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**Research Report**

## New Dynamics for Europe: Reaping the Benefits of Socio-ecological Transition. Synthesis Report Part I. Executive Summary

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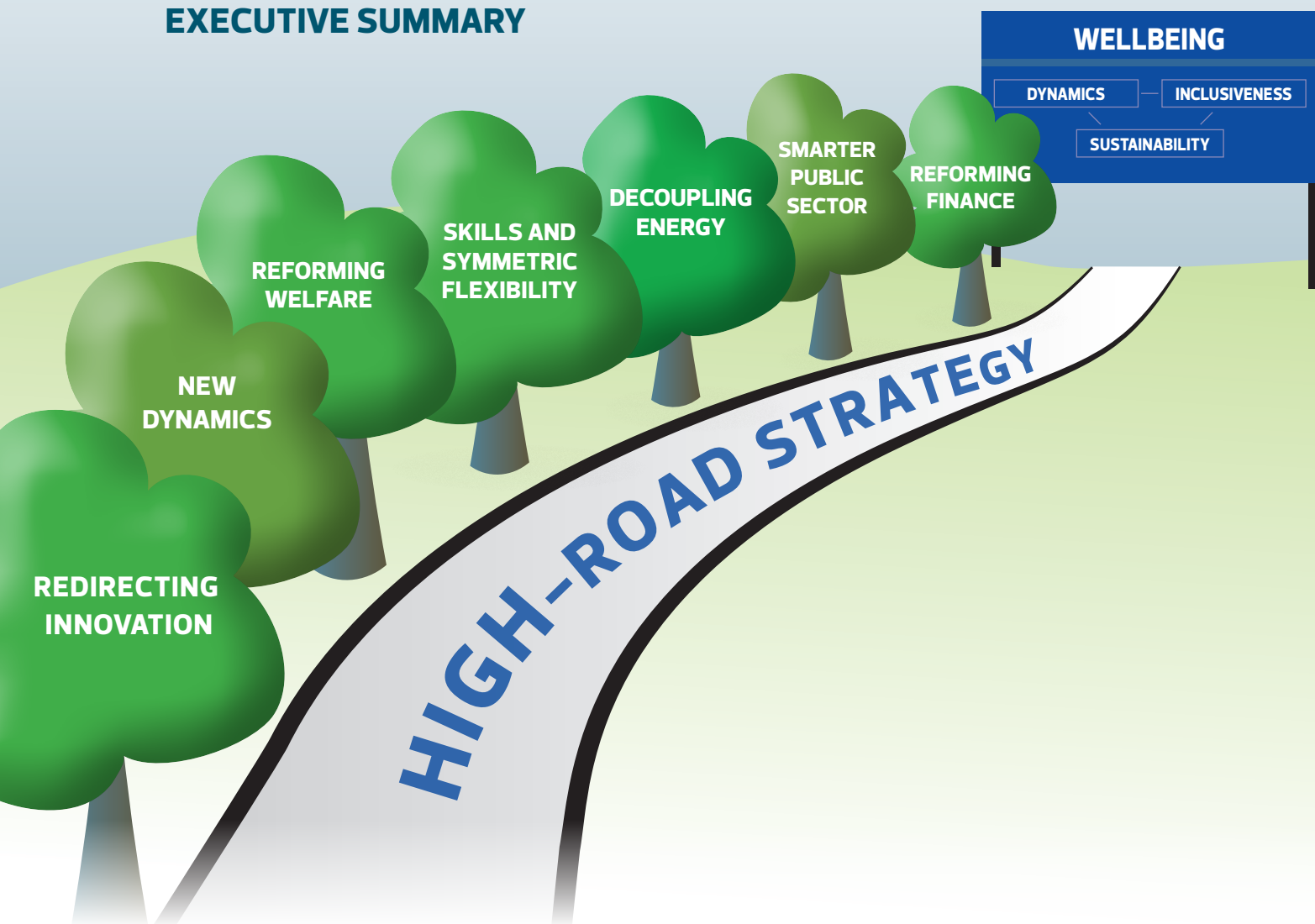
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# NEW DYNAMICS FOR EUROPE: REAPING THE BENEFITS OF SOCIO-ECOLOGICAL TRANSITION

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# NEW DYNAMICS FOR EUROPE: REAPING THE BENEFITS OF SOCIO-ECOLOGICAL TRANSITION

Karl Aiginger

## EXECUTIVE SUMMARY

### Europe 2016: facing unprecedented challenges

#### A success model under stress

The European project is a long-run success story. Up to the 1990s, Europe thrived and experienced rising prosperity, as well as a catching up process with technology frontiers, while simultaneously extending its welfare model. The integration process, starting with six Member States, led to a single market of 28 countries. It culminated in the creation of a currency union for 330 million Europeans. The political integration of former communist countries and their economic catching-up with Western Europe were achieved at an unprecedented historical pace.

