Opinion | Liam Denning & Mark Gongloff, Columnists

A Crisis Is Brewing in the Business of Paying for Catastrophes

Rising insurance premiums are the market's way of saying there's danger ahead.

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When disaster strikes. *Photographer: Patrick T. Fallon/AFP*

President Donald Trump's election owed much to the pervasive sense of a cost-of-living crisis. But there lurks another threat to US prosperity that is much harder to address. Call it a cost-of-crisis crisis.

Insurance is capitalism's way of shielding us from the gods. It only works if we don't shield ourselves from insurance itself. Wildfires in Los Angeles have put a spotlight on how regulations to prevent premiums from pricing people out of neighborhoods can tip into pricing them into risks that prove to be financially devastating. This branch of illusory capitalism extends beyond

homes to other bedrock economic sectors, such as energy and transportation, as well as a bedrock risk, climate change. The result is a growing set of underpriced and nebulous contingent liabilities ready to open up like a sinkhole under everything from house prices to power supply when disaster strikes.

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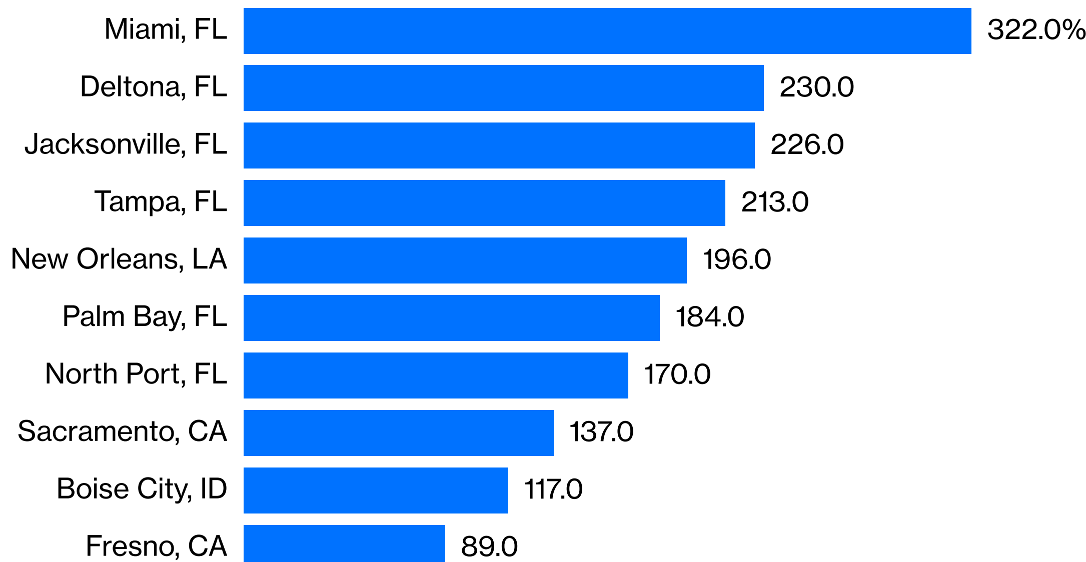
NOT Paying Enough!

Nowhere is the disconnect between risk and price clearer than in property insurance. Homeowners across the country aren't paying nearly enough to meet the threat of more frequent and intense natural disasters. Dave Burt, an investor who spotted the subprime mortgage crisis, estimates the hidden potential damage from wildfires and floods to underinsured US housing at $1.7 trillion to $2.7 trillion. Similarly, First Street, a research firm, estimates that factoring in climate risk will lead 70,000 US neighborhoods to suffer falling property values at some point over the next 30 years. Matching that heightened risk would raise the average insurance premium by 29%, with some locales requiring far more.

A Chaotic Climate Is an Expensive Climate

Damages from wildfires, hurricane wind and hail alone will drive up home-insurance premiums in the riskiest US cities in the decades ahead



Source: First Street
Note: Ranking includes aggregated US metropolitan statistical areas with 500,000 or more residents in 2024
Does not include flood insurance premiums.

California has long been a poster child for underpriced risk thanks to Proposition 103, which sharply limits insurers' ability to raise premiums. Meant to protect consumers, it instead led many insurers to abandon the state. As a result, the number of homeowners using the state-organized insurer of last resort, California's FAIR Plan, has more than doubled since 2020 to more than 450,000 despite supposedly being a temporary solution for those who can't obtain private insurance. These policies are bare-bones and, even then, FAIR doesn't have nearly enough assets or reinsurance to cover anything close to its $458 billion in total loss exposure. Only very recently has the state's insurance commissioner, Ricardo Lara, tried to lure insurers back with more leeway to raise premiums. But his response to Los Angeles' disaster, a yearlong moratorium on insurers leaving fire-affected ZIP codes, pushes in the other direction. And it's unclear whether an emergency request by State Farm General, the state's biggest home insurer, to raise rates by 22% will be approved.

