

Environmental and Social Compliance through the Financial Market: ESG Investments as a Condition for Public-Private Partnerships

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Abstract

This article discusses the possibility of public administration requiring environmental and social compliance from private legal persons who compete in the bid to establish public-private partnerships (PPPs) by stipulating environmental and social concerns as requirements for the establishment of PPPs through investments in the maintenance, restoration, and upgrade of the natural heritage (ESG investments). The focus is dogmatic, the method of approach is deductive, and the research method is bibliographic. In conclusion, this article argues that PPPs are not simply justified in accordance with financial motives but are also paths towards sustainable development. Hence, they are made into legislative proposals.

Keywords

Public-Private Partnerships, Compliance, Sustainable Development, ESG Investments, Fundamental Rights

1. Introduction

This article analyzes the use of public-private partnerships (PPPs) for promoting sustainable development. Therefore, its purpose is to include environmental and social concerns as necessary requirements for the establishment of PPPs.

This subject is justified on the grounds of the current reality. First, the financial market has seen an increase in social and environmental interest in responsible investments. For example, there is an increase in available investment options that are related to non-financial issues, with various events that take place to discuss these concerns. Second, two political situations contribute to the importance of this matter: a) the state's financial crisis, leading to the adoption of

programs for privatization and partnership with private enterprises; and b) the current negationism, including the state-sponsored denial, predominantly in terms of the environment.

The method of approach is deductive, which is the process of reasoning from one or more statements (premises) to reach a logical conclusion. More specifically, the starting hypotheses are that the PPPs are instruments to achieve the State's purpose. Even the private sector is bound by the effectiveness of fundamental rights. Therefore, it is considered possible to amend the respective laws to make the PPPs more environmentally and socially responsible and beneficial.

The research method is bibliographic, which is based on the interpretation of various legal norms (constitutional and infraconstitutional), in the light of doctrines and international treaties. It is important to stress that this article has a dogmatic focus, that is, to seek legal responses to the challenges of conservation and development, from the standpoint of creating more sustainable and rational PPPs.

This article is divided into six sections: an introduction; an explanation of why and how the PPPs are instruments for achieving the state's purpose; and the effectiveness of fundamental rights. The fourth chapter proposes the environmental and social governance as a requirement for PPPs. The fifth includes ESG investments as a crosscutting issue. The sixth and final chapter contains the main conclusions.

2. Achieving the State's Purpose through Public-Private Partnerships

A state's purpose is, or at least should be, the common good. As Ronald Dworkin wrote, it is a utilitarian purpose, which comprises the role of law and its institutions as instruments acting on behalf of the general welfare (Dworkin, 2020: p. VIII). Nonetheless, "the State, as a juridical-political entity, has as its general purpose the common good of its people, that is, ensuring the conditions that collaborate to the integral development of human personality" (Kim & Eisaqui, 2020: p. 176). To do this, "the state must foster innovation, encourage investment, boost worker productivity, raise production standards, or stimulate the efficient use of scarce resource" (Holmes & Sunstein, 2019: pp. 58-59).

In achieving this goal, it is possible for the state to act by itself or allow for private initiatives (Azambuja, 2005: p. 123). This possibility is justified, principally, due to financial reasons: "rights cost money. Rights cannot be protected or enforced without public funding and support" (Holmes & Sunstein, 2019: p. 5). Indeed, to keep both individual and social fundamental rights, the state is obliged to invest resources: "become demandable the implementation of social conditions which enables the human being to develop all its potentialities" (Kim & Eisaqui, 2020: p. 177). As Stephen Holmes and Cass R. Sunstein state, "rights are an enforced uniformity, imposed by the government and funded by the public" (Holmes & Sunstein, 2019: p. 44).

However, as Nicholas Gregory Mankiw (2008: p. 3) wrote, "the management

of society's resources is important because resources are scarce. (...) society has limited resources and therefore cannot produce all the goods and services people wish to have." Therefore, "the fundamental social rights are dependents of the available economic resources, of the existing financial and budgetary cover" (Kim & Eisaqui, 2020: p. 183). In accordance with Bruno Bodart and Luciana Yeung (2019: p. 118) and Osvaldo Ferreira de Carvalho (2019: p. 186), we think that "if the government who is in charge of provide access to these rights doesn't have resources or management capacity" the enjoyment of rights will be delayed, maybe forever.

