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<b>14. ABSTRACT</b>  Corporate interest in Environmental, Social, and Governance (ESG) initiatives encouraging companies to include more diverse groups of stakeholders and objectives other than profit maximization. Some of these ESG objectives overlap with the work and responsibilities of the government. Government policies often depend on incentivizing corporations through financial incentives. Overlapping interests between corporations and government policy do not guarantee that the actions taken to achieve them will be in alignment and may cause disruptions. In an increasingly globalized economy, ESG initiatives remain subject to the preferences of a corporation's controlling officers and shareholders that may not share the values and objectives of the American people expressed through government policies. The government should develop standard corporate ESG reporting processes that provide reliable information to stakeholders and represent American values and objectives. Additional research is needed to understand how corporate ESG initiatives affect specific government policies, especially those relating to national security issues such as energy, sanctions, and technological innovation.									
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## Corporate ESG Initiatives: A Complicating Factor in National Security Policy



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## Introduction:

The critical relationship between the government and private corporations is changing. For various reasons, corporations are becoming more active in sharing their values or taking a stance on public issues. The expression of corporate values and efforts to shape their environment are called environmental, social, and governance initiatives or ESG. In February 2022, the world witnessed remarkably rapid and widespread actions taken to impose economic punishment on Russia and its leaders due to its invasion of Ukraine. Over thirty countries imposed sanctions in a matter of weeks, and over 1,000 companies took additional actions beyond the sanctions to penalize Russia.<sup>1</sup> The US and EU closely coordinated the government sanctions with other allies and partners to achieve the best mix of pressure on financial services, businesses, oligarchs, and government officials to try to alter behavior without degrading the world economy. The corporations acted independently and were not limited to specific industries or targeted pressure points in Russia. Actions by corporations had wide-ranging effects on manufacturing, energy, consumer goods, and transportation.<sup>2</sup> For example, McDonald's shut down operations in Russia, affecting 62,000 employees.<sup>3</sup> While the government and corporate actions shared a goal of punishing Russia and changing its behavior, there needed to be greater unity of effort to maximize the effectiveness of the government policies and corporate actions. Corporate activism on international or transnational issues is not limited to events in Russia. These corporate interests and actions can be seen in British Petroleum's transition

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<sup>1</sup> "Over 1,000 Companies Have Curtailed Operations in Russia-but Some Remain." Yale School of Management. Yale School of Management, November 2022. <https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain>.

<sup>2</sup> Funakoshi, Minami, Hugh Lawson, and Kannaki Deka. "Tracking Sanctions against Russia." Reuters Graphics. Reuters, July 7, 2022. <https://www.reuters.com/graphics/UKRAINE-CRISIS/SANCTIONS/byvrjenzmve/>.

<sup>3</sup> "McDonald's To Exit from Russia." *McDonald's*. McDonald's Inc, May 16, 2022.

<https://corporate.mcdonalds.com/corpmcd/our-stories/article/mcd-exit-russia.html#:~:text=CHICAGO%2C%20May%2016%2C%202022%20%E2%80%93,to%20sell%20its%20Russian%20business>.

to green energy and ConocoPhillips' corporate ethics and transparency policies.<sup>4</sup> More companies are participating in ESG initiatives for a growing list of reasons and desired end states.

It is difficult to find an agreed-upon definition of ESG initiatives and their force on the market; however, their effects can be seen prominently in two areas. First, businesses are pursuing objectives in environmental, social, or governance areas as new measures of their success. Over 70% of companies on the S&P 500 published an ESG report, and shareholder proposals for ESG initiatives rose by 37% in 2021.<sup>5</sup> Second, the changes in investing and capital management support companies with ESG objectives. The latter group is based partly on the United Nations Principles of Responsible Investing (PRI), created in 2005.<sup>6</sup> Since its founding and partnership with the New York Stock Exchange, PRI has grown to over 7,000 participating fund managers with over \$120 trillion under management. Despite the growing participation, there is very little standardization about what actions qualify as ESG initiatives, what is materially significant to investor decisions, and what the ESG efforts mean for government efforts and regulations.<sup>7</sup>

Many government policies and initiatives would fail to achieve results without predictable participation by the private sector. The development and implementation of national security policies are becoming more complicated because of the increased pursuit of ESG initiatives by US-based multinational corporations. There are three critical reasons the interaction between corporate ESG interests and government aims will hinder the effectiveness of government policy. First, government programs and policies such as international sanctions and developing a defense-industrial base are less successful and harder to develop when corporations act unpredictably.

