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Rethinking Capitalism

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Katharina Pistor & Guy Canivet

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Joachim-Nicolas Herrera • PhD candidate, Sciences Po, LLM, Yale Law School

Hugo Pascal • PhD candidate, Panthéon-Assas University

Vasile Rotaru • PhD candidate (DPhil), University of Oxford, Faculty of Law

Seeking a Sustainable Capitalism Through Law

The deluge of recent legislative proposals and academic writings leaves no doubt: the call for a profound overhaul of capitalism is once again on the agenda. What makes the present moment unique is that the call is not only being heard in traditionally critical quarters but also in the very bastions of liberalism. Multiple reasons come to mind: the concentration of capital in a few hands increases inequalities, the financial system has come close to cardiac arrest several times over the last years and had to be revived by an infusion of public funds, and climate and ecological disasters have become all but unavoidable.

Admittedly, capitalism is an ill-defined concept. It can be contrasted with socialism, or with the local and communal economy that preceded it historically. Either way, the law plays a major role in enabling and maintaining it, through the clear definition of property rights, the respect of contractual freedom, and the incentivisation of private entrepreneurship. From an ideological point of view, the great transformation of the system of production has been accompanied by what might be called capitalism's 'anthropological bet': as in Mandeville's beehive, the pursuit of private interests promotes the common good, while creative destruction supposedly drives societies towards ever better versions of themselves (see Aghion, pages 170-172).

In theory, many conditions need to be met for such a system to be 'sustainable': the existence of a competitive market, whose rules are set in a transparent and impartial manner; the absence of negative externalities, or, more precisely, society's ability to redress them perfectly through regulations and taxation; and a fair redistribution of capitalism's gains. But, as the crises and turmoil of the last twenty years show, these conditions are seldom perfectly met in reality. Against this backdrop, the role of the law in promoting a more sustainable capitalism gives rise to a renewed debate, which the authors of this new issue of the Revue européenne du droit, jurists, economists, and philosophers, set out to shed light on.

To overcome these crises, a first strategy is to confront directly the negative externalities generated by the pursuit of private interests, without abandoning the 'anthropological bet' underlying capitalism. Consider the climate crisis. A Pigouvian tax on carbon emissions and strict regulation of polluting activities could reduce the private gains of socially harmful activities (see Esty, pages 119-126), although this cannot be the end of the matter if a true sustainability transition is to be brought about (see Sachs and Sachs, pages 143-148; Sharpe, pages 149-156; Attali, pages 178-182).

But these initiatives are often politically costly, because they affect ordinary citizens disproportionately, thus failing to usher in fundamental change. Even when the least controversial of these measures get approved, the measures often win rhetorical battles without achieving significant substantive goals. Hence the temptation, faced with the urgency of the matter, to enlist the living forces of private law, substituting the courts for deficient or absent public policies (see Rochfeld, pages 135-142). The same is true of inequalities: the promise of a reasonable redistributive policy being often untenable, many seek to tip the scales of private law to redress unequal social relations (see Davis and Pargendler, pages 78-82), while waiting for fair long-term solutions to emerge (see Dagan, pages 77-77; Tcherneva, pages 90-98).

When these efforts fail to realise the conditions for a sustainable capitalism, the very idea that the pursuit of private interests promotes the public good seems to be undermined. Hence the initiatives in favour of a 'responsible capitalism' concerned with the common good, promoted at a breakneck pace, albeit with varying degrees of success, by the European legislator (see Ringe and Gözlügöl, pages 127-34; Conac, pages 111-118). The aim is to change the way in which large companies are governed, the interests and purposes they are intended to serve, and to limit the social costs arising from their activities (see Henderson, pages 22-28). In this area, France is at the forefront of a global reform movement, particularly since the reform of its Civil Code and the enactment of the 2019 PACTE statute.

Indeed, while the relevance of cost-benefit analyses in a complex and unpredictable reality is questionable, being guided by unequivocal ethical principles is often a good business strategy (see Edmans, pages 9-13). But current legislative initiatives go far beyond this, to require, or at least facilitate more 'virtuous' business conduct. Arising from the frustration of not being able to mitigate negative externalities, this second strategy takes aim at the profit motive itself.

But the attitude towards the role which the market is supposed to play in the transition to a more sustainable capitalism remains ambiguous. Sometimes the market is seen as an ally, for example when it allows investors to exert ‘virtuous’ pressures on irresponsible decision-makers (see Christie, pages 29-35), although this also undermines traditional democratic decision-making procedures in favour of those who own the capital (see Masconale and Sepe, pages 37-43). At other times, the market is distrusted, and attempts are made to 'protect' managers from its supposedly 'short-termist' pressures. The topic is a complex one and deserves a reflection on sound bases, drawing lessons from comparable experiences in foreign jurisdictions (see Puchniak, pages 14-21).

Law can also play a more subtle role in promoting a sustainable form of capitalism. The belief that underlies each issue of our journal is that law and its language are not irrelevant epiphenomena, but are constitutive of social and economic relations, and the power dynamics that they embody. If the accumulation of wealth is intrinsically linked to the way in which assets are 'coded' in the legal language, it is legitimate, once these mechanisms have been set out, to ask whether we recognise ourselves in the mirror that is thus put in front of us (see Pistor, pages 5-7). If private property is the fundamental concept underpinning the market economy, a proper understanding of its current shape and possible reconfigurations is an unavoidable step in any reformist endeavour (see Robé, pages 162-169; Dagan, pages 157-161). Finally, if one recognises that the substance of all economic activities ultimately consists of the labour of real men and women, it becomes critical to ask what type of human being the current labour law is shaping (see Pereira, pages 99-104), and what its horizon should be if the law is to bring about a more sustainable form of capitalism (see Barbara, pages 83-89).

One of the essential tasks of jurists in the public space is to shed light on the dynamics hidden in the shadows of the law and on the way in which legal concepts bring about and maintain the existing state of the world. The contributions in this issue engage in this task with great skill, as, we hope, our readers will agree.

Katharina Pistor • Edwin B. Parker Professor of Comparative Law at Columbia Law School and director of the Law School's Center on Global Legal Transformation. Author of *The Code of Capital: How the Law Creates Wealth and Inequality* (2019)

Law, Wealth, and Inequality The Political Economy of Coding Capital

My recent book *The Code of Capital: How the Law Creates Wealth and Inequality*[1] aims to illuminate the basic principles of how law can be used as a tool for creating wealth for some, while leaving the rest much less well off. Importantly, I did not mean to suggest that the handful of legal institutions, which I identified as the basic modules of the code of capital are the only legal devices that can be used to create wealth; nor did I want to imply that the entire body of administrative and regulatory law should be left out of the equation when analyzing contemporary capitalist systems. Policing, as Adam Smith called the core functions of the state, has always co-existed with institutions of private law, which enable trade, commerce, and finance.[2] Moreover, the relation between these two bodies of law, the public and the private, has always been an uneasy one.[3] As much as traders, entrepreneurs, and financiers depend on sufficient state capacity to police, i.e., to provide for internal and external security and ensure that contracts are enforced and property rights respected, as much do they also resent state action that might limit their freedom.[4] Conversely, when the economy prospers, states benefit as well. They can increase their revenue by levying taxes and fees, attract capital as well as skilled workers to their shore, and benefit from the development of new technologies that might be used for security or the advancement of sciences.

Yet, neither markets nor politics are stable and, contra standard economic models, rarely if ever trend towards an equilibrium. For this reason alone, states can simply not limit their role to guarding against market failure for very long. The inherent fragility of financial markets can put the entire system at risk;[5] excessive market concentration undermines competition, the very motor for innovation and economic progress;[6] and excessive income or wealth gaps undermines the fabric of democracies.[7] There are other reasons as well for states to play a more proactive role in the economy. In constitutional democracies, the people are the sovereign and 'the state' is only a shorthand for the organizations and agents that exercise state power on behalf of the people.[8] It is easy to dismiss this as wishful thinking and to instead argue that politicians and bureaucrats are ultimately selfish individuals as well who operate in their own, and not necessarily in the public's interest.[9] This view, espoused by the public choice theory, effectively denies the very possibility of a public interest. If all are selfish individuals, then a public interest cannot exist. It follows that there is no public agency to address even the most basic market failures, much less develop institutions in support of markets, including a functioning legal system. Without this legal infrastructure, however, complex markets cannot exist.[10]

If the state and markets are imbricated, indeed, if markets depend on law and agencies of the state to protect them against abuse or self-destruction, and if in constitutional democracies the people are the sovereign, then it only makes sense for the people as a collective to set the ground rules for their social, political, and economic life. No doubt, collective decision making is cumbersome. Polities are heterogenous and their members have different, often conflicting objectives. This means that every decision takes time and often involved horse trading across different policy objectives. This is why political decision making is often compared unfavorably to the market mechanism.[11] With the price revealing most relevant information, in efficient markets even all publicly available information, all that is necessary is to respond to the price signal.[12] Critically, however, the pricing mechanism works only under well specified conditions. First, all market participants have a common point of reference, a shared

1. K. Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (2019).
2. Adam Smith, *Lectures on Jurisprudence* (1982).
3. Note that the Soviet theorist of socialist law argued that the duality of private and public law is a core characteristic of law in capitalist systems. Evgeny B. Pashukanis, *Law and Marxism: A General Theory. Towards a Critique of the Fundamental Juridical Concepts* (1929).
4. The German sociologist, Max Weber, noted that entrepreneurs always bargained for exceptions from the rules that were binding on everybody else. He called this the new "legal particularism". Max Weber, *Economy and Society* (1978).
5. Hyman P. Minsky, 'The Financial Instability Hypothesis: An Interpretation of Keynes and an Alternative to "Standard Theory"', in *Can "it" Happen Again? Essayson Instability and Finance* 59-70 (Hyman P. Minsky Ed. 1977).
6. Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (1942).
7. The basic argument can be found in Karl Polanyi, *The Great Transformation: The political and economic origins of our time* (1944).
8. Jean L. Cohen, *Globalization and Sovereignty: Rethinking Legality, Legitimacy and Constitutionalism* (2012).
9. George J. Stigler, 'The Theory of Economic Regulation', 2 *The Bell Journal of Economics and Management Science* 3–21 (1971). This line or argument is followed more generally in the public choice literature.
10. The basic argument is developed in Katharina Pistor, 'A Legal Theory of Finance', 41 *Journal of Comparative Economics* 315–330 (2013).
11. Robert C. Ellickson, *Order Without Law - How Neighbors Settle Disputes* (1991). Timothy Frye & Andrei Shleifer, 'The Invisible and the Grabbing Hand', 87 *American Economic Review* 354–358 (1997).
12. Eugene Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work', 25 *Journal of Finance* 383–417 (1970).

currency, or at least a currency that is convertible into another currency that is shared by others.[13] This money system is, like the legal system, a collective product. Only state issued money retains its nominal value even in times of crisis, and only state money can be used to meet one's obligations with the state.[14] Even when banks and other financial intermediaries issue most of the money in circulation, they do this qua a government franchise.[15] Absent such authorization, their currencies would find far fewer takers, because their convertibility into state currency would be much less certain. Witness the run on repos and other complex financial instruments in the Great Financial Crisis: When the value of these assets declined, they become toxic, because investors realized that they had no clear path to convert them into state-issued currency.[16] This is also why central banks can stabilize markets by simply announcing that they would be a willing buyer of last resort for any assets, including the ones that had been issued without a government franchise.[17] In short, the pricing mechanisms works, because they monetary system works, and the most stable monetary systems are the ones that are backed by state issued currency.[18]

There is also another reason for why the comparison of political decision making with the pricing mechanism is misleading. Not all issues of individual or social value can be quantified, but without quantification the pricing mechanism does not work. Even if more people prefer apples over pears, they may still wish to have pears on offer at least once in a while or would support measures that protected pears from extinction should demand for them decline relative to apples. In capitalist economies, capital is often given the treatment of pears in the above example. It is privileged in law and regulatory treatment over other assets, but without admitting that these privileges are the primary source of private wealth creation. Capital, as I argue in my book, is coded in law.

Capital enjoys several attributes that give it a comparative advantage over competing assets, namely priority, durability or convertibility, and universality.[19] Priority implies that certain claims to the same asset are stronger than others; durability means that the assets are legally protected from liability or certainty claimants; convertibility provides durability to financial assets by given them a put option on state issued currency vis-à-vis a private agent or (preferably) vis-à-vis the issuer of that currency. Universality, finally means that rights that are recognized as legal enjoy the full protection of the law, including access to the centralized means of coercion by way of litigation and, if necessary, execution of the obtained award. Of course, not every interest enjoys these legal protections. Only interests that have been coded in law to trigger them do. A simple idea does not enjoy priority when others come up with the same idea later on just so. Only if the idea meets the legal requirements for an intellectual property right, and in the case of patents or trademarks is registered as such, will it enjoy these protections. Neither does every organizational form protect the assets of that organization from its members of their personal creditors and thereby confers durability on them. Only the corporate form or the trust do. Nor can any claim against a debtor be converted into cash at all times, including after the debtor has become insolvent. Only assets that enjoy special treatment in bankruptcy, or have been safe-harbored, do. Lastly, not all interests are equally enforceable in a court of law. Standing rules and other procedural hurdles limit access to dispute resolution in a court of law and access to the centralized means of coercion, which in principle require court endorsement. As a generally rule, collective interests are more difficult to litigate than individual interests, and for individual interests, civil procedure law creates a number of default rules that prioritize some interests over others: Disputes over property will typically have to be litigated in the jurisdiction where the asset is located; tort claim where the harm occurred or is still felt; contractual claim where the gravitas of the contractual relation lies, and so forth.[20]

All these rules are somewhat technical and few of them are well known of publicly debated. They do, however, set the stage for savvy parties to mobilize the legal system to their advantage, while leaving others to fend for themselves. Critically, in complex economic and social systems the complexity of rules tends to increase.[21] This is not necessarily the result of some government over-reach, but in large parts reflects the increased division of labor, which inevitably increases agency costs.[22] It also emerges from the back and forth between attempts to curtail socially undesirable behavior and the sophistication of lawyers in helping their clients to circumvent these constraints, which results in a renewed attempt of regulating the be-

13. Christine Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (2015).

14. Morgan Ricks, *The Money Problem* (2016).

15. Robert Hockett & Saule T. Omarova, 'The Finance Franchise', 102 *Cornell Law Review* 1143–1218.

16. Gary Gorton & Andrew Metrick, 'Securitized banking and the run on repo', 104 *Journal of Financial Economics* 425–451 (2012).

17. Perry Mehrling, *The New Lombard Street: How the Fed Became the Dealer of Last Resort* (2011).

18. Clemens Jobst & Stefano Ugolini, 'The Coevolution of Money Markets and Monetary Policy', 1815-2008, in *Central Banks at a Crossroads* 145–194 (Michael Bordo, Oyvind Eitrheim, & Marc Flandreau dir., 2016).

19. For details see Pistor, *supra* note 1; Chapter 1.

20. John H. Langbein, 'Comparative Civil Procedure and the Style of Complex Contracts', 35 *American Journal of Comparative Law* (1987); Bradley Bryan, 'Justice and the Advantage in Civil Procedure: Langbein's Conception of Comparative Law and Procedural Justice in Question', 11 *Tulsa Journal of Comparative and International Law* 521–555 (2004).

21. This has been recognized by authors as different as Ostrom and Smith. See Elinor Ostrom, 'Beyond Market and States: Polycentric Governance of Complex Economic Systems', 100 *American Economic Review* 641–672 (2010); Henry Smith, 'Property as Complex Interaction', 13 *Journal of Institutional Economics* 809–814 (2017).

22. On the importance of the division of labor for economic development, see Adam Smith, The Wealth of Nations (1776); Emile Durkheim, The Division of Labour in Society (1984). On agency costs, which are often discussed without reference to the division of labor, see Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', 3 *Journal of Financial Economics* 305–360 (1976); Trond Olsen, 'Agency Costs and the Limits of Integration', 27 *Rand Journal of Economics* 479–501 (1996).

havior and another round of legal arbitrage.[23] In addition, the latest generation of capital assets are themselves fashioned in law. Intellectual property rights and financial assets are the primary case in point. Today, they account for the greatest share of the market capitalization of firms.[24] Not surprisingly, the law itself has become the prime instrument by which wealth is created.[25] If I can ask my lawyer to increase wealth by shifting accounts to different jurisdictions, creating new financial assets, or ensure that my patent will be extended yet again by swapping out some minor compounds, why bother produce much, if anything?

Coding capital does not benefit everyone equally. True, there may be some spillover effects for others who do not own assets, or if they do, do not have access to lawyers to put their assets on legal steroids. Most constitutional democracies endorse the principle that everyone is equal before the law, but this does not entail that everyone has the same means to strategically utilize the law to their own benefits. Forty years after trickle-down economics was declared the new mantra in major democracies, the UK and the US, the income gap between the rich and the poor has widened dramatically.[26] This is all the more surprising, because the past four decades have been accompanied by a series of crisis, which could have operated as a corrective, just as the Great Depression did in the 1930s. Yet, most of these crises were caught before they could wreak havoc, mostly be stabilizing asset prices to the benefit of capital holders. The savings-and-loans crisis and the collapse of Long-Term-Capital-Management in the US, as well as the collapse of BCCI in the UK could all have easily morphed into a full-blown crisis, had the state not stepped in and softened the blow. Given the apparent fragility of the system that has been created and the discrepancy between promises made about prosperity for all and observable increase in inequality in income and wealth, we should ask, why democracies endorse and actively create a system that runs counter to the interest of most.

Several plausible explanations are on offer. Capture is one, both in its cognitive and material dimensions.[27] Most politicians in most democracies have a hard time imagining anything other than the system as is and if they have any doubts, they are dissuaded from thinking about real alternatives by the “captains of finance and industry”.[28] In fact, cognitive capture often extends to the judiciary, especially in common law jurisdictions, in which judges are recruited from the practicing bar.[29] The revolving door between government posts and top jobs as well as directorships in the corporate sector is a well-known phenomenon, as is at least in some countries the revolving door between regulators and the regulated.[30] Not simply the self-interest of the individuals that serve, but the concerted efforts of lobbyists is at work in forming the public interest. Another explanation is that legislatures lack the capacity to monitor the evolution of the economy and intervene in a timely manner. With the increasing complexity of the economy, their task has become even more daunting They often delegate this task to regulators, but their powers are purposefully curtailed to ensure that they do not exercise too much legislative power. Moreover, as noted, many regulators maintain close ties to the regulated. While this may enhance their ability to monitor, their impartiality and independence is at risk. The strong influence of the regulated is also evident in advice and comment procedures that precede any major regulatory efforts in many countries today.[31] The ones with the greatest stake in not being subjected to regulation are often over-represented in comparison to those in whose interest a regulatory proposal is advanced.[32] In the event that new laws or regulations are passed, this does not mean that they are effective. With the right legal advisors on their side, private actors can often avoid the reach of regulation by recasting their activities, or shifting their accounting business, not necessarily their real business elsewhere. The efficacy of laws and regulations, it turns out, is not just a question of good or bad institutions, but of the interaction between laws and regulations on one hand, and coding practices on the other. Last but not least, given the complexity of many legislative and regulatory tasks, legislatures often outsource the drafting of new laws to major law firms, the same firms that otherwise work primarily for asset holders and code their capital.

In short, the political economy of coding capital goes much further than simply molding new capital assets in old laws, which I highlighted in my book. It has deeply infiltrated the operation of ordinary legislative, regulatory, and judicial processes. In the last consequence, it is undermining the very idea of democratic self-governance.

23. Victor Fleischer, ‘Regulatory Arbitrage’, 89 *Texas Law Review* 227–290 (2010); Annelise Riles, ‘Managing Regulatory Arbitrage: A Conflict of Laws Approach’, 47 *Cornell International Law Journal* 63–117 (2014).

24. Jonathan Haskel & Stian Westlake, *Capitalism without Capital: The Rise of the Intangible Economy* (2018).

25. Katharina Pistor, ‘The Value of Law’, 49 *Theory and Society* 165–186 (2020).

26. Thomas Piketty, *Capital in the 21st Century* (2014).

27. Michael E. Levine & Jennifer L. Forrence, ‘Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis’, 6 *Journal of Law, Economics & Organization* 167–198 (1990); I. Ayres & J. Braithwaite, ‘Tripartism - Regulatory Capture and Empowerment’, 16 *Law and Social Inquiry* 435–496 (1999); Joel S. Hellman, Geraint Jones & Daniel Kaufmann, ‘Seize the state, seize the day: state capture and influence in transition economies’, 31 *Journal of Comparative Economics* 751–773 (2003).

28. Morris R. Cohen, ‘Property and Sovereignty’, 13 *Cornell Law Quarterly* 8–30 (1927).

29. Richard Posner, ‘What do Judges Maximize? (The Same Thing Everybody Else Does)’, 3 *Supreme Court Economic Review* 1 (1993).

30. Susan Rose-Ackermann, *Corruption and Government: Causes, Consequences, and Reform* (1999).

31. Jose Edgardo Campos, ‘Legislative Institutions, Lobbying, and the Endogenous Choice of Regulatory Instruments: A Political Economy Approach to Instrument Choice’, 2 *Journal of Law, Economics, and Organization* 333–353 (1989); Pieter Bouwen, ‘The Logic of Access to the European Parliament: Business Lobbying in the Committee on Economic and Monetary Affairs’, 42 *Journal of Common Market Studies* 473–496 (2004).

32. Katharina Pistor, ‘Host’s Dilemma: Rethinking EU Banking Regulation in Light of the Global Crisis’, in *Festschrif für Klaus J. Hopt* (Harald Baum et al. eds., 2010).

Governing Corporations: Between Profit and Purpose

Alex Edmans • Professor of Finance at London Business School, author of *Grow The Pie: How Great Companies Deliver Both Purpose and Profit*, named to the Financial Times Books of 2020

The Power of Purposeful Business

Even before COVID-19 devastated the world, capitalism was already in crisis. The 2007 financial crisis cost 9 million Americans their jobs and 10 million their homes. Although the economy recovered, the gains largely went to bosses and shareholders, while worker wages stagnated. In 2019, the world's 22 richest men enjoyed more wealth than all the women in Africa. This inequality will only increase due to the coronavirus pandemic. While 100 million people are being plunged into extreme poverty, the wealth of tech billionaires is skyrocketing.

Corporations aren't just passive beneficiaries from global trends – they actively contribute to them. To squeeze out every last dollar of profit, many pay their employees as little as possible and work them to the bone, flouting health and safety regulations. Every day, 7,500 citizens around the world die from work-related diseases and accidents. A company's impact is so far-reaching that it can harm people who aren't even its customers or employees. In June 2020, US power supplier PG&E pled guilty to 84 manslaughter charges stemming from California wildfires caused by its faulty equipment.

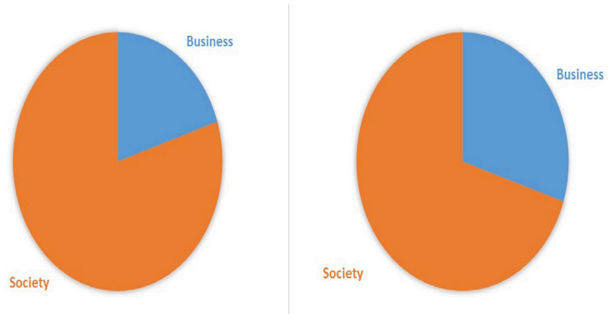
The damage isn't just to people, but to the planet too. In 2010, the explosion of BP's Deepwater Horizon drilling rig saw 4.9 million barrels of oil spill into the sea, threatening eight US national parks, endangering 400 species and spoiling 1,000 miles of coastline. Five years later, Volkswagen admitted installing a 'defeat device' in its cars, which cheated emissions tests and contributed to 1,200 deaths in Europe alone. In May 2020, mining company Rio Tinto detonated Juukan Gorge in Australia, a sacred site for the indigenous Puutu Kunti Kurrama and Pinikura people, which had been continuously occupied by humans for 46,000 years. Over and above these individual cases, the environmental costs created by business are estimated at $4.7 trillion per year.

Citizens are fighting back. On 15 April 2019, the activist group Extinction Rebellion organised demonstrations in 80 cities across 33 countries, blockading roads, bridges and buildings in protest at climate change. Myriad other responses include Occupy movements, Brexit, the election of populist leaders, restrictions on trade and immigration and revolts on CEO pay. But while the precise reaction varies, the sentiment's the same. 'They' are benefiting at the expense of 'us'.

In turn, companies were responding – or at least are appearing to. Sustainability has become the corporate buzzword of the day. It was the theme of the 2020 World Economic Forum in Davos. In August 2019, the Business Roundtable, a group of influential US CEOs, radically redefined its statement of the 'purpose of a corporation' to include stakeholders, rather than just shareholders. In June 2020, Danone was the first French company to become a '*société à mission*', writing its purpose into its corporate bylaws.

But it wasn't clear whether these leaders genuinely meant what they said. Critics argue that Davos is more about appearing to do good than actually doing good. Sceptics claim that the Business Roundtable statement was a public relations exercise to stave off regulation. Indeed, several signatories shed thousands of workers in the coronavirus pandemic, at the same time as paying huge dividends to investors. A few months after becoming a *société à mission*, Danone announced 2,000 job cuts. Critics argued that Danone's focus on purpose was an attempt to mask its poor performance – its stock price was flat over CEO Emmanuel Faber's 6.5-year tenure, compared to a 50% rise for its competitor Nestlé and the broader CAC-40.

Why is it that some leaders may not do as they say? Why do they reduce sustainability to an ancillary activity to be buried in a 'Corporate Social Responsibility' department rather than part of the core business? Because many fear that sustainability is at the expense of profits. Traditional management thinking is that the value created by a company is represented by a pie, which is fixed in size. So any slice of the pie given to society means a smaller slice for shareholders. A CEO's goal, therefore, is to squeeze as much as possible out others, by holding down wages, price-gouging customers, and paying scant attention to the environment. This *pie-splitting mentality* would argue that you should practice sustainability to the minimum possible, and reduce it to PR initiatives that cost little but create much fanfare.



And the pie-splitting mentality is also practiced by many advocates of business reform. If the pie is fixed, the only way to increase the share that goes to society is to straitjacket business with heavy regulation so that it doesn't make too much profit.

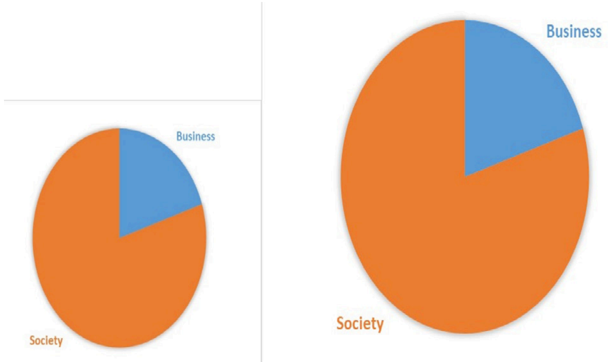
Under the pie-splitting mentality, business and society are enemies. And the battle they've been fighting has been around for centuries. In the mid-19th century, Karl Marx wrote about the struggle between capital and labour. Since then, we've seen a pendulum swing back and forth between business and society. Think of the late 19th century robber barons who created giant monopolies such as Standard Oil; policymakers responded by breaking some up. Or the peak of trade unions in the 1970s, followed by legislation that caused their decline. Or the rise of big banks in the early 20th century which culminated in the 1929 financial crisis and their regulation by the Glass-Steagall Act - itself partially reversed since the 1980s, contributing to another crisis in 2007. Unless we can come up with another way, this movie will keep on being replayed.

But the good news is that there is another way.

By applying a radically different approach to business, companies can create both profit for investors and value for society. The pie-growing mentality stresses that the pie is not fixed. By investing in stakeholders, a company doesn't reduce investors' slice of the pie, as assumed by some CEOs - it grows the pie, ultimately benefiting investors. A company may improve working conditions out of genuine concern for its employees, yet these employees become more motivated and productive. A company may develop a new drug to solve a public health crisis, without considering whether those affected are able to pay for it, yet end up successfully commercialising it. A company may reduce its emissions far beyond the level that would lead to a fine, due to its sense of responsibility to the environment, yet benefit because customers, employees, and investors are attracted to a firm with such values.

Under the *pie-growing mentality*, a company's primary goal is to serve society rather than generate profits. Surprisingly, this approach typically ends up more profitable than if profits were the end goal. That's because it enables many investments to be made that end up delivering substantial long-term payoffs. It's important to acknowledge that a profit-focused company will still invest in stakeholders - but only if it calculates that such an investment will increase profits by more than the cost of the investment. Indeed, comparing costs and benefits is how finance textbooks argue companies should decide whether or not to take an investment.

But real life isn't a finance textbook. In practice, it's very difficult to calculate the future payoff of an investment. In the past, this was easier when investments were in tangible assets - if you build a new factory, you can estimate how many new widgets the factory will produce and how much you can sell them for. Most of the value of a 21st century firm comes from intangible assets, such as brand and corporate culture. If a company improves working conditions, it's impossible to estimate how much more productive workers will be, and how much higher profit this greater productivity will translate into. The same is true for the reputational benefits of a superior environmental record. A company that's free from the shackles of having to justify every investment by a calculation will invest more and may ultimately become more profitable.



This new approach to business is the subject of my recent book, *Grow the Pie: How Great Companies Deliver Both Purpose and Profit*.[1] I wrote this book out of concern for the polarisation between business and society that the world finds itself in. In the face of this conflict, this is a fundamentally optimistic book. Yet this optimism is not based on blind hope, but on rigorous evidence that this approach to business works - across industries and for all stakeholders - and an actionable framework to turn it into reality.

Let's indeed turn to the evidence. The idea that both business and society can benefit might seem to be a too-good-to-be-true pipedream. However, rigorous evidence suggests that companies that treat their stakeholders well deliver superior long-term returns to investors. For example, one of my own studies, shows that companies with high employee satisfaction outperformed their peers by 2.3-3.8% per year over a 28-year period.[2] That's 89-184% compounded. I do further tests suggest that it's employee satisfaction that leads to good performance, rather than the reverse. Other studies find that customer satisfaction,[3] environmental stewardship,[4] and sustainability policies[5] are also associated with higher stock returns.

1. Edmans, Alex (2020): *Grow the Pie: How Great Companies Deliver Both Purpose and Profit*. Cambridge University Press.
2. Edmans, Alex (2011): 'Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices.' *Journal of Financial Economics* 101, 621-640; Edmans, Alex (2012): 'The Link Between Job Satisfaction and Firm Value, With Implications for Corporate Social Responsibility.' *Academy of Management Perspectives* 26, 1-19.
3. Fornell, Claes, Sunil Mithas, Forrest V. Morgeson III and M.S. Krishnan (2006): 'Customer Satisfaction and Stock Prices: High Returns, Low Risk.' *Journal of Marketing* 70, 3-14.
4. Derwall, Jeroen, Nadja Guenster, Rob Bauer and Kees Koedijk (2005): 'The Eco-Efficiency Premium Puzzle.' *Financial Analysts Journal* 61, 51-63.
5. Eccles, Robert, Ioannis Ioannou and George Serafeim (2014): 'The Impact of Corporate Sustainability on Organizational Processes and Performance' *Management Science* 60, 2835–2857.

So creating value for stakeholders isn't just a worthy ideal – it's good business sense. When I speak to practitioners on the importance of purpose, I'm introduced as a Professor of Finance and the audience often thinks they've misheard. The finance department is frequently the enemy of purposeful business, believing that it's simply a distraction from creating profits. This might be true in the short-term, but the long-term evidence shows that any finance department with this mindset is failing at its job. The positive relationship with long-term returns also means that it's in companies' own interest to transform the way they do business and take very seriously their impact on society. In fact, it's urgent that they do. Otherwise, anti-business regulations will be passed, and customers and workers will switch to competitors whose values they share. Serving society isn't an optional extra to be confined to a CSR department, but should be fundamental to how a business is run.

A Shift in Thinking

The pie-growing mentality shifts our thinking on some of the most controversial aspects of business. First, it transforms what leaders' and enterprises' responsibilities are, and how what society should hold them accountable for. We often 'name and shame' companies who engage in *errors of commission* – actions seen as pie-splitting, such as making what we see as too much profit. But high profits may be a by-product of serving society. Instead, we should hold businesses accountable for *errors of omission* – spurning opportunities to grow the pie through inaction. For example, Kodak failed to invest in digital cameras and ultimately went bankrupt. Yet it's rarely seen as a corporate governance failure because investors didn't profit – but that's of no consolation to the 150,000 workers were made redundant. An irresponsible company is one that shrinks the pie or fails to grow it, harming everyone.

Second, the pie-growing mentality changes our view on how to reform executive pay. The level of CEO pay is perhaps the single most-cited piece of evidence that business is out of touch with society. In the US, the average S&P 500 CEO earned $14.8 million in 2019, 264 times the average employee. The idea is that, if the CEO wasn't so greedy, her pay could be redistributed to her colleagues or invested. But that's the pie-splitting mentality. The amount that can be reallocated through redistributing the pie is tiny. The median equity value in the S&P 500 is $24 billion. $14.8 million is only 0.06% of the pie – far smaller than the 2.3-3.8% that can be created by growing the pie through improving employee satisfaction.

Moreover, just like high profits, high pay could be a by-product of creating value. It's fair for CEOs to be paid like owners – to own a long-term share in her business, so that she's on the hook if it underperforms. But the flip side is that, if she grows the long-term stock price, she'll automatically be rewarded as her shares will be worth more. For example, Disney's Bob Iger was criticised for earning $66 million, but the market value of Disney had risen by 578% in his four years at the helm, and 70,000 jobs had been created. So we shouldn't criticise high CEO pay without first asking whether it results from pie-growing or pie-splitting.

And that's where there is indeed major room for reform. Some CEOs aren't paid like long-term owners. They're instead given bonuses based on short-term targets – and so it's indeed possible for them to earn millions by exploiting workers and customers. So the solution isn't so much to change the *level* of pay, even though this might win the most headlines, but its *structure* – to move away from short-term targets and pay the CEO with shares that she can't sell for (say) 5-7 years. Giving her long-term incentives rewards her for pie-growing and discourages pie-splitting. Indeed, research shows that short-term incentives lead to CEOs cutting investment to meet quarterly earnings targets,[6] while long-term incentives are associated with not only higher financial performance, but superior innovation and stakeholder welfare.[7] Importantly, both papers document causation, not just correlation.

Importantly, the CEO should continue to hold her shares after retirement, to ensure that her horizon extends beyond her tenure. And shares should be awarded to all employees, to ensure that everyone benefits from pie-growth. If the company does well, it's not just due to the CEO. Giving shares to colleagues treats them as partners in the enterprise, rather than hired labourers.

Third, the pie-growing mentality shifts our thinking on investors. Investors are often viewed as nameless, faceless capitalists who extract profits at the expense of society. One book claimed that 'Shareholder activists ... are more like terrorists who manage through fear and strip the company of its underlying crucial assets, ... extracting cash out of everything that would otherwise generate long-term value',[8] and politicians in both the UK and US have made proposals to restrict investor rights. But such views aren't backed up by the evidence. Rigorous studies show that, while shareholder activism does indeed increase profits, this doesn't arise from pie-splitting but pie-growing – improved productivity and innovation, which in turn benefits society.[9]

Investors are not 'them'; they are 'us'. As mentioned earlier, they include ordinary citizens saving for retire-

6. Edmans, Alex, Vivian W. Fang and Katharina Lewellen (2017): 'Equity Vesting and Investment.' *Review of Financial Studies* 30, 2229-2271.

7. Flammer, Caroline and Pratima Bansal (2017): 'Does Long-Term Orientation Create Value? Evidence from a Regression Discontinuity.' *Strategic Management Journal* 38, 1827-1847.

8. Georgescu, Peter (2017), *Capitalists, Arise!: End Economic Inequality, Grow the Middle Class, Heal the Nation*, Berrett-Koehler Publishers, 118.

9. Brav, Alon, Wei Jiang, Frank Partnoy and Randall Thomas (2008) 'Hedge Fund Activism, Corporate Governance, and Firm Performance.' *Journal of Finance* 63, 1729-1775. Brav, Alon, Wei Jiang and Hyunseob Kim (2015): 'The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes' *Review of Financial Studies* 28, 2723–2769. Brav, Alon, Wei Jiang, Song Ma and Xuan Tian (2018): 'How Does Hedge Fund Activism Reshape Corporate Innovation?' *Journal of Financial Economics* 130, 237–264.

ment, or mutual funds or pension funds investing on their behalf. Policies that suppress investors will not only make companies less purposeful and less productive, but also harm citizens. Investors aren't the enemy, but allies in growing the pie. Any serious proposal to reform business should place investor engagement front and centre.

Putting It Into Practice

So how does a company actually 'grow the pie'? The starting point is to define its purpose – why it exists, its reason for being, and the role that it plays in the world. A purpose might be to develop medicines that transform citizens' health; to provide an efficient rail network that connects people with their jobs, family and friends; or to manufacture toys that entertain and educate children.

Importantly, a company's purpose cannot be to earn profits – instead, profits are a by-product of serving a purpose. This is similar to how a citizen's vocation is not to earn a salary; instead, he earns a salary by choosing a career he enjoys and thus flourishes in. Equally importantly, a purpose should be focused. Many companies have broad purpose statements, such as 'to serve customers, colleagues, suppliers, the environment, and communities while generating returns to investors,' because it sounds inspiring to be able to serve everyone. But a purpose that tries to be all things to all people offers little practical guidance because it sweeps the harsh reality of trade-offs under the carpet. Leaders need to make tough decisions that benefit some stakeholders at the expense of others.

In November 2016, French electricity firm Engie announced the closure of its Hazelwood power station in the Latrobe Valley of Victoria, Australia. This decision caused 450 Engie employees and 300 contractors to lose their jobs. Customers also suffered – since Hazelwood provided a fifth of Victoria's electricity-generation capacity, average household bills rose by 16% over the next year. But Engie took the decision because, earlier that year, it had announced a transformation plan to prioritise the environment. As then-CEO Isabelle Kocher said: 'We want to focus our investments solely on generating low carbon energy . . . we are redesigning our entire portfolio.' Hazelwood was the most polluting plant in Australia, responsible for 3% of its greenhouse gas emissions, and one of the most polluting plants in the world. In 2005, the World Wide Fund for Nature had named it the least carbon-efficient power station in the OECD.

Having a focused purpose statement guided Engie on this tough decision. Because its purpose ranked the environment as even more important than employees and customers, it knew what it had to do. It *first* chose to close down the plant, and *then* sought to mitigate the job losses by finding jobs for its employees at nearby companies.

And evidence highlights the criticality of focus. Companies that do well on ESG (environmental, social, and governance) dimensions across the board don't beat the market. But those that do well on only dimensions material to their business – and scale back on others – do significantly outperform.[10] The book introduces three principles (the principle of multiplication, the principle of comparative advantage, and the principle of materiality) to provide practical guidance on which investments in stakeholders a company should make, and when it should show restraint. This balance is critical. Some leaders misinterpret the call to 'serve society' as an imperative to invest as much as possible, and many politicians advocate such behaviour. But there are many cautionary tales of companies imploding through overinvestment, Daewoo being a particularly prominent one.

Of course, purpose must go beyond a mere statement and must be put into practice. The book discusses five tools through which a company can do so – aligning its strategy, operating model, culture, reporting, and governance. It also stresses the role of investors in stewarding a company's purpose – holding CEOs to account for embedding it throughout the organisation, and providing an independent sounding board on long-term issues. I provide a practical guide for how investors can undertake stewardship effectively, and how the relationships between different players in the investment industry – asset managers, asset owners, investment consultants, and proxy advisors – can be reformed from the transactional to the trusted, in turn providing the long-term context necessary for stewardship to thrive.

And citizens have a major part to play too. The popular narrative is that corporations are so large that citizens are powerless to shape them. But I stress how citizens – in their roles as employees, customers, and investors – enjoy *agency*: their capacity to act independently and influence their environment, rather than being acted upon. One source of agency is the power to put their time and money into companies that reflect what they would like to see in the world, and walk away from others. Customer boycotts for allegedly non-purposeful behaviour are arguably more powerful than ever before due to social media, as shown by the #boycottvolkswagen and #DeleteUber campaigns. In the modern firm, human (rather than physical) capital is more important than ever before, and departures of key employees severely damage a company's competitiveness.

A second source of agency is the power to shape companies they do choose to be members of. Every night, Abdul Durrant worked hard to clean the London offices of HSBC, including that of chair Sir John Bond. But he struggled to support his five children on his low wages. So Abdul attended HSBC's AGM and addressed Sir John, saying 'I am here on behalf of all the contract staff at HSBC and the families of East London. We receive £5 per hour – a whole £5 per hour! – no pension, and a measly sick pay scheme. In our struggles our children go to school without adequate lunch. We are unable to provide neces-

10. Khan, Mozaffar, George Serafeim, and Aaron Yoon (2016): 'Corporate Sustainability: First Evidence on Materiality.' *The Accounting Review* 91, 1697-1724.

sary books for their education. School outings in particular they miss out on.' Moved by this plea, Sir John gave HSBC's cleaners a 28% pay rise. This shows the power of a single employee to change the wage policy of a large multinational.

