Calvert Institute for Responsible Investing

Facing hard truths: How a pandemic brought inequality into the board room

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- For more than 40 years, economic inequality, the gap in opportunity and outcome between the highest- and lowest-income members of society has grown unabated in the US and other English-speaking developed countries.
- Inequality presents material risk to both global economies and individual corporations and investors.
- As a long-term investor, Calvert has long recognized the financial materiality of this issue to its investment process, as demonstrated by our continued work to integrate social factors into investment decisions.
- Enter COVID-19: For many workers and employers, it is a perfect storm. The crisis has exposed how inequality is a central feature of our economy's reliance on low-paid service-sector workers, and how underprepared many companies are to deal with risks to their workforce. More broadly, other risks also have come to the fore, like exposure to civil unrest and supply-chain disruption, which have deep roots in societal inequality.
- At the same time, continued social upheaval in the US concerning institutional racism and police brutality is exposing yet more barriers to equality, and rapidly changing the calculus that companies and investors face when addressing these issues.
- Calvert continues to develop frameworks to facilitate the integration of material social factors – the "S" in ESG. In doing so, we recognize the continued need for investors and corporate management to agree on material determinants of inequality, and related disclosure metrics that are substantive, informative, standardized and regularly reported.

Inequality: A long-term trend

Calvert has long considered inequality to be an important thread in the overall fabric of responsible investing, embedded in the middle term of ESG — environmental, **social** and governance factors that influence corporate performance. In 2015, Calvert President and CEO, John Streur, stated that inequality was a bigger problem than climate change, because it was poorly understood, not being addressed and getting worse. To understand why this issue is so important, we must explore the recent history of inequality in the US and globally, as well as understand the effect that this phenomenon has on the systems within which investors and corporations operate.

Inequality represents a gap in both opportunity and outcomes between the highest and lowest income households in a society, and it is these outcomes that are most easily observed. In the US, there has been little-to-no real wage growth for a majority of the population since the 1970s[1], and the wage gains that have manifested have flowed to the highest-paid Americans. The effects on wealth have been severe – the bottom 50% of wealth owners have experienced no net wealth growth in real terms since 1989. At the other end of the spectrum, the top 1% has seen their wealth grow by almost 300% in real terms over the same time frame.[2] Predictably, this has grown overall wealth disparity (Exhibit A). This is a pattern that repeats across most developed English-speaking countries[3] even as country-level inequality on the world stage has shrunk.

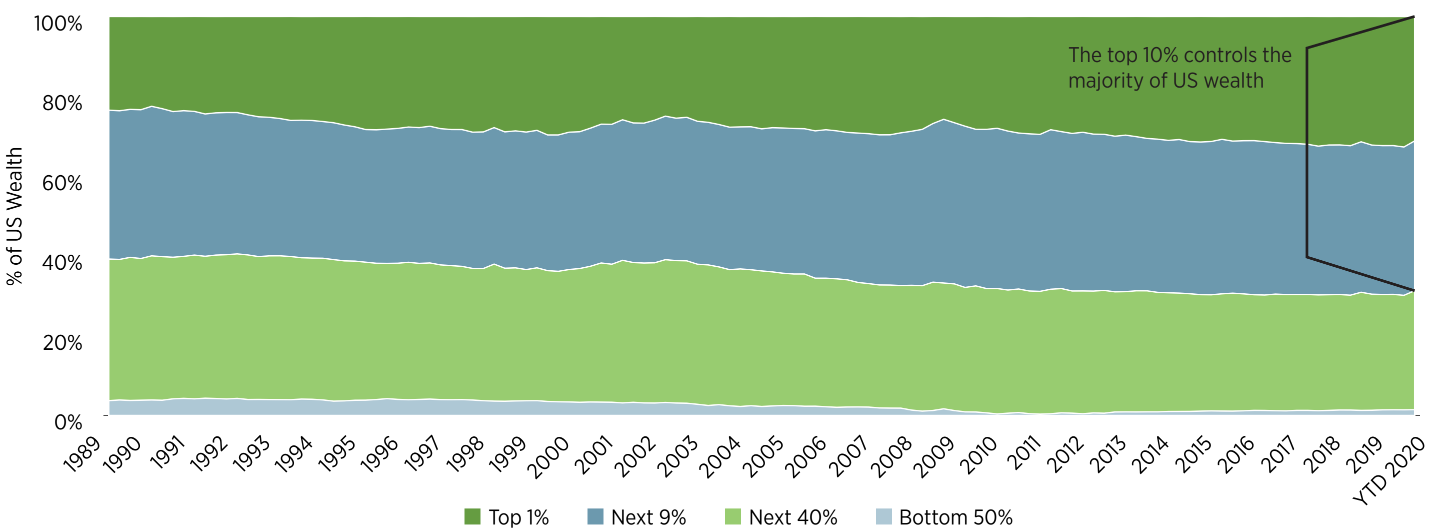
The causes underlying the observed growth in inequality are numerous and complex, but several material drivers are clear. Skills-based technological change and the offshoring of manufacturing jobs have fundamentally changed the American labor force, leaving high-wage, highly skilled jobs or low-wage service jobs with fewer middle-skill, middle-class jobs. The global financial crisis of 2008 exacerbated these trends. The collapse of the housing market led to wealth loss for middle income households, while the boom in the stock market in the decade that followed primarily benefited wealthier families that owned stock. Racial, gender and cultural biases also continue to suppress earnings among different segments of American society, an effect that persists even across income levels in those groups[4] (Exhibit B).

