NORGES BANK
INVESTMENT MANAGEMENT

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THE SUSTAINABLE DEVELOPMENT GOALS AND THE GOVERNMENT PENSION FUND GLOBAL

ASSET MANAGER PERSPECTIVE

The UN Sustainable Development Goals (SDGs) set out an ambitious policy agenda to achieve sustainable economic, social and environmental development by 2030. As a long-term and global owner, the Government Pension Fund Global has an interest in a more sustainable global economy. Achieving the SDGs, in both developed and developing countries, could contribute to the long-term return of the fund through increased economic resilience.

This note explores the economic context of the SDGs and the role institutional investors may play in achieving these goals. The fund supports the transition to a more sustainable global economy in four main ways. We provide long-term capital to over 9,000 companies and exercise our ownership to strengthen governance, improve performance and promote sustainable business practices. We invest in 38 developing markets, of which nearly half are outside our benchmark, thereby providing long-term capital to countries most in need of investments. Through our environment-related mandates, we make additional investments in companies offering or developing solutions for a more environmentally friendly economy. Finally, we reduce our exposure to unacceptable risks through ethical exclusions and risk-based divestments.

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The Asset Manager Perspective series articulates Norges Bank Investment Management's views and reflections on issues topical for the financial industry. They are not meant to be definitive, rather they are intended as timely contributions for the benefit of all market participants. The series is written by employees, and is informed by our investment research and our experience as a large, long-term asset manager.

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In September 2015, the 193 member states of the UN unanimously adopted the SDGs, setting out an ambitious policy agenda to achieve sustainable economic, social and environmental development by 2030.[1] How governments – together with the private sector and civil society – pursue these goals by mobilising and sharing knowledge, expertise, technology and financial resources, will have a significant impact on the global economy.

We manage the Government Pension Fund Global on the basis of a mandate laid down by the Ministry of Finance. The objective of our management is to ensure a high long-term return after costs. We consider this long-term return to be dependent on sustainable development in economic, environmental and social terms, and integrate our responsible investment efforts into the management of the fund. Ultimately, the future value of the fund depends on the long-term value created by companies we are invested in. Responsible investment management supports the overall objective by furthering the long-term economic performance of our investments and reducing financial risks associated with these companies' environmental and social practices.

Our goals as a responsible investor to a large extent align with the 2030 Agenda for Sustainable Development ("the 2030 Agenda"). The fund is invested across many countries and markets to diversify risk and capture global growth. Solutions to global challenges such as climate change and environmental degradation will increase the resilience of our portfolio. The SDGs provide a common direction for addressing sustainability issues from which our investee companies may benefit.

The purpose of this document is twofold. First, we briefly explore the SDGs and their economic context, including the role of private investment. Second, we discuss how the fund as a responsible investor may affect sustainable development in general and the SDGs in particular.

The UN Sustainable Development Goals and their economic context

The 17 SDGs seek to address a range of social, economic and environmental challenges to create socially inclusive and environmentally sustainable economic growth across the world. They set a global policy agenda for governments and articulate a vision for the world. The vision set by the UN is that the world's population in 2030 should live in peaceful and inclusive societies, where economic progress is widespread, thus eliminating extreme poverty, and where the environment is protected from man-made degradation. The SDGs form a global agenda, since developed countries too need to make progress on specific goals, such as inequality and climate change. There are 169 targets for the 17 goals. Each target has up to three indicators used to measure progress towards reaching the targets. In total, 232 indicators will measure compliance.

1 See United Nations (2016), "The Sustainable Development Agenda", available at: http://www.un.org/sustainabledevelopment/development-agenda/.

Figure 1. Overview of the 17 SDGs

The SDGs are not legally binding, but governments are expected to take leadership and establish national implementation plans for the goals. Countries face widely different challenges to achieve the SDGs by 2030 and are therefore encouraged by the UN to design implementation plans that reflect national priorities. According to Goal 17, implementation should be supported by a "Global Partnership", referring to joint efforts from the public sector, private sector and civil society. Governments are expected to set a clear direction for this partnership and to operationalise the goals. To track progress towards the SDGs quantitatively in a global framework, countries are encouraged to submit annual Voluntary National Reviews to the UN High-level Political Forum.