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<sup>4</sup> "Corporate Governance Winners 2019." Ethical Boardroom | Global Governance Issues & Analysis, August 6, 2019. <https://ethicalboardroom.com/corporate-governance-winners-2019-the-americas-caribbean/>.

<sup>5</sup> Pérez, Lucy, Dame Vivian Hunt, Hamid Samandari, Robin Nuttall, and Krysta Biniek. "Does ESG Really Matter--and Why?" McKinsey & Company. McKinsey & Company, October 24, 2022. <https://www.mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why>.

<sup>6</sup> Gnanarajah, Raj, Gary Shorter. *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*. CRS Report No. IF 11716. Washington, DC. Congressional Research Service, 2023. <https://crsreports.congress.gov/product/pdf/IF/IF11716>

<sup>7</sup> Gnanarajah. *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*.

Second, the government's ability to shape its interests is weaker when corporate ESG initiatives overlap with interests that have historically been the purview of the state. Finally, different prioritization and loyalties between the government and corporations cause them to have diverging objectives for their overlapping interests and can create new opposition to government policies. Additional research is needed to craft policies that maximize the benefits of the changing relationship between the government and US-based corporations engaging in ESG actions.

### **Corporate Unpredictability - A hindrance to policy**

A fundamental tenet in American society is free market capitalism. This open market shapes how corporations interact amongst themselves, with stakeholders, and the government in pursuit of their business objectives. This objective is often assumed to be profit maximization; however, the rise of ESG initiatives is opening the door to pursuing other goals. The US government depends on private companies to be predictable in their actions to operationalize policies, including international sanctions and developing a defense-industrial base. Without this predictability, the effects of a policy will be unknown and potentially counterproductive to the US national aims.

Many US government policies, including those on sanctions and energy resource development, are not directly implemented and operationalized in the market by the government. Francesco Giumelli and Michal Onderco's analysis of how the government implements and enforces sanctions found that the work falls largely to private corporations.<sup>8</sup> In response to government policies, corporations self-limit their business activities to reduce the risk of violating laws and punishment or pursue opportunities with government incentives. The responsibility to interpret the sanctions law and the necessary measures to enforce them resides with the corporation.<sup>9</sup> This policy

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<sup>8</sup> Giumelli, F., & Onderco, M. (2021). *States, firms, and security: How private actors implement sanctions, lessons learned from the Netherlands*. *European Journal of International Security*, 6(2), 190-209. doi:10.1017/eis.2020.21

<sup>9</sup> Giumelli. (2021).

approach relies on corporations to implement sanctions or other policies based on a profit-maximizing calculation of the following elements: the value of the forgone transactions, the cost of customer due diligence, the probability of enforcement action and penalties for violations that consider if the corporation made an honest mistake or was negligent. The government can tweak the degree of sanction effect on the targeted entity by altering the risk and cost calculations of US companies that may desire to do business with a sanctions target.<sup>10</sup> The government does this by changing the likelihood of being prosecuted for violations or the penalties imposed. Examining the business environment makes it possible to understand each element of the company's calculations. When aggregated with other firms facing the same choices and seeking the same goals, it can be relatively predictable for government policymakers. The government can no longer predict this cost-benefit calculation when corporations introduce new motivations besides profit maximization, such as various ESG interests.