Other elements that contribute to growing inequality include the intertemporal nature of inequality of opportunities – lower household income often affects childhood factors that can impact earnings for future generations (access to health care, education, technology and finance). In countries such as the US, which has decentralized government and a weak social safety net, these effects are more likely to compound over time.

Exhibit A

The majority of US wealth is controlled by the top 10%

Percent owned by each wealth group, 1989-2020



Source: US Federal Reserve, "Distributional Financial Accounts: Levels of Wealth by Wealth Percentile Groups," 3/31/20.

Note: On December 30, 2016, Calvert Research and Management (Calvert) was formed as a wholly owned subsidiary of Eaton Vance Management and indirect subsidiary of Eaton Vance Corp. At that time, substantially all of the business assets of Calvert Investment Management, Inc. were purchased by Calvert

[1]This stagnation has not been even - Real wages for production and nonsupervisory employees in the USA declined from the 1970s to the mid-1990s. They have climbed unevenly since then, only now reaching levels comparable to the late 1960s and early 1970s. (https://www.factcheck.org/2019/06/are-wages-rising-or-flat/)

[2]US Federal Reserve, "Distributional Financial Accounts: Levels of Wealth by Wealth Percentile Groups," 3/31/20. Available at: https://www.federalreserve.gov/releases/efa/efa-distributional-financial-accounts.htm

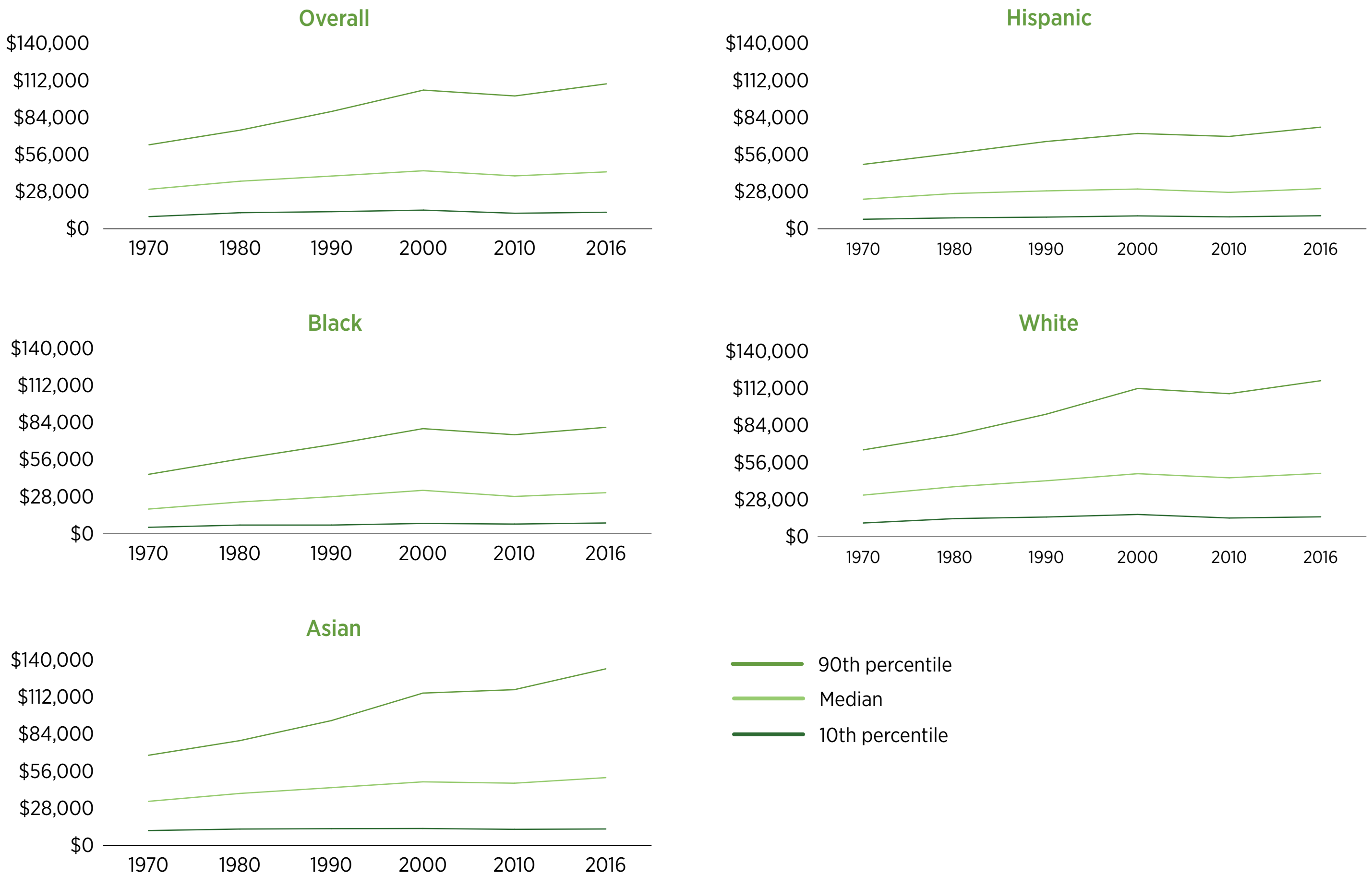
[3]Roser, Max and Ortiz-Ospina, Esteban, "Income Inequality," Our World in Data, October 2016. Available at: https://ourworldindata.org/income-inequality.