Purpose in the Pandemic

The importance of viewing purpose as growing the pie, rather than splitting it differently, is particularly critical in the pandemic. Some companies have indeed been able to serve society by splitting the pie in the pandemic. For example, Unilever donated €100 million of food and sanitiser to local communities and safeguarded the jobs of its 155,000 workers – including contractors, such as cleaners and catering staff.

Such actions are highly laudable and should never be downplayed. But the problem with viewing responsibility as only about splitting the pie is that many companies don't have pie to share, particularly in a pandemic. What if you're not in the food and sanitiser industry and don't have relevant products to donate? What if you're a small enterprise that doesn't have millions lying around?

The value of thinking about responsibility as pie-growing is that it unlocks the potential for all companies to play their part. Unlike splitting the pie, growing the pie often doesn't cost a huge amount of money – what it requires is the mindset to create value for society. A responsible leader asks herself 'What's in my hand?' What resources and expertise does my company have, and how can I deploy them innovatively to serve society?

Such a mindset can inspire some great ideas. LVMH's luxury perfumes were indeed a luxury in a pandemic. But what's in its hand is a production facility that uses alcohol, which it redeployed to manufacture hand sanitiser. Many of JetBlue's planes were grounded as passenger numbers plummeted. So it partnered with charities such as the Red Cross and Médecins Sans Frontières to use these planes to transport medical professionals, devices and supplies to where they're most needed.

And thinking of responsibility as growing the pie is particularly relevant for small businesses, who don't have pie to give. Take Barry's, the boutique fitness studio. What's in its hand is fitness expertise, which it used to offer free livestreamed workouts – particularly valuable when citizens are locked down at home. Now it might seem not particularly innovative for a fitness studio to provide fitness classes, albeit online. The real creativity was in how it redeployed its office and desk workers. Some of them also had jobs as actors; since acting can be volatile, they also worked for Barry's to provide a stable income.

If you're an actor, what's in your hand is that you're entertaining. How does that help in a crisis? Barry's launched a 'Barry's Cares' programme, which included their staff reading stories and providing entertainment to children over Zoom – taking the load off working parents whose kids were at home due to school closures.

Citizens practised the pie-growing mindset in the pandemic too. For some, what's in their hand was time – by doing grocery shopping for their vulnerable neighbours. For others, it was money. One friend advance-purchased 100 coffees from his local coffee shop, supplying them with a liquidity lifeline. For others still it was words, which are often seen as vacuous compared to 'hard' actions or financial contributions. But telephoning someone who is self-isolating alone, or giving a sincere thank you to an overworked delivery driver, can make a big difference.

These inspiring examples give us hope even in bleak times. If there's any silver lining to the crisis, it's that it will permanently lead to a shift in thinking about what responsible business entails – from splitting the pie by spending money to growing the pie by innovatively using what's in our hand. The latter can be practised by companies both large and small, in bad times as well as good, and by citizens and junior employees not just senior executives.

A Collaborative Effort

So it's not business *or* society – it's *and*. This observation gives us great hope, but also great responsibility. Not only can all stakeholders benefit from a growing pie, but it's also their duty to work together to grow the pie. When they do so, bound by a common purpose and focused on the long-term, they create shared value in a way that enlarges the slices of everyone – shareholders, workers, customers, suppliers, the environment, communities, and taxpayers. Evidence suggests that visionary leaders can transform a company, growing the pie for the benefit of all. Engaged shareholders can intervene in a failing firm, growing the pie for the benefit of all. A motivated workforce can innovate from the bottom up, growing the pie for the benefit of all.

Importantly, an approach to business driven by purpose typically ends up more profitable in the long-term than an attempt to maximise shareholder value. So it's one that leaders should voluntarily embrace, even in the absence of public mistrust or threats of regulation. Creating social value is neither defensive nor simply 'worthy' – it's good business. The highest-quality evidence, not wishful thinking, reaches this conclusion: to reach the land of profit, follow the road of purpose.

Dan W. Puchniak • Professor at the Yong Pung How School of Law at Singapore Management University; Research Member of the European Corporate Governance Institute (ECGI)

No Need for Asia to be Woke:
Contextualizing Anglo-America's "Discovery" of Corporate Purpose

In 2018,[1] Colin Mayer, a stalwart of the British Academy, published *Prosperity*.[2] The Book is the new "bible" of corporate governance that "is destined to change the world", says Martin Lipton, a prolific prophet for America's white-shoe lawyers.[3] The Book's revelation is that corporations should no longer be governed for the sole purpose of maximizing shareholder value. In 2019, the Business Roundtable, a club of America's elite CEOs, reportedly "made headlines around the world" by releasing its new statement on corporate purpose.[4] The statement's epochal epiphany echoed Mayer's clarion call for corporations to have a purpose other than maximizing shareholder value: corporations no longer exist principally to serve shareholders but "for the benefit of all stakeholders—customers, employees, suppliers, communities and shareholders".[5] In 2020, Larry Fink, founder and chief executive of the American-cum-global investment goliath BlackRock, issued a letter to CEOs around the world imploring them to govern corporations to embrace "purpose and [serve] all stakeholders" – ostensibly spelling an end to the shareholder primacy obsession.[6] The same year, the World Economic Forum, an international organization comprising major global corporations and thought leaders, "issued a manifesto urging companies to abandon the traditional model of 'shareholder capitalism'" and its executive chairman likened "the session focusing on the subject to 'the funeral of shareholder capitalism'".[7]

Viewed through an Anglo-American lens, corporate governance around the world is living a woke moment.[8] The "discovery" that corporations have stakeholders (other than shareholders) and purposes (other than maximizing shareholder value) promises to deliver global corporate governance from Tartarus to Elysium – or as Mayer describes it, perhaps drawing on Hinduism for global effect, corporate "nirvana".[9] Mayer tells us that this woke moment has the potential to emancipate the global community from the "Friedman Doctrine", which posits that the corporation's sole purpose is maximizing shareholder value. In Mayer's words, the Friedman Doctrine "has been a powerful concept that has defined business practice and government policies around the world for half a century".[10] Not so fast.

That the Friedman Doctrine has played a central role in shaping *Anglo-American* corporate governance is beyond reproach. Despite their myriad differences, until recently, modern corporate law and governance in the United Kingdom and United States has, in theory and practice, been defined by shareholder primacy. Recognition of the interests of other corporate stakeholders (aside from shareholders) has largely been on the margins of corporate law and governance in both systems – with "shareholder primacy" at the core.[11] At the dawn of the new millennium, two of America's preeminent law professors, Henry Hansmann and Reinier Kraakman, in their pugnaciously titled article "The End of History for Corporate Law", boldly claimed that "[t]he triumph of the shareholder-oriented model of the corporation over

1. I am grateful to Umakanth Varottil for generously allowing me to use his ECGI Blog post, 'Responsible Capitalism and Corporate Purpose: The India Way' <https://ecgi.global/blog/responsible-capitalism-and-corporate-purpose-india-way> as the primary substantive content for the section on India in this article (see, Part II(C) below). This article builds on my ECGI Blog post, 'No Need for Asia to be Woke: Responsible Capitalism Through an Asian Lens' <https://ecgi.global/blog/no-need-asia-be-woke-responsible-capitalism-through-asian-lens>. I am also grateful for extremely helpful feedback on earlier drafts of this article from Afra Afsharipour, Gary F Bell, Brian R Cheffins, Michael Dowdle, Gen Goto, Amir N Licht, Tamane Harata, Christian Hofmann, Dionysia Katelouzou, Kon Sik Kim, Alan K Koh, Lin Lin, Roza Nurgozhayeva, Mariana Pargendler, Elizabeth Pollman, Samantha S Tang, and Umakanth Varottil. Any errors remain my own.
2. Colin Mayer, *Prosperity* (OUP 2018).
3. Colin Mayer, *Prosperity* (OUP 2018) viii.
4. Jill E Fisch, 'Purpose Proposals' (ECGI Law Working Paper 638/2022, April 2022) <https://ecgi.global/working-paper/purpose-proposals> accessed 14 May 2022, 8.
5. 'Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' (*Business Roundtable*, 19 August 2019) <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> accessed 14 May 2022.
6. Larry Fink, 'A Fundamental Reshaping of Finance' (*Harvard Law School Forum on Corporate Governance*, 16 January 2020) <https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/> accessed 14 May 2022.
7. Lucian A Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' [2020] 106 *Cornell Law Review* 91, 107.
8. For an excellent nuanced comparative analysis that unpacks the complexities of the purpose debate see, Amir N Licht, 'Varieties of Shareholderism: Three Views of the Corporate Purpose Cathedral' in Elizabeth Pollman & Robert Thompson (eds.), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021).
9. Colin Mayer, *Prosperity* (OUP 2018) 35-37.
10. Colin Mayer, *Prosperity* (OUP 2018) 2. It should be noted that Mayer's claim about the Friedman Doctrine may even be incorrect in the context of the United States as a leading corporate law professor has convincingly explained how it is erroneous to blame (or credit) Milton Friedman for the rise of shareholder primacy in corporate America. Brian R Cheffins, 'Stop Blaming Milton Friedman!' (ECGI Law Working Paper 523/2020, June 2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3552950> accessed 6 June 2022.
11. For an excellent overview of this topic in the Anglo-American context see, Lucian A Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' [2020] 106 *Cornell Law Review* 91, 103-108.

its principal competitors is now assured".[12] In the echo of such Anglo-American shareholder primacy triumphalism, perhaps the iniquities of those who now suggest that the Friedman Doctrine is a powerful concept that has defined business practice and government policies in Asia (and everywhere else) over the last fifty-years can be forgiven.

What seems to have been forgotten is that the Friedman Doctrine is as autochthonous to Asia as the fortune cookie.[13] Asian economic miracles have propelled the world's economic growth for half a century.[14] However, they have not been built on the Friedman Doctrine. Instead, for better or worse, the corporate governance systems in Asia's most important economies have been driven by a variety of purposes – with neither the Friedman Doctrine nor its corporate law incarnation in the form of "shareholder primacy" reigning supreme.

This is a positive observation with normative implications. As illuminated below, the failure to accurately understand the purposes corporations have served – and do serve – in Asia has real-world consequences. It risks the well-intentioned Anglo-American-cum-global corporate purpose movement providing cover for rent-seekers in Asia – who are (or should be) disciplined by shareholder wealth maximization – in systems long steeped in corporate purpose. It may hinder efforts to address climate change as repurposing corporations for this task requires understanding what their core purpose is to begin with. It cancels convincing evidence that corporate governance without shareholder primacy can produce economic success; and, in some cases, spawn economic miracles that lift hundreds of millions of people out of poverty, produce world leading innovations, and build stable and safe societies. It masks the dark sides of Asia's economic miracles, in which corporations with core purposes other than shareholder wealth maximization can produce – and have produced – societal ills, which other countries would do well to avoid.

1. A Brief History of Corporate Purposes in Asia Usurping Shareholder Primacy

Asia is diverse. With over four billion people, two thousand languages, and around fifty countries, one should almost never make claims about Asia as a whole. However, when it comes to economic power and financial markets a handful of countries in Asia dominate.[15] For this short article, it makes sense to consider Asia's three largest economies respectively – China, Japan, and India – which comprise three of the four largest economies in the world.[16] It is also instructive to consider Singapore as it is one of the world's wealthiest economies – which as a Commonwealth, English speaking, international financial centre would be the jurisdiction that one may predict should have embraced shareholder primacy more so than anywhere else in Asia.

1.A Understanding Stakeholderism With Chinese (Communist Party) Characteristics

Two decades ago, the United Sates had almost twenty times as many Fortune Global 500 Companies as China. Today, the number of Fortune Global 500 Companies in China (124) has surpassed the United States (121). China's listed companies are leaders in many of the world's most important industries, a fact that was unthinkable at the dawn of the new millennium. China now has the world's largest market for initial public offerings and the world's second largest stock market, which has grown five-fold in the past decade.[17]

These facts help explain how China has enjoyed decades of economic success which have lifted hundreds of millions of people out of poverty, placing it on a trajectory to be the world's most powerful economy. To Western observers, claims that China has achieved its economic success at the expense of Western democracy, individual liberties, and human rights are well-known. That the Chinese economy is on the precipice of imploding has been repeated ad nauseam for decades – but has not (yet) transpired. Given China's global economic superpower status and Anglo-America's corporate purpose obsession, including China in the corporate purpose debate would seem unavoidable. This is especially so considering claims of the Friedman Doctrine's global ubiquity and the declaration that world domination of Anglo-American shareholder-primacy marked "the end of history for corporate law". Yet, the leading Anglo-American-cum-global corporate purpose literature barely considers China at all.

Based on a conventional understanding of stakeholderism, Chinese corporate law and governance ticks all the boxes. From the inception of China's modern PRC Company Law in 1994, employees have been recognized

12. Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 468.

13. What is commonly known as the "fortune cookie" is ubiquitous in Chinese restaurants in the United States and now in Chinese restaurants in several other Western countries. It was most likely created by Japanese immigrants in California in the late 19th or early 20th century. The fortune cookie appears to have nothing to do with traditional Chinese culture – as is often erroneously assumed. These cookies may have drawn some inspiration from different cookies historically produced in Japan – but which are different from the American fortune cookie. 'Fortune cookie' (*Wikipedia*) <https://en.wikipedia.org/wiki/Fortune_cookie> accessed 16 May 2022.

14. Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015) 511, 511-512.

15. Dan W Puchniak et al., 'Introduction' in Dan W Puchniak et al. (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (CUP 2017) 7-8; Dan W Puchniak at al., 'The Complexity of Derivative Actions in Asia: An Inconvenient Truth' in Dan W Puchniak et al. (eds.), *The Derivative Action in Asia: A Comparative and Functional Approach* (CUP 2012) 98.

16. Measured on a Purchasing Power Parity basis (PPP) the largest economies in the world based on 2020 data are: China (1); United States (2); India (3); and, Japan (4) ('The World Bank Data, GDP, PPP' (*The World Bank Data*) <https://data.worldbank.org/indicator/NY.GDP.MKTP.PP.CD?most_recent_value_desc=true> accessed 14 May 2022. Measured in US Dollars the largest economies in the world based on 2020 data are: United States (1); China (2); Japan (3); Germany (4); United Kingdom; (5) and, India (6) ('The World Bank Data, GDP, (current US$)' (*The World Bank Data*) <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=true > accessed 14 May 2022.

17. For the original text with the sources supporting this paragraph see, Lin Lin and Dan W Puchniak, 'Institutional Investors in China: Corporate Governance and Policy Channeling in the Market Within the State' (2022) 35 *Columbia Journal of Asian Law* 74, 77.

as important corporate stakeholders. Employee board representation has always been enshrined in the company law and the requirement that employees must play a meaningful role in corporate decision making has always been made explicit.[18] More broadly, from its inception the PRC Company Law has included provisions that have been all about purpose – exhorting companies to act ethically, strengthen China's socialist society, and to be accountable to the wider community.[19] In 2006, the PRC Company Law was amended to explicitly require companies to "undertake social responsibility".[20] The newly issued draft of the revised PRC Company Law is as purposeful as ever; Article 19 states that "companies should fully consider the interests of the company's employees, consumers and other stakeholders, as well as ecological and environmental protection and other social public interests, to assume social responsibility. The State encourages companies to participate in social welfare activities and publish social responsibility reports."[21]

In 2002, China joined one of the most significant international corporate governance trends in modern times: adopting a UK-style corporate governance code. One may have thought that this would be a catalyst for China to join "the end of history for corporate law" by implementing a shareholder primacy corporate governance model. Instead, the inaugural 2002 Chinese Corporate Governance Code (CCGC) reads like it was woke in 2022. It encouraged listed companies to "be concerned with the welfare, environmental protection, and public interests of the community" and to "pay attention to the company's social responsibilities".[22] The 2018 CCGC goes even further by encouraging listed companies to "actively implement the concept of green development, integrate ecological and environmental protection requirements into the development strategy and corporate governance process, actively participate in the construction of ecological civilization, and play an exemplary role in pollution prevention, resource conservation, and ecological protection".[23] As if that were not purposeful enough, it encourages listed companies to assist "poverty-stricken counties or villages, and actively connect with and earnestly support poverty-stricken areas to develop local industries, train talents, and promote employment".[24]

China was clearly awake to corporate purpose long before Mayer penned *Prosperity* or Fink proclaimed the end of shareholder-primacy; at least on paper, Chinese corporate law and governance is as purposeful as can be.[25] What is less clear, is whether Chinese companies can fulfil these lofty purposes. Another question that looms large is: Can Chinese companies stay on their world changing trajectory in an economy where the Chinese Communist Party (CCP) appears to be ratcheting-up its control over which purposes companies may serve?

If President Xi's "common prosperity" campaign is to be taken at face value, companies' purposes are being defined by the government for the public good – whether it involves effectively banning trading on cryptocurrency and for-profit tutoring, restricting gaming for children, or cajoling prominent companies to make large charitable donations.[26] If one is more cynical, the CCP's role as China's *de facto* largest controlling shareholder, its informal control over private corporations and institutional investors, and its campaign to formalize its control over corporate management by having it formally inserted into corporate charters, suggest that the real purpose of corporate governance in China is to reinforce the CCP's ultimate control.[27] From either perspective, considering the CCP's more assertive role in restricting and controlling corporate purpose, it appears that fewer purposes and a narrower focus on maximizing shareholder value may be exactly what is required in China at this moment – the opposite of what Anglo-America's awakening prescribes.

1.B "Company Community" Defines Corporate Purpose in Post-war Japan

After more than three decades of tepid economic growth, it is easy to forget that in the late 1980s Japan

18. Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 *Berkeley Journal of International Law* 64, 68. Li-Wen Lin, 'Mandatory Corporate Social Responsibility? Legislative Innovation and Judicial Application in China', (2020) 68 *American Journal of Comparative Law* 576, 582.
19. Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 *Berkeley Journal of International Law* 64, 69. Li-Wen Lin, 'Mandatory Corporate Social Responsibility? Legislative Innovation and Judicial Application in China', (2020) 68 *American Journal of Comparative Law* 576, 582.
20. PRC Company Law (2006), art. 5. For an excellent analysis of this development see, Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 *Berkeley Journal of International Law* 64, 71-72.
21. Revised Draft of PRC Company Law, issued on 24 Dec 2021, art. 19 <https://npcobserver.com/wp-content/uploads/2021/12/Company-Law-Draft-Revision.pdf> accessed 14 May 2022.
22. Code of Corporate Governance for Listed Companies 2002, art 86.
23. Code of Corporate Governance for Listed Companies 2018, art 86.
24. Code of Corporate Governance for Listed Companies 2018, art 87.
25. See, Dan W Puchniak and Lin Lin 'Institutional Investors in China: An Autochthonous Mechanism Unrelated to UK-cum-Global Stewardship' in *Global Shareholder Stewardship* (Dionysia Katelouzou and Dan W. Puchniak eds, CUP 2022), 416.
26. For a critical Western perspective discussing President Xi's "common prosperity" campaign see, 'China's new reality is rife with danger' *The Economist* (2 October 2021) <https://www.economist.com/leaders/2021/10/02/chinas-new-reality-is-rife-with-danger> accessed 14 May 2022; 'Xi Jinping's talk of "common prosperity" spooks the prosperous' *The Economist* (28 August 2021) < https://www.economist.com/finance-and-economics/xi-jinpings-talk-of-common-prosperity-spooks-the-prosperous/21803895> accessed 16 May 2022.
27. For an excellent analysis of the CCP's role as China's de facto largest controlling shareholder see, Li-Wen Lin and Curtis J Milhaupt, 'We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China' (2013) 65 *Stanford Law Review* 697. For insight into the CCP's control over private corporations see, Curtis J Milhaupt and Wentong Zheng, 'Beyond Ownership: State Capitalism and the Chinese Firm' (2015) 103 *Georgetown Law Journal* 665. For a detailed analysis of the CCP's formal and informal control over institutional investors in China see, Lin Lin and Dan W Puchniak, 'Institutional Investors in China: Corporate Governance and Policy Channeling in the Market Within the State' (2022) 35 *Columbia Journal of Asian Law* 74. For an empirical analysis of the CCP's campaign to formalize its control over corporate management in corporate charters see, Lauren Yu-Hsin Lin and Curtis J Milhaupt, 'Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance' (2021) 50(1) *Journal of Legal Studies* 187. For a fascinating analysis of the possible risks and benefits of the CCP using China's corporate social credit system (CSCS) to shape the purpose that Chinese companies fulfil see, Lauren Yu-Hsin Lin and Curtis Milhaupt, 'China's Corporate Social Credit System and the Dawn of Surveillance State Capitalism' (ECGI Law Working Paper 610/2021, October 2021) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3933134> accessed 6 June 2022.

was, by many measures, the richest country in the world. It had the world's highest per capita Gross National Product, largest net holdings of foreign assets, and by far the largest stock market capitalization and highest property values. Japan's rise to the zenith of the world economy was even more extraordinary considering that merely a few decades earlier its devastating defeat in World War II had reduced it to the level of a poor developing country.[28] Japan's post-war economic miracle produced growth rates unseen in human history. It was the first time an economy had ever doubled in size in under a decade – which set the stage for other Asian economic miracles that transformed Asia into the world's engine of economic growth.[29]

It is well-known that Japan's post-war economic miracle transpired in a corporate governance environment defined by stakeholderism.[30] Prior to the burst of the economic bubble in the early 1990s, the world marvelled at Japan's unique system of corporate governance – in which shareholder voice was scant. As if taken from the pages of *Prosperity*, Japan's corporate governance model was referred to as the "company community" – in which boards were overwhelmingly staffed by lifetime employees.[31] Japan's comparatively small wage gap between senior executives and average workers appeared to be the embodiment of woke egalitarianism.[32] Rather than hostile takeovers, Japan's success was credited to "the efficiency of friendliness" in which friendly mergers rather than hostile takeovers produced corporate governance efficiency.[33] Informal corporate groups, called *Keiretsu*, produced innovative and high-quality products, without the need for detailed contracts, which used "just-in time" production to dominate global product markets.[34] Shares were held between *Keiretsu* members and their "main bank" (a feature coined "cross-shareholding") as informal symbols of commitment to the *Keiretsu* members and to act as a defence against hostile takeovers – but not to reap profits by maximizing their value.[35] When things went wrong in companies, the main bank (not shareholders) would efficiently sort things out.[36] Researchers and pundits wondered whether the world would converge on Japan's woke model of corporate governance.[37] But, then, in the early 1990s, Japan's economic bubble burst.

In the post-bubble period, an era of American hegemony transpired in which legions of academics and pundits predicted that Anglo-American-style shareholder-primacy would emerge as the dominant corporate governance model in Japan.[38] These predictions were not without reason. Japan's post-war corporate law had (and still has) strong legal protections for minority shareholders that lay moribund for decades before the bubble burst.[39] At least empirically, the shareholding in Japan's large public companies was (and still is) as widely dispersed as in the United Kingdom and United States – a fact that is often overlooked because historically a majority of the "dispersed-shares" were held in informal cross-shareholding arrangements.[40] In the decades following the bubble's burst, economic stagnation forced banks and *keiretsu* members to "unwind" their cross-shareholdings and the main bank system of monitoring management withered. Foreign ownership of Japanese listed companies spiked, and activist shareholder campaigns emerged.[41] A bevy of legal reforms that ap-

28. For original text with the sources supporting this paragraph see, Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4, 10.

29. Michael Spence, *The Next Convergence: The Future of Economic Growth in a Multispeed World* (Farrar, Straus and Giroux 2011) 14. See generally, Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing, 2015) 511, 511.

30. Gen Goto, 'The Japanese Stewardship Code: Its Resemblance and Non-resemblance to the UK Code', in *Global Shareholder Stewardship* (Dionysia Katelouzou and Dan W Puchniak eds, CUP 2022) 223; Gen Goto et al., 'Diversity of Shareholder Stewardship in Asia: Faux Convergence' (2020) 53 *Vanderbilt Journal of Transnational Law* 829, 834; Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015) 511, 521; Dan W Puchniak, 'The Japanization of American Corporate Governance? Evidence of the Never Ending History for Corporate Law' (2007) 9 *Asian-Pacific Law & Policy Journal* 7, 51-69. For an interesting comparative analysis of other forces that may have driven these corporate governance changes see, Mariana Pargendler, 'The Grip of Nationalism on Corporate Law' (2020) 95 *Indiana Law Journal* 533, 559.

31. Zenichi Shishido, 'Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions' (2000) 25 *Delaware Journal of Corporate Law* 189, 201-214.

32. For an analysis that sees Japan's low wage gap as a positive feature of its system of corporate governance see, Alberto R Salazar and John Raggiunti, 'Why Does Executive Greed Prevail in the United States and Canada but Not in Japan? The Pattern of Low CEO Pay and High Worker Welfare in Japanese Corporations' (2016) 64 *American Journal of Comparative Law* 721. For another perspective see, 'Japanese executive pay: Spartan salarymen' (*The Economist*, 30 June 2010) <https://www.economist.com/newsbook/2010/06/30/spartan-salarymen> accessed 25 May 2022.

33. Dan W Puchniak, 'The Efficiency of Friendliness: Japanese Corporate Governance Succeeds Again Without Hostile Takeovers' (2008) 5 *Berkeley Business Law Journal* 195.

34. For an overview of how the Keiretsu were seen to improve corporate governance, contracting and productive efficiency see, Ronald J Gilson and Mark J Roe, 'Understanding the Japanese Kieretsu: Overlaps Between Corporate Governance and Industrial Organization' (1993) 102 *Yale Law Journal* 871.

35. Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4, 17.

36. For an explanation of the classic Japanese main bank model see, Masahiko Aoki, 'The Japanese Main Bank System: An Introductory Overview', in *The Japanese Main Bank System: Its Relevance for Developing and Transforming Economies* (Masahiko Aoki and Hugh Patrick eds., OUP 1994) 1-50.

37. Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015) 511, 521; Dan W Puchniak, 'The Japanization of American Corporate Governance? Evidence of the Never Ending History for Corporate Law', 9 *Asian-Pacific Law & Policy Journal* 7, 17-18.

38. Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015) 511, 521-522.

39. Gen Goto, 'Legally "Strong" Shareholders of Japan' (2014) 3 *Michigan Journal of Private Equity & Venture Capital Law* 125. For an analysis of how the derivative action lay moribund before Japan's economic bubble and exploded after the burst see, Dan W Puchniak and Masafumi Nakahigashi, 'Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation' (2012) 45 *Vanderbilt Journal of Transnational Law* 1, 2.

40. Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4, 15-16; Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015) 511, 521.

41. Gen Goto, 'Legally "Strong" Shareholders of Japan' (2014) 3 *Michigan Journal of Private Equity & Venture Capital Law* 125; Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4.

peared as if they would usher in American-style shareholder primacy were enacted, including making derivative actions less costly,[42] providing companies with the option to adopt American-style boards with independent directors,[43] and ostensibly developing a Delaware-style regulatory framework for hostile takeovers.[44]

However, over three decades have passed, economic stagnation has continued to stimulate repeated reforms, but American-style shareholder primacy has not yet emerged. Until the 2010s, independent directors were absent on the boards of most Japanese listed companies and even though the number of independent directors has increased in recent years, lifetime employees still dominate corporate boardrooms.[45] Despite a wave of shareholder activism in the 2000s, Japan remained an oddity among large-developed-economies as the only one without a successful hostile takeover - until its first occurred last year.[46] Although some cross-shareholding has unwound and foreign shareholders have increased, the regulatory regime for hostile takeovers has turned out to look nothing like Delaware.[47]

It is noteworthy that in the 2010s, as part of former Prime Minister Abe Shinzo's hallmark economic policy to revitalize the Japanese economy after two "lost decades", Japan adopted UK-style Stewardship and Corporate Governance Codes, but with Japanese characteristics.[48] The goal of these codes was to shift Japan's traditional stakeholder-oriented corporate governance system to a more shareholder-oriented system - but this never fully materialized. Now Abe's successor, Prime Minster Kishida Fumio, under the slogan of "new capitalism", "talks about the importance of other stakeholders in businesses, such as workers and customers, evoking the Edo-era merchant philosophy of *sanpō-yoshi*, or "three-way good" for buyers, sellers and society".[49] Many experts believe that Japan should still work to move away from its stakeholder-centred approach towards having a more shareholder primacy focus - the opposite of what Anglo-America's awakening prescribes.

1.C A Long History of Stakeholderism in India – But Still a Work in Progress

With the rapid rise of China, India's economic importance is sometimes erroneously overlooked. As the world's fourth largest economy, with 1.4 billion people, and growth projected to be the highest among all major economies in 2022, what happens in India clearly has global consequences.[50] With approximately 5 million people working in tech, about 100 unicorns (unlisted start-ups worth over US $1 billion), the world's fourth largest stock market (behind only the United States, China and Japan), India's future appears bright.[51] Distinct from China and Japan, India is a common law country and is part of the Commonwealth. As the most cited empirical scholarship in comparative corporate law posits that common law countries provide stronger protection for minority shareholders than civil law countries, one may anticipate that India has been a bastion for shareholder primacy.[52]

To the contrary, stakeholderism has a long history in India that has accelerated in recent times.[53] Several age-old business groups have long inculcated broader corporate responsibility as part of their business motto

42. Dan W Puchniak and Masafumi Nakahigashi, 'Japan's Love for Derivative Actions: Irrational Behavior and Non-economic Motives as Rational Explanations for Shareholder Litigation' (2012) 45 *Vanderbilt Journal of Transnational Law* 1, 34-36, 64-65 (explaining the legal changes that lowered the cost of derivative actions after Japan's economic bubble burst and how irrational behaviour and non-economic forces must also be understood to accurately understand derivative actions in Japan).

43. Gen Goto et al., 'Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis' in Dan W Puchniak et al. (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (CUP 2017) 135, 138; Dan W Puchniak, 'The 2002 Reform of the Management of Large Japanese Corporations: A Race to Somewhere?' (2003) 5 *The Australian Journal of Asian Law* 42.

44. Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4.

45. Gen Goto et al., 'Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis' in Dan W Puchniak et al. (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (CUP 2017) 135, 146 (showing the percentage of independent directors in Japanese listed companies); Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4, 38-41 (explaining the resilience and importance of lifetime employees in Japanese corporate governance).

46. Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4 (explaining why Japan was an outlier with no hostile takeovers); Stephen Givens, 'Murakami vindicated by Japan's first successful hostile takeover' *Nikkei Asia*, (August 11, 2021).

47. Dan W Puchniak and Masafumi Nakahigashi, 'The Enigma of Hostile Takeovers in Japan: Bidder Beware' (2018) 15 *Berkeley Business Law Journal* 4. However, it should be noted that recently there has been an increasing shift towards more shareholder activism and a unique environment triggering more hostile takeover activity in Japan. See, Leo Lewis and Kana Inagaki, 'Japan's icy climate for hostile takeovers starts to thaw', *The Financial Times* (22 December 2020) ; Stephen Givens, 'Murakami vindicated by Japan's first successful hostile takeover' *Nikkei Asia* (August 11, 2021).

48. Gen Goto et al., 'Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis' in Dan W Puchniak et al. (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (CUP 2017) 135-172 (discussing independent directors and Japan's corporate governance code); Gen Goto, The Japanese Stewardship Code: Its Resemblance and Non-resemblance to the UK Code, in *Global Shareholder Stewardship* (Dionysia Katelouzou and Dan W. Puchniak eds, CUP 2022), 222-238 (discussing Japan's stewardship code).

49. 'Kishida Fumio's "new capitalism" is many things, but it is not new' (*The Economist*, 12 February 2022).

50. Measured on a Purchasing Power Parity basis (PPP) the largest economies in the world based on 2020 data are: China (1), United States (2), India (3) and Japan (4) ('The World Bank Data, GDP, PPP' (*The World Bank Data*).

51. 'India is likely to be the world's fastest-growing big economy this year' (*The Economist*, 14 May 2022).

52. For the most cited literature claiming that common law countries provide stronger protection for minority shareholders than civil law countries, which has a significant impact on economic development and stock markets see, Rafael La Porta et al., 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; Simeon Djankov et al., The Law and Economics of Self-Dealing, 88 *Journal of Financial Economics* 430 (2008). For critiques of this scholarship see, Holger Spamann, 'The "Antidirector Rights Index" Revisited' (2010) 23 *Review of Financial Studies* 467; Dan W Puchniak and Umakanth Varottil, 'Related Party Transactions in Commonwealth Asia: Complicating the Comparative Paradigm' (2020) 17 *Berkeley Business Law Journal* 1.

53. The following five paragraphs have been reproduced with permission from the author: Umakanth Varottil, 'Responsible Capitalism and Corporate Purpose: The India Way' (*ECGI Blog*, 26 April 2022) < https://ecgi.global/blog/responsible-capitalism-and-corporate-purpose-india-way > accessed 14 May 2022.

over more than a century.[54] However, in recent decades, the push towards a stakeholder orientation in corporate governance has been driven largely by the government. In the years following India's independence in 1947, and consistent with the socialist economic policies of the time, company law underwent amendments that incorporated the requirements for companies to act not only in the interest of their shareholders, but also in the "public interest".[55] In the 1980s, the Supreme Court of India enunciated that "a company is now looked upon as a socio-economic institution wielding economic power and influence on the life of the people".[56] No longer was the company a private contractual construct between the entity and its shareholders, but one that took on wider form given its larger societal impact.

If there was even any doubt regarding the purpose focus for Indian companies, that has been set to rest with the enactment of the revamped Companies Act in 2013. Section 166(2) imposes duties on directors of a company to act "in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment". As evident, shareholders are only one among several constituencies that deserve the attention of directors. This embodies the pluralist approach which places the interests of all stakeholders (whether shareholders or others) on par without creating any hierarchy among them.[57]

The judiciary too has rendered an expansive reading of the duty. For instance, the Supreme Court's interpretation of the expression "environment" in section 166(2) is adequately capable of accommodating the risks corporations face due to climate change.[58] Hence, a consideration of matters such as climate risk and sustainability is not merely an option for directors on Indian companies that they may account for on a voluntary basis, but it is an obligation, which they can afford to ignore only at risk of liabilities for breach. Overall, the jurisprudence surrounding corporate law in India suggests that directors ought to consider the long-term interests of the company. Conduct that involves sacrificing the long-term interests of the company in favour of short-term profitability would militate against the statute.[59]

It is clear, therefore, that the legislative duties and responsibilities of directors clearly define the corporate purpose for Indian companies that is altogether stakeholder oriented. At the same time, it is worth noting that the corporate purpose debate in the Indian context tends to be enmeshed with the statutorily mandated corporate social responsibility (CSR) requirements under corporate law. This requires companies to spend at least two percent of their average net profits made during three immediately preceding financial years towards earmarked social purposes.[60] However, this generates some amount of conceptual murkiness in the context of the corporate purpose debate as the CSR provisions in India veer towards corporate philanthropy through mandatory spending rather than the all-inclusive view that company managements must adopt on how their business operations impact society.[61] In that sense, while the CSR regime supplements the corporate purpose stance in India, it ought not to drive the discourse.

The government has trained its focus largely on ensuring compliance with the CSR requirements in terms of corporate spending rather than addressing the broader questions of corporate purpose. Despite the perceived lucidity in aspirations of the Indian corporate legal system towards stakeholder capitalism, there could be several hurdles in operationalizing the idea. First, there is a lack of clarity regarding the enforcement of directors' duties to consider stakeholder interests.[62] Second, the government has trained its focus largely on ensuring compliance with the CSR requirements in terms of corporate spending rather than addressing the broader questions of corporate purpose.[63]

In sum, India appears like a textbook case of having a long history of a corporate governance philosophy with stakeholderism at its core. This philosophy has also been operationalized by clearly articulating stakeholderism in the legislative design of Indian corporate law. Obviously, India does not need to be woke by Mayer's prophesy that purpose can be the path to "nirvana". However, implementing stakeholderism to work in practice has been a challenge for India and it is possible that even more rhetoric about stakeholderism – with less focus on protecting minority shareholders in India's concentrated shareholder environment, may exacerbate India's corporate governance challenges.[64] Yet again, given India's context, Anglo-Ame-

54. Colin Mayer, *Firm Commitment* (Oxford: OUP, 2013), 195-197.

55. Umakanth Varottil, 'The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony' (2016) 31 *American University International Law Review* 253, 278-280.

56. *National Textile Workers v. P.R. Ramakrishnan*, (1983) 1 S.C.R. 9 (India).

57. Umakanth Varottil, 'The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony' (2016) 31 *American University International Law Review* 253, 315-316.

58. *M.K. Ranjitsinh v. Union of India*, (2021) SCC Online SC 326, as discussed in Shyam Divan, Sugandha Yadav & Ria Singh Sawhney, 'Legal Opinion: Directors' obligations to consider climate change-related risk in India' (7 September 2021) <https://ccli.ubc.ca/wp-content/uploads/2021/09/CCLI_Legal_Opinion_India_Directors_Duties.pdf> accessed 16 May 2022.

59. Umakanth Varottil, 'Directors' Liability and Climate Risk: White Paper on India', *Commonwealth Climate and Law Initiative* (4 October 2021) <https://ccli.ubc.ca/wp-content/uploads/2021/10/Directors-Liability-and-Climate-Risk-White-Paper-on-India.pdf> accessed 16 May 2022.

60. Companies Act, 2013, s. 135(5).

61. See Afra Afsharipour, 'Redefining Corporate Purpose: An International Perspective' (2017) 40 *Seattle University Law Review* 465, 469-470.

62. Mihir Naniwadekar and Umakanth Varottil, 'The Stakeholder Approach towards Directors' Duties under Indian Company Law: A Comparative Analysis' in Mahendra Pal Singh (ed), *The Indian Yearbook of Comparative Law 2016* (OUP 2016).

63. Akshaya Kamlnath, 'A Post Pandemic Analysis of CSR in India', ANU College of Law Legal Studies Research Paper Series < https://ssrn.com/abstract=3826832> accessed 16 May 2022.

64. For an excellent in-depth analysis of this risk see, Afra Afsharipour, 'Lessons from India's Struggles with Corporate Purpose' in Elizabeth Pollman & Robert Thompson (eds.), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021).

rica's prescription for a more purposeful approach to corporate law and governance appears to be bad medicine.

1.D Profit Making State Owned Enterprises and Family Firms as Models for Purpose – The Singapore Story

In 1965, Singapore was a poor developing country with no significant natural resources. Today, its GDP per person is double Japan's and significantly higher than every G7 country. Singapore has a strong common law legal system and has historically led the Commonwealth in its protection of minority shareholder rights. Its company law jurisprudence and legislation have been heavily influenced by the United Kingdom, as well as Australia, Canada and New Zealand.[65] Its corporate governance code,[66] stewardship code for institutional investors[67] and takeovers law[68] were modelled on the United Kingdom's equivalent legislation.[69] Singapore's listed companies have long had boards with a majority of independent directors and directors have a duty to act in the interests of the company, which in solvent companies generally means maximizing the long-term shareholder value of the company.[70]

These facts suggest Singapore should be a bastion for shareholder primacy in Asia. However, if one drills-down deeper, in many respects, Singapore is the antithesis of the Friedman Doctrine. In Singapore, the state is the largest shareholder of public listed companies.[71] This relatively new form of capitalism combines the state as the controlling shareholder, with private investors as minority shareholders, in what has come to be known as "mixed-ownership" companies. Singapore's mixed-ownership companies have consistently delivered strong corporate performance and good corporate governance for decades - resulting in them trading at a premium, with exceptional rates of return on capital. As a result, other countries, particularly China, have looked to Singapore as a potential corporate governance model.[72]

Ironically, the secret to the success of mixed-ownership companies in Singapore is the unique institutional architecture it has developed to ensure that profit maximization - and not politics - drives how its mixed-ownership listed companies are governed.[73] However, as the government benefits from the success of these companies and Singapore citizens in turn benefit from the government's social programs, Singapore's mixed-ownership model may ultimately be the most purposeful of all. That its success lies in the unique institutional architecture that ensures state controlled companies have a focus on profit maximization runs counter to Mayer's call to *Prosperity* and Fink's proclamation.[74]

The other significant type of company in Singapore's highly concentrated shareholder environment are family-controlled listed companies. In Singapore, listed companies with family-controllers have consistently outperformed non-family companies and are the most common type of company listed on the stock exchange.[75] The purpose of these family companies is the family's prosperity - which some have posited is reinforced by Singapore's culture.[76] Singapore is unique in that it is the only country in the world that has a stewardship code for family companies. The code does not seek to displace family ownership. Rather it aims to ensure that family-controlled companies are governed in a way that ensures their longevity and that the family's longevity benefits all corporate stakeholders and the entire community.[77] Once again, Singapore's family companies do not need to be woke.

