



The COVID-19 pandemic is exposing gaping fissures in the economic, social and political structures of many countries.

COVID-19 and ESG data: spotting the cracks before the quake

Can country ESG data help identify potentially dangerous fissures and help predict its preparedness for crises?

The Coronavirus has shaken the foundations of many countries with devastating effect. But many of the structural weaknesses that have exacerbated the crisis, were already visibly evident in country ESG performance data. A closer look reveals striking parallels between ESG scores and effective crisis management. Surprisingly, high scores on health system metrics proved insufficient in predicting a country's coping capacity—proving that there are no magic indicators with full predictive power. Data must be analyzed collectively and comprehensively for patterns to surface and true root causes identified.

Reflective of this, strong governance and institutional indicators were strongly correlated with a country's coping capacity, helping explain the surprising success and failure of many countries in dealing with the crisis. But strong governance should not be confused with absolute governance; authoritarian regimes have fared no better than Western democracies in combatting and controlling the coronavirus' spread and impact.

For investors the implications are clear— if ESG data can provide insights on a global pandemic, it can also be a powerful tool for understanding and mitigating geopolitical and country risks within an investment portfolio. And as recent events this year (and last) have emphatically underscored, societal and geopolitical risks can be sweeping and destructive for countries, companies, and portfolios alike.

Article
Marketing materials for professional
investors
04/2020

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“The COVID-19 pandemic is exposing gaping fissures in the economic, social and political structures of many countries”

While the Corona crisis appears to be ebbing in some early hotspots, its spread continues with vengeance in other parts of the world with equally devastating economic impacts. Moreover, the threat of a second pandemic wave has not been averted and the situation remains fluid and far from stable. It is still too early to estimate final death tolls, economic damage, and their potential effects on global financial stability, let alone draw clear and instructive conclusions. And yet, it is obvious that some countries have been more successful in their fight against COVID-19 than others. Indeed, there are early indications that a country’s ESG assessment can provide useful insights into effective crisis management as well as potential pathways to economic recovery.

The COVID-19 pandemic is exposing gaping fissures in the economic, social and political structures of many countries, particularly those most affected by the crisis. A closer look at country ESG profiles reveals those fissures were already evident within ESG data and that striking correlations appear between country ESG performance and their capacity to contain the virus, reduce economic fallout and mitigate socio-political ramifications.

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And while the current pandemic began as a public health risk seemingly limited to health and welfare variables (social dimensions within ESG data), it has quickly and aggressively contaminated and crippled the broader macroeconomy. Given the resulting contagion of the macroeconomy, financial markets, the geopolitical landscape and society, it should now be compellingly clear that a country’s ESG profile should be an essential part of investment considerations and decision-making.

ESG country data not only gives a read on a country’s social dimension but also on its governance (the “G” in ESG). And as the coronavirus crisis indicates, a country’s “G-force” provides valuable insights when trying to evaluate its capacity to deal with the pandemic and its potential to overcome this crisis.

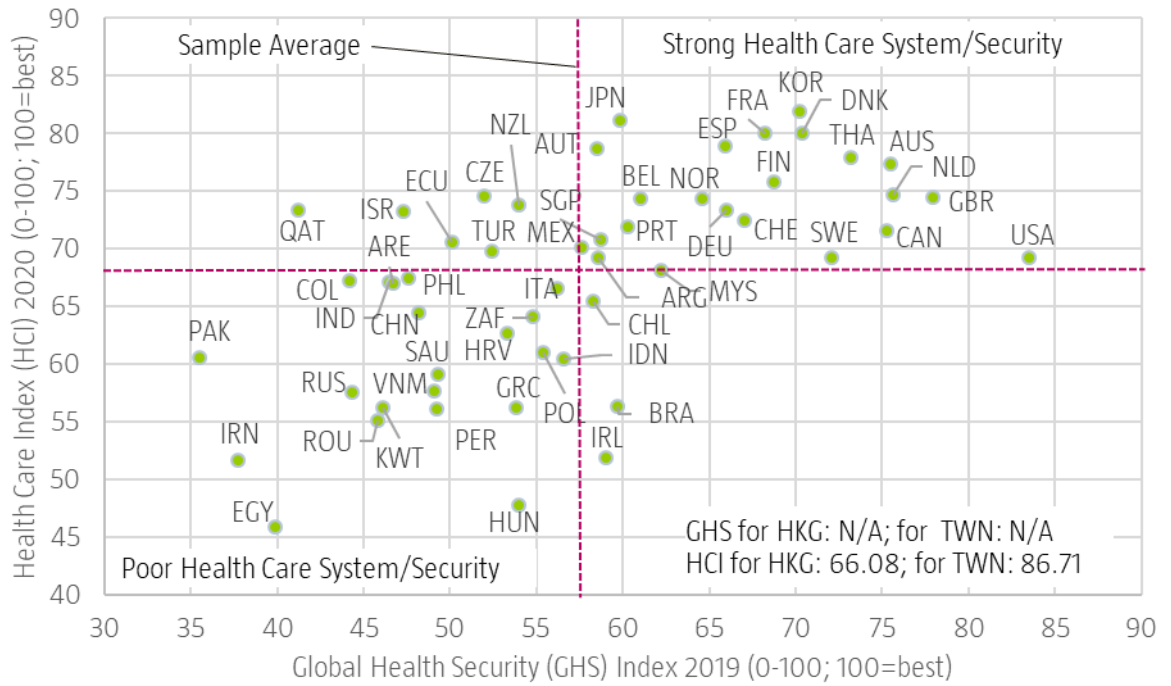
Pandemic causes and solutions are far from one dimensional

