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Emission Talks at COP 26 and Hertz Buys a Tesla

Featuring:
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Mike Disabato:

What's up everyone and welcome to the weekly edition of ESG Now where we cover how the environment, our society and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato. And this week we have two stories for you. The first we talk about one of the major aspects of the upcoming COP 26 climate discussions, which look to be one of the most important global meetings on climate change since the Paris Agreement was signed. And then we have a hot take on the new deal inked between Tesla and Hertz. Thanks as always for joining us. Stay tuned.

Mike Disabato:

If you haven't heard about it yet, there's a meeting of the global mind, starting on Halloween, October 31st, called COP 26. And it's going to be the most important climate summit the world has held in years. I'll get to why that is, but first let's do some jargon defining. COP stands for conference of the parties, and it is a chance for negotiators representing humanity's governing bodies to come together and review how we are getting on with our efforts to combat climate change. COPs have been happening since 1995. They have steadily gotten bigger and involved more than just negotiators. For example, this year, we are speaking at the COP on the important role that private capital has an ushering the world toward a low carbon future.

Mike Disabato:

The ultimate goal of a COP is to emerge at the end of the two week conference with a plan of action. Like what happened in 2015, when members came together to sign the Paris Agreement in an attempt to keep warming below a two degree centigrade, but preferably at 1.5 degrees centigrade compared to pre-industrial levels. The Paris Agreement basically said the best weapon to achieve this was to dramatically reduce our greenhouse gas emissions. And the best way for countries that sign the agreement to work toward this goal was to submit emissions reduction plans or in the COP jargon, Nationally Determined Contributions or NDCs. NDCs are the heart of the Paris Agreement, the reality behind the bluster.

Mike Disabato:

But initially the NDCs that were submitted during COP 21 in Paris were what countries thought were feasible at the time, but they resulted in a set of NDCs that would put us well above the warming limit. The negotiators knew this would happen. So they put in a ratcheting mechanism into the agreement at COP 21 that every five years countries must return to the negotiating table with updated commitments to bring emissions in line with the overarching temperature targets that were set in COP 21, AKA the Paris Agreement.

Mike Disabato:

And here is where we get to why COP 26 is so important. It's the first official deadline for countries to talk about the ratcheted up NDCs. Now a lot of these NDCs have already been disclosed. And for us it's important to understand them since as NDCs are the heart of Paris, companies are often at the heart of NDCs. The issue with comparing country's NDCs from another though is countries use a multitude of formats and approaches to calculate their NDCs. So what we did for you all of course is we took each country's old and new target and made a map showing how they have changed and how each new NDC stacks up to other countries.

Mike Disabato:

And by we, I mean my colleague and guest today, Bhaveer Shah. By the way, if you want to see this map, I will post the link to it in the podcast description. And if you are itching to look before you look at the description itself, you can just go to Google and type in MSCI net-zero knowledge hub. Anyway, I called Bhaveer to walk me through his NDC map. And first I asked him to give the context as to why making a map that compares these NDCs country by country was important.

Bhaveer Shah:

There are a lot of headline numbers in the press at the moment that one country would have committed to a 50% reduction and other would have done a 40% reduction. The exercise that we have done is to try and dig into the actual implied level of emissions in 2030, that each country is effectively saying that they would commit towards. And that requires a pretty extensive data efforts because when you read the small print of a lot of these pledges, there are different numbers implied by which reference year you are taking as the start of that reduction amount or which sectors you're including in that target. For instance, there's some quite big sectors like land use, which may or may not be included in a country's target. And also the conditionality around financial support from other countries, especially for developing countries. So the exercise that we did was to go through each and every single country's NDC, and actually quantify a hardcore number of 2030 emissions.

Mike Disabato:

In practice, what this allowed us to do was set up this visual summary, showing which countries have indeed ratcheted up their NDCs and which have been lacking in the year since Paris. And before we get into what this map is showing us analytically, we first need to address why these pledges are important. The reason being is that often discussions around climate change and climate pledges can seem almost esoteric and impenetrable. Basically you have powerful people writing hard to understand treaties in order to hopefully save us all from destruction. It can all be maddening. So I asked Bhaveer before he took us through the results to describe how companies and in fact, we, those that make up the workforce of these companies will be affected by these pledges.

Bhaveer Shah:

We start off with just a policy risk for companies. The thinking is that countries that do have more ambitious commitments to reducing their emissions will at some stage need to change their policy environment to either implement carbon taxes or to design policies that achieve a similar effect. And for companies in those countries, that is a challenge that they need to be prepared for. And on the other side as well, for countries that are laggards in setting ambitious NDCS, if they suddenly do switch to a more ambitious climate pledge, whether it's under pressure from other countries, there's going to be a sudden or a disorderly change in policy that the companies will also be effected by.

