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Competitiveness for Sustainability – Positions and Perspectives

A contribution to discussion at the 2006 annual conference of *Öko-Institut e.V.*

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Introduction

In March 2000 in Lisbon, the EU Heads of State and Governments agreed to “make the EU the most competitive and dynamic knowledge-driven economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”. The EU sustainability strategy was ratified a little later in Gothenburg in 2001. Not only the EU Strategy for Sustainable Development but also the Lisbon Strategy for increasing competitiveness was recently reviewed in terms of their objectives and the extent to which they have been achieved. In the course of the mid-term report of the Lisbon Strategy, the Commission suggested that the focus should lie on growth and the creation of new employment opportunities. The Lisbon Strategy brought the achievement of objectives, which the Commission regarded as unsatisfactory, to the centre of the Commission’s attention. This is reflected by the much-quoted dictum of the Commission’s President, José Manuel Barroso, on the three strategic pillars of the Commission: „If one of my children [e.g. competitiveness] is ill, I focus on that one, but this does not mean that I love the others less.”

Focussing on the competition strategy and the priorities outlined in the Lisbon Strategy leads to policy initiatives for rigorous environmental and social standards being put under pressure – inter alia under the heading “Better Regulation”. The argument that environmental and social standards have a negative effect on the competitiveness of the European economy is being raised by various sides.

As a result of these developments, *Öko-Institut* felt urged to become increasingly involved in the relationship between sustainability, innovation and competitiveness in the context of European policy making. This is even more so the case given that the Lisbon Strategy will form the explicit focus of the German Presidency of the Council of the EU in the first six-month period of 2007. We perceive great risks associated with the increasingly intense debate on competition, but also opportunities for sustainable development. The risks lie, in our opinion, in the achievements and advances made in the areas of environmental protection and social justice being jeopardised in the course of the debate on competitiveness in the European economy. We do, however, also perceive the opportunity for promoting **competitiveness for sustainability**. This means: laying the focus of policy to an even greater degree on effectively meeting EU sustainability objectives by promoting innovation, thereby also contributing to economic success in the competition.

Within the scope of the “Competitive, Innovative and Sustainable (CIS) Europe” project, which was financed by resources of the executive board of *Öko-Institut* and the *Zukunftserbe* Foundation, positions and perspectives were developed which form the basic principles of future research projects to be conducted by *Öko-Institut* in this area. The present paper summarises these as a contribution to discussion at the 2006 international annual conference of *Öko-Institut*. The results of the conference discussions are available in German language at www.oeko.de. An additional output of the “CIS Europe” project is the background paper “Competitiveness, innovation and sustainability – clarifying the concepts and their interrelations”, which may be downloaded soon from the same website.

Öko-Institut will incorporate the findings of the “CIS Europe” project in activities aimed at boosting European networking on this topic. These networking activities will be subsidised in the coming three years by the German Federal Ministry of Education and Research. The annual conference marks, at the same time, an intensification in the continuing European networking of *Öko-Institut*.

Positions for the debate on competitiveness and sustainability

1. The priorities are not well-balanced

The Lisbon Strategy gives the impression that competitiveness is currently the main goal of the EU under which other political objectives are to be subsumed. As a result of this prioritisation, a number of new initiatives in environmental and social policy have been slowed or watered down in recent months.[1] This priority ranking contrasts with the recently revised EU sustainability strategy, which is ranked above the Lisbon Strategy: "The EU strategy for sustainable development forms an extensive framework, within which the Lisbon Strategy functions as the motor of a dynamic economy thanks to its new focus on growth and employment." Also, equally-ranked social and ecological objectives - such as a high degree of social and environmental protection or the equal treatment of men and women (Art. 2 of the Treaty Establishing the European Community) – are deeply embedded in European treaties, alongside "a high level of competitiveness". There is no basis for subordinating such objectives borne by all Member States to the goal of increasing competitiveness. The insight behind this is that there are social and environmental policies whose primary goal is not to contribute to increased growth or the creation of new employment opportunities. The purpose of such policies lies in the fulfilment of values which are of just as great importance to EU citizens.

2. The concept of competitiveness is being overloaded

The concept of competitiveness is multi-layered and diffuse. This leads to the debate on competitiveness being partly (and partly purposely so) carried out at cross purposes. In particular, a lot of jumping between company, sectoral and national levels is taking place in the discourse.