65. Meng Seng Wee and Dan W Puchniak, 'Derivative Actions in Singapore: Mundanely Non-Asian, Intriguingly Non-American and at the Forefront of the Commonwealth' in Dan W Puchniak et al. (eds), *The Derivative Action in Asia: A Comparative and Functional Approach* (CUP 2012) 326-330, 359.

66. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 267.

67. Dan W Puchniak and Samantha Tang, 'Singapore's Puzzling Embrace of Shareholder Stewardship: A Successful Secret' (2020) 53 *Vanderbilt Journal of Transnational Law* 989, 992.

68. Wai Yee Wan and Umakanth Varottil, *Mergers and Acquisitions in Singapore: Law and Practice* (Singapore: LexisNexis 2013), 90.

69. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 267.

70. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265 (provides an in-depth analysis of independent directors in Singapore). *Raffles Town Club Pte Ltd v Lim Eng Hock Peter and others* [2010] SGHC 163 (High Court, Singapore), paras. 163-164 (articulating that acting in the interests of the company normally equates to acting in the long-term interests of its shareholders). See generally, Pearlie MC Koh, *Company Law* (3rd edn, LexisNexis 2017) 107. It should also be noted that the first sentence of the Singapore Code of Corporate Governance (2018) states that: "Corporate governance refers to having the appropriate people, processes and structures to direct and manage the business and affairs of the company to enhance long-term shareholder value, whilst taking into account the interests of other stakeholders." See 'Code of Corporate Governance 2018' (*Monetary Authority of Singapore*, 6 August 2018) <https://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulatory%20and%20Supervisory%20Framework/Corporate%20Governance%20of%20Listed%20Companies/Code%20of%20Corporate%20Governance%206%20Aug%202018.pdf> accessed 20 May 2022. See also, Walter Woon, *Walter Woon on Company Law* (Tan Cheng Han ed, 3rd rev edn, Sweet & Maxwell 2009) para 8.22 & 8.25.

71. Tan Cheng Han et al., 'State-Owned Enterprises in Singapore Model: Historical Insights into a Potential Model for Reform' (2015) 28 *Columbia Journal of Asian Law* 61, 67.

72. Tan Cheng Han et al., 'State-Owned Enterprises in Singapore Model: Historical Insights into a Potential Model for Reform' (2015) 28 *Columbia Journal of Asian Law* 61, 67-69.

73. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 305-17.

74. See, Curtis Milhaupt and Mariana Pargendler 'Governance challenges of listed state-owned enterprises around the world: National experiences and a framework for reform' (2017) 50 *Cornell International Law Journal* 473, 518-524, 535-536.

75. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 296-298.

76. Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 302-303.

77. Dan W Puchniak and Samantha S Tang 'Singapore's Embrace of Shareholder Stewardship: A Puzzling Success' *Global Shareholder Stewardship* (Dionysia Katelouzou and Dan W Puchniak eds, CUP 2022), 310-313.

2. Risks of Failing to Recognize Asia's Purposes and the Prosperity of Diversity

Long before Anglo-America's "discovery" of corporate purpose, Asia was already awake to it. This positive claim has important normative implications as Anglo-America's call to become more purposeful sweeps the globe. In Asia, it risks providing cover for the CCP in China to use purpose to stray further from shareholder maximization for its own self-interested purposes. It has the potential to provide a justification for Japan's old guard to roll back hard-fought moves towards delivering more value for shareholders, in a corporate governance system built for an earlier age. It has the potential to allow India to bask in its purposeful legislation, without tackling the problems of implementation nor focusing on its core corporate governance problem of controlling controlling shareholders.[78] It may disrupt Singapore's successful mixed-ownership model by allowing politics to enter corporate boardrooms under the guise of purpose.[79]

The failure to understand how Asia has been built on systems where corporations have had purposes other than maximizing shareholder value also cancels convincing evidence that corporate governance without shareholder primacy can produce economic success. It is undeniable that China's system of corporate governance, which is the antithesis of the Friedman Doctrine, has helped lift hundreds of millions of people out of poverty. Japan has built a remarkably successful, safe, innovative, peaceful, and free post-war society, with a system of corporate governance where lifetime employees, not shareholders, have been at the core. Singapore is one of the wealthiest, healthiest, safest, cleanest, and most educated countries in the world, with a state-ownership model that would make Friedman roll in his grave. Cancelling this history to feign an Anglo-American discovery is simply sad.

However, Asia's purposeful systems of corporate governance have been far from perfect. China's system has emboldened the CCP which risks turning its rule even more towards party tyranny than common prosperity.[80] Japan's lifetime employment system has counterintuitively created one of the harshest work environments in the world where lifetime employees die from overwork and women have been largely excluded.[81] India has had enviable purposeful ambitions for generations, but its enormous human potential has too often been squandered, while too few reap enormous rewards among toiling masses.[82] The limits of Singapore's mixed-ownership model will be tested as it is not yet known whether the next generation of political leadership will be as disciplined as the past in keeping politics out of corporate boardrooms – a reality that Covid may have made more difficult as government support for critical industries was required. Asia's purposeful approaches demonstrate that the absence of the Friedman Doctrine is not a panacea – in and of itself.

The point is not that a move away from shareholder primacy towards purpose is good or bad. The point is that context matters. Asia demonstrates that different jurisdictions have different understandings of the purpose that corporations should serve and that there is no one model that fits all. Also, at any given time each jurisdiction will be at a different point along the shareholder-primacy/stakeholderism continuum.[83]

However, this much is certain: corporations must be governed, within the context of *their* environment, in a way that benefits the public good. How this is achieved will vary from jurisdiction to jurisdiction and within each jurisdiction over time.[84] Responsible capitalism and good corporate governance mean ensuring that the purpose that corporations (should) serve is aligned with maximizing the public good in each jurisdiction at any given time.

What is also certain is that the existential threat of climate change can only be successfully addressed through intervention on a global scale. Global action will require accepting diversity in approaches, allowing each system to achieve climate change goals in their own way. As such, *outcomes* should be the focus of good corporate governance and the purpose corporations serve, not prescribed methods of achieving those outcomes. Ultimately, prosperity requires diversity.

78. See, Afra Afsharipour, 'Redefining Corporate Purpose: An International Perspective' (2017) 40 Seattle University Law Review 465, 491-495.

79. Interestingly, it appears that Temasek Holdings Private Limited (Temasek) – the privately incorporated company that is wholly owned by the Singapore government and controls the voting rights in most of Singapore's largest listed companies – is acutely aware of this risk. Although Temasek has embraced a purposeful approach as an investor, it also realizes the need to keep politics out of the boardroom. Stephen Forshaw 'Letter to the Editor: Responsible companies must deliver sustainable value over the long term' (*ECGI Blog*, 22 March 2022) <https://ecgi.global/blog/letter-editor-responsible-companies-must-deliver-sustainable-value-over-long-term> accessed 16 May 2022.

80. 'Xi Jinping's talk of "common prosperity" spooks the prosperous' *The Economist* (28 August 2021) <https://www.economist.com/finance-and-economics/xi-jinpings-talk-of-common-prosperity-spooks-the-prosperous/21803895> accessed 16 May 2022.

81. 'Death by work: Japan's habits of overwork are hard to change' *The Economist* (2 August 2018) < https://www.economist.com/asia/2018/08/02/japans-habits-of-overwork-are-hard-to-change> accessed 16 May 2022.

82. 'Compounding inequality: India's super-rich are getting much richer' *The Economist* (3 December 2020) <https://www.economist.com/asia/2020/12/03/indias-super-rich-are-getting-much-richer> accessed 16 May 2022. For an excellent analysis of the risks of corporate purpose in India see, Afra Afsharipour, 'Lessons from India's Struggles with Corporate Purpose' in Elizabeth Pollman & Robert Thompson (eds.), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021).

83. For an interesting analysis that generally supports this observation see, Ronald J Gilson and Curtis J Milhaupt, 'Shifting Influences on Corporate Governance: Capital Market Completeness and Policy Channeling' (*ECGI Law Working Paper* 546/2020, January 2021) <https://ecgi.global/working-paper/shifting-influences-corporate-governance-capital-market-completeness-and-policy> accessed 23 May 2022, 76-77.

84. For an analysis about how good corporate governance is about adaptation, and not any particular model see, Dan W Puchniak, 'The Japanization of American Corporate Governance? Evidence of the Never Ending History for Corporate Law', 9 *Asian-Pacific Law & Policy Journal* 7, 15-16, 69-70 (2007).

Rebecca N. Henderson • Professor at Harvard Business School, Research fellow at the National Bureau of Economic Research

Changing the Purpose of the Corporation to Rebalance Capitalism

Capitalism is one of the great inventions of the human race.[1] But at the moment it is not working for the vast majority of the world's population. Climate change is raging, many of the world's eco-systems are on the edge of collapse, inequality continues to accelerate, and systemic racial and ethnic exclusion characterize nearly every society on the planet.

The key to reforming capitalism is to rebuild the institutions that govern and constrain the economy. It is vital to revitalize our democracy,[2] rebuild democratically accountable, capable government,[3] strengthen civil society,[4] reduce corruption,[5] and 'recouple' capitalism.[6] But while making progress on these fronts is critically important, it will not be enough. We must also change the purpose of the firm—away from maximizing shareholder value and towards 'solving public problems profitably and avoiding creating new problems',[7] so that the private sector can become an active partner in creating a just and sustainable society.

1. A version of this article first appeared in print in *Oxford Rev. Econ. Policy*, Volume 37, Issue 4, Winter 2021, Pages 838–850 (https://doi.org/10.1093/oxrep/grab034).
2. Levi, M. (2021), 'Capitalism: What Has Gone Wrong? How Can It Be Fixed?', *Oxford Review of Economic Policy*, 37(4), 773–82.
3. Admati, A. (2021), 'Capitalism, Laws and the Need for Trustworthy Institutions', *Oxford Review of Economic Policy*, 37(4), 678–89; Levi, M. (2021), 'Capitalism: What Has Gone Wrong? How Can It Be Fixed?', *Oxford Review of Economic Policy*, 37(4), 773–82.
4. Bowles, S., and Carlin, W. (2021), 'Shrinking Capitalism: Components of a New Political Economy Paradigm', *Oxford Review of Economic Policy*, 37(4), 794–810.
5. Admati, A. (2021), 'Capitalism, Laws and the Need for Trustworthy Institutions', *Oxford Review of Economic Policy*, 37(4), 678–89.
6. Kelly, C., and Snower, D. (2021), 'Capitalism Recoupled', *Oxford Review of Economic Policy*, 37(4), 851–63.
7. Mayer, C. (2018), *Prosperity: Better Business Makes the Greater Good*, Oxford, Oxford University Press; Mayer, C. (2019), 'The Future of the Corporation: Principles for Purposeful Business', Report of the British Academy on the Future of the Corporation, available at https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/.

Consider, for example, the case of climate change. As a large and lively literature has suggested, putting in place an effective regime for pricing greenhouse emissions is more essential than ever.[8] But it is unlikely to be sufficient. Global warming needs to be limited to 1.5°C (2.5°F) above pre-industrial levels in order to avoid potentially dangerous climate change. This is almost certainly technologically feasible,[9] but it will require sustained investments at the rate of roughly 3-4 per cent of global GDP for many years, and not only the complete restructuring of the power, transportation, construction, and agricultural sectors, but also profound changes in consumer behaviour. Fully greening the US power grid, for example, will require a host of systemic investments—from control systems to power lines to storage systems—and hundreds of regulatory approvals. In the current political environment, driving this kind of transformative change will be very difficult without the active support of a private sector that is actively committed to creating social value.

Effectively addressing inequality and inequity will also be much easier when the state and civil society can partner with firms who understand their mission as being more than maximizing profits. Purpose-driven firms are much more likely to implement so-called 'high-commitment employment systems'—that is, raising wages, treating employees with dignity and respect, and relying largely on intrinsic motivation to motivate effort.[10] Moreover as Rodrik and Strancheva[11] and Shafik[12] suggest, solving the 'good jobs' problem will require building a new social contract between employees and firms, developing labour market policies that are closely linked to individual employers, and what Rodrik and Strancheva describe as a 'process of strategic collaboration' in combination with 'a collaborative process of discovery' to overcome the problem of regulatory lag and to create effective policies. Firms that are committed to solving public problems are much more likely to be willing partners in this process.

What will it take to persuade firms to adopt a pro-social purpose, and why might it make so much difference?

Across much of the world, business leaders have long believed that the purpose of the firm is to maximize shareholder value, or, in the words of Milton Friedman, that 'the responsibility (of managers) is to conduct the business in accordance with (the desires of the firm's owners) which generally will be to make as much money as possible'.[13] This may once have been a useful framing, but it is now actively dangerous.

8. Aldy, J., and Stavins, R. (eds) (2007), *Architectures for Agreement*, Cambridge, Cambridge University Press.
9. Goodall, C. (2020), *What We Need To Do Now*, London, Profile Books.
10. Henderson, R. (2020a), *Reimagining Capitalism in a World on Fire*, New York, Hachette, PublicAffairs.
11. Rodrik, D., and Stantcheva, S. (2021), 'Fixing Capitalism's Good Jobs Problem', *Oxford Review of Economic Policy*, 37(4), 824–37.
12. Shafik, M. (2021), 'Capitalism Needs a New Social Contract', *Oxford Review of Economic Policy*, 37(4), 758–72.
13. Friedman, M. (1970), 'The Social Responsibility of Business is to Increase its Profits', *New York Times*, 13 September.

It is an idea that rests on three fundamental beliefs.[14] The first is that maximizing shareholder returns maximizes public welfare.[15] The second is that since an individual's ability to make decisions about the disposition of her resources and time should be one of society's highest goals, free markets are an important foundation for individual freedom.[16] The third is that since managers are agents for their investors they have a duty to manage the firm as their investors would wish–which has been widely assumed to be to make as much money as possible. From this perspective, failing to maximize shareholder returns not only constitutes a betrayal of a manager's responsibility to her investors but also threatens to reduce both prosperity and individual freedom by compromising the efficiency of the free market.[17]

But maximizing shareholder value only maximizes social welfare when markets are fully competitive–when there is full information, externalities are appropriately priced, there is relatively free entry and exit, and when corporations cannot fix the rules in their own favour. These conditions may have been approximately true in the years immediately following the Second World War, when governments nearly everywhere were popular and strong, but they no longer hold today–if they ever did.

In the 50 years since shareholder value maximization first took hold, the world has changed almost beyond recognition. Global capitalism looks less and less like the textbook model of free and fair markets on which the injunction to focus solely on profit maximization is based. Free markets only work their magic when prices reflect all available information, when there is real freedom of opportunity, and when the rules of the game support genuine competition. In today's world, many prices are wildly out of whack, freedom of opportunity is increasingly confined to the well connected, and firms are rewriting the rules of the game in ways that maximize their own profits while simultaneously distorting the market. If maximizing shareholder value implies fishing out the oceans, denying the reality of climate change, fighting against the policies that might enable broad based labour market participation, and corrupting the political process, there is no reason to believe it maximizes social welfare, individual freedom, or–increasingly–meets the wishes of investors. Firms whose sole goal is profit maximization are increasingly destroying society, rather than helping to build it. It is time to rediscover the old idea that the purpose of the firm should be to support the flourishing of the society in which it is embedded.

14. For an intellectual history, see Burgin, A. (2012), *The Great Persuasion: Reinventing Free Markets since the Depression*, Cambridge, MA, Harvard University Press.

15. For an early articulation of this model, see Stigler, G. (1952), *The Theory of Price*, London, Macmillan.

16. Friedman, M. (1962), *Capitalism and Freedom*, Chicago, IL, University of Chicago Press.

17. Jensen, M., and Meckling, W. (1976), 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', Journal of Financial Economics, 3(4).

What might this look like in practice? This is a question that is very much in flux. In August 2019 the Business Round Table–an organization composed of the CEOs of many of the largest and most powerful American corporations–released a statement redefining the purpose of the corporation as 'to promote an economy that serves all Americans'. More than 180 CEOs committed to lead their companies for 'the benefit of all stakeholders: customers, employees, suppliers, communities and shareholders'. Nearly every major consulting company and all the big accounting firms have practices devoted to the promotion of 'corporate purpose', or to the idea that firms should attempt to 'do good' as well as to 'do well'.

Much of this activity is almost certainly PR, but an increasing number of firms appear to be genuinely committed to embracing the creation of social wellbeing as their primary goal. In 2010, for example, the European consumer goods giant Unilever committed itself to pursuing a 'Sustainable Living Plan'–or 'to help more than a million people improve their health and well-being, to halve the firm's environmental footprint and to enhance the livelihood of thousands of people in its supply chain'.[18] Natura, the Brazilian cosmetics company, claims that its 'reason for being' is 'to create and sell products and services that promote the harmonious relationship of the individual with oneself, with others and with nature'.[19]

These firms understand that they must succeed financially if they are to survive and to attract capital, but they view profitability as a means to an end, not as a goal in itself, and they signal the authenticity of this commitment by routinely sacrificing short-term returns in the service of achieving their (pro-social) purpose. For example, on the day that Paul Polman took over as the CEO of Unilever, he urged shareholders to put their money elsewhere if they did not 'buy into this long-term value creation model, which is equitable, which is shared, which is sustainable' and announced that Unilever would no longer issue either quarterly earnings guidance or reports. The share price fell roughly 6 per cent, taking nearly $2.2 billion off Unilever's market capitalization (he later joked that he chose that day to make his announcement since he thought the board was unlikely to fire him on his first day).

So called 'purpose driven' or 'stakeholder orientated' firms can afford to make these kinds of costly commitments for three inter-related reasons. The first is because both customers and employees are increasingly demanding that firms address the world's problems. While there is little evidence that consumers will pay more for more sustainable products or services, in at least some cases they will switch providers when they believe they can do so without trading off either quality or price.[20] Similarly, there is an increa-

18. See Unilever's 2010 Annual Report, available at https://www.unilever.com/Images/unilever-ar10_ tcm244-421849_en.pdf

19. https://www.naturabrasil.com/pages/about-us

20. Henderson, R. (2020a), *Reimagining Capitalism in a World on Fire*, New York, Hachette, PublicAffairs.

sing body of intriguing qualitative evidence suggesting that many employees–particularly young people–are increasingly willing to take lower salaries to work for a firm that they perceive embodies their value.[21]

The second is because purpose-driven firms are better positioned to identify (and to act on) the commercial opportunities that our increasingly salient environmental and social challenges are creating. For example, in the early 2000s Iberdrola and Enel–both firms that made early, public commitments to 'doing the right thing' with regard to climate change–committed to making significant investments in renewable energy, despite the fact that at the time renewables were significantly more expensive than traditional fossil fuel fired plants, and many of their competitors were openly questioning whether climate change was caused by humans and actively lobbying against climate regulation. Ten years later, a major change in European utilities regulation in support of renewable energy cut nearly half a trillion euros from the valuations of the top 20 European utilities firms, while Iberdrola and Enel emerged as industry leaders.[22]

The third factor that can make the adoption of a pro-social-purpose social value affordable is the effect that it has on employee productivity and on organizational agility. The fact that there are large and persistent differences in productivity across 'seemingly similar' firms is well documented.[23] For example, Syverson found that within 4-digit SIC (Standard Industrial Classification) industries in the US manufacturing sector, plants at the 90th percentile of the productivity distribution *made almost twice as much output with the same measured inputs* as the 10th percentile plant. These results are robust to a wide range of controls, including controls for the nature of competition, for the measurement of output in physical units rather than in revenue, and for problems of selection and simultaneity.[24]

One important source of these differences is persistent differences in the ability to adopt so-called 'high performance work.[25] In general, firms with high-performance work systems invest heavily in skills development, offer significant levels of job security, promote on merit, and do everything they can to support team work, dense patterns of communication across the organization, and local problem solving.

Gibbons and Henderson[26] argue that these kinds of practices are difficult to adopt–and hence an enduring source of advantage–because they rely on the development of high levels of trust, or on 'relational contracts'–contracts predicated on subjective metrics that can only be enforced by the shadow of the future–that cannot simply be 'declared' but that must be built over time. For example, Spector and McCarthy[27] claim that for many years the (very successful) retailer Nordstrom's employee handbook consisted of a single paragraph that read:

Welcome to Nordstrom

We're glad to have you with our Company. Our number one goal is to provide outstanding customer service. Set both your personal and professional goals high. We have great confidence in your ability to achieve them.

Nordstrom Rules: Rule #1: Use good judgment in all situations. There will be no additional rules. Please feel free to ask your department manager, store manager, or division general manager any question at any time.

Gibbons and Henderson suggest that the kinds of behaviour such a statement is designed to evoke cannot be motivated by a formal contract, since by definition it is not possible to know in advance exactly what form 'exercising good judgment' will take. Employees must trust that managers will reward behaviours that haven't yet been observed. This requires the development of 'clarity' and 'credibility'–where clarity is a shared set of beliefs about the nature of the world, the strategy of the firm, and the likely effects of a set of plausible actions on possible outcomes, and 'credibility' is an informed belief that–all other things equal–the parties to the relational contract are likely to live up to their commitments, and that this implies that their adoption will require continued costly commitments over time to 'behaving well'.[28] In earlier work I argue that this process is likely to be significantly easier in purpose-driven firms, both because employees are more likely to understand the firm's strategy and because purpose-driven firms are more likely to attract pro-social individuals, and it is much easier to build cooperation when some significant number of the parties involved have a positive preference for cooperation.[29]

These effects are likely to be compounded by the fact that a firm's embrace of pro-social values often creates a shared sense of meaning and identity among employees. The belief that one's work has meaning is one of the core drivers of intrinsic motivation and a driver of higher-qua-

21. Archor, S., Reece, A., Rosen Kellerman, G., and Robichaux, A. (2018), '9 out of 10 People are Willing to Earn Less Money to Do More Meaningful Work', *Harvard Business Review*, 6 November.

22. Henderson, R., and Serafeim, G. (2020), 'Tackling Climate Change Requires Organizational Purpose', *American Economic Review*, Papers and Proceedings, May, 177–80, available at https://www.aeaweb.org/articles?id=10.1257/pandp.20201067

23. Bartelsman, E., and Doms, M. (2000), 'Understanding Productivity: Lessons from Longitudinal Microdata', *Journal of Economic Literature*, 38, 569–94; Syverson, C. (2004), 'Market Structure and Productivity: A Concrete Example', *Journal of Political Economy*, 112, 1181–222.

24. Gibbons, R., and Henderson, R. (2013), 'What Do Managers Do? Exploring Persistent Performance Differences among Seemingly Similar Enterprises', ch. 17 in R. Gibbons and J. Roberts (eds), *The Handbook of Organizational Economics, Princeton*, NJ, Princeton University Press, 680–731.

25. Bloom, N., and Van Reenen, J. (2007), 'Measuring and Explaining Management Practices across Firms and Countries', *Quarterly Journal of Economics*, 122, 1351–408

26. Gibbons, R., and Henderson, R. (2013), 'What Do Managers Do? Exploring Persistent Performance Differences among Seemingly Similar Enterprises', ch. 17 in R. Gibbons and J. Roberts (eds), *The Handbook of Organizational Economics*, Princeton, NJ, Princeton University Press, 680–731.

27. Spector, R., and McCarthy, P. (2012), *The Nordstrom Way to Customer Service*, 2nd edn, Hoboken, NJ, Wiley.

28. Zaheer, A., and Bachmann, R. (eds), (2008), *The Handbook of Trust Research*, Cheltenham, Edward Elgar.

29. Henderson, R., (2020b), 'Innovation in the 21st Century: Architectural Change, Purpose, and the Challenges of Our Time', *Management Science*.

lity, more-creative work.[30] It can also create a strong sense of shared identity, another important source of intrinsic motivation.[31] To the degree that shared purpose also supports genuine authenticity–the ability to live a life in accord with one's deepest value–it also increases the presence of positive emotions–something that is strongly correlated with the ability to see new connections, to build new skills, to bounce back after difficult times, and to be more resistant to challenges or threats.[32]

In short, there is a significant body of research consistent with the idea that a firm's authentic commitment to pro-social goals not only makes it easier to hire and to attract customers and to identify new sustainability-related growth opportunities but is also likely to increase the productivity and creativity of its employees. Indeed, a large literature suggests that on average there is no reason to believe that purpose-driven firms underperform their competitors,[33] and some reason to think that purpose-driven firms may actually be more profitable.[34]

1. Why purpose-driven firms might help drive systemic change

Purpose-driven firms cannot alone solve problems such as climate change or inequality since there are far too many problems that cannot be profitably addressed and that can only be solved through regulation. Building a just and sustainable economy will, as I suggested at the outset, absolutely require rebuilding our institutions. But there are at least three ways in which purpose-driven firms could be helpful.

The first is through their ability to catalyse change within individual industries. Decarbonizing the world's transportation systems, for example, will require a host of systemic innovations and close engagement with local and national authorities. Even in the presence of strong, well-designed regulation, persuading firms to embrace this kind of sweeping change will be difficult.[35] Large, successful firms develop cultures, organizational processes, and incentive structures that reflect the needs of their existing business. Established firms–particularly when they are overwhelming focused on the need to generate short-term financial returns–often have great difficulty understanding the ways in which the world is changing, and struggle to act in new ways.[36]

A sizeable body of research suggests that purpose-driven firms are ideally positioned to pioneer this kind of systemic innovation. As I suggested above, their commitment to a broader purpose is likely to alert them to the importance of these shifts, since purpose-driven firms are likely to have a much broader vision of their industry and are often run by leaders who possess what the psychologist Robert Kegan called a 'self-transforming' mind and the ability to see systems as malleable and capable of systemic transformation.[37]

Firms who master systemic innovation must be 'ambidextrous'–that is, they must be able to combine the ability to juggle the need to attend to business as usual with the ability to manage the dynamic, faster-moving units that are required to incubate fundamental change. This ability requires the senior team to develop a shared understanding of the state of the world and of the firm's strategy, to communicate this effectively to the rest of the organization, and to manage the firm through a judicious mix of subjective and objective measures that must be constantly revisited.[38] The characteristics that make purpose-driven firms likely to be more productive than their rivals are also likely to make this process significantly easier.[39]

Purpose-driven firms are also proving to be leaders in building the cooperative public-private efforts that are also crucial to making progress. Their commitment to doing the right thing often gives them strong incentives to try to persuade their competitors to join them in addressing social problems. Unilever, for example, initially committed to buying only sustainably grown palm oil because it was keen to protect its brand and the long-term viability of its supply chain. But sustainably grown palm oil proved to be expensive–so expensive that the firm could only afford to meet its commitment if the other large consumer goods firms agreed to make the same commitment–thus ensuring that using sustainably grown oil would be 'pre-competitive'. Unilever was able to persuade the buyers of more than 65 per cent of the world's globally traded palm oil to cooperate in an attempt to reduce deforestation, beginning a process of public-private engagement that continues to this day.[40] As Ostrom's research suggests, sustaining these kinds of self-regulatory efforts is difficult but entirely possible, and purpose-driven firms often have the incentive to invest in

30. Pink, D. H. (2011), *Drive: The Surprising Truth about What Motivates Us*, New York, Penguin Random House.

31. Henderson, R., and Van Den Steen, E. (2015), 'Why do Firms have Purpose? The Firm's Role as a Carrier of Identity and Reputation'. *American Economic Review, Papers and Proceedings*, May.

32. Henderson, R., (2020b), 'Innovation in the 21st Century: Architectural Change, Purpose, and the Challenges of Our Time', *Management Science*.

33. See eg, Eccles, R., Ioannou, I., and Serafeim, G. (2014), 'The Impact of Corporate Sustainability on Organizational Processes and Performance', *Management Science*, 60(11), 2835–57; Edmans, A. (2020), *Grow the Pie: How Great Companies Deliver Both Purpose and Profit*, Cambridge, Cambridge University Press.

34. See eg, Gartenberg, C., Prat, A., and Serafeim, G. (2019), 'Corporate Purpose and Financial Performance', *Organization Science*, 30(1), 1–18; Ton, Z. (2014), *The Good Jobs Strategy: How the Smartest Companies Invest in Employees to Lower Costs and Boost Profits*, New Harvest.

35. Henderson, R., and Clark, K. (1990), 'Architectural Innovation: The Reconfiguration of Existing Product Technologies and The Failure of Established Firms', *Administrative Science Quarterly*, 35, 9–30; Gans, J. (2016), *The Disruption Dilemma*, Cambridge, MA, MIT Press.

36. Henderson, R. (2020a), *Reimagining Capitalism in a World on Fire*, New York, Hachette, PublicAffairs.

37. Kegan, R. (1982), *The Evolving Self: Problem and Process in Human Development*, Cambridge, MA, Harvard University Press.

38. See eg, Tushman, M., and O'Reilly, C. (2016), *Lead and Disrupt*, Cambridge, MA, Harvard Business Review Press.

39. Henderson, R. (2020b), 'Innovation in the 21st Century: Architectural Change, Purpose, and the Challenges of Our Time', *Management Science*.

40. Henderson, R. (2020a), *Reimagining Capitalism in a World on Fire*, New York, Hachette, PublicAffairs.

the hard work of building bridges and developing metrics that are essential if they are to succeed.[41]

Last but not least, purpose-driven firms often have incentives to support the kinds of regulation that improve social well-being, and to advocate for the institutions that can generate them. Those firms that have made ambitious commitments to reduce greenhouse gas emissions, for example, will be significantly better off if governments can be persuaded to enact binding carbon regulation. It is surely no coincidence that many of the firms who are most visibly advocating for climate regulation are also those that are also publicly committed to pro-social purpose and that some of them are increasingly willing to speak up in defence of voting rights and the health of the democracy.[42]

2. Implications for policy

If changing the purpose of the firm is so essential, how can it be done? Here I focus on three levers that might be useful: changes to accounting standards and to the metrics used to govern corporations, changes in corporate law, and—last but by no means least—changes in the normative and cultural framework within which business operates.

Changing metrics

Changing the purpose of the firm requires changing the metrics used to measure and control the organization. Without material, auditable, replicable measures of the firm's environmental and social impact it will be impossible to hold purpose-driven firms to account. If purpose-driven firms are to persuade customers to buy from them or employees to work for them because they are authentically committed to the social good, they must be able to credibly communicate that they are actually making a positive impact (or genuinely refraining from causing harm). Better measures are critical if purpose-driven firms are to change the incentives of their employees, and to measure the progress they are making towards their goals.

New metrics are also essential if the nature of the conversation between firms and investors is to shift. Business leaders often complain that the dynamics of the capital market are such that they cannot make the kinds of long-term investments that are required if they are to invest in creating social value. In October 2015, for example, when Doug McMillon, the CEO of Walmart, announced that the firm's sales would be flat for the year and that earnings per share would fall 6-12 per cent, the value of the stock sank by nearly 10 per cent, taking with it roughly $20 billion in market value. McMillon had attempted to explain that the decline in earnings reflected not only a $2 billion investment in e-commerce but also a nearly $3 billion investment in paying hourly employees more—an investment that he believed would not only improve the firm's performance by significantly increasing employee engagement, but that was also essential if Walmart was to begin addressing the issue of increasing inequality—but Wall Street was not impressed. Walmart's stock is still majority-owned by the Walton family, who were strongly supportive of the decision, so McMillon kept his job, but many CEOs fear that in similar circumstances they would not be so fortunate. Until and unless firms can point to credible measures of assets like 'reputation' and 'engagement' and/or credible measures of 'impact', it will be difficult for purpose-driven firms to persuade investors to back them.

Better measures are also essential if investors are to hold firms to account for their impact on the broader world. By some measures nearly a third of publicly invested capital claims to be seeking to invest in firms that minimize their environmental impact and maximize their social contribution. Without good measures of a firm's impact in both these areas investors will be unable to allocate their capital in the ways that they wish—and purpose-driven firms will be unable to attract the capital they need.

In the case of the very large majority of publicly traded equities that are managed by professional asset managers, good metrics will also allow asset owners to translate a concern for the long term and for social and economic performance into specific instructions for the professionals who manage their money. Many of the ultimate owners of stock—employees saving for their retirement or parents saving for their children's education—have both much longer time horizons than their asset managers and a strong interest in ensuring that firms behave ethically and sustainably.

Developing these kinds of metrics will not be easy. There are hundreds of so called 'ESG' or environmental, social, and governance metrics in use, many specialized to particular industries, and few are routinely audited or comparable across firms. But this is changing. Groups like the Sustainability Accounting Standards Board have invested heavily in developing useful standards, and a recent proposal by the IFRS (the International Financial Reporting Standards, the body that sets international reporting standards for the world) is attracting very significant attention and strong support from the world's largest banks and accounting companies. Appropriate policy could play a powerful role in accelerating this process.

Changing the law

Many managers—particularly in the Anglo-American sphere—believe that their fiduciary duty requires them to maximize shareholder value. This is actually rarely the case. Nowhere in the world are firms legally required to maximize investor returns, and in general it is entirely legal for publicly traded firms to embrace pro-social goals.

Under Delaware law, for example, directors have fiduciary duties of care, loyalty, and good faith to both the corporation *and* its shareholders. This means that

41. Ostrom, E. (1990), *Governing the Commons: The Evolution of Institutions for Collective Action*, New York, Cambridge University Press.

42. Henderson, R. (2020c), 'The Business Case for Saving Democracy: Why Free Markets Need Free Politics'. *Harvard Business Review*, 10 March.

directors can–and should–sometimes make decisions that do not maximize shareholder value in the short term in order to pursue long-term success. US directors facing hostile takeover bids do this routinely, turning down offers that value the firm at significantly more than its current stock price in the belief that the takeover is not in the company's long-term interests. It is probably illegal to make a business decision that will certainly destroy long-term shareholder value, but except in a few tightly defined situations such as when they have committed to sell the firm and so called 'Revlon duties' have been invoked, directors are protected by the business judgement rule and can embrace a pro-social purpose if they can make a convincing case that it will increase long-term.

Nonetheless, in nearly every jurisdiction investors remain very much in control of the company, and their ability to replace directors at will makes many managers reluctant to commit publicly to a pro-social purpose. As I suggested above, improving the ability to measure both the presence and the impact of such a purpose would certainly help, as would changing the rules that govern activist shareholders to make their actions more transparent, increasing the holding period for long-term capital gains tax, and establishing a modest financial transaction tax.[43] But changing corporate law could also make a significant difference.

One option is to require managers to consider the wellbeing of other stakeholders as they make decisions. For example Principle B of the new UK Corporate Governance Code states that 'the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned'. The British Academy Project on the Future of the Corporation suggests that directors of companies should be required to establish a company purpose, to act in a way likely to promote fulfilment of their purposes, and to have regard to the consequences of any decision on the interests of both shareholders and stakeholders.[44]

While these kinds of recommendations might seem relatively toothless in that they leave the investors in control of the firm, they could play an important role in reassuring managers that they cannot be penalized for considering the needs of other stakeholders, and in changing the nature of the conversation within the company and between the company and its investors. The widespread belief that a focus on the creation of social value will reduce profitability is as much an ideological or cultural artefact as it is a reasoned judgement about long-term strategy. Forcing firms to actively confront the question of whether taking a broader perspective might actually be in the long-term interest of the firm–as well as of its stakeholders–could play an important role in driving the shifts in conversation and attention that are fundamental to long-term systemic change.

Another possibility is to require firms to become 'benefit corporations'.[45] Benefit corporations are legally required to create public benefit while simultaneously seeking to give their investors decent returns. They must publish a strategy outlining just how they plan to do this, and produce an auditable report every year detailing their progress toward creating the public benefit they have promised to create. Board members are required to consider the public interest in every decision that they make.

Critically, when directors have committed to sell the firm, they can select the buyer that will create the most value for all the firm's stakeholders, rather than the one that offers current shareholders the most cash. In a conventional firm, the knowledge that there is always a risk that the directors may be forced to sell the firm to the highest bidder can make it much harder to make precisely the kind of long-term investments–in building trust, in treating one's employees well–whose value may not be recognized in a bidding war. Moreover, the fact that conventional firms are subject to the whims of the financial markets makes them untrustworthy partners, which can in turn make it much more difficult to build the long-term, trust-based relationships that are so essential to building purpose-driven firms. Benefit corporations are thus well positioned to play a powerful role in demonstrating the ways in which purpose-driven firms can create both social and private benefit.

However, the model is heavily dependent on the firm's ability to attract investors who share the mission of the firm, or who believe that operating this way is a reliable route to increasing profitability. In a benefit corporation all the power remains with the investors. Only they can elect the directors. Only they can sue to enforce adherence to the mission. Forcing every firm to become a benefit corporation might be a huge step forwards towards creating a universe of values-driven firms–but risks creating a world in which investors give lip service to the creation of public benefit and simply recreate the conventional firm.

Another possibility, of course, is simply to reduce the power of investors, and to vest control of the firm in employees, customers, or some form of trust or foundation. All of these forms are clearly viable: Mondragon, one of Spain's most successful global firms, is employee owned, US customer-owned agricultural cooperatives have revenues of roughly $120 billion, and Novo Nordisk–a pharmaceutical firm whose controlling shareholder is a foundation dedicated to creating long-term social good–has been enormously successful. These are all models that are well worth exploring, and reducing the legal and regulatory hurdles that make them hard to create might support a wave of ex-

43. Strine, L. E., Jr (2019), 'Towards Fair and Sustainable Capitalism', Research Paper No 19-39, Institute for Law and Economics, University of Pennsylvania Law School, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

44. Mayer, C. (2019), 'The Future of the Corporation: Principles for Purposeful Business', Report of the British Academy on the Future of the Corporation, available at https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/.

45. See https://benefitcorp.net/. Becoming a benefit corporation is importantly different from becoming a certified B corporation, which requires only that the firm commit to measuring itself through more than financial metrics.

perimentation that could be immensely valuable. However it is not yet clear that they can effectively access modern capital markets at scale, potentially limiting their reach.

A potentially complementary approach to any of these moves is to change the rules that define the fiduciary duties of investment professionals. Asset managers are agents for the owners of the assets they manage, but these owners often have almost no control over the ways in which their money is invested and in many cases might plausibly wish to see their money invested in firms dedicated to the creation of social value. In response, Leo Strine, the former Chief Justice of the Delaware Supreme Court, has suggested that institutional investors be required to consider their ultimate beneficiaries' specific investment objectives and horizons as part of their fiduciary duties, and to explain 'how their voting policies and other stewardship practices ensure the faithful discharge of their new fiduciary duties and take into account the new information reported by large companies on employee, environmental, social and governance matters'.[46]

Changing norms

In the end, as Bowles and Carlin[47] suggest, persuading firms to focus as much on the creation of social value as on the creation of financial value will require not only significant changes in accounting standards and in corporate law, but also major shifts in the normative frameworks of the business community and of the society around them.

In Germany, for example, a system dedicated to the well-being of the entire community has generated strong economic returns, large investments in environmental protection, and very low levels of inequality. German corporate law is significantly different from Anglo-American corporate law in requiring active 'co-determination' and, for example, the presence of employee representatives on the boards of companies over a certain size, but the nation's commitment to stakeholder well-being is also upheld by a strong social consensus that it is the appropriate way to manage, by investors who have deep experience with its success and who are committed to its continuance, and by strong pressure from a powerful labour movement and a capable, powerful government.

In Japan, in contrast, a strong commitment to stakeholder capitalism was initially very successful but has recently been criticized for contributing to Japan's recent weak performance. Following the Second World War, the business community explicitly embraced a model of capitalism that stressed the well-being of employees, a commitment to the long term, close engagement with suppliers, and an almost obsessive focus on the customer. These relationships were complemented by tight relationships with a few large investors who generally played no formal role in the firm's governance. Japanese firms raised the bulk of their capital from banks, and in most firms the board of directors was staffed exclusively by company insiders and chaired by the CEO. While many firms were publicly listed, they were protected from the threat of takeover by a system of extensive crossholdings.

This approach enabled Japanese firms to conquer the world with innovative, low-cost products of unsurpassed quality, and between 1960 and 1995 Japan's GDP grew at an extraordinary rate. But Japan's equity market has struggled since then, the gap between Japan's GDP per hour worked and the G7 average has steadily increased, and by 2016 Japanese rates of productivity growth had fallen to roughly half of those in the US and Europe. Many experts blame these low rates of return on a system of corporate governance that insulates many Japanese CEOs from the investor pressure that might force them to reallocate capital to more productive uses, suggesting that the way in which stakeholder approaches are implemented and the social expectations surrounding firms matter quite as much as the details of the law.

At the global level, helping firms to find the right balance between a commitment to investors and a commitment to the well-being of the broader society will take time. It will be greatly assisted by the kinds of social and political change advocated here—by the revitalization of democracy, by the emergence of some kind of organized voice for employees, and by a renewed commitment to capable, democratically accountable government. But values-driven firms could be important partners in driving this agenda.

