Transformation from Linear Economy to Circular Economy: Application of ESG Principles

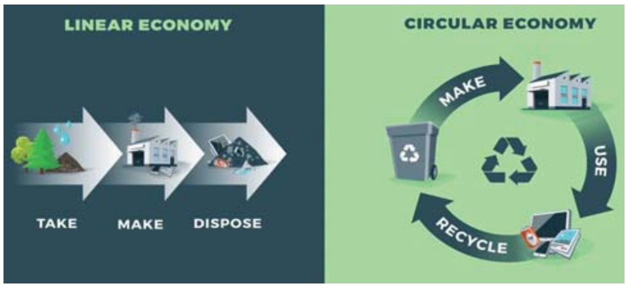
Introduction

Globally, the threats to the existence of human lives are much more pronounced in present times than ever before in history. The human-induced environmental problems, unsustainable use and misuse of natural resources, and climate change warrant responsible systems and practices on the part of the corporate sector. Business organizations across the world are now expected to minimize the negative ramifications of environmental impacts and damaging social implications while ensuring their future financial steadiness at the same time. The efforts to adopt a sustainable and profitable approach by enterprises depend broadly on ESG principles. Moving away from the linear take-make-waste model moving towards adoption of a circular economy model represents a regenerative and waste-minimizing approach that stretches the lifecycle of input materials and resultant products.

ESG Principles

ESG (**E**nvironmental, **S**ocial and **G**overnance) is globally characterized as a set of criteria used to evaluate a company's sustainability and ethical impact. It is used by investors to measure how a company manages environmental risks and opportunities, its relationships with employees and communities, and the quality of its leadership and internal controls. The ESG principles in Pakistan are still in a nascent stage to be applied as a comprehensive framework is at developing level. The ESG model and its approach is inclusive and addresses economic, social, and environmental challenges. Green finance is considered a crucial component of ESG for the improvement of environmental quality, especially in urban settings, which proves its growing importance.

Concept of Linear Economy and Circular Economy



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The Linear economy is a concept that describes the use of resources with a take-make-waste approach that has steadily played havoc with the environment over a period, and now a departure from this approach has become imperative. The trans-formative model of any economy from linear to Circular Economy is now envisioned as a viable solution to the adverse impacts of relentless resource extraction, to arrest accumulation of waste, and to ensure the lengthening of product and material lifecycle. This transition from Linear to Circular Economy is a complex process with which civil society and business organizations literally struggle. ESG principles offer a compelling framework that aligns environmental, social, and governance considerations with sustainable practices *(Van Tulder et al., 2021)*. It is therefore important to understand the indispensable role of governments and businesses working in coordination to permeate and transcend the obstacles and nurture a conducive environment for circularity to flourish.

Hence, in today's dynamic global landscape, the pursuit of sustainability has become a paramount concern for businesses and governments alike *(El-Swaify, 2022)*. Environmental, Social, and Governance (ESG) metrics have developed as a powerful tool to assess a business's sustainability performance. Simultaneously, the circular economy has gained traction as a model for sustainable resource management (*Jackson et al., 2014)*.

Teaming Up of ESG and Circular Economy

This concept has gained currency at the global level as ESG, through sensible business practices, ensures sustainability.

Major threats for the world emanate from climate change, social disparity, environmental problems, and resource depletion. ESG represents a set of parameters that appraises various endeavors of organizations and their practices in key areas of ESG.

- **Environmental:** Business organizations pursuing environmental correction activities like managing waste, reducing carbon emissions, conserving resources, and fostering sustainable practices.
- **Social:** This aspect of any business organization is important from a societal point of view, as the congenial relationship of the company with its workers, clients, suppliers, and adjacent communities is a vital part of positive implementation of ESG. It also evaluates factors such as labor practices, diversity and inclusion, health and safety, and community engagement.
- **Governance:** Every society has a system of governance that oversees and regulates a company's configuration and authority structure to safeguard the rights of all stakeholders and ensure solid functional management of businesses based on ethical prerequisites.

Linear vs. Circular Economy

Companies that prioritize ESG considerations aim to align their operations with sustainable practices, reduce negative impacts on society and the environment, and enhance their financial performance in the long run *(Zu Mente & Bistrova, 2021)*. The best practices of business organizations based on the framework of ESG principles are meant to guide investors and consumers to make informed decisions regarding investments that would be profitable and protect consumers from losses due to faulty consumption of different products supplied by reputable companies in the market.

'ESG and Circular Economy are interconnected notions that highlight the significance of responsible business activities, environmental stewardship, social responsibility, and resource efficiency in a world facing significant sustainability challenges. Embracing these concepts can lead to more sustainable and resilient businesses, economies, and societies' *(Maio & Rem, 2015)*.