While competitiveness is being frequently defined by companies and sectors in terms of its ability to compete with a satisfactory rate of return on international markets[2], it becomes contentious as to whether it is meaningful to talk of the competitiveness of whole nations or economies: In contrast to non-competitive companies, national economies do not drop out of the "market" in the case of deficient economic performance. They are not able to externalise social and environmental costs to the same degree as companies so as to increase their efficiency. Above all, however, a national economy does not necessarily succeed at the expense of neighbouring ones; rather, it can make economic use of them by means of improved sale and import opportunities, etc. In view of globalised value chains, the competitive strength of a company operating multinationally also contributes to the economic success of diverse economies. Against the background of the global networking of economic activities, it is therefore not appropriate for the concept of competitiveness to have a national or regional focus.

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1 In this vein, the planned strategy on air pollution was subjected to an analysis of employment losses; concrete targets were not predominantly added to the Thematic Environmental Strategies. Initiatives in the waste disposal sector are currently being examined with regard to "bureaucratic burden", which could potentially include obligations related to the environment. It is feared that environmental and social standards which entail administrative costs could be phased out in future under the dictum of „Better Regulation".

2 OECD (2001): Environmentally Related Taxes in OECD Countries. Issues and Strategies. Paris, p. 28.

3. The relationship between environmental standards and competitiveness is often analysed in a truncated manner

Studies on the effects of environmental standards on competition often falter on the interrelationship being analysed in a truncated fashion. Additionally, methodological problems compromise the comparability of studies. This makes generalisable statements on the competitive effects of environmental policies difficult.

Such a lacuna can arise, for example, when the aggregation level and sectors selected for the analysis are not fitting. A much-cited study[3] on the ramifications of the European Chemical Regulation REACH on company competitiveness, for example, focused on individual case studies of loser companies that were not representative of the whole chemical industry. Such a customised analysis is also linked to the fact that only the costs of environmental and social regulations for companies and industries are being examined. The monetary advantage lent by the regulations in business and national economies frequently fails to be taken into account. Such benefits encompass inter alia efficiency and innovation effects, which can first be apprehended after a certain period of time, and increased health and safety at work as well as associated gains in productivity in the same sector. Benefits can also arise in sectors which, for example, produce near-substitutes or environmental technologies, or profit from unpolluted inputs such as water. A Dutch study recently demonstrated that it is not unusual for cost effects to be overestimated as twice as high as they are, and sometimes even more.[4] Generally, not only the immediate social benefits of a policy measure are left out of cost-benefit reports; also omitted are those costs which arise when environmental or social problems worsen due to the non-implementation of measures,[5] when health costs rise or productivity losses occur.

Difficulties also arise as a result of methodological problems. Above all, the determination of the stringency of environmental/social policy – which is often rooted in the make-up of the instruments and the dynamic effects they make possible – and the estimation of regulation-based costs are unstable. Different concepts and indicators of competitiveness underlie the analyses. This inconsistency impedes the interpretation and generalisability of empirical results, as do differences in analytical approach with regard to the exact question posed, the environmental issue, sectors, markets or time horizon.

It is precisely in policy-related research that companies are often incorporated. Civil society experts are more rarely integrated, even though their complementary perspectives on issues could help avoid some of the lacunae mentioned above.

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3 KPMG (2005): REACH – further work on impact assessment. A case study approach.

4 This is true in the case of the Directive for large combustion plants, the implementation of the Montreal Protocol and the introduction of lead-free petrol. The systematic bias arises in the process of defining and measuring costs, in the making of assumptions for estimations, and whether cost-cutting dynamics such as innovations and economies of scale are ignored or not. See Institute for Environmental Studies (2006): Ex-post estimates of costs to business of EU environmental legislation, Final Report.

5 In this way, non-implemented training measures in knowledge-based societies lead to losses in competitiveness tomorrow. Also, the damage and mitigation costs of climate change will cause costs for companies and societies in coming years that total billions of dollars. Natural disasters - many of which could have been prevented by an early, stringent climate policy - have, in 2005, already caused record costs of (according to data provided by *Münchner Rück*) more than 210 billion US Dollars.

4. The notion that general competitive disadvantages arise from a rigorous environmental policy is not tenable

That there is a negative relation between rigorous environmental standards and different levels of competitiveness is not fundamentally verifiable. This is the case under the truncating assumptions described above (3.), for instance the omission of economic benefits and innovation effects. To be sure, the "conventional view" of traditional and strategic trade theory connects regulations to rising input prices and the crowding-out of productive investments, and thereby derives competition disadvantages. On the other hand, champions of the Porter Hypothesis lay emphasis on increases in efficiency, the "innovation effect" and first mover advantages, which can benefit not only individual companies, but also sectors and whole national economies.[6]

Indeed, a plethora of empirical studies refer to a positive relation between environmental regulations or activism and sector-specific or macroeconomic competitiveness on various levels.[7] Negative relations often prove to be minimal or insignificant, meaning that the widespread assumption that environmental policy throws a spanner in the works of the economy is scarcely corroborated empirically. Where does it originate from? The OECD[8] states the following possible explanations: that environmental protection costs are too low to influence competitiveness;[9] that environmental standards are ultimately (at least in the OECD) relatively comparable; and that the innovation effects, first mover advantages and spillover benefits (over-)compensate for negative effects.

