

**BUSINESS AND SUSTAINABILITY  
IN THE EUROPEAN UNION**

*REPORT OF A CEPS TASK FORCE*

**CHAIRMAN: TOM GARVEY**

**RAPORTEURS: RICHARD ALMGREN  
WOLFGANG HAGER**

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**CHAIRMAN:**       **TOM GARVEY**  
FORMER DEPUTY DIRECTOR GENERAL  
DG ENVIRONMENT, EUROPEAN COMMISSION

**RAPPORTEURS:**   **RICHARD ALMGREN**  
ENVIRONMENT DIRECTOR  
CONFEDERATION OF SWEDISH ENTERPRISE

**WOLFGANG HAGER**  
SENIOR RESEARCH FELLOW, CEPS

*This report is based on discussions in a CEPS Task Force on Business and Sustainability in the EU. The members of the Task Force participated in extensive debate in the course of several meetings and submitted comments on earlier drafts of this report. Its contents contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position reached among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong. A list of participants and invited guests and speakers appears at the end of the report.*

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Centre for European Policy Studies  
Place du Congrès 1, B-1000 Brussels  
Tel: 32(0)2 229.39.11 Fax: 32(0)2 219.41.51  
E-mail: [info@ceps.be](mailto:info@ceps.be)  
Website: <http://www.ceps.be>

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## PREFACE

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Sustainable development is a concept that is both protean and widely discussed. The Task Force chose to limit its discussion to the growing experience within the business community of the pursuit of sustainability in the corporate sphere and the important role of business in contributing to both the design and implementation of a sustainability strategy in the European Union. We have seen this role as much more than simple compliance; rather, we believe it must be one of active engagement. Indeed, this is what the European Commission calls for in its working paper for the preparation of a European Strategy for sustainable development when it acknowledges that “Governments cannot deliver sustainable development on their own. Business, workers and civil society have an indispensable role to play” and then asks “How do we make this happen?”

This report responds to that question from a business perspective. Additionally we believe the full engagement of the business community will be better assured by bearing in mind the following key points:

- 1) Industry increasingly accepts the need to work towards the goals of sustainability; the Working Group sees the pursuit of the “triple bottom line” as totally compatible with the enhancement of long-term shareholder value.
- 2) Industry is willing to accept change, but that change should allow for well planned integration into its medium- and long-term plans.
- 3) Industry is part of society and generally wants to play a role as good citizen. However, while it can react intelligently to economic terms of reference, including those set by society, those terms of reference must themselves be intelligent, effective and communicated clearly.
- 4) Norms, standards and best practice influence the behaviour of industry, but not all provide socially optimal solutions and may inhibit technological change.
- 5) Industry needs incentives through clear market signals to improve its performance, including socio-economically justified fiscal incentives to SMEs to improve resource and eco-efficiency.
- 6) Industry needs an infrastructure of services which allow it to monitor environmental performance and specific resource use (water, energy, land, etc.) and which provide benchmarks for best practice.
- 7) Industry and business can contribute insider knowledge and experience on how markets can be best adapted to encourage sustainable behaviour by both business and consumers.
- 8) Companies that have instituted sustainability policies have found the need to change management practices towards horizontal lines of responsibility which allow a truly holistic approach.
- 9) These companies can share their experience with the public sector, which must also learn to devise integrated and consistent policies that cut across departmental boundaries.

Perhaps the single most important shared conclusion of the Task Force was that sustainable development will only be achieved in a democratic society on the basis of a radical change in the traditional structures of stakeholder dialogue. This was seen as the sine qua non for reaching the consensus on which political decisions must be based.

Tom Garvey  
Chairman of the Task Force

# **BUSINESS AND SUSTAINABILITY**

## **IN THE EUROPEAN UNION**

### ***REPORT OF A CEPS TASK FORCE***

#### **EXECUTIVE SUMMARY**

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**D**uring the spring of 2001, the European Commission outlined its new sustainability strategy, early drafts of which served as the basis of this CEPS Task Force. The group was less concerned with the details of the proposals than with the more fundamental problem of how such a strategy can be realised in a market economy. More particularly, it sought to identify the contribution that business can make to the success of a strategy that deals with the long-term as a concern of practical policy today.

It suggests that this concern should not be considered as an optional ethical obligation, but as prudent management of predictable trends. Today's 20-year olds expect to live for two "future generations". Moreover, many of the problems identified in the Commission's documents, notably demographic change, social exclusion, public health and a shrinking resource base, e.g. water and land, have an entirely practical medium-term impact on the sustainability of public finances. In short, while correcting known unsustainable trends is perhaps the most complex and far-reaching project of social change since the introduction of the modern welfare state, it must be dealt with as a practical utopia.

This report recognises that business is part of society and hence dependent on its environmental, social and economic sustainability. However, the key behavioural rule under which business must operate – the creation of shareholder value – seems to require maximising short-term benefits. On its own, the market rarely generates price signals that reflect the true long-term economic cost to nature, which sustains economic activity, and to a balanced welfare of society. Yet brutal correction of such market failures through regulation, even if they were politically possible, risks damaging the most efficient mechanism for resource allocation and change, the market itself.

Market failure is not, however, limited to the economic sphere. Democratically elected government are similarly caught in the trap of "short-termism", constrained by the rejection of changes in the status quo by the electorate and powerful groups in society. The public and private sectors must thus find new ways of fostering change that is both socially accepted and supportive of economic prosperity.

This report identifies two linked mechanisms which can help to accelerate evolutionary change towards sustainability: dialogue and stakeholder empowerment as a form of governance suited to this policy area; and the "sustainable company" as the vanguard of adjustment in the business world and partner in dialogue.

"Sustainable companies" seek competitive advantage and medium-term viability in responding to stakeholder values which *do* anticipate the long-term and neglected externalities. By adjusting R&D, product development, supplier relationships, etc. to standards that go well above compliance, they anticipate future government action and shifts in consumer behaviour. An increasing number of businesses now recognise that the pursuit of the "triple bottom line" financial, social and environmental value-added is wholly compatible with the aim of enhancing shareholder value.

Business has a head start in developing sustainability strategies and thus lessons to offer to the public sector. The key elements to success are strong leadership from the top, diffusion of the new approach to all levels of the organisation, the setting of detailed targets, and stakeholder dialogue. The result is often the discovery of innovative solutions that are not reduced to technological fixes but encompass the whole of business activity.

Sustainability requires radical changes. It involves all levels of government, all social forces, and every single business and every citizen. It would be an illusion to assume that such an effort can be “decided” by the conventional legislative processes of politics, and carried out using the executive instruments of the State and the Union. Rather, the scale of ambition inherent in the goals must be matched by an equally ambitious innovation of the means of execution.

European legislation, and especially the prospect of legislation, is indispensable in some areas, notably fiscal policy. But for most purposes, legislation is too slow and clumsy to get Europe moving fast enough towards sustainability (or the knowledge society). Legislation also hits the subsidiarity barrier far too early for a policy area involving grassroots change.

The Lisbon European Council speaks “an open method of coordination”. Coordination means that stakeholders are not just partners in dialogue, but agents of change in their own right. The stakeholders are the same as those identified in corporate sustainability strategies: public authorities at all levels, but also civil society organisations, and the citizen/consumer. Business is clearly a key stakeholder and agent for change. The related question of who can speak for the business community in a manner that avoids premature negotiation and that provides forward-looking perspectives is addressed in this report.

One of the “coordination” tasks to be performed at Union level is the establishment of indicators of performance at various levels – geographical, sectoral and corporate – which can also be the basis for targets of improvement. However, part of the public sector task is also to take a hard look at existing policies, including subsidies, that reward unsustainable behaviour. More generally, the unfinished Union agenda of the past decade aimed at increasing the flexibility of the European economy becomes even more relevant with the prospect of a self-imposed adjustment on the scale of the sustainability strategy.



CHAPTER 1  
INTRODUCTION

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*There is nothing more difficult to carry out, more doubtful of success, or more dangerous to handle, than to initiate a new order of things. For, those who would institute change have enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order.*

Nicolo Machiavelli

In March 2001, the Commission published a consultation paper on a Union Sustainability Strategy. In May there followed a draft policy paper to be adopted at the Gothenburg summit in June. The consultation paper invited public responses to a number of questions. No. 6 reads: “Government cannot deliver Sustainable Development on its own. Business, workers, and civil society have an indispensable role to play. How can we make this happen?” Above all, this report seek to provide some answers to this question while providing comments on most of the others along the way.

The CEPS Task Force did not set out to examine the philosophical or scientific foundations of sustainability, nor did it examine the merits of the Commission’s sustainability strategy, which exists at present in outline form only. The working assumption was that something along these lines will be adopted. The group then asked a narrow but strategically vital question: how can business become an active and constructive participant in perhaps the most complex and far-reaching project of social change since the introduction of the modern welfare state in the late 19<sup>th</sup> century?

The Brundtland report of 1987<sup>1</sup> defined sustainability as “development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs.”

Sustainability has two central elements that define it as a genuinely new departure in the global political economy:

- recognition of the long-term as a matter of practical concern, and
- the search for balance and synergies between three elements – the economic, social and environmental.<sup>2</sup>

The concept assumes that the economic, social and environmental aspects of social development are integrated and interdependent. Economic growth is necessary to meet social needs, such as education and health care. Similarly, education and social security are a prerequisite for economic activity. Economic resources are required in order to protect and take care of our environment, while meeting social and economic needs. Conversely, a clean environment, clean air and living forests are necessary for the economy to function in the long run.