From this perspective, it is necessary to recognize the existence of public interest in the fiscal balance: the sustainability of public finances becomes the principle of public administration, in favor of the common good, as the state's purpose (Kim & Eisaqui, 2020: p. 184). In 1976, the U.S. Supreme Court said [in *Matthews v. Eldridge*], "the Government's interest, and hence that of the public, in conserving scarce fiscal and administrative resources is a factor that must be weighed" (Holmes & Sunstein, 2019: p. 15).

Against this background, we can assume a greater importance in the combination of efforts of private initiative through PPPs. It is possible to define PPPs in a broad sense, as "any and all lasting and continuous relationship of the State with private parties aiming at mutual benefits" (Freitas, 2006: p. 148). As Bruno Moraes Faria Monteiro Belem (2011: pp. 168-169) explains, this definition sees PPPs as "all and every cooperative relationship between the public and private sector whose purpose were the provision of public services".

However, according to the Brazilian positive law, the expression of 'public-private partnerships' is used to refer to the 'administrative licensing contract' (Di Pietro, 2017: p. 351), being the administrative permits or sponsored permits. Unlike privatization, in PPPs, only "the execution and management of the service is transferred" to the private sector. "The title thereto and the base on which it is provided (the public asset or infrastructure) remain with the State, responsible for overseeing how the private business is run" (Nakamura, 2019: p. 132; Carvalho, 2019: p. 194).

The first and most common reason used to explain PPPs is the insufficiency of resources by the state: "PPP reduces pressure on government budgets because of using private finance for infrastructures and they also provide better value for money in the provision of public infrastructure" (Khanom, 2010: p. 152). In this sense, the partnership will allow for both private financing and optimization of available resources (as justified by the expertise of the private partner) (Valle, 2005: p. 205). This cooperative system of investment and management of public goods and services has its origins in government's need to enable investments in a context of severe tax constraints (Belem, 2011: p. 166).

PPPs are not, and may never be, a choice guided by the "ideal of the minimal State and the baseless prejudice that activities undertaken by the State are always less efficient than those undertaken by the private sector" (Nakamura, 2019: p. 144). In truth, the reason behind this type of contractual model is based on pub-

lic interest (Nakamura, 2019: p. 144), as explicitly provided for in Article 4 of Law n. 11.079 of December 30, 2004.¹ This means that the cooperative relationship between the state and the private sector must be justified on various grounds of general interest.

Indeed, the common good (the state's purpose) is achieved through a complex matrix of interests. Constitutionally, in Brazil, this complexity of interests cover *inter alia* citizenship, the dignity of people, a free, just and solidary society, national development, prevalence of human rights, the right to life (characterized as a healthy quality of life), liberty, equality, security, own property, access to information, education, health, food, work, housing, transportation, leisure, social welfare, and last but not least, the right to an ecologically balanced environment.

For this reason, whilst it is perfectly legitimate to be preoccupied with profit, the *raison d'être* of PPPs is not to make the private sector wealthier, but to provide what is necessary to improve the citizens' living conditions. Consequently, a well-architected legal and regulatory framework cover a wide range of juridical duties, rights, obligations and responsibilities in the sense of protecting investors, government and society in general.

As pointed by Philip Kelly (2006: p. 11), the role of law in public-private partnerships is meant to “is meant to facilitate investments in complex and long-term PPP arrangements, reduce transaction costs, ensure appropriate regulatory controls, and provide legal and economic mechanisms to enable the resolution of contract disputes”. He says: “It is the combination of policy, law and other legal instruments, procedures, implementation manuals, relationships with other laws and organizations, public administration and private sector systems, expertise and experience that determine if a country has a workable legal framework for PPP” (Kelly, 2006: p. 12).

Therefore, it is important to emphasize the conception of PPPs as an instrument “aimed at building the Proportional Rule of Law and the effective protection, at its core, of fundamental rights” (Freitas, 2006: p. 177). Consequently, not only is the state itself tied to fundamental rights, but the private initiative is also obliged to respect and ensure fundamental rights (Eisaqui, 2020: p. 50), including the environmental ones.

