Conference reader

Introduction

Over the last two months, the world has spun at least twice as fast. The Russian invasion of Ukraine in its cruelty continues to shock and affect all of us. The consequences will be long-lasting and their impact will be major. The Russian aggression and the reaction by the rest of the world have highlighted long forgotten dimensions of economic discourse. Words such as “financial war”, “economic weapons” and “warfare economics" suddenly have a meaning again.

Will this war mark a turning point of globalization? Some see Russia’s efforts to open channels for trade and finance with India and China as beginnings of a new multipolar order. It will certainly create a new reality in which we should reflect our short and long term policies.

The war in Ukraine has significantly increased the cost of living and demonstrated how our reliance on fossil fuels enabled tyrants like Putin. It has created the urgency to act now, but could also complicate financing investment due to higher inflation and increased pressures to tighten monetary and fiscal policy.

In light of the new geopolitical context, we believe that it is now more important than ever to think of a transformative agenda beyond the Green Deal: Which of our diagnoses, analyses and concepts are still useful in these new times? What does this mean for the socio-ecological transformation in Europe? How can transformative politics be implemented in the crisis and its aftermath? What are the opportunities and risks in the current situation? Which role does the European Green Deal play in this process?

After the outbreak of the coronavirus in Europe, certain policy measures deemed unrealistic were suddenly accelerated. Common borrowing of EU debt became reality. While this has been deemed a paradigm shift, the one now imminent seems all the greater.

At this conference, we want to provide the opportunity to jointly orient ourselves in this quickly changing world, while also exploring the interdependencies between the different domains of policymaking and environmental and social agendas. Therefore, we are inviting experts from different fields of research and civil society (climate, inequality, finance) and different types of policies (fiscal, monetary and regulatory).

In this conference reader you will find a brief introduction to the format of the conference and a teaser of the topics that will be discussed in each workshop.

The project

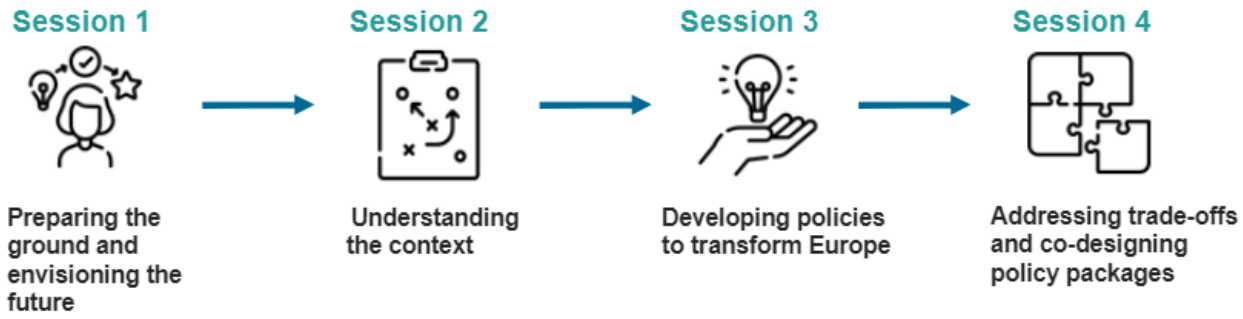
Transformative Responses to the crisis aims to increase our systems' resilience by addressing the socio-economic and ecological challenges at the intersection of finance, ecology and inequality with concrete actions and policies to mitigate crises and initiate structural reform. Transformative Response is a project by Finanzwende Recherche in cooperation with the Heinrich-Böll-Foundation. We are organizing this conference together with the ZOE. institute for future-fit economies.

The co-creative format: workshops and plenaries

In order to facilitate an effective exchange, you will have the unique opportunity to not only participate in keynotes and plenaries but also co-design relevant policy proposals along three key policy-areas: climate, inequality and financial system.

Workshops

We offer three workshops (climate, inequality and financial system) consisting of four sessions each. The methodology is designed to allow highly interactive, result driven and in-depth discussions. The workshops lead to a mix of insightful exchanges, debate and elaboration of common perspectives. Using co-creative methods, participants will elaborate bold yet feasible options to the socio-ecological transformation. There will be opportunities to reflect on the content, both alone and in small groups. The envisioned outcomes are the joint analysis of the current situation and, ideally, a common set of ideas for the next steps of the green transformation.