The concern for the well-being of future generations is often stated as an ethical commitment and moral obligation. But today’s 20-year olds will be 50 in a generation – and expect to live for another 30 years after that. In developing countries, half the population may be under 16 years of age. It is thus not simply altruistic to be concerned for their future – sustainability affects the presently living, not the unborn implied in “future generations”. It is, ultimately, this “short-

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<sup>1</sup> *Our Common Future*, United Nations, New York, 1987.

<sup>2</sup> The magic triangle was first discovered in rain forest management, after straight “keep people out” strategies had failed. On a more political level, it was originally part of a North-South bargain struck at Rio, rather than a concept thought to be relevant to rich countries as such.

term” relevance that drives European governments to implement at least part of what may seem a utopian agenda.<sup>3</sup>

## 1.1 The emerging Union agenda

As a recent report<sup>4</sup> puts it: ‘There is probably no single government or other association of states with such a strong ‘constitutional’ commitment to sustainable development as that expressed in Articles 2 and 6 of the Amsterdam Treaty.’ Article 6 reads:

Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities referred to in Article 3, in particular with a view to promoting sustainable development.

While the “social” element of sustainability has not yet led to concrete policy proposals, the Commission’s proposal for a Sixth environmental action programme has already enlarged the scope of policy action beyond the traditional one of regulation, which appears only as the first of five “approaches”:

- Ensure the implementation of existing environmental legislation,
- Integrate environmental concerns into all relevant policy areas,
- Work closely with business and consumers to identify solutions,
- Ensure better and more accessible information on the environment for citizens and
- Develop a more environmentally conscious attitude towards land use.

Until recently, the major achievement was the commitment to a monitored process of the integration of the environment into other policy areas<sup>5</sup> decided at the Cardiff Summit of June 1998.

As the report of the Consultative Forum<sup>6</sup> puts it: “The level of ambition and innovation represented by the policy integration concept is state-of-the-art and could therefore be presented as a central contribution of the European Union to Rio +10”.<sup>7</sup>

Actually, the Commission’s new sustainability concept has moved beyond this approach. “Cardiff” is limited to one-to-one sectoral examinations and deals only with the environment in isolation from long-term social and economic sustainability issues.

At the end of March, in preparation for the Stockholm Summit, the Commission presented a consultative document and conceptual framework for a sustainability strategy, which is both narrower and wider than the general environmental agenda to be advanced in the Cardiff “integration” process. It is wider, because it includes a social component in the areas to be

<sup>3</sup> Insiders are convinced that the Montreal Protocol on ozone-depleting substances was concluded not only because of the catastrophic implications of depletion, e.g. on plankton and hence the world’s ecosystem, weather, etc., but because increased skin cancer rates were a present reality.

<sup>4</sup> “EU Sustainable Development Strategy. A Test Case for Good Governance”, position paper of the European Consultative Forum on the Environment and Sustainable Development, 30 October 2000, p. 1. Established at the initiative of the European Commission, the Forum includes corporate environmental officers from TetraPak and British Petroleum, but it is largely composed of leading academics, NGOs and senior national planning officers. See <http://europa.eu.int/comm/environment/forum>

<sup>5</sup> The Directorates formally concerned are Energy and Transport, Enterprise, Agriculture, Internal Market, Ecofin, Development, Fisheries and General Affairs. The absence of DG Environment and of Social Affairs makes this a list of the *banc des accusés*.

<sup>6</sup> “EU Sustainable Development Strategy”, op. cit.

<sup>7</sup> Rio + 10 refers to the World Summit for Sustainable Development (Johannesburg, 2002).

integrated in traditional economic policy. It is narrower, and at the same time more ambitious, because it targets a subset of both environmental and social issues defined by three criteria:

- Severity and potential irreversibility,
- Long-term and
- Cross-border and international relevance.

This has led to the identification of a limited number of policy problems:

- Self-replicating poverty and social exclusion,
- Demography/ageing, which raises i.a. unsustainable public finance issues,
- Climate change,
- Public health,
- Resources depletion and
- Land use and mobility.

There is no question that taking these concerns seriously will require deep-reaching changes in the way society lives and works. For example, the aforementioned Consultative Forum on the Environment and Sustainable Development calls for:

- an absolute de-coupling of GDP growth from resource consumption, emissions and waste;
- a reduction of energy consumption by a factor of four in one generation;
- a reduction of material consumption (dematerialisation) by a factor of ten by 2050;
- halting the destruction of soil properties by construction and
- protection of biological diversity of landscapes.

## **1.2 A role for business: From compliance to active engagement**

The CEPS Task Force is particularly concerned with the third of the “approaches” of the 6<sup>th</sup> Action programme, i.e. the contribution of business to the achievement of sustainability. Business is a key participant in any radical process of change, either pro-actively or as the object of regulation of its own activities and those of its customers.

The pro-active approach, which is examined in Chapter 3, is much more than the pre-emption of regulation familiar from negotiated voluntary agreements. It is a strategy by which companies seek to turn the challenges of the longer term into sources of profit. As the innovative Swiss company Sustainable Asset Management (SAM) puts it:

More and more companies are now turning to corporate sustainability as their new business approach. They integrate economic, environmental and social criteria into strategy and management. They pursue opportunities and manage risks that accompany sustainability trends. And they are creating long-term shareholder value by leading their industry with a strong commitment and superior performance in all these dimensions.<sup>8</sup>

The Canada-based International Institute for Sustainable Development (IISD) explains the dynamic of corporate interest:

Consumers demand that goods and services be produced by socially and environmentally responsible companies. Bankers and investors evaluate companies and make decisions, considering both environmental risks and environmental

<sup>8</sup> <http://www.sam-group.com/e/center/essentials.cfm>

market opportunities. Consequently, more companies are discovering the benefits of going beyond regulatory compliance, toward sustainability.<sup>9</sup>

A growing number of businesses are developing a methodology for such a strategy: the “triple bottom line”.<sup>10</sup> They monitor not just the financial results, but also the social and environmental value added by the company. This Task Force report looks at the economic rationale behind such strategies and identifies them as a potentially powerful tool to reach Rio-type sustainability faster, better and at lower adjustment costs. It also considers lessons to be learned by public decision-makers from corporate leaders in this area as well as the public policy framework that would encourage and reward such leadership.

Taking the International Chamber of Commerce’s Business Charter for Sustainable Development as evidence, there appears to be a perfect congruence between the Commission’s main objective and the commitment of business. Thus, the Charter’s principle no. 10 –the precautionary approach – commits signatories:

To modify the manufacture, marketing or use of products or services or the conduct of activities, consistent with scientific and technical understanding, to prevent serious or irreversible environmental degradation.

As the IISD points out, however, “such a broad commitment would have little practical value if it were not backed by a force which combines purely economic with social responsibility. That combination acknowledges not simply a concern about resource depletion/damage per se, but also a concern about business viability in the longer term.”<sup>11</sup>

That interest is sometimes referred to as the creation of a “sustainable company” – one that survives over time by responding to, and anticipating the needs and aspirations of its environment. The environment in question is not directly the physical or social one targeted by public policy, but the context for doing business defined by social actors – public authorities and people who value sustainability. It is this realisation that competitive advantage can be gained by anticipating a future, socially defined market, that acts as a potentially powerful force of real progress in the real economy.

Harnessing this force is a make-or-break condition for a true sustainability strategy – i.e. one in which change is real but prosperity is not jeopardised. Business is a potentially creative powerhouse of solutions that go beyond the merely technical. They include organisational and institutional “least-cost” solutions to sustainability issues. Such solutions inevitably involve the cooperation of stakeholders. Hence a well structured dialogue with stakeholders is an essential part of any successful sustainability strategy by business. It must become part of the strategy by public authorities as well. They will find a useful partner in the companies that have adopted sustainability strategies.

Ultimately, the market system only mobilises its full power if it acts in a decentralised way in response to perceived future opportunities and constraints. Nevertheless, an element of certainty is required before companies will risk breaking radically with the status quo. Stakeholder dialogue can narrow the range of uncertainty.

The Commission’s consultative paper stresses the up-side of such cooperation – win-win solutions. This does not mean that all sectors will prosper and no businesses fail in the process of adjustment to sustainability. By that standard, there would have been no trade liberalisation

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<sup>9</sup> <http://iisd.ca/>

<sup>10</sup> The term was coined by the consultancy/think tank SustainAbility, founded in 1987 (<http://www.sustainability.co.uk/>).

<sup>11</sup> Ibid.

and no deregulation of public monopolies. The win-win case most often cited – the export prospects for Europe’s eco-industry – may be the least important.

More important is improving the general eco-fitness of future exports: built-in qualities in plant and final goods that correspond to the future needs of presently more permissive markets. Even broader are the generalised effects of innovation as such, which are triggered by any “policy shock” such as the internal market. Innovation touches not just technology and business organisation, but public institutions and public policy.

The upside of successful sustainability strategies – for corporations and the economy – is one of the themes of this report. However, Machiavelli’s warning at the head of this chapter needs to be taken seriously. Leadership at all levels is the key to success.

