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Briefing Paper

New Ambitions for Europe - Select contributions for the Annual Meeting 2020

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World Economic Forum
91-93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland
Tel.: +41 (0)22 869 1212
Fax: +41 (0)22 786 2744
Email: contact@weforum.org
www.weforum.org

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Introduction

Børge Brende, President of the World Economic Forum

Martina Larkin, Member of the Executive Committee, Head of Europe and Eurasia, World Economic Forum

As Europe enters the new decade, the region faces exciting opportunities as well as profound risks. A majority of Europeans continue to express support for their country's EU membership,[1] but Europe still faces the disintegrating forces of Brexit, populism, widespread concern about climate change, persistent inequality within and between member states and an increasingly turbulent global economy with trade-wars and protectionist policies. Leaders throughout the region and the new European Commission face a daunting task – strengthening European unity while also repositioning Europe in the world to address a very different geopolitical and economic reality.

Still, there are signs that Europe is tackling these challenging times with resilience. The eurozone economy has continued to grow, albeit in a modest pace, with an annual rate of 1.1%, defying expectations that it would suffer a slowdown due to trade tensions and Brexit.[2] The 2019 European parliamentary elections revealed that European citizens want to remain interconnected and to coordinate European-wide responses to common challenges, including security and defence.

European leaders must build on these positive trends to chart an ambitious agenda for Europe for the next decade. Such an agenda should focus on three key areas where Europe can play a global leadership role:

Europe as a growth engine: what will be Europe's economic growth engine for the next decade? Leaders must tackle how to obtain economic growth, inclusion and sustainability in Europe while updating the region's outdated systems of governance and institutions. The purpose of business needs to be reimagined towards a model where it contributes to society and creates shared values for range of stakeholders. This prompts questions, such as how should productivity and company performance be measured in the future?

Defining new standards and metrics, including environmental, social and governance (ESG) goals, along the lines of the Davos Manifesto 2020 by Klaus Schwab, will be needed to lead the transformation. Likewise, policy-makers must take serious steps to address divided societies, fragmented political systems and institutions in Europe chart a reskilling revolution focused on giving citizens the skills they need to thrive in the Fourth Industrial Revolution.

Making Europe competitive also requires seriously stepping up Europe's R&D spending which, despite a slight increase to 2.07 %[3] of GDP, trails after China's 2.1% of GDP and the United States' 2.84% of GDP.[4] Transforming Europe's growth also requires building the region's intellectual and scientific resources by investing in world class universities, building research institutions and better connecting the private sector with academia to spark off innovation and entrepreneurship.

Europe as a global power: There are several serious foreign policy challenges facing the EU in 2020 and the region must consider how to defend its political and economic sovereignty in an increasingly multipolar and multiconceptual world order where China, Russia and the US are competing for influence against the backdrop of a breakdown of the multilateral system. The European Commission President Ursula von der Leyen has demanded that Europe must "learn the language of power" while presenting her self-dubbed "geopolitical commission".[5] Ultimately, at the heart of defending Europe's future interest and sovereignty lies its unity, without which Europe will become irrelevant. The EU's global clout has already been shaken by Britain's decision to leave the bloc, the US's withdrawal from the 2015 Iran nuclear deal and Europe's failure to help stabilize its neighbours from the Caucasus and the Balkans to the Sahara. European leaders must move forward with confidence and renewed focus on reaffirming core European values and lead the push for a rules-based and democratic world order.

Europe as a green champion: To secure its common future, Europe needs to continue to lead the global transformation to an inclusive, green and climate-neutral economy in line with the Paris Agreement. The EU is in a position to make Europe a global leader in the green transition and to inspire European citizens towards a vision of becoming the first carbon-neutral region in the world by 2050. Therefore, the European Green Deal presents a historic opportunity to modernize the European economy and revitalize the industry while creating jobs and long-term growth for Europe. Implementing the deal must, however, also strongly consider the different starting points of Europe's countries and the need to support those countries heavily dependent on coal and other fossil fuels.

Likewise, green policies should be firmly anchored to the societal and economic realities of European citizens to create the popular support necessary to drive long-term and transformative change and to ensure a just transition. This transition will be neither easy nor cheap. Estimates for the financing requirements of the European green deal amount to €400 billion annually for the next 10 years. It is clear that public funding sources will be insufficient and that the majority of financing will be required from the private sector. The development of new and innovative financing mechanisms and models to drive capital to climate action will be critical. Finally, the monumental challenge of Europe's transition is impossible to achieve by governments or institutions alone. It requires a multistakeholder effort by representatives from government, business, industry and civil society working together to drive change. Here, the Agenda 2030 and the Sustainable Development Goals provide a framework for a truly integrated and multistakeholder approach to stimulate public-private action.

