

Climate Change and Divesting

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April 26, 2021

Climate change and Covid-19 are the defining crises of our time. They demonstrate the difficulty of getting the global community to come together to combat an existential risk. With the lessons learned from the pandemic, maybe just maybe the time is here when we can act in concert on climate change. The Paris Agreement, signed by 195 countries in 2016, finally seems to be getting some traction. Canada has been a global leader in both raising awareness and doing something about it, with a carbon tax. There is a lot of misinformation and emotion involved in this topic. Try starting a discussion on it when we can finally have dinner parties again and see how long it remains a rational, amiable conversation. I want to try to show that the idea of divesting from oil and gas companies is a mistake. It may make intuitive sense that if you believe in climate change then no fossil fuel companies should be in your portfolio but this instinct is wrong.

We have to remember the wonders that fossil fuels have provided humankind. Coal powered the first industrial revolution's steam engines. Gasoline was the energy behind the second one. These revolutions have raised almost everyone's living standards to such astounding levels that we should wake up every morning with a sense of awe at our good fortune. Of course, we don't since we wake up and the first thing we do is turn on our phones and are immediately filled with envy and self righteousness. We are now entering the fourth industrial revolution and the demand for oil and gas is still climbing.

Fossil fuel use is plateauing in the developed countries but with so many people in developing countries striving for our lifestyle, oil use is increasing every year, with a pause during the pandemic. We can't expect developing countries to stop using fossil fuels and it would be disgraceful if we did. They deserve to have the same standard of living that we all too often, take for granted.

What needs to be done, if we consider the continued emissions of CO₂ to be pollution, is to put a cost on it. All countries must accept that these greenhouse gases are an external cost that is not being priced in by the market. This means a carbon tax of some kind. Canada is there now, which is a noble gesture, but we need the USA and Europe at the minimum to participate. Other countries can then follow at the pace their politics and economy allow them to.

Once greenhouse gas pollution (GHG) is properly priced then markets will solve the problem. It could be by improving and cheapening renewable energy sources such as solar, wind, hydrogen, nuclear or as of yet undiscovered sources. New energy storage capabilities through improved battery technology could be a big part of answer. Carbon sequestering - removal of carbon from the atmosphere - may be the solution. What I do know is that there will need to be a lot of testing, failing, trying again, investing, and looking at the issues different ways before the answer(s) are found. This kind of problem solving is ideal for a competitive marketplace. Governments can set the goal of less GHGs through a carbon tax and then individuals and companies with different backgrounds and talents can work on the answer.

This is why selling oil and gas companies out of an investment portfolio doesn't make any sense. These companies are the ones closest to the solution. They have the engineers and scientists most conversant in carbon extraction from the ground. Why not from the atmosphere? They are aware of the pending crisis and many of them want to help. Shareholders should be more vocal in getting the laggards on board. Send emails, letters and vote for aligned board members. What they should not be doing is throwing in the towel in moral indignation.

I have heard the argument for divesting; that if enough shareholders sell then a company's cost of capital goes up which makes them less competitive. Firstly, there is no evidence that this works. There will always be plenty of buyers if the return is high enough. Secondly, remember oil demand is growing globally so even if we shut down all those companies that are attempting to become more accountable for their GHG emissions, countries like Saudi Arabia, Russia, Iran and Venezuela would then increase their oil production to make up the difference. This would mean even less advocacy for change.

Divesting proponents also mention stranded assets and how the fossil fuel industry has not been a good investment recently. Most large-scale new projects, such as Arctic oil exploration, have been shelved. And yes, for the last few years oil has not been a good investment. Both are due to technological advancements such as fracking and better methods of extracting oil from current deposits. New technology implementation in an industry has not been a good reason historically to divest from it. It is usually an indication of dynamism and resilience.

Most of us agree that climate change is a threat. How we go about removing that threat is what we are discussing. Divesting from oil and gas stocks has a visceral appeal but its arguments don't hold up under any objective analysis. What we need to do as investors is continue to encourage energy companies to do better. Use their enormous pools of talent and resources to find answers to these increasingly urgent questions. Advocacy and education over divesting.

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