## CHAPTER 2

### THE COMMISSION'S SUSTAINABILITY AGENDA

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Late in March, the Commission published a “consultation paper” on its website for the European Union’s strategy for sustainable development (SD). It sets out the analytical underpinnings for a strategy, but it is not yet the strategy itself. It nevertheless reveals some initial choices.

The first such choice is a set of three criteria that distinguish sustainability issues from other important problems facing decision-makers. They are:

- *Severity*. Do current trends pose a significant threat to our quality of life or threaten to significantly reduce our stocks of social, environmental and economic assets? Are the costs of doing nothing likely to be high or unevenly distributed?
- *The time dimension and irreversibility*. Is there a “slow burn” problem that worsens only gradually but that may be very costly or impossible to put right if action is left to a very late stage? Is there a significant inter-generational aspect?
- *A European dimension*. Is the problem common to a number of EU countries, or are there spillover effects between countries? Are policy responses likely to have implications going beyond national boundaries?

The second set of criteria – long-term and irreversibility – is clearly the key concept. The first criterion, severity, is probably less exclusive than it sounds, except in combination with the third, the European dimension. Together, these criteria can serve to block claims for attention in this particular context of threats to priceless but local assets, such as a particular nature reserve, a vanishing craft or language, or a particular industry.

By contrast, the “long-term” criterion, also referred as a “slow-burn” issue, has two functions. The first is the useful one of excluding a number of current “crises” from this particular policy. Indeed, a declared crisis shows that a problem is recognised and addressed by conventional politico-administrative mechanisms.

The second function of “long-term” is thus precisely to raise the policy status of problems that do not need to be solved today, in the sense that no government will be punished at the next election if it does not act, nor will the economy suffer. On the contrary, governments acting in the long-term interest risk being punished at the next election. The long-term is thus about this political “market failure” as well as the more familiar economic market failure. Correcting political market failure is an essential first step in summoning the political will to correct economic market failures.

As regards the “European” criterion, a crucial paragraph reads as follows:

Tackling these problems will require a coherent international approach by international organisations. However, *to provide credible and effective leadership in this global context the EU has to show it can make progress at home towards sustainable development*, as well as meet its international commitments. This paper therefore focuses squarely on policy reforms needed within Europe to enhance sustainable development.<sup>12</sup> (Italics added)

This reasoning pre-empts a common early argument against any policy imposing adjustment costs – its threat to competitiveness. Making action by one international actor conditional on actions by all gives a global veto to the slowest mover. This condition is explicit in the Kyoto

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<sup>12</sup> Ibid.

Protocol – but will be ignored by the European Union. However, the Consultation Paper acknowledges the need to complement its domestic sustainability strategy with a strong international counterpart, a task for which Rio+10 provides a concrete deadline.

Based on the three criteria, the Commission services propose the following six topics as priorities for inclusion in the European sustainable development strategy:

- *Climate change and clean energy.* This is the most obvious example of serious and irreversible change. The mention of clean energy is awkward, giving one of the solutions the status of a problem. It suggests a technical fix rather than the broad integrated approach otherwise advocated.
- *Public health.* Generally, the state of public health in Europe is not in irreversible decline. However, this heading refers to three largely unrelated problems that do fit the “slow-burn” criterion. One is the emergence of vaccine-resistant strains of contagious diseases. Another is endemic obesity caused by life style and foods. The fourth is particularly noteworthy from a business point of view: the low-level toxicity of thousands of new chemicals.
- *Management of natural resources.* This is the classic “limits to growth” issue, centred on three concrete areas of concern: fish stocks, bio-diversity and, somewhat awkwardly, waste. The latter problem is a well recognised threat to the present, not future, generations, although effects of continued growth on the aquatic environment may reach the level of irreversibility that justifies inclusion.
- *Poverty and social exclusion.* Here the unsustainability perspective breaks new ground, as it moves the problem of poverty from the traditional concept of social equity to “the risk of an underclass within which poverty replicates itself.” The potential aggravating role of the Union’s push toward the “knowledge-based economy” is recognised.
- *Ageing and demography.* The problem here is public finance and inter-generational conflicts. It is not clear that this issue suffers from policy neglect, since it is well recognised by most governments and “solved” in a succession of reforms within the limits of what is politically palatable. However, bold extensions to the range of instruments beyond the financial to include longer working lives may benefit from collective advocacy at the European level.
- *Mobility, land use and territorial development.* Related to several unsustainable outcomes – including transport congestion, greenhouse gas emissions and loss of country side – this area, together with climate change, is the single most important potential source of far-reaching and invasive “social engineering” involving citizens and industry alike.

## 2.1 Identifying policy added value

The utility of a sustainability policy at Union level may be seen in several areas:

- raising the profile of existing policies and strategies broadly supportive of SD;
- increasing pressure on the Commission’s own services;
- stimulating imaginative policy through a holistic, three-dimensional approach;
- providing a common benchmark for lower levels of government, put beyond the direct reach of Union policies by subsidiarity; and
- strengthening international credibility in the search for global solutions.

More generally, the Union has a unique institutional advantage in tackling long-term issues. Reference was earlier made to “political market failure” as a consequence of four- to five-year electoral cycles. Partly because the Union is a very imperfect democracy, it is not subject to the

same constraints. National governments come and go, but there is no cycle in the aggregate. Collectively, the Union is governed by a grand coalition whose agenda broadly evolves with, and reflects, informed opinion. This means that every time technocrats capture the political imagination of the top long enough to produce a commitment, they set in motion a ratchet effect which provides amazing staying power to projects as different as the internal market, the euro and even the ill-conceived<sup>13</sup> Trans-European Networks.

Sustainability is one of these ideas moving up the ratchet since its first, perhaps rhetorical, insertion into the Treaty. One crucial source of support within national governments are finance ministers with a strong interest in giving sustainability a high profile at European level as support for sensible policies at home. Most of the problems on the Commission's list – from public health to ageing, social exclusion or waste – would also render public finances unsustainable. Finance ministers are thus a crucial, powerful partner, turning a seemingly moral project into a practical utopia.

## 2.2 First sustainability initiatives

During the past few months, the Commission has already launched a series of initiatives that broadly support the as yet non-official sustainability agenda.

On 7 February 2001, the European Commission adopted a Green Paper on Integrated Product Policy (IPP) with the objective of launching a debate on the role and possible measures that could be taken on a European Union level.

IPP is an approach that begins by asking how the environmental performance of products can be improved in the most cost-effective way. It is founded on the consideration of the impacts of products throughout their life cycle, from the natural resources from which they come, through their use and marketing to their eventual disposal as waste.

Rather than limiting the focus of policy to regulating plant level pollution (as in the IPPC<sup>14</sup> approach), IPP presents a potentially much more serious threat to “business as usual”. It targets consumption as much as production. In a sustainability perspective, the materials-intensity of production as such becomes an issue. Eco-efficiency, in this sense, is not just “green technology”, but the search for more value with fewer transported, heated or otherwise manipulated molecules.<sup>15</sup> A key concept distinguishing this from pollution control is that of “diffuse” environmental impacts. The IPP approach can be seen as a way of moving from regulating pollution from point sources to a more comprehensive market-based approach.

A new method for considering these life-cycle aspects suggested by the IPP Green Paper is the planned establishment of “Product Panels”. These are to be composed of relevant stakeholders concerned with the product or product family in question. Although panels raise difficult questions regarding effective stakeholder representation (see Chapter 4), they can contribute to the development of better products if properly set up and used.

The White Paper on Chemicals Strategy, adopted on 13 February 2001, also targets diffuse, often sub-critical forms of environmental degradation that pose a threat in the aggregate and over time. The strategy includes registration of all chemicals marketed in the Union, a phase-out of carcinogenic substances, persistent organic pollutants and other “sustainability-relevant

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<sup>13</sup> This characterisation refers to the grand project announced by Delors in 1992, not the modest basic model of concerted network planning.

<sup>14</sup> Integrated Prevention and Control of [industrial] Pollution.

<sup>15</sup> In its comment on the Commission's paper, the World Business Council for Sustainable Development criticises the fact that the term “eco-efficiency” does not appear in the document. The reason, however, is that sustainability sets a higher target: minimising any materials use. See European Environmental Bureau et al., *EU Strategy for Sustainable Development. Stakeholders' Views*, April 2001.

compounds; risk-assessments of others; and a re-authorisation procedures. Stake-holder consultation is also identified here as a central part of this process. (See also the box in Chapter 5 below containing a case study of the chemicals stakeholder dialogue.)

The recent White Paper on liability<sup>16</sup> also contains a sustainability relevant innovation: the inclusion of “damage to nature” (as opposed to only property and people) as grounds for liability.

The Commission is also seeking to focus the critical examination of its own policies. The largely defensive reports by the Directorates targeted by Cardiff already threaten to reduce “integration into other policy areas” to a routine window-dressing exercise. Thus, in March the Commission adopted a series of action plans to integrate bio-diversity protection – a component of its sustainability short list – into the EU’s agriculture, fisheries, environment, and development and co-operation. While this may do little more than re-focus attention on existing legal commitments, notably the classic birds, habitat and environmental impact assessment directives, it usefully names and shames the Commission’s own services. A dedicated website,<sup>17</sup> grandly named “Clearing House Mechanism”, helps to advance the goal of transparency, which must be part of any sustainability agenda.

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<sup>16</sup> White Paper on Environmental Liability, adopted by the Commission 09.02.2000.