The World Economic Forum Global Future Council on Europe comprises leading thinkers, experts, government leaders, business leaders, heads of international organizations and members of civil society interested in contributing to the debate on the future of Europe. In this paper, select Council members have contributed thoughts and ideas to formulate a dynamic vision for the region's future with the aim of securing a more sustainable, inclusive and entrepreneurial Europe.

The ideas outlined in the paper will be discussed by world leaders at the Annual Meeting of the World Economic Forum in Davos-Klosters from 21-24 January 2020.

A New Green Deal for Europe

There is no more important issue for Europe to lead on than climate, arguably the most fundamental global challenge of the early 21st century. Nor is there any area on which Europe is better suited to doing so. France and Germany have clearly articulated aspirations to a global role and have policies in place to do so. Smaller European states like Denmark and Sweden are exemplary. The Southern European states have huge potential in renewable energy and the broader field of non-EU Europe, notably Norway, Switzerland and the UK are aligned with the need for rapid energy transition. A solid majority of Europe's political and business elite as well as the overwhelming majority of its civil society acknowledge the seriousness of the challenge and see the opportunity for win-win solutions. They aspire to leadership on the issue. This is in stark contrast to the stunted development of European security policy.

That is the good news. The bad news is that in practical terms there are serious challenges ahead. Not all of Europe is equally committed and equipped to deal with the issue. There are major political obstacles in Eastern Europe, based on the fact that the transition to a zero emissions economy is a far bigger challenge in those countries given their much greater dependence on coal. The transition will require substantial investment and a reallocation of resources. It will require careful political renegotiation, which clashes with the need for urgency in climatic and political terms. The momentum in green policy is not good, despite the public mobilization around the climate crisis. This is true in Europe and even more elsewhere. The relationship with China is strategic and yet under huge strain. This makes leadership essential and hard to realize in practice. This year will be a crucial test of what Europe's aspiration to leadership on climate actually means.

Before addressing such challenges, it is worth recapping the unique position of Europe on climate. Though it pioneered the Industrial Revolution and, as recently as 1980, still accounted for one-third of global emissions, Europe today accounts for less than 10% of emission. That is cause for celebration not complaint. Among large economies the EU has gone furthest in uncoupling economic growth from carbon emissions. In the 1990s, Europe reaped the one-off environmental benefits of the deindustrialization of former Communist economies. Since 2000 the globalization of industrial production has outsourced emissions above all to China, but this is also an effect of a concerted push to contain and reduce emissions.

In international climate negotiations Europe anchored the Kyoto agreement in 1997 and sustained it after the US dropped out. After the debacle at Copenhagen in 2009 it was Europe's willingness at Durban in 2011 to unilaterally recommit to a second round of Kyoto that opened the door for China and India to agree to negotiate national commitments. This set the stage for the first truly comprehensive climate agreement and it was fitting that the agreement should have been concluded in Paris in 2015 under the leadership of European, and above all, French diplomacy.

In 2005, Europe pioneered emissions trading. It has enjoyed some success and valuable lessons have been learned. If reformed and expanded it could provide a framework for effective carbon pricing in future. More immediate in their impact have been Europe's national subsidy programmes for renewables, led by Germany, which can claim credit for launching a new generation of low-cost wind and solar power. Europe served as a locomotive for global industrial policy substantially assisting China's green development. Europe's biofuel measures have had more mixed effects, helping to stimulate deforestation for palm oil. Reflecting this, Europe's trade treaties now include tough environmental provisions. The European Green movement would like them to be even tougher, but as the protests from Brazil and Malaysia attest, Europe's trade partners already feel the pressure.

For the future, Europe has committed to becoming a major power in battery technology. It is already a pioneer in earlier generations of non-fossil energy – hydro and nuclear. Though its universities may not score highly in Chinese rankings, in fundamental areas of STEM research Europe's intellectual and scientific resources are second to none.

