04/2017

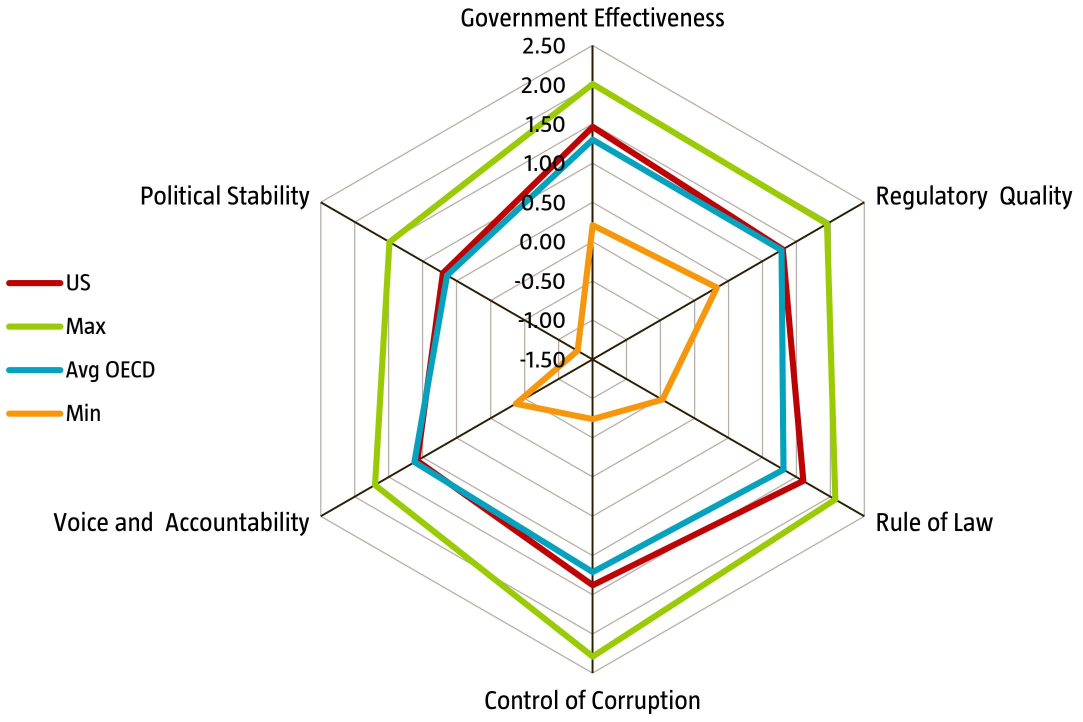
Country sustainability: Trump to derail the US?

Since the inception of our proprietary Country Sustainability Ranking tool in 2007, the United States has always occupied a position somewhat below the average of high income countries. It is currently ranked 15th, with an ESG score of 6.97 (on a scale of 1-10, with 10 being the highest), up from 6.36 in 2007, pointing to a fairly robust and persistent sustainability performance over the past decade. However, the election of Donald Trump to the US presidency has given rise to widespread concern that the country might be drifting off course in terms of sustainability.

Robust governance: the foundation for a solid and balanced ESG profile

The United States exhibits a solid and reasonably balanced overall ESG profile, with governance constituting the strongest pillar, slightly ahead of the social dimension, and with the environmental sphere lagging behind the other two dimensions. The US mostly earns strong scores on our quality of governance indicators, as it boasts a generally strong record of protecting political rights, economic freedom and containing political risk. Although the American political system is characterized by a well-developed system of checks and balances and functioning policymaking institutions, in recent years government effectiveness has been hampered by increasing political polarization and a divided government. A comparison of the World Bank's six Worldwide Governance Indicators shows that the US performs slightly better than the OECD average, exhibiting above-average scores for all indicators – with the exception of "Voice & Accountability" – with the "Rule of Law," "Control of Corruption," and "Government Effectiveness" indicators standing out the most (see Figure 1).