Policies executed through incentives such as tax breaks or streamlined permitting are areas where the government depends on predictable profit-maximizing corporations to make the policy effective, such as in energy extraction on federal lands. Government efforts to achieve "energy dominance" through increasing domestic oil and natural gas production depended on private companies to deliver the projects.<sup>11</sup> To achieve this, regulations and laws were changed to encourage the extraction of fossil fuels. For example, the government may reduce the need for environmental impact studies or fees paid in areas where the government would like to have a new oil field. However, the ESG values of energy corporations such as British Petroleum (BP) opposed this kind of fossil fuel development. BP took action to reduce investment in oil exploration,

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<sup>10</sup> Giumelli. (2021).

<sup>11</sup> IEA (2019), *Energy Policies of IEA Countries: The United States 2019*, Energy Policies of IEA Countries, IEA, Paris, <https://doi-org.usnwc.idm.oclc.org/10.1787/9b460fba-en>.

including cutting the responsible team by 85%, as part of a shift away from carbon fuels.<sup>12</sup> BP took this action despite efforts of the US government to encourage energy security by lowering the royalties paid on oil and coal extraction and offering companies more flexibility.<sup>13</sup> The government will not achieve its policy aims if corporations prioritize ESG objectives and not pursue the project regardless of incentives in government policies.

The government also relies heavily on corporations to implement and enforce sanctions through profitability and legal risk calculations. Closely controlling the pressure applied on states through sanctions is an important balancing act for the government in international politics. Sanctions are best implemented as part of a multi-faceted, multi-lateral policy of coercion to achieve the desired changes by the target state.<sup>14</sup> An example is the complex, tightly controlled sanctions against Iran by the US, EU, and UN that successfully pressured Iran to accept the 2015 Joint Comprehensive Plan of Action and curtail its nuclear program. In comparison, the pressure applied to Russia in 2022 did not have this level of coordination. Western government sanctions aimed to have a profound and targeted impact on individuals who could shape Russian decision-making by restricting particular companies and transaction types.<sup>15</sup> In contrast, corporate actions directly impacted Russian workers and consumers. Excessive economic force can cause undesired consequences, including the collapse of an economy that results in a regime failure or widespread suffering of the population. When governments and corporations take simultaneous actions to

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<sup>12</sup> "BP's Oil Exploration Team Swept Aside in Climate Revolution." Postmedia Network Inc.

<https://www.proquest.com/docview/2480440484?parentSessionId=bkenDv%2B95wDDiu8mkZ1B04pp%2Bt9QMN%2FhyXaKBUEURZw%3D&pq-origsite=primo&accountid=322>

<sup>13</sup> IEA (2019), *Energy Policies of IEA Countries: The United States 2019*.

<sup>14</sup> O'Toole, Brian, and Samantha Sultoon. "Sanctions Explained: How a Foreign Policy Problem Becomes a Sanctions Program." Atlantic Council. The Atlantic Council of the United States, October 1, 2019.

<https://www.atlanticcouncil.org/commentary/feature/sanctions-explained-how-a-foreign-policy-problem-becomes-a-sanctions-program/>.

<sup>15</sup> Welt, Cory, Kristen Archick, Rebecca Nelson, Dianne Rennack. *U.S. Sanctions on Russia*. CRS Report No. R45415. Washington, DC. Congressional Research Service, 2022. <https://crsreports.congress.gov/product/pdf/R/R45415>

impose an economic cost on a state, they may need more synchronization to maximize the effect and apply proper restraint, when required, to achieve national aims.

The extent of corporate interest in sanctions and international issues is difficult for the government to predict. Corporations in the US and EU are generally unlikely to lobby their governments either for or against sanctions.<sup>16</sup> This lack of corporate signaling about their desires makes it more challenging to understand the relationship between their objectives, other than profit maximization, and a proposed policy. If a set of sanctions or other policies aligns with a company's ESG values, they may enforce it with vigor, as seen in the 2022 sanctions on Russia. Conversely, if the government policy is antithetical to ESG values, some companies will not take advantage of opportunities created by the government policy, forgo some profits, and prioritize ESG objectives. Social pressures on employees at Google caused the company to not renew a US Department of Defense contract in 2018,<sup>17</sup> However, by 2021, the company was again prioritizing profitability over employee social pressure and pursuing Pentagon contracts.<sup>18</sup> With an improved understanding of corporate ESG objectives, government policymakers can predict the direction corporations will lean on a policy, the degree to which the policy will change behavior and, more accurately target policies to achieve the desired effect in a free market.

