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Sustainability Pledges By Business Are Outshining Those By Government

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Most press accounts on the outcomes of the November COP26 climate summit in Glasgow focused on pledges by governments to prevent the globe's warming from exceeding 1.5 degrees Celsius compared with pre-Industrial Revolution temperatures.

They promised to undertake actions to foster *mitigation* of carbon dioxide, methane, and other greenhouse gas emissions; facilitate societies' functional abilities to *adapt* to the harmful impacts from rising temperatures; and deploy *financial assistance* from the wealthiest countries to ameliorate the damages climate change engenders on the poorest states.

Most of the *public sector's* commitments were largely in line with what was anticipated. Save for one very important exception. And in a quite disappointing direction. The summit's closing text on the pledge by governments to terminate the domestic use or production of coal was considerably *weakened*—from "phasing out" to "phasing down."

Businesses and other private sector entities from around the world also were in attendance at the summit. And at a significant scale. There was some news coverage of their presence. But the media attention paid to the *corporate* commitments intended to abate warming of the planet was far more muted than those of the public sector.

This is ironic.

A number of these business pledges are far more concrete and robust than those made by governments. And *if fulfilled*, they could well be game changers in how certain firms around the world take more seriously the need to incorporate sustainability into their day-to-day operations in the various sectors and geographic markets in which they function.

The "if fulfilled" qualification is critical.

Two examples are illustrative: Eleven large automobile manufacturers pledged to halt sales of internal combustion vehicles in their largest markets by 2035, and on a global basis by 2040. And more than 450 financial firms spanning 45 countries committed to provide by 2030 $130 trillion for investments that entail net zero emissions.

How should one interpret the motivation behind these pledges? In my view they illustrate that successful attainment of ESG and sustainability goals requires a fundamental understanding that ESG and sustainability are *not just matters of engaging in risk-mitigation but also of pursuing growth maximization*. In a word, corporates, investors, and their advisors must think of ESG and sustainability initiatives as opening new doors of opportunities for business growth.

Regulating Sustainability: Businesses' Stakeholders and Governments

A cynical interpretation of such pledges is they simply reflect businesses' eagerness to promote their "sustainability brand." After all, these COP26 commitments are voluntary; they are not compelled by regulation, unlike, for example, a government's follow-through of the COP26 commitment to restrict the burning of coal.

So why not get a freebie?

One, of course, should not rule out such motives.

But unlike the diffused, infrequent, and possibly sporadic process by which governments can be held accountable for implementation of their COP26 commitments—largely through the electoral process (that is, at least for democracies)—companies, especially publicly held firms, may well face a raft of stakeholders that can serve a checks-and-balances function: think shareholders/potential investors; consumers; workers/unions; competitors; suppliers; distributors; and the press.

Today, when businesses take on specific, measurable high profile, public positions about the types of products they will make; the services they will provide; the nature and location of the production processes, inputs, and supply chains they will utilize; and the working conditions for their employees, the market for feedback can be both immediate and potent.

Both on the upside and the downside.

Bottom lines and career tenure of senior executives have become far less immune to changes in a business' reputation and brand; its share price; the ability to attract high quality employees; and the strength of demand for its products and services.

While such impacts certainly differ across sectors, firm size, nationality, geographic spread, and corporate ownership form, the contemporary scorecard for business conduct bears little resemblance to your grandfather's "naming and shaming".

If anything, the corporate COP26 pledges will focus attention on the need for C-suites to hire *Chief Sustainability Officers* (CSOs) and to give them the significant remits required if a business is truly serious about its commitments to incorporate sustainability throughout its operations.

By the same token, corporate boards would be wise to establish *Sustainability Committees* and bring on new directors who can give more than just lip service to businesses' commitments to sustainability on a companywide basis.

Of course, notwithstanding how businesses are affected by the extent of adherence to their public proclamations to operate sustainably, in most countries they are also subject to direct external environmental and economic regulation administered by governments.

Such regimes likely exact more intense discipline on businesses than does self-regulation.

However, whether such rules are effectively designed and administered by governments to achieve outcomes consistent with the overall sustainability objectives of society—encompassing businesses, workers, and consumers—is always an open question.

A public policy framework where joint *public-private* regulatory reviews of corporate sustainability practices are systematically carried out transparently and on a regular basis would help ensure such questions are fully addressed.

New Global Institutions and Market Mechanisms

To this end, two elements can play important roles: (i) the establishment of new, or the fortification of existing, institutions to engage in global oversight of businesses' sustainability practices and (ii) leveraging market forces to ascribe monetary value to the cost of generating greenhouse gas emissions (or alternatively to the benefit of their reduction.)

Achievements were made on both fronts at COP26.

One was the announcement of the creation of an independent International Sustainability Standards Board (ISSB), an institution akin to what the International Accounting Standards Board (IASB) provides for the auditing profession across the globe to ensure investors have a meaningful, consistent basis on which to make their decisions.

Much like the IASB, the ISSB, drawing on the advice of a stable of independent global experts on corporate sustainability, is to develop a universal set of standards upon which businesses' disclosures on sustainability would be required to adhere to.

This would provide investors with the ability to make well-informed judgments about their monetary decisions across companies or sectors on a consistent basis.

The establishment of the ISSB is important innovation. But how quickly it can become effective—and widely accepted—will be a challenge unless credible progress can be achieved in the near term.

That the world's excessive use of fossil fuels and of other elements contributing to global warming is driven, in part, because the "social" or "public costs" of their consumption is not fully reflected in the market prices we pay for them is increasingly understood, even though that concept has been well-known for decades, and not just by those of us with deep experience in the operations of the natural resources sector.

Placing a monetary value on that gap can be a powerful tool to help bring market prices in line with social costs.

To that end, in some countries, domestic markets for trading credits arising from greenhouse gas emissions abatement have matured over the past couple of decades; indeed, they have become quite sophisticated. But in most countries such markets are either nascent or nonexistent.

However, since the impacts of such emissions are necessarily transboundary, to have a fulsome effect on the globe's environment, the market for greenhouse gas abatement credits is, by definition, not domestic in scope but cross-border. A nascent framework agreement on the rules for a *global* greenhouse emissions market was confirmed at COP26.

Successful cross-country agreements for producing and abiding by a robust rules-based architecture governing such transactions would be truly significant. It is an example of a class of fundamentally critical *transboundary* problems confronting the world today where greater international collaboration in the area of sustainability-focused R&D than heretofore has been the case is urgently needed.

It is hard to overstate the need for adherence to such rules inasmuch as emissions credit trading largely remains bilateral but veering towards a multilateral direction.

Indeed, the calls by some governments to impose carbon-based trade tariffs are increasing in frequency and volume. Will the world soon have its first carbon trade war? Put that on the agenda for COP27.

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Does all this mean that corporates ***will*** fulfill their COP26 commitments? Of course not. But what it does mean is this: there is a growing number of mechanisms and groups of stakeholders in the business ecosystem that can—indeed *should*—hold C-suites' and boardrooms' feet to the fire. My guess is that system of checks and balances will be far more effective than those that governments face.

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