Environmental Crises and Personal Investment choices: Exploring a difficult relationship

By A. Dimmelmeier

The world faces several unprecedented environmental crises, related to the way in which humans organise their economies. "Ethical consumerism" has been suggested as an option for consumers that want to address these systemic issues. However, one sector that has remained mostly absent from discussions on consumer power is finance and investing. I argue that this is due to the structure of the contemporary financial system, where power is concentrated among a handful of financial intermediaries. If retail investors want to change this system, voting with their feet might not be an option. Instead, they probably should raise their voices.

Some weeks ago, I heard from friends in Chile that they observed black mist in the sky. The smoke consisted of particles from the Australian wildfires and had crossed the Pacific Ocean. This phenomenon is only one illustration that shows how human economic activity is already changing the planet on a massive scale. Apart from climate change, there is also the ongoing (6th) mass extinction of species and the increasing degradation of land.

However, the good news is that bold and timely actions can still avoid the worst consequences. The IPCC special report on the 1.5°C goal notes that "Pathways limiting global warming to 1.5°C with no or limited overshoot would require rapid and far-reaching transitions in energy, land, urban and infrastructure."

This then opens the question how such a transition could be achieved. In the absence of a particularly successful track record of states reaching agreements and implementing regulations on environmental matters, some people and organisations have tried to directly influence the economy through their purchasing decisions.

The theory of change here is that if sufficient people switch their habits in terms of transportation (e.g. car to bike), diet (e.g. from meat to vegetarian) and product appraisal more generally (e.g. FairTrade), this will starve environmentally harmful businesses of cash and reward those that offer less damaging alternatives.

There are important shortcomings to this kind of "ethical consumerism", such as the provision of false information (also known as greenwashing), the fact that it gives decision-power to the haves and not the have-nots, and the observation that rather than substituting, green or ethical products are often just a niche that is added to the already existing palette.

For the purpose of this text, I will, however, focus less on the structural problems with consumer decisions as such. Instead, I want to explore its merits and problems in an area that historically has received less emphasis: finance.

Depending on one's salary, the contributions of people in Europe and around the world to the financial system through their pension and insurance schemes can by far exceed their expenditures on e.g. FairTrade clothing or organic vegetables. There is also an argument to be made that finance has shaped the global economy; both in the years before and after Global Financial Crisis. This thesis, also known as financialisation, argues that businesses' focus on short-term profit and their disregard of long-term consequences are at least partly attributable to the logics of the financial system.

These observations notwithstanding, finance has so far been less in the spotlight of ethical consumerism. One explanation might be that investments are a more private topic and as such do not integrate well with the "do good and show it" mantra. To give an example, people might buy a Tesla or a Fairphone to signal their moral credentials (or superiority) to others. Investing in a green Exchange Traded Fund, is, on the other hand, less glamorous.

Yet the main problem with sustainable investments lies arguably on the supply side. Surveys point out that people (especially younger ones) would actually like to invest in assets with positive environmental and social impact. Still, the fraction of financial assets that are invested in a way that addresses environmental challenges is arguably still minuscule.

To understand: (1) why this is the case; and (2) what could be done, it is useful to briefly sketch the structure of the contemporary financial system. At first sight, there seems to be an abundance of choice as there are tens of thousands of funds from which to select. A closer look at the investment chain reveals, however, that most of these depend on only a handful asset managers, index providers (for passive funds), proxy advisory firms (for voting at general assemblies) and, of course, credit rating agencies.

For the time being, and despite of an increasing amount of announcements, letters and speeches on the topic, many of these financial intermediaries do not to be the most trustworthy when it comes to sustainability. A case in point are two fossil free funds offered by State Street, the third biggest asset manager in the world. Despite their label, the funds contained shares from RWE, a German utility that operates coal power plants and Vale, a Brazilian mining company. These are not isolated instances. A study from 2019 found that the biggest 15 asset managers deviated in their investments between 16% and 21% from a strategy that would be consistent with the Paris Agreement.

So, what can a retail investor, who would like to invest in sustainability but is faced with a non-responding financial market, do? Personally, I opted for exit, that is I withdrew from my pension fund. However, I am increasingly convinced that voice, i.e. complaining to financial intermediaries, might be the better strategy.

This is because financial intermediaries still hide behind the assumption that their beneficiaries are rational "economic men" who care only about risk-adjusted returns. Never mind that this view of the disembedded economic decision maker has been falsified in experimental settings and that it has contributed to the destruction of the environment. Perhaps it is time that they got to know their customers.

[1] For example: https://www.firststateinvestments.com/uk/en/institutional/about-us/responsible-investment/millennials-and-responsible-investment.html and http://vigeo-eiris.com/french-sri-results-8th-national-survey-run-ipsos-vigeo-eiris-fir/

[2] https://www.ft.com/content/f521da66-da64-11e9-8f9b-77216ebe1f17

[3] https://influencemap.org/report/FinanceMap-Launch-Report-f80b653f6a631cec947a07e44ae4a4a7

[4] Disclaimer: This is not investment advice. Full Disclosure: I hold 1000 EUR in an active ethical fund and 1500 EUR in member shares of the GLS bank.

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