

Project Group on Ethical-Ecological Rating Political Frameworks for Sustainable Markets and Sustainable Competition

Communiqué

Sustainable development must take increasingly concrete form in all areas of society. It is in the hands of politicians to create the necessary conditions for this change.

At the invitation of the Project Group for Ethical-Ecological Rating an expert symposium met at the Frankfurt University. Working from a broad view of the goal of sustainable development the following questions were addressed within the facilities of the “Kreditanstalt für Wiederaufbau (KfW banking group): In how far market regulations/laws must be changed pertaining to sustainable development; how financial markets can be made future compatible; and how fundamental problems as different as climate change and corruption can be overcome through the concept of sustainability.

Ethical Foundations

The law against unfair competition (“Gesetz gegen unlauteren Wettbewerb”, UWG) of 1909 forbade “immoral” competitive acts. According to the amendment of 2004, however, the law now only protects „the interest of the general public in undistorted competition“. „Undistorted competition“ is as imprecise a legal term as “moral”, but far narrower. In its selection the UWG was brought in line with the anti-trust law (Gesetz gegen Wettbewerbsbeschränkungen, GWB), that prohibits the “prevention, restriction or *distortion* of competition”. The law thus still has an ethical foundation, however it has been restricted to just a small number out of the wide range of morally questionable acts, so that violations of sustainability principles cannot be addressed under it; invoking general “morality” would have given such endeavours a better chance of success.

Commercial acts that are in conflict with sustainability are those that achieve a competitive advantage by transferring costs to the commons – which we today view as immoral. As breaches of sustainability are not within the scope of the UWG, it impedes the achievement of sustainable development. Consequently, it needs to secure both *undistorted* competition and *sustainable* competition with equal priority. The ethical foundations of law are often described by such imprecise legal terms, which leave room for development in case law.

The same thing holds for the GWB. Its role is to ensure that agreements sparing market rivals the need to compete on prices or quality are not made. However, because it is blind to sustainability, it de facto forbids agreements between competitors to avoid the externalisation of certain costs. Thus this law is a hindrance to sustainable development.

We therefore demand a double general clause which declares free and undistorted competition as protection worthy *only* in so far as it simultaneously nurtures an ecologically, socially and culturally

sustainable development. Such a general clause would have to be recognised both in the national norms UWG, GWB, HGB, etc., and in EU legal guidelines and in the world trade agreements.

Agro-Fuels and the Right to Food

Under no circumstances may the use of biomass for energy be at the cost of human food security. One approach to this is the internationally binding agreement on every human's right to food, which has been recognized by 151 nations. Moreover, the use of biomass for energy must not lead to a negative net ecological outcome, neither globally, nor regionally. Additionally it must neither cause nor aggravate social inequalities. Only if these three criteria are fulfilled should agro-fuel projects be permitted.

The current discussion on the preservation of biodiversity shows that alongside this consideration, an obligation to comprehensively mitigate emissions and to ensure carbon sequestration is necessary. Thus an obligation at the national level must be made that puts the goals food security and the protection of the climate above the energetic use of land, and requires to take responsibility both nationally and globally.

Regulation of the Financial Markets

The deregulation of the financial markets since the 1980s has come under broad international criticism. The deficiencies of the global financial system include: (1) a want of transparency and risk control, (2) the out of hand expansion of profit potential (low capital backing, unregulated issuance of derivatives) and (3) the exemption of financial capital from the social obligations of property, in so far as this necessitates an adherence to the principle of sustainable development. To lastingly remedy the two first deficiencies the following *framework* is necessary:

1. *All* large actors in the financial markets- alongside banks this includes pension funds, hedge funds, state funds, private equity corporations etc. must be forced to make *all* taken risks transparent to the appropriate regulatory bodies.
2. All current and future financial market innovations must be subject to registration with, and permission by, the regulatory bodies.
3. An effective, international regulatory body must be established. As long as this does not exist, each national regulatory body must be able to limit and even deny loans to "off-shore" actors.
4. The currently almost unlimited money creation potential of financial markets must be effectively delimited. In particular, the capital backing requirements according to Basel II must also be exercised for loans to states with high solvency. They also need to apply for the purchase of derivatives, and more so in the case of company takeovers: these must only be possible if the necessary capital is for the most part brought in by the corporation conducting the takeover.
5. Transactions and commercial activities "off balance" must be prevented by stricter accounting rules, or at least must be under as stringent a regulation as those included in the balance.
6. In order to counteract the destabilising effect of short-term, speculative financial transactions, a financial transaction tax must be introduced.
7. Actors in the financial market must be responsible for their mistakes, this includes the responsible parties in banks. Short-term bonus payments often counteract the achievement of sustainability goals; when bonuses are paid they should serve the realisation of sustainability goals. Liquidity loans by the state must later be compensated in such a way by the institutions that made use of them that no disadvantage to taxpayers remains.
8. In industrialised nations but especially in developing nations, growing parts of people have no

access to capital markets (current account, savings account, etc.). This undermines their participation in society. Micro Finance Institutions (MFIs) enable the economic development of marginalized people and groups, particularly women. Access to loans and secure saving possibilities need to be supported, as well as *financial education* and the mitigation of debt. MFIs, whose target groups include particularly marginalized people, and those most effected by climate change, are to be strengthened. Insurance models for the “uninsurable” need to be developed. On the other hand, Micro Finance Institutions that offer consumption loans and are profit oriented are not in line with sustainable development.

9. Additionally, the financial markets need to be demystified regarding the profit margins the financial market industry claims. The signs that especially small investors lose more money at the financial markets than they gain are increasing.

Putting Production Factors on Equal Footing

The third deficiency, the de facto missing obligation of financial capital towards the goal of sustainability, can only be addressed by putting all factors of production – capital, labour, nature, and society – on an equal footing. Capital ownership as of now is under *no obligation* to sustainable development. This should be anchored especially in the Stock Corporation Act (Aktiengesetz) and in the German Corporate Governance Codex. The stock corporation law should oblige share holders to give equal consideration to all other means of production: labour, nature and society (education, culture, infrastructure). Together with capital, these lead to value creation in our society.

- Employees must be viewed as co-producers and not as costs that are to be eliminated,
- The natural environment has to be conserved as the source of life and a productive force; it should have the right for restitution of what is withdrawn from it.

Society must not be deprived of the resources to conserve and cultivate the commons. This is currently happening through the pressure on governments to lower the top income tax rates. This leads to the high income earners contributing a smaller part to state budgets and forces governments to take up more loans. If this does not change, national debt will in one or two decades reach such an extent that inflation will be inevitable.

To implement these demands, the board of directors must be legally obliged to realise sustainable development as best possible. This obligation must also be included in the German Corporate Governance Codex.

As a further consequence, the reports of joint stock companies must include verifiable statements on their efforts towards sustainable development. Through this requirement the bylaws of a joint stock company move closer to being a *Charter of Incorporation* which describes the responsibilities of a company; this gives the stakeholders a means to observe critically the sustainability performance of a company.

Analogue rules must also be incorporated into the laws covering other corporations, private companies and owner led companies.

Mainstreaming Sustainable Investments

All this must go hand in hand with the willingness of investors to make sustainable investments, because only those that invest according to environmental, social, and cultural criteria see themselves as equal stakeholders to labour and nature. The willingness to do so is growing. This willingness must not be hindered through institutional regulations which give preference to the return on capital. Therefore

companies must be pushed more strongly to report on their non financial performance with the same intensity as they do on financial matters.

For that purpose, balance reform laws need to be passed. The trade law book (Handelsgesetzbuch, HGB) has been significantly changed since 2005, as large capital institutions are required to incorporate non-financial performance indicators in their reports, but only in so far that these are “relevant to the companies’ success”. This restriction allows board members to arbitrarily decide which non-financial items to include. It must be changed into a commitment to provide the public with verifiable information on the contribution of the enterprise to *sustainable development*.