Figure 1: Country sustainability profiles in comparison



Source: World Bank; RobecoSAM

This picture is reinforced by the country's strong "Political Risk Rating." The US is currently ranked 11th on this measure, earning a score six-points above the OECD average in February – and ranking 2nd among OECD countries (3rd overall) in the World Economic Forum's latest "Global Competitiveness Index" (GCI)[1] (see Figure 5). However, the US is not among the top ten countries on any of the basic requirement pillars of the GCI, namely: institutions, infrastructure, macroeconomic environment, health, and primary education, pointing to the need for action in specific policy areas in order to defend its top position in the overall ranking.

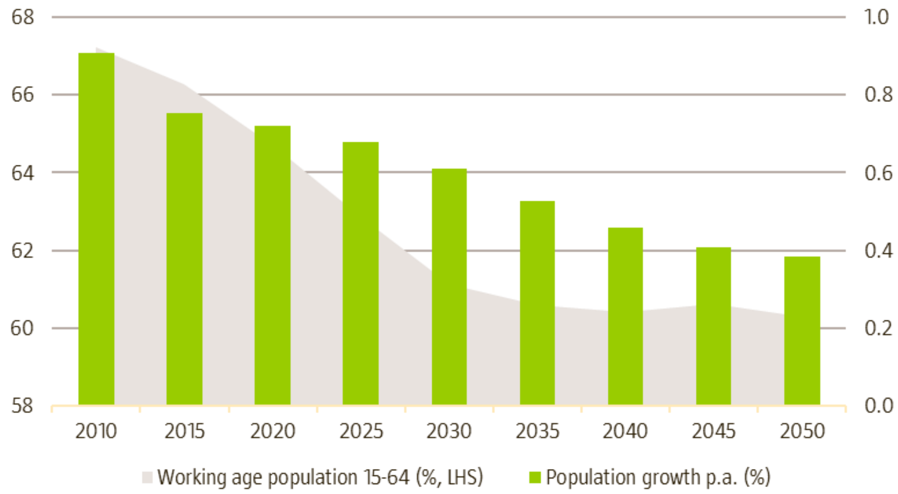
The US generally has a strong record of protecting political rights and civil liberties, with scores in line with those of France or Italy according to the new 2017 Freedom House ranking, but somewhat lower than those of Germany or the UK. However, when it comes to civil liberties, there have been some recent setbacks relating to more widespread internet surveillance, extended restrictions related to antiterrorism measures and excessive police violence against black citizens. Even though the new Trump administration's commitment to civil liberties remains somewhat unclear, various public statements made during the presidential campaign point to a rather harsh stance.

The US – apart from Japan – is the only developed country that still applies capital punishment. The state of Arkansas recently announced that it would carry out an unprecedented eight executions within a span of 10 days in April, prompted by the looming expiration date for a drug – which is in short supply given drugmakers' objections to capital punishment – used by the state for lethal injections. This has once again put the spotlight on this highly controversial practice. Arkansas' move runs counter to recent trends: in 2016 the US recorded the lowest number of executions in 25 years: a total of 20, down 28% from 2015 – and the lowest number of imposed the death sentences since 1972: 30, down 39% from 2015. In addition, a growing number of states is abandoning the death penalty: in May 2015, Nebraska became the 19th state (plus the District of Columbia) to abolish the death penalty. And, for the first time in a generation, less than half of Americans favor capital punishment according to the Pew Research Center. All of this could indicate that the US has gotten one step closer to definitively abolishing the death penalty.

Within the governance dimension, aging is the worst performing indicator. As the population growth rate declines and the Baby Boom generation ages, the share of the working age population is set to further decline in the years ahead (see Figure 2). Falling growth in the labor force from 0.9% to 0.5% over the next decade) and an increasing dependency ratio will negatively affect the country's growth potential, becoming an additional fiscal challenge in the longer term. The federal pension systems' unfunded liabilities alone amount to USD 3.5 trillion, or 20% of GDP, according to latest IMF figures, and come on top of a public debt that has already reached 108% of GDP in 2016.