Session 1: Preparing the ground and envisioning the future

We will start by sketching out the relevance and boundaries of the topic. As our groundwork for further discussions, we will then share our understandings of the respective policy goal of the workshop and map and prioritize obstacles and opportunities to achieve this goal.

Session 2: Understanding the context

To discuss the current context, we will offer an "Open Space". You are invited to discuss the topic of interest to you with other participants in breakout groups. You are warmly invited to host a breakout group discussion yourself or join one hosted by others.

Session 3: Developing policies to transform Europe

In small groups participants will jointly identify fiscal, monetary and regulatory policies to achieve the respective policy goal of the session and assess their transformative impact and how they are perceived in the public debate.

Session 4: Addressing trade-offs and co-designing policy packages

We will mix groups between workshop streams. In doing so, you are able to discuss a selection of policy proposals with experts from the other topics. Together, you will identify potential trade-offs and synergies between the different goals of each workshop stream for selected policy measures.

Plenary

During the plenary, all participants will come together to review and present the results. The plenary will be an open space for debate in which participants can raise further questions and topics they would like to discuss.

In the following you will find three outlines which serve as an orientation for the workshops. These form the main part of this conference. The aim is to teaser the discussion and provide you with some suggested readings. The workshops themselves are interactive and open to topics not mentioned here.

Workshop 1: Climate

How to tackle the climate and environmental crisis with a transformative economic policy?

In the climate workshop, we want to identify the challenges, obstacles and opportunities in different fields of the transformation and discuss strategies. The sudden agreement on the urgency of phasing out the European dependency on Russian oil and gas is one of the unintended consequences of the war in Ukraine. It may speed up the switch to renewable energy and energy efficiency, but also trigger a short-lived rebound of coal, and new investments in fracking and fossil (LNG) infrastructure.

The Russian invasion displaced the climate agenda to a large extent by the energy security agenda. But to get anywhere close to meet our climate objectives, we need to halve emissions between 2020 and 2030. This will require the largest re-allocation of capital the world has seen. It won't happen by itself: it has to be politically accelerated (Lonergan & Sawers).

An important development in this respect is the shift away from the "cost" narrative towards the "investment spent" narrative. The story of costs has stopped progress for way too long. The investment in a sustainable economy should most certainly create employment and could even raise living standards.

However, there are obstacles along the way. The push to transition away from Russian fossil fuels has triggered new investments in fossil infrastructure which may create new demand for fossil gas.

Qualified labor for the new sectors is often scarce. And prices of the materials needed for the green transition are rising rapidly.

To approach an answer on "how to tackle the climate and environmental crisis with a transformative economic policy?" the key questions to be discussed in the climate workshop will be:

1. How to accelerate the speed of green transition?
2. How to manage differences across sectors and places in Europe?
3. How to direct innovation and its diffusion towards sustainable prosperity while phasing out unsustainable technologies?
4. How can sector-specific regulation and innovation of the real economy be supported by financial regulation?

To talk about a way forward, the differences between the older climate economics, with its emphasis on tradeoffs and price mechanisms, and the investment-centered and public-sector-led Green Deal approach will be important (see Mason 2022). There is for example a discussion to define policy principles that go well beyond the idea of 'getting the prices right' (see Markard 2022). In 'Supercharge Me', Eric Lonergan and Corinne Sawers argue that policy should be focused, sector-by-sector, on the relative price of substitutes. That means that the green options have to be made cheaper whereas carbon taxes should primarily be deployed as part of this broader approach.

Policies

Important questions arising from this are: What strategic long term policy approach beyond a market failure-fixing framework can be identified? Which macroeconomic measures are used to drive and coordinate deep industrial restructuring? Where is the complementarity between state and market in an industrial policy for the green transition? Do we need an 'entrepreneurial-regulatory state' (as suggested by Andreoni 2022)? How to ensure that the policy design for different industrial sectors is context-specific (ibid.)? In the workshop, we will try to define an industrial policy that takes many of these aspects into account.

A rebuilding of the European energy system probably includes the diversification of supply sources and stronger interconnection (Pisani-Ferry). But how do we get there? What should policy packages for the different sectors (energy, mobility, industrial production, agriculture, social reproduction and care) look like? What are important innovation, diffusion and decline/phase-out policies? How to combine and align these?