The SDGs have similarities with, and build on, the earlier Millennium Development Goals (MDGs).[2] However, the SDGs go further, as they seek to cover areas previously not addressed by the MDGs, and they are relevant to all UN member states. The SDGs establish economic growth, eradication of poverty and inequality, and protection of the environment as key dimensions of the sustainable development agenda. Considering these dimensions together widens the scope beyond traditional sustainability issues. Historically, much economic growth has caused environmental degradation.[3] The implementation of the MDGs (2000-2015) fell into a period of considerable improvements in living conditions, particularly in reducing poverty. However, during the period 1990 to 2010, large developing countries failed simultaneously to achieve progress across other key dimensions of the SDGs: higher mean incomes resulted in greater inequality and more greenhouse gas emissions.[4] Achieving economic growth that is also sustainable in a wider sense is perhaps the most fundamental challenge that the SDGs seek to address.

2 The MDGs were a set of eight international development goals for 2015 established following the UN's Millennium Summit in 2000. They were replaced by the SDGs in 2015.

3 See Sachs as a starting point for these challenges and how they could be addressed: Sachs, J. (2015), "The Age of Sustainable Development", Columbia University Press.

4 Popov, V. & Chowdhury, A. (2016), "What Does MDGs Experience Tell Us about SDGs Challenges?", available at: https://voxeu.org/debates/commentaries/what-does-mdgs-experience-tell-us-about-sdgs-challenges.

Some academic studies indicate that, at higher levels of income, further economic growth could be associated with declining levels of pollution.[5] The SDGs may thus be more successful in reconciling these dimensions than historical evidence would imply. Reconciling these dimensions is also in the interest of long-term, global investors. As universal owners, such investors have an inherent interest in the internalisation of externalities and economic outcomes that are sustainable over time. Achieving the transition to a low-carbon economy is a notable example in this regard. Many forecasts show net long-term economic benefits from taking increased action on climate change today.[6]

The SDGs are the outcome of a negotiated process, resulting in a comprehensive list of goals and targets. Their broad scope and interrelated nature imply challenges for implementation. The agreement reached by the UN member states does not include binding commitments to the financing of the SDGs. Estimates by the World Economic Forum indicate that additional investments equivalent to around 5 percent of global GDP are needed annually, while currently only 1.4 trillion US dollars flows to SDG-related projects.[7] This top-down estimate is sometimes referred to as the SDG funding gap. Another way to estimate financing needs in the future would be to start with national implementation plans and analyse investments needs.

To meet the financing needs of the SDGs, a frequently applied assumption is that savings are abundant on a global scale and can be matched with sustainable investment opportunities. However, if SDG-supportive projects offered an attractive return given the inherent risks, capital would naturally flow to such projects. An important hurdle to investing in SDG-supportive projects is that the costs of unsustainable business practices are frequently not borne by the producers, but by society, or other businesses at large. Sustainable investments may also create additional costs in the short run, while the benefits may only accrue in the long run.[8] Governments could introduce market-based mechanisms, incentivising companies and individuals to internalise the costs of the pollution and environmental damage they cause. A longer investment horizon could also help match initial costs with revenues further into the future. Recent research indicates that some of the currently employed long-run discount rates for climate change abatement investments may be too high, depressing the attractiveness of such investments.[9]

5 This discussion began with Grossman and Krueger's seminal paper and led to the formulation of the Environmental Kuznets Curve, which suggests that the relationship between environmental degradation and GDP per capita follows an inverted U-shape (Grossman, G. & Krueger, A. (1995), "Economic Growth and the Environment", The Quarterly Journal of Economics).

6 OECD (2017), "Investing in Growth", OECD Publishing, available at: http://www.oecd.org/environment/investing-in-climate-investing-in-growth-9789264273528-en.htm.

7 World Economic Forum (2018), "How to Close the $2.5 Trillion Annual Funding Gap", available at: https://www.weforum.org/agenda/2018/01/closing-2-5-trillion-funding-gap-public-private/. For a more detailed analysis of financing needs see Schmidt-Traub, G. (2015), "Investment Needs to Achieve the Sustainable Development Goals", SDSN Working Paper.

8 Nordhaus, W. (2007), "A Review of the Stern Review on the Economics of Climate Change", Journal of Economic Literature.