3. Vertical and Horizontal Effectiveness of Fundamental Rights for an Ecologically Balanced Environment and Sustainable Development

Stephen Holmes and Cass R. Sunstein (2019: pp. 5-6) define a right as the “important interests that can be reliably protected by individuals or groups using the instrumentalities of government.” According to them, there are two viewpoints that can explain what rights are: “the moral account of rights tries to identify

¹Article 4 provides that public-private partnerships must be made in light of the efficiency in the pursuit of State's missions (subparagraph I) and the respect the rights and the interests of recipients of services (subparagraph II). (See BRASIL. Lei n. 11.079, de 30 de dezembro de 2004. Available at: http://www.planalto.gov.br/ccivil_03/ato2004-2006/2004/lei/l11079.htm. Acesso em: 28 fev.2021).

those human interests that may not, before the tribunal of conscience, ever be neglected or intruded upon without special justification”. Another theory states that “an interest qualifies as a right when an effective legal system treats it as such by using collective resources to defend it” (Holmes & Sunstein, 2019: pp. 5-6).

Both methods of thinking are correct. Fundamental rights are those “rights which, at a specific point in time, are considered essentials to make concrete the dignified existence of human beings.” However, these rights are not simply guarantees or postulates: they are true duties and obligations that must be fulfilled and implemented (Kim & Eisaqui, 2020: p. 177; Carvalho, 2019: p. 177). In this way, “rights, in the legal sense, have ‘teeth’” (Holmes & Sunstein, 2019: p. 6). Therefore, state action is required for fundamental rights to “be a palpable reality rather than a mere paper promise” (Holmes & Sunstein, 2019: p. 63).

Fundamental rights are historical constructs: they are born when new threats emerge or new legal remedies become possible (Bobbio, 2004: p. 9). Stephen Holmes and Cass Sunstein confirm this: “the community does not protect any imagined freedoms, but only those which, at any given historical moment, its government, largely through its judiciary, identifies as enforceable rights, and is willing to protect, which is to say fund, as such” (Holmes & Sunstein, 2019: p. 66).

Historically, “fundamental rights mean a defense mechanism of the freedom of the individual against the State” (Pinto, 2019: p. 168). This is known as the “vertical effectiveness of fundamental rights” (Tushnet, 2016: p. 476). This is not only for the liberties, but also for the social rights that bind the state because they demand “some degree of material well-being beyond that provided through the operation of market mechanisms of distributing material goods” (Tushnet, 2016: p. 476).

In other words, these “rights grant us services by the government,” which means that “the government is therefore under a constitutional duty to perform, not to forbear” and “the government is obliged, by the Constitution, to protect and to perform” (Holmes & Sunstein, 2019: p. 27, 39-40). The same can be said for third generations and those of fundamental rights: the state must respect these rights or provide material conditions which enable individuals to delight themselves with full economic, social, and cultural benefits.

However, more than as a state obligation, fundamental rights also concern private parties, in relationship to what exists between themselves. The German Federal Constitutional Court in the Lüth case rules that fundamental rights are “an objective scale of values which applies, as a matter of constitutional law, throughout the entire legal system” (*BVerfGE 7, 198 - Lüth*). Developing its argument in greater detail, the Court added that this system of values “must direct and inform legislation, administration, and judicial decision. It naturally influences private law as well; no rule of private law may conflict with it, and all such rules must be construed in accordance with its spirit” (*BVerfGE 7, 198 - Lüth*).

The thesis put forward by the German Federal Constitutional Court, who

ruled in the Lüth case, brought about a “radiating effect” of “constitutional rights over the entire legal system”: “the values or principles found in the constitutional rights apply not only to the relation between the citizen and the state but, well beyond that, ‘to all areas of law’” (Alexy, 2003: p. 133). This understanding is known as the “horizontal effectiveness of fundamental rights” (Eisaqui, 2020: p. 50).