[1] "The Global Competitiveness Report 2016-17," World Economic Forum, Switzerland, 2017

Figure 2: Declining population growth & labor force



Source: UN – Population Division; RobecoSAM

Inequality: a key social weakness

Within the social sphere, the US is infamous for its significant social inequality, as evidenced by the country's GINI coefficient and poverty rates. Among OECD countries, only Chile and Mexico score worse than the US on the GINI coefficient, and 17.5% of the US population earns less than 50% of the median income (see Figure 3), making it the second worst performing country on this measure. And both measures are higher (i.e. worse) than the pre-crisis levels of 2007. Although economic growth has rebounded since the crisis, it remains unequally distributed across socioeconomic groups: women typically receive lower salaries than men, and some groups, in particular blacks and Hispanics, are disadvantaged in the labor market and educational system, which in turn exacerbates this polarization in the distribution of income, skills and opportunities. So, while recent economic policies have been fairly effective in promoting the country's international competitiveness and economic growth, they have also come at some social costs in the form of rising income inequality and poverty, which have been put forward as key factors explaining the outcome of the US presidential election.

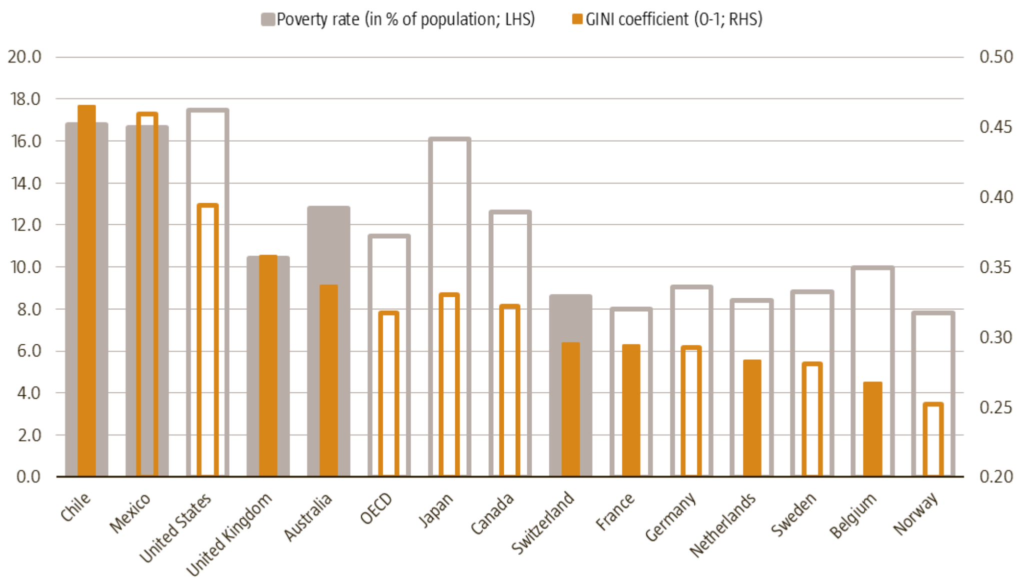
This income inequality goes hand in hand with health inequality and overall health conditions, captured in our "Social Progress" and "Human Development" Indices. Social factors such as race, income and environment still strongly influence who becomes ill and who receives access to quality care. Obama's "Affordable Care Act" (ACA), enacted in March 2010, has expanded health care coverage but has shown only limited success in ensuring access to quality medical care and in making diverse groups equally healthy. The US is by far the biggest spender on healthcare: healthcare costs represented 17.5% of GDP in 2015 according to the OECD. But despite the large sums of money, US healthcare spending is not efficient enough and relatively ineffective. And with a life expectancy of 78.8 years – compared to an average of 82 for other developed economies – the US is clearly lagging its peers on this key health outcome measure.

