GOT THE MESSAGE?

AS THE EFFECTS OF CLIMATE CHANGE TAKE HOLD, UNDUE INFLUENCES IN THE FREE MARKET ARE STILL TRYING TO OBSCURE THE CASE FOR ESG INVESTING

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New year, new start. It's time to put aside the festive feeling to talk instead about raw, unadulterated capitalism and ESG.

Most of you will recognize the familiar objection to ESG investing – that focusing on the environment and human dignity is at odds with making money. There is ample blame to go around when it comes to the question of why that perception exists, but it's actually very difficult to point the finger at the realities of allocating capital, managing risk and operating businesses.

Practitioners in the ESG space deserve a share of the blame here, whether they are focusing too much on their mission and not enough on the fundamental investment thesis, or perhaps trying to put distance between their mission-driven motivations and the practicalities of 'real investing.' However, there are other forces at work too.

The truth is that capitalism has been one of the greatest engines in history for promoting the greater good of humanity. Despite the many problems that the world still faces, capitalism has lifted billions of people out of poverty and opened up access to education, nutrition, healthcare and technology. Human prosperity is good for capitalism, and capitalism is good for human prosperity. So why are we still hearing that investing responsibly is somehow at odds with progress and prosperity?

Well, when you look at it on a global level and over the arc of history, what is good for the prosperity of the few is not always good for the prosperity of the many. This is not a socialist argument. This is simply to say that having more stakeholders in a market-based system makes for more innovation, more productivity, more access – and just plain *more* for everyone, including those perched at the top of the economic ladder.

COUNTING THE COST

What has got us into trouble is our failure to separate politics from profit. Nowhere has this been more evident than in the discussion of climate change. Short-termism and the interests of the powerful few are driving a wedge between policy and what's best for the people. The challenges of climate change are being quantified by the scientific community and should then be priced by the free market, but the crucial message is not getting through.

The Intergovernmental Panel on Climate Change is a body that was created by the United Nations to 'provide policymakers with regular scientific assessments on climate change, its implications and potential future risks, as well as put forward adaptation and mitigation options.' In October 2018, the organization released a study summarizing the 'available scientific, technical and socio-economic literature relevant to global warming.' The following month, the fourth US National Climate Assessment was released, which claimed to 'assess the science of climate change and its impacts across the US, now and throughout this century.'

Regrettably, there were no big surprises in those two reports. Man-made climate change is real, it is material and it is the byproduct of population growth, industrialization and economic progress. The counterargument is a red herring largely grounded in discounting the science entirely; a ploy used by politicians and certain businesses alike. Curiously, these are businesses that rely heavily on the work of scientists to facilitate their businesses. For example, the oil industry relies upon geophysicists, engineers, astrophysicists, oceanographers, paleontologists, chemists and others to find, extract, refine and deliver petroleum and petroleum products, but that doesn't seem to stop it freely disregarding these scientists when it comes to the topic of climate change.

EFFICIENCY WINS THE DAY

In a truly sustainable form of capitalism, systems-level thinking would be able to assess all the variables, ultimately finding the right balance between taking action to halt climate change and meeting the ongoing demands of human consumption. This model would facilitate a marketplace of problems, needs and opportunities, which could then be addressed through access to capital. Failing to acknowledge climate science in this free market would equate to interfering with asset pricing and the quantification of risk.

The effects of our collective failure in this regard are already observable, from the destruction of the power grid in Puerto Rico to cities on the West Coast being reduced to ashes, and from flooding in Houston to populations in Africa fleeing drought, starvation and conflict. The burden falls overwhelmingly on the backs of the un-moneyed, who lack a presence in the capital markets. But the burden also weighs on the prosperous. Thousands of coastal and mountain homes in the US were destroyed by storms and wildfires in 2018 alone.

Acknowledging the systems-level challenges of climate change and allowing them to affect the free market would drive capital allocation and foster mitigation, innovation and adaptation. The market is good at pricing quantifiable risk. Sure, the cost of insurance would rise, the value of at-risk assets would shrink and the return on invested capital would be impaired. But before long – if it's not already the case – it will be more capital efficient to address the root causes of climate change than to discount the capital destruction caused by it. A functional marketplace, incorporating good science and all the available environmental, social and governance data to price assets, is capitalism at its best – unfettered and efficient. ■