

COLLECTED ESSAYS

# ESG: MYTHS and REALITIES



ESG Is Mainly Top-Down Planning by Elites

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## ESG Is Mainly Top-Down Planning by Elites

Matthew Lau

Since Milton Friedman’s famous 1970 *New York Times* essay (Friedman, 1970, September 13), the doctrine of corporate social responsibility (CSR) has undergone significant evolution and rebranding. Today, the more common acronym is not CSR, but ESG, which stands for environmental, social, and governance. Environmental and governance responsibilities are not much of an addition: environmental concerns are a subset of social concerns, and whatever the purpose of a corporation, it will not succeed if poorly governed (and poorly managed).



Where ESG differs from CSR is that it is more expansive; it is meant to be applied not only to corporate behaviour, but also to individual and investor behaviour. Even more expansive than ESG is the doctrine of “stakeholder capitalism,” which holds that the purpose of business is to serve the interests of “society,” since everyone in society is said to have a stake in business activity. Arguably, stakeholder “capitalism” is therefore more socialist than capitalist: if business assets must be used for social purposes, then they essentially belong to society.

Whether it is called ESG or by another name, one constant is that this doctrine has been and continues to be mainly a top-down initiative of certain elites, not the result of widespread bottom-up demand from individual investors, consumers, and workers. Much of the ESG charge is led by governments and elite non-governmental organizations like the World Economic Forum. In the business community, ESG is most popular among politically powerful industry and professional associations. Conversely, most individual investors, as authors of a recent study published

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in the *Financial Analysts Journal* concluded, “are motivated by financial considerations, not other factors” (Serafeim and Yoon, 2022).

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Thus, ESG is often about politicians and bureaucrats indirectly influencing or even controlling the use of other people’s money through the regulatory state, as opposed to individuals themselves deciding what to do with their own money. As Friedman observed, “it’s always so attractive to be able to do good at somebody else’s expense” (Friedman, 1999, February 10). Friedman was talking here about government spending, but the principle is the same. The business person pursuing social responsibility, as Friedman wrote in his *New York Times* essay,

“is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds.”

Whether in the case of corporations pursuing social objectives or governments administering uneconomic programs, Person A spends Person B’s money to achieve Person A’s social objectives. This arrangement is clearly attractive to those in the position of Person A (notably elites in powerful positions), and unattractive to those in the position of Person B (most individual investors, consumers, and workers).

## Governments and the World Economic Forum



The international organization that best embodies the top-down drive for stakeholder capitalism and ESG is the World Economic Forum (WEF). Founded by German engineer and economist Klaus Schwab in 1971, the WEF is a non-governmental organization best known for hosting a conference in Davos, Switzerland each year. It is widely attended by several thousand of the world’s top leaders from the political realm, the business community, and non-governmental organizations. Schwab and the WEF are committed to replacing Friedman’s economic model with stakeholder capitalism, insisting that free markets

and competition may have created prosperity in the past, but today, according to Schwab, are “now creating inequality and climate change” (Schwab, 2020, October 21).

Speaking at the WEF’s “Jobs Reset Summit” in 2021, Schwab said that “we in the business world” now see that companies not “committed to ESG metrics, to stakeholder capitalism” are

“on the wrong side of history” (Schwab, 2021, June 2). Schwab and co-author Peter Vanham write that the centre of business activity must be, under their stakeholder capitalism model, “the well-being of all people and the planet as a whole” (2021, January 22). But again, if private business assets must be used to serve the well-being of society, as in the WEF’s vision, then those assets essentially belong to society—and that is a form of socialism, particularly as it has evolved away from the direct ownership of capital to the regulation and control of capital without ownership.

Along with the WEF, central banks and financial regulatory authorities are also among the main drivers of stakeholder capitalism and ESG. Mark Carney, the UN Special Envoy for Climate Action and Finance, who was governor of the Bank of Canada from 2008 to 2013 and governor of the Bank of England from 2013 to 2020, is a member of the WEF’s board of trustees; so too is Christine Lagarde, president of the European Central Bank (World Economic Forum, Undated). Both the Bank of Canada and European Central Bank are today involved in trying to steer private capital



towards achieving environmental goals. The European Central Bank in particular is pushing for policies that make it more difficult for investment funds to flow to disfavoured industries such as oil and gas (Cochrane, 2020, November 13), and it along with the Bank of Canada are members of something called the Network for Greening the Financial System (NGFS).