A widespread shift in the purpose of the firm could have much more than local effects—although local effects are important. Purpose-driven firms can model new ways of treating employees—raising wages, treating people with dignity and respect, and relying on intrinsic motivation, rather than threats or fear, to motivate behaviour. They can catalyse change across industries, persuading less visionary firms that solving social problems can be an important driver of economic growth. They have the motivation, the skills, and the track record to cultivate cooperation between firms, and between firms, governments, and local communities—cooperation that can solve problems no single player could tackle alone. The private sector is one of the most powerful institutions on the planet, and it has fa- reaching influence on millions of lives. One recent survey suggested that the single institution most people trusted most is the firm for which they work.[48] Values-driven firms can help shift cultural values, shared commitments, and deeply held values. We need broad-based institutional change and a fundamental rethinking of our normative frames. We need firms to be committed to more than simple profit maximization.

46. Strine, L. E., Jr (2019), 'Towards Fair and Sustainable Capitalism', Research Paper No 19-39, Institute for Law and Economics, University of Pennsylvania Law School, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

47. Bowles, S., and Carlin, W. (2021), 'Shrinking Capitalism: Components of a New Political Economy Paradigm', Oxford Review of Economic Policy, 37(4), 794–810.

48. Edelman (2021), Edelman Trust Barometer 2021, available at https://www.edelman.com/sites/g/files/aatuss191/files/2021-03/2021%20Edelman%20Trust%20Barometer.pdf.

Anna Christie • Assistant Professor of Banking, Corporate and Financial Law, University of Edinburgh Law School; Director of Studies in Law, Newnham College, University of Cambridge

Shareholder Activism for Profit and Purpose

In 2021, two campaigns by little-known activist hedge funds attracted global attention due to their perceived consequences for sustainable capitalism. In France, the food products company Danone and its CEO Emmanuel Faber became the target of a London-based activist hedge fund, Bluebell Capital Partners. The abrupt ousting of Faber–who had long been a vocal advocate of corporate social and environmental responsibility–was lamented as a major blow to sustainable capitalism. Meanwhile in the United States, ExxonMobil–the world's largest listed oil company–was targeted by another activist hedge fund, Engine No. 1. The highly publicised proxy contest that followed was the first boardroom battle to be fought and won on a platform of sustainability issues, with three of Exxon's board members ultimately being replaced by Engine No. 1's nominees.[1] Engine No. 1's victory was therefore celebrated as a pivotal moment for environmental and social shareholder activism and sustainable capitalism.

At first sight, these two examples appear to have completely different implications for the growth of purpose-driven companies and the role that investors might play in promoting sustainable capitalism. The campaign at Exxon inspired hope and the campaign at Danone generated despair. However, on closer examination, the campaigns have much in common. They both serve to illustrate that even environmentally and socially focused investors will typically also be astutely concerned with the financial performance of a target company. The Danone campaign reveals that a strong focus on environmental and social issues will not shield a CEO from being targeted by activists who believe the company is underperforming financially. The Exxon case highlights that if a company performs poorly both financially and with respect to environmental, social and governance ('ESG') goals, this can lead to activists launching an even stronger two-pronged attack. The ability to campaign on a dual platform of profitability and sustainability can enable activist hedge funds to secure even more widespread support from other investors.

These recent campaigns also raise important questions about ESG investing, ESG activism and purpose-driven companies. To what extent will investors be willing to trade-off financial returns in favour of environmental and social progress? How should companies and their leaders prioritise and balance environmental, social and governance factors with the pursuit of shareholder wealth maximisation? An examination of the high-profile activist campaigns at Danone and Exxon can perhaps provide some anecdotal evidence of the balancing act that companies need to undertake and the strategies that activists might use against target companies in the future.

1. Danone: From Toppling Milton Friedman to Toppling the CEO

Less than a year before Emmanuel Faber's dramatic exit in March 2021, Danone made history by becoming the first publicly traded company in France to adopt a new *société à mission* legal structure.[2] In 2019, France passed a law to enable companies to take greater account of social and environmental issues.[3] Although such companies remain commercial enterprises, they have a defined corporate purpose (*raison d'être*) and are required to pursue social and environmental objectives aligned with that purpose. Companies are accountable to a 'Mission Committee' that is responsible for monitoring the progress made towards achieving these objectives.[4] In June 2020, following a shareholder vote where 99.4% of shareholders voted in favour of the necessary bylaw amendment to transform Danone into a *société à mission*, Faber congratulated investors, proclaiming 'You have toppled the statue of Milton Friedman here today'.[5] Here, Faber was referring to Friedman's famous 1970 New York Times essay, 'The social responsibility of business is to increase its profits',[6] which has long been associated with (or blamed for) the blinkered focus on shareholder wealth maximisation in corporate America.[7] Shortly thereafter, it was Faber himself who was toppled. In January 2021–less than seven months after the momentous shareholder vote–the activist hedge fund Bluebell Capital campaigned to replace him as CEO,

1. Anna Christie, 'Battle for the Board: Climate Rebellion at Exxon marks a New Era of Shareholder Activism' (*Oxford Business Law Blog*, 12 July 2021) <https://www.law.ox.ac.uk/business-law-blog/blog/2021/07/battle-board-climate-rebellion-exxon-marks-new-era-shareholder> accessed 20 April 2022.

2. Leila Abboud, 'Danone adopts new legal status to reflect social mission' *Financial Times* (Paris, 26 June 2020). Earlier in 2018, Danone's largest subsidiary, Danone North America, had become the world's largest Public Benefit Corporation.

3. The PACTE Act no. 2019-486 encouraged socially responsible business by creating 'mission businesses' (*société à mission*).

4. 'Danone, "*Société à Mission*" (Danone) <https://www.danone.com/about-danone/sustainable-value-creation/danone-entreprise-a-mission.html#Framework> accessed 20 April 2022.

5. Abboud, (n 2).

6. Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits' *New York Times* (New York, 13 September 1970).

7. Brian R. Cheffins, 'Stop Blaming Milton Friedman!' (2021) 98(6) *Washington University Law Review*, 1607, 1608-1609.

and on 15 March 2021 Faber was removed both as CEO and chairman.[8] In the media coverage that ensued, the outcome was viewed as detrimental to sustainable capitalism and the ESG movement and the ousting of Faber was highlighted as 'a case study in the pitfalls of purpose'.[9]

2. Exxon: The Small Hedge Fund that took on Big Oil

Less than a decade ago, ExxonMobil was the most valuable company in the world.[10] Yet in June 2021, Engine No. 1–a newly launched impact hedge fund holding only 0.02% of Exxon's shares–replaced a quarter of the oil giant's board of directors.[11] Unlike Danone, Exxon was a notorious industry laggard in terms of sustainability. Due to decades of denial and misinformation about the impact of climate change, the company was long referred to as a 'fossil fuel dinosaur' by environmentalists.[12] More recently, Exxon's investors had grown increasingly uneasy about its outlier status in an industry where its competitors had taken more meaningful steps towards energy transition.[13] Engine No. 1 put forward four alternative independent director candidates who had expertise in traditional energy, renewable energy, regulation and technology, and energy transition.[14] With Exxon refusing to back down or compromise with the activists, the matter progressed to a full shareholder vote at Exxon's annual meeting in May 2021. Ultimately Engine No. 1 was victorious, with three of its four nominees securing seats on Exxon's board.[15] In direct contrast to the media coverage that the Danone case attracted, Engine No. 1's success at Exxon was heralded as an example of the perils of failing to pursue sustainability, with reports noting that the case represented a 'sea change in the climate battle' and an indication that 'investors are increasingly using their clout to bring carbon-intensive businesses into line on climate change'.[16]

3. Parallels between Danone and Exxon

Although Danone and Exxon are very different companies with completely divergent approaches to sustainability, the shareholder activist campaigns they encountered did have some similarities. For example, both companies were targeted by fledging activist hedge funds, rather than the formidable, established players that CEOs have grown to fear. London-based Bluebell Capital Partners is an activist hedge fund focused on investing in European medium-large cap companies.[17] It was launched in November 2019 and manages around €70 million in assets. Bluebell's asset base primarily comprises the founder's own funds and that of friends and family.[18] Similarly, San Francisco-headquartered impact hedge fund Engine No. 1 was officially formed in December 2020 and was only weeks old when it announced its inaugural campaign at Exxon.[19] It launched with initial capital of around $250 million that was largely comprised of founder Chris James' own funds.[20] By way of comparison, Elliott Management–the biggest activist hedge fund in the US–was founded in 1977 and currently manages approximately $51.5 billion in assets.[21]

If companies are targeted by hedge funds that have minimal capital, this naturally means that they can only acquire tiny shareholdings in such large companies. Bluebell did not disclose the size of the stake that it held in Danone, but it was less than the 5% threshold that triggers a requirement to file a disclosure with France's market regulator.[22] At the time of the campaign, Danone's market capitalisation was €41 billion so even if Bluebell had invested its entire fund in Danone, it would only have held 0.17% of the shares. Given Exxon's size, Engine No. 1 also held an incredibly small percentage of the company's shares – 0.02%. As a result of their small shareholdings, neither Bluebell Capital nor Engine No. 1 could have succeeded in their campaigns alone. Significant levels of support from large (predominantly institutional) investors who hold a much larger proportion of the shares was therefore necessary for these activist hedge fund campaigns to succeed.

Perhaps the most significant similarity between Danone and Exxon–and the one that was most often obscured in the divergent media coverage–is the role that poor financial performance played in each campaign. It is unlikely that either Danone or Exxon would have been successfully targeted by activist hedge funds if they had been outperforming their competitors in terms of shareholder wealth maximisation. Despite its status as an energy giant, Exxon was in many respects an obvious activist target as its financial underperformance stood out

8. Leila Abboud, 'Danone board ousts Emmanuel Faber as chief and chairman' *Financial Times* (Paris, 15 March 2021).
9. The editorial board, 'Danone: a case study in the pitfalls of purpose' *Financial Times* (London, 18 March 2021).
10. Jennifer Hiller, 'Exxon Mobil's fading star: no longer the biggest U.S. energy company' *Reuters* (Houston, 29 October 2020).
11. Jennifer Hiller and Svea Herbst-Bayliss, 'Engine No. 1 extends gains with a third seat on Exxon board' *Reuters* (Houston and New York, 3 June 2021). See Christie (n 1).
12. Terry Macalister, 'Shell chief delivers global warming warning to Bush in his own back yard' *The Guardian* (London, 12 March 2003).
13. Christie (n 1).
14. Reenergize Exxon, 'Engine No. 1 Releases Full Slate of Nominees it Recommends for Election at ExxonMobil's 2021 Annual Meeting of Shareholders' (*Engine No. 1*, 15 March 2021) <https://reenergizexom.com/materials/engine-no-1-releases-full-slate-of-nominees-it-recommends-for-election-at-exxonmobils-2021-annual-meeting-of-shareholders/> accessed 20 April 2022.
15. Hiller and Herbst-Bayliss (n 11).
16. Justin Jacobs and Anjli Raval 'Defeats for Big Oil mark 'sea change' in climate battle' *Financial Times* (Washington and London, 27 May 2021).
17. Although the hedge fund was launched in 2019, its founders had been working alongside high profile activist hedge funds such as JANA Partners, Elliott Management and Third Point Partners for many years through their advisory business, Bluebell Partners.
18. Laurence Fletcher and Leila Abboud, 'The little-known activist hedge fund that helped topple Danone's CEO' *Financial Times* (London, Paris, 24 March 2021).
19. Svea Herbst-Bayliss, 'Hedge fund veteran launches impact firm with former Jana, BlackRock executives' *Reuters* (New York, 1 December 2020); Svea Herbst-Bayliss, 'Exxon faces proxy fight launched by new activist firm Engine No. 1' (New York, 7 December 2020).
20. Saijel Kishan, 'Hedge Fund Veteran Chris James to Start Impact-Investing Firm' *Bloomberg* (New York, 1 December 2020).
21. 'Founded in 1977' (*Elliott Management*) <https://www.elliottmgmt.com/about-elliott/> accessed 20 April 2022.
22. Leila Abboud, 'Activist fund Bluebell Capital takes aim at Danone' *Financial Times* (Paris, 18 January 2021).

among its industry competitors. In 2021, Exxon recorded a $22 billion loss,[23] with commentators describing the company as having 'torched billions in shareholder value in the past few years'.[24] The company was also removed from the S&P Dow Jones Industrial Average for the first time in almost a century.[25] Although the sustainability issues that formed a major part of Engine No. 1's campaign were the central focus of most of the media coverage, Engine No. 1 was always upfront in emphasising that their campaign was as much about shareholder value as it was about wider environmental and social values. The hedge fund noted that their 'idea was that this was going to have a positive impact on the share price'[26] and that the proposals were designed to help the company secure its dividend for shareholders.[27] In essence, Engine No. 1 was 'a shareholder crusader for long-term value, not a climate crusader'.[28]

Of course, poor financial performance was more obviously associated with Bluebell's intervention in Danone. Danone's financial performance and share price significantly lagged major European rivals Nestlé and Unilever. Bluebell's campaign highlighted the company's 'chronic underperformance compared with larger rival Nestlé'.[29] The hedge fund noted that Danone's share price had consistently underperformed Nestlé and Unilever, since Faber had been appointed as CEO in October 2014. While Danone's shares increased by 2.7% since Faber's appointment, Nestlé's shares rose by 45% and Unilever's by 72%.[30] Those are striking differences in financial performance, which would concern any shareholder focused on financial returns. Bluebell also pointed out that Nestlé and Unilever were also 'extremely committed to sustainability' yet received far superior financial returns.[31]

4. ESG Activism: a Trojan Horse?

Given their small shareholdings, Bluebell and Engine No. 1 needed the support of larger institutional investors to succeed in their campaigns. The Engine No. 1 campaign is a masterclass in how an activist with an incredibly small shareholding can effectively secure powerful support from other shareholders. With only a 0.02% shareholding, the hedge fund clearly could not have succeeded in replacing three directors on Exxon's board without widespread investor support. There seems little doubt that Engine No. 1's focus on sustainability was instrumental in generating the level of investor support that was needed for the ambitious campaign to succeed. In that sense, might ESG issues become a form of 'Trojan horse' that enables activist hedge funds to generate broader investor support for their campaigns? Conversely, if ESG issues are now so important to investors, how did Bluebell succeed in ousting such a progressive CEO of an iconic mission-driven company?

One of the most significant changes to take place in the investment ecosystem in recent years is the explosion in demand for passive investment funds and bespoke ESG investment products.[32] This shift in investor ideology has led to a concentration of power among the largest asset managers who dominate the market for these products. In the United States, the 'Big Three' asset managers–BlackRock, Vanguard and State Street–are inevitably the largest investors in the majority of economically significant companies, due to the fact that they offer passive index funds at the lowest cost.[33] With power comes expectations of responsibility and the Big Three and other asset managers have begun to assume the role of 'sustainable capitalists'.[34] The huge shift in investor attention to sustainability has been accompanied by ESG investor stewardship and engagement, alongside a rise in ESG shareholder activism.

In terms of asset manager engagement and stewardship, around the time of Engine No. 1's campaign, BlackRock had strengthened its public commitment to addressing climate change. Each year, BlackRock's chief executive Larry Fink issues an annual letter to CEOs. The 2020 instalment, 'A Fundamental Reshaping of Finance' emphasised that BlackRock will be 'increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them'.[35] As such, the launch of Engine No. 1's campaign was perfectly timed to test the credibility of the Big Three's commitments to vote against directors who failed to take action with respect to the climate crisis.[36]

Engine No. 1 had the support of powerful allies from the outset of its campaign, particularly from one of America's largest pension funds, the California State Teachers Retirement System (CalSTRS), which was vocal in backing

23. Jennifer Hiller, 'Pandemic pushes Exxon to historic annual loss, $20 billion cut in shale value' *Reuters* (Houston, 2 February 2021).

24. 'The little Engine that could: ExxonMobil loses a proxy fight with green investors' *The Economist* (London, 29 May 2021).

25. Eric Platt, 'ExxonMobil booted from the Dow after close to a century' *Financial Times* (New York, 25 August 2020).

26. Derek Brower, 'Hedge fund that beat ExxonMobil says it will have to cut oil output' *Financial Times* (New York, 27 May 2021).

27. Ortenca Aliaj, Derek Brower and Myles McCormick, 'ExxonMobil Under Pressure as Church of England Joins Investor Campaign' *Financial Times* (New York, 10 December 2020).

28. 'Activist investors are both greening and greying, *The Economist* (London, 10 June 2021).

29. Billy Nauman, 'Danone sacking shows limits of stakeholder 'smokescreens'' *Financial Times* (New York, 17 March 2021).

30. Leila Abboud, 'Activist fund Bluebell Capital takes aim at Danone' *Financial Times* (Paris, 18 January 2021).

31. Abboud (n 30).

32. Attracta Mooney and Patrick Mathurin, 'ESG funds defy havoc to ratchet huge inflows' *Financial Times* (London, 6 February 2021) (noting that 2020 "was the year ESG came of age" and that by the end of 2020, total assets in sustainable funds hit a record of almost $1.7 trillion, up 50% over the year).

33. Lucian Bebchuk and Scott Hirst, 'The Specter of the Giant Three' (2019) 99 Boston University Law Review 721, 732-37.

34. Anna Christie, 'The Agency Costs of Sustainable Capitalism' (2021) 55(2) UC Davis Law Review 875, 893-897.

35. Larry Fink's 2020 Letter to CEOs, 'A Fundamental Reshaping of Finance' (*BlackRock*, 16 January 2020) <https://www.blackrock.com/us/individual/larry-fink-ceo-letter> accessed 20 April 2022.

36. Christie (n 34) 926.

the dissident slate of board members.[37] By April 2021, Engine No. 1 had secured the support of the three of the largest U.S. pension funds, with each announcing that they would vote for all four of the dissident nominees.[38] Ultimately, however, the pivotal voters in any proxy contest at a U.S. S&P 500 company are the Big Three asset managers - BlackRock, Vanguard and State Street. The Big Three control more than 20% of the shares of the average S&P 500 company, which ordinarily translates into more than 25% of the voting power.[39] In the Engine No. 1 proxy contest, the Big Three had collective voting power of around 31%, so they had the power to make or break any activist campaign. As a mere 0.02% shareholder, Engine No. 1 relied on its sustainability arguments to boost the success of its campaign.

The Exxon case is a very clear demonstration of how a platform of ESG issues can generate support for an activist campaign. The stewardship activities of big asset managers are slowly becoming more transparent, so during Engine No. 1's highly publicised campaign at Exxon, the world was watching the Big Three to assess whether they would live up to their public commitments on climate change in practice.

Alongside the highly publicised commitments on the part of asset managers, there has been increased interest in ESG campaigns by activist hedge funds. Activist hedge funds–typically portrayed as villainous actors[40]–may seem unlikely protagonists in global efforts to promote sustainability and responsible capitalism.[41] Historically, such funds have been laser focused on financial returns and have neither promoted sustainability goals, nor launched activist campaigns with environmental or social components.[42] Although investing in ESG index funds has now become a mainstream investment strategy, ESG-focused activist hedge fund campaigns are currently a niche strategy. However, a vocal minority of activist hedge funds have transitioned (to varying extents) to focus on ESG activism.[43] The formation of such bespoke funds began in January 2018, when two formidable activist hedge funds, Jana Partners and ValueAct Capital Partners launched the specialist ESG-focused funds, Jana Impact Capital[44] and ValueAct's Spring Fund,[45] respectively, and the first ESG hedge fund campaigns took place.[46] The Spring Fund led to ValueAct's founder, Jeffrey Ubben, leaving the hedge fund altogether to form a new impact hedge fund, Inclusive Capital Partners.[47] New players like Engine No. 1 were then formed, often involving executives who have left more traditional activist hedge funds.

Coming back to the Trojan Horse analogy, sceptics of ESG hedge fund activism might worry that environmental and social issues are being used by hedge funds to obscure the true financial motivations driving their campaigns. Here, some parallels might be drawn with the way that activist hedge funds sometimes append governance issues to their core campaigns as a tactical means of securing support from institutional investors.[48] It seems clear that activist hedge funds can use ESG platforms to increase the appeal of their overall campaigns to a wider range of other investors. However, these ESG-focused activist funds are upfront about their purpose and business model. Engine No. 1, for example, made clear that it is 'a capitalist group, definitely not a non-profit'.[49] Inclusive Capital Partners also grounds its philosophy in the context of sustainability driving superior long-term financial returns.[50]

Engine No. 1's campaign at Exxon demonstrated how effective campaigning on a platform of sustainability can be to gaining the support of powerful institutional investors. What is more curious, perhaps, is how Bluebell managed to succeed in a campaign that challenged Emmanuel Faber, a poster-CEO for sustainability and responsible capitalism. Although Bluebell did not launch a proxy contest like Engine No. 1, they would not have succeeded in their campaign to remove the CEO unless there was considerable institutional investor backing behind the proposal. Given the public pressure on institutional investors to promote ESG issues, and their public pledges to do so, Danone and Faber could have proved to be a risky and misguided activist target for Bluebell.

Notwithstanding the potentially negative implications for the sustainable capitalism and ESG investor movements, Bluebell was reported to have significant investor support at Danone. At the time of the campaign, Danone's shareholding was made up of 78% institutional investors, 44% of which were US-based and 50% were European (including UK) based.[51] In an interview following the ouster of Faber, Bluebell's co-founder stated that 'support by fellow shareholders–also the French ones–was overwhel-

37. 'Statement on alternate board members for ExxonMobil' (*CalSTRS*, 7 December 2020) <https://www.calstrs.com/statement-on-alternate-board-members-for-exxonmobil> accessed 20 April 2022.

38. Jennifer Hiller and Svea Herbst-Bayliss, 'CalPERS to back activist's four director nominees in Exxon board fight' *Reuters* (London and New York, 26 April 2021).

39. Bebchuk and Hirst (n 33), 724.

40. Anna Christie, 'The new hedge fund activism: activist directors and the market for corporate quasi-control' (2019) 19(1) JCLS 1, 1-2.

41. Christie (n 1).

42. Christie (n 34) 916.

43. Christie (n 34) 912.

44. David Benoit, 'Wall Street Fighters, Do-Gooders–And Sting–Converge in New Jana Fund' *The Wall Street Journal* (New York, 7 January 2018).

45. David Faber, 'Jeff Ubben's ValueAct launching fund with social goals, following similar moves by Jana, BlackRock' *CNBC* (New York, 19 January 2018).

46. Christie (n 34) 916-917.

47. Svea Herbst-Bayliss, 'ValueAct's founder Ubben retires from firm, starts new venture' *Reuters* (New York, 23 June 2020).

48. William Bratton, 'Hedge Funds and Governance Targets' (2007) 95 Georgetown Law Journal 1377, 1397.

49. Brower (n 26).

50. 'Inclusive Capital Partners' (*Council for Inclusive Capitalism*) <https://www.inclusivecapitalism.com/organization/inclusive-capital-partners/> accessed 20 April 2022.

51. <https://www.danone.com/investor-relations/danone-at-a-glance/ownership.html> accessed 20 April 2022.

ming'.[52] The activist noted that there had been growing shareholder frustration over lacklustre performance under CEO Faber's leadership.[53] It was revealed that other investors had been agitating for change in private discussions with Danone since the previous year.[54]

The position of asset managers such as the Big Three was much less visible in Danone's case than it had been in Engine No. 1's campaign at Exxon. With Exxon, it was very clear where the Big Three stood with respect to the director nominees. Each of the three asset managers published press releases setting out their position and voting decisions.[55] With Danone, however, the position of the Big Three was much less clear. In 2020 BlackRock had highlighted in an Investment Stewardship Report that it supported Danone designating itself as a *société à mission*.[56] The 2021 BlackRock Investor Stewardship Report, discussing the period when Faber was ousted, describes BlackRock's engagement on that matter in very vague terms.[57] In the latter stewardship report, it is not clear at all whether BlackRock supported the change in leadership at Danone or not. Instead, the report simply notes that BlackRock had a 'strong history of engagement with Danone and following recent investor pressure we... met with the then Chairman and CEO Emmanuel Faber in February 2021 to discuss governance and strategic direction.'[58] Given the sensitivities of challenging a company that was a model for purpose-driven business, BlackRock and other institutions may have been reluctant to publicly support Faber's ousting, even if they privately supported it. Although some large investors–for example, Artisan Partners–publicly voiced concerns about Danone's leader,[59] other well-known asset managers took a similar approach to BlackRock and were relatively quiet on the topic. This illustrates that it is much easier for asset managers to publicly support a campaign like Engine No. 1's at Exxon, than a campaign like Bluebell's at Danone. Therefore, a two-pronged campaign where ESG issues are highlighted may be the most effective means to enable activist shareholders to generate the highest levels of public support for their proposals.

Finally, even the hedge fund activists themselves were keen to emphasise that they were not dismissing environmental and social goals. In its letter to the board, Bluebell stressed that it supported Danone's 'dual economic and social project' but indicated that 'under the leadership of Mr Faber, Danone did not manage to strike the right balance between shareholder value creation and sustainability'.[60] Contrary to some of the press reports, the activist hedge fund generally insisted that sustainability concerns did not play a major role in their decision to target Danone and Faber.

Overall, an analysis of investor behaviour with respect to the campaigns shows that an ESG-oriented campaign can prove to be an effective means of generating widespread institutional investor support, even for a newly created hedge fund with a very small shareholding. However, it is also clear that financial considerations remain key for most investors. A strong commitment to ESG goals will not protect companies from becoming an activist target.

5. The Shareholders Who Want It All: Profit and Purpose

These cases of activist hedge fund campaigns at prominent companies therefore provide significant evidence that shareholders still strongly focus on financial returns, despite growing attention to environmental and social factors. This could prove to be a challenge for companies who try to be more forward thinking and ground-breaking in pushing environmental or social aspirations, or companies whose investments in sustainability will not pay off financially until the much longer-term. As seen with Danone, companies that prioritise environmental and social factors over financial return risk becoming a target of activist hedge funds. It was argued that Faber 'spent too much time talking up the "mission" and too little energising the "enterprise"'.[61] Therefore, 'distractions from the core goal of making a profit can be dangerous'.[62]

These lessons are in line with the enlightened shareholder value version of stakeholder theory, namely that corporate leaders should pursue environmental and social goals as a means of maximising long-term shareholder value.[63] ESG goals are thought of as a means to an end rather than an end in themselves. In the view of shareholders, Danone's CEO veered too far into the territory of prioritising environmental and social goals as ends in

52. 'Shareholder Activism in Europe 2021' (*Insightia*, 2021) <https://www.activistinsight.com/research/Insightia_Europe2021.pdf> accessed 20 April 2022.

53. Fletcher and Abboud (n 18).

54. 'Inside Artisan's Battle With Danone – And What Critics Got Wrong' (*Institutional Investor*, 18 March 2021).

55. BlackRock 'Vote Bulletin: ExxonMobil Corporation' (*BlackRock*, 26 May 2021) <https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf>; Vanguard Investment Stewardship Insights, 'Voting insights: A proxy contest and shareholder proposals related to material risk oversight at ExxonMobil' (*Vanguard*, 2021) <https://static.vgcontent.info/crp/intl/avw/mexico/documents/inv-stew-voting-insights-exxonmobil.pdf> accessed 20 April 2022; State Street, Ross Kerber, 'Top Exxon Investors State Street, Vanguard Backed Activist Nominees' *Reuters* (New York, 28 May 2021).

56. BlackRock Investment Stewardship, 'Our approach to sustainability' (*BlackRock*, 8 July 2020) 23 <https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf> accessed 20 April 2022 (noting that 'This proposal was supported by more than 99% of the company's shareholders, including BlackRock').

57. BlackRock Investment Stewardship, 'Q1 2021 Global Quarterly Report' (*BlackRock*, May 2021) <https://www.blackrock.com/corporate/literature/publication/blk-qrtly-stewardship-report-q1-2021.pdf> accessed 20 April 2022.

58. BlackRock (n 55) 17.

59. Laurence Fletcher and Leila Abboud, 'The little-known activist hedge fund that helped topple Danone's CEO' *Financial Times* (London, Paris, 24 March 2021).

60. Leila Abboud, 'Danone's test case for sustainable business' *Financial Times* (Paris, 24 February 2021); Leila Abboud, 'Activist fund Bluebell Capital takes aim at Danone' *Financial Times* (Paris, 18 January 2021).

61. The editorial board, 'Danone: a case study in the pitfalls of purpose' *Financial Times* (London, 18 March 2021).

62. ibid.

63. Lucian A Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106 Cornell Law Review 91, 108-110.

themselves. Such an approach would be more in line with an alternative version of stakeholder theory, which goes further and considers stakeholder welfare to be valuable independently of its effect on shareholder value.[64]

These theoretical debates over corporate purpose highlight the key challenges for ESG investing and sustainable capitalism more generally. Are investors willing to make any tradeoffs to financial returns to invest in more environmentally and socially responsible companies? Should corporate managers ever prioritise stakeholder interests over shareholder interests?

In their public statements, most companies insist that no such compromise is necessary. For example, in the US a study has shown that almost none of signatories to the stakeholder focused Business Roundtable Statement on the Purpose of a Corporation in 2019[65] expressed any willingness to prioritise benefits to stakeholders over shareholder wealth maximisation.[66] The relevant players in ESG investing, engagement and activism similarly insist that the two goals of profit and purpose are not incompatible, and that ESG strategies are win-win. Starting with activist hedge funds, the business model of these funds relies upon them maximising returns in target companies.[67] Even when funds specifically focus on ESG issues, they will still only be willing to invest in targets where they see potential financial value. The funds themselves are upfront about the focus on a double-bottom line. For example, Jeffrey Ubben has highlighted that the premise of the Spring Fund, launched by ValueAct in January 2018 (and ultimately superseded by a new venture known as Inclusive Capital Partners), was 'that there is not just a societal good to be done, but excess return to be capture in identifying and investing in businesses that are emphasizing and addressing environmental and social problems'.[68]

The big asset managers whose support is necessary for activist hedge fund campaigns to succeed similarly explain ESG goals as a means to the end of shareholder wealth maximisation. In his annual letters to CEOs, BlackRock's Larry Fink consistently emphasises that 'climate risk is investment risk'.[69] In his 2022 letter he also stressed 'We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients' and that 'stakeholder capitalism is all about delivering long-term, durable returns for shareholders'.[70] Action that was taken by the Big Three with respect to increasing the representation of women on boards is also justified on the basis that diversity boosts corporate performance, rather than on any equity or social justice considerations.[71]

More generally, this 'win-win' attitude is reflected in the evolution of the concept of corporate social responsibility to the modern-day ESG movement. While corporate social responsibility 'was once framed in moral terms as a goal for management irrespective of profit', ESG as a concept is generally argued 'to provide sustainable long-term value or higher risk-adjusted returns for shareholders'.[72]

6. The Limits of ESG Shareholder Activism

It is a matter of academic debate whether an ESG investment strategy is likely to also be accompanied by superior financial performance. ESG funds have often been marketed as performing better financially compared to non-ESG funds.[73] Despite these claims, in some respects ESG index investing goes against key principles of passive index investing such as ensuring maximum diversification. As ESG funds might deviate from the broader market by excluding entire industries, this increases some forms of risk for investors.[74] Indeed, in practice, much of the outperformance of ESG funds has been attributed to the funds being heavily invested in technology stocks such as Alphabet, Apple and Microsoft, which have performed particularly well in recent years.[75] However, in the past year, some other industries have performed better than technology. For example, oil and gas outperformed ESG funds in 2021.[76] This illustrates that the financial success and growth that ESG funds have recently enjoyed is by no means guaranteed in future. 'Doing well' may not always align with 'doing good'.[77] Contrary to the assertions of companies and investors, it would be naïve to suggest that profit and purpose always align. If that were the case, companies and investors would already have

64. Bebchuk and Tallarita (n 63) 114-115.

65. Business Roundtable, 'Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'' (*Business Roundtable*, 19 August 2019) <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> accessed 20 April 2022.

66. Lucian A Bebchuk and Roberto Tallarita, 'Will Corporations Deliver Value to All Stakeholders?' (2022) 75 Vanderbilt Law Review (forthcoming), <https://ssrn.com/abstract=3899421> accessed 20 April 2022.

67. Christie (n 39), 21.

68. David Faber, 'Jeff Ubben's ValueAct launching fund with social goals, following similar moves by Jana, BlackRock' *CNBC* (New York, 19 January 2018) (citing a letter from Ubben to ValueAct's limited partners).

69. Fink (n 35).

70. Larry Fink's 2022 Letter to CEOs, 'The Power of Capitalism' (*BlackRock*, 18 January 2022) <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter> accessed 20 April 2022.

71. See Michal Barzuza, Quinn Curtis and David H. Webber, 'Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance, (2020) 93 Southern California Law Review 1243, 1277 and Ann M. Lipton, 'ESG investing, or, if you can't beat 'em, join 'em' in Elizabeth Pollman and Robert B. Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar 2021) 140.

72. Dorothy S. Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 Columbia Law Review 2563, 2566.

73. Siobhan Riding, 'Majority of ESG funds outperform wider market over 10 years' *Financial Times* (London, 13 June 2020).

74. John Armour and Jeffrey N Gordon, 'Systemic Harms and Shareholder Value' (2014) 6 Journal of Legal Analysis 35, 36 (noting that "the portfolios of diversified shareholders are insulated from the effects of idiosyncratic (firm-specific) risks").

75. Adrienne Klasa, 'Sustainable funds face threat from tech sector turmoil' *Financial Times* (London, 18 January 2022).

76. Patrick Temple-West and Kristen Talman, 'ESG shares underperform oil and gas in 2021' *Financial Times* (New York and Washington, 30 December 2021).

77. Christie (n 34) 911.

ample incentives to act responsibly. There will always be situations where companies and their managers need to decide whether to prioritise shareholders or stakeholders.

Just as ESG investment fund success is not guaranteed, the Danone case shows that strong corporate ESG performance will not prove to be an effective shield for companies that are performing poorly financially. To avoid being targeted by activists, companies should ideally meet the challenges of ensuring short-term and long-term profitability while also focusing on sustainability.

ESG-focused shareholder activism will also most likely continue to concentrate on situations where purpose can in fact boost profit. There are some examples of campaigns that focus purely on environmental or social factors for their own sake, but such campaigns do not form part of activist hedge funds' core investment strategies. For example, Bluebell Capital has a programme where it commits to buy one share at one company per year that lags on environmental or social issues, in order to advocate for better ESG performance.[78] As part of this programme, Bluebell campaigned to replace the CEO of the Belgian chemicals company Solvay after she failed to put an end to dumping chemical waste into the sea.[79] The noticeable divergence from the hedge fund's normal investment model to conduct these types of pro-bono campaigns is an implicit admission that activists do always not expect higher ESG standards to increase profitability.

There are various reasons why an activist hedge fund might choose to engage in these types of pro bono campaigns. It could help with visibility and credibility when the fund pursues a for-profit ESG campaign. However, in their core business, activist hedge funds that focus on ESG issues will focus on campaigns that can contribute to the 'double bottom-line' - where the intervention generates a significant profit as well as being environmentally or socially beneficial.[80]

In the past, activist hedge funds adapted their campaigns to align their goals with those of institutional investors.[81] Similarly, preliminary evidence indicates that activist hedge funds are also attempting to adapt their strategies to exploit the fact that asset managers are focusing on sustainable capitalism. Aligning their campaigns with the goals of pivotal voters in a proxy contest–as Engine No. 1 did with Exxon–could result in much higher levels of support for activist campaigns.[82] Ultimately, it seems that ESG-focused investors and activists will increasingly support companies that promote environmental and social goals, but only if this does not negatively impact financial performance and shareholder wealth. Sustainable capitalism is still capitalism, after all.

78. Fletcher and Abboud (n 18).

79. Valentina Za and Simon Jessop, 'Activist Bluebell urges Solvay's board to oust CEO over sea discharge' *Reuters* (Milan and London, 15 September 2021).

80. Christie (n 34) 883.

81. Christie (n 34) 922-923.

82. Christie (n 34) 923.

Politics, Corporations and Corporate Politics

Saura Masconale • Assistant Professor, The University of Arizona Department of Political Economy and Moral Science; The University of Arizona Center for the Philosophy of Freedom

Simone M. Sepe • Professor of Law & Finance, The University of Arizona - James E. Rogers College of Law; Toulouse School of Economics; ECGI; American College of Governance Counsel

Corporate Activism, Economic Efficiency, and Democracy

Public corporations are now brandishing their political identities. They are increasingly engaging in 'corporate activism,' taking stands and messaging on highly charged social issues: gun control, gender and race, immigration, abortion, reproductive rights, free speech–and the list will surely grow.

Critics of corporate activism typically worry that it might jeopardize firm value maximization and the efficiency of the corporation. This criticism, however, overlooks the growing investor demand for activist initiatives and correlated asset price effects. Similar to what happens in financial bubbles, increased investor demand for the shares of 'activist corporations' results in an increase in the share price of these companies. 'Efficient corporate activism,' however, raises a new, more troubling, concern. Because of the divisive and exclusionary nature of the new corporate social agenda (one cannot stand on both sides of a conflicting social issue) and in the attempt to capture positive asset price effects, value-maximizing corporations have incentives to choose activist initiatives that *exclusively* cater to the majoritarian investor demand. Under current patterns of equity reconcentration and the rules of corporate voting, this means that corporate activism is likely to reflect the social and moral preferences of only a few fund families and the handful of individuals that control them.

Hence, the deeper concern is that the rise of corporate activism may carry a democratic loss, both within and outside corporations. Internally, this loss arises because a board-size group of individuals (the funds' agents) can exploit the plutocratic mechanism of corporate governance (ie the one-vote, one-share rule) to dictate a corporation's moral agenda, potentially undermining the political freedom of 'contrarian' stakeholders who do not agree with that agenda. Externally, the risk is that exclusive access to the corporate megaphone may enable investors to disproportionately influence the public discourse around divisive social issues, undermining political equality and introducing distortions in the democratic adjudication of these issues.[1]

What Is Corporate Activism?

Corporate activism is the engagement by corporations into divisive moral and social issues, which are typically associated to one's political or religious beliefs and on which reasonable and principled people may strongly disagree. This novel form of social engagement builds on the classic concept of corporate social responsibility (CSR),[2] but is remarkably different in both substance and form. While a universal definition of CSR is notoriously lacking, commentators agree on one thing: that a corporation's CSR initiatives are designed to deliver universally recognized benefits to all citizens/stakeholders.[3] Classic examples of CSR thus include fighting poverty, improving educational programs, or reducing pollution.[4] On the contrary, the defining feature of corporate activism is that it involves engagement on matters on which it is *not* reasonable to expect that there would be consensus.[5]

Most frequently this engagement is reactive: corporate activism tends to address issues of social or moral responsibility as a response to a catalytic event, often a crisis or, anyway, an event drawing large, national attention. The wave of corporate dissents from the contentious 2015 North Carolina's 'bathroom bill' offers a vivid example of reactive corporate activism. In response to the bill, some 200 major US corporations engaged in boycotting and other forms of economic retaliation against the state.[6] Examples have multiplied since then. The 2018 Parkland high school shooting triggered corporate activism in support of restrictive gun regulation.[7] More recently, the introduction of new abortion restrictions in several South-

1. This analysis described in this essay, as well as additional research relating to the new political engagement of corporations, are set out in greater detail in Saura Masconale & Simone M. Sepe, *Citizen Corp.*, 100 *Wash. U. L. Rev.* (forthcoming 2022).
2. The issue of corporate social responsibility has loomed in the back of the corporate governance discourse since the Berle and Dodd debate on the purpose of the corporation in the 1930s. See A. A. Berle, Jr., 'Corporate Powers as Powers in Trust', 44 *Harv. L. Rev.* 1049, 1067-68 (1931); E. Merrick Dodd, Jr., 'For Whom Are Corporate Managers Trustees?', 45 *Harv. L. Rev.* 1145 (1932).
3. CSR critics simply assumes that it is not up to the corporation to delivers these broad benefits, but rather to the government (or maybe charitable organizations). Progressive approaches assume, instead, that *precisely* because CSR benefits are universal, the corporation has a duty to deliver them and thereby increase social welfare. More recent demand-driven approaches also assume no conflict in moral preferences among stakeholders; at best they concede that some individuals might be 'neutral' toward the moral or social utility produced by CSR.
4. See eg, Roland Benabou & Jean Tirole, 'Individual & Corporate Social Responsibility', 77 *Economica* 1, 2 (2009) (providing a non-exhaustive list of classic CSR initiatives).
5. These matters coincide with what legal theorist Jeremy Waldron calls 'watershed issues of rights': '[t]hey are major issues of political philosophy with significant ramifications for the lives of many people. … They define major choices … that are focal points of moral and political disagreement in many societies.' Jeremy Waldron, 'The Core of the Case against Judicial Review', 115 *Yale L. J.* 1346, 1367 (2006).
6. See eg, Jason Zengerle, 'Can the Black Rifle Company Become the Starbucks of the Right?', N.Y. Times (Jul. 14. 2021), https://www.nytimes.com/2021/07/14/magazine/black-rifle-coffee-company.html.
7. See eg, Joseph Pisani, 'US Companies Take a Stand, Raise Age to Purchase Guns', *AP News* (Mar. 2, 2018), https://apnews.com/article/north-america-us-news-ap-top-news-ar-state-wire-shootings-a70d3d6e213d4b3a8af92ffd1849b725.

ern states as well as Georgia's SB2 voting law prompted strongly worded rebukes of these legislations by most major US corporations and triggered, again, threats of economic retaliation against the states.[8]

The forms corporate activism is taking are also quite distinct from classic CSR programs (which tend to focus on charitable initiatives) and more closely resemble political activity. These forms typically include pronouncements, social-networking and media messaging, boycotting and other types of economic and public retaliation. The means of corporate activism pressure by investors also tend to have a similar political, antagonistic flavor. In particular, top index funds, who hold today what amounts to a controlling interest in most large publicly traded companies, have grown vocal, at times even confrontational, in demanding engagement in salient issues like gender and race equality policies.[9] The Fearless Girl campaign by State Street, for example, epitomizes the lengths to which index funds are now willing to go in defense of gender equality.[10]

Corporate activism and firm value maximization

Surprisingly, both supporters and critics of corporate activism assume away the possibility that individuals may disagree on whether a corporation's stance on a conflicting social issue produces benefits or is, in fact, harmful. A possible explanation for this approach is that commentators might be reducing corporate activism to just an expansion of CSR, despite the remarkable differences between the two.