It is worth reiterating this positive balance sheet because it contrasts with other areas in which Europe has been far less proactive. It is also a reminder of how much more needs to be done. The climate emergency is acute. Europe is not currently on track to reach the Paris Agreement goals of limiting temperature increase to 2°C let alone 1.5°C. Since 2013, when European renewable investment plateaued, it has slumped to one-half of its peak levels. The European power grid remains an inefficient patchwork. Meanwhile, emissions from industry, housing and transport remain stubbornly high. Transitioning from internal combustion engines will pose huge structural problems for Europe's auto industry.

The Green Deal launched by Ursula von der Leyen, President of the European Commission, has to be seen against this backdrop of stagnation. It is a welcome effort to reenergize climate policy in the EU and is all the more important given the uncooperative stance expected of other G20 members including Australia, Brazil, Russia, Saudi Arabia and the US. This is a crunch moment for global climate policy.

COP26, which will be held in Glasgow in December 2020, will be a strong test of the Paris framework. The EU has the opportunity, along with China and India, to anchor a progressive outcome. It is a moment it cannot afford to waste. Without the US's involvement and in light of Brexit, the challenges are even more dramatic than those facing meeting participants in Paris in 2015.

At COP26, the US will be represented by the Trump administration. Even if they lose, one should not count on lame duck Republicans to cede control of policy to a Democratic transition team. The US will be a spoiler and on the basis of recent experience in Madrid it will not be alone. To counter this, it is not certain that China can be counted on as a leader on climate policy. There are worrying reports that suggest a new focus in Beijing on energy security, which is code for domestic coal.

Under these circumstances there is one absolute imperative for 2020. The EU must agree positions with China that place both as committed parties to the COP process, in turn anchoring the continuation of the Paris Agreement. Ideally, this would commit Europe to rapid and deep decarbonization and China to an early peak in emissions. It would open the question of the linkages between trade and climate policy. It should spell out that the EU is not acting as an aggressor in raising the issue of carbon border tax, but is seeking to initiate a new regime. This is not a phase in the trade war, but an issue on which China and the EU – the two largest global trader and climate superpowers – should cooperate. Furthermore, the EU should offer China deep cooperation on technology. We cannot afford to make the energy transition a new front in the technology Cold War. As the example of solar panels demonstrates there is scope for conflict. Batteries are a potential future flashpoint. The EU and China should work out a framework for cooperative and productive rivalry in industrial policy, rather than a zero-sum game.

The chance for a Sino-European deal comes ahead of COP26 in September at the Leipzig-Beijing summit. Europe itself must come to the talks with the best possible offer that it can muster. That requires a focus in the next six months on unity, practicality and urgency. The priority is not to strong-arm Polish nationalists into a verbal commitment to exit coal and achieve zero carbon emissions by 2050, but instead to make the most ambitious advance on the Paris Agreement commitments by 2030 that is possible as well as to agree it by mid-2020 so as to present a united front to China in September. As far as China is concerned, the coal laggards Germany and Poland could even be seen as a laboratory for policies of decarbonization, which it will itself have to go through on a far larger scale.

The same approach should apply to the other issue of the moment, namely the position of nuclear power in taxonomies of green financial instruments. China is a global leader in green finance and its energy policy is open-minded when it comes to nuclear. Meanwhile, Europe is divided on the issue. We cannot allow those divisions, which pit France and Germany against each other, to weaken, let alone derail, a common European position towards China. Setting aside the question of whether nuclear power is truly green, it should be assessed along with other low-carbon technologies above all on the basis of cost. Given the need for urgent action the question that is salient is what is possible with existing technologies in the next ten years. That by itself is enough to force a relentless focus on the key areas of renewable energy – wind, solar and battery technologies – in which China and the EU are leaders.

The overriding priority for 2020 must be to ensure that the COP process does not suffer another meeting like that of Copenhagen in 2009. With hindsight, Copenhagen has been rebranded as the moment when a new negotiating system came into being, which in turn led to the Paris Agreement in 2015. This, however, underestimates how badly Copenhagen destabilized the COP process, as well as the efforts needed to restore goodwill between the key parties, and more widely, the wider public shock at the outcome. On all these counts our situation today is even more precarious. We cannot afford the kind of Sino-Western altercations that followed Copenhagen.

Glasgow will also act as an acid test of Europe's position in an era of Brexit. It will be treated by the UK media as a test of the willingness of the EU to cooperate with an "independent" UK. The EU and UK need to demonstrate that this can work. Meanwhile, the clock of the climate crisis ticks remorselessly on. The stakes are high.