[4]Kochhar, Rakesh and Cilluffo, Anthony, "Income Inequality in the U.S. Is Rising Most Rapidly Among Asians," Pew Research Center, July 12, 2018. Available at: https://www.pewsocialtrends.org/2018/07/12/income-inequality-in-the-u-s-is-rising-most-rapidly-among-asians/.

Exhibit B

When a rising tide only lifts the superyachts

US household income per person in 2016 dollars



Source: Pew Research Center, 7/12/18.

Looming fiscal austerity measures at different levels of government resulting from the economic effects of the pandemic are also likely to impact safety nets and social services. Citizens of countries in earlier stages of development may face a different set of factors most responsible for domestic inequality growth (such as food security, access to utilities and housing). But in all countries, lower-income households face a set of barriers that stack the deck against them and constitute a fundamentally unfair set of opportunities at birth. Racial, gender and cultural biases only add to the disparity in opportunities that many victims of inequality must overcome.

Inequality in the national spotlight

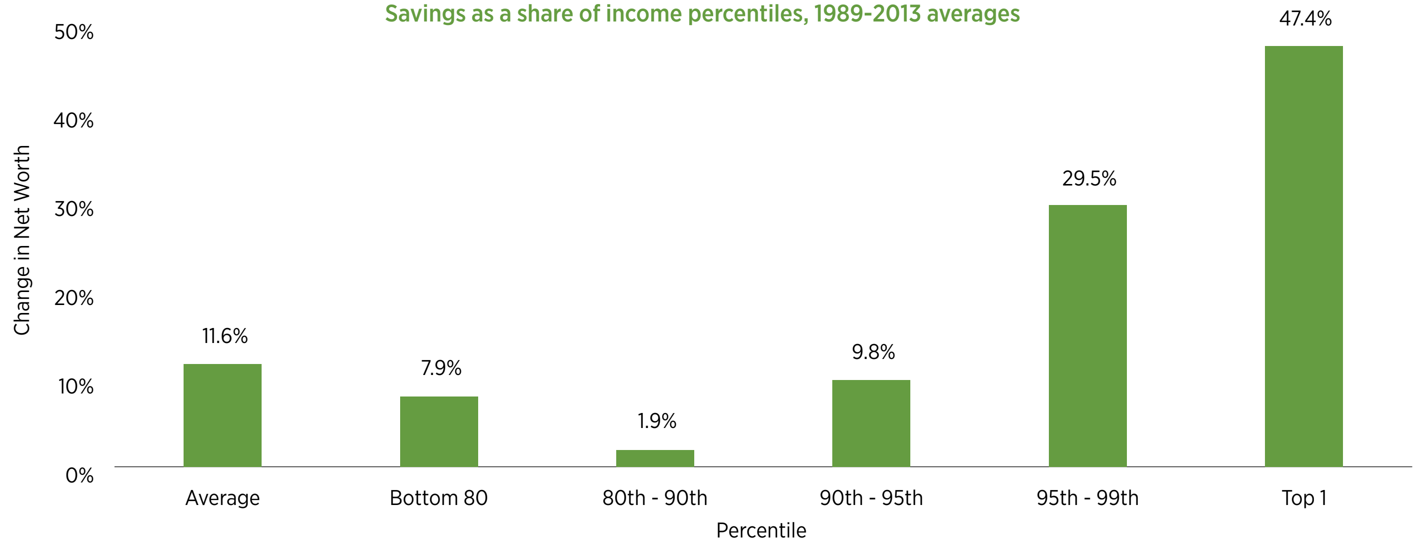
Athough inequality has been a pressing issue for decades, within the span of just a few news cycles it has come to dominate our national conversation. Consider:

