultimately reversed. Observers – including international institutions and civil society – underscored both the absence of adequate social protection and the political costs of abrupt policy shifts (IISD, 2019; Monahan, 2019). These events show how social unrest following fiscal or regulatory reforms can dominate the narrative, overshadowing the reforms' intended goals and reinforcing perceptions of risk among market actors. From the perspective of CRAs, both the unrest and the reversal of Decreto 883 were assessed negatively for the country's creditworthiness, with S&P (2020) explicitly stating that "we could lower the rating over the next 12 months if policy reversals occur that damage investor confidence."

Comparable tensions are evident in Mexico. Between 2019 and 2023, the López Obrador administration significantly expanded social transfer programs. While these contributed to poverty reduction, CRAs nonetheless flagged fiscal risks – particularly in combination with the contingent liabilities of Pemex, the Mexican state-owned oil and gas company – and widening budget deficits. In 2020, Fitch downgraded Mexico's sovereign rating citing weak growth prospects and fiscal pressures amid the pandemic, while more recent commentary continues to highlight the weight of rising government expenditure on fiscal sustainability (Investing.com, 2020; AA, 2024). Although social transfers were not always singled out explicitly, they were incorporated into broader concerns about the trajectory of public finances.

In sum, the conflict between social protection and rating methodologies produces a perverse paradox for Global South countries. Building the social resilience indispensable to climate adaptation requires states to sustain and expand safety nets. Yet the dominant logic of credit assessment often treats such expansions as signals of fiscal weakness, actively discouraging them. In this way, CRAs – by penalizing social spending – may undermine both just transition and climate adaptation, deepening vulnerabilities they themselves recognize as risks.

4.4 The Debt Conflict: Fiscal Space vs. Contractual Rights

Global South countries face a dual existential burden: a growing climate debt – reflecting the urgent need to invest massively in adaptation and mitigation – and a heavy financial debt, often high, costly, and denominated in foreign currencies. To address these interconnected challenges, heterodox economists and international institutions such as UNCTAD have called for a rethinking of the global financial architecture, including debt restructuring, debt-for-nature swaps, extended maturities, and the adoption of more flexible fiscal frameworks to enable long-term investment in resilience and sustainable development (UNCTAD, 2019; Gallagher & Kozul-Wright, 2022).

However, CRA methodologies are built largely around the opposite paradigm: uncompromising protection of creditors' interests and the primacy of aggregate debt metrics over any qualitative analysis of expenditure type. This tension manifests through at least two foundational mechanisms.

First, one of the primary metrics used by CRAs is the trajectory of public debt relative to GDP. A state that, in response to climate emergency, chooses to loosen short-term fiscal constraints to finance national adaptation strategies risks being penalized with a negative outlook or downgrade. Because many rating models do not include an operational concept of "good debt" – i.e., investments that increase future productive or resilient capacity – expenditures are often treated generically as liabilities rather than as long-term assets of resilience.

Second, any form of debt restructuring – including more innovative instruments like debt-for-nature swaps – is subject to being viewed with suspicion. CRAs tend to adhere to principles like *pari passu* and the facial value of debt. Even when a swap is voluntary or includes environmental guarantees, the mere possibility of debt relief or restructuring may be considered a structural weakness, potentially leading to adverse rating consequences.

There are documented cases consistent with these dynamics. Jamaica, for example, saw Fitch affirm its sovereign rating at 'BB-' with a positive outlook in February 2025, explicitly citing "significant progress with debt reduction, sound fiscal framework and strong commitment to deliver large primary surpluses" (Fitch, 2025b). This action underscores how debt/GDP metrics and fiscal discipline are systematically rewarded by CRAs. At the same time, the predominance of fiscal austerity stands in sharp contrast to Jamaica's acute vulnerability in the context of the climate emergency. The country is among the most climate-vulnerable in the world, and the UNDP (2025) recommends that policymakers in Jamaica adopt a growth model that accelerates the transition to renewable energy, green industries and technologies, climate resilience, and climate-smart agriculture and tourism. While international support is an important component of this process, it is highly unlikely that such structural transformations in Jamaica's economy could occur without an active role for the state through a public investment agenda and strengthened state capacities – measures that would undermine the debt metrics valued by CRAs in their assessments.

The controversies surrounding CRA reactions to debt-for-nature swaps further illustrate the obstacles they pose to debt restructuring mechanisms tailored to the climate emergency. Debt-for-nature swaps are financial operations that allow developing countries to reduce their debt burdens in exchange for implementing environmental conservation and restoration measures, and they have been increasingly promoted as tools to simultaneously address the debt and climate crises affecting the Global South (Colodenco et al., 2025). However, CRA responses to such arrangements have raised concerns in the literature (Cash, 2024). There are documented cases of rating actions following debt-for-nature swaps – including downgrades – and, more recently, Colombia abandoned plans to pursue such a swap precisely due to fears of negative reactions from CRAs (Bloomberg, 2025).

