Climate Change: How investors can help deliver a Just Transition

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Executive summary:

- Climate change is well understood as a systemic risk, but there is less understanding of how the transition to a low-carbon economy might affect society
- A Just Transition would seek to leave no one behind and ensure the consequences of associated changes are fairly distributed. Moving to low-carbon energy, buildings, transportation and industrial production will bring dramatic adjustments and challenges to countries and industries – and therefore to workers and their communities
- A failure to anticipate the social implications of those challenges could stall climate progress and contribute to political instability through increasing inequality. This risks disrupting the fragile equilibrium between developing and developed economies
- In this paper we consider how to encourage companies to incorporate the Just Transition into business strategies, and explore how, as an asset manager, we might start to integrate this nascent concept into our investment decision making
- This will require different approaches for different sectors – but it will certainly entail a consideration of how business models are evolving, how human capital is managed and how companies develop their role as employer and stakeholder. Issues of accessibility and affordability must also be integrated in our assessment.
- The Just Transition has broad implications for the asset management industry. A world in which these issues are not addressed is a world of sustained political instability, in which it is difficult to be invested due to a risk/return imbalance. This deserves a separate and specific view, from a top-down perspective including monetary and budgetary policies

The concept of a Just Transition is not new. It sits at the intersection of environmental and social thematics and was promoted in the early 1990s by American labour leader Tony Mazzocchi to "resolve the conflict between jobs and the environment". It was referenced in the 2015 Paris Agreement on climate change, and in the same year by the International Labour Organization (ILO), in guidelines aimed at creating decent jobs and promoting social protection.

At the heart of the issue is an acknowledgment that moving to low-carbon energy, buildings, transportation and industrial production will bring dramatic adjustments and challenges to countries and to industries – to workers and their communities. Failing to anticipate the social implications of those challenges could stall climate progress and increase inequalities at local and global level, disrupting the fragile equilibrium between developing and developed economies.

As such, it requires coordinated action between governments, policy makers, companies, unions and, ultimately, citizens themselves.

A world in which the Just Transition is not addressed is a world of heightened political instability. For asset managers, this is a world where investing is made far more difficult by a long-term risk/reward imbalance. Tackling this topic in full will require a top-down approach that analyses the role of budgetary and monetary policies, and how they interact with financial markets and asset prices. This is not the focus of this paper, which instead will consider how we might measure companies' progress towards a Just Transition, and to understand how, as an asset manager, we can ensure that businesses integrate the Just Transition in their climate strategy.

We need to remain humble here. The Just Transition is still an immature concept when it comes to the inputs that can guide both companies and investors.

Approaches will differ, depending on the sector, but by and large we will consider how business models are evolving, how human capital is managed and how companies develop their role as an employer and stakeholder. We will also have to account for issues of consumer accessibility and affordability.

The social dimension of the transition was of course discussed at the COP26 climate change conference in Glasgow in November, alongside early thoughts on an 'International Just Transition'. But details were lacking, as were milestones, and it remains some distance from becoming a central part of the broad diplomatic haggling – particularly when the countries are still focused on "keeping 1.5°C alive"[1]. Our belief then is that responsible investors who are wary of the risks in play, and willing to work towards addressing them should be prepared to take a lead.

Social exclusion and growing inequality risks

The transition to a lower-carbon world will unfold at a time when many peoples' lives have become more fragile. The World Bank's *Poverty and Shared Prosperity 2020* report highlighted that after more than two decades of continuous progress in poverty reduction and shared prosperity, it has come to a halt[2]. Already stalling pre-pandemic, the results suggest that in 2020, an estimated 88 million people worldwide would be pushed into poverty under the baseline COVID-19 scenario and as many as 115 million people under the downside scenario.

The pandemic has woven new complexity into the expected impact from global temperature rises and related effects. The World Bank's *Shock Waves* report estimated that, if unaddressed, climate change has the potential to push more than 100 million people into poverty by 2030 – or between 68 million and 132 million depending on the scope and severity.[3]

[1] The Paris Agreement said that an ideal scenario for climate action would be restrict global warming to within 1.5°C of pre-industrial times
[2] https://www.worldbank.org/en/publication/poverty-and-shared-prosperity
[3] https://documents1.worldbank.org/curated/en/260011486755946625/pdf/ShockWaves-FullReport.pdf

Rising inequalities, however they emerge, tend to disproportionally affect developing countries, and this effect is amplified by uneven exposure and vulnerability to environmental risks that endanger agriculture and rural jobs, and pose serious risks of water stress and food scarcity.