The network, established in 2017, is a collection of 114 central bank officials and financial regulators around the world (NGFS, Undated a). Its purpose is to strengthen “the global response required to meet the goals of the Paris agreement and to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development” (NGFS, Undated b). In other words, the stated purpose of the network is to have unelected central banks and regulatory authorities re-organize economies by influencing the flow of investment capital from certain industries and redirecting the capital to favoured “green” industries.

In the United States, the ESG movement’s regulatory charge is spearheaded by the Biden administration’s Securities and Exchange Commission (SEC), which has made ESG disclosures a central focus (Globerman, 2022, February 14). Earlier this year, the SEC, which is staffed by appointed officials, voted to propose rules that would force public companies to make climate change disclosures. The SEC already mandates disclosures of financially material information, so the new proposal is meant to cover environmental and social concerns, not financial ones. As legal scholar Richard Epstein describes it, the SEC’s “tedious 506-page proposal for mandated disclosures relating to climate change will expose every major corporation in the United States to unending administrative meddling” (Epstein, 2022, March 29).

The merits of such policies are beyond the scope of this essay; however, it is clear that these changes are being made from the top down, largely by unelected regulators. Moreover, it is also clear that these regulations have to do with environmental and social, not financial concerns, and so are largely outside the formal mandates of central banks and financial regulators. Such agencies are simply not well positioned to set climate policy: first, it is outside

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their area of expertise; second, pursuing collateral objectives will detract from their ability to fulfill their core financial mandates such as controlling inflation; and third, to the extent that governments should deal with climate change, the responsibility should fall to elected legislators instead of bureaucratic officials.

Nevertheless, central banks and financial regulators have generally managed to elbow their way into the climate policy space by claiming climate change poses

significant risks to the financial system and to the economy in general. This is despite the fact that mainstream estimates find only modest economic costs from climate change, including over long time horizons (Levine, 2022). Two examples: the Intergovernmental Panel on Climate Change’s 2018 special report on global warming of 1.5°C (SR15) found that “under the no-policy baseline scenario, temperature rises by 3.66°C by 2100, resulting in a global gross domestic product (GDP) loss of 2.6%” (IPCC, 2018); in a study by economics Nobel laureate William Nordhaus in the same year, his baseline scenario had climate change cutting global output by only around 3 or 4 percent, again, by the year 2100 (Nordhaus, 2018).

In addition to ESG being imposed on businesses by central banks and financial regulators, pension plans—especially public sector pension plans—are imposing ESG goals on individual investors. Some of this is due to political pressure or regulations. In the UK, trillions of pounds in pension funds are being forced into “socially responsible” investments, with the British Conservative government’s pensions minister saying that “we have put climate risk at the heart of pension decision-making” (Stuttaford, 2021, August 3). In Canada, the Canada Pension Plan Investment Board (CPPIB) is leveraging its more than \$550 billion in assets—which it is supposed to invest to achieve the best risk-adjusted return for Canadian workers required to pay into it—to browbeat corporations into adopting climate objectives. The CPPIB declares it is contributing to “global standard-setting that fosters economy-wide GHG emissions reductions and company-specific closures on the path to net zero.” It is proposing “market adoption of a reporting framework that will direct companies to project their capacity to abate greenhouse gas (GHG) emissions,” and plans to “publicly advocate for organizations to align their reporting with the Task Force on Climate-related Financial Disclosures (TCFD).” Moreover, it will leverage its equity positions in companies to achieve its goal of “focusing boards on climate change” (CPP Investments, 2022). This is an example

of senior managers at the CPP Investment Board using other people's money to advance their own ideas of the social good—in this case, fighting climate change.

### The business community

In common with many governmental authorities and public pension funds, much of the business community has also been captured or at least strongly influenced by the ESG movement. ESG, as previously stated, is most popular in elite circles. The most prominent American example of the business community's embrace of ESG is the Business Roundtable Statement on the Purpose of a Corporation in 2019, signed by 181 CEOs of large American corporations (Business Roundtable, 2019, August 19). Signatories of the Business Roundtable's statement committed to delivering value to customers, investing in employees, dealing fairly and ethically with suppliers, supporting communities, and generating long-term value for shareholders.



