

ESG IS NOT LIBERTARIAN: A RESPONSE TO JONATHAN MACEY

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ABSTRACT

Investing, like any market activity, is voluntary. Investors may invest however they wish, whether to maximize returns, minimize risk, or support what they view as good causes. Is the current Environmental, Social and Governance (ESG) movement a libertarian embrace of socially responsible investing, as Jonathan Macey has argued? We answer with a definite no for several reasons. Government policies impel much ESG investment, most prominently through clean energy transition and financial regulations. Most ESG investment dollars stem not from investor decisions but from potential opportunism by managers of public pensions and sovereign wealth funds. Much investor activism for ESG results from shares owned indirectly by passive investors and may also reflect opportunism. Even the modest goal of harmonizing the dozens of different private ESG metrics through regulation violates market autonomy. We conclude, contra Macey, that ESG is not libertarian.

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INTRODUCTION

Jonathan R. Macey argues that the Environmental, Social, and Governance (ESG) movement “reflects a significant libertarian turn in the history of American politics.”¹ He goes on to state that “[t]he current privately driven ESG movement” is “highly libertarian” because “it assumes that the government’s current failings will continue and proposes a path forward that doesn’t rely too much on future contributions from government.”² His case for the alleged libertarianism of ESG is predicated on two contestable conditions: first, society distrusts the government and has turned to corporations to enact social and environmental change,³ and second, corporations’ management has begun to take advantage of this change by shifting their focus to the long-term.⁴ Accordingly, he concludes that “the ESG movement is radically libertarian” and “posits no government.”⁵

He is mistaken. The ESG movement is *anti*-libertarian. Under a libertarian view, private investors may choose to invest in ESG-weighted portfolios, and institutional investors may create mutual funds, exchange-traded funds, or index funds with negative screens that exclude or include companies or industries based on high or poor ESG ratings. However, such voluntary activity is not driving the contemporary ESG movement, and these funds could not thrive without government money such as pension funds or bonds.⁶

This article refutes Macey’s argument by documenting how ESG is inextricably tied to government and contravenes free markets. Contrary to Macey’s characterizations, ESG is, as one critic complains, “mainly a top-down initiative of certain elites, not the result of widespread bottom-up demand from individual investors, consumers, and workers.”⁷ This critic adds, “[m]uch of the ESG charge is led by governments and elite non-governmental organizations like the World Economic Forum.”⁸ However tendentious this charge of elitism might seem, it emphasizes a fundamental point: libertarianism is inconsistent

¹ Jonathan R. Macey, *ESG Investing: Why Here? Why Now?*, 19 BERKELEY BUS. L. J. 258, 258 (2022).

² *Id.* at 263.

³ *Id.* at 258-59.

⁴ *Id.* at 263.

⁵ *Id.* at 271.

⁶ See generally Allen Mendenhall & Daniel Sutter, *ESG Investing: Government Push or Market Pull?*, 22 SANTA CLARA J. INT’L L. 75 (2024) (analyzing whether government or markets are pushing the ESG initiative).

⁷ Matthew Lau, *ESG Is Mainly Top-Down Planning by Elites*, in *ESG: MYTHS AND REALITIES* 1, 1 (Fraser Inst. ed., 2023), <https://www.fraserinstitute.org/sites/default/files/ESG-myths-realities-ESG-is-mainly-top-down-planning-by-elites.pdf>.

⁸ *Id.*

with the laws, regulations, and intergovernmental initiatives, both proposed and instituted, to implement ESG.

Other ESG proponents acknowledge the coercive elements of the ESG agenda. One such proponent believes that stakeholderism, a staple of ESG, can revolutionize legislation and regulation concerning capital markets that, he complains, rely “on unfettered market forces to create value” rather than generating, in his words, “a just, equitable, and inclusive society.”⁹ Still other proponents hope that stakeholderism can usher in a “global New Deal,”¹⁰ hardly a libertarian sentiment.

Rebutting Macey is important to both highlight misleading errors and preserve the integrity of the “libertarian” label. Calling government-driven ESG programs and policies libertarian can lead, after all, to widespread mischief and misunderstanding about a political philosophy that cuts across both major political parties in the United States. Clarity on fundamentals is also important given the emergence of new forms of government activity, including public-private partnerships, government-organized non-governmental organizations (or GONGOs), government funding of university and private sector organizations, government adoption of privately formulated standards, and variants of global governance. The proper interpretation of ESG is also crucial for understanding the emerging “anti-ESG” movement. Perhaps building on Macey’s argument or similar vies, media commentators have characterized Democrats as defending markets against state efforts to rein in ESG.¹¹

This paper is organized as follows: Section I offers a description of libertarianism based on the *Encyclopedia of Libertarianism* to avoid any confusion over variants of the philosophy. Section II details Macey’s arguments as to why the ESG movement is libertarian. Section III discusses a libertarian approach to investing, highlighting the fundamental conflict between personal freedom and imposed investment strategies. We also argue here that compelling the allocation of capital based on someone else’s societal ideals violates

⁹ Frederick Alexander et al., *From Shareholder Primacy to Stakeholder Capitalism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 26, 2020), <https://corpgov.law.harvard.edu/2020/10/26/from-shareholder-primacy-to-stakeholder-capitalism/>.

¹⁰ Michael P. Klain & Leo E. Strine Jr., *Stakeholder Capitalism’s Greatest Challenge: Reshaping a Public Consensus to Govern a Global Economy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 20, 2023), <https://corpgov.law.harvard.edu/2023/07/20/stakeholder-capitalisms-greatest-challenge-reshaping-a-public-consensus-to-govern-a-global-economy/>.

¹¹ See Jasper Goodman, *Democrats Champion Free Markets as Republicans Target Wall Street*, POLITICO (July 25, 2023, 4:30 AM), <https://www.politico.com/news/2023/07/25/wall-street-foes-gop-00107808>.

libertarian principles. Mandated approaches to socially driven investing starkly oppose the core libertarian tenets of individual choice and voluntary action. Section IV presents our first counterargument, questioning whether observed ESG investing and advocacy reflect informed consent. A considerable fraction of ESG investments have come from politicized pension plans and sovereign wealth funds;¹² much ESG advocacy has also originated in asset management firms that use passive investment funds.¹³ Section V presents our second counterargument, examining the influence of government mandates and regulations on investment.

We then consider two extensions. Section VI addresses Macey's depiction of ESG as a market response to government failure. Section VII studies the perhaps innocuous interpretation of ESG regulations as merely synchronizing hundreds of different metrics to assist investors. Section VII concludes.

I. WHAT IS LIBERTARIANISM?

As an initial matter, we offer a serviceable definition of libertarianism. We adopt, for three reasons, the meaning of *libertarianism* elucidated by Stephen Davies in *The Encyclopedia of Libertarianism*: first, because the encyclopedia encompasses a variety of perspectives regarding its subject entries and is therefore broad, general, and uncontroversial in its descriptions; second, because there are many competing notions of libertarianism, and we do not wish, for present purposes, to commit to a narrow one; and third, to show that, even under a broad, general, and uncontroversial understanding of libertarianism—as opposed to a narrow or idiosyncratic one—ESG is not “libertarian.”

Libertarianism is the modern form of liberalism, or classical liberalism, which promotes decentralization of power, constitutionalism, limited government, religious toleration, freedom of conscience, private property rights,

¹² See Paul G. Mahoney & Julia D. Mahoney, *The New Separation of Ownership and Control: Institutional Investors and ESG*, 2021 COLUM. BUS. L. REV. 840, 844 (2022) (“There are good reasons to believe that these institutions’ purpose is in part to pursue public policy goals outside the normal political process. This is a particular concern with respect to large public pension plans, the trustees of which are subject to weak market discipline but strong political forces. The herding behavior of private fund managers, such as BlackRock, State Street, and Vanguard, toward ESG activism is puzzling if they are interested only in uncovering as-yet unpriced risks. Money managers who believe they have found an over or undervalued asset do not generally broadcast that fact to the world and invite others to share in the investment opportunity. Political activism, by contract, relies heavily on bandwagon effects.”) (footnotes omitted).

¹³ See generally Paul Forrester, *ESG and Asset Manager Capitalism* (Mar. 5, 2024) (unpublished manuscript) (on file with PhilPapers), <https://philpapers.org/rec/FOREAA-7> (discussing how asset management firms have acquired considerable voting power and influence).

free speech, free trade and exchange, commerce and economics, sound money, freedom of contract, personal responsibility, individual rights, freedom to assemble and associate, voluntarism, individualism, separation of church and state, rule of law, and peace.¹⁴

For our purposes, the primary element is voluntarism. The economic elements of libertarianism, like freedom of contract, freedom of trade and exchange, and private property, build on a market system of voluntary exchange for mutual benefit.¹⁵ Constitutionalism and limited government permit government activity and marginal government coercion—to address pollution or crime, for instance, or to enforce contracts. Thus understood, libertarianism is averse to government intervention in private affairs and the economy;¹⁶ accordingly, programs or policies empowering or growing government or expanding regulations are not, under this interpretation, libertarian. Government partnerships with private actors to achieve ESG goals are also problematic. Libertarians generally favor government working through philanthropic or charitable organizations to achieve desirable social outcomes. Consider, for instance, tax breaks for charitable gifts. In this article, we will demonstrate how ESG goes against these core tenets of libertarianism.