Under this explanation, the core policy issues associated with corporate activism remains the same that has long characterized the CSR debate: whether this kind of engagement can be reconciled with the goal of firm value maximization and the economic efficiency of the corporation. Supporters of corporate activism defend the view that corporations should be engines of positive social changes, hence taking up broader social obligations, even at the expenses of the maximization of firm value.[11] Critics of activism argue, instead, that the sole purpose of the corporation is to maximize firm and shareholder value and view activism as a costly deviation from this goal.[12]

Both these positions have grown outdated when examined in light of the growing demand for corporate social engagement. The numbers speak loudly. Two-thirds of global consumers declare they are willing to spend more for products and services that are sustainable.[13] Likewise, a majority of American consumers believe it is important for corporations to take a stand on pressing social issues.[14] And a large majority of employees of US companies believe companies should lead 'with purpose.'[15]

But the most striking figures come from socially responsible investing, which has now reached a staggering $40 trillion worldwide.[16] And this figure is only projected to rise.[17] Meanwhile, as we saw above, sustainable investments increasingly revolve around activist initiatives on highly charged social issues. The combination of these factors suggests that today's investors–and especially the largest among them–are choosing to hold 'moral portfolios.' The starting point to understand moral portfolios is portfolio theory, under which all investors can be expected to include *some* 'activist shares' in their diversified holdings.[18] However, 'sympathetic investors' with a taste for corporate activism will include *more* activist shares than other diversified investors (ie investors that look only at a firm's fundamentals and are not sympathetic to activism).[19] These distorted portfolio choices are what we call moral portfolios.

Importantly, moral portfolios trigger asset price effects: similar to a financial bubble, the increased demand for activist assets results in an increase in the share price of activist corporations, helping to internalize (ie compen-

8. See eg, Sinead Baker, '187 Companies, Including Bloomberg, Tinder, and Ben & Jerry's, Teamed up to Slam Abortion Restrictions Sweeping Southern States', *Bus. Insider* (Jun. 11, 2019), https://www.businessinsider.com/187-companies-criticize-state-abortion-limits-new-york-times-ad-2019-6?r=US&IR=T.; Chip Cutter et al., 'With Georgia Voting Laws the Business of Business Becomes Politics', *Wall St. J.* (Apr. 21, 2021), available at https://www.wsj.com/articles/with-georgia-voting-law-the-business-of-business-becomes-politics-11618027250. At times, corporate activism can also be 'proactive' and initiate groundbreaking changes. For example, Target's move to gender-neutral store signage back in 2015 was a huge deal, which prompted new nation-wide awareness about gender issues. See Target, A Bullseye View, What's in Store: Moving Away from Gender-Based (Aug. 7, 2015), https://corporate.target.com/article/2015/08/gender-based-signs-corporate.

9. See Michal Barzuza, Quinn Curtis and David H. Webber, 'Shareholder Value(s): Index Funds, ESG Activism and the New Millennial Corporate Governance', 93 *South Cal. L. Rev.* 101, 105, 121-24 (2020).

10. On March 7, 2017 (the day before International Women's day) State Street placed a commissioned statue of a defiant young girl opposite the Charging Bull statue on Bowling Green in the Manhattan Financial District and announced that it would start voting against directors of firms with no female directors. *Id.* at 122.

11. Professor Einer Elhauge is perhaps the most famous advocate of this view. See Einer Elhauge, 'Sacrificing Corporate Profits in the Public Interest', 80 *N.Y.U. L. Rev.* 733 (2005).

12. As famously put by Milton Friedman, under this view, the exclusive 'social responsibility of business is to increase its profits.' See Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits', *N.Y. Times* (Magazine), Sept. 13, 1970.

13. Nielsen Research, The Sustainability Imperative – New Insights on Consumer Expectations, https://www.nielsen.com/wpcontent/uploads/sites/3/2019/04/Global20Sustainability20Report_October202015.pdf.

14. See Tim Stobierky, '15 Eye-Opening Corporate Social Responsibility Statistics', *Harv. Bus. School Online J.* (Jun. 15, 2021).

15. *Id.*

16. Opimas, 'ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis' (June 17, 2020), http://www.opimas.com/research/570/detail/.

17. See Alastair Marsh, 'Almost 60% of Mutual Funds Will Be ESG by 2025, PwC Says' (Oct. 19, 2020), https://www.bloomberg.com/news/articles/2020-10-19/almost-60-of-mutual-fund-assets-will-be-esg-by-2025-pwc-says (reporting that ESG-mandated assets are projected to soon take up half of all managed assets in the US). The increase in sustainable investments has been so transformational to prompt a 'rebranding' of CSR. Today, the focus has shifted to 'ESG' (environmental, social and governance) criteria in the conduct of business

18. See generally Stephen F. LeRoy & Jan Werner, Principles of Financial Economics 214 (2001).

19. Our characterization of moral portfolios draws on Christian Gollier & Sebastian Pouget, 'The Washing Machine: Investment Strategies and Corporate Behavior with Socially Responsible Investors', No. 14-157 TSE Working paper (2014).

sate for) the cost of activist initiatives.[20] Restated, as long as sympathetic investors are willing to pay a premium for holding the shares of activist corporations, corporate activism is compatible with share value maximization. As we shall see next, however, efficient activism comes at a high price: a democratic loss both inside and outside corporations.

Corporate activism and corporate conformity

To fully grasp the implications of corporate activism, we need to take a step back and consider the divisive nature of activist initiatives. Indeed, the 'production' of activism is not like that of any other good.

In general, the defining virtue of competitive markets is that they allow for the greatest diversity in goals and resources.[21] If you like red shoes and I like blue shoes, corporations will produce both. (In fact, the *same* corporation will likely produce both kinds of shoes.) But activist engagement in divisive moral issues is necessarily 'exclusionary.' This means that if a corporation engages in activist initiative, reflecting, say, a progressive moral identity (eg supporting a pro-choice policy), that corporation will be prevented from engaging in the 'contrarian' activist initiative, reflecting, say, a conservative identity (eg supporting a pro-life policy). This is because engaging in both initiatives would destroy the corporation's ability to satisfy the moral demand of either individual and hence destroy the value to the corporation of either activist initiative.

Now, this 'production constraint' would only have limited effects if different corporations would engage in different activist initiatives. Yet, this is not what we observe. In the present environment it is hard to think of any proactive, visible social stances by publicly-traded companies that could be called moderate or conservative (Hobby Lobby and Chick-fil-A are private companies). By contrast, hundreds of public companies have expressed corporate positions on political topics that are progressive. Yet on many of the underlying social issues—consider, paradigmatically, gun control and pro-choice positions—citizens are more evenly divided. What explains this gap? And what are its normative implications?

The starting point in addressing these questions is the adjudication mechanism corporations employ to decide which *divisive* activist initiative to engage in. Indeed, corporations cannot capture the universal economic demand for activist initiatives as they do with other goods or service they produce, due to the exclusionary nature of these initiatives (recall, one cannot stand on both sides of a divisive issue). In pursuing efficient activism, then, corporations have incentives to capture the largest economic demand for engagement in highly-charged issues. But where is this demand likely to come from?

As we saw, to some extent, all stakeholders now share a 'moral demand.' However, when one considers the magnitude of the asset price effects arising from moral portfolios, the moral preferences of sympathetic investors are likely to 'weigh more' economically and hence have a disproportionate impact in determining a corporation's activist choices. Only by conforming to those preferences will corporations be able to capture the positive asset price effects that are triggered by moral portfolios. Hence, 'corporate conformity'—the tendency of corporation to *exclusively* cater to the *investor* demand for activism—is the price to pay for efficient activism.[22]

There is more: under current rules of corporate voting and the reconcentration of equity ownership due to indexation, corporate activism is likely to have an oligarchical characterization—that is, to exclusively reflect the preferences of the handful of top agents who run the largest fund families.

Oligarchic Activism

Although activist decisions are largely driven by asset price effects, these effects are not independent from corporate voting rules. The one-share, one-vote (OSOV) rule that distinguishes corporate governance from electoral governance enters into a corporation's activist decisions through two channels. First, managers anticipate that the failure to satisfy investors' moral demand would mean suffering negative asset price effects, as sympathetic investors would readjust their portfolios accordingly (while the economic magnitude of this loss is proportional to the investors' equity participation). Second, managers also anticipate that the failure to satisfy investors' moral demand increases the likelihood of retaliatory actions that shareholders can exercise through their voting powers, including removing managers.

It should now be easier to see why a corporation's activist initiative will tend to have an almost oligarchic flavor and exclusively cater to the preferences of top index funds. BlackRock, State Street, and Vanguard (the 'Big

20. See *id.* One could argue that this result only holds as long as the asset price effects arising from the portfolio readjustments of sympathetic investors dominate any corresponding effect that may arise from the portfolio readjustments of non-sympathetic investors. This is a valid objection—but two reasons rebut it. The first is the fast growth of activists investments. Second, even if one were skeptical about the prevalence of these investments, the same asset price effects would hold under a Keynesian view of markets where prices are influenced by herd behavior. For a treatment of this view tailored to a legal audience, see K.J Martijn Cremers & Simone M. Sepe, 'The Empowered Value of Staggered Boards', 68 *Stan. L. Rev.* 67, 113-14 (2016). Herd behavior may induce investors to react to aggregate market demand rather than their own information. As a result, asset price effects may reflect not just market actors' average expectations about fundamental values, but these actors' beliefs about other market actors' beliefs (that is, higher-order beliefs). See eg, Bruno Biais & Peter Bossaerts, 'Asset Prices and Trading Volume in a Beauty Contest', 65 *Rev. Econ. Stud.* 307, 307-09 (1998). In our applied context, this means that if non-sympathetic investors believe that the portfolio readjustment by sympathetic investors will have positive asset price effects, they could decide not to readjust their portfolios or even readjust them in the same way as the sympathetic investors.

21. See John Geanakoplos, 'Arrow-Debreu Model of General Equilibrium', in 1 *The New Palgrave Dictionary Of Economics* 119 (John Eatwell et al. eds., 1987).

22. This does not exclude that the investor demand for activism may, to some extent, overlap with that of other constituencies, including consumers and employees. But corporate conformity simultaneously, pro-actively, excludes all those who do not agree with the side chosen by the majority of corporate investors.

Three') have come to own the largest stakes in 40% of all US listed companies.[23] That percentage goes up to almost 90% if one only considers the largest US companies that are included in the S&P 500.[24] This means that the economic interest of index funds is pivotal in determining the asset price effects triggered by a corporation's activist decisions, and hence in influencing those decisions. The voting power of index funds is similarly pivotal in most corporate decisions that are subject to a shareholder vote, while the anticipation of this pivotality provides strong incentives to managers to respond to the desires of the funds' agents.

This is what John Coates call the 'Problem of Twelve,' to stress that the control of most public companies will soon be concentrated in the hands of a few people.[25] Coates also highlights that index funds tend to form 'policies' regarding various kinds of decisions that the companies in their portfolios must make, while also informally sharing their policies with one another.[26] The funds can thus achieve significant coordination over many issues, while this coordination process is reinforced by the actual votes they cast.[27] Because these votes are public, each fund can obtain strong signals about the other funds' views, without any explicit collusion.

Under this concentration of power and coordinated influence, can we imagine corporations taking a stance on a divisive matter that is not aligned with the preferences of their largest investors?

The Internal Democratic Loss

The skew between voters' moral preferences as expressed in the political sphere and the corporate sphere should now be less puzzling. Our electoral system uses a one-person, one-vote (OPOV) rule to operationalize the key democratic principle of political equality—the view that the interests of all citizens ought to be given equal consideration in case of disagreement over the rules of a society. Under this rule, we observe a distribution from liberal to conservative positions on divisive moral issues. Corporations, instead, are governed based on a one-share, one-vote (OSOV) rule. So for companies, the majority rule lies in the hands of a few institutions (or individuals) which hold what amounts to a controlling interest and which currently appear to be assigning value only to progressive postures.[28]

Now, the idea of an efficient division of labor has provided the traditional argument to justify the different aggregation rules of electoral governance and corporate governance: socially responsible activities are better left to the political process, while economic activities are the realm of corporations. In this realm, shareholders-voters can be safely assumed to partake the same commitment to *one* end: profit maximization.[29] Under this consensus assumption, incentives reasons can prevail over egalitarian ones, thus justifying a deviation from egalitarian instances and the OPOV rule. On the one hand, the OSOV rule gives more voice to those with 'more skin in the game' and hence the best incentives to devote time and effort to corporate affairs. On the other hand, *all* shareholders, even if in the minority, still proportionally benefit from successful corporate outcomes.[30]

With the rise of corporate activism, however, the division of labor between what belongs to the corporate sphere and the public sphere has gone lost. Two normative issues follow. The first concerns the effects of activist decisions within the corporate organization. The second concerns the external relationship between activist corporations and society at large.

Within the corporation, the first-order question is whether the OSOV *formal* deviation from the principle of political equality is justified for corporate voting about moral, rather than economic, issues. The answer is negative. For shareholders will disagree, at times radically, on what a desirable moral end is, while no benefit ever accrues to minority shareholders—or any other individual—which does not partake in the moral preferences of the majority shareholders.

Yet, if the activist decisions made by shareholders were representative of the decisions the median voter would make, there would be no *substantive* deviation from political equality. This additional consideration suggests that it is the combination of the expansion of the OSOV rule to the moral domain with indexation that creates a problem of internal legitimacy for activist decisions. If shareholders were dispersed, as they used to be before the rise of indexation, on the one hand, the aggregation mechanism implemented through the OSOV rule would tend to converge to that implemented through the OPOV rule. Shareholders could also form heterogenous coalitions in choosing activists initia-

23. See Jan Fichtner et al., 'Hidden Power of the Big Three? Passive Index Funds, Re- Concentration of Corporate Ownership, and New Financial Risk', 19 *Bus. & Pol.* 298, 313 (2017).

24. *Id.*

25. See Joan Coates, 'The Future of Corporate Governance Part I: The Problem of Twelve', (unpublished manuscript), https://ssrn.com/abstract=3247337.

26. *Id.*

27. *Id.*

28. It is not clear why index funds' agents prefer progressive positions. Some scholars think is just a manifestation of opportunism or a form of elitism, others that the funds are trying to capture the trust first and the wealth later of Millennials. For a discussion of possible causes, see Masconale & Sepe, supra note 1 (manuscript at 53-55).

29. This conclusion does not go without qualifiers. See William W. Bratton & Simone M. Sepe, 'Corporate Law and the Myth of Efficient Market Control', 105 *Cornell L. Rev.* 675, 707-11 (2020) (discussing conditions under which shareholders may not share the same objective function). But in the economic domain, the one share, one vote rule provides a correction to those qualifiers. See Peter M. DeMarzo, 'Majority Voting and Corporate Control: The Rule of the Dominant Shareholder', 60 *Rev. Econ. Stud.* 713, 719 (1993) (showing that a dominant blockholder with a financial incentive to move the firm to a production plan that maximizes value can build a majority coalition and solve shareholder disagreement on the firm's objective function).

30. Cf. Jill E. Fisch & Simone M. Sepe, 'Shareholder Collaboration', 98 *Tex. L. Rev.* 863, 903 (2018) ('the equity contract provides a premium to all shareholders … (proportionally to their equity stake), leveling the bargaining power of all interested parties in the distribution of the gains arising from deliberation.').

tives, which would promote pluralism. Under indexation, instead, there is only one stable coalition of shareholders who hold the majority of votes–the index funds coalition.[31] The result is that the preferences of these investors always prevail and pluralism is lost.

Combined, these factors may produce a loss in the political freedom of corporate employees (and other stakeholders that are economically dependent on the corporation, eg small suppliers), by interfering with the exercise of basic liberties. Employees' lack of voice in corporations' moral decisions intrinsically reduces their political freedom by depriving them of the ability of making these choices for themselves. And because of corporate conformity (ie the tendency of corporations to converge toward the same activist initiatives), employees cannot resort to exit (ie vote with their feet by joining a competitor) to avoid this interference. Also note that no active coercion on the part of the corporation is required to produce this result, as minority stakeholders are likely to anticipate the dire consequences of manifesting contrarian opinions and hence engage in self-censorship. The repercussions in the case of James Damore–the Google engineer who was fired for circulating a memo on the differences between men and women–are telling.[32] And a few years ago, Twitter CEO Jack Dorsey openly acknowledged that Twitter conservative employees were afraid to express their opinions.[33] Yet for all the publicity these and a few others cases received, who knows how many employees these days would feel at ease to 'look others in the eye without reason for the fear or deference that a power of interference might inspire'?[34]

The External Democratic Loss

The plutocratic adjudication of activist decisions by corporations also matters for society at large as it risks undermining political equality in electoral governance–that is, the equal consideration of the political preferences and needs of all citizens *qua* citizens.

This risk is both direct and indirect. The direct risk is that activist corporations may attempt to interfere with the democratic adjudication of political and moral outcomes, for example trying to halt the implementation of those outcomes or to otherwise alter them. As we saw above, recent corporate threats of economic retaliation and actual economic retaliation against the adoption or implementation of state laws suggest this is now a tangible risk, which could well increase if corporate activism continues to grow at the rapid pace we have observed in recent times.

The indirect risk is more subtle. This is the risk that corporate activism may give the wealthiest few exclusive access to the corporate megaphone to influence the public discourse around divisive moral issues, thus undermining equal political activity. Indeed, the equal consideration of the preferences and needs of all citizens requires not only equal voting access, but equality in other forms of political voice.[35] To this extent, the risk is that corporate activism might introduce distortions in the deliberation of divisive moral issue and, hence, indirectly, in their democratic adjudication.

This last concern closely echoes the warning of Justice Stevens in *Citizens United* that corporations' disproportionate means and resources may lead to the marginalization of the voices of ordinary citizens.[36] Several factors, however, make the democratic risks arising from corporate activism much more severe today.

First, the problem is not corporate intervention in political activity per se, as Steven's argument seemed to suggest. Instead, it is the exclusive 'appropriation' of that intervention by a board-size group of individuals (the funds' agents). If different corporations engaged in different activist initiatives–that is, if the market for morality offered some level of pluralism–that some corporations might serve as a megaphone for some individuals would only have limited impact on political equality. For other corporations would offer a counterweight, by serving as a megaphone for individuals holding different views. It is only when there is no pluralism in the marketplace for morality but rather corporate conformity, that citizens 'will lose faith in their capacity, as citizens to influence public policy.'[37]

Second, in the past decade, large corporations have grown into 'large economies,' endowed with means and resources that are comparable to those of some among the wealthiest Western states. The market capitalization of companies like Apple (ie $2.2 trillion) or Amazon ($1.73 trillion) is comparable to the gross domestic products of countries like Italy (ie about $2 trillion) or France (ie $2.7 trillion). And these companies are global in their reach, flush with cash and ready to expand their services in realms far afield from the digital one.

31. To some extent, Elon Musk's recent attempt to buy Twitter can be seen as an attempt to inject some pluralism in the new morality market. Indeed, Mr. Musk has declared that the reason he wants to acquire control of the company is not (just) to increase its profitability – and meanwhile make money – but rather to turn it into 'an inclusive arena for free speech.' Given that Mr. Musk is a self-declared free-speech absolutist, this likely means that he intends to relax the company's current content moderation policy in favor of a more libertarian—and hence more conservative—approach. Remarkably, however, Mr. Musk thinks that in order to achieve his free speech ambitions, he will have to take Twitter private.

32. See eg, Paul Lewis, 'I See Things Differently: James Damore on His Autism and the Google Memo', *The Guardian* (17 Nov. 2017), www.theguardian.com/technology/2017/nov/16/james-damore-google-memo-interview-autism-regrets.

33. See Kristine Philips, 'Twitter CEO Jack Dorsey Admits 'Left-leaning' Bias But Says It Does Not Influence Company Policy', *Wash. Post.* (Aug. 19, 2018), https://www.washingtonpost.com/technology/2018/08/19/twitter-ceo-jack-dorsey-admits-left-leaning-bias-says-it-doesnt-influence-company-policy/.

34. This is political philosopher Philip Pettit's 'eyeball test,' under which citizens are free when by local social and cultural standards, and having only ordinary courage, they 'can look others in the eye without reason for the fear or deference that a power of interference might inspire; they can walk tall and assume the public status . . . of being equal in this regard with the best.' Philip Pettit, *On The People's Terms: A Republican Theory and Model of Democracy* 84 (2012).

35. In other words, political equality requires not only equality in the aggregation of citizens' preferences but in the deliberation that precedes or accompanies that aggregation, because deliberation might lead to changes in preferences. See eg, Christian List et al., 'Deliberation, Single-Peakedness, and the Possibility of Meaningful Democracy: Evidence from Deliberative Polls', 75 *J. Pol.* 80 (2013).

36. Citizens United, 130 S. Ct. at 977 (Stevens, J., dissenting).

37. Id.

Third, some companies do not just engage in the political discourse by providing content. Companies like Facebook and Twitter also provide the platform where the political debate takes place and relevant political information is aggregated, while retaining exclusive control over the platform's engagement rules. This further exacerbates the democratic risk raised by corporate activism along the dimensions of political deliberation. For equality in political deliberation requires that both deliberative procedures (ie the setting in which deliberation takes place) and deliberative behavior (ie the actual way in which people deliberate) share democratic features.[38] But how can these requirements be satisfied when a few individuals have exclusive control over the deliberative procedures of critical political platforms as well as over the behaviors allowed on those platforms?

Democratizing corporate activism

Changing these dynamics will be challenging. In theory, restoring the losses engendered by corporate activism would demand a reversion to the division of labor assumption. But it seems unrealistic that corporations will spontaneously go back to a model of moral neutrality when their largest investors do not want it. (In Coates' terms, we cannot rely on 'The Twelve' to solve 'The Problem of Twelve'). On the other hand, a mandatory model of moral neutrality seems normatively undesirable, as it is unclear how regulators could draw the line between a corporation's economic and moral decisions, while avoiding inefficient one-size-fit-all solutions.

Nonetheless, the moral neutrality model provides a useful benchmark to evaluate the soundness of alternative policy options. Take, for example, the proposal, advanced by several scholars, to restrict or otherwise dilute the voting power of index funds.[39] These proposals are concerned with the effects of index funds' concentrated power on corporate governance rather than corporate activism. In theory, however, they could also serve to advance a more morally neutral corporate model, by drastically reducing the influence of index funds on corporate voting. Yet, unless these voting restrictions were accompanied by ownership caps (which have also been proposed but present their own problems),[40] they would have no effect on the asset pricing channel of investors' influence over a corporation's moral decision. And even assuming that a package of measures could be introduced to curb the control of index funds on corporations, it is unclear what consequences this would produce. These measures would effectively boost the ability of other investors such as hedge funds to gain that control.[41] Then, the only effect of similar measures would be to transfer oligarchic control over activist initiatives from one class of investors to another.[42]

Another possibility would be to make the corporate decision-making process regarding social engagement more democratic. Indeed, if reverting to a moral neutrality model is unfeasible, promoting pluralism in the marketplace for morality might be our best alternative.[43] If different corporations would engage in different activist initiatives, this would help both enhance the political freedom of corporate employees within corporations and mitigate the loss in political equality outside corporations. Employees would have a viable exit option if they disagreed with the specific moral position endorsed by a corporation. And different corporations would provide a megaphone to individuals with different moral-political preferences.

This process of democratization could be implemented through an enabling model under which corporations could opt to extend corporate voting rights on activist decisions to constituencies other than shareholders including employees and consumers. This model would avoid the difficulties of one-size-fits-all mandatory solutions, leaving the details of the process to firm insiders as the parties with the best information on firm-specific situations. The question, however, is how to overcome the lack of incentives of large shareholders to move toward more democratic activism. In theory, one could imagine that to begin a robust process of public discourse around the democratic implications of corporate activism could suffice to create enough of a reputational risk for activist corporations and investors to prompt a self-correction process. After all, if activism gained democratic legitimacy this would help advance the cause that the idea of corporate activism is motivated by– that corporations can be engines of positive social change.

38. On the special features of corporate conformity in Big Tech companies, see Saura Masconale & Simone Sepe, 'Big Tech and Political Equality', in *Technology Ethics: A Philosophical Introduction and Readings* (Gregory J. Robson & Jonathan Y. Tsou ed.) (2022).

39. See eg, Sean J. Griffith, 'Opt-in Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority', 98 *Tex. L. Rev.* 983 (2020) (proposing that mutual funds should not vote the shares they hold for their beneficiary owners on environmental and social issues because 'meaningful information is not produced nor can mutual funds assume a common investor purpose' on these issues); Dorothy Lund, 'The Case Against Passive Shareholder Voting', 43 *J. Corp. L.* 493, 516 (2018) (suggesting to restrict voting by index funds on the ground that their weak incentives to invest in monitoring will 'distort' the market for corporate influence).

40. Ownership caps have been proposed to curb the power of index funds but present their own problems. See Coates, *supra* note 25, (manuscript at 21-22) (noting that ownership cap could further reduce the weak incentives of index funds to monitor companies in their portfolios).

41. *Id.*

42. At the same time, under the hypothesis that the progressive posture adopted by index funds aims at monetizing on Millennials' interests in activism, it seems unlikely that other investors may demand more pluralistic activism.

43. It should be noted, however, that a pluralistic morality market may provide just a partial solution to the overall problems raised by corporate activism. Added pluralism would enable market actors to choose from a wider range of options, but it would not fully restore the benefits of moral neutrality. As we explained elsewhere, these benefits include the provision of a platform that habituated individuals to a benign indifference toward divisive moral or political issues, helping to facilitate cooperation and social cohesion. See Saura Masconale & Simone Sepe, 'Moral Capitalism and Social Order', *Social Phil. & Pol.* (forthcoming 2022). Under moral neutrality, market interactions train individuals to ignore disagreement on political or moral issues, or at least to treat disagreement as an incidental concern that cannot impede more important and productive activities. But when these issues take center stage in business activities, market participants are forced to take a position about them, which may induce disagreement even when individuals would not otherwise had an immediate reason to disagree. Put differently, under a more pluralistic morality offer, individuals could still have a second-order reason to disagree. *Id.*

While this is a possible equilibrium, it might be too optimistic. A more realistic solution might then be to rely on an experimental model of soft-regulation, under which the relevant stock exchange authority (eg the US SEC) could issue guidelines on the features that more democratic corporate activism should possess (the 'Guidelines'). For example, one could imagine a system under which managers would retain discretion on deciding whether a corporate decision falls within the moral domain and, in this case, be held to call for 'constituency voting' rather than just shareholder voting. Each class of constituencies would have one vote, where the Guidelines could provide either for a rule of unanimous approval by each class or majority approval by two classes over three. Under a unanimity rule (by classes), a lack of agreement among the corporate constituencies on activist decisions would return the corporation to a model of moral neutrality, which would be normatively desirable but likely politically unfeasible. Conversely, a majority rule (by classes) might be easier to implement.[44]

Regardless of the form the Guidelines would take–our proposal above is just meant to be exemplificatory–they would not be mandatory. Corporations, instead, could decide whether and how to reflect the Guidelines. In principle, this system should suffice to create strong reputational incentives. At the equilibrium, the expectation is that few corporations and shareholders will want to acknowledge that thy fall short of the Guidelines standards and prefer plutocratic activism. However, an off-the-equilibrium-path outcome, under which corporations and shareholders remain indifferent to non-mandatory Guidelines on corporate activism, cannot be excluded. This is why we talk of experimental soft-regulation. In such a case, the only alternative, especially if activism and indexation continue to rise, would likely be costly mandatory regulation.

Finally, there is no easy cure when it comes to addressing the democratic costs of the new corporate activism. But this should not discourage us from asking the right questions for pursuing that end.

44. Concerning the voting rules that would apply to each class, one could imagine that employees and consumers would vote based on the OPOV principle, while shareholders could either continue to vote under the OSOV rule but with a supermajority requirement or also vote based on the OPOV rule. In particular, non-shareholder constituencies could either be issued voting rights under the form of special rights or vote in specially held surveys through which managers could gather their preferences (something which in a wired world, corporations already ordinarily do with consumer surveys). In the case of shareholders, instead, requiring a OPOV vote would be the most consequentialist choice, but would likely encounter strong opposition by index funds. This proposal, however, is not too dissimilar from—and, in fact, could be combined with—recent reform proposal to implement pass-through voting or survey voting for index funds, under which fund managers would vote in accordance with the preferences expressed by the beneficiary investors.

Anne-Laure Kiechel • Founder & CEO, Global Sovereign Advisory

Julien Marcilly • Chief economist, Global Sovereign Advisory

Théo Maret • Analyst, Global Sovereign Advisory

International Trade: Towards Increased Regionalization?

Despite the proliferation of regional trade agreements in the 2000s, the share of intra-regional trade in world trade has been reduced since the great financial crisis of 2008. Apart from Europe, Asia and, to a lesser extent, North America, the importance of intra-regional trade remains low even in Africa and Latin America. However, given the difficulty of reaching a global consensus on multilateral agreements, the current period could mark a turning point.

The recent entry into force of major regional free trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) in Asia-Pacific and the African Continental Free Trade Area confirm this. The desire of companies to diversify their supplies while favouring shorter circuits (Near-shoring) as well as the desire to trade with "friendly" countries (Friend-shoring), against a backdrop of strong global geopolitical tensions, should also favour regional trade. However, the trend towards regionalization could be slowed down by the economic consequences of the war in Ukraine. To limit food supply problems, many governments have implemented measures to restrict exports of food commodities, including to nearby countries.

1. Globalization and regionalization of trade went hand in hand until 2008

1.1. Increased importance of international trade until 2008

Between the end of the Second World War and the great financial crisis of 2008-2009, there was a trend towards globalization of international trade in goods and services. It was first supported by the advent of a new world order under the impetus of the United States, then from the 1980s onwards by the integration of Asian countries into global value chains (first and foremost Japan), and then by China and other emerging countries in the 2000s.

This trend towards inter-regional trade, which is mainly explained by differences in production costs, energy supply or the strategy of penetrating promising markets, went hand in hand with the increase in intra-regional trade in certain areas. During this period, the creation of the European common market was one of the first examples of political efforts to promote extensive regionalization with strong integration of member countries in what would become the European Union, which would increase the share of intra-regional merchandise exports to more than 60 per cent of t=otal international trade by the 1980s.[1]

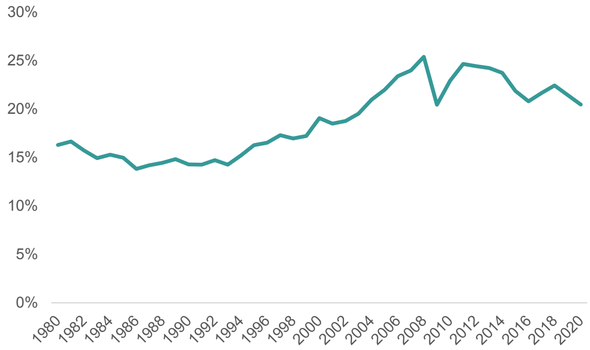


Figure 1. World exports as a share of GDP (Source: IMF, GSA calculations)

In this context, international trade grew faster than global GDP from the 1980s onwards: global exports, which represented about 15% of the world economy in the early 1990s, accounted for 25% of GDP when the great financial crisis began in 2008 (see Figure 1). Since then, growth in international trade has been lower than growth in world GDP.

There are several reasons for the slowdown in the growth of international trade. First, since the strong growth prior to 2008 had been made possible in part by the gradual decline in the cost of transporting goods, the end of this decline has coincided with less dynamic trade. One reason for this is the reduction in technological opportunities to improve the efficiency of supply chains (for example, the size of container ships cannot increase indefinitely).

The internationalization of firms and production chains, which had benefited from the growing integration of many emerging countries into world trade in the 2000s (particularly China since its entry into the WTO), has also shown signs of slowing down since the 2008 crisis, as evidenced by the slower growth of trade in intermediate goods until 2020. Moreover, the growing tertiarization of emerging economies has also contributed to the loss of the relative weight of international trade in the world economy, insofar as services are traditionally less traded internationally.

At the same time, international trade is facing various

1. IMF, trade data

setbacks in terms of trade liberalization: the failure of the Doha discussions within the framework of the WTO initiated in 2001 and lasting more than 10 years, the blocking by the United States under the presidency of Donald Trump as of 2017 of all appointments of judges to the WTO's appeal body, which *de facto* prevents it from functioning[2] or the rise of trade protectionism since 2008. These trends have led to a situation sometimes referred to as *Slowbalisation*, i.e. a slowdown in the globalization of trade in goods.[3]

1.2. Despite the signing of numerous regional trade agreements in the 1990s and 2000s, the share of intraregional trade has changed little

In the face of these institutional blockages complicating trade liberalization in a multilateral framework, two trends are observed:

- The negotiation of preferential trade agreements (PTAs) between countries or regions of different zones, such as the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union or the negotiations between the European Union and the Southern Common Market (MERCOSUR);

- The negotiation of regional trade agreements (RTAs) such as the African Continental Free Trade Area or the Regional Comprehensive Economic Partnership in Asia. The cumulative number of regional free trade agreements has increased since the early 1990s, as shown by World Trade Organization data (figure 2). Note that the peak observed in 2021 is a consequence of the Brexit, with a significant number of agreements concluded by the United Kingdom to replace agreements within the European Union.

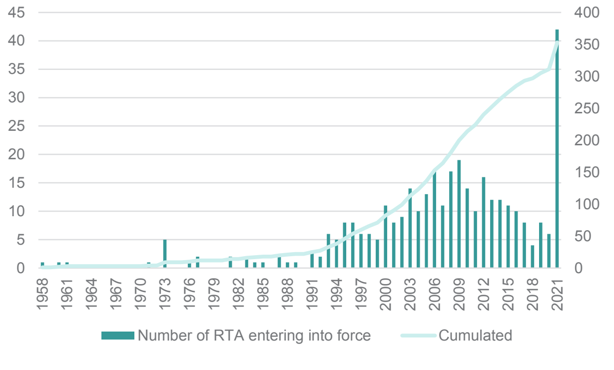


Figure 2 - Number of regional agreements coming into effect per year, and cumulative figure (Source: WTO, GSA calculations)

A study by the World Economic Forum[4] attempted to measure the evolution of the regionalization of international trade by considering the evolution of three distinct indicators:

- The proportion of global trade between countries of the same continent;

- The proportion of global trade between countries sharing a border;

- The weighted average distance of international trade.

Analyses of two separate databases for the periods 1815-2014 and 1950-2019 do not demonstrate a trend toward regionalization. The proportions of trade between countries on the same continent or sharing a border have remained relatively stable, while the weighted average distance of trade has changed little.

The evolution of the share of intraregional trade by zone confirms this conclusion. According to data from the United Nations Conference on Trade and Development (UNCTAD), the European Union and Asia-Oceania are the two zones with the largest share of regional trade, with just over 60% of intra-regional trade in goods.

North America, despite the existence of the North American Free Trade Agreement (NAFTA) and more recently the United States-Mexico-Canada Agreement (USMCA), remains slightly below with a rate closer to 30% and decreasing since 2005. Finally, sub-Saharan Africa and Latin America are still lagging behind, with the share of regional trade representing less than 20% of total trade, underlining the preponderance of exports to other regions of the world, particularly the advanced countries and China in the case of raw materials.

Membership or not in a currency zone does not seem to change these regional differences significantly. For example, in the Economic and Monetary Community of Central Africa (CEMAC) and the West African Economic and Monetary Union (WAEMU), the share of intra-zone merchandise trade is low (3% for CEMAC and 13% for WAEMU). Moreover, there is no upward trend.

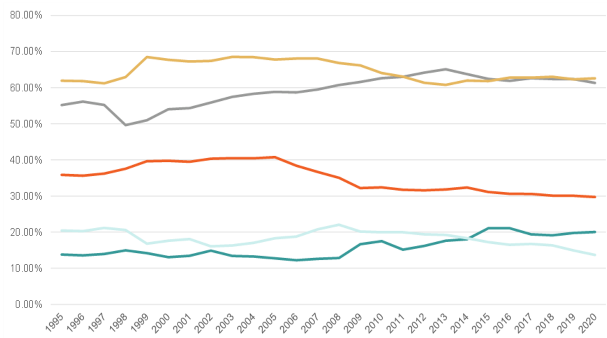


Figure 3: Share of intraregional goods trade by zone (Source : UNCTAD, GSA calculations)

2. The Europeans have tried to set up an interim multi-stakeholder structure to deal with this situation, but this structure has not yet been set up and is still under negotiation.
3. Apart from the exchange of goods and services, the other dimensions of globalization are the flows of capital, people and data.
4. *Regionalization vs. globalization: what is the future direction of trade*, World Economic Forum, 2021

Figure 4: Share of intraregional merchandise trade for different zones (Source: UNCTAD, GSA calculations)

Box 1 – Gravity models justify regionalization of trade

One of the main models used to determine the basis of international trade is the gravity model, which postulates that trade volumes between two given countries are a function of their respective size and the distance between them. It is described by the following equation for two countries a and b:

$$V_{a,b} = G \times \frac{M_a M_b}{D_{a,b}}$$

V denotes the volume of trade between the two countries, M the economic size (e.g. GDP), D the distance between the two countries, and G a constant.

This equation, similar to the one describing the gravitational force, implies that, all other things being equal, trade is greater between two countries if they are geographically close and decreases as the distance between them increases. This model has been verified empirically and has often been used to test the effectiveness of trade agreements.

Disdier and Head[5] (2008), for example, conducted a meta-analysis of 103 research studies and showed stability in the coefficient related to distance and those related to the respective economic weights of countries. Chaney[6] (2011) also provides a review of the literature supporting the empirical relevance of the gravity model, which was notably made compatible with other simple economic models.

The phenomenon of regionalization of international trade seems to be a logical consequence of this model, since it implies a minimization of distances between trading partners.

2. The trend towards diversification of supplies and shorter supply chains favors the regionalization of trade, but not the rise of food protectionism

2.1. The trend is towards diversification of supplies and shorter circuits

The World Economic Forum study[7] cited above observes from partial data available for the period 2016-2021 on the then 28 members of the European Union trend towards regionalization. Indeed, the weighted average distance of trade of the members of the European Union, as defined above, goes from about 5.900 km before 2020 to 5.200 km that year, before oscillating since then around 5.600 km.

This trend is explained in particular by the health restrictions that limited the international movement of people and the production of certain goods as part of the containment measures. These supply chain pressures have continued since then due to the faster and stronger than expected global economic recovery. Beyond the COVID-19 pandemic, other events have highlighted the vulnerability of global supply chains and thus companies dependent on a limited number of suppliers, such as the temporary blockage of the Suez Canal in 2021. The war between Russia and Ukraine is having an impact on value chains, especially as it is leading to measures restricting trade between these two countries.

The question is whether these recent changes will indeed lead to increased regionalization of international trade. For example, the European Union has made announcements on the need for strategic autonomy. To achieve this, the objective is to promote the relocation of value chains in several industrial sectors (foremost among them the medical and pharmaceutical industry) to improve the region's resilience to exogenous shocks such as the COVID-19 pandemic. Similarly, Indian Prime Minister Narenda Modi has emphasized the notion of the need for economic self-sufficiency in the wake of the COVID-19 pandemic, and several countries, including Japan, have included in their recovery plans targeted support for companies that repatriate production activities to their own countries.

But at this stage, the results of these new strategies are not visible: exports of intermediate goods, a good indicator of the health of global value chains, rose 47% year-on-year worldwide in Q2 2021. This strong growth is not just due to favorable base effects (trade having fallen a year earlier during strict confinements), with these same exports up more than 20% year-on-year in Q2 2019. Considering a complete relocation of manufacturing processes domestically or regionally highlights the problems of rising production costs and lack of local skills. Reducing production costs has been the primary driver of past relocation of production in order to offer lower prices to

5. Disdier, Anne-Célia and Keith Head. 2008. 'The Puzzling Persistence of the Distance Effect on Bilateral Trade' *Review of Economics and Statistics*, 90(1): 37-48.