European integration has never been a smooth process. Stress during the process was referred to under the lemma of "eurosclerosis" and entailed competitive devaluations. The Lisbon Strategy was never fully implemented. Disappointment was counter-balanced by "Europe 2020", which intended to address structural problems and give the Member States more leeway to adapt the strategy to their specific situations. The financial crisis quickly spread from the US to Europe, highlighting unresolved governance issues and neglected public sector reforms. These also prevented adequate responses to new problems and opportunities arising from globalisation, technological change, demography, the environment and most recently the refugee crisis.

Consequently, Europe today faces unprecedented social, economic and environmental challenges.

Internal dynamics and structural renewal are faltering. Innovation is disappointing, and consumption is sluggish due to stagnant real wages, high taxes on labour and large income differences. Private investment is low due to deleveraging efforts, uncertainty and pessimism about the European future. The public sector is big while

aimed at past priorities. Regulation is complex and public investment is restricted by debt. Reforms that could kindle new dynamics are meeting resistance in many countries where reform-opposing old elites and vested interests remain strong.

Unemployment has risen from 7% to 10% since 2008 and declined only marginally in 2015. The employment rate is still lower at the end of 2015 than at the start of the crisis. Youth unemployment remains at an intolerable level of 20%, leading to the disillusionment of the young people with the European project. Poverty rates are rising and new social risks cannot be mitigated without reforms since tax rates and the share of revenues used for pensions and other social expenditures are already very high in most Member States. A heavy tax burden dampens employment.

Disequilibria across countries and regions are far too deep for an economic or political union and even more so for an area with a common currency. Per capita income differs by 14:1 between the ten richest and the ten poorest regions, differences in unemployment, export potential, governance and trust are persistent.

R&D spending has stagnated at 2% of GDP since 2000, far below the target rate of 3% called for in first the Lisbon Strategy, then the Europe 2020 Strategy.

Europe has so far successfully defended its comprehensive system of health, pension and unemployment insurance. To not undermine competitiveness, the expensive system has to be adapted to new challenges.

Europe used to be the world leader in environmental policies. Energy intensity and per capita CO<sub>2</sub> emissions are far lower than in the US. However, Europe appears unable to exploit its frontrunner position in green technologies and emissions are by far not falling fast enough to be in line with the decarbonisation goals of the Paris Conference 2015.

## **The need for a new strategy based on a shared vision**

The long-lasting repercussions of the financial crisis, political turmoil in neighbouring countries, including mass immigration from war-torn countries in the east and the south, and the handling of the Greek crisis have raised calls for action in opposing directions: either for a re-nationalisation of policies or for a more prominent role of European institutions.

Diversity and differences in opinions between "Northern" and "Southern Europe", but also the old members and the new ones, are widening. Several reforms are not accepted by all members and therefore restricted to a subset of countries (e.g. Schengen and the Currency Union). In some countries, an important part of the electorate favours exiting from the EU or provinces want to become independent.

The call for "ever closer integration" seems to have lost its glory.

In this context, existing decision-making processes no longer seem appropriate for a Union with 28 members (and further countries applying for membership). Some important changes in European governance have already been initiated, stabilising institutions have been founded, and a European Fund for Strategic Investment has

been created. The role of the European Parliament and the impact of elections on the choice of the Commission have been strengthened. Still more has to be done.

Faced with new challenges it is vital to again convince Member States that main problems can be better solved together. Reforms have to be guided by a comprehensive vision as to where Europe should be heading, a vision that is inspiring for European citizens – a new, reinvigorated European story.

## **Vision for Europe: a dynamic, open region of high wellbeing**

Europe has always been strongest when it has had a common and broadly accepted guiding idea, be it peace, trade liberalisation, the common market project, Social Europe or the common currency. Such “Grands Projets” help to put problems, conflicts and obstacles into perspective; they can unify even diverse groups, generate new ideas and experiments.

Now, as Europe’s long-run success story is facing fundamental challenges and the peace project seems to be losing its inspirational power, it is time to reconsider the model and to formulate a new vision.

### **The new benchmark: wellbeing**

As the overarching benchmark for European performance we propose high wellbeing in a sustainable environment. This involves a definite change in the overall benchmark of success: from GDP and GDP growth to high and increasing wellbeing.