II. MACEY'S ARGUMENTS

Macey argues that ESG is a wholly-private market movement brought on by declining trust in the government and government's failure to address social and environmental concerns.¹⁷ Macey observes that "it is particularly important to note that ESG does not involve a public/private partnership."¹⁸ He further argues that the ESG initiative, rather than motivating or pressuring governments into action, focuses on influencing individual public companies to achieve social and environmental objectives within a context where government is assumed to be either absent or unresponsive to ESG concerns.¹⁹ The driving force behind this privatization of government is the perception that "government has failed to

¹⁴ See generally Stephen Davies, *General Introduction*, in *ENCYCLOPEDIA OF LIBERTARIANISM* xxvi (Ronald Hamowy ed., 2008).

¹⁵ See *id.* at xxvii, xxix, xxx.

¹⁶ See *id.* at xxx (highlighting the "general principle of noninterference by the state in the outcome of private decisions").

¹⁷ Macey, *supra* note 1, at 258-59.

¹⁸ *Id.* at 263.

¹⁹ *Id.* at 271.

produce results, and . . . to even offer hope of achieving meaningful and effective policies” regarding “environmental degradation” and “social justice.”²⁰

Macey highlights the significant growth in ESG investments and corporate responsibility reporting, viewing these as a market response to government failure to address problems like environmental degradation and social justice.²¹ He notes, “[a]s of this writing, almost half of investors are currently investing in ESG products.”²² He adds that 2020 marked a breakthrough year for ESG-focused investments, with ESG-oriented funds attracting \$51.1 billion in new capital—more than doubling the previous year’s \$21 billion—while the global scale of ESG investing reached an estimated \$20 trillion in managed assets, accounting for roughly 25% of all professionally overseen investments worldwide.²³ He also cites a Morgan Stanley Bank survey finding that “almost 90 percent of millennials would prefer to have investments that suit their values.”²⁴ He views the actions of investment managers and corporate executives as reflecting personal affirmation: “By 2017, 83 percent of the top 100 companies in America published a corporate responsibility report, as do 77 percent of the top 100 companies in Europe and 78 percent in Asia. Of the largest 250 companies globally, reporting rates are 93 percent.”²⁵ Macey contends that the rise of ESG investing signifies that government has lost credibility as a catalyst for social change, having failed to effectively address issues such as environmental degradation and social justice.²⁶ As a result, he says, people increasingly look to corporations, rather than the government, to resolve these challenges.²⁷

Macey’s argument that ESG is libertarian, as a private-sector response to declining trust in government due partly to government failure, assumes that the flow of investment into ESG funds represents the careful, deliberate judgment of all investors. His argument presumes the complete absence of government influence. Yet government agencies deputizing private sector organizations to restrict the freedom of private parties deviating from the tenets of ESG violates several of Davies’s enumerations, notably the freedoms to assemble, associate, and contract. Moreover, Macey’s argument also requires one to assume that the

²⁰ *Id.* at 262.

²¹ *Id.* at 261-63.

²² *Id.* at 261.

²³ *Id.* at 261-62.

²⁴ *Id.* at 261.

²⁵ *Id.* at 262.

²⁶ *Id.*

²⁷ *Id.*

laws of other countries do not force ESG initiatives onto American companies. The final aspect of Macey's argument frames ESG as a market-driven response to government failure, mirroring the traditional economic view of government addressing market failures²⁸

III. LIBERTARIAN INVESTING AND LACK OF CONSENT

Before advancing our argument in detail, we wish to acknowledge several general points about investing. The first point is that investing, like any market activity, is voluntary. While models employed to analyze behavior in financial markets assume that investors seek to maximize investment returns for a given level of risk,²⁹ individuals may invest however they wish, including to advance social or environmental goals. Consistent with libertarian principles such as freedom of contract and voluntarism, investors may voluntarily accept a lower return or higher risk of loss to support subjectively perceived good causes.

Socially responsible investment has been promoted for decades.³⁰ Because financial firms can contract for whatever they like, they may launch investment funds consistent with ESG principles; they may even be expected to do so if enough investors value ESG factors in investing.³¹ This freedom of exchange represents financial markets providing customers with the products and services they desire. Beyond this, stockholders, as owners of specific companies, may instruct directors to accept a lower return or pursue other goods to focus on ESG initiatives. Although Milton Friedman famously argued that corporations should maximize profits, his fundamental point is that CEOs should act as faithful agents of stockholders and pursue the goals they specify.³²

Voluntary ESG investing is consistent with libertarianism and free markets.³³ However, any statement about the proportion of investors willing to sacrifice returns for ESG goals is empirical; theory cannot tell us whether 10% or 90% of

²⁸ See Paul A. Samuelson, *The Pure Theory of Public Expenditures*, 36 REV. ECON. & STAT. 387, 388-89 (1954); Francis M. Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351, 357 (1958).

²⁹ R. DAVID MCLEAN, THE CASE FOR SHAREHOLDER CAPITALISM: HOW THE PURSUIT OF PROFIT BENEFITS ALL 16-18 (2023); JONATHAN BERK ET AL., FUNDAMENTALS OF CORPORATE FINANCE 384-90 (4th ed. 2017).

³⁰ STEPHEN R. SOUKUP, THE DICTATORSHIP OF WOKE CAPITAL: HOW POLITICAL CORRECTNESS CAPTURED BIG BUSINESS 81-85 (2021).

³¹ MCLEAN, *supra* note 29, at 144.

³² Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html>.

³³ The situation differs when asset management firms invest, say, government pension funds, which consist of beneficiaries' money; see *infra* Section IV.

investors will make this choice. The selfishness implicit in profit maximization is widely regarded as empirically accurate and not just convenient for building models. Our analysis accepts the modest assumption that many investors prioritize financial returns over ESG objectives. Specifically, we posit that some investors are unwilling to sacrifice returns for ESG goals, and that the majority would not accept zero returns solely to pursue ESG targets. Most people are at least a little selfish.

We also emphasize the limits of market action. In a market situation, any party's only "power" over another is the refusal to transact. No individual, firm, or financial institution can prohibit others from doing business with someone they disfavor. This proposition signals a crucial difference between political and economic power. Even when a firm holds a dominant market share, other market options exist. Without government-created exclusivity, no firm holds a 100% market share or can legally prevent new firms from entering. This lack of exclusivity ensures that investors who do not value ESG goals have opportunities to invest in legal activities. Macey contends that the ESG boom reflects investors' desire to improve the world beyond producing valued goods and services. We do not accept this claim and will offer two counterarguments.

IV. COUNTERARGUMENT ONE: ESG INVESTMENT ACTIVITY IS NOT DEFINED BY CONSENT

The first counterargument is that consent is not implied in much ESG investing and activism. ESG activity has two components: (1) directing funds to businesses pursuing ESG goals and (2) engaging businesses to change their practices to align with ESG principles.³⁴ A significant, albeit challenging to measure, proportion of ESG fund investments involves public sector pension plans and sovereign wealth funds.³⁵ Concurrently, much of the activism, including support for shareholder resolutions, comes from index funds, which traditionally invested passively in a broad range of companies.³⁶ From a libertarian standpoint, both the ESG investments made by pension funds and

³⁴ Allen Mendenhall, *ESG en Route to Etatism*, 26 Q. J. AUSTRIAN ECON. 325, 325-26 (2023).

³⁵ BRETT CHRISTOPHERS, *OUR LIVES IN THEIR PORTFOLIOS* 25-26, 215-16 (2024); Williams W. Clayton, *How Public Pension Plans Have Shaped Private Equity*, 81 MD. L. REV. 840, 851-53 (2022). See generally Danilo Risteski, *Politics Before Pensions: How New ESG Rules Expose Public Pension System Vulnerabilities*, 95 U. COLO. L. REV. 805, 816-818 (2024) (discussing public pension ESG investment); Paul Rose, *Catalyzing Sustainable Investment*, 51 ENV'T. L. 1221, 1232-70 (2021) (discussing how governments invest in ESG through the vehicle of sovereign wealth funds).

³⁶ Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1265-84 (2020).

sovereign wealth funds, as well as the activism from index funds, share a critical flaw: the absence of explicit investor consent. This problem manifests differently for pension funds and index funds, warranting separate examinations of each case.

Defined-benefit pension plans, especially those in the public sector, control substantial assets.³⁷ Some state pension plans, most notably California's CalPERS, are known for their extensive history of politically active investment strategies.³⁸ Regardless of its history or current management structure, CalPERS manages around \$503 billion in assets for its approximately two million members, comprising both current public sector employees and retirees.³⁹ A combination of employee contributions, employer payments, and investment returns funds pension benefits.⁴⁰ Ultimately, all these costs are reflected in the employee's total compensation package.⁴¹ Employees could receive higher salaries and save for retirement as they choose. Pension benefits are deferred compensation and, as such, belong to the members just as much as their current pay.⁴² Defined benefit pension plans offer several advantages: they transfer longevity risk from individuals to the system, enable significant diversification, and provide members with annuities for their accumulated savings on favorable terms.⁴³ Pension plans require a collective decision-making

³⁷ Elizabeth S. Goldman & Stewart E. Sterk, *The Impact of Law on the State Pension Crisis*, 54 WAKE FOREST L. REV. 105, 111-13 (2019); T. Leigh Anenson, *Public Pensions and Fiduciary Duty Law: A View from Equity*, 50 U. MICH. J.L. REFORM 251, 275-77 (2017).

³⁸ See Raymond Venner, *The Fable of Shareholder Environmental Activism by Government Pensions*, 28 INDEP. REV. 345, 349 (2023).

