

# **Pension Funds: Key to Capitalizing Natural Capitalism**

**By**

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Capitalism, if it is to endure, must encourage businesses to behave in ways that do not destroy the capacity of the planet to support life. Capitalism is the greatest known system in the history of the earth for the creation of wealth. However, as currently practiced, it is defying its own logic by not valuing, but rather liquidating, the most important forms of capital. This includes the *natural* capital: the resources and ecosystem services that make possible all life. Capitalism, intelligently practiced, would seek the productive use and increase of all forms of capital.<sup>1</sup>

An analysis of the world's ecosystems prepared by the United Nations, the World Bank, and the World Resources Institute in 2000 stated, "There are considerable signs that the capacity of ecosystems, the biological engines of the planet, to produce many of the goods and services we depend on is rapidly declining."<sup>2</sup> A recent article in *Nature* warned, "Humanity's assault on the environment has left many ecosystems in such a fragile state that the slightest disturbance may push them into a catastrophic collapse. Human impacts on many of the world's ecosystems could cause them to abruptly shift with little or no warning from their apparently stable natural condition to very different, diminished conditions far less able to support diversity of life, including human."<sup>3</sup> These ecosystems give us services worth tens of trillions of dollars each year<sup>4</sup>, or more than the global economy.<sup>5</sup> But none of this is reflected on anyone's balance sheets.

Capitalism arose at a time in history, the first industrial revolution, when it made sense to use the abundant cheap natural capital to increase labor productivity. At that time there were relatively few skilled people to run the new machines. So profit-maximizing capitalists economized on their scarce resource, human labor, and profligately used the

natural resources and the ability of the planet to absorb and detoxify industrial waste. This approach increased labor productivity over 100 fold, and came to be seen as the basis of prosperity. Now, however, when 6 billion people crowd the planet, and 10,000 more arrive every hour, what is scarce is hardly people. In a time of collapsing ecosystem services, when half the world's people live on less than \$2 per day, the current economic model that ultimately would lead to one person squandering the natural capital to produce all the goods in society, with the rest of us out of work should be re-examined.<sup>6</sup>

The approach known as Natural Capitalism offers such an alternative.<sup>7</sup> Its three principles of corporate behavior enable companies to prosper while shifting their operations towards greater environmental responsibility. The first principle, to dramatically increase the productivity with which companies use any resource borrowed from the earth, restates the basic capitalist logic of economizing on scarce resources, but considers the new relative scarcities. Four-fold increases in resource productivity are now the basis of economic development policy for the European Union, and an increasing number of European countries.<sup>8</sup> But such eco-efficiency is only the first step.

The second principle, Biomimicry, named after the seminal book of that title by the science writer Janine Benyus, describes an approach to industry based on nature's wisdom. This approach utilizes the 3.8 billion years of design experience of living things to guide industrial innovation, eliminate waste through better design, and preclude the use of toxics.<sup>9</sup>

And finally, any good capitalist reinvests in the capital that is in short supply, to enhance the capacity to produce even greater wealth. Businesses that wish to prosper in the coming decades will behave in ways that restore the earth's capacity to sustain life by increasing the natural capital.

The principles are clear enough, if oversimplified here. The thesis has received no significant critique. Such commentators as the business author Peter Senge has called this approach the "Bible of the Next Industrial Revolution." The Chinese edition sold out in

two days.<sup>10</sup> President Bill Clinton continues to give speeches calling Natural Capitalism, “a huge deal.”

But from the perspective of any given company, putting these principles into practice is not trivial. In a political and economic system that attaches no value to sustainability, few CEO’s feel they can afford to invest for the long-term future while stock analysts demand performance on quarterly evaluations. A growing number of companies are issuing corporate commitments to behave responsibly, and some companies are implementing restorative practices. This is true not only of the rapidly expanding business of sustainable farming and forestry, for example—where it's obviously good business to invest in natural capital and restore the land. Many of the world’s leading industrial companies are also reducing wastes, implementing benign industrial processes and even partnering with environmental groups to develop innovative ways to increase profits and behave more restoratively.<sup>11</sup> More than 90% of chief executives at Fortune 500 companies recently polled by McKinsey & Company believe sustainable development is important to the future of their firms, but less than one-third of them think they are successfully addressing the challenge.<sup>12</sup> Many companies who may wish to do things more sustainably feel that investors won’t give them the time to make the conversion from wasteful, polluting processes, to new ways of doing business. Despite mounting evidence that such a shift reduces costs, many corporate managers still feel it would threaten their profitability.