Africa, Asia and the Pacific have the highest share of employment dependent on ecosystems. All score above 40% as reported by the ILO[4], with most of those jobs related to agriculture (80%). Other sectors most exposed are forestry and fishing (5%) and food, drink and tobacco (6%).

Climate change is thus a direct threat to poverty eradication. And in turn, the nature of the transition will decide if our new era worsens or alleviates conditions for those most vulnerable – those already in poverty, indigenous and tribal peoples, migrant workers. One collateral effect of combined ecosystem reliance and environmental degradation is the risk of severe food insecurity, water shortages, losses and damage, that could prompt disastrous humanitarian consequences and trigger large scale displacement and migration[5]. The transition must acknowledge and address such macro impacts. The potential effect of millions more people being displaced every year has significant implications for the world and for every investor.

Climate change mitigation measures may themselves bring challenges in the short term. However, a number of studies show the potential benefit of a Just Transition to a more sustainable economy in the long term, whether from future growth, job creation or the

Working-life years lost due to disasters, 2000–15

Note: The estimates take into consideration casualties, people affected and damages resulting from meteorological (storms, fog, extreme temperature), hydrological (floods, landslides, wave action), climatological (drought, glacial lake outburst, wildfires), biological (insect infestation) and certain technological (industrial or miscellaneous accidents) hazards. Estimates do not include casualties, people affected or damages resulting from geophysical (earthquake, mass movement, volcanic activity), biological (viral, bacterial, parasitic, fungal or prion disease epidemics, animal accidents), extraterrestial (impact, space weather) or certain technological (transport accidents) hazards. The methods used follow Noy's (2014) approach, with adjustments for retirement age and national employment-to-population ratios. Appendix 1.4 provides more details on the methodology applied.

Source: ILO calculations based on Noy, 2014, EM-DAT Disaster Database, Global Health Observatory, United Nations population statistics, World Development Indicators, World Economic Outlook Database and ILOStat.

[4] https://www.ilo.org/global/research/global-reports/weso/greening-with-jobs/lang--en/index.htm
[5] The Norwegian Refugee Council's Internal Displacement Monitoring Centre (IDMC) reported in May 2020 that on average 25 million people are displaced each year, the vast majority due to extreme weather conditions. The analysis suggested the number could reach 50 million by the end of the century.

promotion of decent work conditions. Estimates from a 2017 Organisation for Economic Co-operation and Development (OECD) report found that a decisive transition package could boost long-term output by 5% on average across the G20 economies by 2050.[6]

Work shift

Looking more closely at jobs, the latest report from the New Climate Economy (NCE), a flagship project set up by the Global Commission on the Economy and Climate, concludes that ambitious climate action could result in a net employment gain of 37 million jobs across the global economy by 2030.[7]

The net increase would flow from the adoption of sustainable practices, including changes in the energy mix, growth in the use of electric vehicles, and increases in energy efficiency in existing and future buildings. The renewables sector would benefit the most from energy sustainability measures and employment needs in 2030.

In the same vein, advancing towards a circular economy to reduce material extraction and waste generation could also contribute to job gains. Promoting the reuse, recycling, remanufacture and repair of goods could create around six million new employment opportunities across the world, according to the ILO.

When viewed in aggregate there may be a positive story to tell around work, but the impact on individual lives, and on each region or country will be uneven – and the job-creating potential of environmental sustainability is not a given.

Institutions, government policy-making and effective implementation are key for a Just Transition that promotes green industries, locks in decent work conditions and builds social protection systems as a first line of defense against income risks, whether they stem from the physical risks of climate change or from the transition to a lower carbon economy.