³⁹ *CalPERS Reports Preliminary 9.3% Investment Return for 2023-24 Fiscal Year*, CALPERS (July 15, 2024), <https://www.calpers.ca.gov/page/newsroom/calpers-news/2024/calpers-preliminary-investment-return-fiscal-year-2023-24>.

⁴⁰ See *Who Pays for CalPERS Pensions?*, CALPERS (Jan. 27, 2023), <https://www.calpers.ca.gov/page/about/organization/facts-at-a-glance/pension-buck>; see also *CalPERS Benefits Basics Handout*, CALPERS (Apr. 2023), https://www.calpers.ca.gov/content/cec/member/class_materials/benefit_basics/benefit_basics_il.pdf; *Your CalPERS Benefits: Planning Your Service Retirement*, CALPERS (Feb. 1, 2023), <https://www.calpers.ca.gov/documents/planning-service-retirement/download?inline=>.

⁴¹ *Welcome to CalPERS: A Benefits Guide for Public Agency Members*, CALPERS 4-5 (Feb. 1, 2023), <https://www.calpers.ca.gov/docs/forms-publications/new-member-public-agency-guide.pdf>; see also CALPERS, 2011-12 CALPERS BUSINESS PLAN FINAL REPORT (Aug. 14, 2012), <https://www.calpers.ca.gov/sites/default/files/spf/docs/board-agendas/201208/financeadmin/item6a-02.pdf>.

⁴² *Cal. Fire Local 2881 v. Cal. Pub. Emps.' Ret. Sys.*, 435 P. 3d 433, 446 (Cal. 2019) (“The [California] Constitution protects an implied contractual right for California’s public employees to receive statutory pension benefits because those benefits constitute deferred compensation.”). Moreover, “[g]iven their character as deferred compensation, the receipt of legislatively established pension benefits [in California] is protected...” *Id.* at 447.

⁴³ Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 456-58 (2004).

mechanism because a unanimous agreement among all members on one investment choice is unfeasible. Public choice economics, which is central to libertarianism,⁴⁴ shows how this system, because it relies on political officers or appointees, can have deleterious and politicized consequences for public pension beneficiaries.⁴⁵ The investment process is highly politicized for two reasons: the frequent political appointment of pension-fund trustees and the fact that “the pension plans they oversee are largely defined benefit plans in which the employee’s entitlement is not a function of investment returns.”⁴⁶

Public pension plans follow a pre-funding model whereby regular contributions by the public employer (state or local government) and the public employees, throughout their careers, finance their retirement benefits in advance with a portion of their wages directed into the fund.⁴⁷ The fund consolidates these contributions, which are then managed by professional investors under the supervision of trustees, who have a fiduciary responsibility to the employee beneficiaries.⁴⁸ Because of this structure, it is impossible for each member of the pension plan to have a say in how their money is invested. Pension managers, like the trustees, have fiduciary duties to members, ensuring investments align closely with all members’ interests.⁴⁹ Accordingly, proponents of ESG investing suggest it can match or even exceed returns from unconstrained investing in the long run, which is not possible.⁵⁰ If pension plan executives are elected by the members, then their election signifies only that perhaps a majority of members approve of ESG investing at the expense of higher returns.⁵¹ At least some pensioners do not consent to the allocation of their funds in this manner. While individual investors may sacrifice returns to support ESG goals, a state

⁴⁴ William A. Niskanen, *Public Choice Economics*, in *ENCYCLOPEDIA OF LIBERTARIANISM* 405-07 (Ronald Hamowy ed., 2008).

⁴⁵ See generally Anthony Randazzo, *There Is a Tangled Web of Factors Causing Inappropriate Pension Funding Behavior*, 14 J.L. ECON. & POL’Y 107 (2017) (applying public choice tools to explain public pension unfunded liabilities).

⁴⁶ Mahony & Mahony, *supra* note 12, at 860-62.

⁴⁷ *Public Pension Resource Guide: Public Pension Basics*, NAT’L INST. ON RET. SEC. 1,3 (Jan. 2010), https://www.nirsonline.org/wp-content/uploads/2017/11/final_module1_public_pension_basics.pdf.

⁴⁸ *Id.* at 2.

⁴⁹ See generally Jill E. Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediary Voting Dilemma*, 102 TEX. L. REV. 1, 7-8 (2023) (discussing pension managers’ difficulty in upholding their fiduciary duty to members).

⁵⁰ MCLEAN, *supra* note 29, at 144-45.

⁵¹ Laws regarding the composition of the board of trustees differ by state. For example, trustees may be elected or appointed. See, e.g., David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 195-96 (2005); Thomas J. Fitzpatrick & Amy B. Monahan, *Who’s Afraid of Good Governance? State Fiscal Crises, Public Pension Underfunding, and the Resistance to Governance Reform*, 66 FLA. L. REV. 1317, 1326 (2014).

retirement system usually may not do so without violating its fiduciary duty to members.⁵² However, some state governments require pension plan decision makers to consider ESG initiatives.⁵³

State taxpayers can also be indirectly burdened by public pension ESG investment. Promised benefits are safeguarded either explicitly or implicitly through contract law in forty-one states, with benefits constitutionally guaranteed in seven states.⁵⁴ Twenty-one states protect both current and future benefits.⁵⁵ In these states, the government is responsible for fulfilling promised benefits should investment earnings fall short of projections.⁵⁶ In principle, the pension system should require sufficient contributions to fund the promised benefit levels given reasonable expected returns on investment. ESG investing's potentially lower long-term returns compared to unconstrained investing may lead to underfunded pensions.⁵⁷ This shortfall would burden state taxpayers, who currently have no say in pension governance, by requiring re-allocation of tax dollars from other state projects to pay out the underfunded pensions.⁵⁸ Such an outcome contradicts the core libertarian principle of voluntarism.

Sovereign wealth funds are another form of politically motivated government investing in ESG that prioritizes perceived ethical, environmental, or societal values.⁵⁹ They are government-owned investment entities funded

⁵² Recent Department of Labor regulations allow 401(k) investors this freedom, but our argument here is normative. The Employee Retirement Income Security Act (ERISA) does not govern state public pension fund investments. The fiduciary duties of state public pension fund managers and board trustees are matters of state law. The authors teach at a public university in Alabama. Alabama Code § 16-25-20 pronounces the fiduciary duty obligations governing the investment of our teacher retirement contributions into the public pension system by a Secretary-Treasurer and Board of Control. See ALA. CODE § 16-25-20(a)(1) (2025).

⁵³ Joshua Lichtenstein et al., *ESG and Public Pension Investing in 2023: A Year-To-Date Recap and Analysis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 22, 2023), <https://corpgov.law.harvard.edu/2023/11/22/esg-and-public-pension-investing-in-2023-a-year-to-date-recap-and-analysis/>.

⁵⁴ Liz Farmer, *How are Pensions Protected State-by-State?*, GOVERNING (Jan. 9, 2014), <https://www.governing.com/finance101/gov-pension-protections-state-by-state.html>.

⁵⁵ *Id.*

⁵⁶ Hence, the term “unfunded liability.” See generally Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, 2015 U. ILL. L. REV. 117 (2015); T. Leigh Anenson et al., *Reforming Public Pensions*, 33 YALE L. & POL’Y REV. 1 (2014); see also Ronald H. Rosenberg, *Cutting Pension Rights for Public Workers: Don’t Look to the Courts for Help*, 62 HOW. L.J. 541, 565-70 (2018).

⁵⁷ ZACHARIAS SAUTNER & LAURA T. SPARKS, *ESG and Downside Risks: Implications for Pension Funds*, in PENSION FUNDS AND SUSTAINABLE INVESTMENTS 137 (P. Brett Hammond et al., eds., 2023).

⁵⁸ Lee Simmons, *Public Pensions Are Mixing Risky Investments with Unrealistic Predictions*, SIEPR (Feb. 4, 2024), <https://siepr.stanford.edu/news/public-pensions-are-mixing-risky-investments-unrealistic-predictions>.

⁵⁹ See, e.g., Anita M. Halvorssen & Cody D. Eldredge, *Investing in Sustainability: Ethics Guidelines and the Norwegian Sovereign Wealth Fund*, 42 DENV. J. INT’L L. & POL’Y 389, (2014).

primarily by profits from commodity exports or foreign currency reserves managed by a central bank.⁶⁰ They aim to generate returns by investing in diverse international assets using portfolios that encompass both tangible and financial assets, including traditional investments like stocks, bonds, or real estate, as well as more sophisticated options within capital markets.⁶¹

Paul Rose highlights the resultant tensions when sovereign wealth funds “focus on financial incentives for divestment or investment while also recognizing what might be termed ‘ethical’ objectives in fund investment.”⁶² He adds by way of example that a “fund such as Norway’s may face political pressure to invest or divest according to societal norms, which may not always be related to profit maximization.”⁶³ He also cites CalPER’s use of negative screens as further evidence of value-aligned rather than profit-focused investing.⁶⁴ These instances demonstrate how public funds can be allocated to social or environmental initiatives without express taxpayer approval, potentially misaligning with the overall preferences of the taxpayer base. Regulatory mandates rather than market forces, moreover, characterize ESG integration of sovereign wealth funds in Europe,⁶⁵ and probably wherever sustainable investment of sovereign wealth funds occurs. The rise of sovereign wealth funds has raised concerns about State Capitalism and associated protectionism,⁶⁶ which are antithetical to libertarianism.