This clearly points to the need to focus on measures to maintain growth and tackle poverty in order to halt or even reverse these recent negative trends. Focusing on the education system is one way to promote social inclusion and opportunities. Even though education is generously funded and has a robust infrastructure in terms of school buildings and facilities, the performance of primary and secondary education has been unsatisfactory and reveals scope for improvement, as illustrated by a score of 5.11 (on a range of 1-7, with 7 the best) and rank 17 in the WEF's "Quality of Education" assessment.[2] And

[2] "The Global Competitiveness Report 2016-17," World Economic Forum, Switzerland, 2017

although the US has many top notch universities, higher education remains too expensive and out of reach for many, with a large share of college graduates burdened with huge student debt, further exacerbating poverty and inequality.

Figure 3: Income inequality and poverty increased (2014 figures)



Blank columns indicate a deterioration compared to 2007

Source: OECD; RobecoSAM

Environmental challenges remain

Of the three ESG dimensions, the environmental sphere is the weakest one, despite the country's tradition of ambitious environmental protections. The US economy is still largely based on an unsustainable growth pattern that relies heavily on fossil fuels, consumes a huge amount of raw materials and has little regard for renewable resources, as reflected in the country's rather mediocre ranking for most environmental indicators. Out of the 32 OECD countries included in our country universe, it is ranked 19th on the 2016 "Environmental Performance Indicator," and 14th on the 2016 "Energy Trilemma Index" (ETI).[3] The US is a major consumer of coal and one of the world's largest greenhouse gas emitters, while the share of renewables in its overall energy mix remains inadequate, as illustrated by its poor ranking – 28th – on "Environmental Sustainability," i.e. one of ETI's three core dimensions (see Figure. 5). Overall a disappointing picture, as is also reflected in the country's ecological footprint, which reveals that the US is an ecological debtor country with an ecological footprint of 8.2 global hectares (gha) per person, i.e. 4.5 gha beyond its bio capacity of 3.8 gha according to the Global Footprint Network.[4]

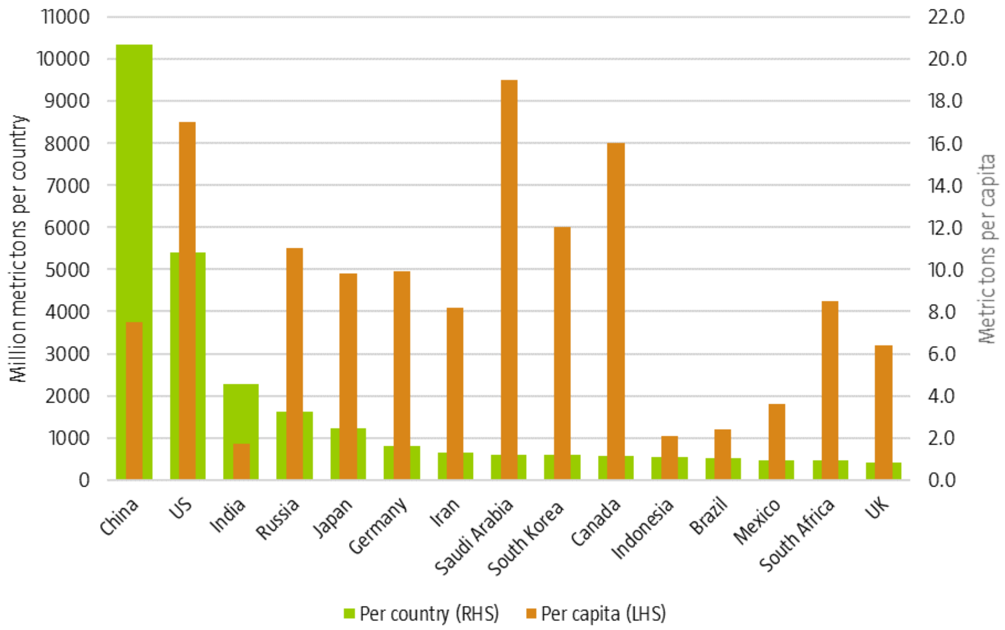
Climate change has proven to be a major hurdle, as many climate change skeptics, particularly within the Republican base, vocally oppose large-scale emissions-reduction measures. Obama's 2015 Clean Power Plan (CPP) requires states to collectively to cut carbon emissions from power plants by 32% from 2005 levels by 2030, but heated legal disputes have hampered implementation of the CCP. Still, efforts by individual states to increase the use of natural gas and impose stricter fuel-