6. Thomas Chaney. 2011, 'The Gravity Equation in International Trade: An Explanation.'

7. *Regionalization vs. globalization: what is the future direction of trade*, World Economic Forum, 2021.

consumers. A relocation of production processes to more developed markets would necessarily mean higher prices, which would be shared at least partially by consumers. The differences in production costs between countries remain significant, even if they have narrowed somewhat over the past 20 years: while China's GDP per capita was 6% of that of the United States in 2000, it is now around 30%. Finally, even with a complete relocation of manufacturing processes to the national or regional level (within the EU, for example), this new local production process would still be dependent on the supply of raw materials, which is highly dependent on location.

Moreover, while previous regional trade agreements appear to have had a minor effect on intraregional trade (see section 1), the recent signing of a few major agreements could change this. The African Continental Free Trade Area (ACFTA), as well as the Regional Comprehensive Economic Partnership (RCEP) for Asia-Oceania, illustrate this trend. According to initial estimates[8] from the United Nations Economic Commission for Africa (UNECA), the ACFTA is expected to increase intra-African trade by 40%.

These two free trade agreements are being implemented in areas with extremely different situations: the RCEP signatory countries represent 30% of world GDP in Asia, compared with only 2% in Africa. On the other hand, Asia-Oceania is more highly integrated than Africa, with nearly 60% of intra-regional merchandise trade already in place. The longer-term potential for the African free trade area is therefore even greater. The RCEP overlaps with many already deep agreements between countries in the zone, such as the ASEAN Free Trade Area. In this sense, the marginal impact of the African agreement could also be particularly important as existing regional agreements in Africa are less deep.

This strategy of adopting a pragmatic approach by favouring the signing of regional agreements over multilateral agreements does not, however, have all the advantages: it does not make it possible to respond to certain issues that are global in scope.

This is the case, for example, with environmental changes: a regional approach could indeed favor the lowest bidder on environmental standards or working conditions and perpetuate the dumping phenomena already observed today. The questions linked to the implementation of the European carbon tax confirm this.

2.2. Rise of food and energy protectionism in the context of the war in Ukraine

The war between Ukraine and Russia has accelerated the rise in energy and food commodity prices. In response to this rise, which is increasing inflationary pressures with significant risks of social protest, many states are tempted to implement protectionist measures.

Such measures have emerged very quickly, both in low-income countries (such as Burkina Faso) and in high-income economies such as Japan. They target a variety of food commodities: meat, grain, or oil. These measures consist mainly of restrictions on exports. But they also involve facilitating imports by lowering tariffs (which is therefore not protectionist).

For example, Indonesia – after several progressive measures – banned all palm oil exports at the end of April in order to limit price increases on the domestic market. Yet the country is the world's leading producer and exporter with two thirds of its production exported, representing 60% of the world market. This decision has therefore quickly pushed up prices on the international markets.

In the short term, the evolution of protectionist measures observed for foodstuffs will probably be dictated by the evolution of the conflict, even if other economic factors could reinforce this trend, such as the drought underway in the Horn of Africa or the heat wave in India which is destroying wheat crops.

8. UNECA, *African Price Monitoring Report*, 2022.

Peter John Oliver • Visiting Professor at the Institut d'Études Européennes of the Université Libre de Bruxelles; his new book, titled *The Fundamental Rights of Companies – European, US and International Law Compared*, will be published by Hart Publishing in 2022.

What Fundamental Rights, if Any, Should Companies Enjoy? A Comparative Perspective

Every year,[1] the US Supreme Court, the European Court of Human Rights (ECtHR) and the Court of Justice of the EU (CJEU) all deliver a significant number of judgments relating to the fundamental rights[2] of companies.[3] For reasons which will become clear to the reader, the US case law has spawned a vast amount of literature in that country.[4] In contrast, with the notable exception of EU competition (anti-trust) law,[5] there is a marked dearth of literature on this topic on this side of the Atlantic. With this article and his forthcoming book,[6] this author seeks to make a contribution towards filling that gap.

No-one could seriously deny that human beings always have been, and must continue to be, the primary beneficiaries of fundamental rights; and of course some of the most important rights of all (e.g. the right to life and freedom from torture) can only apply in favour of natural persons. Yet the fact is that companies enjoy fundamental rights in all the domestic jurisdictions which this author has examined (the US, the EU, France,[7] Germany, Ireland[8] and the UK).[9] The same applies to the European Convention of Human Rights (ECHR). In any event, apart from the ECHR, international law only recognises fundamental rights enjoyed by natural persons,[10] which has provoked some criticism from very eminent international quarters.[11]

Many lawyers consider the very idea of companies enjoying such rights as preposterous, [12] and of course this is fully understandable. So why have so many legal systems endorsed the contrary view?

Any doubts on the need to do so should be dispelled by the egregious treatment of Yukos at the hands of Russia. Merely because Mikhail Khodorkovskiy, the controlling shareholder of Yukos, had had the temerity to oppose President Putin politically, the Russian authorities imposed an exorbitant and arbitrary tax bill on the mammoth oil company and committed major procedural irregularities in prosecuting it for tax fraud, resulting in its demise.[13]

1. Editor's note : the original version of this article was written in English. The version published in the French version of the RED was translated by the editors.
2. "Fundamental rights", which is the term used in EU law and which corresponds to the German *Grundrechte*, is employed here to designate rights that are entrenched in the Constitution or Bill of Rights of the jurisdiction concerned, in view of their exceptional importance. Manifestly, it would be absurd to speak of the "human rights" of companies, although that term has the same meaning. The corresponding term in the US is "constitutional rights". In the US, "fundamental rights" refers to those constitutional rights which are so essential to individual liberty that any act impinging on them is subject to the strictest judicial scrutiny; but the term is not used in that sense here.
3. "Company" is used here to denote commercial entities, and is used interchangeably with "corporation". The adjective "corporate" is used in the same sense.
4. See e.g. P. Blumberg 'The Corporate Entity in an Era of Multinational Corporations' 15 *Delaware Journal of Corporate Law* (1990) 283, C. J. Mayer 'Personalizing the Impersonal: Corporations and the Bill of Rights' 41 *Hastings LJ* (1990) 577, B. Garrett 'The Constitutional Standing of Corporations' 163 University of Pennsylvania Law Rev 95 (2014) and A. Winkler *We the Corporations – How American Businesses Won their Civil Rights* (Liveright Publishers, 2018).
5. See e.g. T. Bombois *La Protection des Droits Fondamentaux des Entreprises en Droit Européen Répressif de la Concurrence* (Larcier, 2012), M. Le Soudeer *Droit antitrust de l'Union européenne et droits fondamentaux des entreprises – Approche contentieuse* (Larcier, 2019) and A. Scordamaglia-Tousis *EU Cartel Enforcement – Reconciling Effective Public Enforcement with Fundamental Rights* (Wolters Kluwer, 2013). See also F. Castillo de la Torre and E. Gippini Fournier *Evidence, Proof and Judicial Review in EU Competition Law* (Edward Elgar, 2017) and N. Khan in Kerse and Khan *EU Antitrust Procedure* (Sweet & Maxwell, 6th ed, 2012).
6. P.J. Oliver *The Fundamental Rights of Companies – EU, US and International Law Compared* (Hart Publishing, forthcoming).
7. See in particular Decisions 79-112 DC of 9 January 1980 http://www.conseil-constitutionnel.fr/conseil-con..decision-n-79-112-dc-du-09-janvier-1980.7767.htm and 81-132 DC of 16 January 1982, http://www.conseil-constitutionnel.fr/conseil-con..decision-n-81-132-dc-du-16-janvier-1982.7986.html of the *Conseil Constitutionnel* (French Constitutional Court).
8. The leading judgment of the Irish Supreme Court was delivered in *Iarnród Éireann v Ireland* [1996] 3 I.R. 321, [1995] 2 I.L.R.M. 161.
9. See e.g. *Bank Mellat v HM Treasury* [2013] UKSC 39 (right to be heard) and *Jameel v Wall Street Journal* [2007] 1 AC 359 (right to reputation). But, applying the definition set out in n 2 above, it is questionable whether fundamental rights exist in UK law at all, since in the absence of a written Constitution they cannot be fully entrenched. Some fundamental rights are recognized under the common law (see e.g. *Kennedy v Charity Commission* [2014] UKSC 20); but they can be overridden by clear statutes to the contrary. The Human Rights Act 1998 introduces a significant number of provisions of the ECHR into UK law, but it does not empower the courts to set aside Acts of Parliament – and the present Government is seeking to water it down or to replace it https://rozenberg.substack.com/p/what-is-raab-thinking-of?s=w
10. That is the case across the board, including both global and regional international human rights instruments. See e.g. the decision of the Inter-American Commission on Human Rights in *Mevropal v Argentina* (Report nº 39/99 Inter-Am. CHR OEA/Ser. L/V/II.95 doc. 7 rev 297 (1999) http://www.cidh.org/annualrep/98eng/inadmissible/argentina%20mevopal.htm).
11. 'Outside the scope of the ECHR, international human rights protection for companies is dim' (J. Wouters and A.-L. Chané *Multinational Corporations in International Law* Working Paper 129 (December 2013, updated February 2015), 10 https://ghum.kuleuven.be/ggs/publications/working_papers/2013/129wouterschane). See also the virulent criticism of the *Mevropal* decision (n 9 above) by R. D. Bishop, J. Crawford and W. M. Reisman: "The Inter-American Human Rights Commission, in deciding not to entertain petitions from juridical persons, but only from natural persons, excluded a significant part of the economic claims that arise under the American Convention [on Human Rights]" (*Foreign investment disputes: cases, materials and commentary* (Wolters Kluwer, 2005), 485).
12. See e.g. D. Ciepley 'Neither Persons nor Associations: against Constitutional Rights for Corporations' Journal of Law and Courts 1(2) (2013) 221 and Mayer (n 3 above). The more radical view is that companies should not be treated as persons at all: F. Capra and U. Mattei *The Ecology of Law – Toward a Legal System in Tune with Nature and Community* (Berrett-Koehler, 2015), 185.
13. In *Yukos v Russia* (application 14902/04, judgment of 20 September 2011), the ECtHR found Russia to be in breach of the right to property under Article 1 of Protocol 1 to the ECHR and the right to a fair trial under Article 6 ECHR. In its judgment of 31 July 2014, the ECtHR awarded the shareholders €1.9 billion damages.

Manifestly, without the right to property, companies cannot function at all.[14] Moreover, such action wholly undermines the rule of law, quite apart from its catastrophic effect on the economy and thus the welfare of the population as a whole.[15]

As regards certain fundamental rights, it is particularly obvious that companies should enjoy certain fundamental rights not merely for their own benefit, but for the benefit of others or even the public as a whole. Freedom of speech is a case in point: in the contemporary world where all publishing houses are corporate bodies, this fundamental right would be an empty letter if it did not protect the publishing company as well as the author and other individuals.[16] Another clear example of the utilitarian rationale is the rule against double jeopardy (ne bis in idem), which is intended not merely to protect the accused against repetitive harassment, but also to prevent the courts being encumbered with repetitious prosecutions which would waste public resources.[17]

Crucially, however, two different questions arise. First, should companies enjoy a particular fundamental right? Second, if so, should they enjoy that right to the same extent as natural persons? For instance, as we shall see, corporations should enjoy most, but not all, aspects of the right to a fair trial.

1. What is Corporate Personality?

But first of all we need to consider what corporate personality is. Put simply, three broad theories of the corporation can be discerned:[18]

- the aggregate theory, which views the corporation as an aggregate of its members or shareholders (i.e. it is no more than a bunch of individuals);

- the artificial entity theory (sometimes known as the 'grant theory'), which treats the corporation as a creature, or even extension, of the State which is therefore at liberty to close it down at its will; and

- the real entity theory, according to which the corporation is to be regarded as a genuine legal person quite distinct from the sum of its owners and as no mere extension of the State.[19]

These theories must be understood against their historic background.[20] Corporations[21] were a familiar feature of Roman law. However, it was only in the second quarter of the 19th century that it became the norm for businesses to be incorporated, as the advantages of limited liability became clear with the advent of the railways.

Accordingly, in the late 19th century some progressive lawyers began to espouse the real entity theory.[22] The plain fact is that only this theory takes the concept of legal personality seriously and recognises the realities.[23] After all, companies enjoy at least three crucial advantages which natural persons do not, namely:

- the benefits of limited liability;

- longevity and even (theoretically) immortality; and

- a system of direct taxation which is often more favourable than the income tax imposed on natural persons.

Consequently, the aggregate and artificial entity theories gradually receded into the background, but they have not disappeared. Indeed, as we shall see, the majority judgment of the US Supreme Court in *Burwell et al. v Hobby Lobby Inc.*[24] is based on the aggregate theory, with highly questionable effects.

For completeness, it should be stressed that all of these theories take into account the need to pierce the corporate veil in exceptional circumstances such as fraud.

2. The United States

In the US,[25] neither the Constitution (1789) nor the Bill of Rights (1792) expressly mention corporations' fundamental rights - which is scarcely surprising, given that hardly any businesses were incorporated at the time. Nevertheless, according to the case law, companies enjoy very far-reaching fundamental rights.[26] Just like the CJEU,

14. "When a State creates a corporation with the power to acquire and utilise property, it necessarily and implicitly guarantees that the corporation will not be deprived of that property absent due process of law." (Justice Rehnquist in *First National Bank of Boston v Bellotti* 435 US 765, 824 (1977)).

15. Of course, the atrocities perpetrated by the Putin Government in the Ukraine at the time of writing show that foreign investors paid insufficient attention to these blatant breaches of human rights - and to countless more barbarous acts committed by it across the world. Nevertheless, there can be no doubt that other more prudent and scrupulous businesses were deterred by the Yukos scandal from investing in Russia.

16. *New York Times v Sullivan* 376 US 254 (1964) and *Sunday Times v United Kingdom* (application 6538/74, judgment of the plenary ECtHR of 26 April 1979). Similarly, see *Lee v McArthur and Ashers Baking Company Ltd* [2018] UKSC 49, discussed in the text accompanying n 142 below.

17. *Crist v Bretz* 437 US 28, 33 (1978). See M. Luchtman 'The ECJ's Recent Case Law on *Ne Bis in Idem*: Implications for Law Enforcement in a Shared Legal Order' 55 CMLRev. 1717, 1721 (2018). C. Karakosta describes the rule as being akin to *res judicata*: « Ne bis in idem : une jurisprudence peu visible pour un droit intangible » 2008 *Rev. Trim. Dr. H.* 25.

18. Numerous variants of these theories exist, and other terminology is frequently used.

19. On these theories, see e.g. R. Avi-Yonah 'The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility' 30 *Delaware Journal of Corporate Law* 767 (2005), K. Beran *The Concept of Juristic Person* ((Prague, Wolters Kluwer, 2020), Blumberg (n 3 above) and M. Dan-Cohen *Rights, Persons and Organizations – a Legal Theory for a Bureaucratic Society* (Berkley, University of California Press, 1986).

20. In addition to the sources mentioned in n 19 above, see P. Ireland 'Capitalism without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' 17 *Journal of Legal History* 41 (1996) and Winkler (n 4 above) 44 – 45.

21. See n 3 above.

22. See e.g. O. von Gierke *Die Genossenschaftstheorie und die deutsche Rechtsprechung* (1887) and *Das Wesen der Menschlichen Verbände* (1902), and the seminal judgment of the House of Lords in *Salomon v Salomon and Co Ltd* [1897] AC 22.

23. See Dan-Cohen (n 18 above), E. Decaux 'L'application des normes relatives aux droits de l'homme et aux personnes morales de droit privé' 54 RIDC 549, 559 (2002) and L. Favoreu *et al Droits des libertés fondamentales* (Dalloz, 2000) 177.

24. 573 US 682 (2014).

25. Only federal American law will be considered here.

26. See the literature set out in n 4 above.

the US Supreme Court has failed to develop a general approach to the two difficult questions set out in the final paragraph of section I above - but neither court can be criticised on this count, since it is no easy task. Admittedly, the US Supreme Court has held that, in determining whether a fundamental right enshrined in the Constitution or the Bill of Rights extends to corporations, regard must be had to its 'nature, history and purpose';[27] but this approach is as vague as it is sound.

Let us begin with the good news. Ever since its seminal ruling in *Hale v Henkel* decided in 1906,[28] it has been repeatedly held that corporations cannot plead the Fifth Amendment (the privilege against self-incrimination in criminal and quasi-criminal proceedings).[29] This case arose out of an antitrust investigation into two tobacco companies pursuant to the Sherman Act. The Court declared that, if it were otherwise, "the privilege claimed would practically nullify the whole act of Congress" (the Sherman Act).[30] In other words, it would then become excessively difficult to enforce the Act. This ruling is most welcome, since the purpose of this ancient right is also to avoid "physical torture and other less violent but equally reprehensible modes of compelling the production of incriminating evidence", as the Supreme Court subsequently acknowledged in *White*.[31]

Now we come to the bad news - at least it is bad for anyone who is not a hard-line economic libertarian.

This is not the place to explore the case law of the 19th and early 20th centuries which massively favoured businesses especially against the most vulnerable members of the population. Nor can we dwell on the "infamous" judgment in *Lochner*,[32] the Supreme Court struck down a labour law of the State of New York prohibiting bakers from employing staff for more than sixty hours per week, on the grounds that it constituted an unreasonable interference with the liberty of the person and the freedom of contract contrary to the Due Process Clause of the Fourteenth Amendment (1868).[33] Suffice it to say that this ruling sparked a wave of extreme 'cowboy capitalist' judgments which ended abruptly in 1937.[34] That is all confined to history - except that, according to Cass Sunstein, *Lochner* never fully went away.[35]

Let us concentrate on four highly controversial judgments dating from 2010 and 2011. But, for a proper understanding of the first of these cases, *Citizens United,*[36] we have to cast our minds back over the previous few decades. The background to this case is the overriding importance attached to free speech under the First Amendment, including speech by corporations.[37] A judgment which deserves a particular mention in this regard is *Miami Herald*,[38] where the Supreme Court unanimously struck down a Florida statute which granted a mandatory right to reply free of charge to a political candidate for nomination to refute accusations made against him in a newspaper. Any compulsion on a newspaper to publish anything which 'reason tells them should not be published' was held to be unconstitutional.[39] This ruling appears to confirm the sardonic quip that: 'Freedom of the press is guaranteed only to those who own one'.[40]

Moreover, this provision has been interpreted very broadly to cover the right to make political donations,[41] even for corporations[42] - despite the fact that they have no right to vote or run for office. Thus in *Bellotti a* bare majority of the Supreme Court struck down a Massachusetts law which prohibited corporate expenditure for the purpose of influencing the vote on any referendum submitted to the voters other than one materially affecting the property, business or assets of the corporation.

In *Citizens United*, the US Supreme Court took this line of cases a dangerous step further. By a 5-4 majority, the Supreme Court held that corporations have a right under this provision to incur expenditure to influence elections. In 2008, the plaintiff, a non-profit political action committee, produced and released a documentary criticising Hillary Clinton, who was seeking the Democratic nomination for President of the United States. To promote this film, it produced various advertisements which fell foul of a federal prohibition on 'electioneering communications' by corporations and unions within 30 days of a primary

27. *Bellotti* (n 14 above), 779.

28. 201 US 43 (1906).

29. This judgment was confirmed in *United States v White* 322 US 694 and *Curcio v US* 354 US 118, 122 (1957).

30. *Hale* (n 28 above), 70.

31. n 29 above, 698. This understanding of the origin of this right is shared by legal historians R. H. Helmholz *et al. The Privilege Against Self-Incrimination: Its Origins and Development* (University of Chicago Press, 1997) and J. Langbein 'The Historical Origins of the Privilege against Self-incrimination at Common Law' 92 *Michigan Law Rev.* 1047 (1994).

32. 198 US 45 (1905). The 'infamous' description, reflecting a stance which is very widely shared today, is to be found in J Nowak and R Rotunda, *Constitutional Law* 8th ed (St Paul, West Law, 2010), 472.

33. This clause reads "... nor shall any State deprive any person of life, liberty, or property, without due process of law ...". According to Winkler (n 4 above), pp xv and 157-8, this clause, which was intended to give equal rights to African Americans in the wake of the Civil War, was the basis on which the Supreme Court conferred very broad rights on undertakings during this period – but very few on African Americans. But let us not forgot that the European powers frequently acted in equally reprehensible ways at the time.

34. Nowak and Rotunda (n 32 above), 476.

35. '*Lochner*'s Legacy' 87 *Columbia Law Rev* 873 (1987).

36. *Citizens United v Federal Election Commission* 558 US 310 (2010)

37. *New York Times* (n 16 above).

38. 418 US 241 (1974).

39. At 256.

40. Attributed by M Tushnet in *An Advanced Introduction to Freedom of Speech* (Edward Elgar, Cheltenham, 2018), 116-117) to A.J. Liebling. In the same spirit, in 1987 the Federal Communication abolished the Fairness Doctrine, which required radio and television channels to present controversial issues of public importance and to do so in a manner that fairly reflected differing viewpoints. This step, which opened the door to widespread "fake news", has had catastrophic effects in the US and (thanks to the Internet), around the world.

41. *Buckley v Valeo* 424 US 1 (1976)

42. *Bellotti* (n 14 above).

election.[43] This prohibition was held to be incompatible with the First Amendment. Because this case concerned an election – and a presidential election at that – its repercussions are considerably more far-reaching than those of *Bellotti*.

This judgment resulted in a massive increase in political donations by corporations, which were already extremely high. Not only has this increased corporate interference with American democracy, but it has also required politicians to devote even more of their working days to raising funds for their re-election, and consequently devoting insufficient time to their work as lawmakers.

Shortly afterwards, the Supreme Court delivered its judgment in *Hobby Lobby*,[44] a challenge to the Affordable Care Act 2010 ("Obamacare"). Hobby Lobby Stores Inc. was a national chain of 500 arts and crafts stores with more than 13,000 employees. The five individuals who owned the company ("the Green family") were devout Christians and maintained a sincere conviction that human life begins at conception. Although they do not oppose contraception as such, they had a profound objection to four out of the twenty methods of contraception approved by the Food and Drugs Administration, since they considered those four methods to be a form of abortion. Accordingly, they objected to the requirement under "Obamacare" to contribute towards the healthcare coverage of their staff so far as those four methods of contraception were concerned.

The Supreme Court ruled that the company could rely on the freedom of the religion since it was simply a vehicle for the Green family to do their business and was in effect a mouthpiece for the family's religious views. On this basis, the contested provisions of the Act were held to be repugnant to the freedom of religion in so far as the four types of contraceptive were concerned. This approach to the nature of companies is deeply flawed.[45] Moreover, this judgment had the pernicious effect of introducing gender discrimination within the workplace: by definition, only female employees were affected; and of course it is by no means easy for staff to move to another employer.

Another highly controversial judgment was delivered in *Sorrell v IMS Health Inc.*[46] The case concerned a statute of the State of Vermont restricting the use of pharmacy records to describe the prescription practices of doctors. This effectively prevented pharmaceutical companies from sending their agents to persuade individual doctors to prescribe their products, which were not in the best interests of patients or the public purse. In effect, the law was intended to encourage the use of generic drugs which are generally cheaper. The Supreme Court ruled by a majority that the contested statute was an unjustified interference with free speech. In so doing, the judges favoured "big pharma" at the expense not only of patients, but also of smaller competitors and the public purse. An eminent legal journalist described *Sorrell* as a 'particularly egregious' example of the Court using free speech to 'serve a deregulatory agenda'.[47]

Finally, *J. McIntyre Machinery Ltd. v Nicastro*[48] concerned a three-ton metal shearing machine manufactured by the appellant company, which was based in England and which had severed four fingers off the respondent worker's right hand. The company's products were marketed in the US by its distributor, based in Ohio. Since the accident occurred in a scrap-metal factory in New Jersey, Mr Nicastro brought his action in the courts of that State. Incredibly, because J. McIntyre had no links with New Jersey, the Supreme Court held by a majority that to allow the case to be heard in the courts of New Jersey would violate the company's right under the Due Process Clause of the Fourteenth Amendment to be 'subject only of lawful authority'.[49] The majority seemed oblivious to the fact that the injured workman almost certainly lacked the resources to bring the action in Ohio, and would probably be unable to take the necessary time off work to do so.

3. Europe

3.1. Germany

In Europe, Germany long has been in the vanguard in this field ever since Article 159 of the abortive national Constitution of 1849[50] provided for a right of petition which expressly covered corporations.[51] This development culminated in 1949 with the adoption of the Basic Law or Grundgesetz (GG), Article 19(3) of which reads: 'Fundamental rights also apply to ... legal persons to the extent that their nature permits'. This may well be the very first provision of any Constitution, Bill of Rights or treaty anywhere in the world to recognise expressly the fundamental rights of legal persons.[52]

Unsurprisingly, legal persons cannot rely on Article 1(1) GG, which provides: 'Human dignity shall be inviolable. All public authorities are under a duty to respect and protect it'.[53] In a ruling reminiscent of *Hale v Henkel*[54] and its

43. Section 203 of the Bipartisan Campaign Reform Act 2002.

44. n 24 above.

45. See section II above.

46. 564 U.S. 552, 579 (2011)

47. L Greenhouse 'Over the Cliff' New York Times 24 August 2011 : https://opinionator.blogs.nytimes.com/2011/08/24/over-the-cliff/?ref=opinion&emc=tya1.

48. 564 US 873 (2011).

49. At 887.

50. http://verfassungen.de/de/de06-66/verfassung48-i.htm

51. See B. Remmert, commentary on Article 19(3) in *Dürig et al Grundgesetz Kommentar* (Beck Online, 2021), paras 2 – 14.

52. Article 19(3) has served as a model for more recent constitutional provisions, including Article 12(2) of the Portuguese Constitution (1976) and Article 8(4) of the South African Constitution (1996).

53. See the judgments of the German Constitutional Court (*Bundersverfassungsgericht*) in BVerfG 95, 220 (1997), 242, BVerfG 118, 168 (2007), 203. (Many of the judgments of this Court are available in English, as are its press releases.) See Remmert's commentary (n 51 above).

54. n 28 above.

progeny, it was held that the privilege against self-incrimination is rooted in human dignity under Article 1(1) and therefore applies only to natural persons.[55]

Nevertheless, corporations enjoy a very wide range of other rights, including the freedom of expression (Article 5(1) GG),[56] privacy of correspondence and telecommunications (Article 10),[57] and the rights to occupational freedom (Article 12(1))[58] and to property (Article 14).[59] The latter two provisions should be viewed in the light of the clause in Article 20(1) GG specifying that the Federal Republic is a 'social State'[60] as well as the concept of the 'social market economy' ('*Soziale Marktwirtschaft*'). That concept, according to which social and economic rights must be balanced against one another, has played a crucial role in post-war Germany even though it is not enshrined in the Basic Law.[61]

3.2 The ECHR

The ECHR, which was opened for signature in 1950, contains various indications that some of its provisions apply for the benefit of companies.[62] First, Article 10 on the freedom of speech contains a sentence stating: 'This Article shall not prevent States from requiring the licensing of broadcasting, television or cinema *enterprises*'.[63] Second, Article 34 of the Convention provides: 'The Court may receive applications from any person, non-governmental organisation or group of individuals ...'. This has been interpreted widely to cover companies. What is more, Article 1 of Protocol 1 to the Convention, which was opened for signature in 1951, contains a sentence which reads: 'Every natural or *legal person* is entitled to the peaceful enjoyment of his possessions'.[64]

Together with its protocols, this treaty focuses primarily on first generation rights (e.g. the right to life, equality before the law, freedom of speech, freedom of religion and the right to a fair trial). Nevertheless, in *Airey v Ireland*, the ECtHR held that, while the rights enshrined in the Convention are 'essentially civil and political', 'many of them have implications of a social or economic nature'.[65] At the same time, as one would expect, the Court has repeatedly asserted that economic rights are less deserving of protection than political and civil rights.

The very first case in which a company succeeded in an action before the ECtHR was *Sunday Times v United Kingdom*,[66] in which the Court found a breach of that company's right to freedom of non-commercial expression under Article 10 ECHR. Since then the ECtHR has applied several other provisions of the Convention in favour of companies.[67] However, it has almost always been at pains to limit the fundamental rights of companies to what is strictly necessary.[68] For instance, in *Spacek v Czech Republic* the ECtHR found that a company, unlike an individual taxpayer, can be expected to take expert advice.[69] That Court has also has also held that companies have no right to legal aid under Article 6 ECHR.[70]

An extremely rare judgment in which that court was insufficiently cautious is *Grande Stevens v Italy*.[71] In that case, the Court took the unprecedented step of applying the rule against double jeopardy (*ne bis in idem*) to a company;[72] and at the same time it simply applied its earlier case law[73] in which it had construed the relevant provision[74] in a manner which is particularly favourable to accused individuals. As explained in section 1 above, the case for applying this fundamental right in favour of companies is overwhelming, but it does not necessarily

55. BVerfGE 95, 220, paras 83-84 (1997).

56. BVerfGE 20, 162 (1966), 171 (the written press) and BVerfGE 95, 220 (1997) at 234 (radio)

57. BVerfGE 100, 313 (1999) at 356 and BVerfGE 106, 28 (2002) at 43

58. BVerfGE 21, 261 (1967) at 266 and BVerfGE 118, 168 (2007) at 202 and 205.

59. BVerfGE 4, 7 (1954) at 17

60. "Die Bundesrepublik Deutschland ist ein ... sozialer Bundesstaat."

61. M. Ruffert 'Public law and the economy: A comparative view from the German perspective'11 I-CON 925 (2013); and see generally Christian Joerges and Florian Rödl, "The 'Social Market Economy' as Europe's Social Model?",EUI Working Paper LAW No.2004/8 (2004) https://cadmus.eui.eu/bitstream/handle/1814/2823/law04-8.pdf

62. M. Emberland, *The Human Rights of Companies: Exploring the Structure of ECHR Protection* (OUP 2006); E. Fura-Sandström, 'Business and Human Rights – Who Cares?' in L Wildhaber, *Liber Amicorum Luzius Wildhaber: Human Rights – Strasbourg Views* (Engel 2007) 159 and T. Kleinlein 'Die juristische Person des Privatrechts in der Rechtsprechung des EGMR' *Jahrbuch des öffentlichen Rechts der Gegenwart Neue Folge* vol. 65, 85 (2017).

63. Emphasis added.

64. Emphasis added.

65. Application 6289/73 (judgment of 9 October 1979), para 26.

66. n 16 above.

67. The list includes amongst other rights the right to property and to a fair trial (*Yukos* (n 13 above)) and the right to the protection of the "home" and correspondence (*Société Colas Est v France* (application 37971/97, judgment of 16 April 2002).

68. See e.g. *Niemietz v Germany* (application 13710/88, judgment of 16 December 1992), para 31 (protection of the "home and correspondence" under Article 8 ECHR); and commercial expression (advertising and promotion) is less protected than non-commercial expression: e.g. *Krone Verlag GmbH v Austria* (n° 3) (application 39069/97, judgment of 11 December 2003). See T. Bombois and P. Oliver 'La liberté d'expression commerciale en droit de l'Union européenne' Annuaire de Droit de l'Union européenne 2014 (Editions Panthéon-Assasse, 2015), 3.

69. *Spacek s.r.o. v Czech Republic* (application 26449/95, judgment of 9 November 1999), para 59. This case concerned the company's right to property; see also *Yukos* (n 13 above), para 559 and the charmingly named *Crash 2000 OOD v Bulgaria* (application 4983/07, decision of 17 December 2013). Similarly, in *Elcomp v Poland*, a case concerning the right to a fair trial and the applicant's failure to mitigate its court fees, the ECtHR ruled that 'the level of diligence expected from an entity engaged in a commercial activity may be higher than that required from a natural person' (application 37492/05, judgment of 19 April 2011, para 41); see also *Pietka v Poland* (application 34216/07, judgment of 16 October 2012), para 61 concerning a partnership. In *Crash 2000* and *Elcomp*, the applicants were a company and its owner and manager. Sometimes it is appropriate to treat individuals acting in an economic capacity in the same way as other natural persons (see section VI below), and sometimes it is right to treat them in the same way as companies as in *Niemietz* (n 68 above).

70. *VP Diffusion Sarl v. France* (application 14565/04, decision of 26 August 2008).

71. Application 18640/10, judgment of 4 March 2014.

72. In fact, the case concerned two companies and three individuals (all of whom had been found to have disseminated false or misleading information about a financial transaction in FIAT's shares); but that is of no consequence here.

73. *Zolotukhin v Russia* (application 14939/03, judgment of 10 February 2009.

74. Article 4 of Protocol 7 to the ECHR.

follow that their rights should be as extensive as those enjoyed by natural persons.[75] However, that is not the point. The problem was that the ECtHR did not even allude to the fact that two of the applicants in the case before it were companies and not individuals - let alone set out any reasoning in support of its approach.

In this author's submission, it is vitally important for courts to proceed with great caution when called upon to decide whether to extend to companies existing case law on the fundamental rights of individuals. In each case, the judges should ask themselves whether it is appropriate to take this step, and their reasoning should be set out clearly in the judgment. Otherwise, there is a real danger that the courts will inadvertently be unduly generous to companies; and once such a step is taken, it is hard to reverse.

3.3 The EU

The fathers of the Treaty of Rome of 1957 (there were no mothers), which established what is now the EU, and related treaties concluded in the 1950s saw no need to include any provisions relating to human rights. At that time, those treaties focused almost exclusively on creating the common market (now known as the single market), and this economic goal was thought to be quite unconnected with such rights. Thus, while the ECHR is primarily concerned with first generation rights, the primary focus of the EU is economic rights.[76]

However, starting with its seminal judgment in *Internationale Handelsgesellschaft*, the CJEU began to develop its own body of fundamental rights "inspired by the constitutional traditions common to the Member States".[77] Moreover, ever since its ruling in *Nold*,[78] the Court has given considerable weight to the ECHR and the case law of the ECtHR. This case law is now reflected in Article 6(3) of the Treaty on European Union (TEU).[79]

A major turning-point was the promulgation of the Charter of Fundamental Rights of the European Union in the year 2000.[80] When the Treaty of Lisbon came into force in December 2009, the Charter became binding in an amended form[81] with "the same legal value as the Treaties", by virtue of Article 6(1) TEU. A very high proportion of the provisions in the Charter mirror those enshrined in the ECHR, and most of them reflect the earlier case law of the CJEU. According to Article 52(3) of the Charter, the provisions in the Charter which 'correspond' to those in the ECHR have the same meaning and scope as their counterparts in that Convention; but that does not 'prevent Union law providing more extensive protection'. Despite this provision and Article 6(3) TEU, the CJEU has been known to depart from the case law of its counterpart in Strasbourg without providing 'more extensive protection'.[82]

For present purposes, one of the most important provisions of the Charter is Article 16, which provides: 'The right to conduct a business in accordance with Union law and national laws and practices is recognised.'[83] This right, which was first recognised by the CJEU in *Nold*,[84] is not based on any provision in the ECHR but on Article 12 of the German Basic Law and Article 41 of the Italian Constitution, which recognise this right, albeit in different terms from Article 16.[85]

Articles 6(1) TEU and 52(7) of the Charter require all courts to pay due regard to the official Explanations of the Charter.[86] According to these Explanations, the right enshrined in Article 16 falls into three parts: (i) the freedom to exercise an economic or commercial activity;[87] (ii) freedom of contract;[88] and (iii) the right to free competition in accordance with Article 119(1) and (3) TFEU.[89] Finally, the Explanations state that, as one would expect, these rights may be subject to the exception clause contained in Article 52(1) of the Charter.[90]

The striking feature of Article 16 is the almost

75. In fact, *Zolotukhin, Grande Stevens* and the related case law are controversial – and not merely in relation to companies. For one thing, they ran roughshod over formal reservations entered by several Contracting Parties when ratifying Protocol 7.

76. See the text accompanying nn 118 to 120 below.

77. Cases 11/70 *Internationale Handelsgesellschaft v EVGF* [1970] ECR 1125, para 4.

78. Case 4/73 [1974] ECR 491, para 13.

79. That provision reads as follows: "Fundamental rights, as guaranteed by the [ECHR] and as they result from the constitutional traditions common to the Member States, shall constitute general principles of the Union's law".

80. 2000 OJ C364/1.

81. 2007 OJ C303/1.

82. A case in point is double jeopardy, a consequence of the ECtHR's controversial interpretation of Article 4 of Protocol 7 to the Convention (n 75 above); see *Garlsson Real Estate SA and Ricucci* ECLI:EU:C:2018:193.

83. See F Benoît-Rohmer 'Economie de marché et liberté d'entreprise dans l'Union européenne' in W Mastor (ed.) *Mélanges en l'honneur d'Elisabeth Zoller* (Paris, Dalloz, 2018), 6 and P. Oliver 'What Purpose does Article 16 of the Charter Serve?' in Bernitz *et al* (eds.) *General Principles of EU Law and European Private Law* (Wolters Kluwer, 2013), 281.

84. n 78 above, para 14.

85. Although the French Constitution contains no such clause, the Constitutional Court subsequently held that the right is nevertheless enshrined in the constitution: Decision 81-132 DC of 16 January 1982 http://www.conseil-constitutionnel.fr/conseil-con..decision-n-81-132-dc-du-16-janvier-1982.7986.html

86. See also footnote 27 to AG Cruz Villalón's Opinion in Case C-426/11 *Alemo-Herron* ECLI:EU:C:2013:5212007 OJ C303/17.

87. On this point, the Explanations refer to Nold (n 78 above), para 14 and Case 230/78 *SpA Eridiana* ECLI:EU:C:1979:216, paras 20 and 31. See also Case C-314/12 *UPC Telekabel Wien* ECLI:EU:C:2014:192, para 49.

88. On this point, the Explanations refer to Cases 151/78 *Sukkerfabriken Nykøbing* ECLI:EU:C:1979:4, para 19 and C-240/97 *Spain v Commission* ECLI:EU:C:1999:479, para 9. Other authorities on this point include Case C-90/90 *Neu* ECLI:EU:C:1991:303, para 13, AG Jacobs in Case C-7/97 *Oscar Bronner* ECLI:EU:C:1998:569, para 56, *Alemo-Herron* (n 86 above) and AG Saugmandsgaard Øe in Case C-152/19P *Deutsche Telekom* ECLI:EU:C:2020:678, para 73.

89. The Explanations do not refer to any case law on this point. But note *Eco-Swiss China Time* where the CJEU pronounced Article 101 TFEU to be a 'fundamental provision which is essential for the accomplishment of the task entrusted to the [EU] and, in particular, for the functioning of the internal market' (Case C-126/97 ECLI:EU:C:1999:269, para 36). See also Case C-52/09 *TeliaSonera Sverige* ECLI:EU:C:2011:83, paras 20 -22.

90. Nearly all the provisions in the Charter are subject to that exception clause. Among the few which are absolute is the right to human dignity which is "inviolable" according to Article 1 – but by definition companies cannot rely on that right.

diffident terms in which it is formulated, in two respects.[91] First, the phrase 'the freedom to conduct a business ... is recognised' contrasts with the much stronger language to be found in several other provisions of the Charter. Numerous articles begin with the words 'Everyone has the right ...', which are much stronger. Second, the phrase 'in accordance with Union law and national laws and practices' further lessens the intensity of Article 16. Not only is it entirely fitting that this freedom should be a weak right, but it is also in keeping with the pre-Charter case law.

Accordingly, the Court has repeatedly held that, like its close relative the right to property (Article 17 of the Charter), this right is 'not absolute but must be viewed in relation to [its] social function'.[92] On this basis and 'in the light of the wording of Article 16 of the Charter, ... the freedom to conduct a business may be subject to a broad range of interventions on the part of public authorities which may limit the exercise of economic activity in the public interest'.[93] Consequently, in numerous cases competing interests including public health,[94] animal health,[95] the protection of privacy,[96] freedom of speech[97] and consumer protection[98] have been held to prevail over Article 16. Of course, this can only be decided on a case by case basis.

A case which has been the subject of considerable controversy is *Alemo-Herron v Parkwood Leisure Ltd*.[99] It related to Council Directive 2001/23 on safeguarding employees' rights in the event of transfers of undertakings.[100] In 2002, the London Borough of Lewisham's leisure activities had been contracted out to a private sector undertaking, CCL Ltd, and the employees working in that department became part of the staff of that company. In May 2004, CCL sold the business to Parkwood in a contract including a 'dynamic clause' referring to collective bargaining agreements. By this clause, which was designed to soften the blow of privatisation for the employees, Parkwood undertook to abide by the conditions set out in future collective agreements decided by a third party, namely the local government collective bargaining body. However, as a private sector company Parkwood could not be represented in any way within that body.