9 Giglio, S., Maggiori, M., Stroebel, J. & Weber, A. (2015), "Climate Change and Long-run Discount Rates: Evidence from Real Estate", Working Paper No. 21767, National Bureau of Economic Research.

Governments could also enter into co-investments and closer co-operation with the private sector.[10] Increasing private sector investment aimed at the SDGs requires an understanding of where the greatest investment gaps to achieving the SDGs lie. National implementation plans can establish governments' SDG priorities, thereby helping companies identify business opportunities, and more generally provide guidance on the involvement of the private sector in achieving the 2030 Agenda. To encourage more investment in SDG-related projects, governments could consider aligning financial incentives with the SDGs through public policies and sound institutional, legal and regulatory frameworks.[11]

The fund and the SDGs

The fund's investment mandate enables us to invest in public equities, tradable fixed-income instruments, and real estate, but does not include other asset classes outside public markets. Certain forms of financing, such as public-private partnerships and foreign direct investments (FDI) are therefore beyond the scope of our mandate.[12] Our main contribution to a more sustainable global economy will be through our investments in public markets. Due to our size and presence in financial markets, our diversified investments may contribute directly or indirectly to many SDGs. Beyond providing long-term capital to companies, we relate to the SDGs in four main ways: i. by promoting long-term value creation in companies, ii. by investing in developing markets, iii. by investing in companies providing environmental solutions, and iv. by divesting from unsustainable businesses.

Promoting long-term value creation in companies

Our main contribution to the 2030 Agenda is to promote long-term value creation by the companies in which we are invested. We work with companies to strengthen governance, improve performance and promote sustainable business practices.

The benchmark for our equity portfolio is based on a broad global equity index which captures most of the value creation by the world's listed companies. As a starting point, our fund is as financially aligned with the SDGs as the world's listed companies. We currently provide long-term capital to over 9,000 listed companies in 72 countries across a wide range of sectors.[13]

At the market level, we promote standards and research. Our aim is to contribute to the development of well-functioning markets and sustainable business practices. We recognise a set of internationally agreed standards from the UN and the OECD that provide the framework for our interaction

10 Blended finance is one solution for providing concessional funding for projects that would not attract funding on strictly commercial terms. More information on blended finance at the International Finance Corporation (World Bank Group) can be found at: https://www.ifc.org/wps/wcm/connect/45c23d804d9209fab2f8b748b49f4568/Blended-Finance-Factsheet-May2017.pdf?MOD=AJPERES.

11 United Nations (2015), Addis Ababa Action Agenda of the Third International Conference on Financing for Development, Resolution A/RES/69/313.

12 FDI is an investment by a firm or an individual to acquire a lasting interest in businesses outside the economy of the investor. The equity ownership threshold to qualify as a foreign direct investor reflecting this lasting interest is commonly set at 10 per cent. For more information, see UNCAD 2018, "Foreign Direct Investment", available at: http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-(FDI).aspx.

13 Norges Bank Investment Management (2018), "Government Pension Fund Global – Annual Report / 2017", p.26.

with companies and other market participants. We contribute to the further development of standards through consultations with regulators and other standard-setters. We promote our views on well-functioning markets through our Asset Manager Perspectives and formulate our expectations of companies. These public documents provide a principled basis for our ownership and apply to all companies, regardless of the country in which they operate.

A better understanding of the relationships between economic growth, company behaviour and environmental and social impacts is critical to the achievement of the SDGs. It can help governments identify potential gaps in their SDG implementation plans and in the measurement of outcomes. The fund supports research on a range of sustainability topics relevant to the 2030 Agenda. For instance, we currently support two projects through the Norwegian Finance Initiative that are focusing on environmental risks, in particular owing to climate change, and studying their relationship to capital markets.[14] The insights and data gained from these research projects are made public and can help inform other investors, businesses, governments and civil society, and aid them in developing their own approaches to the SDGs.

At the company level, we exercise our ownership to strengthen governance, improve performance and promote sustainable business practices. We achieve this by exercising our voting rights and engaging in dialogue with companies. Almost ten years ago, we began devoting special attention to three focus areas – climate change, water management and children's rights – in order to understand better the challenges faced in these areas and how we could help address them. We are also looking at how company boards account for issues related to human rights, ocean sustainability, tax and transparency, and anti-corruption.

