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Climate-related financial disclosure

Submission by
Australian Environment Foundation

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Addressing the Issues

We have seen big government and woke financiers working hand in glove over recent years to advance the cause of Environment Governance and Social. Superannuation funds have been increasingly orientating their investments towards ESG. The governance part involves avoiding firms with boards and senior executives containing too many white males and, therefore, inadequate ‘diversity’. The Environmental and Social parts used to mean avoiding firms in the defence and tobacco industries, but the pariahs in the modern woke world are avoiding hydrocarbons – coal, gas, and oil.

When the Bank of England released its support package for firms facing difficulties due to the Ukraine war, it insisted that firms looking to take advantage of this must disclose whether they have a Net Zero transition plan and, if so, deliver it to the Treasury within six months of the drawdown of funds, or before termination of the guarantee!

In support of ESG, Treasury is examining whether to make it mandatory for firms to report in what it regards as being climate change risks. This represents an unfortunate departure for Treasury from its traditional role in seeking to combat cost impositions on productive enterprises.

The “Climate-related financial disclosure” Consultation paper argues there are financial risks associated with ‘the transition’ to net zero emissions. For some, the aim of the proposal is to push firms into reformulating their inputs to avoid carbon emissions but such policies, if applicable belong to other arms of government. According to an [estimate](#) by Peter Wells, the regulations will apply to over 23,000 entities but only 51 entities account for 80 per cent of net energy consumption. Hence 99.8 per cent of entities that will potentially be forced to report comprise a very minor component of what is said to be a problem. Moreover, the highest emitters are already, rightly or wrongly, obligated to report on their emissions under National Greenhouse and Energy Reporting.

Some advocates of the policy will claim that it is a path to allow greater uniformity and combat “greenwashing” deceptions and hence offering greater scope for investors and others to judge where to allocate their funds. We see little merit in this argument since it should be left to those firms seeing merit in promoting their carbon-light credentials to do so without government compulsion. The regulations would impose needless cost on other entities, costs that must be reflected in the prices they charge, with adverse implications for their customers and on their competitiveness and productivity. In this respect, there is no attempt to estimate the costs of compliance and any benefits that might emerge, a shortcoming that is contrary to government policies regarding new regulations.

Moreover, the so-called transition is not without controversy. It is by no means certain that “net zero” will remain as a goal for Australia, still less for the world as a whole. It therefore makes no sense to enshrine standards to promote this within corporate regulatory frameworks.

The tentacles of the ESG reporting system create a parallel network that firms must administer. That involves - in addition to selecting their inputs on the basis of price, quality, and availability - also ensuring the provenance of their chain of suppliers.

This seriously distorts the efficiency that capitalism generates through the price system. Its impact is forcing firms to engage in wasteful activities.

Funds in general – including those like BlackRock which vigorously embrace capitalism – have moved from passive investors, motivated by firms’ perceived future values, to active investors counselling company management to mend its ways and subscribe to the current fads. These include gender and race issues and, above all, anything perceived as contributing to the fabled global warming.

Productive businesses take such advice seriously since a major investor selling a firm’s shares depresses its value. In the process, this may also be lowering its ability to attract funds and even make it vulnerable to corporate raiders. Hence Whitehaven, one of the few pure coal plays among listed Australian shares, has introduced a ‘Sustainability Report’ in which it is exploring ‘carbon abatement opportunities for its Scope 1 and 2 greenhouse gas emissions, including options to generate and purchase carbon offsets’.

It is seldom that sentiment will prevail over genuine returns on investment. For most of us, most of the time, cupidity trumps a general disposition to sacrifice income and this has been the driving force of income growth that capitalism has delivered.

For many years the ESG funds claimed they were outperforming regular funds but such consistent performance is unlikely – the early investment funds that eschewed alcohol recognised this. Australian ESG funds, did in fact comprise nine out of the top ten performers in returns measured over the past ten years. To a major degree this has been due to the anti-hydrocarbon funds being overweight in tech shares, which had performed well above the rest of the market. Those funds may also have benefited from a herd effect, whereby funds avoiding coal, gas, and oil firms have depressed their price while causing a bubble in favoured ‘ethical’ stocks.

Last year things came down to earth. Australia’s top 200 shares were down 8.6 per cent while the energy index is up 38 per cent – and coal shares have actually doubled. One outcome is that two of the most anti-coal funds, Future Super and Spaceship, saw the largest falls in value, 11.5 per cent and 18.5 per cent respectively. By contrast, four of the best five performers, including number one and two, Perpetual Wealth Focus Super Plan and Australian Retirement Trust Super Savings, have no climate protection policies.

Notwithstanding the magnitude of ESG funds – expected to control a third of global stocks – and all their official support, they are under pressure from the reality of markets and the shortages of reliable energy to which they have contributed.

While virtue signalling has a powerful place, there are limits to which people will tolerate their savings custodians’ decisions causing a diminution of their wealth. In addition, recognising the detrimental effect of such funds on their economies, several US states are cutting BlackRock, the largest and most vocally pro-ESG investment fund, out of government business. Such factors have caused analysts to downgrade BlackRock’s stock,

bringing about a change in the firm's public stance on energy. Larry Fink is even saying he will no longer use the term ESG because it has been weaponised.

The same push back on net zero insurers has forced the arrangements they agreed to in 2021 to collapse. And, bowing to reality, Shell has abandoned its pledge to reduce oil production by 1-2 per cent a year.

Conclusions

It should be left to firms of their own volition to submit material that will help investors better understand their operations.

If firms choose not to supply ESG material, investors wishing to see this will avoid buying shares in those firms. And if the lack of such information means lower than optimal purchases of such shares by investors, the firms will have self-harmed. On the other hand, if firms are forced to engage in the costly reporting behaviour envisaged and, still more, distort their operations in order to accommodate forces that are not conducive to maximising the wealth of their shareholders, a great disservice will have been done to economic well-being.

In this respect, we are seeing grave concerns about flagging levels of productivity. This outcome is surely a result of the mounting regulatory interventions by government agencies that impose the sorts of costs and inflexibilities to which this legislation would add.