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Old Wine in a new bottle: stakeholder conflicts in green transition

Alperen Afşin Gözlügöl: Whether and how stakeholder conflicts can arise during the green transition and what can be done about it

Climate change mitigation is one of the highest-ranking issues on the social and political agenda. On the macro level, the net zero transition is expected to have an overall positive impact on the growth and employment although models differ in their assumptions and results (see e.g. UN 2020; ILO 2018; OECD 2017). Therefore, the outlook is positive from a social welfare perspective. However, on the micro level, the net zero transition may not be utility-maximizing for some individuals. This is especially the case for labor. Significant adverse employment effects are to be expected, especially in certain regions and sectors such as energy, at least in the short-term. Furthermore, contrary to what the models assume, jobs created in the green economy may not offset these job losses due to some labor market frictions. For example, labor markets can be sticky, indicating the inability or unwillingness of workers to move to other regions to find employment in the transformed sector or a totally new sector (Banerjee & Duflo 2019).

In a recent paper and accompanying projects, I examine the potential conflict of the current environmental agenda with social (employment) aspects as well as the potential implications of this conflict for the decarbonization of the economy, especially at the company level.

Stakeholder conflicts arise

This conflict has already played out in the political arena with important repercussions for the country-level measures and targets for the climate action. This was most acute, for example, when Donald Trump declared "I happen to love the coal miners" in withdrawing the US from the Paris Agreement. Importantly, however, it is the companies where these conflicts will show their face in the first place.

Corporations are among the main contributors to climate change and therefore urged to undertake swift and decisive climate action, putting in place net zero transition plans and targets. This, however, if history is any indication, is quite unlikely to happen without stakeholder conflicts. Past experiences show that environmental concerns and labor interests are not always reconcilable, and that worker-oriented governance does not always produce best results for the environment (for example, the Volkswagen diesel scandal; see Armour 2016; Gelter 2016). Shareholders' interests will also be largely aligned with green transition, especially if the transition risk is acute, in terms of long-term value creation for the company (see e.g. Krueger et al. 2020). Shareholders may also have green preferences irrespective of financial returns (see Hart & Zingales 2017; Hartzmark & Sussman 2019).

Unions point towards importance of consideration of labour issues

Unsurprisingly, unions started to express their concerns and mobilize action to affect the direction of net zero transition in companies. In general, unions navigate between strategies of opposing outright climate change mitigation policies, accepting in principle the need for decarbonization but seeking to minimize any potential attempts or genuinely supporting climate action (see Thomas & Doerflinger 2020).

If labor has any countervailing power (via corporate governance such as co-determination, or contractual arrangements, or labor laws), the potential conflict of interests may delay, dilute, or lead companies to abandon the necessary swift and decisive action. Negative consequences of the net zero transition in companies may make the workforce unwilling and resistant to climate action to a certain degree (see Vona 2019), at least in the absence of any concessions for the labor. The reasons include direct negative impacts for the employees, poor understanding of climate change and cognitive biases, and collective action problems.

A "just" transition?

A relatively frictionless transition that serves the interests of the shareholders and environment but also employees can be possible if the distributional consequences of the net zero transition for the latter are addressed. This has been called 'just transition', a term originally coined by the unions, but later adopted generally, including in the preamble of the Paris Agreement, to refer to the support to be provided to those who stand to lose economically in the decarbonization of economy.

Different actors at various levels can contribute to just transition. For companies, this encompasses entering a social dialogue with workers, reskilling and retaining them, creating decent jobs and ensuring a social floor for those who are retrenched (see Smith 2017). Enel, for example, engaged in a major transformation of its business in line with its climate goals, affecting more than 68.000 workers. Through social dialogue and a just transition framework that includes retention, redeployment, reskilling and early retirement of elderly workers, all affected workers have found new jobs or retired.

Although 'just' recalls the idea of equity and fairness, it may actually reflect a Coasian bargaining between rational value-maximizers to solve a material conflict. As stated above, if managers want to decarbonize the company in line with the shareholder value or shareholder welfare (which should also include the green (non-financial) preferences) but labor has countervailing power, this can create a situation where managers need give labor some concessions (a Coasian bribe) which may involve material adaptation benefits for the workforce (as enumerated above in the Enel's case).

The role of the state as a controlling shareholder

The situation may of course be more complex than this as institutional and governance structures are different in each case. For example, the existence of a controlling shareholder, especially in the form of state, can change incentives. The state has generally incentives to address social impacts of net zero transition for various reasons, and it may address these directly in the carbon-intensive companies it controls. Given that carbon majors are often state-owned, this may be important. In doing so, however, the state may have consumed some private benefits of control at the expense of (minority) shareholders – the so-called 'policy channelling' (see Milhaupt & Pargendler 2018).

Still, it is possible to offer a few general observations for the sustainable corporate governance and finance initiatives and debate in terms of potential stakeholder conflicts in green transition.

Do directors' duties matter?

Firstly, there is a lively debate on how directors' duties are to be shaped (shareholder vs. stakeholder orientation). Although it is likely that the content of fiduciary duties may affect differently how companies would consider potential tensions in their climate action, case studies concerning utilities companies show that it may not matter much in the end. Five utilities companies that have addressed stakeholder conflicts (albeit to different extent) come from different jurisdictions where different models of directors' duties apply: Enel (Italy), EDF (France), SSE (the UK), E.ON (Germany) and ZE PAK (Poland) (see Robins et al. 2021). What may matter however is how incentives in executive remuneration are constructed. When compensation is tied only to environmental key performance indicators, managers may become fixated on the environmental side of the net zero transition without considering the social impacts. If they cannot afford to not consider such impacts, they are even more incentivized to enter into a Coasian bargain and give labor some concessions.