The “horizontal effectiveness” enables individuals to invoke the fundamental rights *vis-à-vis* other individuals (Sever, 2014: p. 39). Other definitions argue that the fundamental right “produces [a] horizontal effect when it may be directly applied to legal relationships between individuals, in the sense that subjective rights and obligations are created, modified, or extinguished between individuals” (Sever, 2014: pp. 41-42). In short, even other private individuals or entities may offend the legal sphere of another person. Hence, the idea of horizontal effectiveness of fundamental rights implies that private entities act to comply with these rights (Carvalho, 2019: p. 195).

Connecting all the above arguments, ecologically balanced, sustainable development has been deemed a fundamental right since the 1970s (when the first broad provisions focusing on the protection of the environment were enacted) (Boyd, 2013: p. 6). This underscores the historicity of fundamental rights. However, these rights are also appropriate for exemplifying vertical and the horizontal effectiveness.

The Brazilian Constitution provides that “both the Government and the community shall have the duty to defend and preserve [the ecologically balanced environment] for present and future generations” (Article 225). The Brazilian Supreme Court held, “the environment is public patrimony which must necessarily be ensured and protected by the social bodies and government institutions” (Brasil, 1995: p. 21). Additionally, María Florencia Ramos Martínez stated that “the recognition, for all people, of a right to a healthy and ecologically balanced environment, clearly introduces the obligation on authorities to ensure the rational use of natural resources” (Ramos Martínez, 2017: p. 60).

Highlighting both perspectives (i.e., the vertical and horizontal effectiveness of fundamental rights), Ramos Martínez (2017: pp. 60-61) synthesized, in accordance with the Argentinian Constitution, that the right to an ecologically balanced environment is a directive to provide guidance on the type of conduct expected from individuals and the state. This involves not only the omission of any conduct that degrades the environment, but also, a positive obligation regarding contributing to the preservation of the environment.

Therefore, it becomes necessary to harmonize socioeconomic development with environmental protection. The question is no longer whether development and the environment contradict each other, but how sustainable development can be achieved. This idea binds any and all initiatives: governmental or non-governmental, public or private (Mata Diz & Caldas, 2016: pp. 250-251). In this way, sustainable development and environmental protection are guidelines

that should orient PPPs.

4. Environmental and Social Governance as a Requirement for Public-Private Partnerships

One of the main concerns about the PPPs is that they “generate more effective social and economic benefits than those brought by direct state investment” (Freitas, 2006: p. 147). As Nakamura (2019: p. 139) points out, “the analysis of partnerships with the private sector should always be based on the criterion of the public interest, and a PPP should only be chosen when it shows itself to be more economic and efficient than the State undertaking infrastructure work directly.”

The notions of economy, efficiency, and benefits that are brought on by PPPs are not merely about financial matters; that is, the partnership cannot be justified merely for budgetary reasons (Machado & Resende, 2016: p. 181). There are additional justifications, such as the state’s purpose, the respect for the rights and interests of service recipients, and the public’s interest. These lead to the conclusion that there is a social element, in a broad sense, behind the legal authorization of government building a partnership with the private sector.

In effect, sustainable development does not focus exclusively on the environmental problem, although the search for balance between human being’s needs and the environment is generally accepted in terms of this concept (Feil & Schreiber, 2017: p. 668). However, beyond this, sustainable development covers peace, economy, environment, justice, democracy, human rights, dignity, and having a triple basis: the social pillar, the economy, and the environment (Resende & Gabardo, 2013: pp. 111-112).

In accordance with Carlos Augusto Alcântara Machado and Augusto César Leite de Resende (2016: pp. 170-171), sustainable development is broken down into economic, social, and environmental sustainability, which means efficiency in the allocation and use of public resources, distributive justice, increasingly effective measures to protect fundamental rights, and intergenerational environmental justice.

From this perspective, the 2030 Agenda for Sustainable Development, adopted by all UN Member States in 2015, consists of 17 goals and 169 targets that are related to various areas of human existence, like poverty, hunger, gender equality, and clean energy (United Nations, 2015). However, ever since the U.N. Declaration on the right to development (1986), the notion of development includes the enjoyment of economic, social, cultural, and political benefits and the improvement in well-being for the entire population (United Nations. Resolution 41/128 (Declaration on right to development)).