<sup>17</sup> <http://biodiversity-chm.eea.eu.int/>

CHAPTER 3  
**THE SUSTAINABLE CORPORATION**

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*The European model is a market economy, not a market society.*<sup>18</sup>

In order to situate the role of business in advancing the Union's sustainability agenda, it is important to realise that sustainability is at least superficially an illiberal project. An economist would define it as an intervention to correct market failures. It thus contradicts much of the thinking and institutional arrangements on which global governance and most of the European Union's regulations are based. Influential economists, notably in the US, deny that the long term is of particular concern, since prices, behaviour and technology will adjust in a series of incremental steps. Similarly, the rise of socially and economically dysfunctional populations – the core of social sustainability concerns – is best met with good governance which allows markets, including labour markets, to function efficiently.

Both these propositions are half right. Indeed, one of the virtues of the triple Rio concept is that it incorporates the economic – which means allocative efficiency – with the two other goals that are seemingly based on values.

It would be more accurate to say that they are based on valuations – experts second guessing the market which does not “price in” either the long term or social diseconomies. Both the “pure” and the corrected market can claim to improve efficiency.<sup>19</sup> The theoretical foundation for the latter – the existence of market failures, is not put in doubt by anyone. The liberal critique rests on the proposition that the cure is worse than the disease – there will always be a disproportionate loss in “classic” efficiency (through clumsy state intervention) for an at best marginal correction of market failures. Although this pessimism is less prevalent on this side of the Atlantic, it identifies a real problem that is central to the question of the role of business in SD strategy.

It is the essence of market failures that certain (real!) costs are not internalised, i.e. are not reflected in current market prices and thus do not figure in the calculus of business or consumers. Even under a do-nothing scenario, they do, in time, fall partially back on both – through added taxation on corporations or their customers, risk to capital assets or supply lines. But – with exceptions to be noted below – this feed-back loop is generally too slow and too fuzzy to act as a motor to instigate sustainable practices by business. On the other hand, in trying to establish the “true” price of a product or service, public authorities have no direct empirical evidence – they must rely on models.<sup>20</sup> Eco-nomy and Eco-logy share a common root: (good) *house* (keeping). Sustainability is about merging two methods for achieving efficiency.

There is a view that sees business as inherently unable to take account of long-term issues. This is patently false. True, quoted companies appear to be looking at quarterly results – units of measurement that represent 0.8% of the sustainability time scale of a generation. But corporate planning cycles are typically five years, R&D cycles twice that, while strategic examinations of a ten-year future are now common practice in large corporations.

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<sup>18</sup> Prime Minister Jospin cited by a former director of the CBI: Adair Turner, *Just Capital: The Liberal Economy*, Macmillan, 2001.

<sup>19</sup> One need not take recourse to ethics to seek to avoid the costly adjustments predicted in climate change scenarios, or the bankruptcy of public services from the health effects of certain social developments encouraged by the market.

<sup>20</sup> The growing incidence of asthma in children can be observed. Its negative value cannot be established with any precision. The precise contribution of a multiple chemicals brew to this condition is surrounded by uncertainty. The cost of banning certain chemicals is again unknown, since the capacity of the market to find substitutes emerges only over time.

Getting sustainability issues into these longer cycles is clearly the key to changing the course of economic development with minimum disruption and least costs. In fact, this process is further advanced than many realise.

### 3.1 Beyond compliance

The Task Force starts from the premise that systemic change of the magnitude required can only succeed with the active participation of business which, together with consumers, are the subjects of economic activity in a market economy. To this extent, it fully subscribes to the view of the International Chamber of Commerce:

It is industry that will meet the growing demands of consumers for goods and services. It is industry that develops and disseminates most of the world's technology. It is industry therefore that will be called upon to implement and finance a substantial part of governments' climate change policies.<sup>21</sup>

Although rejecting any implication that this role confers exclusive ownership<sup>22</sup> of the issue to business, the Task Force sees the market as a key element for success. Whatever macro re-allocation of economic activity may be required, the cost of achieving it would be prohibitive if the proven efficiency of microeconomic allocation were damaged. One of the virtues of the sustainability triptych is to insist not just on balancing the economic with social concerns, but to seek positive synergies between the three objectives.

In this search the Task Force has identified one real-world microeconomic mechanism – the “sustainable company” – where such synergies between the three objectives can be achieved to the mutual benefit of business and society. Without relying on altruism, good business management, properly understood, can yield a rich harvest in innovations and timely adjustments.

Corporate support for sustainability derives from a better understanding of the source of profits themselves. If the 1980s were the decade of the cost-cutters and unlockers of shareholder value, the current decade has re-discovered stakeholders as a source of, and risk to, long-term profits.

Solid and sustained support from modern quoted companies cannot be based on ethical commitments as such. Such commitments are the sole prerogative of owner-managers. Quoted companies are legally obliged to maximise shareholder value, i.e. profits. Some features of modern stock markets (and management reward systems) in practice reduce this broad obligation into a narrow concern with short-term profits only.

However, other substantial investors – the so-called institutional investors, as well as “value”-oriented private investors – do rely on long-term asset-value growth. Moreover, there is a growing number of companies that realise that they are part of society – and sink or swim with the sustainability of that society. It is in this area of intelligent and enlightened self-interest that a bridge can be found between raw capitalism and the “collective” pursuit of a sustainable future.

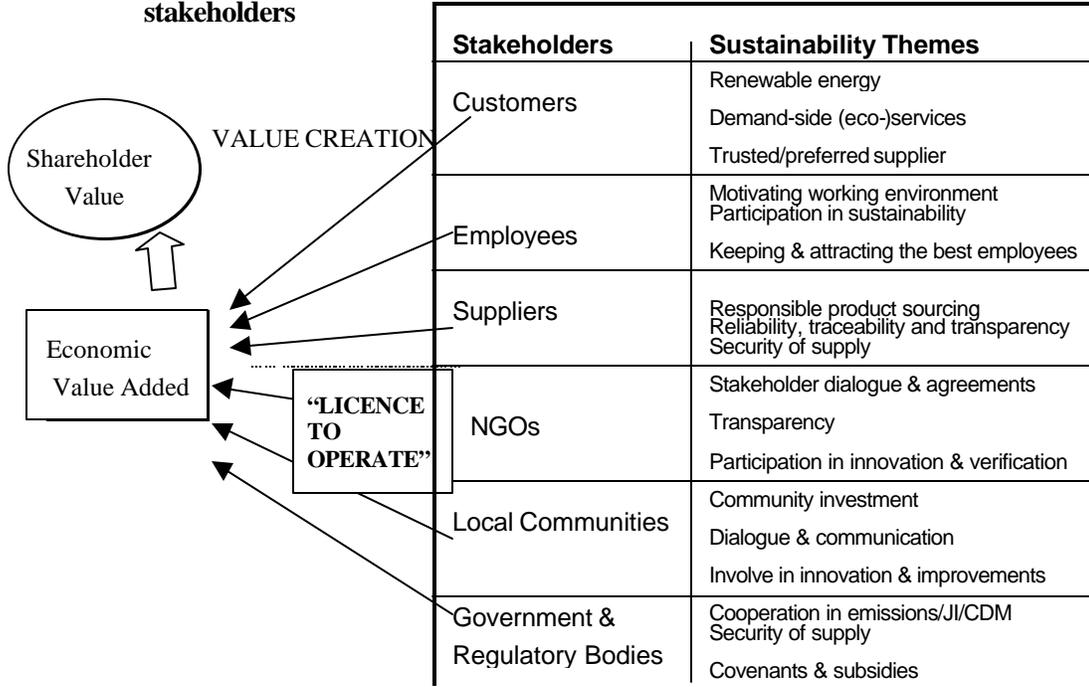
For our purposes, one important element in this broader management concept is the strategic role of the longer term as a source of competitive advantage: not the long-term of Rio-sustainability, but the next best thing: the sustainable company anticipates future shifts in public

<sup>21</sup> <http://www.iccwbo.org/sdcharter/features/workshop/>

<sup>22</sup> The Global Climate Coalition is very clear on this point: “It is imperative that climate policies focus on responsible voluntary actions, further research, innovation, and deployment of current and future technologies.” (First page at <http://www.globalclimate.org/>) This “leave it to us” approach, by itself denies the legitimacy of democratic government in an area where it has clear responsibilities.

regulation and social values which themselves are partially generated by Rio-type sustainability concerns.

**Figure 1. Corporations create shareholder value by balancing the interest of all stakeholders**



The schemes illustrated above shows some of the general elements of the model for corporate sustainability linked to social sustainability concerns. We thank Triple Value Strategy Consulting<sup>23</sup> for the right to reproduce their graphs.

The first element is the rediscovery of the stakeholder. While the corporation continues to pursue its sole statutory goal – shareholder value – in practice it changes behaviour in the pursuit of that goal.

The customer is no longer seen as a simple *homo oeconomicus* looking for the best quality at the lowest price, but (also) as a citizen endowed with values. One of these is concern over the environment and the social role of the corporation. This concern is, of course, wider than the agenda of Rio-type sustainability, but in practice the overlap is substantial. The corporate bottom line is improved by 1) an increased and more secure market share, possibly 2) premium pricing and 3) eco value-added products and services.

Employees are not just rewarded with money, but through a sense of purposeful, socially meaningful activity. The corporate bottom line benefits from increased productivity, reduced turnover and above all from the ability to recruit the most talented employees.