- The killing of George Floyd forced a widespread reappraisal of how racism and inequality continue to disadvantage Black Americans and other minorities in every aspect of society.
- The COVID-19 pandemic revealed how existing stratification in our society can be a life or death situation. The gulf between those who have been able to safely work at home and workers who have borne the brunt of the exposure to the virus have highlighted the consequences of inequalities in the labor market.
- Data show that underprivileged communities, in particular Black, Hispanic and Native Americans, are suffering disproportionately from COVID-19.[5] The

[5] "COVID-19 in Racial and Ethnic Minority Groups," Centers for Disease Control and Prevention, June 25, 2020. Available at: https://www.cdc.gov/coronavirus/2019-ncov/need-extra-precautions/racial-ethnic-minorities.html.

Exhibit C

Higher-income households have much higher savings rates



Source: Economic Policy Institute, December 2017, based on analysis of data from the Federal Reserve Board's Survey of Consumer Finances (SCF), the Federal Reserve Board's Financial Accounts of the US (FAUS), and Congressional Budget Office data on household income and effective tax rates (CBO 2016).

victims of economic inequality are about 10% likelier to have a chronic health condition, and people with lower incomes tend to develop these conditions between five and 15 years earlier in life. These chronic conditions increase the deadliness of a COVID-19 infection.[6]

- Millions of people have no access to affordable health care after losing their jobs.

The stresses and dislocations to society imposed by COVID-19 and social justice issues have both created new fault lines and exacerbated long-standing tensions. Increasing awareness of these issues has highlighted for many companies and investors what Calvert has long believed — the private sector must do more to address this issue.

A recent special report on Brands and Racial Justice from Edelman Trust Barometer revealed that, among other things, four times as many respondents say that companies taking a stand on racial injustice gain, rather than lose, brand trust, (and this holds true across the political spectrum). Sixty percent of customers said that brands must take a stand to speak publicly on systemic racism and injustice and six out of 10 respondents said that they will buy or boycott a brand based on its response to the current protests.[7]

However, addressing this issue is not simple – the causes and effects of inequality are tremendously complex, which can lead corporations and investors to either inaction or failure to recognize the risks inequality poses to corporate performance. Therefore, it is important to highlight the financial materiality of addressing inequality from both a macroeconomic and corporate perspective, and for those in positions to affect change to develop real plans to better address this systemic risk.

Inclusive economic growth is more sustainable

Research has found that more inclusive economic growth is also more sustainable economic growth. At a macro level, greater inequality can reduce aggregate demand, pulling down a country's GDP growth while at the same time increased leverage can lead to greater market volatility (as discussed below). Calvert believes that these negative outcomes pose significant material risks to investors and corporations, as recent events have demonstrated.