The UK Supreme Court posed a series of questions asking whether the Directive and the relevant fundamental rights provisions permitted Member States to allow such dynamic clauses. AG Cruz Villalón found that, although the clause encroached on the freedom of contract, Article 16 was only breached if Parkwood was bound 'unconditionally and irreversibly' to the collective bargaining agreement in which it could not participate.[101] Unfortunately, the Court of Justice took a more radical position based on the unusual circumstance that Parkwood was unable to participate in the collective bargaining process in any way. It concluded that 'the transferee's contractual freedom is seriously reduced to the point that such a limitation is liable to adversely affect the very essence of its freedom to conduct a business'.[102] This hard-line position left no room to take account of the employees' rights.

Not surprisingly, this judgment provoked a storm of criticism.[103] The AG had found a fair balance between the rights of the employees and the rights of the company, while the Court did not. In any case, fears that this ruling opened the door to wholesale deregulation have turned out to be misplaced.[104] In this author's submission, that is not surprising because a dynamic clause linked to a collective bargaining procedure in which the employer has no say is of a quite different nature from legislation laying down standards relating to public health, the environment, consumer protection or the like.

Another extremely controversial judgment in which Article 16 was pitted against employees' rights (*in casu* the right to be protected against unjustified dismissal in Article 30 of the Charter) is *AGET Iraklis*.[105] The plaintiff company in the main proceedings, a subsidiary of the French multinational Lafarge, produced cement at three locations in Greece. When the company decided to close one of its plants there, the Minister prohibited this move on the basis of a Greek statute which required his approval for collective redundancies on the basis of (a) the conditions of the labour market, (b) the situation of the undertaking and (c) the interests of the national economy.

The Court held that the freedom of establishment under Article 49 TFEU includes the right to scale down or

91. S Garben 'The Fundamental Freedoms and (Other) Fundamental Rights' in S Garben and I Govaere (eds) *The Internal Market 2.0* (2020) 335, 351 and X Groussot *et al* 'Weak Right, Strong Court – the Freedom to Conduct a Business and the EU Charter of Fundamental Rights' in S Douglas-Scott and N Hatzis (eds.) *Research Handbook on EU Law and Human Rights* (Cheltenham, Edward Elgar, 2017), 326.

92. e.g. Cases C-453/03 *ABNA* ECLI:EU:C:2005:741, para 87 and C-283/11 *Sky Österreich* ECLI:EU:C:2013:28, para 45.

93. *Sky Österreich* (n 92 above), para 46.

94. Case C-477/14 *Pillbox 38 (UK) Ltd* ECLI:EU:C:2016:324

95. Case C-101/12 *Schaible* ECLI:EU:C:2013:661

96. Case C-1/11 *Interseroh Scrap and Metals Trading GmbH* ECLI:EU:C:2012:194

97. *Sky Österreich* (n 92 above), para 53.

98. Case C-12/11 *McDonagh v Ryanair* ECLI:EU:C:2013:43

99. n 86 above.

100. 2001 OJ L82/16.

101. Para 55.

102. Para 35.

103. Garben (n 91 above), 360 – 361, E Gill-Pedro 'Freedom to Conduct Business in EU Law: Freedom from Interference or Freedom from Domination?' 9 European Journal of Legal Studies 103 (2017), X Groussot *et al* (n 91 above), 341 and S Weatherill 'Use and abuse of the EU's Charter of Fundamental Rights: On the improper veneration of freedom of contract' 10 *ERCL 167* (2014).

104. See e.g. Case C-570/16 *Willmeroth* ECLI:EU:C:2018:87, discussed below.

105. Case C-201/15 ECLI:EU:C:2016:972

close a business in another Member State.[106] The Court recalled its settled case law according to which purely economic grounds such as safeguarding the interests of the national economy cannot justify restrictions on free movement.[107] At the same time, it also recalled that the protection of workers is a recognised ground of justification of restrictions on free movement,[108] as is the promotion of employment[109] and the maintenance of employment.[110] After rejecting criterion (c) on the grounds that it was purely economic,[111] the Court stated that the other two criteria could not be ruled out *a priori*. However, it then proceeded to rule that these criteria failed because of their very general and imprecise terms, which gave no indication as to the specific circumstances in which authorisation for a collective dismissal would be refused.[112]

Beyond any doubt, this judgment had very harsh consequences for the staff concerned, especially as Greece was undergoing an acute economic crisis at the time. But, while this judgment also caused an outcry,[113] one author has welcomed it as a sound compromise:[114] the Court gave its blessing to schemes requiring collective redundancies to be authorised by the State, but drew the line at such arbitrary and vague criteria as those in question. For this author at least, it is impossible to see how the Court could have given its blessing to such questionable national legislation without jeopardizing the internal market, which remains central to the EU. Moreover, although the Court made great play of Article 16 of the Charter, it would have reached precisely the same conclusion without relying on that provision at all.

In any case, one most welcome development is that the CJEU has now made it clear that some of the social rights enshrined in the Charter are enforceable and not merely aspirational (*in casu*, the right to an annual period of paid leave under Article 31(2)).[115] Previously, the Court had been reluctant to accept this,[116] which created a serious imbalance in favour of economic rights. Manifestly, this imbalance ran counter to the clause in Article 3(3) TEU, which requires the EU to strive towards the creation of 'a highly competitive social market economy, aiming at full employment and social progress'.[117]

Even so, numerous commentators have argued that the EU is currently far removed from achieving the balance between social and economic rights which this concept envisages.[118] That is in part because according to the case law of the CJEU the Treaty provisions on the single European market frequently prevail over social rights enshrined in the Charter.[119] That is beyond dispute,[120] and there are undeniably judgments in which the Court has gone too far in protecting the internal market at the expense of social and labour rights. Nevertheless, one should never lose sight of the fact that without the internal market the EU could not survive.

Like the US Supreme Court, the CJEU has never developed a general test for determining the extent to which companies should benefit from fundamental rights. Nevertheless, it did address this issue squarely in *DEB*,[121] which concerned the third paragraph of Article 47 of the Charter. That provision reads: 'Legal aid shall be made available to those who lack sufficient resources in so far as such aid is necessary to ensure effective access to justice.' The question was whether companies could rely on this provision, and in a very thorough and meticulously drafted judgment the Court held that they could do so if need be.[122] The reason was that Article 47 is to be found in Title VI of the Charter ('justice'), which contains various provisions applying both to natural and to legal persons. The fact that the right to receive legal aid is not to be found in Title IV ('citizens' rights') was an indication that under the Charter, in contrast to the position in German law, that right is not primarily regarded as a form of social assistance. Unsurprisingly, the Court added that, in determining whether DEB had a right to legal aid in the instant case, the national court could take into account

106. Para 53.

107. Para 72. This principle was first enunciated in Case 7/61 *Commission v Italy* ECLI:EU:C:1961:31, the very first judgment on the free movement of goods and probably the very first on the four freedoms generally; and it has been re-affirmed on countless occasions since then. See S Enchelmaier in *Oliver on Free Movement of Goods in the European Union* (Hart, 2010, 5th ed.), 239ff. In Iraklis, the Court did not cite this judgment, but referred instead to a series of more recent cases, including Case C-398/85 *SETTG v Ypourgos Ergasias* ECLI:EU:C:1997:282.

108. para 73, citing Case C-438/05 *Viking Line* EU:C:2007:772, para 77.

109. para 74, citing *inter alia Case C-379/11 Caves Krier Frères* ECLI:EU:C:2012:798, para 51.

110. para 75, citing C-464/05 *Geurts* ECLI:EU:C:2007:631, para 26.

111. See n 107 above.

112. Paras 99ff.

113. See e.g. F de Witte 'The architecture of the EU's social market economy' in P Koutrakos and J Snell (eds.) *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar, 2017), 117, Garben (n 91 above), D Schiek 'Towards more resilience for a social EU – the constitutionally conditioned internal market' 13 EUConst 611, 629 (2017) and Weatherill (n 103 above), 176 -177.

114. L Driguez in her case note on *Iraklis* (Europe February 2017, 81) describes the judgment as both balanced and conciliatory, in contrast to the free-market rulings in *Viking* (n 108 above) and Case C-341/05 *Lava* EU:C:2007:809 (In view of the word limit, the latter two highly controversial rulings cannot be discussed here.)

115. *Willmeroth* (n 104 above).

116. Cases C-176/12 *Association de médiation sociale* ECLI:EU:C:2014:2; see S Robin-Olivier commentary on Article 31in F Picod *et al* (eds.) *Charte des droits fondamentaux de l'Union européenne* (Brussels, Bruylant, 2020, 2nd. ed.), 798.

117. As to the meaning of a "social market economy" in the German context, see n 61 above.

118. See nn 103 and 113 above and N Nic Shuibhne, 'Fundamental Rights and the Framework of Internal Market Adjudication: Is the Charter Making a Difference?' in P Koutrakos and J Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar, 2017).

119. The other reason is that the EU's body of social legislation is inadequate. But that issue falls outside the scope of this article.

120. E.g. *Viking* (n 108 above), *Laval* (n 114 above) and *Iraklis*.

121. Case C-279/09 ECLI:EU:C:2010:811; see the author's case note on this case case note in 48 CMLRev. 2023 (2011).

122. Paras 40ff. The comparison with *VP Diffusion* (n 70 above) is a clear illustration of the fact that economic rights are more important under the EU Treaties and the Charter than under the ECHR.

the fact that it was a commercial company.[123] From the full reasoning of the Court it is plain that companies are by no means entitled to legal aid as a matter of course.[124]

Occasionally, the CJEU has taken the fundamental rights of companies too far. A case in point is *Orkem v Commission*,[125] which concerned the rights of a company being investigated for breaches of EU competition law. The Court acknowledged that in most Member States the privilege against self-incrimination was confined to natural persons, and that the ECtHR had not considered the point. Despite these factors and the extremely sound reasons for rejecting Orkem's argument,[126] the Court went half-way towards accepting that argument: it held that undertakings could be compelled to disclose documents and to answer factual questions so long as this did not require them to admit infringing EU competition law. Fortunately, the Court has subsequently rejected calls by other undertakings to find that they enjoy a fully-fledged right not to incriminate themselves like natural persons;[127] but the Court has not reversed its judgment in *Orkem*.

Another example is *Digital Rights Ireland*,[128] where the Court struck down the Data Retention Directive[129] in its entirety as being contrary to Articles 7 and 8 of the Charter. This Directive imposed far-reaching obligations on providers of publicly available electronic communications services to retain large quantities of electronically generated or processed data. Although the Directive stated in the clearest possible terms that it applied to data emanating from legal entities as well as from natural persons, neither the Advocate General nor the Court even alluded to this fact – even though it is highly questionable legal persons should be entitled to data protection at all.[130] Given the importance of the case, the Court's failure to explain why the Directive should be annulled even as regards data generated or processed by legal persons constitutes a serious omission.

4. Should Different Categories of Company be Treated Differently?

To complicate matters further, there is a very strong case for treating certain categories of company more favourably or less favourably than others.

An obvious example is **small or medium-sized companies**, and especially very small companies.[131] This is illustrated by the ruling in *Ketelä*, which concerned an EU aid to young farmers setting up in business. It was held that it might be contrary to the principle of equality to exclude from that aid to young farmers who chose to use the vehicle of a company for doing so – provided that they had the decision-making power of that company.[132] It seems hard to imagine circumstances in which a measure granting an advantage to natural persons only could be held to constitute unlawful discrimination against large companies.[133]

As to **incorporated enterprises owned by the State**, such entities cannot usually enjoy fundamental rights under the Basic Law, although exceptions are made for broadcasters, universities and churches.[134] The basis for this is the premise that the State cannot be both guarantor and beneficiary of fundamental rights For the same reason, applications to the ECtHR by State-owned companies are inadmissible in view of the wording of Article 34 ECHR, which provides that applicants may only to lodged by a 'person, non-governmental organisation or group of individuals'.[135] In contrast, State-owned companies are not subject to such restrictions in EU law. In *Council v Bank Mellat*, the CJEU held that 'any natural person or any entity bringing an action before the Courts of the European Union' may invoke its rights of defence and its right to effective judicial protection under Article 47 of the Charter.[136] The context in which that statement was made is particularly striking: Bank Mellat, which was wholly owned by the Iranian State, was contesting a series of EU acts imposing economic sanctions against bodies sus-

123. Para 62.

124. See the author's note on this case case note in 48 CMLRev. 2023 (2011).

125. Case 374/87 ECLI:EU:C:1989:387

126. See nn 28 to 31 above. The Bundesverfassungsgericht had now taken the same position as the US Supreme Court (see nn 28 and 55 above). The ECtHR has still not ruled on this issue.

127. Case C-238/99P "*PVC II*" ECLI:EU:C:2002:582, paras 273 – 275 and Case C-301/04P *SGL Carbon* E.CLI:EU:C:2006:432, paras 33ff. In para 272 of its judgment in *PVC II* the Court in effect endorsed the following statement of the court below in the same case: "The recognition of an absolute right of silence, as argued for by the applicants,would go beyond what is necessary to preserve the defence rights of undertakingsand would constitute an unjustified hindrance to the Commission in theaccomplishment of its task under Article 89 of the Treaty of ensuring compliancewith the competition rules in the common market." (Case T-305/94 *PVC II* [1999] ECR II-931, para 448)

128. Case C-293/12 ECLI:EU:C:2014:238

129. Directive 2006/24 of the European Parliament and the Council (2006 OJ L105/54).

130. The EU's data protection legislation (including Regulation 95/46 (1995 OJ L281/31) and now Regulation 2016/679 (2016 OJ L119/1) protects natural persons only; and, while Articles 7 an 8 of the Charter appear to overlap to some extent, it seems unlikely that the latter provision applies for the benefit of companies; see P Oliver 'Privacy and Data Protection: the Rights of Economic Actors' in *The EU Charter of Fundamental Rights as a Binding Instrument* (eds. Bernitz *et al* Hart Publishing, 2015), 287

131. Conveniently, the European Commission has devised an official definition of the term 'small and medium-sized enterprises' (SMEs) : Recommendation 2003/361 (2003 OJ L124/36) and its 'User Guide to the SME Definition Ares (2016) 956541 of 24 February 2016 <https://ec.europa.eu/regional_policy/sources/conferences/state-aid/sme/smedefinitionguide_en.pdf>. This definition is non-binding, but is sometimes incorporated by reference into binding EU acts; see Case T-70/22 *Novasol* (pending).

132. Case C-592/11 EU:C:2012:673, especially para 44.

133. *Lee v McArthur* (n 16 above) will be considered in the next section.

134. BVerfGE 21, 362 (1967) and BVerfGE 75, 196 (1987). Also, the Court waived this rule in the exceptional circumstances of the joint judgment in 1 BvR 2821/11, 1 BvR 321/12 and 1 BvR 1456/12 (2016) (Vattenfall), paras 185ff.; see M Steinbeis 'Die Menschenwürde des Staatskonzerns Vattenfall: zum Atom-Urteil des Bundesverfassungsgerichts' https://verfassungsblog.de/die-menschenwuerde-des-staatskonzerns-vattenfall-zum-atom-urteil-des-bundesverfassungsgerichts/

135. e.g. *Islamic Republic of Iran Shipping Lines v Turkey*, (judgment of the ECtHR of 13 December 2007), para 81 and *Východoslovenská vodárenská spoločnosť v Slovakia* (judgment of 2 July 2013), paras 32 and 37.

136. Case C-176/13P ECLI:EU:C:2016:96, para 49

pected of involvement in terrorism. It remains to be seen whether other Charter rights can be invoked by companies owned by States which are not members of the EU.[137]

Even **companies in liquidation** can enjoy certain fundamental rights. Both the ECtHR and the Court of Justice have recognised that companies in liquidation enjoy the right to an effective judicial remedy;[138] and indeed they may well enjoy other fundamental rights as well. It is not clear in which circumstances liquidators are required to maintain 'zombie' companies in existence to enable them to exercise their fundamental rights.[139]

5. Where Companies and Their Stakeholders Act Together

Quite apart from captivating the interest of the British public for some time, the 'gay cake case'[140] is of considerable importance. Mr and Mrs McArthur, the directors of Ashers Backing Company Ltd., were devout Christians who believed that same-sex marriage was contrary to God's law. At the material time, the company had six shops and some sixty-five employees and offered its products on-line throughout the UK and Ireland. Mr Lee, a gay activist, visited one of the company's bakeries in Belfast and placed an order for a cake with Mrs McArthur. Mr Lee subsequently returned to the shop and informed her that he wished the cake to bear the inscription 'Support Gay Marriage'. Accordingly, the McArthurs declined to proceed with the order. Mr Lee then sued both the McArthurs and their company. To the surprise of many lawyers, the UK Supreme Court[141] found unanimously against Mr Lee.

First, they dismissed his claim that he had suffered discrimination: the McArthurs and the company had not declined to sell him a cake because he was homosexual or because he supported same-sex marriage. In either event, such a refusal would have constituted unlawful discrimination.[142]

Second, the judges held that it was repugnant to Article 9 ECHR (freedom of religion) and to Article 10 ECHR (freedom of speech) to compel the couple to express an opinion which they did not hold.[143] The Court added that this would have been the same whatever the message to be conveyed (e.g. support for a particular political party or for a particular religious denomination).[144] As to the company, the Supreme Court recalled the two cases in which the European Commission of Human Rights had held that companies cannot rely on Article 9,[145] but pointed out that 'to hold the company liable when the McArthurs are not would effectively negate their convention rights'.[146]

This reasoning, it is submitted, is unassailable. This case is at the other end of the spectrum from *Hobby Lobby,*[147] which concerned a very large corporation[148] – but the crucial point was that there was no interaction between the shareholders or management and the employees. In contrast, Mr Lee had communicated directly with the McArthurs. Accordingly, the fact that their business was incorporated was irrelevant.[149]

Conversely, we have seen that in other circumstances it is appropriate to treat a company as the predominant rights holder, in which case the rights of the shareholders and management are therefore no greater than those of their company.[150]

6. The Fundamental Rights Obligations of Corporations

Companies can be bound by fundamental rights obligations in two separate ways. First, some provisions have horizontal effect ("State Action" in the US and *Drittwirkung* in Germany), meaning that they do not merely bind the State but also private natural and legal persons.[151] Second, in the last few decades various non-binding measures have been adopted by international organisations to prevent abuses by multinational corporations and similar entities.[152] Of course, these measures are most welcome, and it is to be hoped that they will soon be replaced by binding provisions.

Even natural persons can bear the burden of certain fundamental rights provisions as a result of horizontal effect, while the international law measures only target multinational corporations. Furthermore, no direct correlation exists between either of these phenomena and the fundamental **rights** of companies; and it would be mis-

137. In Case C-548/09P *Bank Melli Iran v Council* [2011] ECR I-11381, the Court of Justice had left open the question as to whether a bank wholly owned by the Iranian State could rely on the right to property (para 113).

138. *Capital Bank v Bulgaria* (application 49429/99, judgment of 24 November 2005) and Case C-663/17P *European Central Bank v Trasta Komercbanka* ECLI:EU:C:2019:923 respectively.

139. N. Cariat and T. Martin 'Le droit à un recours effectif des sociétés en liquidation et le droit de l'Union européenne' 2020 Rev. trim. dr. h. 969.

140. n 16 above.

141. See n 16 above.

142. Paras 37ff.

143. Paras 49ff.

144. Paras 55. Equally, freedom of contract is one of the three facets of Article 16 of the Charter; see n 88 above.

145. *X v Switzerland* (decision of 27 February 1979, application No 7865/77) and *Kustannus Oy v Finland* (decision of 15 April 1996, application No 20471/92). Surely, these decisions are preferable to *Hobby Lobby* (n 24 above), where the US Supreme Court reached precisely the opposite conclusion.

146. Para 57. The judgment in *New York Times v Sullivan* (n 16 above) is based on precisely the same reasoning.

147. n 24 above.

148. On the other hand, Ashers Backing Company would have qualified as an SME under the Commission's definition (n 131 above), if EU law had been relevant.

149. A further difference between this case and *Hobby Lobby* is that it was relatively easy for to Mr Lee to buy a cake bearing his message in another shop, whereas it was much more difficult for Hobby Lobby's staff to switch to another employer.

150. See n 69 above.

151. Horizontal effect can be observed in the US (*Shelley v Kraemer* 334 US 1 (1948)), the ECHR (*Gustafsson v Sweden* (application 15573/89, judgment of 25 April 1996)), the EU (*Willmeroth*, n 103 above) and Germany (*Lüth* 7 BVerfGe 198 (1958)).

152. See e.g. *The OECD's non-binding Declaration on International Investment and Multinational Enterprises* (revised in 2011), the *International Labour Organisation's Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy* (revised in 2017) and the N*orms on the responsibilities of transnational corporations and other business enterprises adopted by United Nations Sub-Commission on the Promotion and Protection of Human Rights*.

guided to claim that companies must enjoy a particular fundamental right because they are required to respect the same right in their relations with third parties.

Conclusion

The recent judgments of the US Supreme Court discussed above undoubtedly reflect the hard-line laissez-faire ideology of its conservative members, whereas that is clearly not the case with their European counterparts. The rare instances of the ECtHR or (more frequently) the CJEU overstepping the mark appear to be due simply to a failure to address the particularities of companies' fundamental rights.

The quest for a general test to determine to what extent particular fundamental rights apply in favour of companies has proved somewhat elusive except (at least to some extent) for the German Constitutional Court. Having said that, a number of lessons can be drawn from this brief survey.

First, save in exceptional situations such as the 'gay cake case' (where the corporate nature of the business concerned was not even relevant), it is a fallacy to treat companies as nothing more than a group of individuals, as the US Supreme Court did in *Hobby Lobby*. Companies are entities in their own right with different rights and obligations from their shareholders and management.

Second, certain rights must by their very nature benefit companies, albeit not necessarily to the same extent as natural persons. Obvious examples are the rights to property and (where such a right exists) the freedom to conduct a business as well as the right to a fair trial, whether the proceedings are civil or criminal in nature.[153]

Third, the very sound principle set out in *Spacek* and its progeny[154] should be applied to all fundamental rights, where appropriate.

Fourth, it is crucial for courts to proceed with great caution when called upon to decide to what extent the fundamental rights of individuals should apply to companies. In each case, the courts should ask themselves: in view of the 'nature, history and purpose'[155] of the provision or right in question, is it appropriate to extend it to companies and, if so, under what conditions? In so doing, the courts should have regard inter alia to the criteria set out by the CJEU in DEB.[156]

Fifth, the courts' reasoning on this question should be clearly set out in each judgment in which they have take such a decision. Only by following this course can judges convince themselves that they are following the correct path. Otherwise, there is a real danger that the courts will inadvertently be unduly generous to companies; and once such a step is taken, it is hard to reverse.

153. One aspectof the latter right which should not be enjoyed by companies include the privilege against self-incrimination (*Hale* and *Orkem*), and the right to legal aid for companies should be limited to exceptional cases (see *DEB*, n 123 above).

154. n 69 above.

155. *Bellotti* (n 14 above), 779.

156. n 121 above.

Andrej Leontiev and Radovan Pala • Drafters of pioneering Slovak UBO legislation, Partners Taylor Wessing

Fighting Money Laundering Must Go Hand in Hand With Transparency of Beneficial Ownership

"Darkness cannot drive out darkness; only light can do that".
Martin Luther King, Jr.

Money laundering is one of the most pervasive economic crimes in the world today. It has been estimated that some USD 0,8 to 2 trillion, or 2 - 5% of global GDP, goes through a laundering cycle each year.[1] The enormous volume of "dark" money creates severe threats to democracy and erodes the rule of law worldwide. This would not be possible without the involvement of offshore jurisdictions, shell companies, and professional intermediaries.[2]

But where does this money come from? Technically, the term "illicit financial flows" is used to describe the movement of illegal funds in their source, transfer, or intended use. Such are the proceeds of tax evasion, corruption, or capital for terrorist financing.[3] Essentially, "corruption is just a form of financial alchemy"[4] - transforming power into illicit money or illicit money into power. As noted by US Secretary of the Treasure Janet Y. Yellen, bad actors often require the use of intermediaries to execute such transformations.[5]

In Eastern Europe, a pervasive and often latent conflict of personal interests and "entrusted" public goods remain the primary source of dirty money. Competing private and public interests naturally lead to misuse and abuse of power and are reflected in politics, legislation, judiciary system, business relations, and education or healthcare. In sociological terms, the abuse of power for personal financial gain is corruption in its purest form.[6] However, the abuse of power often also takes other forms like lobbying, clientelism, nepotism, or the concept of "revolving door".[7] The existence of these phenomena and their (often accidental) detection fundamentally weakens public confidence in state institutions and democratic decision-making processes. It is, therefore, necessary to look for ways to prevent the existence of an environment that tolerates or justifies any form of conflict of interest.

In the former Eastern bloc countries, business interests "growing" into politics also materialized the conflict of interest. At first glance, there is nothing wrong with a successful entrepreneur offering money or skills for the benefit of society.[8] As the recent examples of Czech Prime Minister Mr. Babiš [9] or Mr. Putin's close friends show,[10] it turns out to be very difficult or awkward to defend the public benefit of sitting on two chairs at once. However, a simple solution to hide business interests in politics is offered mainly by offshore jurisdictions. This is where anonymous shell companies enter the stage.

People artificially created corporations about two hundred years ago. They were initially intended to enable several entrepreneurs to invest together as shareholders. Their private property is protected against business risk since the property of a corporation is separate from the property of its shareholders and vice versa.[11] Only later did entrepreneurs find out how to hide their true identities behind companies they own or control. The anonymity

1. https://www.unodc.org/unodc/en/money-laundering/overview.html
2. Speech of Slovak Minister of Justice, Mrs. Kolikova at the side event of 2021 UNGASS "Enlisting Gatekeepers in the Fight Against Illicit Financial Flows", https://www.justice.gov.sk/Stranky/aktualitadetail.aspx?announcementID=3407
3. https://star.worldbank.org/sites/default/files/2021-06/WEF_Gatekeepers_A_Unifying_Framework_2021.pdf The total amount of illicit finance crossing the globe solely related to trade, according to research by Global Financial Integrity (GFI), amounted to USD 8.7 trillion in the ten years from 2008 to 2017, representing trade payments between 135 middle- and low-income countries and thirty-six advanced industrial nations. See The Report by GFI, March 3, 2020: "Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008– 2017."
4. As noted by US Secretary of the Treasury Janet L. Yellen at the Summit for Democracy, https://home.treasury.gov/news/press-releases/jy0524
5. As noted by US Secretary of the Treasury Janet L. Yellen at the Summit for Democracy, https://home.treasury.gov/news/press-releases/jy0524
6. Nye, J. (2017). "Corruption and political development: A cost-benefit analysis". *Political Corruption*, https://doi.org/10.4324/9781315126647-26.
7. In 2016, Robert Barrington (then CEO of Transparency International UK, now Professor of Anti-Corruption Practice at Centre for the Study of Corruption (CSC) at University of Sussex) criticized UK's rules on revolving door as "woefully out of date", opening the door for former public officials to leverage their position of entrusted power for private gain, without proper oversight, and came to following conclusion: "The revolving door is a corruption time-bomb at the heart of British politics." https://blogs.lse.ac.uk/politicsandpolicy/lobbying-loopholes-honours-and-revolving-doors-without-reform-the-government-perpetuates-corruption/ It needs to be added, that the 'revolving door' has two ways and in Eastern Europe, local oligarchs are able appoint their nominees to generally underpaid influential public offices (e.g. at tax authorities) but keep them on their own payroll. See e.g. https://spectator.sme.sk/c/22554521/how-the-mafia-took-over-the-police-detained-tax-inspector-tells-his-story.html
8. https://www.linkedin.com/pulse/zodpovedn%C3%A9-podnikanie-ale-bo-ke%C4%8F-sa-firmy-nemusia-hanbi%C5%A5-leontiev/
9. https://www.europarl.europa.eu/news/en/press-room/20210517IPR04145/conflict-of-interest-and-misuse-of-eu-funds-the-case-of-czech-pm-babis One of the reasons of the defeat of Mr. Babis and his party in the Czech parliamentary elections in 2021 was that he was one of the 35 world leaders named in ICIJ's Pandora Papers just few days before the election. https://www.icij.org/investigations/pandora-papers/czech-prime-ministers-party-narrowly-loses-re-election-days-after-pandora-papers-revelations-in-surprise-outcome/
10. https://panamapapers.sueddeutsche.de/articles/56fec05fa1bb8d3c3495adf8/
11. Chief Justice Marshall referred to the corporation as "an artificial being, invisible [and] intangible" and to its "individuality," as being evident in such features as its power to sue and amenity to suit and its durational existence defined without regard to the lives of its shareholders. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819)

of shell companies provides a cheap and highly efficient tool to hide assets from family members, creditors, police, or tax authorities.[12] A wholly new industry was formed.[13]

Global investigations - including the so-called "Pandora," "Panama," and "Paradise" papers and "FinCen Files" have drawn attention to the essential role of certain professional intermediaries - so-called "gatekeepers."[14] To successfully "steal, hide and spend" the proceeds of illegal activities, assistance from gatekeepers like banks, lawyers, accountants, corporate service providers, and others, mainly in the "layering stage," is required[15].

To identify conflict of interest and thus the potential source of illegal money and "financial alchemy," we must have legal instruments to determine which natural person (materially) stands behind companies and benefit from their business. In other words, transparency, not as the ultimate goal but as a tool, is essential for fighting money laundering. In this process, we must focus on persons in conflict of interest and gatekeepers who can either enable or stop the undetected flow of illegal money.

Legislative Background

In 2003, the FATF became the first international body to set global standards on beneficial ownership. In 2012, the FATF strengthened its standards on beneficial ownership to clarify how countries should ensure that relevant information is available. FATF suggested in its 2012 Recommendations[16] that countries should identify, assess, and understand the money laundering risks and apply a risk-based approach in choosing the measures.

In 2013 the European Commission released its proposal for the 4 AML Directive,[17] with intended transposition in June 2017, intending to strengthen screening processes to disable dirty money from being laundered. The proposal was based on the FATF 2012 Recommendations. Specifically, more due diligence around ultimate beneficial ownership has been cited consistently as a way to fight corruption. Greater emphasis was put on a risk-based approach to addressing money laundering.

In 2016, the European Commission published a proposal for the 5 AML Directive[18], intended to be transposed until January 2020. While the 4 AML Directive specifies that companies must obtain and hold "adequate, accurate, and current information" about their beneficial owners, the 5 AML Directive emphasizes transparency around ultimate beneficial ownership. Member states must maintain inter-connected, publicly available national beneficial ownership registries. It also extends the requirements relating to central registries, requiring them to contain information on beneficial ownership, adequate, accurate, and current. In many circumstances, members of the general public shall be able to access this information.

In Slovakia, corruption in public procurement was always perceived as a severe issue. Over the past decade, there have been several cases, often in the procurement of large government construction contracts. The media or non-profit organizations have pointed out the lack of transparency or possible undisclosed connection between political leaders and successful bidders. Shell companies registered in offshore jurisdictions were often used as successful bidders or their shareholders. These cases have increased public pressure to demand transparency in state-private business relations.[19]

In November 2015, Slovakia became the first EU Member state to introduce a register of beneficial owners of companies that participated in public procurement. The Act on Public Procurement[20] established public procurement register where companies registered their beneficial owners. It also provided a unique definition of a beneficial owner, defined as an individual, but not a company, with at least a 25% share in the enterprise, with the power to appoint or revoke a statutory body, or with another means of controlling the company. This register was published online in an open data format, available for the public. Nonetheless, it contained several shortcomings:

(i) First, its scope covered only companies bidding in public procurement procedures.

(ii) Secondly, there were severe doubts about the accuracy of the data entered into the register as there were no means of verification.

(iii) Finally, the sanctions were insignificant and often unenforceable.

12. https://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf
13. Emile et. al. (2012) "The Puppet Master: How the Corrupt Use Legal Structure to Hide Stolen Assets and What to Do About it", https://openknowledge.worldbank.org/handle/10986/2363
14. From a less favourable viewpoint, these actors are also called "enablers". See Vogl, F. (2021): *The Enablers*. Rowman & Littlefield Publishers.
15. Bullough, O. (2019). *Moneyland: Why Thieves And Crooks Now Rule The World And How To Take It Back*, https://www.amazon.com/Moneyland-Inside-Story-Crooks-Kleptocrats/dp/125020870X
16. https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html
17. Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849
18. Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843
19. Zigo, D. (2021) "'Beneficial Owners' Policy: Comparison of its Efficacy in the West with Prospects for Curbing Corruption in China", unpublished academic paper.
20. Act No. 343/2015 Coll. Act on Public Procurement and on the Alteration and Amendment of Certain Acts, https://www.slov-lex.sk/pravne-predpisy/SK/ZZ/2015/343/20210506

Basic principles and effects

Five years ago, on February 1, 2017, the so-called Anti-Shell Companies Law[21] (Act) replaced the original public procurement register. Although based on the same risk-based principle, the Act focuses on public-private commercial relations in the broadest sense; it does not constitute the Slovak transposition of the 4 AML or 5 AML Directive. The transposition was completed later,[22] and their regime runs parallel to the Act.

The Anti-Shell Companies Act of 2017 is based on the axiom that only those private entities which voluntarily and reliably reveal their beneficial owners can engage in business activities with the state. In other words, companies may receive (non-)monetary consideration from the public sector or deal with public assets only if they disclose and register their beneficial owners in a special register established for that purpose (the so-called Register of Public Sector Partners - RPSP).[23]

The legislation is construed around three main principles, partially in reaction to the main criticism of the original public procurement register. But also to offset several systemic weaknesses of the Slovak law enforcement environment. Analyzing these principles one by one, it can be observed that:

(i) First, the scope of the public-private relations that are governed by the Act and provide the link to the obligation to register is very broad; it does not stop with public procurement, as this represents in Slovakia about 20% of public expenditure,[24] but covers the transfer of the majority of EU, state and regional funds and subsidies, state aid, privatization, and sale of state or regional assets, holding of mining rights concessions[25] and others. Focusing on the whole spectrum of legal relationships in which a third party accepts any performance from the state/public funds, it covers Slovak and foreign corporate vehicles concluding Slovak public contracts.[26] This means that corporate vehicles, incorporated, e.g., in Delaware or an offshore jurisdiction, must comply and register in the RPSP before "doing business" involving Slovak (or EU) public funds. In our view, departing from the focus on entities registered in the EU is the only way to deal with the global and shifting web of anonymous entities - due to the free flow of capital, in many cases, the corporate vehicles used in "shady" schemes do not need to set up subsidiaries in the EU to benefit from the public funds' plans.[27]

(ii) Secondly, the data on beneficial ownership is verified and registered exclusively by local gatekeepers; in other words, the state is utilizing these professional intermediaries to exercise behalf of the state a Know Your Customer (KYC) check on the ownership background of its suppliers or other business partners. As this is a commercial service, the gatekeepers enter co-liability for the accuracy of the verified and registered data. As noted by the World Bank,[28] this can be characterized as a combination of the "central registry" and the "gatekeepers" approach.

(iii) Finally, the compliance and enforcement of the rules are safeguarded by a special court utilizing a rather unique shifted burden of proof which can be regarded as a keystone enabling the Act's effective enforcement. The special court can commence determination court proceedings on its initiative or upon a 'qualified motion' (in practice regularly filed by investigative journalists) if there is reasonable doubt concerning the correctness, accuracy, and completeness of the registered BO data. In nature, this is a so-called non-contradictory civil court proceeding, and the strict criminal law standard of burden of proof does not apply (there is any prosecution that would carry the burden of evidence). In other comparable Slovak civil court determination proceedings involving court investigation (e.g., review of the accuracy of data registered in the Commercial Register), the court's task is to search for and gather all evidence necessary for the decision. In the determination court proceeding concerning the BO, the court does not determine the beneficial owners of a registered entity - it determines whether the partner of the public sector (PSP) produced reliable proof of the BO's authenticity, correctness, and completeness data entered in the register. This means the private entity under investigation – which naturally should have straightforward access to evidence concerning BO – must provide substantial evidence on the accuracy of the registered beneficial ownership data to maintain its registration. When combined with the general public's information (incl. verification documents), shifting the burden of proof is the most vital tool forcing the enablers of the anonymous schemes to pay regard to the Slovak regulation. We

21. Act no. 315/2016 Coll. on the Register of Public Sector Partners and Amendments to Certain Acts, https://www.slov-lex.sk/pravne-predpisy/SK/ZZ/2016/315/20191101

22. Act No. 297/2008 Coll. Act on Protection against Money Laundering and Terrorist Financing and on the Amendment to Some Acts, https://www.slov-lex.sk/pravne-predpisy/SK/ZZ/2008/297/20210101

23. https://rpvs.gov.sk/rpvs/

24. https://www.nrsr.sk/web/Dynamic/DocumentPreview.aspx?DocID=428797

25. Even though the beneficial ownership disclosure obligation of any enterprise that applies for, or holds a mining right concession is not as economically important as the same obligation for public procurement participation, in many natural resources rich countries, it could be the most significant feature of a beneficial ownership register (RPSP).

26. As outlined below, from the point of view of territorial application, this is one of the most important features of the special register distinguishing it from the valid AML Directive - concept based on interconnected national registers - allowing it to review beneficial ownership of foreign corporations, including offshore corporations.

27. According to a study published by Hudson Institute (Nate Sibley and Ben Judah, Countering Global Kleptocracy: A New US Strategy for Fighting Authoritarian Corruption), "the United States is also a leading global producer of these legal entities. Given that shell companies are often used for legitimate business purposes, this in itself might signify nothing more than the relative size of the US economy. But the "Delaware LLC" has become synonymous with shady financial dealings, and the same might be said of other US states engaged in a race to the bottom on financial secrecy." The anecdotal evidence from Slovak practice shows that many off-shore companies were directly involved in dealings with the Slovak authorities prior to the enactment of the Act.

28. See World Bank (2020) "Enhancing Government Effectiveness and Transparency: The Fight Against Corruption," World Bank, Washington, DC, p. 252.

are convinced that the webs of formal legal ownership schemes can be transformed considerably outpacing the regulator's (court's) oversight (regardless of its expertise). The costs of maintaining an anonymous structure should not be externalized and therefore borne by taxpayers; on the contrary, these costs should be firmly and unequivocally located with the beneficial owner (society benefits in no way from the concealed ownership of the assets).

This special register (RPSP) is operated parallel to the Commercial Register that collects the information on beneficial owners of all Slovak companies, as required by the 5 AML Directive. Though those data have been publicly accessible too since November 2020, the verification and scrutiny of the registered data on beneficial ownership (no gatekeeper involvement) and the sanctioning mechanism for inaccurate information are much lower. However, to avoid any unnecessary administrative burden to the companies not entering business relations with the public sector, the registration of beneficial owners in the particular registry (RPSP) substitutes for their obligatory registration in the Commercial Registry. It is important to note that the RPSP does not necessarily overlap with the Commercial Registry. In contrast, the latter strictly follows incorporation principle[29] and applies only to companies registered based on this principle; the scope of the former can be much broader as it utilizes a "functional" link that allows requiring beneficial ownership disclosure also from legal entities that are not Slovak nationals. It applies to any corporate vehicle that engages in a specific, statutorily outlined activity in Slovakia, regardless of its actual seat or incorporation.

According to a recent review,[30] out of the Top 100 Slovak companies (ranked according to their 2020 profit), only 11 companies fall outside the Act's scope. Therefore, their beneficial owners are registered with Commercial Register only and are not subject to higher scrutiny. The remaining 89 Slovak companies have their beneficial owners reviewed and verified by gatekeepers and recorded according to the Act with the special register (RPSP).

After five years in operation, the Act's benefits are already measurable. Out of more than 31,000 private Slovak and foreign entities registered, only around 15 natural persons - Cypriot citizens - registered as beneficial owners.[31] That gives us the notion that data accuracy is on the right track. Hundreds of Cypriot shell companies, which Slovak persons directly or indirectly own, disclosed their ownership and managing structures and registered their real beneficial owners.

A recent study[32] confirms that for the years 2018 and 2019, approximately 15.000 public contracts meet the de minimis threshold (below) and are worth around EUR 29 bn. Only 40 public contracts worth EUR 15,5 mil. were missing the registration of beneficial owners in the special register (RPSP). The statistics for the years 2019 and 2020 were even better; only 25 public contracts worth EUR 5,5 mil. were lacking the disclosure of beneficial ownership of the suppliers.

Thanks to the Act and the expert approach of the judges at District Court Zilina, which keeps the RPSP, several court proceedings with regional oligarchs started and forced these persons to admit their status of beneficial owners in companies receiving negligible amounts from the public sector.[33] The recent investigation of the European Commission on a possible conflict of interest of the Czech Prime Minister, Mr. Babiš, was based on the data from this particular registry.[34] The application of the Act also led to the first fines recently imposed by the District Court Zilina, making the Act a genuinely effective tool for controlling the persons who benefit from public funds.

On the other hand, despite the undisputed benefits of the Act, some applicational and interpretative uncertainties have emerged. After all, it has been a unique law, passed when there was no comparable template in any other country.

