

# ESG & SUSTAINABILITY NEWS

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In the last blog post, we argued that sustainable investing and ESG

reporting fulfill the need to preserve trust in the capital markets in an era of increased transparency due to the rise of Big Data. Corporations, which are now accountable for areas of operations not scrutinized before, can use non-financial information to create a shared narrative. In this post, we will shift to the perspective of society at large and examine the public factors fueling the demand for sustainability in business and investing.

## THE NEW SOCIAL CONTRACT.

BY ANNA ALEMANI

**The notion of "social contract" is at the foundation of our liberal democracies:** individuals contribute through taxes, and in return the government provides protection through military defense, law enforcement and the justice system, as well as essential services such as healthcare and infrastructure.

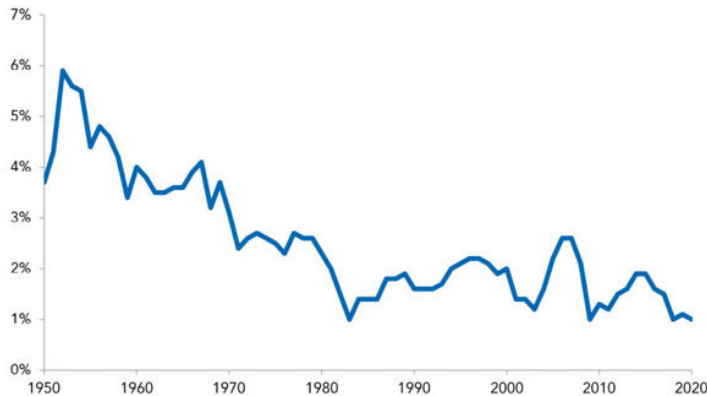
In recent times, as governments have struggled to address pressing global challenges such as climate change, poverty, and inequality, **an increasing worry regarding the erosion of the social contract has emerged.**

One of the factors contributing to the perception of the social contract breakdown is **increasing economic inequality.** A widening gap between the rich and the poor undermines the social contract, which is based on fairness, reciprocity, and mutual benefit.

Another factor contributing to the breakdown of the social contract is the **increase in the average life span.** The traditional career model with three separate sequences (education, work, and retirement) no longer reflects people's needs. Employees need flexible work arrangements, improved benefits, career breaks and training.

Contributing to the perception of a broken social contract is a **growing concern over corporations not fulfilling their tax obligations**. Revenues from corporate taxes as a share of U.S. GDP have been declining, partially due to the use of pass-through entities and other strategies to minimize tax liabilities. These practices undermine the principle of shared responsibility. A failure of corporations to contribute their due taxes also hampers governments' ability to provide essential public services, invest in infrastructure, and address societal needs.

### Corporate Taxes as % of GDP



Source: Office of the Budget, Historical tables, Budget of the United States Government, Fiscal Year 2022

For all the above reasons, **the existing social contract is no longer adequate to respond to the needs of society**. New forms of social contracts are emerging to support a more equitable prosperity. They are informed by principles like sustainability, stakeholder capitalism, equity, economic security and a transition to net zero.

This change cannot be delivered by any single sector nor by any single model. Governments have an essential role in shaping a redefined social contract. Businesses have much to gain by helping ensure that market economies retain the license to operate. Civil society has a more prominent role than it had in the last century. **Collaboration is essential, and all must play a role.**

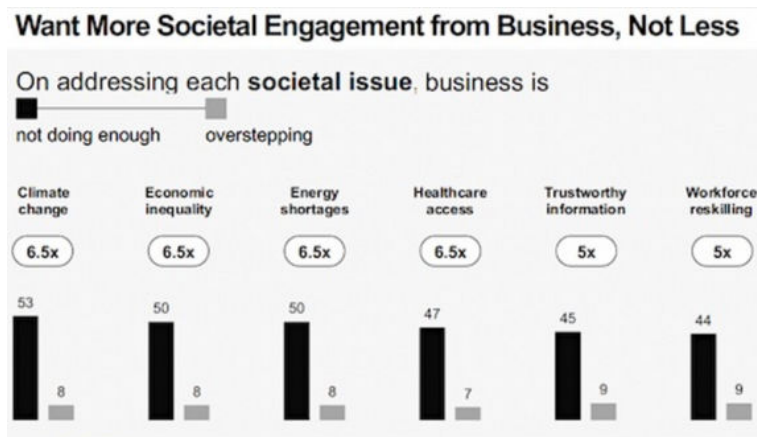
The European Union is an example of government promoting a transition to a sustainable economy. One of the legislations issued is the European Taxonomy, a classification system to identify which of an organization's economic activities (or the activities they invest in) can be deemed environmentally sustainable. The EU is also considering creating a social Taxonomy, which will identify socially sustainable activities.

While this legislation is focused on reporting to increase transparency and encourage change, the efforts of the regulators of the world's third largest economy in categorizing businesses as sustainable could enable the regulators to **apply different tax incentives based on a business's sustainability "status"**.

Tax incentives have always been used to reward positive corporate behavior, and disincentivize negative ones. They are very common in the environmental area to lessen the financial burden of adopting green technology. Tax deductions also incentivize corporations to give back to the communities in which they operate by providing funds, community service hours, or donations-in-kind.

A similar approach could be extended to more areas that have traditionally been subject of public policy. For example, the government could provide tax incentives to businesses offering better healthcare benefits to employees, leading to improved overall health and well-being of the workforce. This, in turn, would reduce the burden on public healthcare system and government-funded healthcare programs.

**In such a scenario the private sector (corporations and their investments) would act as a third actor in the social contract,** actively participating in the provision of public goods and services and acting as a complementary force to government oversight.



Source: Edelman Trust Survey, Global Report, 2023

The benefits of a redefined social contract, wherein the private sector assumes a pivotal role as providers of essential services alongside the government, are compelling. By engaging in strategic collaborations and adopting responsible practices, businesses can effectively meet public demands while fostering innovation, efficiency, and social mobility. This transformed social contract establishes a dynamic ecosystem where the private sector not only prioritizes profitability but also embraces a broader responsibility towards the well-being and progress of society at large.

**Aligning economic interests with social and environmental goals,** this inclusive framework can facilitate sustainable development, strengthen social cohesion, build consensus for addressing climate change, and empower individuals and communities to flourish.