The vision for Europe 2050 could then read as follows:

*By 2050, Europe will be a region with high social and environmental standards guaranteeing its citizens a high level of wellbeing. It will be a dynamic, open and pluralistic economic area. Unemployment will be low, inclusion high and income differences limited. Emissions and resource use will have declined absolutely to a level compatible with environmental resilience, biodiversity protection and mitigated climate change. Energy, transport and housing infrastructure will be decarbonised. Europe will learn from other regions and offer its improved model to neighbouring regions and the world at large.*

### **Three strategic goals**

The notion of “wellbeing” calls for the simultaneous accomplishment of three strategic goals: economic dynamics, social inclusiveness and environmental sustainability.

- Economic dynamics include what is usually called income dynamics. It implies that an ever-increasing number of people benefit from the attainment of a broad set of economic achievements. An equally important component of dynamics is structural change and mobility (as opposed to the petrification of existing or inherited structures).

- Social inclusiveness implies that unemployment as well as income differences are low. Social, religious and ethnic conflicts are addressed. Life chances, education and capabilities are distributed more equitably; spreads in income and wealth are based on merit, limited to levels determined by democratically-based political decisions.
- Environmental sustainability demands that the planetary boundaries be respected. Technological, behavioural and institutional changes lead to an absolute reduction of emissions and resource use, to a level of safeguarding the resilience of key economic systems. This gives poorer countries scope for economic development and poverty reduction and allows the next generation to make choices.

Defining "wellbeing" as the overarching benchmark of performance for Europe substitutes the prevailing dominant concept of GDP and GDP growth. It is in line with the "beyond-GDP" approach, as underpinned by the broad economic literature. It is made operational in the WWForEurope strategy by defining the three strategic goals of economic dynamics, social inclusiveness and environmental sustainability. The goals are measurable by the "Better Life" indicators of the OECD and the EU.

Finally, cross-cutting principles such as gender or inter-generational equity and openness have to be kept in mind when shaping the strategy and defining the drivers of change.

## The strategy for a socio-ecological transition in Europe

The WWForEurope strategy is based on the vision, the new benchmark of success and the three strategic goals. It furthermore

- defines *three guiding reform principles*,
- is based on *seven drivers* of change essential for socio-ecological transition,
- carves out *facilitators of reform*, i.e. new processes and actors supporting the transition.

### Three guiding reform principles

The success of the strategy is dependent on three guiding principles.

#### Principle 1: Simultaneity between goals

The principle of simultaneity demands that the three goals – economic dynamics, social inclusiveness and environmental sustainability – be pursued in a systemic and comprehensive approach and not by striving to achieve the goals separately. The principle of simultaneity represents a demanding but also promising renunciation of the "silo approach", which addresses problems in isolation, resulting in high costs and low effectiveness.

The three goals interrelate in a way that could lead to negative tradeoffs as well as positive synergies. WWForEurope screened existing models and developed

new ones in order to investigate the interrelation between the three policy goals. The result of the majority of models is that the possibility of negative tradeoffs between the goals cannot be excluded. However, several model simulations highlight how tradeoffs between the goals can be averted (e.g. if energy taxes are combined with lower taxes on labour and a specific compensation of low incomes) and how double or triple dividends can be achieved (e.g. by using a part of the energy taxes for environmental innovations). If emissions are taxed without reducing taxes on labour, employment as well as incomes will suffer and income spreads will rise. Tradeoffs between environmental goals and economic dynamics are lower than expected; they can be further mitigated if taxes on emissions are used to boost and redirect innovation. WWWforEurope concludes that a carefully designed strategy simultaneously addressing the three goals provides space for triple dividends. Isolated strategies for the three goals or strategies using a few instruments only will yield suboptimal solutions.

### **Principle 2: High-road ambition**

At a strategic crossroads, the choice is often between two alternatives: either opting for a cost-driven strategy by doing the same as before but at lower costs, or adopting a quality-driven strategy, aiming for a new path based on innovation and skill upgrading. We refer to the first option as a "low-road strategy" and to the second as a "high-road strategy".

WWWforEurope strongly postulates that Europe has to adopt a high-road strategy. On this road, economic dynamics is supported by structural change, improving skills and boosting innovation. Ambitious social and environmental standards support high and rising wellbeing.

Only a high-road strategy provides the chance to develop an authentic, distinct model built on Europe's own preferences. This model can then be evolved further, being used internally as a coordination tool and externally as defining characteristics of the European model. If high-income countries pursue a low-cost approach, emerging economies can always retaliate. This would also cut incomes and undermine social and environmental goals in the richer countries, thus reducing wellbeing.

### **Principle 3: Two-stage implementation**

A new strategy for Europe has to lead to a new trajectory but must also address existing disequilibria and imbalances. Transition therefore necessitates a two-stage strategy.