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6 In a more radical critique, ecological economics refers to limits to growth and the role of natural capital (i.e. ecological goods and services) in the creation of wealth.

7 A good summary of this can be found in the paper of the Network of Heads of European Environment Protection Agencies (2005): The Contribution of Good Environmental Regulation to Competitiveness.

8 OECD (2001): Environmentally Related Taxes in OECD Countries. Issues and Strategies. Paris, pp. 71-85.

9 According to Hitchens (1998), they amount on average (i.e. varying between sectors) to around 1% of the gross value added. Hitchens David (1998): The Influence of Environmental Regulation on Company Competitiveness: A Review of the Literature and Some Case Study Evidence. In: Hitchens, David/ Clausen, Jens / Fichtner, Klaus (eds.): International Environmental Management Benchmarks. Best Practice Experiences from America, Japan and Europe. Berlin, pp. 39-54.

Perspectives for the debate on competitiveness and sustainability

1. Enhancing the integrated European sustainability strategy

The European Union and its Member States have committed themselves to sustainable development. This commitment was reinforced in June 2006 when the European sustainability strategy was renewed. Herein it is stated that: „The EU strategy for sustainable development forms an extensive framework, within which the Lisbon Strategy functions as the motor of a dynamic economy thanks to its new focus on growth and employment."

Commensurate with this emphasis, Europe has to consistently integrate the Lisbon Strategy in the sustainability strategy. This includes:

- Politically and institutionally enhancing the social and environmental dimension in comparison with the competition agenda. This encompasses important initiatives with regard to fundamental socio-ecological challenges, for which resources also have to be provided accordingly. Institutionally, the Lisbon Strategy is currently better embedded, with its clearly assigned accountabilities, specified objectives and national implementation plans, than the sustainability strategy, which has to be reinforced by appropriate reforms.
- Improving the integration of the three pillars beyond the collective reporting obligation. A prerequisite of this is a well-structured debate on possible conflicts of objectives between and amongst the three dimensions of sustainability. These are currently not being mentioned nor addressed. A mechanism that can be drawn upon already exists in the form of the principle of environmental integration, which is incorporated in the EC Treaty (Art. 6); balanced regulatory impact assessments lend further starting points.

2. Analysing the Lisbon Strategy in terms of its effects

In respect of the Lisbon Strategy, the EU defined its objectives above all in terms of the economic and social development of the European economy. The mechanism of Regulatory Impact Assessment was developed as part of the strategy, according to which specific draft laws ought to be subjected to an extensive analysis of their social, ecological and economic effects.

Up to now, the Lisbon Strategy has done without an impact assessment, although it should, as a broad, policy-defining document, potentially be subjected to an impact analysis. It has to be assumed that the Lisbon objectives, such as the three-percent growth goal or the promotion of innovation in the areas of genetic engineering and nanotechnology, will lead to environmental effects. The strategic importance of the Lisbon Strategy, its potentially wide and deep ramifications, could – according to the principle of "appropriate analysis" – even make it possible to carry out a quantified and monetarised analysis. An initiative of the Commission and the Member States to subject the renewed Lisbon Strategy and the national reform programmes to a well-balanced impact assessment would buttress the sustainability and acceptance of the strategy. At the same time, the question as to what consequences the current form of the Lisbon Strategy has for ecological, social and economic development in newly industrialised and developing countries has to be raised and addressed.

3. Improving the technique of impact assessment

Fours years after its implementation, the technique of impact assessment of legislative initiatives developed by the EU Commission has only fulfilled its original objective („to allow policy makers to make choices on the basis of careful analysis of the potential economic, social and environmental impacts of new legislation“) to a limited extent. Various studies show that the evaluation and quantification of negative economic effects were represented in an exaggerated manner – to the detriment of the planned environmental and social standards; that the costs of policy initiatives were taken into account to a greater degree than the assumed benefits; and that short-term effects were overestimated in comparison to long-term ones.

The guidelines on the systematic implementation of impact assessments which were laid down by the EU are clearly not sufficient for avoiding internal difficulties in the evaluation of policy initiatives. The following points constitute, in our opinion, basic starting points for an improved impact assessment:

Ex-post analyses help to demonstrate the extent to which initial estimates of the effects on competitiveness were unreasonably high and to which they provide tested data to counter a systematic overestimation of costs. The potential costs of political non-action ought to be integrated in impact assessments in the same systematic way as the mid- and long-term economic benefits of a policy initiative – this includes increases in efficiency and health and safety at work, innovations, first mover advantages, etc. as much as declining health costs and external benefits.