Clearly, companies must feel that investors will reward them if they engage in more socially and environmentally responsibly behavior. To provide such rewards, various socially responsible investment funds have been created. Over the past decade, millions of individuals have shifted their personal investments to favor such companies. One of the largest of these, the Domini Fund, now manages two billion dollars. A 2001 study by the Social Investment Forum estimated that well over two trillion dollars is invested just in the U.S. using some form of social criteria. Between 1997 and 1999 total assets involved in socially and environmentally screened investment grew 82 percent; assets in

screened portfolios grew 183 percent. They grew another third by 2001<sup>13</sup> Contrary to popular myth, such investments often outperform conventional ones.<sup>14</sup>

The results have been so successful that several stock indices have been created to track their performance, for example the Domini index, the Citizen index, and more recently the Dow Jones Index of Sustainable Companies, which track the stock performance of hundreds of socially and environmentally screened companies. These have demonstrated that in comparison to the performance of the Standard & Poors index, responsible companies can often out-perform traditional companies.

Clearly, however, such investments represent only a tiny part of the capital flows through the economy. How can a much larger part of the investment community be encouraged to participate in shifting business to more restorative behavior? One possible answer is emerging in, of all places, pension funds. The book, *Natural Capitalism*, never mentioned pension funds but they may turn out to be a key to implementing its principles. Pension funds own much of the privately held equity of western economies. U.S. pension funds represent, directly and indirectly, 46 percent of American GDP, and 33 percent of market capitalization of the U.S. Stock Exchange. In the U.K. it is 62 percent of GDP and 42 percent of market cap. These figures are lower in some European countries but only because in those countries pensions are provided by the government.<sup>15</sup>

You might think that pension funds should have been investing in socially and environmentally responsible companies all along. Pension fund members are typically people who should have a high interest in the principles of Natural Capitalism. They're employees, workers, representatives of universities, of trade unions and of churches. They are people who tend to have strong social or environmental values. And yet pension funds traditionally have been among the most conservative of investors. What has kept these funds from being a force for social change?

In looking for leverage points to shift the pension funds, one key seemed to be the pension fund trustees, the individuals, who could, if they chose, decide to manage the

funds differently. The trustees, in theory, represent the values of the pension fund members. Yet in one instance, at a time at which workers were on strike against Continental Airlines, the workers' pension fund was increasing its investment in the Airlines' stock.

The conservative behavior of pension funds has persisted, in part, because trustees, however much they might wish to manage the pension funds according to their values, have typically felt that they could not simply vote their conscience. Feeling that they knew too little to responsibly invest the money entrusted to them, the trustees hired investment specialists, who, they believed, would know much better what to do. These investment specialists, however, rarely shared the values of the trustees or their members.

They also came equipped with a restrictive definition of the legal term "fiduciary responsibility", the responsibility of the pension fund trustees to take good care of the money entrusted to them and to invest it in such a way that at the end of the pension fund members' work life there will be money to pay a pension. Until very recently, this term has been defined in such a way as to explicitly exclude making socially and environmentally oriented investments. The definition arose because of a pervasive economic belief that such investments were financially less attractive.

To overcome such hurdles, The Global Academy, in partnership with Progressive Asset Management, held a conference to bring together trustees and managers of pension funds with experts in Natural Capitalism, and socially responsible investing. The goal was two-fold: to help those who manage pension funds to realize why investing in companies with a commitment to behaving restoratively was crucial to the long term success of pension funds, and enable the managers to take a more realistic approach to their duty. The conference needed to address not only the trustees at the individual level of their disempowerment, but also the investment advisors. It needed not only to demonstrate the economic superiority of values driven investing, but to deal with the legal definition of fiduciary responsibility. It needed to clear the barriers that arose at the level of the legal and economic systems, the barriers that arose at the organizational level of the trustees

ceding their authority to the experts, in order to deal with the sense of disempowerment at the individual level.

At this meeting, the chair of CalPERS, one of the world's largest pension funds, stated that it mattered little to him whether he invested in a company that prospered in the next quarter as against another company. CalPERS is so big, \$160 billion in assets, that it invests in essentially every major company in the economy. What matters vastly more is whether the entire economy is healthy 20 years from now, 50 years from now when he has to pay out those pensions. This line of argument introduced the concept that pension funds may be the institution in society with the biggest vested interest in sustainability. Even if short-term profits might be attained with unsustainable business practices, in the longer term business needs a healthy and natural environment to prosper.