Stability and Trust for a Global Euro

With the distraction of Brexit out of the way, the European Union must now look forward and put its own future first. The challenges are clear and range from strengthening Europe's position in an increasingly hostile world to ensuring its competitive strength and addressing the threats of climate change, locally and globally. The EU's leadership has rightly decided to invest much of its political capital in these future issues.

At the same time one of the foundations of the European construction needs to be reinforced to secure investment, integration and prosperity, namely the trust in the stability of the common currency. As long as there are lingering doubts about the future of the Euro, as long as investors consider a "Euro crisis scenario with multiple exits" in their stress tests and as long as financial markets respond nervously to political pronouncements by running for cover in safe havens to other Euro area countries, the common currency remains fragile and the European project remains in doubt.

Much of this weakness is home-made. It is the result of a still-incomplete construction of the common currency, the divisions within on reforms and the questions about the robustness of the European financial system. This incompleteness also means that the Euro is not living up to its potential as a global currency.

The Euro as global currency

At inception, the Euro seemed destined to become a rival to the US dollar in terms of its role as an international currency. With the weight of the European markets behind it and given the desire of international reserve holders to diversify, the Euro was uniquely positioned, not only to become a regional currency (which it still is), but a significantly larger player in international finance and trade.

These gains were lost in the aftermath of the global financial crisis and the subsequent crisis of the Euro and in 2017 the currency's international standing was at a historic low, with only a very small upturn since. Arguably, the Euro is punching well below its weight class.[6]

In contrast, the US dollar is punching above its weight and has become the dominant global currency. The US dollar is used for 50% of global trade. Similarly, most global invoicing and two-thirds of all emerging markets debt is calculated in dollars, and official foreign exchange reserves and of global securities issuance are conducted in the currency. This is despite the fact that the US's share of world GDP is barely 15% and its share in world trade is just 10%.

Until recently the EU and the European Central Bank (ECB) maintained that they had no particular ambition for the Euro as an international currency. This has changed, mainly because the US has increasingly imposed geopolitical interests on Europe with the threat of secondary sanctions and using the dollar as a leverage. As a result the Euro is now viewed as key to Europe's economic and political sovereignty.

The weakness from within: dangerous narratives

The Euro will not be able to become a currency in wide international use as long as it suffers internal weakness. Granted, much has been done to try to complete the European monetary union, but this work remains unfinished.

Unfortunately, divisions inside the Euro area on the final elements of reform have deepened. A great deal of political capital is invested in fighting these reforms, which are often not even properly understood by the contestants.

Here are several examples:

In Germany, there is a narrative that equates any form of risk sharing with transfers. In macroeconomic terms risk sharing simply means that negative developments in one region are partly absorbed by other regions. For instance, if households in Germany invest in shares of companies in Spain then developments in Spain's economy (positive or negative) will be shared with German households. In fact, inside countries like Canada, Germany and the US, most risk sharing takes place through financial market and banking integration rather than public buffers. In comparison, in the Euro area these private risk-sharing mechanisms, as well as the public ones, are underdeveloped. This explains the need to complete the integration banking and capital markets.

In a similar vein, popular narratives often confound transfers with insurance. Why do we buy car insurance and why does car insurance not involve redistribution in expected terms? Car insurance pools the risks of damage and redistributes the premiums after the fact to those involved in accidents. To reduce (or eliminate) possible incentives to be negligent and create the accident, the premiums are risk adjusted and often require significant co-payment. Well-designed insurance minimizes moral hazard and does not involve any expected transfers. In the same manner it is possible to design a European unemployment reinsurance scheme that deals with moral hazard. This is very different from fiscal transfer union, which is designed to create transfers in expected terms, namely from rich to poorer states.

A third popular narrative in Germany equates zero budget deficits and surpluses with moral virtue and rectitude. This may be good advice at the personal level, but it doesn't seamlessly transfer to a macroeconomic level because the appropriate macroeconomic policy stance always depends on the economic cycles. As such, an absolute target for the budget deficit or surplus is inappropriate much of the time.

A final example of a dangerous narrative relates to the serious political crisis that occurred in Italy, about a rather technical reform of the bond contracts – so-called single limb collective action clauses – which all experts agree would have little effect. Somehow, a false narrative spread suggesting that the contracts' clauses gave "foreigners" (the EU) the power to force Italy into taking European Stability Mechanism loans and to lose sovereignty. Eventually, the upheaval was contained, but not before causing damage.