Understanding ESG in the Context of Pakistan

Advanced markets across the world have adopted the notion of ESG Principles as a mandatory mainstream concept, but it is a comparatively new and challenging idea in Pakistan. There is limited awareness, especially among those who matter most, such as policymakers, businesspersons, and civil society. It has still not been considered a core business requirement and is being treated as a voluntary activity, like CSR.

Most organizations in the corporate sector believe that ESG has a very minor role to play, confined to philanthropy, whereas ESG has a broader and critical role in managing risks, creating resilience in the supply chain, and building investor trust. ESG requires technical expertise that could help in its effective implementation and make it part of business strategies. Businesses lacking such expertise face a knowledge gap. Small and medium-sized enterprises (SMEs) in Pakistan form a vital and sizeable sector of production, with almost no experience and awareness of the significance of global ESG and its reporting framework. Hence, ESG is not given priority over other activities, which has rendered its progress very sluggish, whereas regional countries like India have seriously embraced ESG.

Weak ESG Reporting and Data Infrastructure

Data transparency and reporting frameworks are global indicators of the successful adoption of ESG. One of the crucial barriers to adopting standardized ESG reporting systems is its complete non-existence in Pakistan. The absence of ESG guidelines and clear reporting regulations contrasts with mandatory ESG disclosures in developed countries. There are some large organizations in the corporate sector of Pakistan that regularly publish reports on sustainability, but they ignore internationally recognized frameworks like GRI, SASB, or TCFD, which creates inconsistencies in corporate disclosures. Issues of non-authentic data, resulting from weak monitoring systems, raise questions on the reliability and precision of reported ESG data. It is imperative for countries, including Pakistan, to remain integrated in the global supply chain through proper compliance with ESG to fulfill this precondition.

Macroeconomic Burdens and Financial Pressures

Pakistan's economy is afflicted with unintended burdens like scarce finances, inflation, and the persistent issue of timely retirement of debt. For many organizations, sustainability becomes irrelevant in the face of their existential threats. Transitioning to renewable energy, reducing carbon footprints, and improving labor conditions is very costly and demands substantial financial investments that most companies are unable to afford or meet to fulfill ESG requirements. Pakistan is largely faced with missed opportunities for green financing and loans to pursue models for sustainability. It is conveniently taken as a superfluity instead of an obligation.

Governance and Institutional Challenges

Governance is a pivotal element of ESG, like a pillar, but a weak governance system does not allow ESG to be practiced in letter and spirit. Corruption, lack of transparency, and weak enforcement of regulations reduce investor trust in ESG claims. There are certain regulatory gaps that render compliance with ESG very frail, leaving businesses with fragmented standards. Political instability is another factor that creates an inconsistent policy environment. ESG needs a robust governance system to instill authenticity in its framework and to be solidly accepted by industries.

Environmental Challenges Specific to Pakistan

Pakistan is considered one of the most climate vulnerable countries in the world, but environmental governance remains neglected. Disastrous climatic impacts that result in frequent floods, droughts, and heatwaves highlight the urgency of ESG adoption, yet adaptation measures are slow. Water scarcity, mismanagement of water resources, and lack of conservation policies worsen Pakistan's water crisis. Pollution and deforestation result in one of the worst air quality environments globally, and deforestation continues at alarming rates. These environmental realities demand immediate ESG integration, but weak infrastructure and inadequate investments hinder progress.

ESG in Pakistan Encounters Social Impediments

The key and indispensable component of ESG is social. When a country is faced with innumerable challenges to address, it turns the tide against compliance. It is directly connected to gross negligence of human rights in society, which include the informality of labour markets, hazardous working conditions, and absence of worker representation.

The social element of ESG is very critical. Pakistan struggles with systemic social challenges that make compliance difficult. Informal labour markets, unsafe working conditions, and lack of worker representation persist in various organizations. Exploitation of female labour is pervasive. The female participation rate as part of the labour force is pathetically low (25%) as compared to the contribution of females in the global workforce on average. The quality of training and education is again shamefully low, which is a major constraint in inculcating the importance of ESG among the workforce.

Conclusion

Adoption of ESG is not just a byword of the corporate world but an inevitable requirement. The adverse impacts of climate change, social unpreparedness, and economic and social disparities have left no room for Pakistan to continue as a complacent nation. The advantages of serious and early adoption of ESG principles in our systems will help develop resilience against the devastating impacts of climate vagaries. Inclusive development could be ensured through ESG-oriented social policies and would fortify the ability to compete in the global economic arena. Sustainability leads to long-run prosperity. In Pakistan, while formal ESG reporting is an emerging practice, several major organizations and companies exhibit strong commitments through their sustainability and corporate social responsibility (CSR) initiatives that align with ESG principles.

***About the Author: Prof. Dr. Samina Khalil** is the former Director of the Applied Economics Research Center (AERC), University of Karachi. She earned her PhD in Environmental Economics and Management from the University of York, UK, and an M.Phil in Economics of Developing Countries from the University of Cambridge, UK.*