Besides all peculiarities and differences, we believe that we need a systemic approach that uses the synergies of various policy tools and sectors. In the workshop, we want to discuss and identify these synergies by unpacking 1) regulation 2) fiscal policy 3) monetary policy and define specificities of the toolbox: Where to apply which tool?

Synergies and interdependencies

Climate policy has strong interdependencies with inequality, both within countries – with the cost of green transition being mostly borne by workers and the most vulnerable - and between countries, as developing countries suffer most from climate induced disruptions and new global rules imposed on them, without receiving adequate support. At the same time, decarbonization policies can alleviate inequality, when they create co-benefits to, e.g. public health or social infrastructure.

Climate policy is strongly connected to the financial system. Unfolding climate risks, for instance, translate into financial stability risks and stranded assets might in future be addressed with public bailouts, further deepening inequality. At the same time, integrating sustainability risks in financial regulation can make the financial sector more resilient to climate shocks and even turn it into an enabler of the green transformation.

While fiscal policies are crucial for transformation investments, high public debt can also weigh on the financial system. Reducing our energy reliance on Russia will cause additional costs and it is an open question how they will be shared between member states and the EU.

Outlook

The increased focus on the effects of fossil energy dependency due to the war could speed up the necessary reform for the transformation. However, the direction of change is not set in stone as e.g. new fossil infrastructure is built to reduce the dependency from Russia.
The crisis has certainly created a moment in the EU where increased investment is needed and demanded. At the same time the economic shock is likely to increase concerns about sustainability of public debt in fiscally vulnerable EU member states. However, the EU's current fiscal framework is not sufficiently flexible to react to that (Pisani-Ferry). This is why first proposals for a joint budget response (e.g. Draghi here) have already been made. Making use of this fast changing environment and designing reforms aimed at a new macro-financial framework in support of the green transformation will be key.

Workshop 2: Inequality

How to design economic policies that are just and inclusive and support a socio-ecological transition?

In the workshop on inequality, we will look at the distributional challenge as a core issue to understand the ongoing crises of the EU and discuss strategies for a fair and green transformation. Inequality is a key factor in the ecological crisis. While the responsibility for emissions lies with high-income households and countries, vulnerability falls disproportionately on the poorest groups and regions. The costs of a European Green Deal are also asymmetrically distributed across countries depending on their production structure. One key challenge is to make sure the benefits that come with the transition are distributed as fairly as possible.

Inequality also plays a role with regard to implications from Russia's invasion in Ukraine. Central and Eastern European (CEE) countries are expected to feel the strongest consequences of the economic sanctions in place. They are much more dependent on exports to, and energy imports from, Russia. For example, natural gas from Russia represents almost 100 percent of imports in Czech Republic, Latvia and Hungary, while Russian oil accounts for almost 80 percent of imports in Slovakia (Redeker 2022). On top of that, the record increase in energy prices puts extra pressure on low-income households, increasing their vulnerability.

Inequality affects crises at all levels, from a cross-country perspective to groups within society. Unequal impacts and burden sharing raise concerns regarding the EU's coherence. In the long term, economic divergence calls into question the necessary consensus for transformative reforms.

This workshop aims to first reflect on the dynamics that reproduce inequality. When the EU introduced a common currency, this was based on the assumption that member states would increasingly converge. However, economic performance in the EU has noticeably diverged (Gräbener et al. 2020; Tokarski 2019). This structural polarization entails great challenges: How are countries able to respond to macro policies? To what extent does austerity hit them? How will countries be able to mitigate the impacts of the current gas and energy shocks? Structural polarization further undermines the prospects for a green transition. Since CEE countries build on a productive structure highly dependent on carbon emissions, they are likely to incur the greatest transition costs.

Secondly, the workshop will focus on the measures addressing inequality that need to accompany the transition to keep up political support in the long term. With this in mind, three main questions come to view in this workshop:

1. What immediate answers to the energy price increases can reduce social impacts while avoiding future carbon lock-ins?

2. What green transition policies can account for different regional production regimes and strengthen convergence processes?
3. What policy mechanisms can support a more balanced distribution of benefits and costs from a green transformation?