Mike Disabato:

So let's stick with carbon taxes for a second. If put into place, carbon taxes would likely affect the electricity sector the most first. If your country is operating on cheap coal, for example, and it has an ambitious NDC that it begins to implement using a carbon tax to meet its ambitions, then you would see the coal sector shrink rather dramatically. That could have knock on effects for a number of sectors, but also the smooth running of an economy that's not prepared for it. One has to only look at the coal shortage in China to see what happens when feed stocks become scarce.

Mike Disabato:

Now that shortage isn't due to a carbon tax, but it's a good parallel example of what can happen to an economy's energy system if ambitious targets are put into place that don't actually reflect what's happening on the ground. Also knowing what a country's NDC says can help you understand where a government might spend its money. So that's another important aspect of this map.

Bhaveer Shah:

It's well known that the public sector tends to invest a lot in renewables and there's a partner in these bigger projects that need some quasi sovereign funding. And the countries that do actually invest in that technology will help companies to achieve their own net-zero targets either through wider or cheaper access to renewables.

Mike Disabato:

Availability of renewables can enable companies operating in those regions to achieve their own emissions reduction goals in the most cost effective manner compared to those companies operating in less ambitious regions. There's also ample evidence that countries which invest in any kind of system that is going to combat climate change will save tenfold in costs that are sure to come later as the planet continues to warm. But there are other factors that should be considered. Infrastructure spending to decarbonize local economies has the potential for job creation, but may also be coupled with inflationary effects on commodity prices or labor market segments affecting company costs.

Mike Disabato:

There's also the geopolitical issue. The EU said it is going to ensure it only imports goods that, when possible, are produced in line with its low carbon ambitions. A company without a local policy to help guide it could be caught off guard by carbon import tax that raises the price of their product to an infeasible level. One only needs to look at the complications caused by various tariffs already in place to see what can happen when such things occur. Okay. So we've touched on why this will affect companies and people in reality. Now let's go to the country by country results that Bhaveer found in his map.

Bhaveer Shah:

I think we've seen a big improvement in ambition from the US as is now well-known from the Biden pledge. And that's really resonated on to countries like Japan, perhaps to Canada as well and even to develop countries that's slightly smaller, such as South Korea, where the ambition of their pledges is materially improved compared to what you had before. I think obviously there are still gaps in terms of how exactly we get to net-zero, but it seems as if the bigger countries are leading the way in some aspects. We have seen some laggards in that space. Australia. [inaudible 00:09:39]. We haven't seen perhaps as big an improvement as we expected in their ambition.

Mike Disabato:

But what Bhaveer saw overall was a more aligned developed market. With the US coming back into the climate agreement and ratcheting up its NDC under the Biden administration, it joined other players like the EU, Canada, Japan, the UK, and others in uniformly updating their NDCs toward a more ambitious commitment. And the developed market is responsible for a large majority of the globe's emissions. So these are encouraging moves. On the emerging market side, however, there's less uniformity with leaders and laggards becoming more apparent and separating themselves from each other.

Bhaveer Shah:

So Latin America is really interesting because for a lot of countries, we actually see an increase in the ambition of the pledge bar, perhaps Brazil and Mexico. And one thing that some countries in Latin America have done is switched the way that their target was expressed from a business as usual target to a fixed level of emissions. So in other words, what the countries have done is not just raised ambition of what they're committing to, but put a specific number on it that is less vulnerable to ambiguity. And business as usual targets remain very well used within emerging markets. We think it's really encouraging that some of these countries have actually gone away from them and committed to a number.

Mike Disabato:

Let's move into a more technical aspect for all this for a moment. Country reduction plans can loosely be put into three camps. There are some countries that have set a fixed number for their reduction plans. For example, South Africa has a new fixed emissions reduction pledge to reduce emissions by 419 mega tons of CO2 equivalent by 2030. Then there are the business as usual reduction plans, which set emission targets based on current emissions and estimates for GDP or population forecasts or trends in energy consumption and emissions. For example, in China's new NDC, they said they would reduce their emissions by 65% by 2030 using a 2005 greenhouse gas emissions intensity level based on their GDP. I.e, they're reducing the amount of carbon emitted per unit of GDP.

Mike Disabato:

And then there is the most common type of carbon reduction plan. The baseline plan. The plan that says we emitted 4 million metric tons of carbon dioxide in 2001. So in 2030, we are going to emit 30% less than that. This is what the US used to set its new NDC to reduce emissions by 50% to 52% by 2030 from 2005 levels. And countries in the EU have set their NDCs to follow a similar strategy using a baseline of 1990 for their emission reduction targets. There's a problem with baselines though. You can choose a year that you want. There's no rule saying you have to choose one year or the other. So you can find a year where you had, let's say, higher emissions than normal. And what you can do is then use that as a way to set a less ambitious plan than it might seem. Actually one country in Latin America did this that Bhaveer saw.