These examples show how national narratives emerge and are promoted by national politics to the detriment of the common interest. In principle, common interest in a stable and credible common currency should be one of the motivations for governments to engage in healing the divisions and overcoming differing narratives. Ultimately, what is needed to secure the Euro should be achievable, namely several Euro area-wide instruments, which can be designed in such a way that they address the fears that underpin false narratives.

Therefore, the EU Commission and other European institutions, along with national governments, need to do a better job in countering such narratives. For example, they could better highlight the progress and significant achievements that the European project has already made, including achieving long-term stability, founding the Euro and creating the common European market. This would foster credibility, help counter negative slogans and deepen support for necessary future reforms.

What needs to be done: area-wide instruments

A common safe asset

A common safe asset would solve many problems in one go. First, it would resolve the issue of there being a limited pool (about one-third the size of the US dollar) of what investors consider safe assets.[7] This means that global and local demand for these safe assets is high and very sensitive to any type of news. This also leads to the second problem, namely destabilizing flows within the Euro area with the possibility of multiple equilibria and debt runs. Third is the problem of the "doom loop" between banks and sovereigns, which could be addressed with the introduction of a common safe asset. At the same time, a safe asset would contribute to deepening and integrating capital markets.

For all these reasons a common safe asset would be the most important boost for the Euro as an international currency. Moreover, a common safe asset can be designed without any transfers and it does not have to be a fiscal instrument (see separate item below). Proposals for such designs are all on the table; policy-makers simply need to select one.

A full banking union

The banking union also remains incomplete. A common European deposit insurance scheme is the most evident missing piece. When implementing this, progress needs to be made in breaking the "doom loop" by incentivizing banks to diversify their sovereign exposures without disrupting government bond markets. Furthermore, the bank resolution framework needs to strengthen. Again, the technical designs exist and they can address the different concerns that are commonly raised, but what is most needed is political will.

A common unemployment reinsurance fund

The monetary union need a fiscal instrument that can stabilize shocks to individual countries preventing them from turning into a full-blown crisis. The budgetary instrument that was agreed and is being put in place does not have this aim. It is meant to foster competitiveness and convergence, which is the same aim as much of the EUs budgetary funds. Instead, the Euro area should implement a common unemployment reinsurance fund which would have a stabilizing action without creating any permanent transfers.

A common fiscal mechanism

Ultimately, the Euro area will need a mechanism to stimulate aggregate demand, especially when monetary policy has reached its limits. National fiscal policies alone will not lead to an adequate fiscal stance for the Euro area even if coordination can be improved. A common fiscal instrument would do much to boost confidence in the common currency, at home and abroad. As Benoît Cœuré, former member of the executive board of the ECB, put it: "All successful and stable monetary unions have genuine fiscal instruments built on strong legal and market-based mechanisms ensuring fiscal discipline at the state level. Such an instrument should not replace national policies, but it will need to be large enough to complement them effectively."[8]

Conclusion

If Europe is to be a strong global political as well as economic player it will need the backing of a strong global currency. The reforms required to strengthen the architecture of the Euro are known and can be designed in ways that address concerns about transfers and instability. The most important element would be a common safe asset. This will, however, require overcoming some false narratives and building trust. The EU and the governments of its member states will need to deploy political capital for this mission.

Making Europe a Geopolitical Actor

As a great power competition asserts its dominance over the international arena, many in the EU have called for a geopolitical strategy. The EU is the largest market in the world, has the second-highest defence spending (after the United States), has 55,000 diplomats and the world's largest development assistance budget. It struggles, however, to make its strengths count in the new geo-economic as well as multipolar era of international politics. China and the US are adept at integrating geopolitics with their economic interests, but the EU treats them as if these were separate agendas.

The core challenge the EU urgently needs to address is twofold: first, Europeans are constrained by the fragmentation of European power among and within member states and EU institutions, and secondly, Europeans need to adopt tangible measures to build the capacity to act on the world stage. Precise actions are difficult to pinpoint, but this essay provides some ideas.

Rebuilding European unity

Rebuilding European unity and trust in the EU may be the biggest challenge for Europe's relevance in the 21st century. We have witnessed a remarkable level of EU unity in the face of Brexit, but so far the EU's member states have been unable to replicate this unity in other areas.

In foreign policy the use of qualified majority voting (QMV) is difficult. Nevertheless the EU needs to be more efficient. As such, the forthcoming EU-Conference for the Future of Europe should consider further options to achieve this goal. The need for consensus-building on issues of critical and strategic importance is self-evident.