[3] The Energy Trilemma Index ranks countries on their ability to provide sustainable energy based three measures: energy security, energy accessibility and affordability, and environmental sustainability.

[4] Global Footprint Network: "National Footprint Accounts," 2016 Edition

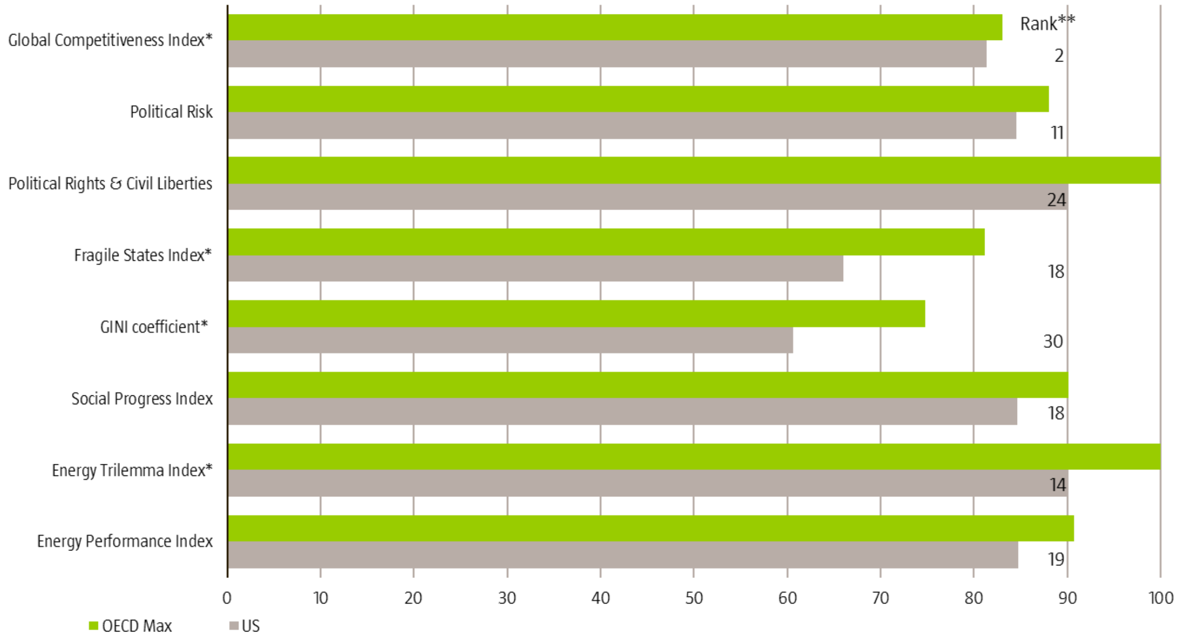
economy and coal plant regulations have resulted in a steady reduction of emissions in recent years. Overall, by 2015, CO_2 emissions had declined by 8% since 2005, leaving the US with a share of 15% of total global emissions (see Figure 4).