Suppliers, in this model, have a complex two-way role. In part they are merely the more or less willing executors of their upstream client’s corporate strategy, a logical consequence of its life-cycle analysis. This does not directly benefit the bottom line: it is a potentially restrictive and

<sup>23</sup> For more information, see their website (<http://www.triple-value.com>).

hence costly contribution to the overall credibility and effectiveness of a committed corporate sustainability strategy.

From the social point of view, the hierarchical organisation of the chain of value-added gives the “integrators” at the top enormous leverage over the much larger “virtual corporation” over which it presides. For while some of the competitive logic of the triple-value approach – the benefits of public image – works best for end-use providers with a high-profile presence in the market, the smaller, in this context anonymous, companies upstream are integrated in the sustainability strategies of the majors.

However, suppliers are also sources of innovation in technology and practice, allowing the systems houses to “buy into” best practice through their sourcing portfolio and improving their overall sustainability record at low cost. In other words, SMEs can and do obtain competitive advantage by anticipating the needs of their ultimate clients. The beauty of this client-supplier relationship is further enhanced by the fact that a supplier serving one advanced client automatically improves the sustainability performance of all its clients.

The last three stakeholders – NGOs, local communities, and governments – are all relevant to the bottom line because, together with consumers and workers, they can grant or refuse what is termed a “license to operate”. This concept includes the conventional technical permit, but goes well beyond this legal instrument. It is almost identical with the concept of long-term viability itself – the acceptance by social partners of the good faith of the company, which in turn facilitates products acceptance and investment on the ground.

One powerful incentive for corporations to adopt such strategies is the avoidance of risk.

In the United States, liability has long been a daily concern of companies in all areas of activity. Together with consumer safety/health issues, the environment represents the single biggest source of risk. Conversely, risk management has become arguably the most effective tool for enforcing environmental legislation in the United States, well ahead of EPA regulatory enforcement.<sup>24</sup>

The proposed European liability regime<sup>25</sup> is a great deal less dangerous, notably through excluding retroactive application and punitive damages. However, it breaks new ground by introducing the victimless crime: damage to nature. It also advocates so-called strict liability, including “non-fault” damages, which put a much more generalised onus of self-regulation on companies than compliance testing by legal departments.

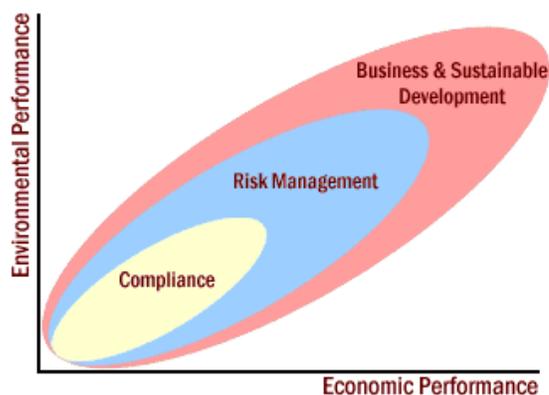
But the concept of risk as used by proponents of a stakeholder-based sustainability policy goes well beyond the legal. It includes avoiding major public relations disasters and more broadly, being avoiding or shortening contentious debates about products or investment plans requiring approval. Even more broadly, there is the risk to be in the wrong markets with the wrong products as the social environment evolves.

The importance of risk as a driver towards corporate sustainability is illustrated in the graph below.

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<sup>24</sup> In the US, liability has much broader effects than the specific sanctions provisions in regulation, since, in civil cases, there is virtually no limit to the imagination of plaintiffs and courts both as regards causality and damage awards. In other words, corporations can be held liable for actions that are or were legal when committed. This explains the willingness of US industry to sign up to the Super Fund, buying legal certainty at the price of taking responsibility for past pollution.

<sup>25</sup> White Paper on Environmental Liability, op. cit.

**Figure 2. Risk Management as SD policy**

Source: IISD (<http://iisd1.iisd.ca/business/journey.htm>).

### 3.2 Operationalising the triple bottom line

“Bottom line” is an accountant’s term for benefit net of cost. In theory, adopting a “triple bottom line” suggests an annual report that states net financial returns, plus the net balance between environmental damage and benefits, and ditto for the social area. Such triple accounting would not be very useful, as it would inevitably show a huge negative balance on the environment (resource use) and huge positive balance (employment, value of output) on the social side. One could, however, imagine such accounts using a zero-based approach, tracking annual net changes from the status quo.

Something along these lines is, in fact, observed in practice by companies adopting the triple bottom line approach. At the minimum, there is an internal audit on social value-added on the two dimensions, which forms the basis for a formal report in the annual accounts. It is this “gross” value added that is communicated to the outside world, an essential step if some of the benefits to the company itself are to be realised – those depending on image. However, best practice in reporting as advocated by the IISD and as practised, e.g. by BC Hydro,<sup>26</sup> includes explicit references to failures, such as toxic spills, as well as to the negative effects of planned business expansion.

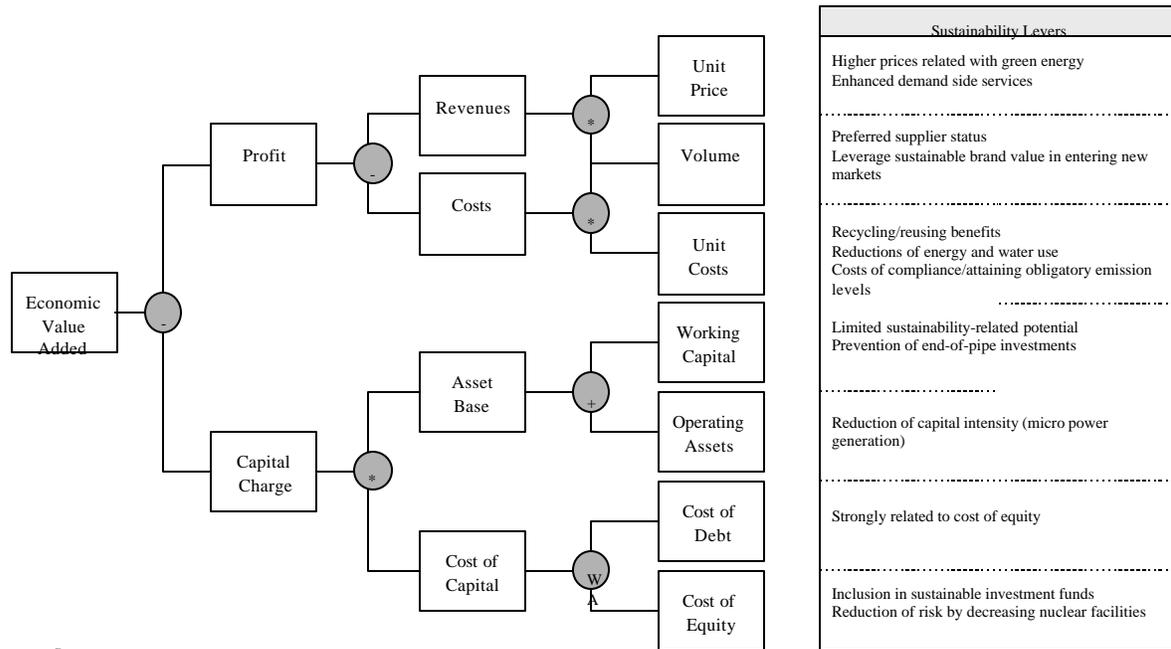
Accounting practices can, however, be refined in one important respect– quantifying the effect on the *financial* bottom line of social value creation and netting these against the financial cost of these initiatives. As communicated to us by Triple Value,<sup>27</sup> such an exercise has in fact been successfully carried out by some Dutch companies. Measuring social value-added in monetary equivalents will always remain an inexact science – like its public sector cousin, socio-economic return. However, the attempt to formalise a broadly based concept of value creation renders it more robust in internal corporate decision-making, where visionary strategists must do battle with the bean counters.

Like accounting, triple-bottom line accounting has a double function: external reporting and internal controlling. As concern over company sustainability grows, the controlling aspect becomes more important while also strengthening the credibility of the external reporting.

<sup>26</sup> <http://www.bchydro.bc.ca/environment/reports/triple.html>

<sup>27</sup> Triple Value Strategy Consulting, op. cit.

**Figure 3. A Systematic Approach to Sustainability: An Example from the Energy Sector**



Source: Triple Value Strategy Consulting.

If businesses are to remain viable in conventional terms while adjusting and contributing to the creation of an alternative future, there must be adaptations to the institutional framework, both private and public, within which business must operate. Using the market as an instrument directs attention to its functioning, notably transparency, price signals, fiscal and other incentives and disincentives, as well as institutional rigidities as obstacles to adjustment.

More generally, if political leaders – and, in its own areas of competence, the Commission – wish to provide credible leadership for sustainability, they must mobilise the kind of political courage that made the Internal Market and the euro possible. They must accelerate the programme of regulatory reform and also stop being owner-managers of utilities. As long as the present Common Agricultural Policy continues, there can be no credible leadership. As long as monopoly railways prevent, delay or sabotage efficient continental rail freight services, eco-taxes on fuel will simply raise costs. As long as there are widespread subsidies for the use of fossil fuels, leadership on climate change will lack credibility.

We start by looking at the institutional setting provided by finance before turning to the public sector contribution.