Individual growth opportunities of sustainably acting companies must not hide the fact that all economic activities take place in a constrained world: Sustainable economic growth respects the natural boundaries of surface area, the atmosphere, ecosystems, and material resources. High capital returns must therefore be considered an exception, and marginal returns as a rule should be seen as complement to the contribution to sustainable development that is being made. *Patient capital* from *responsible owners* is required not only in the area of Micro Finance Institutions (MFI).

The influence of sustainable or socially responsible investments on the debates in the financial market is not to be underestimated. Especially for long-term investments, like pension funds, the observation of sustainability criteria enable responsible and future proofing investments. To make responsible investment decisions easier, transparency and reporting need to be developed and expanded.

Global Rules for Sustainable Development

The different levels achieved in reaching sustainability in different countries must not be an obstacle for the advanced countries to keep moving onwards. The European nations have a special responsibility hereby. The current rules of the WTO are already compatible with the introduction of eco-taxes to protect national *sustainable* competition (*Border Tax Adjustments* for Imports and Exports); these must be legitimated by a cutting-edge role. They should be valid for a limited period of time and regularly checked in regard to their justification. In return, the export subsidies of developed - especially European - countries must be dismantled because they compromise sustainability efforts of developing countries.

The boundaries of development based on the consumption of resources and fossil fuels are given by the constrained environmental space. A CO₂ concentration of 450 ppm in the atmosphere must not be exceeded, in order to avoid transgression into the high risk zone of more than 2°C global warming above pre-industrial levels. This must be seen as the uppermost maximum, we must try everything to stay under this mark. At a population of almost 9 billion people in 2050, every person has a share of at most 2t CO₂ per year in order to stay below 450ppm. We support the political effort of consistently transforming the concept of world wide equal per capita emissions rights into concrete policy measures. Whatever this means for the wider development of climate politics (keyword: *Commons Trusts*), it is essential that in the long term all emission rights are sold under a legally binding regime and their volume is continually reduced. We must begin with this immediately and effectively, as the window of opportunity for switching to a post-fossil fuel economy is only open for another 10 to 15 years. The investments that will shape our energy future are currently being made and the necessary political framework must respond rapidly.

The large emitters in our Greenhouse Earth are threatened by compensation law suits and actions for injunction. The financial markets need to react actively through greater transparency and encouraging appropriate products and forms of commerce. In the end it will be necessary to acquire new cash flows: The financial markets can and should be willing to contribute to the existing and developing mechanisms of financing a) the adaptation measures concerning the consequences of climate change, b)

the reduction of greenhouse gases (mitigation), and c) technology transfer to developing countries and emerging markets.

Corruption

Corruption poses a threat for sustainable development in economy and democracy. It is a medium for organized crime and terrorists. Corruption is a source of poverty and hunger, and in effect, the destruction of the rainforests. Before 1999 bribery abroad was not punishable in Germany and only now is no longer tax-deductible; however that has not arrived in most people's minds, as the latest corruption charges show. To prove it is serious in the battle against all forms of corruption, the German parliament (Bundestag) must ratify the 2004 UN-Convention against corruption, although and because that implies the grounds for charges of bribery of members of parliament would be broadened. The enterprises need to follow up the damage that is caused to them by corruption more effectively against the responsible managers and employees. They (the enterprises) must be watched especially vigilantly by the public and law enforcing authorities if they are dealing in countries which have a high ranking on corruption indexes (e.g. the Transparency International Corruption Perceptions Index). Banks must specifically be committed to revealing suspect cash flows. Corruption must be afforded as little protection by banking secrets as fiscal fraud is. In general, national and international structures must be changed so that the threshold for systematic corruption is considerably elevated. We must all contribute to this purpose.

For the Project Group on Ethical-Ecological Rating, 31.5.2008:

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