As a large, long-term global investor, we want to understand better how companies manage the risks and opportunities associated with these global challenges. We use our expectation documents to guide our company dialogue. Figure 2 illustrates how our seven prioritised sustainability topics relate to ten out of the 17 SDGs. Naturally, due to the interrelated nature of the SDGs, each of our expectation documents may also touch upon additional SDGs. We believe that our ownership activities indirectly contribute to the SDGs by emphasising that company boards have a responsibility to account for and address these sustainability issues.

14 Norges Bank Investment Management (2018), "NFI Research Programme", available at: https://www.nbim.no/en/investments/research/the-norwegian-finance-initiative-nfi/nfi-research-programme/.

Figure 2. The fund's expectation documents and their relationship with the SDGs

We encourage companies to be transparent on material sustainability issues because improved disclosure enables us to assess the steps they are taking to address material risks and opportunities. We engage with companies with poor or limited disclosure on those issues and encourage them to improve their disclosure. Improved transparency and consistency in disclosure will also benefit other stakeholders, as this enables evidence-based planning to support the SDGs. We believe that such an approach to the SDGs is also in the longer-term interest of the fund.

We recognise that the tools and methods for measuring the sustainability exposure and performance of investment portfolios are evolving. Reporting on the SDGs will require companies to gather new data and to use new indicators. Once SDG metrics and disclosures have become more developed, financial investors will be more likely to use them in their sustainability analyses. At the same time, there are reporting standards and industry guidelines in existence for many of the same underlying sustainability challenges, albeit with varying degrees of company disclosure. Rushing the adoption of additional SDG reporting may divert attention from producing meaningful information for investors as provided by existing material indicators. We favour the increased harmonisation of company disclosure across sectors and markets according to agreed frameworks and standards.

Investing in developing markets

Developing countries arguably face the greatest need for investment towards the SDGs.[15] Reaching the goals is an ambitious target, and financing remains a challenge for many developing countries, as they often lack domestic savings and a strong tax base to finance necessary investment in infrastructure and social services. External financing could help close the gap.

Foreign direct investment (FDI) constituted the largest and least volatile flow of external capital to developing economies over the past ten years.[16] FDI is particularly valuable, as it is not only a source of capital, but also supports the transfer of skills and technology, leading to greater productivity and accelerated

15 Schmidt-Traub, G. (2015), "Investment Needs to Achieve the Sustainable Development Goals", SDSN Working Paper.

16 UNCAD (2017), World Investment Report, p.12, available at: http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.

economic growth. We indirectly contribute to FDI, as a large number of our investee companies listed in developed countries are multinational enterprises that make investments and generate a significant portion of their revenue in developing countries. We expect the companies we invest in, to pay taxes where they generate economic value, and we believe that country-by-country reporting should be a core element of transparent corporate disclosure.[17]

The 2015 UN Action Agenda on Financing for Development highlights the importance of foreign portfolio investments – the purchase of stocks and bonds in one country by an entity from another – and of fostering capital markets for financing development.[18] We are a global investor with direct equity investments in 38 developing countries, of which almost half are outside our benchmark.[19] When we invest in developing countries, we rely primarily on local managers that have specialist expertise in the countries' financial markets. This gives us an in-depth understanding of the investee companies and their business practices. Our investments in sovereign debt provide capital to governments that they may use to finance SDG-related projects.

Financial markets in recipient countries need to be sufficiently deep, stable and efficient to attract portfolio flows.[20] Improving conditions in financial markets, including corporate governance, especially in developing countries, could help attract foreign portfolio investments to projects with a comparatively high impact on the SDGs. In addition to providing long-term capital to developing countries through our investments, we also share best practices and support initiatives to help build capacity and strengthen financial markets in developing countries. Through our support for the African Corporate Governance Network, we seek to promote effective corporate governance and the development of well-functioning markets in Africa, thus making these countries more attractive for portfolio investors.

Investing in companies providing environmental solutions

How companies manage opportunities and risks associated with sustainability may drive long-term returns for investors. Within our financial objective, we integrate sustainability data into our investment strategy to identify long-term opportunities, and we may decide to invest more in companies with positive environmental externalities. While our portfolio broadly reflects the

17 Norges Bank Investment Bank (2018), "Tax and Transparency", available at: https://www.nbim.no/en/responsibility/risk-management/tax-and-transparency/.