We conclude this section by focusing on how consent is not a central feature of passive index funds. We contend that the proliferation of passive index funds, particularly from firms like BlackRock, Vanguard, and State Street, has unintentionally affected corporate governance and public policy; that these firms wield substantial voting power in public companies, often using it to influence decisions on issues like ESG without direct investor consent; and that this voting

⁶⁰ Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises, and the Chinese Experience*, 19 *TRANSNAT’L L. & CONTEMP. PROBS.* 3, 11-21 (2010); Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 *GEO. J. INT’L L.* 101, 101-26 (2009); Matthew A. Melone, *Should the United States Tax Sovereign Wealth Funds?* 26 *B.U. INT’L L.J.* 143, 148-51 (2008).

⁶¹ *Id.*

⁶² Paul Rose, *Catalyzing Sustainable Investment*, 51 *ENV’T. L.* 1221, 1242 (2021).

⁶³ *Id.*

⁶⁴ *Id.* at 1243-46.

⁶⁵ Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 *CARDOZO L. REV.* 1921, 1981-85 (2020).

⁶⁶ Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, 14 *L. & BUS. REV. AM.* 179, 183-84 (2008).

power and influence over corporate decision-making raises ethical and legal questions about fiduciary duty and investor autonomy.

Non-consensual activity can involve pressuring financial institutions and corporations to adopt or promote ESG practices and investments. Passive investors contribute significantly to this pressure, particularly via shareholder voting power gained through index funds.⁶⁷ Funds resembling broad stock indexes like the S&P 500 offer extensive diversification, essentially ensuring the investor earns the market return.⁶⁸ Because the funds are not actively managed, they charge low fees and consequently have become the dominant form of stock investment in the U.S.⁶⁹ As index funds continue to grow, their influence grows as well. According to John Coates, “[i]ndex funds have now gathered so much capital and concentrated so much ownership that they have enough voting power to strongly influence, if not determine, how public companies are governed. Corporate managerialism is threatening to give way to index fund managerialism.”⁷⁰ Moreover, index funds shape public policy, having “become increasingly politically influential on issues such as diversity, treatment of workers, and climate change, drawing charges of socialism from the right, and of antitrust harm and of dragging their feet on other issues, such as corporate political disclosure, from the left.”⁷¹

How do index funds impact public policy? Namely, through “direct political influence.” Coates explains: “Each major index fund complex now has a substantial public and government relations staff. They write long comment letters on proposed regulations, attend conferences dedicated to issues they care about, and directly lobby elected officials and their staffs.”⁷² Their efforts yield success: “Their support for an idea for a new regulation, or a listing standard

⁶⁷ Reiser, *supra* note 65, at 1932-33; Eric C. Chaffee, *Index Funds and ESG Hypocrisy*, 71 CASE W. RES. L. REV. 1295, 1296-97 (2021); Michael Barzuza et al., *supra* note 36, at 1265-1283.

⁶⁸ McLEAN, *supra* note 29, at 134-35.

⁶⁹ Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771, 1774 (2020); Thomas A. Lambert & Michael E. Sykuta, *The Case for Doing Nothing About Institutional Investors’ Common Ownership of Small Stakes in Competing Firms*, 13 VA. L. & BUS. REV. 213, 263 (2019); William W. Bratton, *Shareholder Primacy Versus Shareholder Accountability*, 47 SEATTLE U. L. REV. 405, 439 (2024).

⁷⁰ JOHN COATES, THE PROBLEM OF THE TWELVE 28 (2023).

⁷¹ Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POLITICS 298, 309 (2017); Alexander I. Platt, *Index Fund Enforcement*, 53 U.C. DAVIS L. REV. 1453, 1464 (2020); Jim Hawley & Jon Lukomnik, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons*, 41 SEATTLE U.L. REV. 449, 465-66 (2018); Richard A. Booth, *The Duty to Diversify and the Logic of Indexing*, 75 HASTINGS L.J. 555, 586 (2024).

⁷² COATES, *supra* note 70, at 39.

being considered by the stock exchanges, can significantly increase the odds of the idea's adoption. Their opposition makes a proposal harder for officials to push through.⁷³ Funds resembling broad stock indexes like the S&P 500 offer extensive diversification, essentially ensuring the investor earns the market return. There are several related options, the differences between which are immaterial for our argument.

Index fund investors do not seek to profit from stock price fluctuations, nor do they actively manage the included firms.⁷⁴ They own shares in companies in which they invest. Because of the popularity of passive investing, index funds “now own more than 20 percent of large US public companies.”⁷⁵ In 2003, the SEC issued guidance that incentivized these shares to be voted, influencing the board of directors' election and the outcome of stockholder resolutions.⁷⁶ Broad, passively managed funds do not necessarily claim to screen investments on ESG principles, and engagement with corporations or voting shares of explicitly ESG-targeted investment funds would presumably align with investor intent. Our concern lies with index funds, ETFs, and others not explicitly branded as pro-ESG, particularly due to the actions of BlackRock, Vanguard, and State Street advocating for social and environmental causes across all their investment funds.⁷⁷ Passive index funds, which simply mirror a market index, generally comport with libertarian principles because they offer a politically neutral investment vehicle that is voluntarily chosen.⁷⁸ However, institutional investors and proxy advisory services now exert significant influence over these funds, creating a coercive and non-voluntary dynamic for individual investors.⁷⁹ Such

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ Jeff Neal, *Is Greed Still Good?*, HARVARD L. TODAY (Aug. 24, 2023), <https://hls.harvard.edu/today/harvard-law-professor-explains-why-private-equity-and-index-funds-need-reform>.

⁷⁶ See Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 17 C.F.R. §§ 239, 249, 270, 274 (2003); see also Jill Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 44 (2019); Caleb N. Griffin, *Margins: Estimating the Influence of the Big Three on Shareholder Proposals*, 73 SMU L. REV. 409, 416 (2020).

⁷⁷ The stocks in index funds are owned by a trust while the asset manager is the trustee. Although the ownership and consequent authority to vote these shares is complex, the dollars used to purchase the stocks come from the investors and not the asset management companies. The legal complexity does not, we think, affect our argument on consent.

⁷⁸ See Richard A. Booth, *The Duty to Diversify and the Logic of Indexing*, 75 HASTINGS L.J. 555, 561-62 (2024) (discussing indexing and voluntarism).

⁷⁹ See Barzuza et al., *supra* note 36, at 1248-49, 1265-83 (accounting of how institutional investors and proxy advisory firms compel companies through shareholder engagement or activism to act in ways they would not otherwise act). The authors refer to this shareholder push against firms to change practices or policies “corporate governance interventions.” *Id.* at 1283.

practices potentially undermine the libertarian principles of free choice and voluntary association. The issue is not with index funds themselves but with how they are used to advance certain agendas without explicit investor consent, challenging the historically neutral nature of index investing and raising questions about investor autonomy and freedom of choice in the market.

Fiduciary duty requires the trustees of index funds to act in the interest of the beneficiaries.⁸⁰ Using passive index funds to support ESG causes without explicit consent raises ethical and legal concerns. While specific authorization can justify actions that deviate from maximizing returns, most index fund investors probably do not have such authorization and expect a focus on maximizing financial returns. Unlike pension funds, retail investors in the index or mutual funds can opt out if they object to ESG activism. However, the existence of an opt-out option does not negate the fiduciary duty asset managers have to their clients. This duty exists to protect asset owners from all forms of mismanagement, not just those explicitly outlined in advance. When asset managers vote for stockholder resolutions that could potentially reduce a corporation's profitability, they may breach their fiduciary duty. This practice effectively leverages investors' assets to support causes without their explicit permission, which contradicts the principle of investor autonomy and the original purpose of passive index investing, and is not libertarian.

Passive investment has created an additional complication for authentic consent: concentrated ownership. One Harvard Law professor predicts a concentration in shareholder voting power consisting of just twelve mutual fund advisers, the "Problem of the Twelve," holding majority voting shares in publicly traded companies in the United States.⁸¹ By amassing and concentrating power in themselves, index and private equity funds "have become threats to American-style democratically managed capitalism."⁸² The rapidity of the rise of asset managers as owners of public equity is astounding: "At the beginning of the 1980s, asset managers' collective ownership share of . . . the public equity circulating in US stock markets was close to zero. Today, their ownership share of the average S&P 500 company is in the region of 30-40 per cent."⁸³

⁸⁰ Again, the fiduciary duty laws vary from state to state.

⁸¹ See John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve 2* (Harv. Pub. L. Working Paper No. 19-07, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337.

⁸² COATES, *supra* note 70, at 141.

⁸³ CHRISTOPHERS, *supra* note 35, at 13.

The common ownership of stocks through index funds has created anti-trust concerns.⁸⁴ Interlocking directorates were banned decades ago, but ownership by the Big 3 or The Twelve can have similar effects. Common ownership creates a conducive environment for collusion. Even without explicit collusion, common ownership reduces the benefit to owners of a firm's aggressive price cutting.⁸⁵ José Azar and coauthors have documented how differences and changes in concentration of ownership affect pricing by airlines⁸⁶ and banks⁸⁷ across markets. Common ownership may even contribute to the dearth of business investment known as “secular stagnation.”⁸⁸

These problems are not features of free markets but of government intervention and regulation of the financial sector.⁸⁹ Large asset management firms and activist institutional investors are largely to blame for the politicization of corporate America.⁹⁰ They are the chief reason that companies “go woke.”⁹¹ As one of us (Mendenhall) has explained elsewhere:

For most of the 20th century, shareholders either did not vote their shares or simply stayed out of everyday corporate governance, voting only on big-picture issues such as the hiring of executives or mergers and acquisitions. If a shareholder did not like the direction the company was taking, she would simply divest by selling her shares.