Sectors most affected by the transition to a circular economy

Industries set to experience the highest job demand growth (absolute)		Industries set to experience the strongest job demand decline (absolute)	
Sector	**Jobs (millions)**	**Sector**	**Jobs (millions)**
Reprocessing of secondary steel into new steel	30.8	Manufacture of basic iron and steel and of ferro-alloys and first products thereof	–28.2
Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	21.5	Mining of copper ores and concentrates	–20.8
Production of electricity by solar photovoltaics	14.7	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	–10.2
Wholesale trade and commission trade, except of motor vehicles and motorcycles	12.2	Mining of iron ores	–8.0
Reprocessing of secondary wood material into new wood material	5.0	Manufacture of glass and glass products	–7.6
Sale, maintenance, repair of motor vehicles, motor vehicles parts, motorcycles, motor cycles parts and accessories	4.7	Mining of coal and lignite; peat extraction	–4.9
Research and development	3.5	Mining of nickel ores and concentrates	–4.3

Notes: Percentage difference in employment between the circular economy scenario and the IEA 6°C (business-as-usual) scenario by 2030. Appendix 2.1 provides further methodological details on the data and methods used.

Source: ILO calculations based on Exiobase v3.

[6] https://www.oecd.org/environment/taking-action-on-climate-change-will-boost-economic-growth.htm
[7] https://newclimateeconomy.net/sites/default/files/nce_facts_sheet_just_transition.pdf

Past experience of deindustrialisation in many parts of the world has highlighted the importance of looking beyond direct employment impacts to understand the wider ecosystem of affected regions. This requires appropriate local economic development tools in the most affected regions, improving associated knowledge sharing (the adoption of best practices from other jurisdictions), and public/private partnerships.

The transition will inevitably cause job losses in some sectors, perhaps most notably in developed markets. Carbon- and resource-intensive industries will be scaled down. A Just Transition requires the retraining of workers to reallocate them, and the oversight to ensure decent working conditions in the sectors rapidly scaling up to meet new demand. For investors there will be a huge potential advantage if key economies can keep a lid on labour market upheaval.

Social dialogue will be instrumental in promoting frameworks and legislation that include both labour and environmental concerns, as well as contributing to the implementation of appropriate governance structures to manage and tackle risks. This illustrates the priorities established by the UN Agenda for Sustainable Development and the principles embedded in international labour standards, which include a focus on consultation and collective bargaining.

Responsible investors must also consider how gender differences in social and economic spheres have exacerbated the vulnerability of women, most prominently in developing countries where they have lower access than men to resources including land, credit or education. This is also at stake in developed countries, where the pandemic has seen women's employment fall disproportionately.[8]

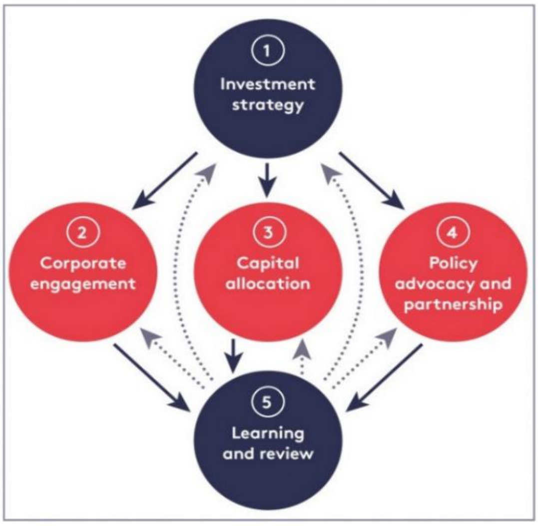
The renewables sector – including manufacturing and construction – is male-dominated which should encourage measures to ensure that the transition to a lower carbon world does not exacerbate that trend seen during the pandemic. Recognizing the gendered effects of climate change, a gender action plan was adopted at the 23rd Conference of the Parties (COP23) of the United Nations Framework Convention on Climate Change (UNFCCC). The plan sought to promote the integration of gender considerations into all activities including the means of implementation (finance, technology development and transfer, and capacity building). A Just Transition would do the same.

How can asset managers help?

The motivation for asset managers to act in these areas is clear. The potential social impacts in the transition run from grand macro evolutions over decades, to rapid and dramatic adjustments at individual issuers. Reflecting the need for investor action in this area, the Grantham Research Institute on Climate Change and the Environment at the London School of Economics, produced a guide in collaboration with the Initiative for Responsible Investment at the Harvard Kennedy School.

