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Electric vehicles solve one ESG problem but create others

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While electric vehicles (EVs) receive much praise for their emission-cutting capabilities and the associated health benefits in polluted cities, they're not necessarily the ESG panacea many are hopeful for.

Sophisticated ESG investors know to look beyond the exhaust pipe and consider the impact of the entire manufacturing chain before rolling out the environmental credentials.

A move to EVs shifts dependence away from the oil industry, but this fossil-fuel hole has to be filled by another power source. For EVs, the reliance shifts to the mining industry, which has its own geopolitical, environmental and social challenges. EV manufacturers also need to take into account recycling options for used parts, especially batteries, as well as consider near-shoring suppliers to reduce long and environmentally unfriendly supply chains.

Once an EV is manufactured, there's the environmental impact of powering it to consider. Currently, only one third of the EU's electricity consumption is from renewable sources and the auto industry is reliant on governments to boost investment in green energy suppliers. If they fail to do this, the extra demand will fall on hydrocarbon-burning power stations, which would mean the environmental problem is shifted rather than resolved.

On a social level, the immediate ESG risk is the huge potential upheaval in the auto industry itself. As manufacturers struggle to adapt, this could lead to collapses and redundancies on a large scale. Additionally, many suppliers are ill-equipped to produce the parts required for EVs and will likely become obsolete if they fail to rapidly adapt. It remains an open question as to whether governments will step in to support legacy industries whilst at the same time pursuing a green agenda.

A second social dimension of the EV revolution that is getting little recognition is the potentially negative impact on access to mobility for lower and middle-income households. If governments implement policies that make petrol and diesel cars prohibitively expensive whilst EV prices remain high (partly due to commodity price inflation), this could mean personal transport is unaffordable to poorer households. It would also favour metropolitan dwellers over those in rural communities, due to greater public transport options in towns and cities. The price of electricity itself may rise due to increased demand or because of surcharges imposed by governments to support their green energy build-out policies. Overall, this could prove a negative environment for low and middle-income households, as well as those located in rural areas.

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Addressing these varied and challenging ESG factors is likely to prove a very difficult balancing act for European governments. The EU has planned to set aside EUR72 billion to cushion the social impact of the EV transition, but there are currently no details of how this money will be spent. As European governments are democratically elected, it is highly likely that many compromises will have to be made to appease voters if politicians wish to have a chance of re-election.

November, 2021.

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