#### **4.1 The role of financial institutions**

The economic premise of the need for a sustainability strategy rests on the weakness or absence of market signals about the long-term and social costs of economic activity. Banks and insurance companies are specifically in the business of mediating between the short and the long term. It is thus natural to look there for early recognition of the long term in the practical conduct of their business.

Perhaps the best example is the recognition a decade ago by the re-insurance company, Swiss-Re, of the reality of climate change when much of business was still in a denial mode. The insurance industry in general has since followed the example.<sup>28</sup> The actuarial accounting of the future, which is at the heart of insurance, requires setting a price today on probabilities of the future and hence taking that future seriously. However, insurance companies put a monetary value on risk which, being entirely market driven, is devoid of any element of socio-economic costing.<sup>29</sup>

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<sup>28</sup> As in other areas, like auto theft, insurance companies have an ambiguous attitude towards disasters. On the one hand, their business depends on disaster striking with some frequency to encourage custom; on the other, existing policies become more profitable if customers, industry or governments reduce the incidence.

<sup>29</sup> To the extent that rising insurance rates provide market signals, they do so in selected markets, notably real estate, major works and infrastructure. They do not, in themselves, trigger policy adjustment. Rather, theory would predict activities shifting, at the margin, from exposed geographical areas to those less likely to suffer. The role of this price signal is thus to lower the cost of passive adjustment to the extent that costly investment mistakes are avoided. On the other hand, the insurance industry's view of, e.g. the probability of climate change and its economic consequences, adds the voice of a mainstream business sector to those of scientists, NGOs and governments.

The role of banks is more complex. Like insurance, banks put a price on the risk of future events – in this case those affecting the soundness of investments. Accordingly, industrial lending is beginning to take account of the exposure of activities to sustainability risks and/or of management’s ability to pre-empt such risks. As regards environmental liability, such “due diligence” has long been routine in the US, but is also being adopted in Europe. Its value to the economy, like due diligence in general, is to provide a thorough, because interested, check on company performance – in this case mostly SMEs. It thus may diffuse current best practice faster than otherwise, making a small but real contribution to sustainability.

***Example: FöreningsSparbanken***

This Swedish savings and loan bank has developed a PC-based environmental analysis model used in SME loan applications in all its branches. While serving as a risk management tool for the bank, it is also used as a basis for dialogue with the loan applicant encouraging him to improve management practices.

***Sustainability responses in capital and equity markets***

A more general approach is the translation, in banking terms, of the “sustainable company” logic described earlier. Here, the banks, and indeed the financial markets in general, judge a company’s long-term prospects not just in the usual categories, but include judgement on management’s ability to cope with the evolving social and regulatory environment. This judgement then feeds into either credit ratings or equity valuations – in either case affecting the cost of capital.

There is a growing number of information sources now available in the financial markets to monitor sustainability performance. Transparency is less than it might be, however, since many of these sources serve in part a different purpose: that of guiding customers in the niche markets for “ethical investment”.

However, information sources that focus on sustainability as such are becoming available. They include eco-rating services such as the London-based Ethical Investment Research and Information Service (EIRIS) and the Swiss Sustainable Asset Management (SAM).<sup>30</sup>

SAM was the first to take up an offer by Dow Jones to contribute to its existing portfolio of specialised indices by constructing a sustainability index of corporate performance. The resulting Dow Jones Sustainability Group (DJSI) was launched in September 1999, followed by a separate European index. More than twenty-five financial institutions are managing approximately €1.5 billion based on the DJSI. The total value of the shares of the selected companies may be a thousand times higher.

A higher-profile index to be launched by the Financial Times and the London Stock Exchange in July, “FTSE4Good”, while based on “ethics” rather than sustainability, will provide broad incentives to companies to improve their strategies. A change in British law obliging Pension Funds to disclose whether they consider environmental, social or ethical issues in their investment choices will provide further leverage.

The ethical market is served by an increasing number of unit trusts. These tend to exclude companies on a variety of grounds while not necessarily rewarding sector-specific sustainability performance. However, identifying “active engagement” by companies has become a recognised objective of rating agencies. “Active engagement” – going beyond compliance and beyond PR-effective good deeds – is another term for sustainable corporate performance in the terms used in this report, i.e. shaping the future by anticipating the future.

<sup>30</sup> <http://www.sam-group.com/>

### **Public banks**

Public investment banks, other than international financial institutions (IFIs), are a dying breed. IFIs, however, are disproportionately engaged in the most long-term markets, i.e. infrastructure. Another part of the public credit market – municipal bonds with similarly long tenures of up to 30 years – add more volume to the long-term credit market. Infrastructure has broad effects on the way the economy is organised – what is called in French *effet structurant* – notably in the area of “transport/land-use” from the Commission’s priority list.

While sovereign-debt financed investments may be amortised in “only” 20 or 30 years, the actual roads, railway lines, subway systems, power or gas grids so financed are expected to have a useful life of 50 years or more. These, then, are inherently investments for “future generations”. Can long-term sustainability concerns be financially “engineered” into the investment decision?

In contrast to private productive investment, public investment can and does take account of socio-economic returns – benefits to the citizen/taxpayer and the economy at large rather than just financial returns accruing to the project itself.<sup>31</sup> Thus, there may be an opportunity to adjust the valuation methodology to take account of “future-proofing” the economy as part of the benefit stream.

The EIB is reported to be reflecting on these matters. It already supports the Commission’s sustainable transport strategy by financing rail and public transport investment projects with often poor conventional bankability.

## **4.2 A new model of governance**

Improving the market framework for change through transparency, clear price signals, incentives and the removal of obstacles direct involves the public sector at all levels. Most generally, the conventional agenda of structural reforms which has dominated the last twenty years does not become less but more relevant. A Europe mired in structural unemployment on the present scale cannot mobilise the resources or will to support change.

The search for innovative governance which would allow European society to “get things done” must be seen as a distinct and new theme in the general, rather “constitutional” governance debate triggered by enlargement and concerning the distribution of powers among European institutions. Getting things done is not in the first instance about power, but about leadership, information and management reform. That reform of public governance is an ongoing process, not limited to ICGs or indeed the Union’s institutions.

The concept of sustainability is inevitably radical and requires radical changes. It involves all levels of government, all social forces, and every single business and every citizen. It would be an illusion to assume that such an effort can be “decided” by the conventional legislative processes of politics, and carried out using the executive instruments of the State and the Union. Rather, the scale of ambition inherent in the goals must be matched by an equally ambitious innovation of the means of execution.

European legislation, and especially the prospect of legislation, is indispensable in some areas, notably fiscal policy where power at the centre must be increased if Europe is to use this market-conformance tool for change and rely less on regulation. But for most purposes, legislation is too slow and clumsy to get Europe moving fast enough towards sustainability (or the knowledge society). A decade can pass between proposal, adoption, national transposition

<sup>31</sup> Socio-economic analysis seeks to translate diffused economic advantages into monetary terms, preferably related to economic growth, which raises the tax base from which authorities repay the loan.

and actual implementation. Legislation also hits the subsidiarity barrier far too early for a policy area involving grassroots change.

After Lisbon, the Portuguese Prime Minister Gueterres spoke in simple but crucial terms of “an open method of coordination”. Coordination means that stakeholders are not just partners in dialogue, but agents of change in their own right. The stakeholders are the same as those identified in corporate sustainability strategies: public authorities at all levels, but also civil society organisations and the citizen/consumer. Business is clearly a key stakeholder and agent for change. If this is neo-corporatism (see Martin Wolf’s remark in the box), then we must accept that “there is no such thing as society”.

As regards Europe, the key elements of an innovative strategy for the pursuit of the collective public interest on the scale of sustainability (and the knowledge society!) are:

1) Strong and sustained leadership at the top as the prime political task. In an EU context, this means above all the Council acting as a College. Sustainability must not be seen as another interfering policy imposed by “the Brussels bureaucracy”, but the project of the Union – of European society taking charge of its own future. Passing “ownership” of good ideas to politicians was one of the key methods of Jean Monnet.

2) Legislation – the formal exercise of power – is not the first order of business, but follows after a large social consensus has identified promising policy fields and *if* these initiatives are shown to require, inter alia, a legal framework at European level. “Getting things done” must be the only criterion for choosing implementation instruments.

3) The Commission gains an enormous workload, as it must provide the practical underpinnings, and most importantly data, to allow the setting of concrete and verifiable targets, developing benchmarks and devising indicators of performance at sector and company level. It must also help to diffuse best practice and in general encourage rather than impose change. Providing analysis and policy ideas respecting the three dimensions of sustainability will require new structures, while implementing “coordination” requires careful selection of pro-active managers rather than dossier managers.

4) Policies, including social sustainability policies, must as much as possible work through market mechanisms, even when their purpose is to correct market failures. Such an approach is dictated both by the need for efficiency and the need for innovation – i.e. solutions that cannot be centrally imagined but emerge from a thousand responses from public and private organisations, associations and increasingly the citizen.

5) The market context is shaped towards sustainability outcomes by the action of all stakeholders, which set formal, organisational and simply behavioural parameters for business. Only companies that correctly anticipate this evolving market framework will survive by the end of the decade.