Bhaveer Shah:

So one interesting example is Brazil, where the actual headline pledge to reduce emissions in terms of percentage reduction remained pretty much unchanged at 43% from 2005 levels. But when you dig into what was actually submitted to the UNFCCC and the Paris Agreement, one of the things that Brazil did was to revise up the historical level of emissions in 2005, which effectively means that the target now is weaker than what it was before because in some sense history has been rewritten to a high level of emissions. And that's not always visible from the headline pledge. It's not always visible even from the way the NDC document is presented.

Mike Disabato:

And so what this map allows you to do is you can see that, and then also compare Brazil with one of its neighbors. Let's say Argentina.

Bhaveer Shah:

Argentina is a country where previously the pledge was to reduce emissions by a certain amount relative to a 2030 hypothetical. And now we actually have a fixed level of emissions that's been committed to by the country, irrespective of business as usual conditions, such as economic growth or population change.

Mike Disabato:

There's another piece of this map that we didn't get to, but is as important as the ambitions of a country's government. The sectoral burdens that are included within a country's economy. Countries that might otherwise be economically or geographically similar, may differ considerably on their sectoral emissions profile. This suggests the need for different strategies and policies in the years ahead. So to provide a clear picture of this sectorial challenge that could lie ahead, we have a pop-up bar in that map that Bhaveer made, which shows each sector's current share of emissions within each country.

Mike Disabato:

So I want to end this section today with a philosophical discussion of maps, because maps are quite important. They provide an identity to a region and its countries. They allow us to solve problems to the physical world by seeing large expanses in miniature form. And being able to show the ambition of climate targets at a map allows us as investors, as companies, as citizens to understand where risks might lie or where opportunities are being formed. We can be galvanized by that to do either support work or to try to rally those that have the power to change, to work toward a future we would like to see. And this is good to know because COP 26 will be extremely important for the future of our society. And we have to hope that it can provide us with a map that we can all use to go forward and lower our collective emissions.

Mike Disabato:

So one way to help countries meet their NDCs is to electrify their transportation systems. And this week, one of the loudest players in the electric vehicle market, Tesla, signed a deal with rental car company, Hertz, for Tesla to deliver over 100,000 of its cars to Hertz by the end of 2022. The deal was for 4.2 billion us dollars, and it pushed the valuation of Tesla up to around one trillion US. I don't talk about Tesla much, but I can't resist talking about the company when there's big news like this. So I called up my cohost Bentley Kaplan, who also covers the transportation sector for us, and I asked him what he thought about the deal.

Bentley Kaplan:

So Hertz, the car rental company has been through a weird couple of years. Last year was COVID 19 so there was a big drop in travel and the company actually filed for bankruptcy in May. And just before that, a laid off furloughed about a quarter of their workforce. So it was really, really tough times. They've managed to find their way through that and then a few days ago dropped this very big announcement that they're going to order 100,000 Teslas to strengthen the electric vehicle offering of their fleet. So across the world, you've got car rental companies that are slowly trickling in EVs and hybrid electric vehicles, but it's not a core offering. And there's a few reasons for that.

Bentley Kaplan:

But obviously now there's a lot of pressure on car rental companies to provide some differentiation. So if you're a traveler who wants a low carbon option, or if your business, especially is that's now looking to reduce scope three emissions or something like that, then having electric vehicles available is a big deal. So Hertz deciding to make this very, very big order from Tesla signals that it's leapfrogging over a number of competitors that may have been ahead of them.

Mike Disabato:

I think this was a big deal for Tessa because they've had questions about whether or not they can actually become a major car player, the likes of which are Ford and Toyota and other major manufacturers like that. But in terms of spearheading the electric vehicle market, helping the world decarbonize, is this a bigger deal for Tesla or is this a bigger deal for Hertz in your opinion?

Bentley Kaplan:

What is interesting is that the questions around whether Hertz is doing this as a carbon emission saving option, if that's their main reason for doing it. And there's some question marks around that because Hertz has not really got any clear carbon reduction targets out. And a lot of our internal modeling shows the company is not aligned with a two degree warming scenario. But what is interesting is combined with the electric vehicle offering, the Tesla brings you a new level of convenience. Because of the automation and because of the connectedness, you aren't necessarily tethered to a rental hub. You don't need to go to the airport to get a Tesla. if you have the right app set up on your phone, you can unlock it where it happens to be. There's a certain level of convenience, plus prestige and the consumer preference for low carbon. So whatever is driving this demand it will result in a reduced carbon footprint for Hertz. But if investors are looking to the company for a two degree scenario trajectory, they still have quite a way to go to do that.

Mike Disabato:

And that's it for the week. Go on, thank Bhaveer and Bentley for discussing this week's news of [inaudible 00:19:43] twist. I want to thank you so much for listening. Don't forget to tune into COP 26. It'll be really interesting to see what the aspects of the negotiations come out to. And I'm definitely going to be watching. We'll be reporting on that next week and probably the weeks to come. If you liked what you heard, don't forget to rate and review us. That always helps. Subscribe if you want to hear my voice every week. Thanks again, and talk to you next week.

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