The guide identified five main ways in which institutional investors could connect their action on climate change with inclusive development pathways[9]:

Five key areas for investor action



Source: LSE/Grantham Institute 2019

[8] Based on a sample of 38 advanced and emerging market economies in the IMF working paper: [Gender and Employment in the Covid-19 recession: Evidence on "She-cessions"](#).

[9] https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2019/02/Investing-in-a-just-transition-in-the-UK_Full-policy-report_40pp-2.pdf

Our engagement with corporates will be a powerful part of this process, as we seek to ensure they include the Just Transition as part of their climate strategies.

Despite a steady accumulation of academic research on the topic, the Just Transition is still an immature concept when it comes to effective consideration by companies and investors. Human capital management has been absent from most business responses to climate change, although it is crucial at a time of transformational change in technologies, business models and market demand.

We have seen in our interactions on climate that engagement is an effective engine for change[10]. It can also be crucial as we drive the Just Transition. The first step is to understand a company's strategy on:

- The climate change impact (for employees, jobs in the supply chain, and communities affected)
- The implications for human resource management (need for restructuring, quantity and quality of employment, impact on wages, pensions)
- Investments made to mitigate the risks, upskill/reskill people and create new business opportunities

In July 2021, the World Benchmarking Alliance (WBA) released its Just Transition methodology, presenting the indicators that will be used to assess companies' alignment with the goals of the Paris Agreement alongside their approach to addressing the social challenges of a low-carbon transition[11]. It establishes six main areas of company assessment:

1. Social dialogue and stakeholder engagement ("stakeholders" employees, shareholders, trade unions, governments and regulators, community groups notably)
2. Just Transition planning
3. Access to decent and green jobs
4. Re-skilling and re-training employees
5. Social protection and social impact management
6. Advocacy for policy and regulation (including lobbying activities)

Those indicators are sector agnostic but could potentially be enhanced by sector-specific indicators. Some 180 companies in three high-emitting sectors (oil and gas, utilities and auto manufacturers) are being assessed by the WBA in 2021, with results due in the fourth quarter.

The Climate Action 100+ investor coalition will also release a Just Transition indicator, as part of its benchmarking assessment[12]. Both initiatives will help us frame our engagement with companies in this area, even though, as is often the case for thematics in their infancy, engagement will begin with disclosure. Gathering appropriate data will prove more difficult for the social dimension than it is for climate – the objectivity and suitability of indicators will have to be tested. As with climate, responsibility for the Just Transition should lie at the highest level of decision making within the company structure. In terms of priorities, high-emitting sectors such as energy, building and construction, transport, agriculture and food are most at stake.

The criteria used to assess how companies address the Just Transition will for some aspects remain sector specific. Criteria in the agri-food business will significantly diverge from those applying in the energy sector.

Whatever the sectors though, companies must be assessed from a range of perspectives – as an employer, as a provider of services/goods, and as a stakeholder impacting local communities.

In the same vein, criteria will have to include affordability for customers – the transition should be accessible for as many people as possible. In that

[10] https://www.axa-im.com/document/3870/download
[11] https://www.worldbenchmarkingalliance.org/
[12] https://www.climateaction100.org/progress/net-zero-company-benchmark/background/

respect, the relationship with governments or regulators will likely differ, across sectors but also within a sector, depending on jurisdictions.

An increased focus on human rights issues will have to apply, given the likely increase in usage of raw materials such as lithium and cobalt, which are already in high demand for electric vehicles batteries and solar panels. The pursuit of these “transition minerals” will put working conditions in mining in the spotlight. On this front, the French Law on Duty of Care[13], implemented in 2017, will help establish how we might assess this.

We are still at the early stages of measuring how companies are contributing to a Just Transition. And although COP26 may not have heaped fuel on the fire, things are still moving quickly. Increasing traction on the topic, combined with companies' interaction with active and responsible investors, has already resulted in some behavioural changes that take us towards that first step of true integration. We think that our involvement in collective engagement initiative the Coalition for a Just Transition, will help us identify best practice across the most affected sectors, increasing the potential to spot leaders for our Social Progress strategy, and helping us to identify and engage with the laggards accordingly.

[13] https://www.tresor.economie.gouv.fr/Articles/2017/05/09/devoir-de-vigilance-des-societes-meres-et-des-entreprises-donneuses-d-ordre

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