18 Within portfolio investment, impact investing is a particular investment strategy which aims to generate beneficial social and environmental effects in addition to financial gain. It could help directly address particular investment needs relating to the SDGs, although impact investments cover a range of strategies and assets, and constitute only a very small share of global investments. For more information, see: Global Impact Investing Network (2017), Annual Impact Investor Survey, available at: https://thegiin.org/assets/GIIN_AnnualImpactInvestorSurvey_2017_Web_Final.pdf.

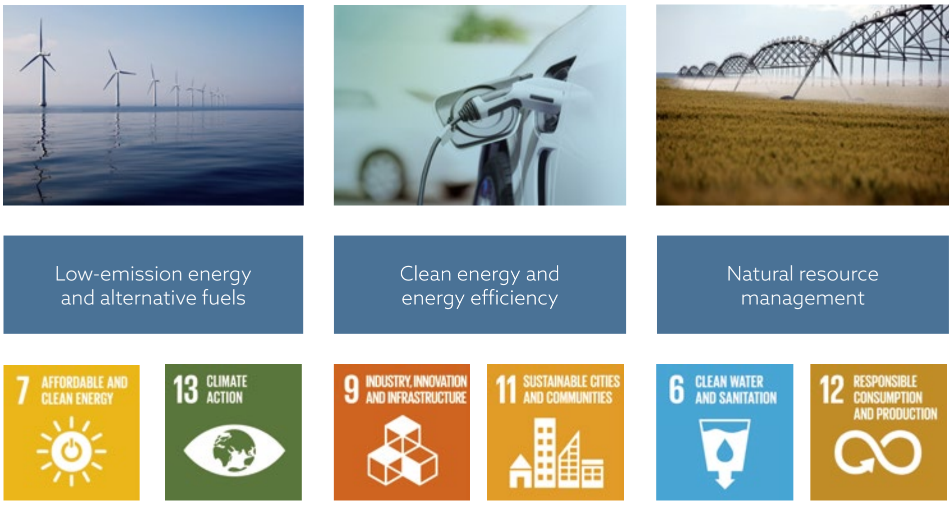
19 We use the UN country classification in "World Economic Situation and Prospects 2018" from the UN Department of Economic and Social Affairs (UN/DESA). The UN classification of developing countries is different from the one used by index providers for emerging and frontier markets. See United Nations (2018), "World Economic Situation and Prospects 2018", available at: https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/WESP2018_Full_Web-1.pdf. The numbers are based on our own analysis. Information on the underlying data is available here: 1. Norges Bank Investment Management (2018), "Holdings as at 31.12.2017", available at https://www.nbim.no/en/the-fund/holdings/holdings-as-at-31.12.2017/; 2. Norges Bank Investment Management (2018), "2017 Benchmark", available at: http://www.nbim.no/en/investments/benchmark-index/historical-benchmarks/2017-benchmark/.

20 Görg, H., Krieger-Boden, C. & Nunnenkamp, P. (2016), "Merits of Financial Market Development for Developing Countries", available at: https://voxeu.org/article/financial-market-development-economic-development.

state of progress of listed companies towards the SDGs, these decisions could increase investments with a positive impact on the SDGs.

Through our environment-related mandates, we invest in companies and technologies that foster more environmentally friendly economic activity. A part of our work involves defining the environmental investment universe. We use specialised external data providers and our own sustainability data to analyse companies' activities in order to identify providers of goods and services in environment-related industries. The companies we invest in can be broadly classified by the main type of technology they develop: i. low-emission energy and alternative fuels, ii. clean energy generation and energy efficiency, and iii. natural resource management. These environment-related investments support the transition to a more sustainable global economy and thus make a contribution to a number of SDGs, such as SDG 6: Clean Water and Sanitation, SDG 7: Affordable and Clean Energy, SDG 9: Industry, Innovation and Infrastructure, SDG 11: Sustainable Cities and Communities, SDG 12: Responsible Consumption and Production and SDG 13: Climate Action.