Today, however, massive, wealthy institutional investors—not retail or household investors—engage corporate boards on the specificities of quotidian operations and management. They own large shares of companies and in many cases are majority shareholders. Unlike individuals who invest their own money, they invest other people's money for fees. Rather than divesting when the company takes an action they do not approve of, they intervene. Many, if not most, of

⁸⁴ See, e.g., INTERIM STAFF OF H.R. COMM. ON THE JUDICIARY, 118TH CONG., CLIMATE CONTROL: EXPOSING THE DECARBONIZATION COLLUSION IN ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) INVESTING 18-19 (Comm. Print 2024).

⁸⁵ Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1268-69 (2016).

⁸⁶ José Azar et al., *Anticompetitive Effects of Common Ownership*, 74 J. FIN. 1513, 1517 (2018).

⁸⁷ José Azar et al., *Ultimate Ownership and Bank Competition*, 51 FIN. MGMT. 227, 232-34 (2022).

⁸⁸ José Azar & Xavier Vives, *Common Ownership and the Secular Stagnation Hypothesis*, 109 AM. ECON. REV. 322, 322 (2019).

⁸⁹ See generally Nathan Atkinson, *If Not the Index Funds, Then Who?* 17 BERKELEY BUS. L.J. 44, 46 (2020) (discussing the size, power, and wealth of the Big Three); Suren Gomtsian, *Voting Engagement by Large Institutional Investors*, 45 J. CORP. L. 659 (2020).

⁹⁰ COATES, *supra* note 70, at 95-128.

⁹¹ See VIVEK RAMASWAMY, *WOKE INC.: INSIDE OF CORPORATE AMERICA'S SOCIAL JUSTICE SCAM* 56-81 (2021); VIVEK RAMASWAMY, *CAPITAL PUNISHMENT: HOW WALL STREET IS USING YOUR MONEY TO CREATE A COUNTRY YOU DIDN'T VOTE FOR* xi-xix, 1-20 (2023). But see Nicolai J. Foss & Peter G. Klein, *Why Do Companies Go Woke?*, 37 ACAD. MGMT. PERSP. 351, 353 (2023) (blaming “wokeness” on middle managers).

these “institutional investors” are also “activist investors,” pushing corporations into politics. The beneficiaries of the funds managed by these investors are often unaware of the politics that their investments support. When an asset management firm invests beneficiaries’ money in underperforming funds to support causes rather than maximize returns, they breach their fiduciary duties to the beneficiaries while avoiding legal retribution or punishment. That’s wrong and unethical.⁹²

As passive index funds gain popularity, a few large asset management firms have accumulated substantial corporate voting power, which they often exercise without explicit direction from their individual investors.⁹³ The Big Three asset managers together own more than 25 percent of the stock of S&P 500 firms, according to recent figures.⁹⁴ These firms hold other privileged positions within the financial system. BlackRock, in particular, is known for its rent-seeking and regulatory influence.⁹⁵ It advised U.S. government officials regarding financial responses to the COVID pandemic.⁹⁶ In 2009, the U.S. Treasury hired BlackRock to manage the toxic assets involved in the 2009 Financial Crisis.⁹⁷ The Federal Reserve entrusted BlackRock with the debt settlement of Bear Stearns.⁹⁸ Blackrock has advised the British Treasury,⁹⁹ the European Central

⁹² Carlon Howard & Allen Mendenhall, *The Rise of Woke Corporations: Examining Their Impact on Society*, DIVIDED WE FALL (Feb. 8, 2023), <https://dividedwefall.org/woke-corporations/>.

⁹³ Lucian Bebchuk & Scott Hirst, *Big Three Power, and Why It Matters*, 102 B.U. L. REV. 1547, 1558 (2022).

⁹⁴ *Id.*

⁹⁵ See Ryan Clements, *Misaligned Incentives in Markets: Envisioning Finance that Benefits All of Society*, 19 DEPAUL BUS. & COM. L.J. 1, 23-24, 51 (2021) (“The larger, more influential, and more interconnected that asset managers grow, the more that global governments will rely on them for expertise.”).

⁹⁶ See Matthew Goldstein, *The Fed Asks for BlackRock’s Help in an Echo of 2008*, N.Y. TIMES (Mar. 25, 2020), <https://www.nytimes.com/2020/03/25/business/blackrock-federal-reserve.html>; Jeanna Smialek, *Top U.S. Officials Consulted With BlackRock as Markets Melted Down*, N.Y. TIMES (June 24, 2021), <https://www.nytimes.com/2021/06/24/business/economy/fed-blackrock-pandemic-crisis.html>; Annie Massa & Caleb Melby, *In Fink We Trust: BlackRock is Now ‘Fourth Branch of Government’*, BLOOMBERG (May 21, 2020), <https://www.bloomberg.com/news/articles/2020-05-21/how-larry-fink-s-blackrock-is-helping-the-fed-with-bond-buying>; see also Ryan Clements, *Are ETFs Making Some Managers Too Interconnected to Fail?*, 22 U. PA. J. BUS. L. 772, 808 (2020).

⁹⁷ Liz Rappaport & Susanne Craig, *BlackRock Wears Multiple Hats*, WALL ST. J. (May 19, 2009, 12:01 AM), <https://www.wsj.com/articles/SB124269131342732625>; Annie Massa, *BlackRock’s Decade: How the Crash Forged a \$6.3 Trillion Giant*, BLOOMBERG (Aug. 30, 2018, 5:00 AM), <https://www.bloomberg.com/news/articles/2018-08-30/blackrock-s-decade-how-the-crash-forged-a-6-3-trillion-giant>.

⁹⁸ *Id.*

⁹⁹ Press Release, HM Treasury, HM Treasury Appoints BlackRock Solutions as Asset Specialist Advisor to the RBS Bad Bank Review (July 12, 2013), <https://www.gov.uk/government/news/hm-treasury-appoints-blackrock-solutions-as-asset-specialist-advisor-to-the-rbs-bad-bank-review>.

Bank,¹⁰⁰ and the Government of Greece.¹⁰¹ CEOs have an incentive, in light of these close relations with governments, to heed Larry Fink's annual letter.

Using passive investment dollars to push ESG may be short-lived, illustrating a true free market (and hence libertarian) effect. Rival funds committed to avoiding politicizing investment are emerging in the market.¹⁰² If Blackrock's investors are dissatisfied, Larry Fink will no longer lead one of the world's biggest financial institutions. ESG outflows and fund underperformance in 2023 may signal that the ESG backlash has influenced the behavior of asset

¹⁰⁰ Angel Au-Yeung, *This Powerful BlackRock Team Has the Ear of Governments and Megabanks*, WALL ST. J. (Oct. 20, 2022, 8:00 AM), <https://www.wsj.com/articles/this-powerful-blackrock-team-has-the-ear-of-governments-and-megabanks-11666235717>; Question for Written Answer, ECB Hires BlackRock, EUR. PARL. DOC. E-007933/2014 (May 14, 2014), https://www.europarl.europa.eu/doceo/document/E-8-2014-007933_EN.html; see also *ECB Says Selects BlackRock to Help Develop ABS Plan*, REUTERS (Aug. 27, 2014, 12:26 PM), <https://www.reuters.com/article/idUSKBN0GR1DE/>; Paul Gordon & Alastair Marsh, *BlackRock Hired by ECB as ABS-Program Consultant*, BLOOMBERG (Aug. 27, 2014), <https://www.bloomberg.com/news/articles/2014-08-27/blackrock-appointed-by-ecb-as-abs-program-consultant>.

¹⁰¹ Press Release, Growthfund, Growthfund Appoints BlackRock FMA as It Strives to Become Greece's National Fund in Par with International Wealth Funds (Apr. 4, 2023), https://growthfund.gr/wp-content/uploads/2023/04/Press_Release_BlackRock_Growthfund_EN_04_04_2023.pdf.