### **Overlapping Government and Private Interests:**

Corporate ESG initiatives are creating new overlapping interests and responsibilities for the government and corporations. As clearly stated in the United States Constitution, the government's purpose is to "establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty." Through measures such as the

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<sup>16</sup> Giumelli. (2021). p 207.

<sup>17</sup> Daisuke Wakabayashi and Scott Shane, "Google Will Not Renew Pentagon Contract That Upset Employees," The New York Times, June 1, 2018, Accessed 11 May 2023, <https://www.nytimes.com/2018/06/01/technology/google-pentagon-project-maven.html>.

<sup>18</sup> Daisuke Wakabayashi and Scott Shane, "Google Will Not Renew Pentagon Contract That Upset Employees," The New York Times, June 1, 2018, Accessed 11 May 2023, <https://www.nytimes.com/2018/06/01/technology/google-pentagon-project-maven.html>.



Clean Water Act (1972), Civil Rights Act (1964), and Securities Act (1933), the government has traditionally held responsibilities to regulate and support environmental, social, and governance areas of public interest. These laws impose restrictions or offer incentives to shape the free market to serve the people's interests. The government's agenda is shaped by the population's values, fears, or interests and reflected in the elected lawmakers.

The governing stakeholders in corporations today are showing a greater interest in areas that have traditionally been the purview of the government. ESG initiatives encourage corporations to take an interest in international and transnational issues, such as climate change and sanctions. The energy sector has had exceptionally high ESG activity in recent years. Some of the most high-profile ESG activism include companies such as Exxon, Royal Dutch Shell, and BP.<sup>19</sup> In 2022, after pressure from activist investor groups, BP adopted a resolution to be carbon neutral by 2050, along with intermediate goals.<sup>20</sup> The reasons cited for pursuing these business changes were primarily about stopping global climate change and other harmful environmental impacts from the existing business models. Controlling environmental impacts from business operations is no longer just a government concern.

Corporations are finding economic incentives to pursue actions in ESG fields. Studies by McKinsey and Co. have shown that ESG investing by companies has positively impacted financial performance in 63% of cases and negative impacts in only 8%.<sup>21</sup> Consumer trends to support products from companies with ESG initiatives further incentivizes corporations to change. Specifically, within the environmental initiatives, consumers across various sectors are willing to

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<sup>19</sup> Wilson, Tom. "Oil Majors under Pressure as Activist Investors Circle." Financial Post. Financial Times, December 23, 2021. <https://financialpost.com/commodities/energy/oil-gas/oil-majors-under-pressure-as-activist-investors-circle>.

<sup>20</sup> Bouso, Ron, and Shadia Nasralla. "BP Wins Shareholder Support for Climate Strategy." Reuters. Reuters, May 12, 2022. <https://www.reuters.com/world/uk/bp-chief-says-uk-windfall-tax-would-not-affect-investment-plans-2022-05-12/>.

<sup>21</sup> Witold Henisz, Tim Koller, and Robin Nuttall. "Five Ways That ESG Creates Value - McKinsey & Company."

McKinsey Quarterly. McKinsey and Co., November 2019.

<https://www.mckinsey.com/~media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx>.

pay five percent more for a green product than a similarly performing alternative.<sup>22</sup> The evidence gives companies backing to support ESG initiatives even when they do not meet traditional profit maximization criteria. The Supreme Court has ruled in *Burwell v. Hobby Lobby Stores Inc.* that corporations can exist for any lawful purpose, and this is not limited to profit maximization.<sup>23</sup> This ruling opens legal pathways for corporations to state their ESG objectives and incorporate them into business practices. Corporations now have the economic and social incentives to pursue ESG interests and a legal precedence that allows them to pursue these interests. This new overlap in areas of concern will complicate the formulation of government policy and inherently contains a risk of diverging objectives.