Reduced aggregate demand

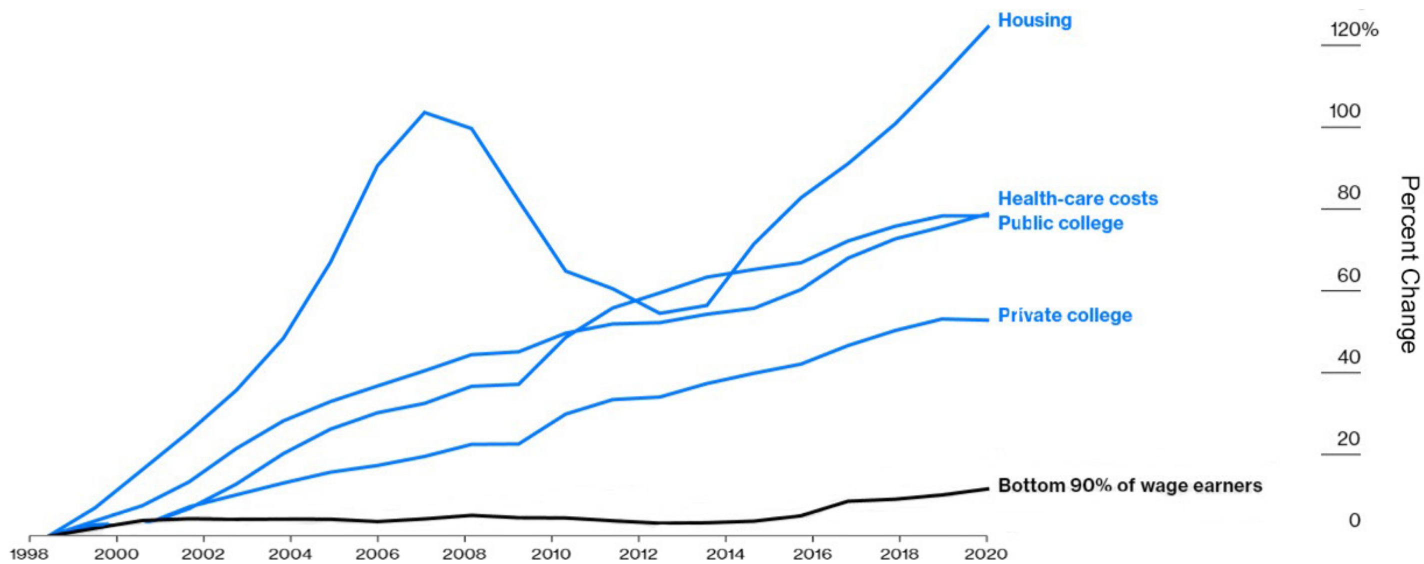
Research by the World Bank Group has found that, on average, a 1% increase in inequality (as measured by the Gini coefficient)[8] reduces GDP per capita by around 1.1% over a five-year period. The Economic Policy Institute (EPI) estimates that the shifting of an ever-larger share of US income to high-income households since the late 1970s has reduced aggregate demand (spending by households, businesses and governments) an estimated

[7] "Special Report: Brands and Racial Justice," Edelman Trust Barometer 2020. Available at: https: www.edelman.com/sites/g/files/aatuss191/files/2020-06/Trust%20%2B%20Racial%20Injustice%20One%20Pager_0.pdf/.

[8] The Gini coefficient is a measure of statistical dispersion intended to represent the income or wealth distribution of a nation's residents, and is the most commonly used measurement of inequality.

Exhibit D

US worker pay hasn't come close to keeping up with key living costs



Sources: Bur. of Labor Statistics, Economic Policy Institute, Social Security Admin. Bur. of Economic Analysis, Unionstats.com, Federal Reserve Bank of St. Louis, College Board, Centers for Medicare & Medicaid Services, 7/2/20.

2 to 4 percentage points of GDP annually in recent years.[9] That is because high-income households tend to save a higher portion of their income compared to low-income households, whose income goes toward consumption (Exhibit C).

The impact of reduced aggregate demand has thus far been offset primarily by falling interest rates, but this mechanism cannot continue to mitigate this problem in a sustainable manner; in a different environment, lower demand could translate more directly to slower GDP growth. Since corporate earnings growth has been correlated with GDP growth historically, corporations are exposed to the risks posed by growing inequality and have a key role to play in addressing it.

Increased instability

Inequality's impact on aggregate demand has also been mitigated by increasing levels of debt among lower-income households. Despite large transfers of wealth to the top 10%, spending among lower-income Americans has not decreased proportionately, resulting in increasing levels of household debt.[10] While the causes for maintained spending likely include the welfare loss that would be induced by proportionate consumption cuts,[11] another fact is clear – key costs of living have gotten more expensive. In the US, real wage growth for the bottom 90% of American workers since 1998 has been vastly outstripped by the growth of costs such as housing, health care, and public and private college (Exhibit D).[12] As a result of increased debt, the bottom 90% of Americans have been saving 0% of their income over the last 30 years.[13]

[9]Bivens, Josh, "Inequality is slowing US economic growth," Economic Policy Institute, December 12, 2017. Available at: https://www.epi.org/publication/secular-stagnation/.