As mentioned above, sustainable development is a fundamental right which binds both the Government and private sectors. At this point, Public Administration should consider sustainability as a cornerstone for contracting with private legal persons. Acting as such, the Government encourages the private sector

to look for alternatives that are environmentally and socially responsible (Franco, 2013: p. 277).

This assumption becomes a public policy, and the reasoning is simple. Public policies are the adoption of a course of action aimed towards specific objectives (Terenzi, 2020: p. 34). In this case, the Public Administration intervenes in the market through differentiated consumption practices, replacing unbridled accumulation with a more rational model. Therefore, PPPs are not simply mechanisms that supply the government's structure needs. They are a method of achieving sustainable development (Franco, 2013: pp. 278-279).

This idea has already been developed by the World Business Council for Sustainable Development (WBCSD), under the name of “eco-efficiency,” which is “the delivery of competitively priced goods and services that satisfy human needs and bring quality of life, while progressively reducing ecological impacts and resource intensity throughout the life-cycle to a level at least in line with the Earth’s estimated carrying capacity” (World Business Council for Sustainable Development, 2006: p. 3). This principle was actually introduced into Brazilian law by Law n. 12.305 of August 2nd, 2010, pursuant to Article 6 (V).² Also, in 2010, Law no. 8.666/93 (the Brazilian Bidding Law) was altered to include sustainable national development as a guiding principle in bidding procedures (Ferreira & Giusti, 2012: p. 188).

In summary, this article exposes the need of Public Administration to prioritize suppliers and partners that adopt sustainable management principles for their services and products (Franco, 2013: p. 283); that is, private legal persons with environmental and social governance structures.

In conclusion, this article proposes the promulgation of an amendment to Law n. 11.079 of December 30, 2004. It is about a rule that requires private legal persons to certify that they possess compliance structures. *De lege ferenda*, it proposed a new eighth subparagraph in Article 4, demanding ‘the existence of compliance and governance structures,’ as is already the case in the Law n. 12.462 of August 4th, 2011 (Differentiated Public Contracting Regime), *ex vi* its Article 7, III, which allows the Public Administration to require quality certification, including environmental ones (Ferreira & Giusti, 2012: p. 190).

5. ESG Investments as a Mechanism to Ensure Environmental and Social Compliance

How should one guarantee the correct working of compliance and governance structures; that is, how does one know that these bodies are not merely formal or *ad hoc* measures? It is necessary to encourage ongoing practices related to social and environmental responsibility, which can be done by resorting to the logic of

²In the original: “V - a ecoeficiência, mediante a compatibilização entre o fornecimento, a preços competitivos, de bens e serviços qualificados que satisfaçam as necessidades humanas e tragam qualidade de vida e a redução do impacto ambiental e do consumo de recursos naturais a um nível, no mínimo, equivalente à capacidade de sustentação estimada do planeta”. (BRASIL. Lei n. 12.305, de 2 de agosto de 2010). Available at:

http://www.planalto.gov.br/ccivil_03/ato2007-2010/2010/lei/12305.htm. Acesso em: 28 fev. 2021).

the market and profit.

The private sector is motivated by profit and business growth, which is not, by itself, a bad thing. However, this logic can also be used as a tool to promote sustainable development by respecting and ensuring human rights. Not without reason, nowadays there is an increase in the debate on “ESG” investments.

“ESG” is the acronym for “environmental, social, and governance” and its parameters are used in the “analysis, selection and management of investments.” In a descriptive and analytical form, the “E” issue can be exemplified by a concern with “climate change, carbon emissions, pollution, resource efficiency, and biodiversity.” The “S” includes “human rights, labor standards, health and safety, diversity policies, community relations, and development of human capital (health and education).” Under G, “corporate governance, corruption, the rule of law, institutional strength, transparency” are key issues for consideration (Inderst & Stewart, 2018: p. 2).

ESG investments are linked to the demand for “investment that may bring important social or environmental benefits, such as community development loan funds or clean technology portfolios” (Chen, Li, et al., 2021: p. 1). ESG investment discussions entail that “socially responsible investors (SRIs) consider non-financial criteria (e.g., social responsibility performance) in their investment decisions, in addition to conventional criteria such as return, risk or liquidity” (García et al., 2019: p. 1). Companies themselves are realizing there is potential for gaining a business advantage through positive social and environmental behavior because the spirit of ESG and sustainable investing is in “promoting change by diverting capital resources towards companies that are more likely to acknowledge sustainability issues” (De Franco, Nicolle, & Tran, p. 1).