The sensible interests of member states have to be taken into account in a very sensitive way, which was not the case in handling the migration question.

As such, the long-term challenge lies elsewhere, namely in cementing a basic joint understanding that the EU is the first line of defence for many countries' core interests. Rather than avoiding controversial issues in foreign and security policy, the European Council and the Foreign Affairs Council should discuss these issues with a view to reconciling competing positions and finding compromise.

Within the European Council, a core European approach to key global issues including climate change, cybersecurity and human rights should be defined. It should also describe how the EU should relate to other great powers and key regions, starting with the EU's neighbourhood. The intent is to define a basic approach that has strategic agreement from the member states at the highest level and that enlists them all in supporting the core interests of their EU partners.

Furthermore, agenda items that already enjoy a basic consensus or widespread support from member states, such as the Sustainable Development Goals or emphasis on the rules-based, multilateral international order and international law, should be strengthened and prioritized within the Common Foreign and Security Policy.

Another way to facilitate the reconciliation of different positions would be to appoint core groups of member states to work on divisive issues in an attempt to develop common positions that rise above the lowest common denominator. The core groups would report to other member states or an EU representative, much like the E3 did with the HRVP on Iran.

Building Europe's capacity to act

The very structure of the EU holds that economic considerations can be governed by global rules and separated from geopolitical disputes. So foreign economic policy issues like trade and competition policy are the province of the Brussels machinery, while more geopolitical considerations, such as foreign and defence policy or relations with other countries, remain primarily member state concerns.

We need the EU to have sufficient capacity to tackle new challenges, develop a habit of thinking strategically and comprehensively about the Common Foreign and Security Policy, and increase its innate confidence to foster a sort of "strategic sovereignty" so that it will act to protect European interests. This requires integrated action throughout the economic, political and security spheres. It requires the incorporation of non-traditional foreign policy areas such as trade, climate action, the human rights agenda, data protection and others to act alongside diplomacy and defence. The EU's potential as the world's biggest trading power, for example, should be used not only for economic reasons, but to promote its other strategic, environmental and social goals, as well as to defend and strengthen the multilateral rules-based system.

In turn, this includes fostering a greater international role for the Euro and pushing back against secondary sanctions. It involves further strengthening and widening the European investment screening system, rethinking European competition policy and state aid control so that it applies beyond EU companies. It means building the European pillar in NATO with tangible critical capabilities so that the EU can be a better partner to the US, as well as developing a pan-European capacity to respond to cyberattacks. It also means reinforcing and even reinventing partnerships for the EU around common values as well as common interests. It means that instruments of enhanced cooperation and permanent structured cooperation, as introduced in defence policy, should be used more widely. Finally, it includes actively hedging against the blockage of political and economic international institutions as well as preparing Europe's own institutions,

such as the European Investment Bank and the European Stability Mechanism, to engage outside the EU and beyond their current mandates, if necessary.

These measures are not easy to accomplish, but they respond to an urgent need. They express an enormous opportunity to make the EU more fit for purpose in a geopolitical world and to demonstrate that the EU can deliver on the issues that its member states and their populations really care about. Moreover, implementation would present a means by which the EU can move out of a reactionary, crisis management mode into active and proactive thinking. This shift in the European mindset from “responding to” towards “shaping” what happens, is of paramount importance. We urge the new EU leadership to seize that opportunity, particularly in view of the forthcoming Future of Europe Conference.

Beyond Shareholder Value

To meet its targets for growth, sustainability and diversity, Europe will need the close support and commitment of business. In particular, Europe must cultivate a market economy driven by a form of capitalism that has moved beyond a narrow focus on shareholder value.

Fortunately, business increasingly realizes that it must embrace wider objectives, in particular, inclusivity and sustainability. The trend towards stakeholder capitalism is in part driven by mounting evidence – developed in the past few decades – that the most successful and long-lasting organizations are those motivated by a purpose beyond just profit. As highlighted in the Davos Manifesto 2020 by Klaus Schwab, the concept of stakeholder capitalism was proposed nearly half a century ago when business and government leaders convened in Davos in 1973 to develop a code of ethics for business leaders. Today, the shift is given additional impetus with the realization that, if not tackled, wider global problems – including climate change and social inequality – will have an adverse effect on the business environment.