This is far from just a California problem. Though Florida and Louisiana have some of the country's highest premiums, vast swaths of both states are still underinsured relative to the risk of increasingly punishing tropical storms and rising sea levels. Florida's state-run Citizens Property Insurance Corp., with thin coverage like FAIR's, nearly tripled its number of policyholders

between 2018 and 2024 and ranks as the state's top insurer. Meanwhile, homeowners who switch to private providers will have their premium increases capped at 20% by state law.

This also isn't just a homeowners' problem. Los Angeles' devastation extends to California's wildfire fund, set up in 2019 as a reinsurance pool for utilities accused of sparking blazes. While a state commission originally suggested $40 billion as an appropriate capacity, the fund was ultimately sized at only about half that. The latest estimate of economic losses from the Los Angeles fires ranges up to $164 billion, and while nowhere near all of that would fall to the fund, this urban firestorm may well overwhelm it nonetheless. That is the message encoded in plunging share prices for California utilities whose credit ratings depend on that fund's health.

Across the country, in Pennsylvania, utility insurance of another kind is sparking controversy. Governor Josh Shapiro recently pressured PJM Interconnect, the grid operator for his state and several others, to agree to a reduced price cap on so-called capacity auctions where plants are paid simply to be available to meet peak demand. These payments, which are borne by ratepayers, encourage generators to build more capacity – or, put another way, provide insurance against blackouts. Amid a sudden increase in projected power demand, predicated in part on new data centers, an auction last summer delivered a shockingly high price, with further jumps expected. The new cap would save consumers about $21 billion, Shapiro proclaimed, though the logic of lowering the cap just as we need higher prices to incentivize new plants seems nonintuitive. New capacity will still have to be paid for and, notably, the chair of the state Senate's energy committee plans legislation to provide low-interest loans and grants to build new power plants, similar to an existing scheme in Texas.

Politicians of all stripes are scared by rising prices. In New York, regulators scrapped plans to strengthen requirements for insurance covering taxi and ride-sharing drivers, proposed because the dominant provider, American Transit Insurance Co., became insolvent after years of writing underpriced policies. Uber Technologies Inc. had warned the new rule, which specified using a "solvent and responsible" insurer, risked pricing thousands of drivers out of the market.

A common theme here is obscuring the true cost of the risks people take. Perhaps nothing illustrates this political imperative, and its innate fallacy, better than the issue of climate change and the greenhouse gas emissions propelling it. The most efficient economic tool for addressing such an externality, a carbon tax, remains a political third rail outside of some regional efforts. Does ignoring or suppressing that cost make energy "affordable?" In a shallow, short-term sense, perhaps. The same way "competitive" insurance premiums on homes, power grids and taxi drivers are nice and affordable right up until a fire, blackout or accident demand they deliver.

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It is, of course, inherently difficult to adjust the underlying economic compact supporting infrastructure and behaviors built up over decades. The modest household that has existed for generations in a neighborhood now becoming more of a tinderbox or flood plain requires society's assistance with this transition. If that sounds too expensive or not-your-problem, you're missing the creeping socialization of all this that is happening anyway.

Caps on insurance premiums force insurers out, as well as deter the reinsurers behind them, and push more homeowners into state-backed or bare-bones systems. If FAIR fails, for example, unmet obligations would then be passed onto California's private insurers and, thereby, the broad mass of policyholders, whether they live next to or a hundred miles away from a fire zone (it would also give private insurers even more reason to jack up rates or withdraw). Flood insurance is already explicitly dependent on federal support. The same goes for taxpayer-backed loans for gas plants, as Pennsylvania seems to be contemplating. And also for the cost of shoring up critical public infrastructure such as railroads or seawalls against disaster; efforts grouped under the studiedly innocuous term of "adaptation." The added twist here is that, if the cost of trying to prevent climate change is

deemed unaffordable, the cost of remaking cities to live with it hardly looks cheaper.

Unfortunately, incentives favor masking, rather than facing, the reality of these risks until it's too late. In general, people like to, or sometimes have to, live on flood-prone shorelines and in fire-prone woodlands. We bridle at domestic energy prices that other advanced economies, especially in Europe, envy. Supporting house prices, on which a cat's cradle of economic sinews ranging from personal wealth to local taxation to banking stability rest, is a national project that preempts our professed free-market principles when those principles deliver negative outcomes. As Susan Crawford, a senior fellow in the Sustainability, Climate, and Geopolitics Program at the Carnegie Endowment for International Peace has said: "Every part of our financial and legal system at this point is devoted, singularly devoted, to keeping the status quo in place." In doing so, it ensures that change, when it inevitably intrudes, will be brutal.

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(Updates first chart. Firm name in the third paragraph was corrected in a previous version.)

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