[10]Piketty, Thomas and Saez, Emmanuel, "Top Incomes and the Great Recession: Recent Evolutions and Policy Implications," IMF Economic Review, Vol. 61, No. 3, 2013. Available at: https://eml.berkeley.edu/~saez/piketty-saezIMF13topincomes.pdf.

[11]Bertrand, Marianne and Morse, Adair, "Trickle-Down Consumption," NBER Working Paper Series 18883 , March 2013. Available at: https://www.nber.org/papers/w18883.pdf.

[12]Eidelson, Josh, "How the American Worker Got Fleeced," Bloomberg, LLC, July 2, 2020. Available at: https://www.bloomberg.com/graphics/2020-the-fleecing-of-the-american-worker/.

[13]Saez, Emmanuel, "Income and wealth inequality: Evidence and policy implications," Contemporary Economic Policy, 7-25, January 2017. Available at: https://eml.berkeley.edu/~saez/SaezCEP2017.pdf.

In addition to the effect this debt has on households, it holds broader implications for our economy. Recent research suggests that as lower-income households have increased their debt, increased leverage may produce economic bubbles.[14] There is some evidence this occurred during the housing crisis that led to the financial crisis in 2007-2008. Increasing levels of leverage by lower-credit borrowers led to unsustainable rise in housing values, which further fueled leverage consumption. When the housing market collapsed the impact was uneven, with lower-income households experiencing a greater decline in household wealth and widening inequality. Reduced household savings and increased debt also undermine our resiliency to economic shocks such as the COVID-19 pandemic, the full consequences of which are still yet to be determined.

Other considerations

It has been suggested by the International Monetary Fund that excessive inequality can erode social cohesion and lead to political polarization.[15] While these effects are by their nature not well defined, they represent another systemic risk of inequality. Internationally, widespread and long-standing inequality has been a driving force behind recent political upheaval and social unrest in a number of countries over the last several years.

In Chile, an upcoming national plebiscite scheduled as a result of inequality-related protests will soon determine whether the country will establish an entirely new constitution. Distinctive issues exacerbated by inequality also forced the resignation of the heads of state in Bolivia, Iraq and Lebanon.[16] While this level of political uncertainty is not solely attributable to inequality, the issue appears to be a significant risk factor. Significant political events such as these create additional risk and uncertainty for corporations and investors alike.

Factoring in inequality

Companies, as key members of society and the global economy, can be both exposed to inequality's risks and contribute to its worsening. In 2018, the largest 500 corporations in the world directly employed more than 45 million people, indirectly controlled hundreds of millions of workers in their supply chain, paid more than $700 billion in taxes, sold products and services worth over $22 trillion, controlled assets valued at more than $110 trillion, and spent around $1.4 trillion and $540 billion in capital and research and development expenditures, respectively.

To understand the financial materiality of inequality at the level of a corporation or investor, it is useful to note Calvert's foundational beliefs for Responsible Investing. First, a core assumption is that all companies – whether implicitly or explicitly — must address a range of ESG factors that materially affect corporate outcomes.

Second, companies that most successfully manage those factors may gain an edge in long-term financial performance and create positive societal change – they are, in our view, mutually reinforcing goals. Indeed, past research shows that companies with improving performance on industry-specific material ESG issues outperformed their competitors following the improvement both in terms of accounting and stock market performance.[17]

Why is inequality one of these material issues? From an investor perspective, there are several primary reasons:

- Outcomes resulting from inequality may have a material negative effect on long-term corporate and investment performance through its effect on underlying value-drivers.
- Changing societal recognition of this problem, and corresponding efforts to address it, may materially change the risks and opportunities of different investment opportunities, both internally at the company level and broadly for investors.
- Unchecked inequality may destabilize the financial and social systems within which investors operate.

As a vast, multifaceted phenomenon, it has always been difficult for companies and investors to define and measure exposure to inequality.

Connecting inequality to material ESG factors

Calvert research is designed to measure performance on financially material ESG issues faced by individual companies, which are grouped in approximately 200 subindustry models within which issuers share similar ESG exposures. Calvert research analysts analyze each model to determine the ESG factors that are believed to be most financially material for the specific subindustry. Key Performance Indicators (KPIs) are then selected for each model to determine performance on those factors.