Without a focus on sustainability, business will bestow – on shortening timescales – a natural environment that is unfit for future generations. By committing to greater inclusivity in organizations, business will help ameliorate growing inequality, which might otherwise lead to destabilizing populist and nationalist sentiment. It should be said that workforce diversity is also increasingly linked to greater corporate innovation and, perhaps, organizational resilience. In both cases, the business pivot to inclusivity and sustainability reflects the need to attract and retain a new labour force that is increasingly reluctant to work for organizations that do not share its 21st century values.

Happily, European companies have long subscribed to a stakeholder model in which employee, community and environmental goals are balanced with shareholder interests. This culture has its roots in an industrial structure dominated by family-owned enterprises and a regulatory environment that habitually considers a broader range of constituencies than is typical elsewhere in the world.

Europe's political forces are moving to reinforce sustainability and inclusivity objectives. The European Union now has its own Green Deal with the ambition to become the world's first climate neutral continent by 2050. Equality, diversity and inclusion are also top priorities for the new EU leadership. In 2020, the EU will publish a new European Gender Strategy, with a focus on equal pay. The fresh impetus towards policies promoting sustainability and inclusivity is encouraging. How can Europe further support businesses in committing to these goals? What can its institutions do to encourage a wider, more pervasive adoption of stakeholder models?

How can Europe support this momentum?

Sustainability regulation and incentives
Europe must continue to pursue policies, rules and regulations that encourage ambitious climate targets and sustainability outcomes. Among many initiatives, the following appear to be the most important:

- Removal of fossil fuel subsidies, which across Europe in 2016 amounted to approximately €55 billion
- Adoption of realistic carbon pricing or at least an Emissions Trading System with a price floor
- Support for the improvement of the energy efficiency and circular economy performance of the digital sector, from broadband networks to data centres and ICT devices, while also promoting the use of cloud computing and artificial intelligence to support inclusivity and sustainability goals
- Market incentives to encourage the reduction of carbon emissions must be tempered with the development of a pragmatic Carbon Border Adjustment Mechanism to ensure that European companies are able to compete on even terms and that European citizens do not export their carbon emissions to other countries or regions
- Stronger R&D incentives reflecting the fact that public investment in green energy technologies has not grown in the past decade (among International Energy Agency members)
- Encouragement of climate-friendly bank lending by easing the capital requirements for such loans, complementing the action of the European Investment Bank and the InvestEU Fund

Such regulation and market signals from European institutions could encourage companies to follow the lead of visionary European companies like Unilever and ABB who have long committed to improving the natural environment

New metrics and consistent reporting mechanisms
To uphold the principles of stakeholder capitalism, companies will need new metrics and a new measure of shared value creation. Europe's business leaders must consider how they track the progress of its market economy towards the stakeholder model and its associated goals. For this reason, the adoption of Europe-wide and preferably global standards of Environment, Social, Governance (ESG) reporting would represent a significant facilitating step. Such standards would become the guide for business leaders – and their lingua franca – for judging progress towards inclusivity and sustainability objectives.

These types of standards are beginning to emerge with the Task Force on Climate-related Financial Disclosures and the Global Reporting Initiative just two such examples. Using these standards, businesses can be benchmarked and advised on the migration towards best practice. Armed with such information, other standards like the Stewardship Code would drive investors to divert capital to the best-managed European companies. Using such standards, Europe might then consider the implementation of compulsory environmental reporting for European companies. Regulation should then encourage the linkage of executive remuneration to ESG goals and long-term performance, in addition to short-term indicators such as share price.

Diversity of ownership models

Europe must support moves that lead to a plurality of ownership models. The standard path for many companies is to start as private firms, then grow to the point where they list on public markets. Although acceptable, this sways companies to focus on shareholder returns. Therefore, where possible, Europe should encourage firms to consider other models such as co-operatives, mutuals, partnerships, trusts and foundations. A more recent example is the Community Interest Company, a legal form that was introduced in the UK in 2005, to give businesses the opportunity to use their profits and assets for the public good. Where these models are appropriate, they can be economically successful and lead to improved social outcomes.

Creation of new business

European institutions should also support the creation of new companies. Many large, established businesses recognize the value of the stakeholder model, but re-engineering their corporate culture is typically very difficult to achieve. Encouraging new business with an innate commitment to values-based organizations will deepen the hold of stakeholder capitalism. It will have the added benefit of increasing competition for established companies with more traditional approaches to value creation. Beyond the creation of new business, it is also important that Europe creates the conditions for the emergence of large, innovative and well-funded enterprises. To support this, Europe must focus on further developing its single market to increase the competitiveness of European businesses and their ability to develop across national borders in a market of 500 million consumers.