¹⁰² See Dan Morenoff, *Break Up the ESG Investing Giants*, WALL ST. J. (Aug. 31, 2022, 3:10 PM), <https://www.wsj.com/articles/break-up-the-esg-investing-giants-state-street-blackrock-vanguard-voting-ownership-big-three-competitor-antitrust-11661961693>. Strive Asset Management, founded by Vivek Ramaswamy, has emerged as a challenger to asset management firms that promote ESG. *Id.* See also Mahi Roy & Alyssa Stankiewicz, *What's Inside Anti-ESG Funds?* MORNINGSTAR (June 7, 2023), <https://www.morningstar.com/sustainable-investing/whats-inside-anti-esg-funds> (discussing "anti-ESG" fund investment); Kim Clark, *ETF Funds for Anti-ESG Investors*, KIPLINGER (Mar. 27, 2023), <https://www.kiplinger.com/investing/etf-funds-for-anti-esg-investors>; Suzanne McGee, *Anti-ESG Funds Face Obstacles to Broad Investor Acceptance*, WALL ST. J. (Aug. 20, 2023, 11:00 AM) <https://www.wsj.com/finance/investing/anti-esg-fund-investor-acceptance-90a1e0f8>; Robert Armstrong, *Anti-ESG Investment*, FINANCIAL TIMES (Sept. 26, 2023), <https://www.ft.com/content/0caf08cd-88d8-4c17-b694-b5ed757b0b47>.

managers.¹⁰³ Vanguard has dropped out of NetZero Asset Managers,¹⁰⁴ while Larry Fink and BlackRock are deemphasizing ESG.¹⁰⁵

V. COUNTERARGUMENT TWO: ESG IS NON-LIBERTARIAN WHEN IT IS INFLUENCED BY INVESTING AND LOBBYING IN ANTICIPATION OF POTENTIAL REGULATION

The second counterargument is that regulation and the threat of regulation push investors into ESG. Current and anticipated regulation has driven the ESG boom in recent years,¹⁰⁶ thus providing another reason to question the voluntariness of current investments. The voluntary effort to avoid regulatory impacts should not be mistaken for genuine voluntary action. We contend that current and impending government action drives much of the flow of funds into ESG. Moreover, businesses' public support for ESG rules and regulations may not signal genuine endorsement; the potential for regulation could incentivize firms to lobby and influence impending regulatory changes or avoid more intrusive regulations.¹⁰⁷ Moreover, it seems reasonable to assume that, in a

¹⁰³ Hortense Bioy, *Global ESG Funds Hit With Outflows for First Time in Q4*, MORNINGSTAR (Feb. 2, 2024), <https://www.morningstar.com/sustainable-investing/globally-esg-funds-suffer-first-ever-quarterly-outflows-fourth-quarter-2023>; Natasha White & Sheryl Tian Tong Lee, *Goldman, JP Morgan Weigh In as ESG Funds Suffer Historic Blow*, BLOOMBERG (Jan. 30, 2024), <https://www.bloomberg.com/news/articles/2024-01-29/goldman-jpmorgan-weigh-in-as-esg-fund-flows-hit-historic-low>; Bernhard Warner, *Investors Pull Billions From Sustainable Funds Amid Political Heat*, N.Y. TIMES (Jan. 19, 2024), <https://www.nytimes.com/2024/01/19/business/esg-funds-withdrawals.html>; Grace O' Donnell, *ESG Funds Faced Their Worst Year on Record in 2023*, YAHOO! FIN. (Feb. 6, 2024), <https://finance.yahoo.com/news/esg-funds-faced-their-worst-year-on-record-in-2023-221852192.html>; Tommy Wilkes & Patturaja Murugaboopathy, *ESG Equity Funds Suffer Big Outflows, Buffeted by Market Jitters and U.S. Backlash*, REUTERS (Jan. 6, 2023), <https://www.reuters.com/sustainability/sustainable-finance-reporting/esg-equity-funds-suffer-big-outflows-buffed-by-market-jitters-us-backlash-2023-07-06/>; Frances Schwartzkopff, *A \$6 Trillion ESG Headache Is Bleeding Into Fund Flows*, BLOOMBERG (Oct. 23, 2023), <https://www.bloomberg.com/news/articles/2023-10-25/investors-flee-esg-funds-without-clear-targets-morningstar-says>.

¹⁰⁴ Ross Kerber & Noor Zainab Hussain, *Vanguard quits net zero climate effort, citing need for independence*, REUTERS (Dec. 7, 2022), <https://www.reuters.com/business/sustainable-business/vanguard-quits-net-zero-climate-alliance-2022-12-07/>; Kenneth P. Pucker, *Vanguard Confronts an Inconvenient Truth*, HARV. BUS. REV. (Apr. 24, 2023), <https://hbr.org/2023/04/vanguard-confronts-an-inconvenient-truth>.

¹⁰⁵ Isla Binnie, *BlackRock's Fink Says He's Stopped Using 'Weaponised' Term ESG*, REUTERS (June 26, 2023, 8:19 PM), <https://www.reuters.com/business/environment/blackrocks-fink-says-hes-stopped-using-weaponised-term-esg-2023-06-26/>; Ramsey Touchberry, *BlackRock's Larry Fink Ditches ESG for 'Energy Pragmatism'*, WASH. TIMES (Mar. 26, 2024), <https://www.washingtontimes.com/news/2024/mar/26/blackrocks-larry-fink-ditches-esg-for-energy-pragm/>.

¹⁰⁶ See Mendenhall & Sutter, *supra* note 6, at 81.

¹⁰⁷ This point signals a key feature of public choice economics, namely "rent-seeking," which refers to "[r]estrictions on the ability of potential competitors to supply the same or similar good results in *economic rents* for those who capture the market." Maxwell L. Stearns, Todd J. Zywicki, and Thomas J. Miceli, Law and

Hotelling-style spatial model,¹⁰⁸ an affected group might propose or promote regulations closer to the median to prevent more extreme or onerous regulations.

Government policy affects profitability.¹⁰⁹ Regulation influences stock prices,¹¹⁰ which reflect the present value of expected future profits.¹¹¹ The efficient markets hypothesis asserts that information is incorporated into stock prices as soon as it becomes publicly available.¹¹² The best evidence of regulatory policy changes impacting stock prices comes from event studies of unexpected policy changes.¹¹³ Asset prices quickly adjust to anticipated changes in government policy.¹¹⁴ If investors anticipate regulation, they might reallocate funds from assets expected to lose value to those likely to gain, and they might do so before the policy changes occur to minimize potential losses and position themselves for future gains.

Prospective ESG policies could already influence current investments. For example, if banks are banned from working with companies with low ESG scores, demand for these companies' bonds and loans would drop, decreasing their value. Investors probably would want to avoid holding stocks or corporate

Economics: Public and Private 423 (2018). See also *Id.* at 423-425 (explaining protectionist regulatory policy in more detail) and 433-438 (explaining how interest group activity incentivizes lobbying, regulation, and rent-seeking). A landmark work of public choice economics addressing the collective action problem and how groups mobilize to advocate regulation is Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976).

¹⁰⁸ In Hotelling spatial competition theory, two entities—e.g., businesses or political parties—compete for support by positioning themselves along a linear spectrum. This spectrum could represent a physical market for businesses or, for political parties, an ideological continuum. The theory posits that the most stable outcome occurs when competitors converge toward the center of the spectrum. This central positioning allows competitors to capture the largest share of customers or voters because those on the extremes will still favor the closest option while the critical middle remains highly contested. See Harold Hotelling, *Stability in Competition*, 39 ECON. J. 41 (1929). The authors thank Todd J. Zywicki for this point.

¹⁰⁹ “[A]ll activity other than immediate consumption is potentially affected by changes in government policy.” Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 516 (1986).

¹¹⁰ The literature here is vast, so we cite just two representative examples, one older and one more recent. See, e.g., John J. Binder, *Measuring the Effects of Regulation with Stock Price Data*, 16 RAND J. ECONOMICS 167 (1985); Baris Ince & Han Ozsoylev, *Price of Regulations: Regulatory Costs and the Cross-Section of Stock Returns*, 14 REV. ASSET PRICING STUD. 381 (2024).

¹¹¹ G. William Schwert, *Using Financial Data to Measure Effects of Regulation*, 24 J.L. & ECON. 121, 121-22 (1981). On the deregulation of stock brokerage, see Sam Peltzman, *The Economic Theory of Regulation After a Decade of Deregulation*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1, 32-33 (Martin Neil Baily & Clifford Winston eds., 1989).

¹¹² Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

¹¹³ See Schwert, *supra* note 112, at 121-58; Kenneth A. Carow & Randall A. Heron, *Capital Market Reactions to the Passage of the Financial Services Modernization Act of 1999*, 42 Q. REV. ECON. & FIN. 465 (2002).

¹¹⁴ Schwert, *supra* note 112, at 122.

bonds from companies facing exclusion from financial markets when the rule is announced. Conversely, investment funds could flow into wind and solar power companies if subsidies and mandates are expected to boost future profits.

Potential changes in the regulatory environment can prompt firms to adjust their stance on regulation. By opposing policy changes, businesses diminish their ability to shape new regulations, as demonstrated by the deregulation of U.S. airlines in the 1970s.¹¹⁵ Legacy airlines were reluctant to dismantle the regulatory regime.¹¹⁶ Although the Civil Aeronautics Board was shut down, deregulation did not signal the complete disappearance of regulation but rather a reduction in regulatory controls.¹¹⁷ A key moment occurred when a legacy carrier seized the opportunity to influence the new rules, supporting regulation and bolstering the coalition for change.¹¹⁸ Having a say in shaping these rules can offer a competitive advantage over rivals.

ESG regulations are under consideration, and businesses will strive to play a role in formulating these new regulations.¹¹⁹ After all, “every industry or occupation that has enough political power to utilize the state will seek to control entry” into a market through regulation.¹²⁰ Corporations or executives vociferously opposing ESG may find themselves excluded from this legislative process. The potential financial impact is so significant that few businesses would risk exclusion from shaping new ESG regulations. Moreover, including ESG opponents in this process might lead to ineffective rules. Consequently, public support for ESG or portfolio adjustments may not reflect a genuine acceptance of ESG but rather a response to the threat of government action.

Furthermore, Macey does not consider the external pressures from outside the United States that prompt companies to adopt ESG initiatives. According to Paul H. Tice, “[o]ver the past 40 years, the UN and its member governments and supranational affiliates have taken the lead in pushing the sustainability agenda.”¹²¹ The United Nations and the Swiss Federal Department of Foreign Affairs cosponsored the Who Cares Wins Conference, which catalyzed the ESG movement, recommending in the conference report that governments and

¹¹⁵ MARTHA DERTHICK & PAUL J. QUIRK, *THE POLITICS OF DEREGULATION* 157 (1985).