#### **Stage 1: Consolidation and reprogramming**

In the first stage – the next ten to twenty years – policies will still have to focus on preventing new crises and solving inherited disequilibria (unemployment, debt, inequality). This is the ideal point of time to start rebuilding the infrastructure, so as



to prepare for decarbonisation. Massive policy efforts and investment are required to redirect technologies and build a low-carbon infrastructure. These efforts will impact positively on economic dynamics and employment. And it is a good time to decrease unemployment by skill upgrading as well as to reduce inequality.

Thus, economic growth at this stage is the consequence of aiming to reduce unemployment, debt and inequality. Investment needed for decarbonisation and consumption enabled by the increases of lower incomes serves double or triple purposes. But this first stage should by no means be the continuation of established policies. Solving inherited problems has to be combined with massive investment in order to prepare for the second stage. We therefore label stage one as "consolidation and reprogramming" with a strong emphasis on the latter.

### **Stage 2: Socio-ecological transition**

Long-term forecasts for industrialised countries predict lower growth rates declining even further along the time horizon. This may follow from the catching-up of emerging economies, limits of the planet, decreasing marginal utility of higher incomes or secular stagnation tendencies. Therefore, in the second stage, the highest priority has to be given to achieving higher levels of wellbeing (employment, housing, health) based on – in a historical perspective – low growth rates. We call this second stage "socio-ecological transition".

Preconditions for this are a reduced gap between high and low incomes, a lower public debt and a stable financial sector serving the needs of the real economy. These changes, as well as the decoupling of employment and emissions from output, have to be started by implementing new incentives, regulation and behavioural change as soon as possible in the first stage. Countries can switch to stage two earlier if preconditions are given.

## **The seven drivers of change**

### **Innovation: boosting its power and redirecting its focus**

Innovation is the crucial link which mitigates negative tradeoffs between the three goals and provides the simultaneity of economic dynamics, social inclusiveness and environmental sustainability. Boosting innovation is also vital to a high-road strategy since it reduces the dependence of firms and economies on low costs. In the first stage of the strategy, the European knowledge base and the incentives for innovation and innovative performance have to be improved, so as to close the technology gap between Europe and the technology frontier.

Today, the focus of innovative activity is primarily on saving labour. Rising labour productivity creates potential for income increases, but also generates the necessity for high GDP growth rates: they have to be as high as the increase in labour productivity in order to stabilise employment. This is neither a future-oriented nor

a socially inclusive and environmentally sustainable strategy. The game changer we propose is to *redirect* innovations towards energy and resource saving.

#### **WWWforEurope proposes:**

- Industrial and innovation policy can no longer be isolated, but must be systemic policies. Redirecting innovation requires the simultaneous and consistent use of different instruments, such as carbon pricing or taxation, regulation, R&D subsidies, refocusing public procurement and reducing taxes on labour.
- The conditions for young innovative, fast-growing firms in Europe should be improved, e.g. by creating a pan-European venture capital market and ensuring a stream of qualified researchers and graduates.
- Breakthrough scientific research should be fostered by making university funding more competitive and by adopting the tenure track model and flat hierarchies based on merit.
- Social and environmental innovations should gain relative importance to those improving labour productivity.

#### **Dynamics: reducing inequality and uncertainty and fostering investment**

Economic dynamics in Europe have dwindled due to both supply and demand factors.

On the demand side, private sector investment is low, due to the underutilisation of existing capacities, pessimistic expectations about the future dynamics of Europe and high taxes, administrative burden and red tape. Long decision-making processes, a reluctance to use innovations for a new infrastructure and the lack of funds for small, young and fast-growing firms increase the European investment gap.

Infrastructure investment could be bolstered by new financing vehicles, from a private-public partnership to the European Fund of Strategic Investment. Investing in a new, energy-efficient infrastructure and decarbonisation – ranging from housing and offices to transport and energy grids – could reduce unemployment and enable an absolute reduction in energy and resources in the second stage.

Private consumption will increase if income spreads are reduced, thus leading to higher consumption, specifically of low-income earners. At the same time, consumption structure should change towards less material and energy-intensive products.

Imbalances, country-level crises and a lack of confidence and trust will keep demand below its potential and unemployment persistently high. Social innovations should be supported and a change in the consumption structure towards higher durability and lower energy and resource input has to be incentivised.

To summarise, demand will increase as a consequence of the investment needed for decarbonisation and as a result of the changes in the income distribution and the consumption pattern. This helps to reduce unemployment and debt and enables transition.