In order to contextualize the materiality of inequality, Calvert has identified a subset of indicators in our data pool that we believe measure performance on issues that contribute to "inequality of opportunity" – a broad

[14] Wood, David, "Discussion Paper: Why and how might investors respond to economic inequality?" The Principles for Responsible Investment," 2016. Available at: https://iri.hks.harvard.edu/files/iri/files/pri_inequality_discussion_paper.pdf.

[15] "IMF Fiscal Monitor: Tackling Inequality," October 2017. Available at: https://www.imf.org/en/publications/fm/issues/2017/10/05/fiscal-monitor-october-2017.

[16] "The Global Risks Report," World Economic Forum 2020. Available at: http://www3.weforum.org/docs/WEF_Global_Risk_Report_2020.pdf.

[17] Khan, Mozaffar and Serafeim, George and Yoon, Aaron. "Corporate Sustainability: First Evidence on Materiality." The Accounting Review, Vol. 91, No. 6 (2016), pp. 1697-1724. Available at SSRN: https://ssrn.com/abstract=2575912.

designation comprising a number of major drivers of inequality such health and access to education and the labor market. By demonstrating the extent to which these indicators are financially material for different Calvert subindustries, we can illustrate the importance of this issue.

All Calvert subindustry models were evaluated to determine the weighted percentage of their KPIs that measure performance on issues that contribute to inequality. Because KPIs within each model are chosen and weighted based on financial materiality for that subindustry, the presence of indicators that impact inequality of opportunity suggests that corporate management of these issues is also thought to be inherently material to a company's long-term performance.

Calvert's mapping of KPIs to underlying drivers of inequality allows for a broader consideration of how material inequality may be across the entire economy. Attributing different indicators to individual drivers of inequality also allows for a more nuanced understanding of how different corporations may be exposed to inequality. For example, a pharmaceuticals model is more heavily weighted with inequality-related KPIs connected to health, while airlines are more closely tied to the labor market. Exhibit E shows the weighting of those KPIs across subindustry models.

The distribution bars show that all Calvert models have at least some inequality-related KPIs, while the great majority of models have at least a third of their weight in inequality-related KPIs.

The broad distribution of weightings highlights the fact that companies in different segments of the economy vary widely in their exposure to financially material ESG issues related to inequality.

This research illustrates that inequality-related KPIs play an important role in the Calvert system -- inequality indicators already overlap to a significant extent with the KPIs Calvert has utilized across our investment universe.

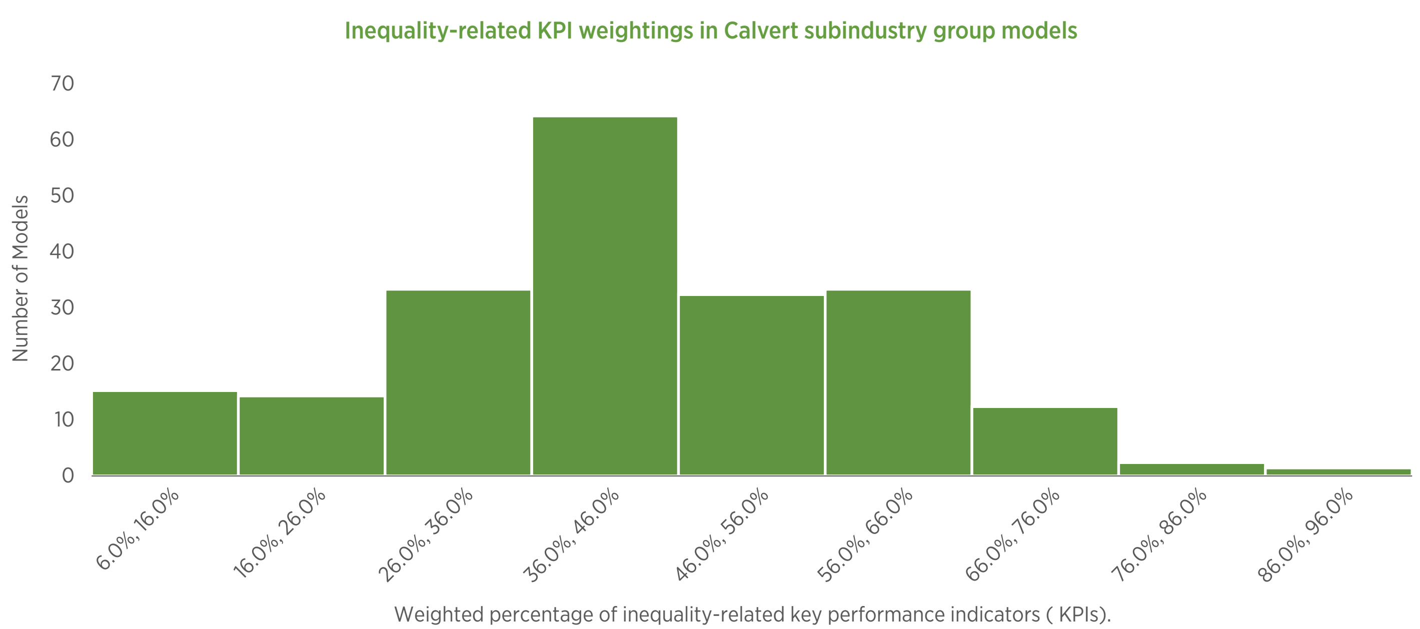
We should note that data availability remains an issue when evaluating corporate exposure to and management of inequality issues, and that the indicators employed are by no means a comprehensive tally of all the determinants of inequality.