Figure 4: CO_2 emissions by country, 2015



Source: Global Carbon Atlas, RobecoSAM

Figure 5: Selected ESG indicators: US position relative to OECD peers

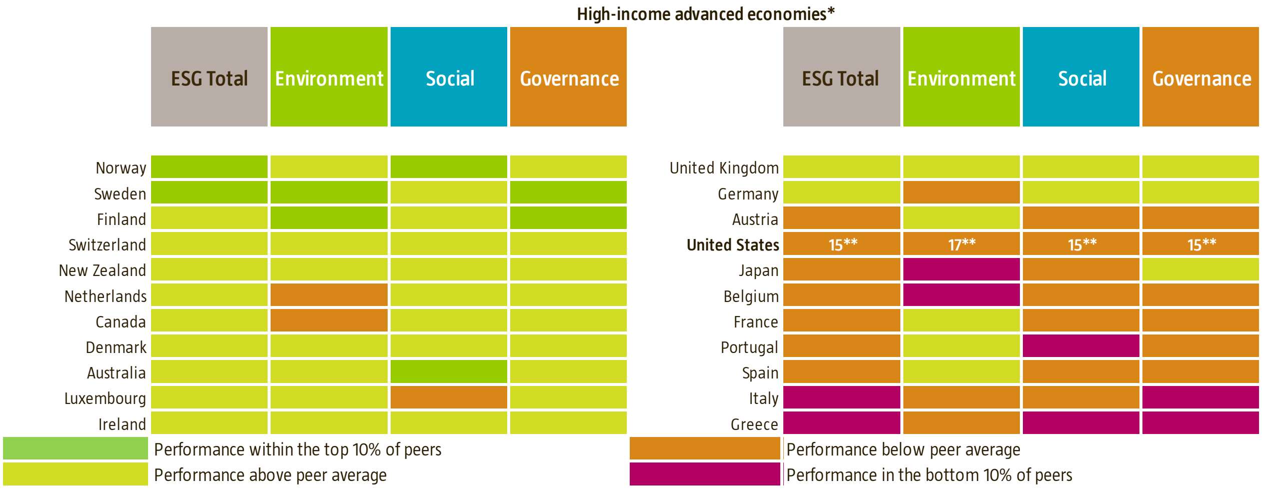


Sources: Freedom House, Fund for Peace, OECD, PRS Group, Social Progress Imperative, World Economic Forum, World Energy Council, Yale University; RobecoSAM

In short, the United States exhibits a solid and reasonably balanced – albeit not top – overall ESG profile, which becomes clear when it is compared to its peers within the OECD (see Figure 6). RobecoSAM's sustainability assessment of the US seems more or less in line with the country's overall SDG performance, in which the US scores 72.7/100 and is ranked 23rd within the OECD (25th globally), i.e. not among the top ranked countries either. The SDG index – developed by the Bertelsmann Stiftung with the support of the Sustainable Development Solutions Network – ranks countries based on their initial status when the 17 SDGs (Sustainable Development Goals) were first launched, and is aimed at monitoring each country's progress towards achieving the SDGs.[5]

[5] Sachs, J., Schmid-Traub, G., Kroll C., Durand-Delcare, D. and Teksoz, K. (2016): "SDG Index and Dashboards – Global Report"; New York: Bertelsmann Stiftung and Sustainable Development Solutions Network (SDSN)

Figure 6: Comparison of country sustainability profiles



* Country classification according to World Bank. For the 2017 fiscal year, the World Bank defines high-income economies as those with a GNI per capita of $12,476 or above, of which only the ones considered as advanced economies are included in this table.

**Rank within the 22 advanced economies covered by the RobecoSAM Country Sustainability Ranking tool.

Source: RobecoSAM

Trump's agenda: what does it mean for the US country ESG performance?

Sure, if Donald Trump lives up to (and is allowed to live up to) all of his campaign promises, the country's ESG profile would come under pressure and the US would certainly suffer a major reversal of recent positive trends in several sustainability areas.[6] Various statements, controversial executive orders and, in particular, his first formal budget proposal to Congress indeed point in that direction. The 2018 budget blueprint drastically slashes expenditure on education, environmental protection, foreign aid and health, while massively boosting defense spending by USD 52 billion.