### WWFforEurope proposes:

- Private investment will recover if uncertainty about the future of Europe and administrative burdens decrease. Credits for small and young firms have to be provided, including new instruments of finance.
- New types of public and private partnerships and the EFSI can boost investment. A shift from physical to intangible investment and to projects promoting social innovations and enabling decarbonisation is called for. This reduces unemployment, poverty and public debt now, and enables absolute reductions in emissions tomorrow.
- Keeping real wages in line with productivity growth will have a stabilising effect on consumption. The same holds for a reduced income spread initiated by re-forming education or by re-enforcing the redistributive function of taxes and transfers.

### Welfare: from ex post protection to social investment

Europe has the most comprehensive welfare systems of all major regions. Nevertheless, most Member States have not been able to prevent unemployment and inequality from rising in the past two decades. Besides, new challenges have come up: the ageing of populations leads to higher dependency ratios and new social risks are created by the break-up of traditional family structures and career paths. Lifestyle changes are reducing traditional family-based as well as public social safety nets. Increasing national and also international mobility calls into question work-based benefits.

Globalisation generally raises income and productivity levels; however, it constitutes a challenge to the welfare system: on the one hand, it constrains social policy due to higher levels of competition; on the other hand, as a by-product of structural change, it creates losers in labour-intensive and low-skilled sectors. Demand for skilled workers is rising faster than the corresponding labour supply. In contrast low-skilled workers are confronted with very high unemployment rates in their labour market segments and do not find a job after dismissals. These vulnerable groups require assistance in the areas of retraining, searching for new employment and incentives for re-employment.

The game changer is to shift the welfare systems from *ex post protection* after a problem has occurred to *ex ante investment* in capabilities.

### WWFforEurope proposes:

- Adapting the welfare system to new challenges and switching from a focus on social protection to the social investment approach. Ex ante training or activation should become more important relative to ex post financing of unemployment.
- Education, and particularly early education, is essential to creating equal opportunity as well as limiting income spreads later in life. Lowering taxes on labour

and specifically on low-paid labour will increase chances of employment and re-employment.

- Migrants should be integrated into the labour market quickly by appreciating their qualifications without excessive red tape. Migrants and their offspring should be given full and effective access to schools, the apprenticeship and training systems. Integrating a qualified and flexible group into the workforce will boost dynamics, reduce public spending and mitigate political conflicts.

### **Employment: upgrading skills and symmetric flexibility**

Lower unemployment is an essential pillar of a social inclusion strategy and therefore a major objective of WWWforEurope. In contrast to presumptions in other analyses we expect that over the next ten to twenty years the problem of unemployment and insufficient demand, specifically in the case of low-skilled jobs, will be more important than a labour shortage due to ageing. Mobilising untapped reserves from unemployment, from early retirement and from involuntary part-time work, will provide a rising quantitative labour supply at least until 2030.

The main labour-market problem will be a significant mismatch between the qualifications demanded and the skills supplied. There is high unemployment for low-skilled employees (aggravated by the influx of refugees), while some firms cannot expand due to shortages of skilled employees. This prevents Europe from tapping the power of innovation and from reducing private or public debt. In the very long run, labour supply might indeed decrease, but if economic growth levels off as expected, this will not be a problem if the skill structure has adapted, increasing the share of high-skilled employees.

Unemployment can be decreased by a voluntary reduction of working time, primarily for those with long working hours and higher wages. A general reduction of working time may lead to greater poverty among low-skilled workers and contradict upward mobility ambitions. Given that the reduction would primarily be without compensation by higher hourly wages, it could lead to a dual labour market as well as downward spirals of lower consumption and lower investment. However, overtime compensation and preferential tax treatment for overtime should be cancelled and voluntary reductions should be enabled.

Work-sharing options should be offered. They are a way to decouple growth and employment, to prevent burnouts, and to increase leisure and wellbeing. Moreover, productivity increases might be translated into fewer working hours and more employment instead of general wage increases. In any case, decreasing working time should not result in working poor or greater old-age poverty. This is even more important since the ability of public budgets to upgrade low wages or pensions is limited under low growth.

Increasing flexibility is a welfare-improving goal in both stages. It is a core message of WWWforEurope that flexibility has to be symmetric: firms should have more leverage to adapt working hours to short-run demand. Employees should

have a guaranteed right to adjust working time to individual preferences and life cycle needs. The rights of employers as well as employees should be negotiated in collective agreements or contracts at the firm level.

Reductions in taxes on labour will lower unemployment in the first stage and make production more labour-intensive and less energy-intensive in both stages. In the second stage – to some extent dependent on trends in output, labour productivity and labour supply – a decoupling of employment from growth becomes increasingly important.