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ See Mendenhall & Sutter, *supra* note 6, at 88-101 (detailing numerous similar regulations).

¹²⁰ George J. Stigler, *The Theory of Economic Regulation*, 2 *BELL J. ECON. & MGMT. SCI.* 3, 5 (1971).

¹²¹ PAUL H. TICE, *THE RACE TO ZERO: HOW ESG INVESTING WILL CRATER THE GLOBAL FINANCIAL SYSTEM* xii, 22, 41 (2024).

multilateral agencies “proactively consider the investment of their pension funds according to the principles of sustainable development”¹²² while regulators “shape legal frameworks in a predictable and transparent way” to “support integration in financial analysis.”¹²³ Although private institutions are not required to join the U.N.’s Principles for Responsible Investment or adhere to U.N. recommendations, consider the position of an executive who chooses to oppose or disregard these initiatives. Such a decision would mean going against the collective influence of 193 member states, each of which contributes to funding the U.N. The U.N. does not have to enact and enforce laws to coerce companies.

Government regulations regarding ESG, moreover, involve mandatory disclosures. “The clearest path to the consolidation of the ESG reporting ecosystem,” Adam Sulkowski and Ruth Jebe explain, “is for governments to mandate ESG disclosure around globally accepted reporting standards.”¹²⁴ Moreover, they add, “adopting a unitary ESG reporting standard that harmonizes the existing multiplicity of standards into one would simplify the system for reporting companies and for information users.”¹²⁵ That sentiment encapsulates the antilibertarian character of ESG.

ESG investing is largely driven by government money rather than private capital. Reports generally agree that total global assets under management are around \$100 trillion.¹²⁶ However, according to *Forbes*, there are just 2,781 billionaires in the world.¹²⁷ To reach that \$100 trillion figure, then, asset

¹²² THE GLOBAL COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD iii (2004), <https://documents1.worldbank.org/curated/pt/280911488968799581/pdf/113237-WP-WhoCaresWins-2004.pdf>.

¹²³ *Id.* at iv.

¹²⁴ Adam Sulkowski & Ruth Jebe, *Evolving ESG Reporting Governance, Regime Theory, and Proactive Law: Predictions and Strategies*, 59 AM. BUS. L.J. 449, 453 (2022).

¹²⁵ *Id.*

¹²⁶ See Press Release, PwC Global Asset & Wealth Management Survey, One in Six Asset and Wealth Management Companies Will Be Swallowed Up or Fall by the Wayside in the Next Five Years (July 10, 2023), <https://www.pwc.com/gx/en/news-room/press-releases/2023/pwc-2023-global-asset-and-wealth-management-survey.html>; Chris McIntyre et al., *The Tide Has Turned*, BOS. CONSULTING GRP. (May 15, 2023), <https://www.bcg.com/publications/2023/the-tide-has-changed-for-asset-managers>; Press Release, WTW, Top 500 Investment Managers See Assets Drop by \$18 Trillion (Oct. 23, 2023), <https://www.wtwco.com/en-us/news/2023/10/top-500-investment-managers-see-assets-drop-by-dollar-18-trillion>; Christopher Marchant, *Global AUM Rises in 2023, Even as Profits Fall*, PENSIONS & INVS. (May 6, 2024, 12:01 AM), <https://www.pionline.com/money-management/global-aum-rises-2023-even-profits-fall-bcg>.

¹²⁷ *Forbes World’s Billionaires List 2024: The Top 200*, FORBES (Apr. 2, 2024, 6:00 AM), <https://www.forbes.com/sites/chasewithorn/2024/04/02/forbes-worlds-billionaires-list-2024-the-top-200>.

managers must invest government money in pension funds, bonds, sovereign wealth funds, and foreign exchange reserves.

We have shown elsewhere that governments, rather than private firms or actors, primarily impel ESG through mandates, regulations, and subsidies.¹²⁸ In that previous article, we addressed the challenges of discerning the causative factors between investors' decisions and government regulations and highlighted government initiatives as the driving force behind ESG.¹²⁹ We outlined how governmental actions introduced the modern ESG movement nearly two decades ago and discussed their role in mandates, particularly in the transition to clean energy, which redirects investment toward government-favored firms and fields.¹³⁰ We examined the regulatory pressures that ESG places on private enterprise, citing notable examples from the United States, the European Union, France, the United Kingdom, Australia, and Canada.¹³¹ Moreover, we considered the use of subsidies and tax incentives to advance ESG objectives.¹³² Finally, we illustrated how national governments collaborate with non-governmental organizations to advance ESG agendas.¹³³

Rather than repeating those findings, we incorporate them by reference. The most recent and far-reaching example of how national governments rather than markets impel ESG is the European Union's Corporate Sustainability Due Diligence Directive (CSDDD), which applies not just to European Union companies (those with over 1,000 employees and a global turnover exceeding \$489 million) but also to non-European Union companies, in the United States or elsewhere, which produce a net turnover of \$489 million within the European Union.¹³⁴ The CSDDD compels businesses to follow Europe's ESG rules in their operations and supply chains, regardless of their suppliers' locations.¹³⁵ Among other mandates, it requires qualifying businesses to reduce and reverse biodiversity loss, prohibit certain forms of disinformation, ensure labor union rights, and adopt climate transition plans to phase out the use of fossil fuels.¹³⁶

¹²⁸ See generally Mendenhall & Sutter, *supra* note 6.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Corporate Sustainability Due Diligence*, EUR. UNION, https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en (last visited Mar. 3, 2025).

¹³⁵ *Id.* See also Letter from General Secretariat of the Council, to Delegations (Mar. 15, 2024) (on file with Council of the European Union), <https://data.consilium.europa.eu/doc/document/ST-6145-2024-INIT/en/pdf>.

¹³⁶ *Corporate Sustainability Due Diligence*, *supra* note 134; see also Letter from General Secretariat of the Council, *supra* note 135.

Failure to meet these requirements may result in fines of up to 55% of a company's global turnover, not to mention potential lawsuits against alleged violators.¹³⁷ The CSDDD purports to bind American companies to European Union regulations and ESG metrics both upstream and downstream of supply chains, a situation that undermines the sovereignty of corporate law at both the state and federal levels in the United States.

In short, governments have been instrumental in advancing ESG strategies and finance globally. The European Union's CSDDD serves as a prime example of how governmental policies enforce ESG standards on businesses worldwide, impacting their operations and supply chains.

VI. A MARKET RESPONSE TO GOVERNMENT FAILURE

Macey suggests that ESG is a market response to government failure, inverting the usual justification for government intervention in market failures.¹³⁸ While this portrayal seems to balance public and private sector roles, closer scrutiny reveals its contradictions.

Libertarianism prefers voluntary action whenever feasible. All else equal, voluntary solutions to public goods and externality problems are preferable. Market failure arises because voluntary actions driven by self-interest, aimed at subjective preference satisfaction, often fail to produce effective collective action. Individuals might choose to free ride instead of contributing to a public good, hoping others will contribute instead. Or they pursue actions yielding significant private benefits while imposing costs on third parties. For instance, poachers might harm endangered animals for the profits gained from illegal sales.

Market inefficiencies result when voluntary exchanges fail to provide adequate quantities of public goods or fully internalize negative externalities. Such failures can justify government intervention under the libertarian contractarian notion that the government's role should be limited to addressing public goods issues.¹³⁹

¹³⁷ *Corporate Sustainability Due Diligence*, *supra* note 134; *see also* Letter from General Secretariat of the Council, *supra* note 135.

¹³⁸ *See* Macey, *supra* note 1, at 262.

¹³⁹ JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN* 38 (1975); *see generally* DAVID SCHMIDTZ, *THE LIMITS OF GOVERNMENT: AN ESSAY ON THE PUBLIC GOODS ARGUMENT* (1990).

When deciding between market and government solutions at a constitutional level, citizens weigh the relative effectiveness of each in addressing public goods or externalities. Government failure is a genuine concern; as public sector efforts prove less effective or more wasteful, citizens become less likely to favor government intervention over market solutions. The government may lack sufficient information or incentives to institute policies producing superior outcomes to a less-than-perfect market outcome; in the terminology of Liebowitz and Margolis, a market failure may not be “remediable” through government.¹⁴⁰

Consequently, government failure is relevant to the choice between markets and government, but the existence of government failure does not improve the performance of voluntary mechanisms, as Macey implies. When comparing market and government solutions, we assume all voluntary tools are already in use. If government intervention fails, what new voluntary actions could address the inefficiency that was not already considered when identifying the market failure?

Climate change, the primary focus of the “E” in ESG, illustrates this concept. As a global externality with long-term, negative consequences, it presents the most challenging case for market-based solutions (known as “free market” environmentalism).¹⁴¹ Markets operate through decentralized, permissionless, voluntary exchanges; willing buyers and sellers can transact without approval or facing objections from others. In a market economy, if consumers are willing to pay enough for gas-powered cars and their fuel, manufacturers and oil refiners will meet this high demand. High consumer prices allow these companies to offer attractive interest rates, drawing investors who may not prioritize ESG concerns. Fossil fuels continue to provide significant benefits to individuals.¹⁴² According to Michael Greenstone and coauthors, these benefits are sufficiently substantial to sustain market demand for fossil fuels for the foreseeable future.¹⁴³

¹⁴⁰ Stan J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J. L. ECON. & ORG. 205, 207 (1995).