Though Health and health systems are at the epicenter, the crisis reveals deeper fractures across other ESG dimensions. The COVID-19 pandemic is a stark reminder of the crucial importance of a widely accessible and strong public health system. But good physical health is only one pre-requisite for a thriving individual, a thriving population and a thriving economy. Other factors within the social dimension such as demographics, living conditions, education and opportunity—in short, human capital—are also essential. A prospering and stable economy requires human beings to live under reasonable and healthy circumstances in order to rely on a productive and adequately skilled workforce. It is therefore imperative that these kinds of social indicators are meaningfully reflected in a country’s sustainability profile.

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Moreover, solely focusing on singular ESG data indicators can be dangerously misleading as recent events have proven. For example, trusting in health system variables alone were insufficient in judging a country's preparedness for this pandemic threat. Examining current numbers of confirmed COVID-19 cases and comparing them with Figure 1 shows that top-ranking countries based on major health care system indicators are among the hotspots of this pandemic—most notably the United States, Spain, Italy and France.

Figure 1 | Health Security & Health Care Quality of selected countries

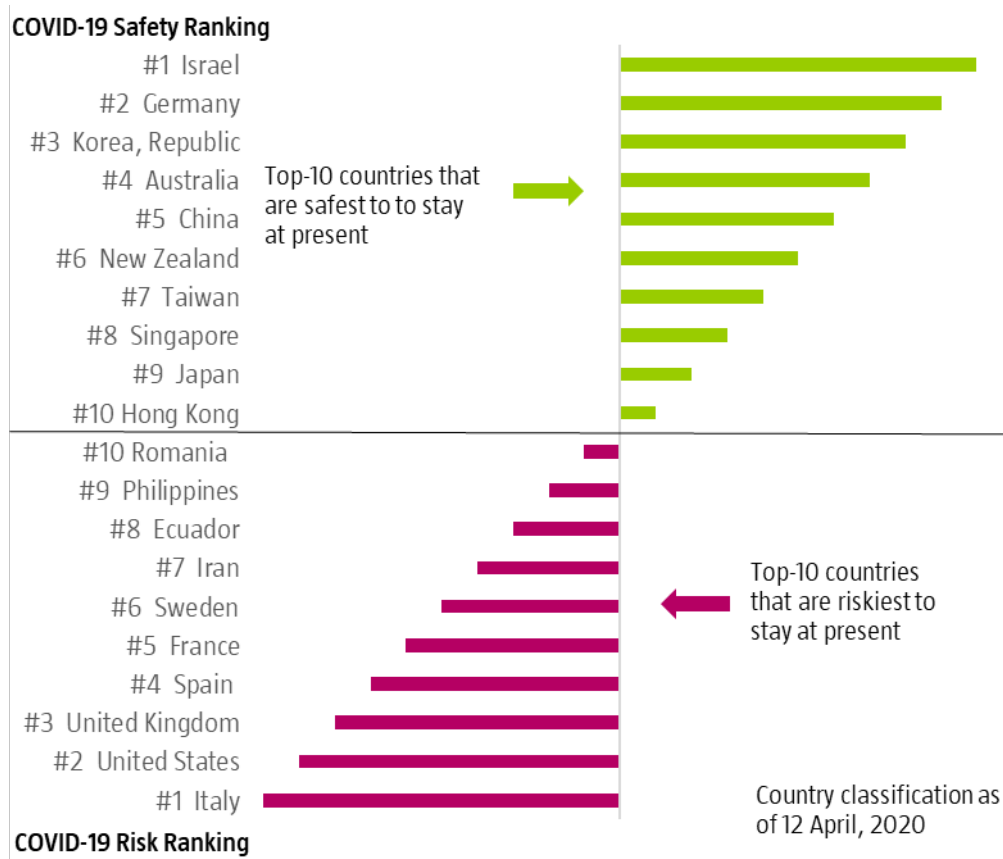


The Global Health Security (GHS) Index lists the countries best prepared for a pandemic. The Health Care Index (HCI) is an estimation of the overall quality of the health care system.