Moreover, it is important to recognize that the financial materiality of inequality is dynamic and will continue to change over time and must be determined at the company or sector level. Materiality also does not have to arise from a direct cause-and-effect relationship with company financials. If inequality threatens the fundamental pillars of a business (e.g., supply chains, labor force, customers, regulatory environment, etc.) then there will always be an element of materiality to it.

The dynamic nature of this factor adds to our determination to seek new ways to measure corporate performance on material social issues. Ultimately, we believe this will help us refine and enhance our models and provide better guidance for investors and management.

Exhibit E

Financially material inequality indicators are prevalent in Calvert research



Source: Calvert Research and Management, July 2020.

Seeking corporate leaders to fight inequality

Inequality, especially in the US, may be seen as a tragedy of the commons in which those with the power to change the system act myopically due to the benefits they derive from the current system, and a belief that others would exploit short-term opportunities in their stead. Unless actors in such a system think strategically and act with long-term interests in mind, exploitation of resources such as human capital can result in system collapse or degradation.

Considering the long-term risks to systemic and individual corporate growth that inequality presents, Calvert seeks to identify issuers that can successfully manage inequality-related issues, which may serve to increase their resilience to future expected impacts. As our societies and governments begin to reckon with this issue, Calvert believes that and investors that demonstrate a willingness to adapt, build strong relationships with key stakeholders and clearly communicate strategies to address these issues will be more resilient.

Due to the broad nature of this problem, discussions of material inequality issues can be vague. To better illustrate the importance of these issues, consider American public companies in the physical retail space. An overview of strategies by which these companies may address financially material inequality issues can be found in Appendix A.

For investors, data availability remains an issue when evaluating corporate exposure to and management of inequality issues. Companies would be well served to conduct internal materiality analyses and communicate the results internally as well as externally.

At Calvert, we will continue to push for greater corporate disclosure through our active engagement with companies, but we will also continue to perform our own research on these issues to drive our investment selection for our clients.

Appendix A- Physical retailers in the US

American large-cap retailers employ many lower-skill, lower-wage employees:

- Due to these corporations' reliance on sales to the general public, their reputations and brands have a significant impact on revenues, and perceptions of employee treatment and positioning on social issues may be material, especially as societal views shift.
- Corporate senior management should be demographically representative of a company's country of operation and consumer base.
- Continued wage stagnation and reduced purchasing power among low-income citizens may also present headwinds for future sales. Decisions to raise minimum wage for retail employees, either alone or in tandem with competitors, may increase purchasing power for employees, protect companies from regulatory risk in the form of minimum wage increases, and/or improve employee performance.
- Expansions of performance bonuses beyond senior management to lower levels of companies may also increase employee productivity.
- Providing opportunities for vertical and lateral advancement to entry-level employees will improve wage growth while also increasing institutional knowledge at the managerial level.
- Audits undertaken to identify and mitigate supply chain issues related to human rights or poor working conditions may help avoid brand damage and make supply chains more resilient.
- Benefits such as health insurance and maternity/paternity pay increase recruitment effectiveness and allow younger members of employee households a more equal opportunity set.
- Prioritizing the offering and sales of healthier products may help companies take advantage of healthier consumption trends while increasing the health of households who shop with them.
- Decisive and considered corporate responses to the COVID-19 pandemic should address key stakeholders and may provide increased operational resilience in the face of crisis.

While this does not represent an exhaustive list of pathways by which companies may address financially material inequality issues, these examples serve to illustrate the potential advantages of a long-term strategy that incorporates a consideration of this issue.

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Source of all data: Calvert as of July 1, 2020, unless otherwise specified.

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