To this end, the further harmonization of regulations and an ambitious competition policy that promotes innovation and investment are needed. As noted by Margrethe Vestager, Executive Vice-President of the European Commission: “The challenges we are facing, at the start of this new decade, mean that we need to look again at the tools we use to enforce the competition rules in Europe.”[9] This requires thinking through how European competition policies can be made sufficiently flexible in a highly digitalized and globalized economy and how to create the necessary digital and innovation ecosystems needed for European businesses to thrive.

European universities and other educational institutes also have an important role to play. By placing greater emphasis on the importance of sustainability and inclusivity throughout their educational programmes, young start-up founders are more likely to take a stakeholder approach when setting up and running their own business. Accelerator and incubation programmes sponsored by the European Commission can also support the development of the stakeholder approach. Such programmes stimulate participating individuals and teams to develop new ventures that embrace sustainability and inclusivity, as well as commercial profitability.

Contributors

The Forum would like to thank the following for their contributions to these essays.

A New Green Deal for Europe

Adam Tooze, Director, European Institute, Columbia University, USA

Stability and Trust for a Global Euro

Beatrice Weder di Mauro, President of the Centre for Economic Policy Research, UK

Making Europe a Geopolitical Actor

Miroslav Lajčák, Minister of Foreign and European Affairs of the Slovak Republic
Mark Leonard, Director, European Council on Foreign Relations, UK

Beyond Shareholder Value

Lien De Cuyper, Postdoctoral Researcher, Chair of Entrepreneurship, ETH Zurich, Switzerland
Olivier Marchal, Partner and Chairman, Bain & Company, France
Miguel Milano, President, Sales, Europe, Middle East and Africa, Asia-Pacific, and Latin America and the Caribbean, Salesforce

World Economic Forum

Pim Valdre, Community Lead, Regional and Geopolitical Affairs, Europe

Global Future Council on Europe 2019–2020

1. **Miroslav Lajcak**, Minister of Foreign and European Affairs of the Slovak Republic; Global Future Council Co-Chair
2. **Beatrice Weder di Mauro**, President, Centre for Economic Policy Research, United Kingdom; Professor of Economics, Graduate Institute Geneva, Switzerland; Global Future Council Co-Chair
3. **Elsa Amouzgar**, Vice-President; General Manager, Global Sales, ManpowerGroup, France
4. **Agnes Benassy-Quéré**, Professor, Paris School of Economics, France
5. **James Bell**, Vice-President, Global Strategy, Pew Research Center, USA
6. **Elmar Brok**, Special Adviser to the President of the European Commission, European Commission, Belgium
7. **Pablo Casado Blanco**, President, Partido Popular; Member of the Congress of Deputies of Spain, Spain
8. **Arne Cartridge**, Special Adviser, Strategy and Business Development, Yara International, Norway
9. **Lien De Cuyper**, Postdoctoral Researcher, Chair of Entrepreneurship, ETH Zurich, Global Future Council Fellow, Switzerland
10. **Ann-Kristin Achleitner**, Professor of Entrepreneurial Finance, Technical University of Munich, Germany
11. **Pascale Baeriswyl**, State Secretary for Foreign Affairs of Switzerland
12. **Karen Donfried**, President, German Marshall Fund of the United States, USA
13. **Ivan Krastev**, Chairman, Centre for Liberal Strategies, Bulgaria
14. **Eva Maydell**, Member of the European Parliament, Belgium
15. **Mark Leonard**, Director, European Council on Foreign Relations, United Kingdom
16. **Olivier Marchal**, Chairman, France, Bain & Company Inc., France
17. **Miguel Milano**, President, Sales, Europe, Middle East and Africa, Asia-Pacific, and Latin America and the Caribbean, Salesforce, United Kingdom
18. **Peter Seidel**, Author, Germany
19. **Timo Soini**, Minister of Foreign Affairs (2015-2019) of Finland
20. **Alexander Stubb**, Vice-President and Member of the Management Committee, European Investment Bank, Luxembourg
21. **Peter Szijjarto**, Minister of Foreign Affairs and Trade of Hungary
22. **Adam Tooze**, Director, European Institute, Columbia University, USA

Endnotes

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World Economic Forum
91–93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland

Tel.: +41 (0) 22 869 1212
Fax: +41 (0) 22 786 2744

contact@weforum.org
www.weforum.org