### **Shared Interests, but (Sometimes) Diverging Objectives**

Despite the growing overlap in corporate and government interests, the objectives and methods used to achieve results may still conflict. The stakeholder priorities and non-negotiable requirements for a corporation and government to continue functioning are substantially different. The path to achieving even shared objectives may be fraught with conflict.

To be sustainable, a state must deliver security and prosperity for all its people. States operate within an anarchical system where the people have organized to advance their interests and take care of themselves.<sup>24</sup> The US government pursues the interests outlined in the Constitution and National Security Strategy (NSS) by putting forth laws and policies to shape the community's actions and serve the collective interests. The NSS specified two goals for the US government that drive policymaking. The first goal is to succeed in international competition with other states by promoting human rights and growing a free and level economy. The second is to overcome

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<sup>22</sup> Witold Henisz, Tim Koller, and Robin Nuttall. "Five Ways That ESG Creates Value - McKinsey & Company.", November 2019.

<sup>23</sup> Lyman Johnson, and David Millon. "Corporate Law After Hobby Lobby." *The Business Lawyer* 70 (2015). [https://www.americanbar.org/content/dam/aba/publications/business\\_lawyer/2015/70\\_1/article-hobby-lobby-201501.pdf](https://www.americanbar.org/content/dam/aba/publications/business_lawyer/2015/70_1/article-hobby-lobby-201501.pdf).

<sup>24</sup> John Ruggie, "The Balance of Global Public and Private Power: A Tale of Two Worlds." *Journal of International Affairs*, 2018. <https://jia.sipa.columbia.edu/online-articles/balance-global-public-and-private-power-tale-two-worlds>.

challenges, including climate change, energy shortages, and food insecurity, to promote the welfare of the United States.<sup>25</sup> The NSS makes it clear that the objectives of the United States government policies are to benefit all American people by securing power in the international system, creating opportunity, and protecting against transnational threats. The government does not get to choose its stakeholders and is ultimately accountable to the voters to deliver on their interests and objectives.

In contrast to the government objectives, a corporation exists to maximize value for its select group of stakeholders. Through ESG initiatives, controlling officers expand the stakeholder groups considered in corporate decision-making beyond shareholders and fiduciary obligations. Companies now include employees, customers, suppliers, and the community as stakeholders in their decisions.<sup>26</sup> The community stakeholder group can include the neighborhood, environment, and government. Not all voices and opinions of the stakeholders have an equal contribution. As discussed in the case of BP, activist investors have become more influential in their decision-making process. Venture Capital (VC) investors can have a similar effect in altering the objectives and loyalties of a company by influencing the corporate directors.<sup>27</sup> Diversifying ownership through VC or multinational operations or ownership can bring in more goals and interests that contribute to shaping ESG initiatives and interests. Through complex ownership and stakeholder management, corporations can shape who has a voice, but without transparency, it isn't easy to understand the company's objectives. As corporate interests consider more stakeholders and objectives beyond profit maximization, no two companies will balance these stakeholders in the same way.

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<sup>25</sup> President (2021- : Biden), National Security Strategy § (2022). <https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf>.

<sup>26</sup> “Business Roundtable Redefines the Purpose of a Corporation to Promote 'an Economy That Serves All Americans'.” Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' | Business Roundtable, August 18, 2019. <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

<sup>27</sup> Lei Wang, Huanhuan Huang, and Yunbi An. “Technological Fit, Control Rights Allocation, and Innovation Performance of Corporate Venture Capital-Backed Enterprises.” *Venture Capital (London)* 23, no. 3 (2021): 229–55. <https://doi.org/10.1080/13691066.2021.1905931>.