#### **WWWforEurope proposes:**

- Reduce taxes on labour, so as to lower the pressure on firms to increase labour productivity.
- Upgrade skills in general and improve the matching of qualifications supplied and demanded by fostering apprenticeship, training and lifelong education.
- Promote symmetric flexibility that allows firms to adapt production to demand and at the same time allows employees to adjust working hours to preferences and work-life balance. Promote this right as well as choices between wage increases and working time reductions in labour agreements.
- Integrate migrants into preschool education, schools and training, and respect their qualification attained at home.
- Cancel overtime compensation or preferential tax treatment and do not block preferences for shortening working time or work sharing.
- Introduce preferential treatment of part-timers when applying or returning to full-time jobs and offer them training opportunities.

#### **Resources: decoupling energy from output**

Absolute reductions in the use of energy and material resources are necessary in order to slow down climate change and respect other planetary boundaries. In a strategy simultaneously aiming at economic dynamics and social inclusion, this is a very ambitious goal. A deep decarbonisation of production and consumption is required in order to mitigate climate change, as is acknowledged in long-run scenarios and as a result of Paris 2015.

WWWforEurope research shows that, in most European countries, domestic resource use has stagnated or even declined since the early 1970s, while economic growth has continued, albeit at a lower rate.

Global CO<sub>2</sub> emissions as well as emissions embodied in imports, however, have risen significantly in the past. In recent years, they tend to increase at a lower rate than GDP. For 2014, the IEA for the first time reported a stabilisation of global energy-related greenhouse gas emissions in a year of a fast-growing global economy. Still, despite some encouraging signs, there is no evidence of an absolute global decoupling of the scope needed to limit climate change.

As the very first step of a more ambitious decarbonisation strategy the distorting subsidies for fossil fuels should be phased out. This reduction in subsidies can generate multiple dividends. It reduces path dependency and lock-in positions favouring old technologies. The elimination of subsidies for fossil energy also improves the cost competitiveness of the new (low-carbon) technologies and – as a side effect – also reduces public deficits and debt, thus creating budgetary leeway to reduce overall taxation or to increase future-oriented expenditures.

#### **WWWforEurope proposes:**

- Eliminate the current subsidies for fossil energy quickly in a period of low energy prices.
- Improve incentives for energy efficiency for renewable energy and innovation in technologies promoting decarbonisation.
- Set up more ambitious standards for housing, offices and transport and raise them continuously, since investment today will determine emissions and resource use tomorrow.
- Ensure that the prices of fossil energy and CO<sub>2</sub> emissions continuously rise in order to signal the long-run trend of decarbonisation as well as to prevent rebound effects. Declines in the price of oil, gas and coal should be smoothed by higher taxation, so as to prevent wrong decisions of consumers.
- Price incentives have to be combined with regulation, procurement policy and behavioural changes. Innovation policy has to foster environmental innovations.
- Set up funds for energy and resource efficiency in emerging economies. Obligate multinational firms to use best technology in all subsidiaries and provide indicators for all plants in international trade and investment agreements.

#### **Public sector: an all-important game changer**

With an expenditure-to-GDP ratio of 48%, almost one half of the output of Europe's economies is re-allocated through the public sector. This implies a huge potential latent in the public sector to contribute to a socio-ecological transition by changing expenditure and revenue structures. Its importance is further increased by its impact via legislation, regulation and other non-monetary activities.

Changing the *tax structure* is probably the most effective and comprehensive game changer we propose. Currently, high taxes on labour contribute to low employment and the tax systems do little to boost environmental transitions.

First, labour is heavily taxed. Taxes (including social contributions) even burden low incomes considerably. Secondly, energy is taxed moderately and its share in tax revenues has even declined on average in EU Member States since 2000. Thirdly, though equal opportunity is important for wellbeing as well as economic efficiency, inheritance taxes and wealth-based taxes are decreasing or being abolished. This is particularly a problem when interest rates are low, since in this case life-time income depends even more on starting positions. Fourthly, although financial transactions

tend to destabilise the real sector, especially if the bulk of transactions is speculative, the financial sector is under-taxed and no financial transaction tax has been introduced. If all these structural deficits of tax systems were corrected, wellbeing would increase significantly.

#### **WWFforEurope proposes:**

- WWFforEurope worked out a back-of-the-envelope proposal for how the tax burden on labour could be halved from currently 20% of GDP in Europe to 10% within a revenue-neutral tax shift.
- The labour tax cut could be compensated by the following measures (in % of GDP):
  - moderate taxes (tax increases) on property, inheritance, financial transactions of 2.5%,
  - doubling environmental taxes, so as to raise revenues by 2.4%,
  - introducing a carbon tax of € 100 per ton of CO<sub>2</sub> raising 2%,
  - increasing tax compliance, so as to result in additional revenues of 1.6%,
  - reducing tax exemptions for fossil energy, increasing taxes on alcohol and tobacco yielding 1.5%.
- The resulting substantial tax shift would increase employment, reduce emissions and tobacco or alcohol-related diseases. It will increase the equality of opportunity and lower the impact of inherited wealth.

