Why the coming months are critical to a decisive green transition

by Stefan Hofrichter | 28/07/2020

Summary

As the world battles the Covid-19 pandemic, responsible investors can help make the economic recovery sustainable and inclusive by engaging with the right stakeholders. A PRI working group has developed recommendations for a policy-engagement framework to help guide the investment community's actions. Here are highlights of the group's findings.

Key takeaways

- Sustainability objectives can be built into the financial stimulus and policy mechanisms that support the recovery from the downturn triggered by Covid-19
- The coming months are critical to a decisive green transition, and research shows that many stimulus measures aimed at decarbonisation have high job creation potential and economic multipliers
- Companies, investors, policymakers and other stakeholders must focus on social issues and human rights to build a fairer, more inclusive economy
- Corporations should examine the role they play in promoting sustainability – and recipients of stimulus funds will need to demonstrate how they will create value for a range of stakeholders
- To address the Covid-19 crisis effectively, investors have a clear role to play – but it's also incumbent on the investment industry to act responsibly and encourage policy change

While the Covid-19 pandemic has put many aspects of our economy and lives on hold, it has not changed the need to build a more sustainable world. From fighting climate change to addressing social inequality to improving corporate governance, the list of pressing issues is long. Fortunately, there are many ways to build sustainability objectives into the financial stimulus and policy mechanisms that support the recovery.

The coming months are critical to a decisive green transition

The climate emergency continues to be one of the most pressing issues facing our world today. Policymakers should seize the opportunities created by shifts in markets and behaviours to accelerate change, focusing where possible on areas in which the Covid-19 recovery and decarbonisation priorities are most closely aligned. A May 2020 paper from the Smith School of Enterprise and the Environment at the University of Oxford underscores the urgency. The authors concluded that "progress on climate change will depend significantly on policy choices in the coming six months", arguing that "the right choices could drive a long-term downward trend in greenhouse gas emissions".

To create a decisive green transition, governments must target their stimulus spending while helping to shape markets that deliver for people and the planet. Fortunately, many governments – including those in Canada, Germany, France and South Korea – have already signalled that they intend to pursue that direction of travel. The European Union has published ambitious proposals for a recovery plan to build "a more sustainable, resilient and fairer Europe". Global leaders have recognised that the UN Sustainable Development Goals (SDGs) can support global responses that "leave no one behind", and there is a growing consensus around the need to mobilise significant private capital to deliver on these ambitions. This creates opportunities for investors.

Research shows that many stimulus measures aimed at decarbonisation have high job creation potential and economic multipliers. This adds to the case for sustainable investment – which has grown stronger over time:

- Sustainable innovations in areas such as low-carbon infrastructure have achieved great success over the past decade, showing how green stimulus can deliver growth and jobs alongside decarbonisation.
- Vital technologies (such as renewable energy generation) have become cost-competitive globally, and others (such as electric vehicles) may be ready to enter the mainstream, given the right infrastructure and incentives.
- During the pandemic, sustainable investments have performed relatively well, and many low-carbon sectors continue to have more growth potential than high-carbon incumbents.

Now is the time to reconsider "social" outcomes

The Covid-19 pandemic has had an outsize impact on the world's poorest citizens and highlighted the poverty and vulnerability experienced by millions of people, for whom decades of economic growth and development have failed to deliver prosperity and security. This is prompting more investors to focus on social issues and human rights, bringing much-needed attention to the "S" in ESG (environmental, social and governance).

To help these efforts, the investment industry must improve the methodology and data for incorporating social outcomes into investment strategies, the allocation of assets and overall stewardship. Corporations must also do their part, and many are leading the way in defining their social purpose and impact. International human rights standards have also been sharpened, offering companies, investors, policymakers and other stakeholders a framework on which to build a fairer, more inclusive and resilient economy.

Expect more scrutiny of corporate purpose and value

The pandemic has sparked renewed scrutiny of corporate purpose and the role that the responsible investment industry can play in shifting businesses towards sustainable development objectives. Companies will be expected to take a responsible approach towards capital allocation decisions – particularly on the issue of executive pay. Stakeholders increasingly expect pay to be tied to performance, which should include the impact on employees, suppliers and communities. And recipients of bailouts or stimulus funds will need to demonstrate even more clearly how funds will be used to create value for a range of stakeholders.

Successful implementation also takes clear fiscal and monetary policies

As governments respond to the crisis affecting their citizens, they need to incorporate sustainability objectives into the financial stimulus and policy mechanisms that support the recovery. So far, we have seen fiscal stimulus and monetary policy that are reminiscent of wartime in their scale and scope. While these measures have been appropriate, given the urgent need to kick-start the economy, a credible exit strategy is needed on multiple fronts:

- An extended period of low capital costs – for both debt and equity – could trigger excessive risk-taking and a misallocation of resources, potentially fuelling another asset bubble.
- If ultra-easy monetary policy supports risky assets for longer, whether via a low discount rate or through the "socialisation" of investment risks (as central banks buy up private-sector assets), wealth inequality could increase further.
- Governments are rescuing private-sector firms by taking equity stakes and providing liquidity – an inevitable consequence of crisis – but they need to find a way of exiting from this fiscal support in the medium term. Governments are unlikely to be better entrepreneurs than the business owners themselves.

The world needs urgent action and cooperation on many fronts

To address the Covid-19 crisis effectively, governments, investors, asset managers and other stakeholders must work together to design policies that are transparent, effective and aligned with sustainability goals – while securing funding that can accelerate solutions.

Investors have a clear role to play, but it's also incumbent on the investment industry to act responsibly and encourage policy change. As an active and responsible asset manager, we owe it to our clients and beneficiaries to support a recovery that is sustainable and inclusive – and delivers concrete reforms. We are confident that our colleagues in the investment industry will do the same as we address today's global challenges together.

Stefan Hofrichter participated in interviews with the PRI (Principles for Responsible Investment) on behalf of Allianz Global Investors to provide input into this report.

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Stefan Hofrichter is AllianzGI's Global Economist and Head of Macro Research since 2011. Stefan and his team are responsible for advising clients, in-house professionals and sales colleagues on global economic trends and asset allocation.

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