This fear is justified because CRAs hold the power to decide what does or does not constitute a default—and, in doing so, to unleash the severe consequences of such a designation on a given country. This was evident, for instance, in the conflict between the Argentine government and the holdouts, also known as vulture funds, in 2012. In that context, when a New York district court judge ruled in favor of the vulture funds, the country was prevented from servicing its debt until payments to the holdouts were normalized (Guzmán, 2016). As Stiglitz and Guzmán (2014) noted, "it was the first time in history that a country was willing and able to pay its creditors, but was blocked by a judge from doing so." From the perspective of the CRAs, the dispute created an unprecedented situation: the Argentine government continued servicing its debt in line with the restructuring agreements reached with the majority of creditors in 2005 and 2010; however, these creditors were unable to access payments due to the banking block imposed by the judicial ruling. Faced with this scenario, the CRAs chose to rate Argentina as in default – a controversial decision, not foreseen in their methodologies, with severe economic and political repercussions for the country (Machado, 2025b).

In sum, CRA approaches to sovereign debt create a financial lock for Global South states. By fetishizing the debt/GDP metric and stigmatizing restructuring or non-orthodox fiscal maneuvers, rating methodologies may inhibit the creation of the necessary fiscal space to address the climate crisis. These practices reinforce a cycle in which short-term creditor interests prevail over long-term resilience, leaving vulnerable economies trapped between servicing debt and investing in survival. Unless rating methodologies evolve to differentiate between destabilizing fiscal laxity and strategic climate-oriented investment, they risk becoming structural obstacles to a just transition.

5. The Crossroads of Rating: What to Do?

In light of the obstacles that CRAs impose on the adoption of reformist policies necessary to confront the climate emergency and enable a just transition, both academic literature and international forums have advanced proposals targeting the rating sector. These suggestions can be grouped into two broad strands: on the one hand, pressures for methodological reforms in sovereign ratings to better align criteria with sustainability goals; on the other, initiatives to create new credit rating agencies capable of democratizing the sector and adopting climate-aligned methodologies. Yet a crucial question remains: how feasible are these measures in practice, and how effective could they actually be?

Proposals for methodological reform directly address several of the conflicts identified in the previous section. Scholars and international institutions, for example, have called for the creation of parallel rating systems with an extended time horizon that reflects the long-term nature of the climate crisis, or for the introduction of metrics that reward sovereigns investing in resilience and adaptation (UN, 2022; IIED, 2024; Capiello et al., 2025). There are already marginal signs that external pressure has produced some adjustments: in recent years, CRAs have begun to explicitly disclose how climate risks are incorporated into sovereign risk assessments and to publish ESG appendices in rating reports.

Yet, as in the post-subprime context (Sinclair, 2021), these adjustments have largely reframed sustainability within the confines of existing models, without altering the structural logics of fiscal orthodoxy and investor primacy. Given the historical trajectory of CRAs – born from the internal demands of U.S. capital markets in the early twentieth century and globalized through the financial liberalization of subsequent decades – it is unlikely that external demands driven by climate objectives will fundamentally reshape methodologies in the absence of investor-led pressure. In short, unless investors themselves begin to view long-term resilience as a core component of creditworthiness, structural reform of CRA methodologies remains improbable – and would, in fact, contradict the very purpose for which these agencies exist.

Alternative proposals advocate the creation of new CRAs. A recent example is the proposal for a public CRA under the auspices of the United Nations, explicitly mandated to advance climate objectives (Vasudevan, 2024). Yet historical experience tempers optimism: the abandoned plan for a BRICS rating agency (Helleiner & Wang, 2018), the high costs and uncertain effectiveness of proposals for a European agency during the eurozone crisis (Kruck, 2016), and the failure of China's Dagong and other challengers (Bush, 2021) illustrate the difficulty of breaking the Big Three's oligopoly. Although dozens of smaller CRAs operate globally, very few are taken seriously by international investors, whose trust remains deeply rooted in the century-long authority of S&P, Moody's, and Fitch. This structural entrenchment explains why new initiatives often struggle to gain traction. Still, dissatisfaction with the Big Three continues to fuel new attempts – such as the recently launched African Credit Rating Agency (UNCTAD, 2025; Cash & Khan, 2024), which seeks to reduce bias against African sovereigns and provide an alternative evaluative perspective.