The new Trump administration has signaled its intention to focus on energy independence and make a clear break from energy and environmental policy. In fact, on Tuesday, March 28, President Trump signed a new executive order rolling back Obama-era climate change regulations, keeping his campaign promise to support the coal industry and oil & gas drilling. This jeopardizes Obama's Clean Power Plan objective to cut carbon emissions from power plants by 32% by 2030, set in line with the commitments made in the Paris Agreement in 2015. This executive order, however, does not address a withdrawal from the Paris climate deal – another one of Trump's campaign promises. Although the US played a major role in bringing about the Paris Agreement, the threat to pull out of the accord (or to do the bare minimum to remain in the accord) could seriously impair global efforts to combat climate change. True, Trump's new environmental policy, which seems to support fossil fuels at the expense of the development of renewables and GHG reduction while minimizing pollution prevention and ignoring other externalities, does not bode well for the environment. However, the practical effects in terms of CO_2 emissions might nevertheless remain somewhat limited, assuming that China, the world's largest emitter (accounting for 28.5% of global emissions total) and other important countries stick to the deal and do not weaken their own efforts as well. Dismantling Obama's CCP, however, will not be that easy and Trump's executive order is likely to face legal challenges. Moreover, Trump's move is unlikely to bring about a restoration of the coal industry for economic reasons alone, as coal is no longer cost competitive compared with other sources of energy, such as natural gas or renewables . And last but not least, private sector activity on climate as witnessed in increasing corporate efforts to minimize their own emissions, and from state governments such as California, Massachusetts and New York, as well as cities such as Chicago or Philadelphia will not simply stop.

[6] RobecoSAM: "The Trump victory: the impacts on country sustainability," November 2016

More immediate problems could arise from Trump's "America first" vision and his proposals on trade and immigration. One of Trump's guiding principles is his desire for increased protectionism, as already evidenced by the abandonment of the Trans-Pacific Partnership (TPP). A crackdown on immigrants has already been set in motion and could hurt economic prospects in the medium term if not handled carefully. The size of the labor force is a major determinant of a country's growth potential and, after all, immigrants accounted for about half of the annual increase in the labor force in recent years. Mishandling immigration therefore risks reinforcing the already unfavorable demographic trend described above.

Trump's intention to stimulate the economy by massively increasing infrastructure spending, cutting both corporate and personal tax rates, and reducing excessive regulation could prop up the country's crumbling physical infrastructure and help strengthen competitiveness. This would also have many implications for the country's sustainability performance, given the strong link between competitiveness and environmental and social developments. Empirical evidence shows, for example, that environmental sustainability is often positively correlated with superior economic performance and greater competitiveness.[7] Strict environmental regulations can force firms to innovate, develop technological advances, and pursue efficiency gains and cost reduction, translating into the more efficient use of resources, an improved environmental performance and productivity and competitiveness gains at the national level. Stronger competitiveness can support sustainable economic growth, which – in turn – enhances a country's capacity to protect the environment. And a healthy natural environment, on the other hand, has a positive impact on the health and productivity of the workforce and can thus be considered as a kind of investment in human capital. A recent Harvard Business School[8] study found that US competitiveness is declining and should be restored with adequate measures with regard to the corporate tax reform, infrastructure, the political system, early and secondary education and health care. Within this context, it is noticeable that the Trump agenda has not offered any concrete plans on how to improve education and healthcare – beyond his intention to replace Obamacare.