¹⁴¹ On free market environmentalism, *see generally* TERRY L. ANDERSON & GARY D. LIBECAP, ENVIRONMENTAL MARKETS: A PROPERTY RIGHTS APPROACH (2014). *See also* TERRY L. ANDERSON AND DONALD D. LEAL, FREE MARKET ENVIRONMENTALISM FOR THE NEXT GENERATION (2015).

¹⁴² *See* ALEX EPSTEIN, FOSSIL FUTURE: WHY GLOBAL HUMAN FLOURISHING REQUIRES MORE OIL, COAL, AND NATURAL GAS—NOT LESS 109-201 (2022); ROGER BEZDEK ET AL., NONGOVERNMENTAL INT’L PANEL ON CLIMATE CHANGE, CLIMATE CHANGE RECONSIDERED II: FOSSIL FUELS 293-380 (Joseph L. Bast & Diane Carol Bast eds., 2019).

¹⁴³ Thomas Covert et al., *Will We Ever Stop Using Fossil Fuels?*, 30 J. ECON. PERSP. 117, 123 (2016).

The libertarian approach to pollution can include constitutionally limited government action. Citizens, through their representatives, must consent to the imposition of coercive limits on their actions or to restrictions on the use of fossil fuels to mitigate climate change. Congress has not passed climate change legislation, and the Senate never ratified the Paris Climate Accord. Macey suggests that this inaction is due to the fossil fuel industry's lobbying.¹⁴⁴ We do not accept this claim, but it is unclear what market solutions remain if rent-seeking has blocked legislation. Will fossil fuel companies voluntarily reduce output after their legislative victory? Is it realistic to expect institutional investors like BlackRock to use their shareholder voting power to compel fossil fuel companies to cease operations? Regulations forcing the closure of coal and gas power plants or mandating electric vehicles are government actions taken without direct public consent. Major financial institutions can choose to stop financing fossil fuels, yet they have no market power to prevent others from funding new companies in this sector. None of these approaches represent libertarian principles.

Macey does not appear to accept markets as a viable alternative to the government on climate change.¹⁴⁵ Despite seemingly celebrating the alleged libertarianism of ESG, he contends that “the response to climate change involves a paradigmatic case in which government action is the appropriate channel for redressing grave social injury.”¹⁴⁶ Moreover, he claims, “[t]here are many reasons for government and not corporations to play the key role in the ESG campaign.”¹⁴⁷ He insists that governmental intervention is “the *only* effective means for addressing significant collective action problems.”¹⁴⁸ He specifically cites as necessary those “government regulations that impose a price on carbon, such as carbon taxes or cap-and-trade programs,” which, he submits, “provide a promising pathway to making those who benefit from carbon emissions internalize the costs of those emissions.”¹⁴⁹ He also claims that “[g]overnment support for low-carbon innovation, including support for developing new and nascent technologies for carbon capture and sequestration is also of paramount

¹⁴⁴ Macey, *supra* note 1, at 270.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 269.

¹⁴⁸ *Id.* at 270 (emphasis added). Elsewhere he claims, “a strong, clearly articulated and mandatory government response to ESG concerns is vastly superior to corporation-by-corporation approaches to ESG investing and governance.” *Id.* at 264. Still elsewhere he claims, “To overcome the significant collective action problems ESG investing aims to solve, a coordinated government response is necessary.” *Id.* at 264-65.

¹⁴⁹ *Id.* at 270.

importance.”¹⁵⁰ These are not libertarian positions. They could only pass libertarian muster if implemented through the legitimate mechanisms of constitutionally limited government—specifically, through legislation rather than executive orders or regulations by administrative agencies peopled by unelected bureaucrats.

VII. HARMONIZATION OF ESG RATINGS

As we have discussed elsewhere, one of the most seemingly benign aspects of ESG regulation is the standardization of ratings.¹⁵¹ According to one estimate, over 600 ESG ratings exist.¹⁵² The various ratings use different variables, weights, and data sources, resulting in low correlation. A 2016 study found that the correlation between top ESG metrics ranged from +0.13 to +0.52, with an average overall correlation of +0.30.¹⁵³ Differences in the “theorization” and “commensurability” categories explain the differences. A more recent study found that correlations between six leading ESG metrics still diverge significantly, averaging +0.54 and ranging from +0.38 to +0.71.¹⁵⁴ The primary driver of divergence between metrics is measurement, followed by scope and weight.¹⁵⁵

Is standardizing ESG ratings, without forcing any businesses or financial institutions into compliance, libertarian? Ultimately, no. Creating one or a small number of government-approved metrics is not libertarian. A multiplicity of relatively uncorrelated metrics exists because of the range of factors potentially falling under ESG. Investors might prioritize one ESG element over the others or weigh a company’s statements differently than its tangible deeds. In a free market, investors may invest based on their chosen criteria. Voluntarism and freedom of contract imply that all financial analysts enjoy the freedom to construct and market ESG metrics to investors. Synchronization can occur through the market, facilitated by voluntary mergers of competitor ratings, perhaps in response to customer demands. In a free market, competitors cannot prevent others from offering rival products. It is not libertarian for companies

¹⁵⁰ *Id.* at 270.

¹⁵¹ See Mendenhall & Sutter, *supra* note 6, at 84, 86, 88-89, 93-96, 100-102, 112-113.

¹⁵² Xiaomin Bao et al., *The Impact of Environmental, Social, and Governance (ESG) Rating Disparities on Corporate Risk: The Mediating Role of Financing Constraints*, 371 J. ENV’T MGMT. 1, 1 (2024).

¹⁵³ Aaron Chatterji et al., *Do Firms’ Ratings Converge? Implications for Managers, Investors, and Strategy Researchers*, 37 STRATEGIC MGMT. J. 1597, 1604 (2016).

¹⁵⁴ Florian Berg et al., *Aggregate Confusion: The Divergence of ESG Ratings*, 26 REV. FIN. 1315, 1321 (2022).

¹⁵⁵ *Id.* at 1317.

like MSCI or Sustainalytics to use government power to make their ESG metrics the only allowable standards.

Investors can find the metric that best matches their ESG perspective without synchronization. The strongest market-based case for a single or a few government-approved ratings is to reduce confusion from having numerous ratings. The existence of hundreds of ratings increases the risk that investors will rely on an unreliable or bogus metric. Unsuspecting investors may mistakenly rely on a metric that highly rates gun manufacturers, coal companies, and firms with all-male boards of directors.

This market failure argument is weak. First, unlike traditional product ratings whereby companies pay to be rated, investors rather than companies pay for ESG ratings.¹⁵⁶ Investors may choose to allocate their funds without ESG guidance. Investors who pay for ratings should be expected to conduct minimal research on their purchases. Persistence ratings pass a market test rather than indicating market failure. Investors who prioritize ESG considerations are unlikely to be confused or misled by unreliable ratings, while indifferent investors are unlikely to purchase ESG ratings.

Market discovery presents a compelling case against forced synchronization.¹⁵⁷ Even accepting, *arguendo*, that ESG should impact corporate governance and investment, the optimal assessment metric must be discovered. Which measurables correlate most closely with improved performance on these dimensions? Which metrics are most susceptible to manipulation? What are the compliance costs of different variables, and is the improved performance worth the added expense? Allowing numerous expert groups to measure various ESG components, with investors providing feedback on their effectiveness, offers the best approach to developing robust performance measures and mitigating greenwashing.

Synchronization is only necessary when anticipating government mandates that use ESG compliance to alter market behavior or restrict certain economic activities indirectly. A mandate for publicly traded companies or regulated financial institutions to maintain a minimum ESG score on *any* metric is toothless.

¹⁵⁶ *Id.* at 1320.

¹⁵⁷ Friedrich Hayek, *Competition as a Discovery Procedure*, Q.J. AUSTRIAN ECON., Fall 2002, at 9 (Marcellus S. Snow trans.).

Gun manufacturers and coal companies could pay for a metric rating them highly. Similarly, mandating CEO compensation based on ESG scores is futile if the CEO can choose a metric awarding high scores for his or her intended actions. Conversely, when a private company's ESG metric is adopted to guide government mandates, the metric is no longer purely private because an adverse score prevents others from doing business with it.

A multiplicity of ESG ratings catering to diverse investor preferences is libertarian; government-driven synchronization is not.

CONCLUSION

The characterization of ESG as a market-driven phenomenon has gained considerable traction and influenced discourse about the nascent "anti-ESG" movement as a governmental resistance to market forces. Yet libertarianism does not harmonize with the governmental regulations and intergovernmental initiatives that facilitate ESG through extensive legislation and regulation, both proposed and instituted.

Genuinely libertarian approaches to achieving all three prongs of ESG exist. For instance, fossil fuel deposits could be purchased from current owners and left unused. Corporations can also support social causes through their policies, as evidenced by firms that offered health insurance coverage for employees' same-sex partners long before *Obergefell v. Hodges*.¹⁵⁸ Even absent conclusive evidence, executives enjoy discretion under the business judgment rule to pursue measures they believe will be profitable. Governance can be addressed by including employees on boards of directors. None of these goals require government intervention or quasi-private measures like stock exchange listing requirements. If ESG governance and investing are as beneficial as advocates suggest, major financial institutions and policymakers will not need to impose them on corporations. They will be adopted voluntarily. Companies that lag in embracing profitable ESG practices will face pressure to catch up or risk losing market share and financial decline.

¹⁵⁸ See generally *Obergefell v. Hodges*, 576 U.S. 644 (2015).