Many of these things are in fact consistent with Friedman's doctrine that the social responsibility of business is to increase its profits. A corporation that does not deliver value to its customers or treat its employees and suppliers fairly will not be profitable in the long run. Some activities towards these ends might be labelled as ESG or "social responsibility" activities even if undertaken to achieve profits. Friedman called this window-dressing. He objected to it because, by promoting the idea that business is obligated to pursue social objectives separate from seeking profits, it "harms the foundations of a free society." However, he also noted this was different from actually eschewing the shareholders' interests to pursue those other objectives.

Where the Business Roundtable Statement went wrong was in going further to redefine the purpose of a corporation to promote "an economy that serves all Americans," and to move "away from shareholder primacy" to include a "commitment to all stakeholders." Said one signatory of the statement: "CEOs work to generate profits and return value to shareholders, but the best-run companies do more. They put the customer first and invest in their employees and communities. In the end, it's the most promising way to build long-term value." The obvious implication of this statement is that value to the public at large is in conflict with and should be prioritized over value for shareholders.

An important mitigating factor in the advancement of CSR, ESG, and stakeholder capitalism among the US Business Roundtable and others in the business community is that preaching these doctrines is not the same as practicing them. An analysis by a pair of Harvard researchers found that the vast majority of CEOs who signed the Business Roundtable Statement did

not consult their boards of directors before doing so, suggesting that signing the statement was just for show (Bebchuk and Tallarita, 2020, August 6). Of the signatory companies that updated their corporate governance guidelines, most did not add language to elevate the status of stakeholders and generally “reaffirmed governance principles supporting shareholder primacy” (Bebchuk and Tallarita, 2021, August 18).

In Canada, the private sector’s ESG charge is embodied best by the Coalition for a Better Future, a collection of over 130 of the country’s most powerful business and industry associations, think tanks, and community organizations. Since its inception in 2021, the organization has called for “a bold vision and a commitment from business, government, and others to work together” to build a “more inclusive, sustainable, and prosperous Canada” (Coalition for a Better Future, 2021, August 5). It wants, in other words, a consolidation of business and governmental objectives and powers to achieve environmental and social goals. “Capitalism as we’ve known it,” former cabinet minister Anne McLellan, one of the coalition’s co-chairs, said in a recent interview, “it’s not going to work any longer.” The way forward, she said, is to embrace “stakeholder capitalism” (McLellan and Raitt, 2022, January 20).

In terms of its elite membership and ideological orientation favouring stakeholder capitalism and greater government economic intervention, the Coalition for a Better Future is something like a domestic version of the World Economic Forum. Like the WEF, it also holds

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periodic summits. One of the main speakers at its 2021 Ottawa summit was Carolyn Wilkins, a member of the coalition’s advisory council and formerly the senior deputy governor of the Bank of Canada. She is also, as the coalition advertised, a member of the G7 panel on economic resilience appointed by and reporting directly to G7 leaders, and a co-author of the panel’s “Cornwall Consensus” report. That report, premised on a supposed consensus on the failure of free

markets, claims the Paris Accord is insufficient to avert climate catastrophe, advocates global minimum taxation, and pushes business to adopt ESG goals, among other interventionist policies (G7 Panel on Economic Resilience, 2021). The theme emerges again: trying to do social good at other people’s expense.

### Concluding remarks

When it comes to business activity, individual investors—the people who actually own the businesses—are mainly concerned about financial performance, not environmental or social issues. There is nothing wrong with that: the business person who pursues his or her self-interest “frequently promotes that of the society more effectually than when he really intends to promote it,” as Adam Smith famously observed, but “I have never known much good done



by those who affected to trade for the public good” (Smith, 1776/1904: Book IV, Chapter II). Unfortunately, the refocus of business and financial activity toward ESG concerns has been pushed from above by government bodies (central banks, regulatory authorities, and public pension plans among them), politically powerful organizations like the World Economic Forum and, to a lesser degree, influential voices within the business community, such as the US Business Roundtable and the Coalition for a Better Future.

The top-down nature of ESG is unavoidable. The doctrine of “social responsibility,” as Friedman wrote in his *New York Times* essay, “involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.” That sort of system, of course, ineluctably requires centralized top-down control.

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