The conference also emphasized the news that the Calvert Socially Responsible Investment Funds had successfully filed suit against the old definition of fiduciary responsibility and prevailed in court because it could demonstrate that companies with superior social and environmental performance are performing as well or better than less consciously managed companies.

Transforming pension funds into the instrument of funding investments in Natural Capitalism will be a gradual and long-term process, but the process is clearly underway. This should give hope to all who seek to shift the economy and its massive accumulation of financial capital more in the direction of Natural Capitalism.

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<sup>1</sup> This analysis concentrates on the how reversing the planetary destruction of the natural capital can be profitable. It is also true, however, that capitalism as practiced is liquidating human capital. Just as natural capital is more than the store of natural resources to be extracted from the planet, and includes the ability of the planet to sustain life, so human capital is more than a skilled workforce and includes the stability and integrity of community and culture. Part of the problem with the current ideology of globalization is that it believes that increasing and trading the two forms of capital that can easily be counted and traded: manufactured and financial capital, will increase well being for all. This formulation ignores the other two forms of capital, which being place-based, rooted in a culture or an environment, are not amenable to trade, and may in fact be harmed by it. The answer is not to ban globalization, assuming that could be achieved, but to practice it in a way that protects and enhances all forms of capital.

<sup>2</sup> WRI report: *A Guide to World Resources, People and Ecosystems, the Fraying Web of Life*, 2000, WRI, 10 G St., Washington DC, 20002, USA.

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<sup>3</sup> "Catastrophic Shifts In Ecosystems," Marten Scheffer, Steve Carpenter, Jonathan A. Foley, Carl Folke, and Brian Walker, *NATURE* #413, 10/11/01, pp. 591-596.

<sup>4</sup> All dollar figures are U.S. dollars

<sup>5</sup> Robert Costanza, et al, "The Value of the World's Ecosystem Services and Natural Capital," *Nature*, 387:253 – 260, May 15, 1997.

<sup>6</sup> Similarly, our current tax system arose from this mental model. It penalizes employment and income, and subsidizes the use of resources and needs to be reoriented. Many European countries, the EU and various states in the U.S. are considering such forms of tax-shifting as pollution taxes and employment credits.

<sup>7</sup> Paul Hawken, Amory and Hunter Lovins, *Natural Capitalism, Creating the Next Industrial Revolution*, Little Brown, 1999, available from [www.rmi.org](http://www.rmi.org). See also the website: [www.natcap.org](http://www.natcap.org).

<sup>8</sup> How to achieve this was described in the book *Factor Four*, Ernst von Weizsäcker, Amory Lovins, and Hunter Lovins, *Factor Four: Doubling Wealth, Halving Resource Use*, Earthscan Publications Ltd, London, 1997

<sup>9</sup> Janine Benyus, *Biomimicry : Innovation Inspired by Nature*, William Morrow & Co, May 1998.

<sup>10</sup> The book has been translated into about a dozen languages

<sup>11</sup> Over 50 companies have endorsed the CERES Principles, including 13 Fortune 500 firms. Such companies include: American Airlines, Arizona Public Service, BankBoston, Bethlehem Steel, Catholic Healthcare West, Ford Motor Company, General Motors, Northeast Utilities, and Polaroid. Over 2000 companies worldwide regularly publish environmental reports. And an increasing number of CERES Companies are recognized in the media, by governments, and by their stakeholders as environmental leaders in their industry and business sector. CERES Coalition Members collectively represent more than \$300 billion in invested assets and tens of thousands of individual members.

<http://www.ceres.org/about/history.htm> - top

<sup>12</sup> [www.wri.org](http://www.wri.org), Beyond Grey Pinstripes

<sup>13</sup> "The 2001 report on Socially Responsible Investing Trends in the United States", Social Investment Forum. It is available at <http://www.socialinvest.org/areas/news/2001-trends.htm>

<sup>14</sup> "Corporate Social Responsibility and Financial Performance," New Circle Communications, a presentation to Bottom Line 2001, San Francisco, April 2001.

<sup>15</sup> A.G. Monks, *The New Global Investors, How shareholders can unlock sustainable prosperity worldwide*, Capstone, Oxford, UK, 2001, P. 82, 83.