The limitations of both approaches – methodological reform and the creation of new CRAs – point to a deeper challenge: making reformist climate policies viable ultimately requires a broader transformation of the global financial architecture. This would entail rebalancing the asymmetrical relationship between financial markets and sovereign states and curbing the structural power of CRAs – and of financial markets more broadly – that was politically constructed during the unravelling of the Bretton Woods system (Helleiner, 1994; Strange, 1996). Only a comparable political process could realign global finance so that it does not undermine, and ideally supports, reformist climate strategies.

Such a transformation is complex and politically unlikely until the climate crisis reaches an even more acute stage – one that triggers a deeper systemic rupture and a corresponding shift in political power correlations. In the meantime, more pragmatic regulatory measures could at least mitigate CRA biases. Regulators such as the SEC and ESMA could, for instance, require that sovereign rating methodologies extend the logic of CRDCs to prevent downgrades following extreme climate events, regardless of whether such clauses are contractually agreed upon with state creditors. Likewise, as suggested by Capiello et al. (2025), sovereigns that invest more heavily in climate adaptation could be systematically rewarded within rating criteria. This could be pursued, for example, through the inclusion of mission-oriented climate experts in rating committees to advise on final sovereign rating decisions – similar to the proposal by Ilango and Cash (2023) to improve credit analysis.

In sum, neither methodological reforms nor the creation of new CRAs seem capable, on their own, of resolving the structural contradictions of sovereign ratings in the era of climate crisis. Yet these debates underscore a growing recognition that the entrenched logics of CRAs must be challenged. Without regulatory innovation and, ultimately, a rethinking of the global financial order, the rating sector will continue to reproduce a narrow conception of creditworthiness – one that obstructs the urgent imperatives of a just climate transition.

6. Concluding remarks

This article has analysed how the sovereign rating methodologies of the Big Three CRAs relate to the imperatives of the climate crisis, and what this reveals about their role in the transition to a low-carbon economy. The analysis demonstrates that this relationship is fundamentally contradictory and, for countries in the Global South, likely to be deeply damaging. Far from acting as neutral facilitators of the transition, S&P, Moody's and Fitch function as gatekeepers of a narrow and restrictive pathway for climate action, aligned with the principles of the Wall Street Consensus.

The argument unfolded along two interconnected axes. First, the incorporation of climate factors into methodologies, by translating them into financial risk language and filtering their materiality through traditional credit categories, constrains states' policy space. This creates a double pressure: it demands that countries act on climate risks, while signaling that the only credit-positive action is one that conforms to market-liberal approaches. Second, and more broadly, the conventional methodological logic of CRAs

– with its bias toward fiscal austerity, aversion to state "interventionism," and fetishization of aggregate debt metrics – systematically penalises reformist climate strategies often advocated in the specialised literature and by international organisations.

These findings mean that the sovereign rating methodologies of the Big Three constitute a structural obstacle to achieving global climate goals, particularly in the Global South. By fiscally and ideologically penalising the strengthening of the investing and regulating state, they deepen the climate financing gap under an inverted logic of justice: the countries that contributed least to the crisis and most need state capacity are precisely those whose policy space is most constrained by the pursuit of creditworthiness.

The article makes three main contributions. For the literature, it advances the political economy of green finance by uncovering the mechanisms through which a key private financial actor – the CRAs – governs and constrains the trajectory of the transition, moving beyond analyses focused solely on rating outcomes. For policymakers and regulators, the implications are direct: international pressure for CRAs to "integrate climate" is naïve if not accompanied by a deeper interrogation of the structural biases embedded in their methodologies. Regulators such as the SEC and ESMA, and forums such as the G20 and UNFCCC, should focus on how to demand transparency and methodological reform that stops treating resilient investment as a liability and strategic state action as a risk.

Importantly, the analysis also underscores what is at stake in current reform debates. Proposals for alternative rating systems, the introduction of resilience-oriented metrics, or the inclusion of climate-resilient debt clauses represent attempts to move beyond the short-termism and biases embedded in current methodologies, in favor of climate goals. Yet these initiatives remain fragmented, and their adoption and effectiveness appear unlikely given the entrenched power of the Big Three. Future research should therefore examine how such proposals are negotiated, resisted, or co-opted. Moreover, further studies should dig deeper into the mechanisms through which CRAs constrain the adoption of climate policies in Global South countries, as other dimensions emerging from the dynamics explored in this article remain to be fully understood.

Ultimately, the climate debt crisis will not be resolved within the parameters of the current financial architecture, of which CRAs are central pillars. A truly just transition will require not only new instruments but also a rebalancing of power between private creditors and sovereign states – placing resilience, equity, and long-term survival at the core of financial governance.

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