Moreover, a pre-requisite of an improved impact assessment has to be to develop a common understanding or “negotiated knowledge” of the consequences of a political initiative. “Common understanding” requires the early and long-term involvement of stakeholders – representatives from industry as well as NGOs – in all basic decision-making processes (Joint Fact Finding). Fact finding as regards the consequences of a policy initiative is based on a multitude of decisions and analyses, which are generated in the course of impact assessment. This includes the following inter alia: the selection of suitable indicators, the selection of suitable industries and types of company, the time frame of the analysis and the time horizon of scenarios, and the selection of methods for collecting, processing and interpreting data. It is precisely here that the integration of stakeholders is fundamentally important since they are able to bring into the process the (common) interests, which transcend economic efficiency, of social groups.

4. Creating the basic conditions of competitiveness for sustainability

Sustainable development requires institutional basic conditions and political instruments which specifically promote social and ecological behaviour and thereby create competitiveness for sustainability. Economic actors will precisely be successful when they economise in a sustainable fashion. An appropriate set of instruments has to guarantee on the one hand that environmental and social objectives are effectively met. On the other hand, it ought to increasingly stimulate innovations which push forward ecological structural change and a transformation towards sustainability.

Better Regulation in *this* context

- sets general conditions on a national level in order to steer the investment, innovation and purchase decisions of economic actors in a sustainable direction. This encompasses a greening of the social and fiscal system and procurement amongst others;
- utilises, in the course of this, a broad palette of instruments which stimulate (system) innovation, inter alia ambitious reduction rules, dynamic standards that go beyond existing technologies (e.g. the top-runner approach) and, where appropriate, economic instruments. Regulatory law also gives rise to innovations, as evidenced by the debate on the WEEE[10] and the RoHS[11] Directives, and additionally guarantees that environmental objectives are met comparatively securely;
- supports the relevant innovation processes by means of a systematic research policy, which - alongside concrete new technologies and social forms of organisation – also addresses the macro structures of production and consumption systems;
- flanks these instruments with measures, which cushion strong effects on other sustainability interests – also in a global context.

The last thirty years of environmental policy has given rise to impressive successes, both with regard to environmental quality and the boosting of innovation and employment effects. In the coming years, competitiveness for sustainability above all has to be strengthened in those areas where sufficient progress has not been possible up to now. The concentration of resources in such areas not only increases efficiency, but also the acceptance of environmental policy.

5. Adopting a pioneering role

Europe has an exemplary function with regard to other economies: The high level of wealth and productivity makes it possible, to a certain degree, for us to integrate environmental and social concerns in our economic model. At the same time, the high level of resource consumption and environmental pollution within Europe – which has global effects in part – obliges us to do this to a certain extent.

Newly industrialised and developing countries are entitled to increase their affluence. So that this can be achieved harmonically with the biosphere, it is necessary that wealth and the consumption of resources are decoupled globally and that Europe convincingly integrates this in its own economic model - and does not convey the impression of placing social and environmental concerns behind economic considerations. Concurrently, Europe has to be a pioneer in international environmental policy. The course of climate protection and the protection of biological diversity, of environmentally and developmentally sustainable trade regulations, etc. must be set globally in order to accelerate, steer and cushion a requested global structural change. European initiative is particularly important at present in terms of pushing forward ambitious climate obligations for the phase after the expiration of the Kyoto Protocol. For the purposes of sustainable development, international environmental obligations are to be combined with development measures and the transfer of sustainable technologies.

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[10] Directive 2002/96/EG of the European Parliament and Council of 27 January 2003 on old electric and electronic appliances.

[11] Directive 2002/95/EG of the European Parliament and Council of 27 January 2003 on the restriction of the use of certain dangerous substances in electric and electronic appliances.

The role of *Öko Institut e.V.*

Öko Institut will engage in the debate on the influence of ambitious environmental and social policy on economic success in the following ways:

1. We critically engage in the present discourse on sustainability and competitiveness.

2. We promote a sustainability strategy that is rigorous and integrated.

3. We will increasingly analyse methods for evaluating the relationship between sustainability and competitiveness and will improve them.

4. We will carry out impact assessments of competition strategies in order to ensure that they do not compromise the environment, global sustainability or justice.

5. We identify and communicate factors of success regarding the way in which rigorous environmental and social standards can be implemented via sustainability innovations on a company, sectoral and national level in an economically successful manner.