But Trump is also discovering the limits of his power

However, since taking office on January 20, President Trump has been confronted with the power of other branches of government, the federal bureaucracy, Congress, the judiciary, various other institutions, grass roots organizations, and the media, all of which make up the country's famous system of "checks and balances." Despite Trump's efforts to invalidate and delegitimize multiple US institutions, the country's institutional framework appears to be resilient, at least for the time being. As a result, Trump has been unable to make much progress on some of his key policy objectives. Like its first version of January 27, the revised immigration decree signed on March 6 and aimed at introducing a temporary ban on entry for citizens of six countries in the Middle East and Africa has once again been suspended by the court. And although it enjoys a Congressional majority, on Friday, March 24, the Republican Party suffered one of its worst policy defeats in recent history, as it was unable to pass the Affordable Health Care Act – also a major setback for President Trump. The failure to replace Obamacare could also indicate that Trump will face some major legislative hurdles with regard to his planned tax reform, and his latest executive order signed on March 28 to undo Obama-era climate change policies is also likely to end up in court. Finally, given that final say over the budget lies with Congress, the president's budget proposal is primarily a wish list and most likely will not pass in its current form.

Although it may still be too early to anticipate the impact of Trump's presidency on the country's overall ESG profile, it is more likely to weaken going forward. Still, most recent events also suggest that the worst fears may have been exaggerated, as the country's well balanced and robust institutional framework will likely prevent too rapid and drastic fundamental change. The biggest threat to sustainability for the time being appears to be in the environmental dimension, in part because proposed cuts to the relevant budget positions are likely to face less opposition in Congress. Still, various counteracting forces should be able to contain adverse impacts on the environment. Considering the outlined budget priorities, any hopes for an

[7] Esty, Daniel C. and Charnovitz, Steve, "Environmental sustainability and competitiveness: policy imperative and corporate opportunity," http://www.hbs.edu/competitiveness/Documents/USComp-EstyCharnovitz-WorkingPaper.pdf

[8] Porter, M.E., Rivkin, J.W., Desai, M.A., Raman, M.: "Problems unsolved and a nation divided" – The state of US competitiveness", Harvard Business School, September 2016

improvement in some of the social aspects like health, inequality and social inclusion might be met with disappointment as well. In the governance sphere, increasingly polarized parties in Congress and infighting within the Republican Party could impair policymaking and therefore negatively affect some governance indicators, such as Government Efficiency, Political Risk, or Political Stability. And the latter two in particular, could always be affected by surprising developments such as the recent bombing of a Syrian airbase in retaliation for the chemical attack by the "official" Syrian army. Such a move directly contradicted the administration's earlier statements that it would refrain from getting too involved in the Syrian or other Middle Eastern conflict, and is yet another indication of Donald Trumps' unpredictable nature.

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About RobecoSAM

Founded in 1995, RobecoSAM is an investment specialist focused exclusively on Sustainability Investing. It offers asset management, indices, impact analysis and investing, sustainability assessments, and benchmarking services. The company's asset management capabilities cater to institutional asset owners and financial intermediaries and cover a range of ESG-integrated investments, featuring a strong track record in resource efficiency-themed strategies. Together with S&P Dow Jones Indices, RobecoSAM publishes the globally recognized Dow Jones Sustainability Indices (DJSI) as well as the S&P ESG Index series, the first index family to treat ESG as a standalone performance factor using the RobecoSAM Smart ESG methodology. Based on its Corporate Sustainability Assessment (CSA), an annual ESG analysis of over 3,900 listed companies, RobecoSAM has compiled one of the world's most comprehensive databases of financially material sustainability information. The CSA data is also included in USD 86.5 billion of assets under management by the subsidiaries of the Robeco Group.

RobecoSAM is a sister company of Robeco, the Dutch investment management firm founded in 1929. Both entities are subsidiaries of the Robeco Group, whose shareholder is ORIX Corporation. As a reflection of its own commitment to advancing sustainable investment practices, RobecoSAM is a signatory of the PRI and UN Global Compact, a member of Eurosif, Swiss Sustainable Finance, Carbon Disclosure Project (CDP), Ceres and Portfolio Decarbonization Coalition (PDC). As of December 31, 2016, RobecoSAM had client assets under management, advice and/or license of approximately USD 16.1 billion.

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