The United States NSS identified innovation as a critical source of national power that provides a competitive advantage in the international system. Both large corporations and startup companies, often backed by VC, engage in technological innovation. Each is critical to achieving technological advancements. In 1946 the American Development Corporation was created as the first modern VC company. The funding came from local sources and went to local companies that would be future assets for the American people.<sup>28</sup> In this model of VC, owners came from the same national community as the entrepreneur and likely shared some common values or objectives. Many of the most innovative and ubiquitous companies in modern life began as V.C.-backed startups in the last 25 years, including Google (1998), Meta-Facebook (2004), Uber (2009), and Instacart (2012). A 2022 study found that investments from international VC and syndicated investors were more likely to see positive returns than government or local funding for innovation.<sup>29</sup> Since 1989, US-based multinational corporations have conducted approximately 70% of private sector R&D in the US.<sup>30</sup> It is also important to note that for multinational corporations, it costs less and is more rewarding to be politically active and lobby for transnational issues compared to corporations in a single country.<sup>31</sup> A combination of the increasingly global VC market and the amount of R&D conducted by multinational corporations indicates that the controlling ownership of innovation is no longer local or based in a community with common interests. The diverse owner's values and home communities of these innovative US companies can also change their perspective on ESG objectives and actions. The extent to which the US can claim responsibility for fostering

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<sup>28</sup> Dan Xin Huang, "Could Venture Capital Be the New Frontier in Great-Power Competition?" *Foreign Policy*, November 2, 2022. <https://foreignpolicy.com/2022/11/02/venture-capital-us-china-competition-frontier-fund/>.

<sup>29</sup> Cailou Jiang, and Dehai Liu. "Effects of Venture Capital on Green Technology Innovation in New Energy Vehicle Industry in China." *Energy & Environment (Essex, England)*, 2022, 958305-. <https://doi.org/10.1177/0958305X221130135>.

<sup>30</sup> C. Fritz Foley, James R. Hines, David Wessel, and Raymond Mataloni. "Multinational Activity in the Modern World." Essay. In *Global Goliaths: Multinational Corporations in the 21st Century Economy*, 1–32. Washington, DC: Brookings Institution Press, 2021. p18. [https://www.brookings.edu/wp-content/uploads/2020/05/9780815738558\\_ch1.pdf](https://www.brookings.edu/wp-content/uploads/2020/05/9780815738558_ch1.pdf).

<sup>31</sup> Foley. "Multinational Activity in the Modern World." p30.

innovation and depending on it as a national strength diminishes as the values and stakeholders driving corporations become increasingly global.

The motivations and measures of success for ESG initiatives are sometimes unclear as a growing group of stakeholders backs them. ESG initiatives seek to influence societal issues; however, clear economic motivations still drive this decision. While government or non-profit impact investors can spend money for an environmental or social impact, corporate ESG frameworks remain constrained by economic viability and fiduciary obligations.<sup>32</sup> This creates more choices for the owners in deciding if and what ESG initiatives to pursue. Devising a measure of success further complicates the issue after choosing the ESG objective. Research by Deloitte predicts growing expectations for transparency of ESG initiatives that will resemble the detail and scrutiny given to financial reporting and auditing.<sup>33</sup> As part of the 2015 Paris Agreement, the UN promotes transparency in environmental ESG initiatives by introducing the International Sustainability Standards Board in 2021 with regulations on consistent impact reporting for private companies.<sup>34</sup> While the adoption of this transparency is still limited, it will be difficult for outside observers, including government policymakers, to understand and predict corporate actions.

Overlapping interests are insufficient to align the actions of corporations and the government naturally. The shared stakeholder groups for America-based corporations and the government will continue to shrink as corporations become increasingly global due to international supply chains, multinational ownership, and the globalization of VC funding. Each of these elements also drives increased corporate interest in ESG initiatives and potentially diverging

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<sup>32</sup> Jaclyn Froughi, "ESG Is Not Impact Investing and Impact Investing Is Not ESG." Stanford Social Innovation Review, November 10, 2022.

[https://ssir.org/articles/entry/esg\\_is\\_not\\_impact\\_investing\\_and\\_impact\\_investing\\_is\\_not\\_esg](https://ssir.org/articles/entry/esg_is_not_impact_investing_and_impact_investing_is_not_esg).