Policies

We aim to identify and prioritize specific measures for a transformative toolbox towards a fairer EU and social-ecological transformation. For the short term, we can discuss how the EU deals with the asymmetrical social impacts from the Russian conflict. A precondition to deal with this crisis is the alleviation of energy poverty. Without ensuring the wellbeing of vulnerable citizens, policies will hardly be able to lead to lasting changes and advancements towards a socio-ecological transition. We need to discuss how to provide support for both lower-income households and lower-income countries. In parallel, when faced with huge increases in prices, energy and fossil fuel companies might see the crisis as an opportunity to extract windfall profits. This opens space to rethink the role of subsidies and incentives.

Looking at the medium and long term, we want to discuss a policy package that respects the historical process that has led the EU and its member states to where they are today. This needs to acknowledge that different places and regions require policies adapted to their specific context, economic development model and technological capabilities. In consequence, the mix of instruments varies between each region.

Following this understanding, we aim to discuss the interplay of industrial, fiscal and social policy in supporting the creation of sustainable industrial capabilities that enable economic convergence. A coherent approach to policy making can maximize synergies and mitigate trade-offs. We want to discuss exactly these interactions. For instance, competition policy is often good in managing horizontal levels while industrial policy is stronger on vertical levels on which global companies are operating; fiscal policies can provide resources for concrete industrial policy measures; and so on.

As part of this discussion, specific levels in the transformative toolbox towards a fairer EU will appear. These can have various forms: Labor markets institutions that strengthen the bargaining power of workers; technological knowledge transfer to support European peripheries; growing wages to escape the cycle of weak demand; shifting the tax system in a way that redistributes rather than burdening low-income citizens; ensuring access to good quality services and the job market and, overall, guarantee a minimum living standard for all.

Synergies and interdependencies

The relationship between inequality, debt and financial stability is subject of a vivid debate. While the relation of fiscal policy with inequality is more widely acknowledged, monetary policy also plays an important role, especially when thinking in terms of aggregate demand or the rate of interest.

But also the other way around, it is worth asking if inequality and regional disparities cause financial crises. Furthermore, the issue of fiscal policy is closely linked with the discussion of the State as an enabler of the green transition, which raises questions on the future of fiscal rules, public debt and the impacts of austerity.

On top of that, inequality can be seen as a major driver of overshooting planetary boundaries. Solving the sustainability puzzle will require a far-reaching technological transformation and changes in norms and behaviors. This is hard to achieve in a polarized and fragmented society with high levels of insecurity. Insecure employment conditions, a lack of access to essential goods and services for low-income groups and a lack of perspectives for economic development for peripheral regions in the EU are just some of the barriers in that regard.

On the other hand, a failure of the socio-ecological transformation and an advance of the climate crisis will have significant effects on inequality. Especially regions that will be affected by higher temperatures, heat waves, storms and floods will have to bear high adaptation costs. Economically weaker regions in Europe will only be able to afford these costs to a limited extent.

Outlook

Now more than ever, socio-economic cohesion is needed to ensure the political feasibility of a green transition. The EU requires a new and optimistic narrative of socio-economic convergence and allocation of social impacts from the Green Deal to be able to strengthen ecological reforms. Enabling cohesion and reducing inequality between and within member states is therefore the basis for succeeding on the current and future challenges the EU is facing.

Workshop 3: Financial system

How do we ensure that our financial system supports the social-ecological transformation (instead of hampering it)?

In this workshop, we want to look at the role of the financial system for the green transformation. The transformation will require large amounts of both public and private investment. Yet, financial institutions continue to invest in fossil fuels, hampering the transition. Meanwhile, financial instability has increased and remains a serious threat to the transformation.

In this workshop we aim to answer these main questions:

1. What are the dangers that today's financial markets pose to a successful green transformation?

2. How can we achieve a transformation that involves the investments of the private sector without once again providing it with an opportunity to make profits at the expense of everyone else?
3. What reforms do we need to generate both public and private funding of the transformation and ensure financial stability?

The war against Ukraine has brought the global financial system to the forefront of public debate. Financial sanctions and turbulent commodity markets are closely linked to the ongoing war and have changed the context in which we view our financial system ('weaponization' of finance). All of this could very well lead to a new era for the global financial system and its order. Furthermore, balancing inflation risk has become far more difficult for central banks.