This back-of-the-envelope calculation illustrates the extent to which the public sector can be a game changer by changing the tax structure. Going for an ambitious change in the tax structure is a rewarding policy reform, because it supports all three goals of the strategy, thereby unambiguously increasing wellbeing. Some of the compensating measures, such as pricing of carbon emissions, would be easier if international commitments e.g. following the Paris agreement could be reached.

A more moderate approach which could be implemented in the short run with less international cooperation. In this version, taxes on labour are reduced by one third. Both proposals are revenue-neutral on the tax side. If future repair costs (environmental or health-related costs) can be reduced, the tax shift could also lead to a reduction in public expenditures and thus create room for reducing the high tax ratios in Europe.

Meta analyses using parameters from different model simulations carried out in this project indicate that the ambitious tax shift would increase employment by approximately 5% in the short run (2020) and 10% in the long run (2050). Emissions of greenhouse gases would be reduced by 65% in the long run. These calculations model the shift between labour taxes and environmental ones, and assume that other countries will not increase taxes on emissions. Under these extreme conditions a marginally negative effect on European GDP growth (between 0.2% and 0.3% p.a.) may occur. If the other countries increase taxes at least to some extent, the European GDP will also rise as compared to the no-change scenario. Triple dividends would also occur even more if environmental taxes were levied to a larger extent on consumption instead of production.

On the *expenditure side*, the public sector finances a large share of the public infrastructure and has a heavy impact on private infrastructure via legislation or regulation. Investment in infrastructure has to adapt to reflect environmental and social goals. The infrastructure provided today determines the potential for future decarbonisation.

Subsidies should be shifted away from securing low prices for fossil-based energy to supporting activities with positive dynamic externalities (e.g. R&D subsidies). The potential role of public procurement should be intensified by effectively accounting for environmental and social criteria.

Expenditure structures should also be shifted at the EU level. The lion's share of EU expenditures consists of transfers preserving existing structures rather than contributing to a socio-ecological transition. This is particularly true for the largest share of agricultural subsidies and for cohesion policy. The upcoming midterm review of the Multiannual Financial Framework is an excellent opportunity to increase the impact of the EU budget for transition.

### **Financial sector: re-committing to the real sector and aligning to the needs of society**

Once again, problems primarily originating in the financial sector have destabilised the real economy and led to the recent financial crisis. An essential precondition for the socio-ecological transition of Europe is a healthy and resilient financial sector supporting the real economy.

Financial sector reforms should have three main goals:

- (1) preventing negative spillovers from the financial sector to the real economy,
- (2) incentivising the financial sector to effectively strengthen the real economy,
- (3) motivating and enabling investors and funds to include the needs of society into portfolio selection, e.g. being able to select funds investing in social cohesion, poverty reduction and the transition towards a low-carbon economy.

#### **WWFforEurope proposes:**

- The Banking Union should be completed by establishing a common deposit guarantee scheme.
- Smart regulation with fewer details and broader goals should stabilise the financial sector.
- A financial transaction tax should be implemented, so as to reduce speculation and also to lower taxes on the real economy.
- Venture capital and crowd funding for innovative firms should be promoted.
- Investment that benefits society and the economy should be boosted by better information about the social and environmental impact of the portfolio.



## **Facilitators of reforms: new processes and actors**

Europe does not lack strategies, but often their delivery. Based on evidence from past reforms and new research, we propose processes, an institutional design and taking new actors on board as to increase the probability of success.

### **Overcoming reform resistance by inclusion, fairness, and (partial) compensation**

Given the three goals of the strategy with their potential tradeoffs, the reforms will be more successful if they do not aim for the maximal attainment of one of the goals if this hinders the attainment of the others. Striving for acceptable solutions to all stakeholders can mitigate the risk of losing the support of certain segments of society, the electorate, or strong pressure groups which would otherwise be able to block reforms. Broad consultation processes, open discussions of feasible options and outcomes as well as early communication of reform strategies are conducive for success. Deliberations should include civil society and encourage local bottom-up processes. Technical solutions alone will not be sufficient, behavioural change is also required, and therefore opinion leaders, schools as well as the media have to be invited to support socio-ecological transition.

The perceived fairness of reforms, and in particular the fairness of the decision-making process, trust in government and in other actors involved, are essential. Short-run and partial but not full compensation of reform losers should ensure support for the changes needed.