Therefore, this type of investment is a two-way street: the private companies change their structures to become more socially and environmentally responsible, and the individuals allocate their resources to “green” financial assets. However, one should not forget that private companies are not simply an object of investment, but are also the investors.

At this point, the ESG investments are useful indicators for checking whether private legal persons are truly engaged in sustainable practices. This occurs because there are indicators and monitoring measures to evaluate the “environmental, social and governance-related business practices of companies throughout the world” and help investors “to make SR portfolio investment-related decisions.” (García et al., 2019: p. 2. The sigla “S.R” means “social responsibility”).

The question arises once again: Which role should the State play? And how does this subject apply to PPPs? This article demonstrated that PPPs may be established in accordance with the State’s purpose; that is, to improve the conditions for the common good and general welfare. For this reason, Law n. 11.079 of December 30, 2004, stipulates the observance of certain principles, like efficiency in the pursuit of the State’s missions and respect for the rights and the in-

terests of recipients of services.

Therefore, to verify if the candidate companies fulfill the legal requirements, the Public Administration may establish assessment procedures, defining clear quantitative and qualitative criteria. Among them, the ESG ratings (or scores) can be included. As George Serafeim and Aaron Yoon point out, ESG ratings “seek to inform decision makers how well a firm is managing its ESG risks and opportunities and are utilized by many investors.” These ratings “reflect the efforts that a management makes to limit negative ESG events and to promote positive ESG events” (Serafeim & Yoon, 2021: pp. 6-7). The higher the score, the more social and environmental responsibilities the company has, and the greater probability they have in terms of winning the public bid.

Therefore, such considerations create one more legislative proposal: it becomes convenient to introduce a ninth subparagraph into Article 4 of Law n. 11.079 of December 30, 2004, stating the need to take account of the ‘level of environmental and social concern, based on trustworthy indicators.

As a final word, it is noted that there are a variety of ratings and that “each rating agency has its own measurement methodologies and uses its own social performance criteria” (GARCÍA, et al., 2019, p. 2). Despite this, the Public Administration may decide, on a discretionary basis, which indicators to consider (Article 14, II, of the Law n. 11.079 of December 30, 2004). The only requirements are the duty to inform, also known as the principle of transparency or disclosure obligations (Article 4, V, of Law n. 11.079 of December 30, 2004, Articles 5, XXXIII, and 37 of the Brazilian Constitution), the demonstration of necessity, and the adequacy of the chosen indicator (Article 20, sole paragraph of the Decree-Law n. 4.657, September 4th, 1942) (Brasil, 1942).

6. Conclusion

The well-being of the world’s population is a relevant and significant topic, not only currently, but also for future generations. There is an increasing need for effective measures that provide a multidimensional quality of life. People need and want to have a job, home, health, leisure time, safety, appropriate financial standing, and finally, the full range of human rights.

Nowadays, we have the well-known third generation rights, but there are also fourth and fifth generation rights that cover the environment, development, democracy, and interests that are understood as asset of common use and the common heritage of mankind (indispensable in protecting citizenship, human life, and natural lifeforms). In other words, the interests of human beings, independent of any politically motivated sovereign state, cover all humans, wherever they may live, as well as future generations.

Therefore, whether it is from the governments or private parties (private legal persons or individuals), high standards of conduct must be developed and maintained. In practice, this is equivalent to saying that both private and public entities are under an obligation to respect and promote fundamental rights, including environmental rights, as a fundamental condition for reaching sustaina-

ble development.

Public partnerships cannot simply be justified in accordance with financial issues because of this duty. Public policies are also available to achieve the State's purpose; that is, the common good, equality, development, and peace. Hence, corporate governance guidelines and compliance systems should be required by Public Administration from private partners. However, as profit is still the main factor driving private initiatives, it becomes particularly appropriate, timely, and essential to use ESG investment indicators as criterion for the bidding procedure.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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