Disclosure of social impacts

Secondly, companies are increasingly subject to climate-related disclosures. Arguably, a related disclosure should be whether and to what extent companies identify and address the social impacts of their net zero transition. This relates to disclosures on climate-related risks. Because, unless companies identify and address the resulting social impacts, their transition can be slowed down or stalled, which amplifies the transition risk. The current framework promoted by the Task Force on Climate-related Financial Disclosures and the Sustainability Accounting Standards Board does not cover such disclosures; Global Reporting Initiative, however, has recently developed related disclosure demands for certain sectors such as coal. Furthermore, these disclosures would add credibility to the net zero transition plans of companies that need to execute a major transformation. It would be naïve to think that these companies can smoothly achieve their net zero transition and climate targets they disclose without addressing huge social impacts (even if labor has no formal countervailing power). In addition, these disclosures can serve as a kind of nudge for companies to identify and engage with the employment effects of their climate action if we desire a just transition as an end in itself (not as a means for a swift transition).

Relevance for institutional investors

Thirdly, potential conflicts are also relevant for institutional investors as fiduciaries. As argued above, solving these conflicts will address the transition risk, making the shift to a low-carbon economy more likely in the investee company. This especially concerns those investors for whom the transition risk poses a systematic risk (i.e., index funds). Another systematic risk concern that may arise in the absence of social impact mitigation in investee companies is deepening inequality that may harm long-term growth (and thus investor returns) (see e.g. Ostry et al. 2014) and heightened social instability as a result of a transition achieved at high social costs (see also Gordon 2022). Apart from financial risk concerns, 'just transition' is relevant for 'socially responsible' investors that (claim to) situate their investment and engagement policies around environmental and social concerns.

The following demonstrates that not only green preferences but also social concerns can be part of the institutional investors' (or their beneficiaries') utility function: some institutional investors (e.g. Generali, Amundi etc.) have already integrated just transition into their engagement policies. On the collective level, Climate Action 100+, SHARE and the Investor Agenda are among the institutional investor networks that incorporate just transition into their initiatives. These high-level commitments also turned into action: for example, two energy companies (SSE and E.ON) took just transition-related initiatives, following engagement by shareholders led by two UK institutional investors. This engagement may encompass assessing companies' just transition awareness levels and examining whether considerations on workforce were included in their climate policies and practices including potential lay-offs due to climate transition and strategies to limit the negative impact on employees (UN PRI 2021).

Sustainability bonds are an option

Fourthly, green finance has a big role to play in the decarbonization and resilience of economy by allocating capital to green assets and climate-resilient activities. It may also play a significant role in just transition in two ways: (i) integrating the impacts on affected workers and communities or more generally stakeholder concerns into capital allocation or (ii) targeting investments to projects that help alleviate adverse impacts. An example is 'sustainability bonds' or 'social bonds': companies that invest in green assets and operations can simultaneously create jobs for workers bearing the brunt of the net zero transition by employing them directly or after reskilling and retraining by using (part of) the bond proceeds for this purpose.

In this regard, the EU has already announced further action, which is however bound to stir controversy like the previous sustainable finance agenda. In a recent communication ('Strategy for Financing the Transition to a Sustainable Economy'), the European Commission stated that "[t]he recovery from the pandemic has highlighted the need for a just transition that supports workers and their communities affected by the transitioning of economic activities", signaling further action regarding the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation (TR). It should be noted that the SFDR already covers the 'social' aspect of sustainability while the TR only concerns 'environmental' sustainability. Works on a 'social taxonomy' are already under way.

The importance of conflict solving

Overall, the rise of potential stakeholder conflicts will be inevitable in the shift to a greener economy at the scale and pace required to avoid catastrophic climate change. Solving potential stakeholder conflicts will be especially important for carbon majors, namely those companies whose net zero transformation will have the most positive environmental impact but the worst social effects. A just transition has been called for in terms of maintaining social equity. At the company level, however, addressing these conflicts may be only a part of rational bargaining between different stakeholders of a company, which depends on the underlying power and incentive structures. In brief, if labor has any power to affect the shape and pace of the green transition, shareholders and managers will be incentivized to address labor concerns. States as controlling shareholders are also incentivized to address these concerns as a form of policy channeling.

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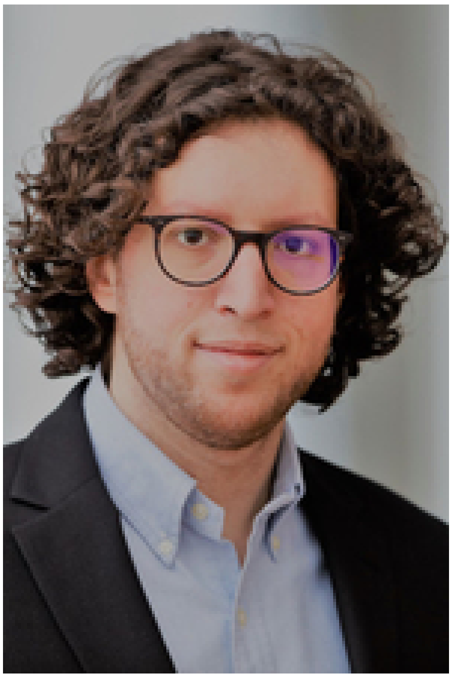

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