### **Pursuing a pluralistic and polycentric approach**

The heterogeneity of the countries, regions and cities in Europe is significant, as is uncertainty about long-term trends, technology and possible solutions. A decentralised approach with regions, cities and Member States as actors in the reform process, each searching for the best solution, has definite advantages in terms of mutual learning, enhancing innovation and for achieving equitable and environmentally sustainable outcomes. Given the existing heterogeneity of Europe, the strategy can turn this heterogeneity into an advantage by means of a pluralistic approach.

### **Establishing a joint ownership**

Some problems, however, such as climate change, income inequality and insecurity, can only be solved at the European or even the global level. In order to promote the strategy at the European level, we propose a "European Declaration of Transition towards Sustainability" jointly issued by the European Parliament, the European Commission and the European Council. This declaration should stipulate the joint achievement of all three goals of transition and stress the need for simultaneity. A new "Vice President for Sustainability" of the European Commission should coordinate the process and be the personalised "anchor" of the envisaged transition.

Member States should develop annual sustainability programmes based on regional and local initiatives.

### **Bringing business, civil society and social partners on board**

Europe has a strong and successful business sector and the institution of social partnerships. A continuous dialogue between governments and stakeholders – with differences between Nordic, Southern, Continental European countries and new members – is partially responsible for the past success of European integration. This should be used and enhanced to improve the European model. Innovation policy could be based on this dialogue as well as used to strengthen it. A new industrial policy has to incorporate societal needs and place a high emphasis on energy and resource efficiency. A systemic industrial and innovation policy becomes more effective by including innovative start-ups and finance in the dialogue.

### **Integrating bottom-up-initiatives and new actors in order to change behaviour**

History shows that transition requires new actors. Our research highlights that non-profit activities originating in civil society are able to yield new institutional arrangements that often lead to better socio-ecological performance than those developed within the traditional market-government dichotomy. These new institutional arrangements could also be considered laboratories for a more sustainable way to produce and consume.

Civil society, NGOs and representatives of new firms, youth and alternative organisations in general are all important to changing behaviour. Education, universities and minority representatives play a major role in transition. This might lead to unconventional solutions, new business models and non-market employment.

New modes of behaviour provide a culture favourable to change. Concepts of a circular economy – focusing on recycling, reuse and the re-manufacturing of resources – and models of collaborative consumption (“sharing instead of buying”) have been recognised as important tools for promoting sustainability and decoupling economic dynamics from resource consumption.

### **Evaluating stocks and flows: the functionality approach**

Wellbeing is the ability to fulfil certain needs, such as mobility, living in a comfortable home, being well nourished, communication etc. Such functionalities can be generated by a combination of stocks (infrastructure) and flows (current expenditures). Initially providing a high quality infrastructure later reduces current expenditures, e.g. for energy and other natural resources. Each functionality can be provided at a high level if systems are planned ex ante with the goal of long-term minimisation of energy and resources, specifically carbon-intensive ones. Future-oriented planning of cities, urban areas and megacities, has the same effect of providing higher wellbeing with fewer resources.

## The European road to wellbeing



### 3. FACILITATING REFORMS

- Overcoming reform resistance
- Pluralistic and policentric
- Participation of stakeholders, civil society & NGOs
- Bottom-up initiatives, new actors
- Monitoring progress

### 2. DRIVERS OF CHANGE

- Redirecting innovation
- New dynamics
- Reforming welfare
- Skills and symmetric flexibility
- Decoupling energy
- Smarter public sector
- Reforming finance

### 1. FOLLOWING THREE GUIDING PRINCIPLES

- Simultaneity between goals
- High road ambition
- Two-stage strategy

Source: WWFforEurope Synthesis Report, Vienna, Brussels, 2016.

### **Monitoring progress through consistent concepts and indicators**

Despite all the well-known criticisms, GDP (and its growth) is still the dominant measure of the performance of an economy. We propose substituting it by taking high and rising wellbeing as the overarching benchmark of success. This is made operational in defining three strategic goals (economic dynamics, social inclusion and environmental sustainability), making use of the Better Life Indicators of the OECD or EU. Monitoring the success of the transition strategy is necessary at the European level as well as for the Member States. If the indicators are not available quickly, proxies have to be used or indicators have to be "nowcasted" (as is common today for components of GDP), since economic policy has to be based on recent evidence. We also propose measuring competitiveness not as "cost competitiveness" implicitly calling for low wages and soft standards. High-road competitiveness is the ability of a region to achieve its goals. In the proposed strategy this implies to promote wellbeing based on innovation and skills and defined by the three strategic goals of economic dynamics, social inclusiveness and environmental sustainability.

Monitoring the progress of the strategy by applying consistent concepts and predefined indicators is a major precondition for long-run success.

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