<sup>33</sup> Kristen Sullivan, "Harness the Power of ESG Transparency." Deloitte United States, May 29, 2020.

<https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/harness-the-power-of-esg-transparency.html>.

<sup>34</sup> Adam Howard, Caroline Kim, Greg Norman, and Simon Toms. "ESG: 2021 Trends and Expectations for 2022." The Harvard Law School Forum on Corporate Governance, February 25, 2022.

<https://corpgov.law.harvard.edu/2022/02/25/esg-2021-trends-and-expectations-for-2022/>.

objectives along their path to a common goal. Corporations can choose their objectives and how they measure and report on their success to the public. This flexibility makes it difficult for policymakers to understand and leverage corporate behavior toward shared goals.

### **Counter Argument:**

Critics may argue that government and corporate objectives are not all that different, and this interaction through shared interests is not new. ESG initiatives are helping the world address pressing issues and create value. The government exists for the expressed purpose of pursuing the vital interests of the people. Corporations are now pursuing some of the same interests and finding synergies with government policies. Instead of framing corporations as pursuing different objectives for shared interests, they can be seen as working towards the same goal with some additional restrictions placed on them by shareholders, similar to how voters shape the government. Many of the corporate ESG objectives are also found in government policy objectives. Examples include BP's carbon neutrality,<sup>35</sup> proactive diversity, equity, and inclusion reporting from CultureAmp,<sup>36</sup> and award-winning corporate governance and ethics transparency practices by ConocoPhillips.<sup>37 38</sup> These corporate initiatives can be matched with a government policy that is working towards the same goal; the climate change targets set in the Inflation Reduction Act,<sup>39</sup> increased opportunities for underrepresented groups through federal affirmative action regulations,<sup>40</sup> and the Sarbanes-

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<sup>35</sup> Alex Blackburne, "Investors Back BP Net-Zero Plan as Activist's Climate Campaign Falter." S&P Global Market Intelligence, May 13, 2022. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/investors-back-bp-net-zero-plan-as-activist-s-climate-campaign-falters-70319803>.

<sup>36</sup> Aubrey Blanche, "DEI in 2022: Key Trends and Findings." Culture Amp Inc., July 11, 2022.

<https://www.cultureamp.com/blog/dei-2022-trends#:~:text=DEI%20in%202022%3A%20Key%20trends%20and%20findings%20%7C%20Culture%20Amp&text=Employee%20engagement%20%E2%86%92Understand%20your,in%20the%20flow%20of%20work>.

<sup>37</sup> "Code of Business Ethics and Conduct." ConocoPhillips code of Ethics. Accessed January 18, 2023.

<http://static.conocophillips.com/files/resources/codeofethics.htm#2>

<sup>38</sup> "Corporate Governance Winners 2019." Ethical Boardroom | Global Governance Issues & Analysis, August 6, 2019. <https://ethicalboardroom.com/corporate-governance-winners-2019-the-americas-caribbean/>.

<sup>39</sup> "New OMB Analysis: The Inflation Reduction Act Will Significantly Cut the Social Costs of Climate Change." *The White House*, August 23, 2022. White House. New OMB Analysis: The Inflation Reduction Act Will Significantly Cut the Social Costs of Climate Change.

<sup>40</sup> "Affirmative Action Program." Federal Register. National Archives, November 13, 2020. <https://www.ecfr.gov/current/title-41/subtitle-B/chapter-60/part-60-2>.

Oxley Act<sup>41</sup> that requires public companies to disclose ethics and governance policies. In these situations, the corporate ESG initiatives are substantially aligned with government interests, and their synergy improves the final outcomes.