The dangers of today's financial markets

Even though the 2008 financial crisis wreaked havoc on the global economy, finance has continued to grow substantially. Yet, overall lending by financial institutions to firms and households has decreased in the Eurozone. A large share of financial transactions takes place exclusively within the financial sector to generate wealth. Another share of financial activities focuses on extracting wealth from the real economy e.g. through private equity firms or excessive dividends and buybacks. This type of finance-led growth has significantly increased inequality and thereby directly affects the just transition, for instance with a view to the acceptance of climate policies.

Financial crises and instability have become a recurring feature. The covid crisis has shown a fundamental instability at the heart of our public debt markets that could only be contained by central bank intervention of an unprecedented scale (Sissoko 2022). Post-2008 financial regulation has been complacent, while debt levels have increased significantly. And climate risks are an increasing threat to financial stability.

If we want to build a financial system that supports the green transformation, we have to understand the dangers of our current system. How can we shrink extractive finance while ensuring sufficient credit for the massive investments that are required? Can we ensure financial stability while continuing expansive monetary policy? Could we do without monetary stimulus?

What roles for public and private capital in financing the transformation

To what extent and how can private finance play a beneficial role in funding the green transformation? This discussion is currently being held all over the globe, from COP26 to the German parliament. While there is a massive amount of private capital in search of investment opportunities, it is not sufficiently financing the transformation. The IPCC estimates that the flow of capital toward sustainable activities needs to increase by 300-600 percent.

This leads to the fundamental question of how financial markets allocate capital. Most would argue by evaluating risk and return of investment. But what type of activities actually require financing? Large-scale infrastructure projects or research projects relevant for the transformation are often associated with high risks and uncertain returns for private investors. Paired with the Maastricht criteria and the prevailing narrative that public funds are insufficient, this has led to calls for subsidizing private capital. Institutional investors in particular are demanding that investment risks (of entire asset classes) be assumed by the state when the risk/return profile does not match investor preferences or regulatory requirements. Daniela Gabor describes this process as de-risking. Gabor, Sissoko (2022) and others question whether this should be considered "private" financing at all. Many argue that it would be cheaper to let the state invest directly without enriching private financiers. But how can we achieve this in Europe, given the fiscal constraints?

Policies

Arising from this are a number of important questions in the area of monetary, fiscal and regulatory policy. We have collected a few of the current policy proposals that could be a starting point for discussion. While some of them are short term and easy to implement, others represent long term and more fundamental changes in policy.

In the field of monetary policy we can discuss how the existing tools could be greened in the short term through e.g. green TLTRO and changes to the collateral framework. More fundamental changes are central bank support for decarbonization taking the form of active credit policy as described by JW Mason (2022), and coordination of monetary and fiscal policy as described by Daniela Gabor (2022). Here fiscal and monetary policy overlap with similar ideas of purchasing publicly issued debt by public banks (KFW, EIB...). Additionally, revising the EU's fiscal rules looms large.

With regards to regulatory policy, one policy question for the short term is how to incorporate climate and nature-related risk into regulation and supervision i.e. prudential requirements and ECB banking supervision of climate risks. More fundamental reforms are needed to limit the extractive nature of finance for example on public goods (health care, housing, pensions) and to ensure financial stability in the long run. Sissoko (2022) discusses the reform of bond markets, central clearing and prohibition of REPO to allow for stable government financing mechanisms.

Synergies and interdependencies

Finance-driven inequality and the impacts of the climate and biodiversity crisis financial system are the first interdependencies that come to mind. How can we achieve a transformation that involves investments of the private sector without once again providing the private sector with an opportunity to make profits at the expense of everyone else (see Driscoll & Blyth 2022)? How do we make sure inequality does not increase even more in the course of a green transformation path highly influenced by finance?

Outlook

There is a lot of discussion on smaller reforms such as green taxonomies, targeted monetary policies or collateral rules. When it comes to the nature of our market-based financial system and the role of regulation, the central bank and shadow banks there is currently little impetus for reform although the questions are crucial for the transformation. The sanctions against Russian financial actors have shed some light on financial infrastructure. However, as we have seen in the past, reforming the financial system is a tedious uphill battle. We should discuss the next steps both for incremental improvements and more radical reform proposals that require opportune political moments.