**A liberal critique**  
 “Since elected governments are wrongly deemed powerless, it is suggested instead that only concerted action can achieve global goals on which every right-thinking person is supposed to agree. But this is global neo-corporatism. As such it is subversive of individual freedom and democratic accountability...”  
 Martin Wolf, FT  
 16 May 2001

***Dialogue: Making the future more transparent***

Implementation of the Commission’s sustainability strategy, particularly its environmental dimension, will have a profound affect on EU industry and hence the economy in general. There is a potentially considerable downside through costly adjustments to production processes, product re-design and outright loss of markets for particular products and services in the

domestic economy. There may even be a short-term threat to some exports, as local products no longer correspond to the preferences of customers abroad.

The key point affecting the cost of adjustment to products and processes is the time scale involved and more particularly the leads and lags between regulation and the planning cycles of industry. There is always an ongoing process of scrapping and rejuvenation of capital stock simply to keep up with conventional technical progress. Similarly, there is a constant adjustment to the design and function of final goods. It is thus not change that is expensive or new, but unexpected change that turns existing productive capital into scrap and leaves companies with unsaleable product lines.

Creating a greater degree of certainty – which includes agreement on feasible and therefore credible adjustment paths is the prime function of stakeholder dialogue which the Commission considers central to its sustainability strategy. The issue is further explored in Chapter 5.

### 4.3 Developing tomorrow’s technologies

Greater certainty as regards the medium-term and long-term framework for business decisions is particularly important for &D, the critical, and non-compressible element in creating economically feasible alternatives. Producers and consumers cannot turn to alternatives that do not exist. It is a tribute to European industry that in most companies, significant amounts of R&D are already devoted to alternative technologies – sometimes, as with hydrogen technology, only expected to become relevant in some 30 years time. The task of a sustainability strategy is to re-enforce this R&D anticipation of the future and, more importantly, to hasten the move from research to demonstration and product launch.

The speed with which the seeds of new products are moved from the potting shed to the garden depends on several factors. One of these is an “announced future” that is credible. Another is, however, the reduction of structural rigidities that generally hamper adjustment in Europe, and would surely put a – both physical, economic and political – brake on any additional adjustment required by sustainability.

Two examples illustrate the importance of single companies taking the lead early in order to provide real products for a future market. Volkswagen now expects to produce 7000 3-litre Lupos this year. This will hardly make a dent in global greenhouse gas emissions. But when price signals and consumer preference change, there will be a mature product on the market with by then years of manufacturing experience and design improvements incorporated. Similarly, BP started in the early 1980s to invest in solar energy. Today, Solar BP Solar has a turnover of \$ 200 million. But by 2007 it expects sales of \$1 billion, again well positioned on an engineering and marketing learning curve.

#### *Example: Vattenfall*

One of the first companies to carry out an in-depth, comprehensive life-cycle inventory for electricity generation is the Swedish energy firm Vattenfall. All resource consumption (metal, chemicals, energy, etc.) has been quantified along with all emissions, regardless of where in the world they occur, including even those from construction, demolition and waste management. The inventory provides a good basis for assessing resource consumption, effects on health, the greenhouse effect, acidification, etc.

### 4.4 Lessons from corporate sustainability

While the European Union is yet at the Working Document stage of implementing a sustainability strategy, a growing number of businesses – some of them members of our Task Force – have years of practical experience in moving from concept to implementation. There are some lessons to be learned, both by other businesses and above all, government itself.

The first and important lesson is that change of this magnitude will not occur without

commitment by the chief executive and key members of the board of directors. By its very nature, a sustainability strategy touches the way things are done in all departments. It also not infrequently requires seeing normally separated management areas in a different integrated context. Much like when European Commission was faced with the challenge of “integrating into other policy areas”, the chief executive must not only broaden the thinking of narrowly focused line managers, but must also mediate the struggles for power and competencies which are the daily life of bureaucracies.

When this change has been entirely internalised, one can speak of a new corporate culture. The Swedish energy company, Vattenfall, has embedded sustainability so deeply in its normal management procedures<sup>32</sup> that it no longer has an environmental department. The results of internal auditing (all subsidiaries are EMAS-certified) are used by top management directly to provide continuous leadership in the company.

Experience shows that the move towards a robust sustainability policy occurs in stages, at the beginning of which stands a rhetorical commitment by the company. It quickly becomes apparent that a statement of company philosophy is greeted by cynicism by the outside<sup>33</sup> and indifference by management and employees. Outsiders – NGOs – may also use the fine words as an embarrassing test of the company’s real performance. At this stage, real management tools have to be introduced.

One of these has been described in the previous chapter: the internal audit of all activities building on the standard set by EMAS, but integrating the environmental and economic dimension. The EU’s “Cardiff” process partially fulfils that function. For both companies and Commission directorates, there is a tendency to report initially only the positive – small improvements or initiatives at the margin, without a hard look at familiar core practices. For corporations, such core practices may be the location of warehouses and just-in-time practices in logistics, which induce extra transport for small savings in capital costs. Surprisingly, it is car companies such as Volvo and Volkswagen that years ago transferred much of their logistics to rail and short-sea shipping. For the Commission, it would mean, e.g. taking a hard and detailed look at the CAP under sustainability criteria – something implied in the Commission’s SD working document. But a serious internal audit of Union policies would need to involve all regulations and all financial subsidies, including the Structural Funds.

Business also offers lessons on how to move from auditing, which tells you what you are already doing, to improvement. Here, the establishment of *measurable goals* in each and every area of corporate practice plays a crucial role. For instance, wood-using industries may commit themselves to increase by sourcing from sustainable forests by precise percentages in a set number of years. This gives the company time to adjust their supply chain and, often, develop products and marketing strategies that do without, e.g. tropical timber. It also gives suppliers time to adjust practices and obtain certification from the NGOs offering such services.

The setting of goals presupposes the existence of units of measurement – indices. This is relatively easy in some areas – the use of non-bleached paper in corporate offices, the proportion of oil transported in double-hulled tankers – but quite complex in others. Complexity often arises from a closer look at life-cycle implications of positive change in a targeted category. The extra transport generated by sophisticated recycling is a familiar example.

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<sup>32</sup> This includes EMAS procedures (the voluntary Community eco-management and audit scheme (EMAS) set up under Council Regulation (EEC) No 1836/93 of 29 June 1993) and ISO.

<sup>33</sup> A sceptical view can be illustrated by the following quotation from The Guardian: “Many companies have been enthusiastic public supporters of the concept of sustainable development, while privately lobbying against the development of robust regulations promoting more sustainable business practice.”

Business has found that it needed to rethink organisational charts to induce a holistic thinking across previously separate lines of responsibilities and to commit different actors to specific common goal sanctioned at management board levels. For the European Commission, with a well developed culture of inter-DG rivalry, such a structure will be difficult to achieve. Nevertheless, business has found that goal-setting at the top does not produce results unless followed by rethinking systems of reporting and responsibility on a horizontal rather than vertical basis.

One concrete management tool for making sustainability “real” in corporate life is to reward managers for good performance on this dimension.

Another important road travelled by business in the last decade is to proceed from stakeholder dialogue to stakeholder partnerships, e.g. in forest management and fisheries. These have moved from certification to a joint reflection on realistic paths to achieving desirable goals, followed by, in some cases, “outsourcing” of the execution of joint strategies. As pointed out in the previous section, for the European Union, the model of stakeholder partnerships, notably including industry, is of even greater significance.

## 5.1 Avoiding defensive stalemate

Consensus and transparency are essential initial conditions to activate a broad process of social mobilisation. Stakeholder dialogue thus becomes part of a successful sustainability strategy. What must be avoided at an early stage is the constellation familiar from traditional environmental regulation, with (organised) business mobilised to resist as long as possible (e.g. the introduction of catalytic converters or phasing out ozone-depleting substances) while NGOs chastise authorities for not going far and fast enough.

Nevertheless, business has to add a specific voice to this dialogue, reflecting its legitimate interests and knowledge. Goals particularly important to business are acquiring:

- a degree of certainty regarding the evolution of the public policy framework;<sup>34</sup>
- a voice on the least-cost methods for achieving goals and
- a chance to critique existing public policies that act as an obstacle to structural change or indeed actively undermine sustainability.

Contradictory regulations and subsidies, some of which encourage while other punish sustainable behaviour, are one such obstacle that needs to be reviewed by, among others, the Commission.

More generally, if political leaders – and, in its own areas of competence, the Commission – wish to provide credible leadership for sustainability, they must mobilise the kind of political courage that made the Internal Market and the euro possible. This means putting their own houses in order. Governments must accelerate the programme of regulatory reform and also desist from being owner-managers of utilities. As long as the present CAP continues, there can be no credible leadership. As long as monopoly railways prevent, delay or sabotage efficient continental rail freight services, eco-taxes on fuel will simply raise costs.

## 5.2 Dialogue with whom?

Advocating dialogue raises the question of who speaks for industry. Trade associations are frequently bound by what is often the lowest common denominator of their members' views.<sup>35</sup> The alternative is direct representation by selected companies. The logic of this report suggests that company selection should be based on proven commitment to sustainability. But who is the judge?

Companies could formally certify themselves by forming an association committed to sustainability, such as the UK Sustainable Business Forum or the US Business Environmental Leadership Council, which would become the preferred partner of the Commission. The World

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<sup>34</sup> A passage from the ICC on Kyoto is of more general relevance: "One thing that business would like to see come out of The Hague is clarity about where it stands. Time will be needed to adjust business development and investment plans, to assess market impact. Countries will enter the first period of legally-binding emissions reductions in 2008, provided enough have ratified, and eight years is well within medium-term corporate planning cycles."