### **Rebuttal**

It would be a mistake to dismiss the advancements achieved by ESG initiatives. However, there are limits on what corporations can and should accomplish regarding international issues. The successes of ESG initiatives and alignment with government policy are easy to see when the objectives are nearly unlimited, such as preventing immediate environmental damage or safety issues. The complicated interactions become more prevalent when government policy tries to strike the right balance between competing priorities. When ESG initiatives toil in these more nuanced policies, the balance of power and authority between corporations and the government shifts to the detriment of the citizens. As seen in the 2022 Russia sanctions, corporate ESG initiatives can hinder the government's ability to apply measured and directed pressure on Russia due to the lack of coordination of government and private actions. Government sanctions targeted the behavior of individual leaders, while private actions directly affected the Russian people and economy, such as McDonald's withdrawal from the country. In the energy sector, government policies strive for a phased transition to green energy as it balances priorities in climate change, energy security, and economic damage that is possible from a rapid change in a global market. ESG initiatives in the energy sector can conflict with this balance as it often prioritizes climate change outcomes, such as BP's plan to rapidly shift away from fossil fuels. These examples show how ESG initiatives can be one-sided and may not balance each factor impacting national security and the holistic operating environment.

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<sup>41</sup> "Sarbanes-Oxley Act." Legal Information Institute. Cornell Law School, April 2021. [https://www.law.cornell.edu/wex/sarbanes-oxley\\_act](https://www.law.cornell.edu/wex/sarbanes-oxley_act).

While every citizen has an equal vote to shape the government, only the shareholders have ultimate control in shaping a corporation. Allowing corporations to assume responsibility for leading change to solve international and transnational issues will include a corresponding drop in the government's accountability to the people to protect their equities in these complex issues. Legal challenges and economic uncertainty may change the corporate appetite for ESG initiatives while having no obligation to follow through on these ESG objectives. However, the existential threat addressed by some ESG initiatives, especially climate change and energy security, will ensure continued interest in some ESG objectives. Even if corporate interest levels off, corporate engagement in government responsibilities will continue complicating the development and implementation of government policies vital to national security. The government can look for ways to utilize corporate ESG interests but cannot abdicate responsibility for national issues that overlap with ESG initiatives today.

## **Recommendations**

Corporate ESG initiatives are here to stay, and policymakers must embrace them as a new factor in planning. The risk created by ESG initiatives is from their complex and unpredictable implementation and potential to not align with US objectives. There are opportunities and a need for additional research in business, economics, and sociology about the motivations and causes for the rise of ESG initiatives. The efforts by the UN to promote consistency in reporting through the International Sustainability Standards Board is a good start, but more can be done. Like technological innovation, the first to arrive has an advantage in shaping the practices for ESG reporting. The United States can secure this leadership role by immediately acting on two fronts. First, study the interaction of ESG interests and specific policy proposals, especially those relating to national security, such as energy policy, global trade, and sanctions. The relationship between government policy and corporate action will be as diverse as the objectives they set out to achieve.



The first policies to study are those critical to national security and with the most significant risk of ineffectiveness due to unpredictable corporate actions. Second, develop comprehensive reporting standards that capture all three ESG elements, incorporate American values, and the ESG initiatives' relationship to government responsibilities and objectives. There is an opportunity for the government to meet the needs of VC and individual investors alike by providing a scorecard to measure ESG performance. In developing this standard, the US can ensure the representation of its values and objectives in the information presented to those best situated to influence corporate ESG actions.

## **Conclusion**

Through this analysis of the intersection of corporate ESG initiatives and government policymaking, it is clear that expanded corporate objectives are making policy implementation more complicated. The United States government depends on consistent behavior from corporations as it maneuvers the country within the international system and promote domestic prosperity. The government needs corporations to operationalize its economic tools of national power through sanctions, energy production, and technological innovation. As corporations individually include a greater range of stakeholders in their decision-making, it is harder for the government to anticipate the actions and extent of corporate effort toward their new interests. Perhaps most importantly, the objectives of corporate ESG initiatives are sometimes unclear in their relationship with government policies, relative importance to the company, and lack of transparency. ESG initiatives will continue to evolve and complicate government policy development and implementation. Still, through additional research on specific policy areas, close collaboration between corporations and the government, and ESG transparency, we can improve the outcomes for corporations, the government, and the stakeholders they serve.