Sources: Nuclear Threat Initiative, John Hopkins Center for Health Security, EIU; Numbeo - The Health Care Index by Country

It has become obvious that when a contagious disease strikes with such a punch, even the most advanced health systems can be overwhelmed if other conditions (measured by other ESG dimensions) have not been met. In countries most severely hit, the disease's spread may have been more effectively contained if swift and decisive action had been taken early on. Figure 2 provides an early indication of which countries have managed the coronavirus crisis more successfully than others so far.

Figure 2 | COVID-19 Country Ranking by Safety & Risk

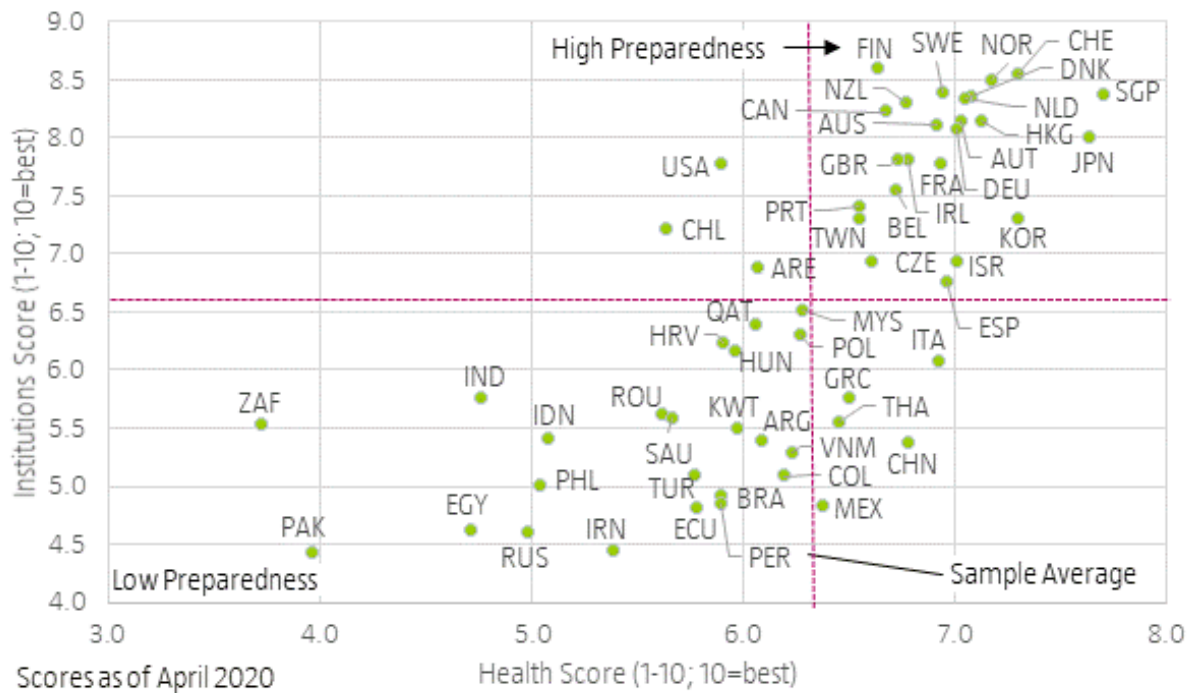


The ranking is based on DKG's framework utilizing raw data from a number of publicly available sources for 72 parameters and aims at assessing the countries in terms of safety and risk in dealing with COVID-19 as well as the economic, political and societal impacts. The country classification may change quite frequently as the ranking is updated continuously.

Source: Deep Knowledge Group

What is surprising is that a country's governance and institutional scores (see Figure 3), rather than its health system/security scores (Figure 1) are better predictors of its ability to successfully manage the coronavirus crisis so far.

Figure 3 | Pandemic preparedness across selected countries



The Institutions score is based on input data from the Worldwide Governance Indicators & the Fragile States Index; the Health score is based on the Health Pillar score of the Prosperity Index; both are part of the RobecoSAM Country ESG Framework.

Sources: Fund for Peace, World Bank, RobecoSAM

Returning to the epicenter, the success of the health-policy response with respect to containing the spread of the virus, treating the ill, and enhancing immunity will also be decisive in controlling the severity and duration of the imminent economic recession to follow.

Strong formal and informal institutional networks are key

The COVID-19 crisis has clearly demonstrated that an effective pandemic response relies on a strong and well-functioning institutional framework. Robust state institutions, a sound system of checks and balances, a capable public administration, strong advocacy groups and a vibrant civil society are essential in ensuring representation and fairness among its citizens and accountability from its leaders. In addition, these societal institutions also serve to support and stabilize society when government authorities are overstrained. It is no coincidence that most of the more severely affected countries display weakness in various institutional or overall governance aspects, visible in lower scores for their institutional framework (see Figure 3 above).