Figure 3. The fund's environment-related mandates and their relationship with the SDGs



Divesting from unsustainable businesses

There are sectors and companies where we choose not to be an owner. To reduce our exposure to business practices that may be considered unsustainable or unethical, the fund has two mechanisms: risk-based divestment and ethical exclusion. Unsustainable practices include business models that are not aligned with evolving technological, regulatory or environmental developments, or operations that are in breach of ethical norms. We base our divestment decisions on assessments of long-term sustainability issues, while exclusions are based on the ethical criteria set by the Ministry of Finance and decided by the Executive Board of Norges Bank.

The fund is not invested in companies that produce certain types of weapons, tobacco, or coal. These ethical exclusions relate to products that could undermine the ambition of SDG 3: Good Health and Well-Being, SDG 13: Climate Action, and SDG 16: Peace, Justice and Strong Institutions. The ethical criteria describe unacceptable risks a company contributes to or is responsible for through its conduct. Such conduct includes serious or systematic human rights violations, which may undermine SDG 8: Decent Work and Economic Growth. The criteria also describe unacceptable risk of severe environmental damage, which may undermine SDG 6: Clean Water and Sanitation, SDG 14: Life Below Water, and SDG 15: Life on Land. The criteria further describe acts or omissions that may lead to unacceptable greenhouse gas emissions, which may undermine SDG 13: Climate Action.[21] Based on the recommendations of the Council on Ethics, the Executive Board may recommend excluding companies, exercising our ownership rights, or placing the company under observation.

Business practices that we consider unsustainable may also impede progress towards achieving the SDGs. Our main areas of risk-based divestments have related to, among others, deforestation, unsustainable water management, and greenhouse gas emissions. For instance, we divested from palm oil producers as their production methods can cause tropical deforestation and thus undermine the ambition of both SDG 15: Life on Land and SDG 2: Zero Hunger. Following assessments of water use and water pollution in the mining sector, we conducted risk-based divestments from companies involved in mountain top removal mining and gold mining whose activities could be seen as impeding progress towards SDG 6: Clean Water and Sanitation. We carried out risk-based divestments from a number of companies producing oil from oil sands, as this carbon-intensive production method is associated with particularly high greenhouse gas emissions, which conflicts with SDG 13: Climate Action. Further risk-based divestments relate to SDG 3: Good Health and Well-being, SDG 7: Affordable and Clean Energy, SDG 8: Decent Work and Economic Growth, SDG 13: Climate Action, SDG 14: Life below Water, SDG 15: Life on Land and SDG 16: Peace and Justice and Strong Institutions.

Figure 4. The fund's risk-based divestments and their relationship with the SDGs

Water	Social and governance	GHG emissions	Ocean	Deforestation	Social and governance
• Mining • Water pollution	• Mining • Heavy construction • Seafood industry	• Mining • Cement • Coal (power generation) • Oil sands	• Water pollution • Seafood industry	• Mining • Palm oil • Pulp and paper • Soy	• Mining • Other corruption

21 *The Royal Norwegian Ministry of Finance (2014), "Guidelines for Observation and Exclusion of Companies from the Government Pension Fund Global", available at: https://www.regjeringen.no/contentassets/7c9a364d2d1c474f8220965065695a4a/guidelines_observation_exclusion2016.pdf.*

Conclusion

The SDGs provide a policy framework that addresses a range of related sustainability challenges on a global scale. National governments are ultimately responsible for achieving the SDGs. Achieving the SDGs, in both developed and developing countries, will probably contribute to the long-term return of the fund through increased economic resilience.

As a long-term and global owner, we have an interest in a more sustainable global economy. Ultimately, the future value of the fund depends on the long-term value created by investee companies. As a long-term investor and responsible owner, we aim to support the transition to a more sustainable global economy and relate to the SDGs in four main ways. First, we provide long-term capital and promote value creation at the 9,000 companies in which we are invested. Second, we invest in 38 developing markets, of which nearly half are outside our benchmark, thereby providing long-term capital to countries most in need of investments towards the SDGs. Third, we invest in companies offering or developing solutions for a more environmentally friendly economy, thereby making a positive contribution to some SDGs. Fourth, we exclude, or divest from, certain companies with unsustainable business practices that may impede progress towards the SDGs.

The implementation of the SDGs and the role of the private sector are rapidly evolving. We will continue to engage with companies, market participants, and other stakeholders to develop our understanding of the SDGs and how they relate to the fund's long-term return.

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