([http://www.iccwbo.org/sdcharter/news\\_archives/2000/mccormick\\_hague.asp](http://www.iccwbo.org/sdcharter/news_archives/2000/mccormick_hague.asp))

<sup>35</sup> "Pioneers don't fight hard enough for the win-win-win outcomes that would help so much along the road to sustainability, and more often than not the reprobates are ably supported by a host of trade associations that are only too happy to plumb the depths of the lowest common denominator amongst their members." Jonathan Porritt.

Business Council for Sustainable Development (WBCSD) which describes itself as “a coalition of some 150 international companies united by a shared commitment to sustainable development, i.e. environmental protection, social equity and economic growth.” is another example.<sup>36</sup>

Membership of a *European Sustainable Business Council* would not just be assured by a commitment to a charter of principles, but by actual and proven practices on the ground. A small group of first movers could constitute the core of the Forum, co-opting future members. While large corporations have a unique strategic role, there must be room for representative, innovative medium-sized enterprises in such a forum. Once membership has reached 50, further members will only be able to join at associated status, with a chance to move to the top tier through mechanisms to be decided by the Forum. The European Round Table (ERT) has shown that exit strategies for less committed members can be made to work.

**Case Study: Chemicals** (From EurActiv)  
**“Fruitful stakeholder conference on chemicals review”**

NGOs and industry representatives agree on the main objectives and orientations of the EU’s review of chemicals policy. That was the outcome of a well attended and successful stakeholder conference organised by DG Enterprise and DG Environment on the White Paper “Strategy for a Future Chemicals Policy”.

The Chemicals White Paper was published on 13 February 2001 and defines the Commission’s intentions to revise the current legislation on chemicals by introducing a single coherent system of registration, evaluation and authorisation (“REACH”) of chemical substances. The new system, which would be introduced over a period of 11 years, should provide a high level of protection of human health and the environment. It will also encourage the substitution of dangerous by less dangerous ones, meet international obligations and reverse the burden of proof to industry, while at the same time enhancing the European chemicals industry’s competitiveness and innovation.

Environment Commissioner Wallström said in a press conference that the new system would cause an extra cost for industry of 0.1%, spread over 11 years, and this for an industry with a yearly turnover of more than 400 billion euro.

Although the stakeholders agree on the main objectives of the chemicals review, serious differences of opinion remain on the actual implementation of the new system. Some of the most controversial issues are:

- the authorisation scheme for substances of particular concern (CMR substances and POPs)
- the scope of the future legislation (PTBs Persistent, Bioaccumulative and Toxic substances and VPVBs very persistent and very bioaccumulative substances are not included)
- the timescale of 11 years
- the division of responsibilities between the Commission, the Central Entity (an expanded European Chemicals Bureau) and the Member States
- sanctions.

Source: EurActiv, 5 April 2001 (<http://www.euractiv.com/cgi-bin/eurb/cgint.exe/>).

On the lines of the ERT, chief executives would form the highest executive organ of such an association, delegating “sherpas” from headquarters as their personal representatives at the working level. Perhaps twice a year, the Forum would meet with the Commission at

<sup>36</sup> see <http://www.wbcds.org/whatis.htm>.

Commissioner level. NGOs, represented by their Executive Directors, should have a similar occasion to meet bilaterally, and in a trilateral context, to help advance strategic consensus.

Agenda-setting and preparation are crucial ingredients for the success of a dialogue. Both these tasks have a political and a technical/scientific component. The International Panel on Climate Change has proven the utility of a neutral scientific “court” to establish the facts, even though the process became heavily politicised. The dialogue is not an international negotiation and will take place within a narrower spread of cultural and economic values and interests. It remains important, however, to separate as much as possible “neutral” assessments from interest-based valuations of facts and the effects of policies.

CHAPTER 6  
CONCLUSIONS

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This report seeks to identify avenues for a constructive engagement by industry and business in general in the sustainability strategy being developed by the European Commission. In particular, it has tried to cut the Gordian knot that seemingly ties industry to short-term profit-maximising goals – and which also dominates the agenda of trade associations.

It recognises that the long-term is only beginning to generate market signals in the traditional demand-supply dimension, for instance in the insurance market. Generally, the market, by itself, does not generate such signals with regard to both free goods – nature – and social externalities of human activities. Yet brutal correction of such market failures through regulation, even if they were politically possible, risks damaging the most efficient mechanism for resource allocation and change, the market itself.

This conundrum can be mitigated by a social mechanism that translates future states of the economy into present realities and hence present markets. This mechanism depends on the intelligent and voluntarist interaction of three actors: citizen-consumers, governments and corporations.

“Sustainable companies” seek competitive advantage and medium-term viability in responding to stakeholder values which *do* anticipate the long-term and neglected externalities; by anticipating future government action and shifts in stakeholder values. Business now recognises that the pursuit of the “triple bottom line” is wholly compatible with the aim of enhancing shareholder value.

Anticipation is the key concept. It helps to synchronise the pace of voluntarist change with the natural rate of change in the economy, R&D schedules, capital replacement schedules and product development. In short, it significantly reduces adjustment costs in the medium term.

Voluntarist means goal-seeking behaviour. It is not the same as voluntary, which implies selective accommodation to public goals, often as an alternative to government action. The success of the sustainable company ultimately depends on government and society “getting serious”. This is when early-mover status pays off: being there while others have to scramble to get back into the game. Changing the goal posts is a legitimate part of the public agenda. The sustainable company anticipates this change and can help to define it. The early mover sets the standard and reaps the market.<sup>37</sup>

It is here that the twin proposals of this study – to encourage the early movers and to create a common stakeholder commitment to the future – become so important. Anticipating the future is the game of the sustainable company. Defining that future credibly is the task of stakeholder dialogue. Following through on the policy agenda is a shared task. In such a comparatively unstructured policy setting, leadership becomes the single most important quality.

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<sup>37</sup> “My organisation is run by Greenpeace today and it my job to ensure that Greenpeace is running yours tomorrow.” CEO of an Australian mining company, as quoted by Martin Wolf, *FT*, May 16, 2002. Wolf translates: “there will be great pressure from ‘socially responsible’ companies to impose the costs they have accepted voluntarily on their competitors.”

## MEMBERS OF THE CEPS TASK FORCE AND INVITED GUESTS AND SPEAKERS

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Chairman: Tom Garvey  
Former Deputy Director General, DG Environment  
European Commission

Rapporteurs: Richard Almgren  
Environmental Director  
Confederation of Swedish Enterprise

Wolfgang Hager  
Senior Research Fellow  
CEPS

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Elisabeth Alteköster  
Head of Office  
Volkswagen Liaison Office

Salvatore Gabola  
Director Public Affairs  
Coca-Cola Greater Europe

Frank Bill  
Director Environment  
Confederation of Danish Industries

Lena Gevert  
Director Environmental Affairs  
Volvo

Piero Biscari  
Advisor EU Affairs  
Exxon Mobil

Hannalena Ivarsson  
Consultant  
Kreab

Per Bondesen  
Senior Officer  
European Free Trade Association (EFTA)

Staffan Jerneck  
Deputy Director & Director of  
Corporate Relations  
CEPS

Walter Brinkmann  
European Affairs Consultant

Sven Jonsson  
Policy Adviser  
Federation of Swedish Farmers

Peter Carter  
Environment Coordinator  
Projects Directorate  
European Investment Bank

Pierre Laconte  
President  
Foundation for the Urban Environment

Robert Constans  
Climate Change Officer  
Total Fina Elf

Britt-Marie Lundh  
Environment Manager  
FöreningsSparbanken

Marie Delafargue  
Deputy Manager EU Corporate Affairs  
Michelin

Bertrand Maus de Rolley  
European Affairs Senior Officer  
Total Fina Elf

Suzanne Fuhrmann  
Fondée de pouvoirs  
European Investment Bank

Geoffrey Moreels  
E-FETS, Project Manager  
SCA

Katarzyna Nowaczyk  
Research Assistant  
CEPS

Per Sjöström  
Environmental Manager  
Vattenfall

Henrik Persson  
Director  
Volvo Group

Christina Tapper  
Coordinator European Affairs  
Vattenfall

Britt Sahleström  
Corp Man Environmental Strategies  
Birka Energi

Andrew Van Chau  
Senior Political Adviser  
BP Europe

Anna Wahlberg  
Birka Energi

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### Invited Speakers and Guests

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Henning Arp  
Member of Cabinet of Margot Wallström  
European Commission

Tom Jones  
Principal Administrator  
Economics Division, Environment  
Directorate  
OECD

Michel Biart  
Principal Administrator  
DG Employment and Social Affairs  
European Commission

Jean-Claude Lahaut  
Manager of European Public Affairs  
Solvay

Antonia Carparelli  
Deputy Head  
Cabinet of Margot Wallström  
European Commission

Tony Long  
Director  
WWF-EPO

Willy De Backer  
Editor  
Euractiv.com

Lucio Pench  
Adviser Forward Studies Unit  
European Commission

Karl Doutlik  
Head of Unit  
Environmental Aspects of Enterprise policy  
DG Enterprise  
European Commission

Elena Saraceno  
Prodi's Group  
European Commission

Katja Gehne  
Stagiaire, Forward Studies Unit  
European Commission

Ulf Svidén  
Environmental Counsellor  
Permanent Representation of Sweden  
to the EU

Stephen White  
DG Environment  
European Commission