Unsurprisingly, the COVID-19 outbreak in the US has exploded. Unlike other countries, the Trump administration not only failed to take early action but also hampered efforts by maintaining a stance of denial and disregard for scientific evidence and dismissing the early warnings of health officials and other experts. President Trump's recurrent attacks on both domestic and international institutions since his takeover of power is already reflected in declining US scores across several governance indicators. Trump's erratic leadership, marked by initial indifference and later belligerence and impatience, has also affected his administration's working relationship with state governors and other public-private actors during this crisis.

“It is no coincidence that severely affected countries display weakness in various governance scores”

Elsewhere, political leaders have taken similarly complacent positions. Even now, the populist Brazilian and Mexican presidents, Jair Bolsonaro and Andres Manuel Lopez Obrador, are downplaying the coronavirus threat, putting their countries at risk for a devastating hit as well.

Combatting COVID-19: Do authoritarian regimes have an advantage?

With several major democracies reeling, a debate has emerged about the alleged supremacy of authoritarian regimes in dealing with this crisis. However, a preliminary glance at the picture to date shows that both authoritarian and democratic governments have mixed responses and mixed results with regard to COVID-19 pandemic; there is little evidence that shows a specific type of political regime has done systematically better.

China's response, though initially disastrous, was eventually targeted and persuasive, while Iran, another authoritarian state, has done very poorly. Irrespective of the veracity of officially reported case numbers and deaths, the two countries' methods of dealing with the crisis have been controversial from a human rights point of view.

“both authoritarian and democratic governments have mixed responses and mixed results with regard to COVID-19 pandemic”

On the other hand, strong democracies such as South Korea, Taiwan, and Japan have done well in comparison, showing visible successes in containing and mitigating outbreaks. In contrast, the US and many European countries were late in recognizing the sheer scale and threat of the COVID-19 crisis and so failed to respond timely and/or strongly enough (see Figure 2). As a result, they have witnessed a pronounced surge in cases and have been forced to adopt more extreme lockdown measures.

This initial assessment of the performance of different political regimes does not yet encompass poorer autocracies and democracies in developing countries (e.g. Brazil, India, Russia). Most of these nations appear to be still in the early stages of the crisis and have not yet felt the virus' full vigor and force.

Is the coronavirus crisis also attacking democracy?

The current COVID-19 crisis has clearly revealed that an effective pandemic response relies on a strong and well-functioning institutional framework, flourishing human capital, high levels of social cohesion and, in particular, an effective network of public and private institutions, alliances and partnerships. Not only are these highly correlated with success at containing the pandemic, they are also factors captured in ESG country data. Moreover, the strength of these same variables will be equally important in overcoming the inevitable economic fallout, in engineering a sustainable recovery, and in retaining socio-political stability.

True, the coronavirus crisis has also brought changes on a massive scale, impacting virtually every aspect of daily life as many nations were forced to use draconian measures to slow the rate of contagion, illness and death within the population. Indeed, when determining their pandemic response, democratic governments often followed a narrow and perilous path between enforcing drastic and effective measures on the one hand and respecting civil liberties and personal freedom on the other. In this regard, governments in many Western democracies will have found it more challenging to strike the right balance than countries with more authoritative versions of democracy like South Korea, Singapore and Taiwan.

“authoritarian regimes are taking advantage of the coronavirus crisis to tighten their grips at home and to promote their political model abroad”

On the other hand, it has also become obvious that authoritarian regimes are taking advantage of the coronavirus crisis to tighten their grips at home and to promote their political model abroad. Prime examples include (but are not limited to) China and Russia. In Hungary too, Prime Minister Victor Orban was only recently granted extraordinary power allowing him to rule by personal decree and to suspend parliamentary democracy for indefinite periods. And this is just one example of

how authoritarian leaders might use the coronavirus crisis as a convenient opportunity to further undermine democracy and consolidate power. These and other developments only serve to reinforce an already concerning rise in authoritarianism globally—a trend that has already been observed and reflected in the respective indicators of our country ESG framework.

Conclusion

Functioning institutions that allow a government to act swift and efficiently are key and will also determine how successful a country can deal with the economic and social impacts of a crisis. Moreover, an assessment of a country's ESG profile is also a valuable tool for insights on a country's resilience and capacity to cope with pandemics and the resulting fallout.

It has taken a crisis of epic proportions to expose to the world to what was already partially visible in country ESG data; we must hope the magnitude and sharpness of the initial shock and subsequent aftershocks will leave us deeply wounded but acutely sensitized to early warnings that can help avert future risks—worthy advice for citizen, countries, and investors.

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