An amendment to the Act came into force on 1 September 2019 (Amendment). It provides a specification of specific terms and a modification of several provisions of the Act to narrow down the possibilities of circumventing the law and, at the same time, eliminate its applicational deficiencies.

Partners of the Public Sector, Beneficial Owners, and Authorized Persons

Every person who is not an entity of public administration that has a statutorily-defined business relation with the public sector or wishes to enter into such a relation is obliged to register. Such a person is called a Partner of the Public Sector (PPS). Statutorily-defined ties with the state include, amongst others: receiving financial means from the public budget, receiving property rights from the public sector, being a supplier in public procurement, or fulfillment of other statutory criteria (for instance, as a mining permit owner or a PPP operator). Several *de minimis* thresholds apply. A person receiving financial means, assets, or rights not exceeding EUR 100.000 in a "one-shot transaction" or repeating consideration from a contract worth more than EUR 250.000 is not considered a PPS. To be able to assess the "value of the contract," i.e., to

29. In line with the Art. 30 of the 5 AML Directive: 'Member States shall ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held. The Member States shall ensure that breaches of this Article are subject to effective, proportionate, and dissuasive measures or sanctions.'

30. https://www.finstat.sk/ ; Status: July 14, 2021

31. https://www.finstat.sk/ ; Status: February 15, 2021

32. https://transparency.blog.sme.sk/c/514094/kazimir-podpisal-zmluvy-s-ratingovymi-agenturami-bez-zapisu-do-protischrankoveho-registra.html

33. https://transparency.sk/sk/prve-pokuty-protischrankoveho-sudu-advokati-bugala-durcek-boli-v-konflikte-zaujmov-pri-overovani-kmotrikovych-firiem/

34. https://www.transparency.org/en/press/andrej-babish-is-our-controlling-person-czech-republic

decide whether or not the company has any obligations under the Act, the Amendment provided a potential PPS with detailed instructions on how to calculate the value of the relation (e.g., the value of a contract - excl. VAT; it does not add up from other agreements among the same parties). The Amendment also provides a specific definition of the public undertaking. An entity falling under this definition is considered a public sector entity. Its business partners must follow the obligations under the Act subject to an important exemption: private entities acquiring goods and services from public undertaking in their regular course of business are exempted. A new exemption also applies to banks and other financial institutions.

A natural person who benefits from the activities of a PPS is a so-called Beneficial Owner (BO). The definition of the BO is taken over from the 4 AML Directive and is basically the same for any other purposes of the Slovak law; it means that Slovakia uses a single BO definition, with one minor exception for the Act (so-called joint or coordinated execution of rights, which means that someone may not meet the definition and threshold of BO on its own, but it may meet it together with one or multiple other persons). BO either exercises control over a legal entity (solely or jointly with another person) or receives an economic benefit from the business of that legal entity. A special regime applies to issuers of shares regularly traded on the stock market and their subsidies. In such a case, provided no natural persons fall under the definition of the BO, the members of the statutory body are registered instead of BOs. The Amendment narrowed down the previously broad scope of top managers required to be written in such a case and enabled any BO to register the company address instead of its residence under certain circumstances.

The active gatekeepers, so-called Authorized Persons (AP), entitled to conduct a registration of a PPS into the register can be an attorney-at-law,[35] a public notary, a bank, or a branch of a foreign bank, an auditor, or a tax advisor. The AP must have a registered seat or place of business in the Slovak Republic and independently collect and assess all available information about the BO in a verification document. In this document, the AP determines the basis upon which the BO has been identified or verified and identifies the PPS shareholders and management structure. The verification document is a crucial component of the system. It provides for an "up to date snapshot" of the ownership and controlling form in a consistent chain of facts connecting the PSS to the beneficial owner. Moreover, as this document is made public and chronologically stored, it makes any ex-post tampering with the title chain, organizational structure, or controlling rights more difficult.

BOs of the PPS must be verified on December 31 of each calendar year if an AP registers a PPS in the register, if there are register changes regarding the BO and AP, if a contract or its amendment is concluded, or if consideration exceeds EUR 1 mil. An agreement has been received. Under the Amendment, voluntary verification is possible at any time. The advantage of such a voluntary verification is that unless there is a change in the BO, no additional proof is needed if the verification was conducted over the past six months.

Where incorrect or incomplete information about the BO is provided in the register, a fine will be imposed by the respective court in an amount corresponding to the economic benefit gained by the PPS. If it is not possible to determine such a benefit, a flat rate ranges from EUR 10.000 to 1 mil. will be set.

In addition, the executive bodies of a PPS can be fined from EUR 10.000 to 100.000 and will subsequently be banned from holding an executive body office in any private company based on registration into a "disqualification registry." For two years following the removal of the PPS from the RPSP by the court's decision, a company cannot be registered again and is therefore prevented from trading with the state or receiving public funds. The AP acts as a guarantor for paying the fine imposed on the PPS executive body unless the AP can prove it acted with professional diligence during registration/verification. The guarantee is a vital ex-post accountability feature of the combined approach that, on the one hand, relies on the data registered in the RPSP and, on the other hand, entrusts professional service providers with the task of verifying the data concerning BO.

The RPSP, including the BO verification documents, is accessible online to the general public, naturally including investigative journalists. Anybody can file a qualified motion to the registration court to examine the registration of the BO. "Qualified" means that facts justifying the doubts about the accuracy and validity of registration must be presented. In case the court opens the examination proceedings, the "tables turn," and it is up to the PPS to bear the burden of proof and provide sufficient evidence concerning the accuracy of the registered information.

Other applications of the Beneficial Ownership data

Transparency of beneficial ownership should not be the aim; it is a tool for effective regulation, policymaking, and law enforcement.

Corporate vehicles with anonymous ownership structures can significantly weaken law enforcement nationally. This is an implicit characteristic of disjoining ownership and accountability. Any legal regulation that requires transparent disclosure of ownership structure to be effective can be undermined beyond practical use by the existence of anonymous corporate systems. This applies not only to public law regulation but also to the regulation of purely commercial matters.

35. Acting as an AP is not considered as attorney activity - therefore in case an attorney-at-law acts as AP for a client, its actions and relation to the client are not subject to attorney-client privilege.

For example, in public law, a state may have a legitimate interest in prohibiting cross-media ownership (TV and radio broadcast, newspapers). However, suppose the state cannot reliably identify the ultimate owners of the relevant media. In that case, it cannot uphold the ban, thus creating only an appearance of having no cross-media ownership. This can be even more damaging than not having the restrictive regulation.

In private law, a good example is the protection of companies' creditors, e.g., insolvency law regulation, where shareholders are treated as a class of residual creditors that are satisfied only in case all other "outside" creditors are met in full. This principle, which also presumes that shareholders cannot acquire a company's assets without adequate consideration, is supplemented by further generally recognized regulations such as claw-back claims. These principles and rules, all protecting *bona fide* creditors, are complicated to uphold if the shareholders do business with their failing company indirectly and use anonymous structures.

The establishment of a register of BO, such as RPSP, enables the legislator to prescribe registration of beneficial owners also in particular policy fields such as media ownership or in certain situations where anonymity can seriously harm legitimate interests, such as interests of creditors when a "hidden" shareholder lodges large claims against an insolvent company.[36]

Furthermore, other existing public policy legal instruments such as foreign direct investment screening procedures,[37] subsidy schemes,[38] unexplained enrichment laws,[39] or asset declarations of officials[40] can be substantially upgraded by using the concept of verified and transparent BO registration.

The overall impact of the Act tested by "benchmarking" and recent challenges

By adopting the Act, Slovakia has taken over a role model position as a country. By applying the highest standards of due diligence and KYC to its business partners, the state increases the transparency of public spending. It makes corruption and illicit financial flows in general much more difficult.

Such an approach aligns with the 10th FATF Recommendation that aims at customer or supplier due care. It can be assumed that similar motivation led the US Congress to pass the H.R.6395 - William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021.[41] It stipulates in Section 885 that all companies receiving federal contracts above USD 500.000 must publicly disclose their beneficial ownership information. This is critical because investigations in the US into abuse of government spending have routinely found companies with anonymous ownership structures to be dangerous facilitators of corruption and misconduct.[42]

The strong momentum about the transparency of BO data in the US continues with the Biden administration. The 2021 U.S. Strategy on Countering Corruption[43] aims to enhance beneficial ownership transparency regulations that "help identify bad actors hiding behind opaque corporate structures," enacting first-of-their-kind laws that target "those closest to real estate transactions" to reveal when real estate is used for money laundering, making it harder for certain gatekeepers to evade ownership scrutiny and through international cooperation bringing greater transparency to the global financial system.

Furthermore, due to the Pandora Papers, the FATF recently initiated multiple actions to raise the international standards of beneficial ownership transparency.[44] Reviewing the impact and importance of the Act, it must be stated that the international standards are progressing towards the level that Slovakia has been successfully using since 2017.[45]

36. This insolvency law application is already implemented in Slovak regulation.

37. https://www.uianet.org/fr/actualites/india-covid-19-and-fdi-screening-mechanisms

38. https://www.oecd.org/coronavirus/policy-responses/covid-19-emergency-government-support-and-ensuring-a-level-playing-field-on-the-road-to-recovery-1e5a04de/

39. https://thedocs.worldbank.org/en/doc/734641611672284678-0090022021/original/BeneficialOwnershipTransparency.pdf, page 253

40. See e.g. Moldovan Law no.133/2016 that governs declarations of income and personal assets, conflicts of interest, and incompatibilities, restrictions, and limitations requires disclosure of the beneficial owners of financial assets and accounts if their total value exceeds 15 annual salaries.

41. https://www.congress.gov/bill/116th-congress/house-bill/6395

42. https://thefactcoalition.org/defense-bill-includes-two-landmark-transparency-provisions/

43. https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/06/fact-sheet-u-s-strategy-on-countering-corruption/

44. https://www.fatf-gafi.org/publications/fatfrecommendations/documents/public-consultation-r24.html

45. The proposed changes to the 24. FATF Recommendation on transparency of beneficial ownership are encouraging countries creating a central register of beneficial owners or an "alternative mechanism". Slovakia has created such register for companies dealing with public assets or funds (RPSP). FATF proposes that countries "consider" public access to beneficial ownership information. Slovakia provides full public and online free-of-charge access to the beneficial ownership information from its special register. FATF also requires a 25% beneficial ownership threshold as a "maximum". Slovakia even lowered the threshold for family members and other shareholders acting jointly. FATF finally accepts the need to cover foreign entities, for example off-shore companies that have a "sufficient link" in the national beneficial ownership registries. Slovakia requires all foreign entities doing business with public sector to register its beneficial owners. FATF requires that the collected data contains "adequate information that is sufficient to identify the natural persons who are the beneficial owners". Despite some GDPR pushback, Slovakia collects and publishes date of birth of beneficial owners as a crucial identification. Importantly, FATF recognizes that beneficial ownership information shall be verified. RSPV provides for compulsory verification of beneficial ownership data by so called gatekeepers, professionals like attorneys, notaries, banks etc. These professional service providers are co-liable for the accuracy of the beneficial ownership data. FATF specifies one month as an example of a "reasonable period" within which information should be changed. Among other verification events, Slovakia requires the beneficial ownership information to be verified before each receipt of public funds exceeding 1 mil. EUR. On top of these high international standards on beneficial ownership, Slovakia requires the publishing of the verification document describing the "algorithm" of how the beneficial ownership was identified by the respective professional, including all the layers of ownership and control. Slovakia also implemented a "reversed burden of proof" in case the registered beneficial ownership information is contested by the public.

Making public which natural person (in)directly deals with the public sector has a positive impact on the competition of entrepreneurs. The aspect of an unlevel playing field plays an increasing role in all market economies. If companies benefit from a preferred treatment from the public sector due to their ownership structure, fair competition becomes inevitably distorted. Such preferential treatment can result in excessive prices for the public sector and "dumping" strategies in private tenders. Thus, according to the Act, any administrative costs related to commercial verification are positively balanced by removing market disturbances caused by a lack of transparency in private-state relations.

Furthermore, progressive tools of the Act represent the involvement of the gatekeepers in the verification process. Several years before international scandals have drawn widespread attention to the essential role of specific professional industries in international money laundering, corruption schemes, and tax evasion, the Act had recognized the need to incentivize these professionals to investigate, verify and disclose beneficial ownership of companies. Recent evidence shows that in pursuit of personal interest, the intermediaries often create corporate enabling structures that facilitate illicit activities of political and economic elites. Thus, motivating them to work for the "side of the light" rather than serve the "side of the dark" (to become gatekeepers instead of enablers) turned out to be a very successful strategy in Slovakia.

In the future, not only governmental actions but also actions of private stakeholders endorsing values such as integrity, transparency, and accountability shall gain importance in the fight against illicit financial flows. Unifying Framework,[46] a value-based self-regulatory framework for private sector intermediaries strategically positioned to prevent or interrupt illicit financial flows, is just one example.

Further standardization and harmonization of the definition of beneficial ownership on the international level and interconnectivity of the different beneficial ownership registers (based not exclusively on the Business Registers Interconnection System (BRIS)[47] and the Beneficial Ownership Registers Interconnection (BORIS)[48]) shall prevent false statements and circumventing of the rules concerning local beneficial ownership registries.

At the time of the final edits of this article, Ukraine was invaded by Russia. The global geopolitical impact of this war and the sheer size of repercussions triggered by it on all levels of liberal societies go far beyond the scope of this paper. Nevertheless, it has become clear that it will no longer be possible to turn a blind eye to the level of tolerance and even acceptance of illicit finance flows into the developed economies in the last three decades. Societies that have tolerated criminal, illegal or unethical, and immoral provenience of funds based on pragmatic justification or rationalization of mutual benefit stand as weak opponents in the fight for liberal democratic values.

Regarding economical sanctioning, the idea of asset and beneficial ownership transparency must return to the center of the discussion. The disconnection of wealth from the liability for the conduct behind its amassing must be effectively challenged and canceled. Russian oligarchs shielded by complex ownership structures and their "enablers" in developed countries must feel again that they have a "skin in the game."

What is down the road?

The new 2021 EU Anti-Money Laundering Package 2021 (6 AML Pack) supports greater harmonization of transposing EU AML rules into national law, enhances supervision at the EU level via a new office (Anti-Money Laundering Authority - AMLA), and better coordination of financial intelligence units (FIUs). These rules will include harmonized beneficial ownership requirements. There shall be a further alignment of the FATF with the EU to create a blocklist and gray list under the FATF. A listing by FATF will also now trigger an EU listing and obligatory enhanced due diligence and countermeasures proportionate to risks stemming from the relevant country. It was reported that the new regulations and 6 AML Pack will only start to apply in 2026 as the AMLA needs to be up and running to prepare technical and regulatory standards that will complete the single rule book.[49]

The expectations are high that the 6 AML Pack will settle the ongoing backlash of some stakeholders against BO transparency based on data protection rules (GDPR). A more precise position of the EU is desperately needed, especially after the release of the Opinion 12/2021 of the European Data Protection Officer regarding the 6 AML Pack, which states that "beneficial ownership information should only be accessible for identification and prevention of money laundering" and only "to competent authorities who are in charge of enforcing the law and to obliged entities when taking customer due diligence measures."[50] In light of the measurable success of the transparency of the BO data to the broad public under the Act, we are advocating a pro-transparency approach. We believe that the recent opinion of Attorney General[51] shall be shared by the CJEU (in litigation concerning the

46. https://star.worldbank.org/resources/role-and-responsibilities-gatekeepers-fight-against-illicit-financial-flows-unifying

47. Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019L1151

48. 4 AML Directive

49. https://ec.europa.eu/info/publications/210720-anti-money-laundering-countering-financing-terrorism_en

50. https://edps.europa.eu/system/files/2021-09/21-09-22_edps-opinion-aml_en.pdf

51. https://curia.europa.eu/jcms/upload/docs/application/pdf/2022-01/cp220012fr.pdf

transparency of BO data) as the lowest possible denominator.[52]

Several "lessons learned" in Slovakia from the introduction of the RPSP and taking into account the future obligations resulting from the 6 AML Pack could be incorporated as an upgrade of the registration and verification process within the Commercial Register: By the same token, all these principles could also be considered as further improvements of the efficiency of the international standards created by FATF or the EU AML framework.

(i) First, dividing the registration process at the Commercial Register into a "fast track" and "slow track." Outsourcing at least a partial verification of the data on beneficial owners of companies that qualify for the slow track based on a "red flag indicator list" to third parties, for example, attorneys-at-law, who shall be in the future eventually entitled to execute electronically certain corporate registration services directly with the Commercial Register (i.e., without the need to involve the scrutiny of the respective registrar court) is an option. Automated checks of submitted data could accompany in-depth verification within the slow track (e.g., the actual existence of the address of an individual registered with the Commercial Register).

(ii) Secondly, the obligation to prepare and submit (even without making it publicly available) a comprehensive verification document that describes the algorithm used by the third party or company itself during the identification process of the beneficial owners could substantially limit the maneuvering space for ex-post "modification and alternations."

(iii) Finally, shifting the burden of proof in case of an official complaint about the accuracy of the registered data on beneficial ownership could encourage the public, investigative journalists, competitors, and NGOs to watch about the inconsistencies in compliance with the obligations.

Conclusively, alongside other prominent international research initiatives, further enhancement and involvement of the IT and machine learning tools, including AI, could better utilize the existing data by their material evaluation and aggregation.[53]

Further interconnectivity or merger of the current public registers and data sets represent a "low hanging fruit" in the continuing anti-corruption endeavors. For example, the Register of Public Contracts[54] contains data about companies awarded public contracts, and the values of these contracts could be easily linked with the RPSP. A standard interface could enable the public or other "watchdogs" to search for natural persons as beneficial owners of different companies commercially dealing with individual state institutions and find out the aggregated public funds received by the respective person. On the other side, this functionality could also enable "filter" a top list of beneficial owners of each public institution and illustrate the total volume of the specific state-private commercial relation in the figures.

Conclusion

The sheer size of illicit finance flows has widely recognized that depriving many countries of funding for their public needs, such as education or health care. Still, it also distorts free-market competition and directly threatens and undermines independent institutions and democracies. A crucial measure in combat illicit finance is to expose who owns shell companies and other illegally-obtained funds. We strongly believe that transparency of beneficial ownership of corporations and other legal vehicles must become a new standard. The openness of legal, lawful (formal) requests has become a standard after the corporations became a prevalent part of the business environment. Information on the legal rights of entities kept solely within the national realm is no longer sufficient to face the unrestricted nature of global financial transactions. The globalized financial world that knows no national borders require a new approach to reveal the beneficial ownership behind the seemingly unlimited and ever-shifting combinations of legal structures. Close cooperation with intermediaries is essential to become true gatekeepers and not enablers. The Slovak RPSP is a uniquely innovative and effective tool that leads along this road.

52. It was concluded that public access to BO information established by the existing AMLD does not result in a disproportionate interference with the rights to respect for private life and to the protection of personal data, guaranteed by Articles 7 and 8 of the Charter. The main arguments are: the rather limited nature and extent of the data available to the general public, existing relationship between the data subjects (UBOs) and the purpose of the data processing, namely the prevention of money laundering, the existence of derogations put in place by the AMLD aimed at ensuring a proportionate and balanced approach and at guaranteeing respect for fundamental rights and application of the GDPR to the processing of personal data taking place within the framework of this regime.

53. https://www.microsoft.com/en-us/research/group/societal-resilience/articles/revealing-the-hidden-structure-of-corruption/

54. https://www.crz.gov.sk/

Aija Lejniece • Independent Counsel

Crypto Takes Center Stage in Russia's War Against Ukraine

Following Russia's recognition of the self-proclaimed Donetsk and the Luhansk People's Republics, on 24 February 2022, the Russian military launched a brutal invasion of neighboring Ukraine. While Western governments and NATO have been categorically against military intervention against Russia, they were swift to implement draconian sanctions against the Kremlin, as well as Putin and his inner circle, be it Russian banks or oligarchs. Individuals and companies have likewise united in their support for Ukraine - major industry players, including international law firms, have pulled out of the Russian market, while people across the globe have rallied together, donating millions of euros directly to the Ukrainian army and government, as well as to displaced and suffering Ukrainians. Cryptocurrencies have taken an unexpected center stage in the Ukraine war, with Ukraine collecting millions in crypto donations. At the same time, some have questioned whether crypto will provide Russia with an avenue to sidestep the world-wide sanction regime. This article explores crypto's role in the ongoing conflict.[1]

Crypto as an alternative to fiat

The international community has rallied around Ukraine: in addition to massive businesses like food giants McDonalds[2] and Coca-Cola,[3] Swedish conglomerate IKEA,[4] as well as luxury brand LVMH[5] donating funds and suspending operations in or pulling out of the Russian market altogether, both private individuals and groups have found novel ways of raising funds and donating to the cause, notably through cryptocurrencies.

A cryptocurrency is a virtual or digital currency secured by cryptography that regulates the generation of units of currency and verifies the execution of payment transactions on a decentralized network.[6] Each unit (or coin) of a cryptocurrency, and all transactions are recorded on a distributed ledger spread across a network of computers or nodes (i.e., a blockchain) linked to that specific cryptocurrency. The system is self-contained, i.e., decentralized, and cryptocurrency payments can be made directly from one party to another, bypassing banks and any centralized interbank settlement.[7] Bitcoin (or BTC) was the first widely adopted cryptocurrency. In the years following Bitcoin's success, other cryptocurrencies have consistently sprung up, reaching over 10,000.[8] Some other widely used cryptocurrencies include Ethereum (ETH), Binance Coin (BNB), Solana (SOL), Tether (USDT), and Dogecoin (DOGE).

Cryptocurrencies are often used as an alternative to sovereign-issued currencies or fiat. Because cryptocurrencies are decentralized,[9] i.e., not issued by a central government authority, they are perceived to be impervious to the politics and actions of national governments, and therefore very attractive to populations in developing markets and countries where national currencies are plagued by hyperinflation or international transactions are limited by the government or foreign currencies are in short supply.[10] One of Bitcoin's early adapters, and currently one of its largest holders, Argentinian entrepreneur Wences Casares, was attracted to the idea of decentralized finance and cryptocurrencies because he had witnessed the financial crisis in Argentina and remembers his mother carrying grocery bags filled with money that she tried to spend as quickly as possible because the peso was in freefall.[11] As will be discussed, in light of the plunging rouble, cryptocurrencies could become increasingly popular in the flailing Russian economy.

Crypto on the frontline

Ukraine is no stranger to crypto, so it comes as no surprise that it is taking advantage of the crypto space in its time of need. Ukraine is ranked first worldwide in terms

1. The reader should note that this contribution relates to a rapidly developing situation. All information is current as of 2 May 2022.
2. McDonald's Statement, McDonald's To Temporarily Close Restaurants & Pause Operations in Russia, 8 March 2022.
3. Coca-Cola Statement, The Coca-Cola Company Suspends its Business in Russia, 8 March 2022.
4. IKEA press release, IKEA pauses operations in Russia and Belarus, 3 March 2022.
5. S. Maheswari, 'Luxury giants LVMH and Hermès will close stores in Russia temporarily', *The New York Times*, 4 March 2022.
6. B. Geva, 'Cryptocurrencies and the evolution of Banking' in *Cryptoassets: Legal, Regulatory, and Monetary Perspectives*, C. Brummer (ed) (Oxford) (2019), p. 31.
7. Ibid, pp. 31-32.
8. CoinMarketCap, *All Currencies*: <https://coinmarketcap.com/all/views/all/>.
9. Note that only cryptocurrencies that are issued, transferred and redeemed over a distributed ledger are said to be decentralized; cryptocurrencies issued and redeemed under a centralized protocol (e.g., cryptocurrencies issued by a central bank), are centralized. This contribution deals with decentralized cryptocurrencies. B. Geva, 'Cryptocurrencies and the evolution of Banking' in *Cryptoassets: Legal, Regulatory, and Monetary Perspectives*, C. Brummer (ed) (Oxford) (2019), p. 31.
10. J. Wheatley, A. Klasa, 'Cryptocurrencies: Developing Countries Provide Fertile Ground', *Financial Times*, 5 September 2021.
11. See N. Popper, *Digital Gold: Bitcoin and the Inside Story of the Misfits and Millionaires Trying to Reinvent Money* (Harper) (2015), pp. 153-161.

of cryptocurrency adoption,[12] with over 12.7% of Ukraine's population owning crypto.[13] In August 2019, Ukraine established its Ministry of Digital Transformation, which is in charge of elaborating and implementing State policy in the sector of digitization, open data, national electronic information resources and interoperability, the introduction of electronic services, electronic trust services, e-government, as well as improving the digital skills among Ukraine's population.[14] On 16 March 2022, President Volodymyr Zelensky approved a bill formally legalizing cryptocurrency in Ukraine.[15] After the war started, Ukraine quickly took advantage of crypto's speed and decentralized nature by using it to raise funds. These efforts have taken two main forms: the sale of NFTs and direct cryptocurrency donations.

An NFT or "non-fungible token" is "a unique digital identifier that cannot be copied, substituted, or subdivided, that is recorded in a blockchain, and that is used to certify authenticity and ownership (as of a specific digital asset and specific rights relating to it)".[16] Blockchain technology is used to record, verify and track each NFT. Like cryptocurrencies, NFTs can be sold and traded by their owners. Unlike cryptocurrencies, NFTs are not mutually freely interchangeable, i.e., they are "non-fungible". For example, like fiat currencies, one Bitcoin has the same value as another Bitcoin, one ETH has the same value as another single unit of ETH and so on. Exchanging one NFT for another would be a much more subjective endeavor - think trading Da Vinci's *Mona Lisa* for Van Gogh's *Starry Night* - the objective value of both is not easy to determine, so any exchange would necessarily entail the subjective valuation of the respective holder.

NFT prices are largely driven by demand - initial prices are set by creators or determined at auction. Like artworks, once an NFT has entered the general circulation, it can be sold or traded for whatever parties are willing to pay for it. While NFT prices are habitually expressed and discussed in fiat currencies (mostly US$), each NFT is purchased with the cryptocurrency that is attached to the specific blockchain the NFT is held on. For example, NFTs held on the Ethereum blockchain can be purchased with ETH, NFTs held on the Solana blockchain can be purchased with SOL and so on. Revenues from NFT sales can be easily transferred to digital wallets, without the need to reconvert it into fiat.

Scores of NFT fund-raising projects have been launched since the beginning of Russia's invasion. For example: world-famous Ukrainian professional heavy-weight boxer Wladimir Klitschko (the brother of the Mayor of Kyiv, Vitali Klitschko) released an NFT collection to raise funds for the Ukrainian Red Cross and UNICEF;[17] existing NFT project, Rebel Society, issued three limited edition NFTs called Good Rebels, with proceeds going to the Ukrainian Army;[18] digital platform Ikonia is releasing 43,287,512 NFTs - one for each citizen of Ukraine - with funds from the initial sale as well as a 10% royalty fee on all subsequent sales going to three Ukrainian charities in perpetuity;[19] famous Russian feminist protest art group Pussy Riot teamed up with various cryptoactors to establish a decentralized autonomous organization (or DAO),[20] selling an NFT of the Ukrainian flag for US$6.5 million in ETH with proceeds going to the Ukrainian "Come Back Alive" charity.[21] The Government of Ukraine is also using NFTs to raise funds and document the war through its NFT project 'Meta History Museum of War', with each NFT featuring a tweet regarding a significant moment in the war and an illustration by Ukrainian artists.[22]

NFT sales represent a small portion of crypto-related donations to Ukraine - the bulk of funds have been raised through direct cryptocurrency donations. Soon after the invasion, the Ukrainian Government published the addresses of the State's official crypto wallets via Twitter and subsequently an official government website.[23] Ukraine is accepting donations in all major cryptocurrencies, including BTC, ETH, UST, DOGE, and SOL, and anyone can transfer cryptocurrency or NFTs to a publicly known wallet address. The Government of Ukraine is likewise collaborating with Ukrainian-based Web3 company Everstake and public blockchain platform Solana (whose native cryptocurrency is SOL), setting up DAO to raise funds.[24] Crypto donations have also been made in NFTs - an anonymous NFT collector transferred CryptoPunk #5364, valued at

12. Note that Russia is ranked second. See Chainalysis, "Eastern Europe: High Grassroots Adoption, Outsized Darknet Market and Ransomware Activity", 14 September 202.
13. Triple A, Ukraine: <https://triple-a.io/crypto-ownership-ukraine/>.
14. See Regulation on the Ministry of Digital Transformation of Ukraine, approved by the Resolution No. 856 of the Cabinet of Ministers of Ukraine on 18 September 2019; Ukraine Government Press Release, "Government endorses the Regulation on the Ministry of Digital Transformation", 18 September 2019.
15. Law of Ukraine "On Virtual Assets" (No. 3637).
16. Merriam-Webster Dictionary.
17. Klitschko is partnering with the artist WhIsBe by creating four limited editions of WhIsBe's existing NFT collection "Vandal Gummy," with price points of US$100, US$1,000, US$10,000 and US$1 million. E. Tan, "Ukrainian Boxer Wladimir Klitschko Releases NFT Collection to Support Relief Effort", *CoinDesk*, 8 March 2022.
18. RebelSocietyNFT Twitter, 26 February 2022: <https://twitter.com/RebelSocietyNFT/status/1497521176012152833>; Good Rebels collection on Opensea: <https://opensea.io/collection/good-rebels>.
19. K. Barcella, "Ukrainian Relief Efforts Within the Crypto & NFT Communities", *JDSupra*, 8 March 2022; N. Buckler, "Ukraine NFTs: The Gift That Keeps Giving Each Time it is Sold", *BeInCrypto*, 1 March 2022.
20. A DAO is a code-based entity collectively owned and managed by its members, with no central leadership. DAOs are transparent and autonomous, with smart contracts laying down foundational rules, as well as automatically executing the community's decisions.
21. UkraineDAO website: <https://www.ukrainedao.love/>.
22. Meta History Museum of War website: < https://metahistory.gallery/>; S. Escalante-De Mattei, "Ukraine Has Launched an NFT 'Museum' to Preserve the Country's History", *ARTnews*, 28 March 2022.
23. Ukraine Government Twitter, 26 February 2022: <https://twitter.com/Ukraine/status/1497594592438497282?s=20&t=2w5qqZC2imd5j56hbG3bvA>; Vice Prime Minister of Ukraine and Minister of Digital Transformation of Ukraine Twitter, 2 March 2022: <https://twitter.com/FedorovMykhailo/status/1498982855162175488>; Ministry of Digital Transformation of Ukraine website: <https://donate.thedigital.gov.ua/>.
24. The initiative is called "Aid for Ukraine." See Aid for Ukraine website: <https://nation.io/dao/ukraine>.

around US$200,000, to Ukraine's ETH wallet.[25]

According to Alex Bornyakov, Ukraine's deputy minister at the Ministry of Digital Transformation, Ukraine's crypto wallets have received close to US$100 million in donations.[26] The Economist reports that by the beginning of March, Ukraine had already spent over half of its crypto donations on military equipment and medical aid, with about a fifth of the funds raised spent in crypto directly.[27]

Crypto's interaction with international sanctions

International economic sanctions have been described as "half-way between diplomatic protest and military action."[28] Deterred by the fear of escalating the conflict further, the international community has chosen financial pressure over military intervention, slamming Russia with unprecedented sanctions. To date, the EU has adopted five sanctions packages[29] via Council decisions and regulations amending the previous sanctions adopted in response to Russia's annexation of Crimea.[30] These include:[31]

(i) Sanctions on over 800 individuals and over 60 entities linked to the Kremlin, including asset freezes;
(ii) An import ban that includes coal, iron and steel products, and new investments in the Russian energy sector;[32]
(iii) An export ban that includes luxury goods, maritime navigation goods and radio communication technology, oil refining technology, and technological goods;[33]
(iv) A ban on transactions with the Russian Central Bank;
(v) The exclusion of key Russian banks from the SWIFT system;
(vi) The prohibition of the provision of euro-denominated banknotes to Russia;
(vii) The ban on broadcasting certain Kremlin-backed media propaganda;
(viii) Closing of the EU airspace to Russian air carriers.

The US, the United Kingdom, Switzerland, Canada and Japan have likewise imposed sanctions targeting Russian companies and individuals, and enacting banking restrictions.[34] Because of the sanctions and market pressure, payment services such as Visa,[35] Mastercard,[36] American Express,[37] as well as PayPal[38] and Apple Pay[39] have exited or severely limited operations in Russia, leaving Russian citizens cut off from the international financial market. The sanctions have also caused the Russian ruble to plummet, hitting an all-time low on 2 March 2022.[40]

Some have questioned whether crypto could enable the Russia to sidestep sanctions. Notably, Senator Elizabeth Warren, along with three other Democratic senators, sent a letter to the US State Treasury,[41] asking what steps it was taking to preclude crypto-related evasion of US economic sanctions. According to the senators, "digital assets, which allow entities to bypass the traditional financial system, may increasingly be used as a tool for sanctions evasion".[42] The letter specifically cites a confidential 2022 UN Report, according to which North Korea used stolen cryptocurrency funds for its nuclear and ballistic missile program,[43] as well as reports that Iran has turned to Bitcoin mining to buoy its cash-strapped economy and lessen the impact of international sanctions.[44] According to Senator Warren "cryptocurrencies risk undermining sanctions against Russia, allowing Putin and his cronies to avoid

25. CryptoPunks is one of the most popular and highly-valued NFT projects to date and consists of 10,000 uniquely generated NFTs that have previously been sold at Christie's. See CrytoPunks collection on OpenSea: <https://opensea.io/collection/cryptopunks>; D. Nelson, "CryptoPunk NFT Is Latest Donation to Ukraine's $33M Campaign", *CoinDesk*, 2 March 2022.

26. See Ministry of Digital Transformation of Ukraine website: <https://donate.thedigital.gov.ua/>; A. Singh, Ukraine Has Received Close to $100M in Crypto Donations, *CoinDesk*, 9 March 2022.

27. The Economist, "How is Ukraine using crypto to fund the war?, 5 April 2022: <https://www.economist.com/the-economist-explains/2022/04/05/how-is-ukraine-using-crypto-to-fund-the-war>.

28. M. Azeredo Da Silveira, 'Chapter 7: Economic Sanctions, Force Majeure and Hardship' in F. Bortolotti and D. Udeme Ufot (eds), "*Hardship and Force Majeure in International Commercial Contracts: Dealing with Unforeseen Events in a Changing World*", Dossiers of the ICC Institute of World Business Law, Vol. 17 (Kluwer Law International; International Chamber of Commerce (ICC)) (2018), p. 161.

29. Note that the EU has likewise adopted multiple sanctions against Belarus.

30. Regulation (EU) No 269/2014 of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine; Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

31. For a summary of all EU sanctions against Russia, see European Commission website: <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/restrictive-measures-sanctions_en#russia>.

32. Note that the ban is not absolute and has carve-outs.

33. Note that the ban is not absolute and has carve-outs.

34. For a summary of all US sanctions against Russia, see US Department of Treasury website: <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/russian-harmful-foreign-activities-sanctions>. For a summary of other international sanctions, see E. Nolsoe, V. Pop, "Russia sanctions list: What the west imposed over the Ukraine invasion", *Financial Times*, 4 March 2022.

35. Visa Statement, Visa Suspends All Russia Operations, 5 March 2022: <https://usa.visa.com/about-visa/newsroom/press-releases.releaseId.18871.html>.

36. Mastercard Statement, Mastercard statement on suspension of Russian operations, 5 March 2022: <https://www.mastercard.com/news/press/2022/march/mastercard-statement-on-suspension-of-russian-operations>.

37. American Express Statement, American Express Suspends Operations in Russia and Belarus, 6 March 2022: <https://about.americanexpress.com/all-news/news-details/2022/american-express-suspends-operations-in-russia-and-belarus/default.aspx>.

38. P. Dave, "PayPal shuts down its services in Russia citing Ukraine aggression", *Reuters*, 5 March 2022; <https://www.reuters.com/business/paypal-shuts-down-its-services-russia-citing-ukraine-aggression-2022-03-05/>.

39. B. Fung, "Apple suspends all product sales in Russia", *CNN Business*, 1 March 2022.

40. Reuters, "Ruble hits record low in Moscow, remains volatile outside Russia", 2 March 2022.

41. Letter from Democratic Senators to US State Treasury, 2 March 2022: <https://www.warren.senate.gov/imo/media/doc/2022.03.01%20Letter%20to%20Treasury%20re%20OFAC%20crypto%20sanctions%20enforcement.pdf> ("Senator Warren Letter").

42. *Ibid*, p. 2.

43. Ibid; BBC News, "North Korea: Missile programme funded through stolen crypto, UN report says", 6 February 2022: <https://www.bbc.com/news/world-asia-60281129>; P. Falk, "North Korea uses cyberattack earnings to advance nuclear and missile development, U.N. panel reports", *CBS News*, 7 February 2022: <https://www.cbsnews.com/news/north-korea-cyberattacks-nuclear-missile-program-united-nations-report/>. See also UNSC doc. S/2019/691, 30 August 2019.

44. Senator Warren Letter; 2021 Elliptic Guide to Sanctions Compliance in Cryptocurrencies: <https://info.elliptic.co/coming-soon-sanctions-compliance-in-cryptocurrencies>; A. Irrera, "Iran uses crypto mining to lessen impact of sanctions, study finds", *Reuters*, 21 May 2021.

economic pain."[45] According to reports, Senator Warren is working on a bill that would mandate US-based cryptocurrency exchanges to identify transactions from Russian wallet addresses that may evade US sanctions.[46] Ukraine's Deputy Prime Minister and Minister of Digital Transformation, Mykhailo Fedorov, has likewise called on crypto exchanges to block Russian users since the invasion began.[47]

While sanctions target foreign governments, they apply to entities and individuals under the jurisdictions of the issuing States or organizations. EU sanctions apply to all EU nationals, be it private citizens or entities incorporated or constituted in EU Member States, as well as persons located in the EU or doing business here.[48] Similarly, US sanctions apply to US nationals, permanent residents, entities formed under US law, as well non-US persons located in the US, doing business in the US or with a sufficient nexus to the US. Accordingly, crypto companies registered or operating in sanctioning jurisdictions, as well as nationals using crypto, fall under the purview of the sanctions.

The EU has explicitly confirmed that its sanctions include crypto – Regulation 2022/394 amending Regulation 833/2014 on the previous Crimea sanctions states that while "it is commonly understood that loans and credits can be provided by any means, including cryptoassets, given their specific nature it is appropriate to further specify the notion of "transferable securities" in relation to such assets."[49] Accordingly, the definition of "transferable securities" now also includes "crypto-assets."[50] The EU's fifth sanctions package went a step further by directly imposing a EUR10,000 limit on digital wallets held by Russian persons or entities.[51]

The US, along with the other G7 countries[52] addressed the group's commitment to closing sanctions loopholes and combating evasion, and confirmed that the "current sanctions already cover crypto-assets," further stating that the group will be "taking measures to better detect and interdict any illicit activity, and [...] impose costs on illicit Russian actors using digital assets to enhance and transfer their wealth, consistent with our national processes."[53] In addition, the US Office of Foreign Assets Control (OFEC), which administers and enforces US economic and trade sanctions, has stated that sanctions apply "regardless of whether a transaction is denominated in traditional fiat currency or virtual currency."[54] The US has also chosen to directly target Russian crypto mining industry by putting one of Russia's major miners, BitRiver and its subsidiaries on the US sanctions list, stating that the US "is committed to ensuring that no asset, no matter how complex, becomes a mechanism for the Putin regime to offset the impact of sanctions."[55]

The UK financial regulatory authorities issued a statement on sanctions and the cryptoasset sector, reiterating that "all UK financial services firms, including the cryptoasset sector, are expected to play their part in ensuring that sanctions are complied with."[56] Japan's Ministry of Finance has also confirmed that its sanctions apply to digital currencies.[57]

All about implementation

The real crux of the matter is implementation of the international economic sanctions in the crypto-space. At the end of 2021, OFAC issued its "Sanctions Compliance Guidance for the Virtual Currency Industry."[58] In this document, OFAC sets out best practices for sanctions compliance and specifies that all cryptocurrency actors, including "technology companies, exchangers, administrators, miners, wallet providers, and users, play an increasingly critical role in preventing sanctioned persons from exploiting virtual currencies to evade sanctions and undermine US foreign policy and national security interests" and are "responsible for ensuring that they do not engage, directly or indirectly, in transactions prohibited by OFAC sanctions."[59]

45. Senator Elizabeth Warren Twitter, 28 February 2022: <https://twitter.com/senwarren/status/1498376453280391178?lang=bg>.

46. L.A. Caldwell, "Warren crafts bill targeting cryptocurrency in Russia sanctions", *NBC News*, 8 March 2022: <https://www.nbcnews.com/politics/congress/warren-crafts-bill-targeting-cryptocurrency-russia-sanctions-rcna19094?cid=sm_npd_nn_tw_ma>.

47. Mykhailo Fedorov Twitter, 27 February 2022: <https://twitter.com/FedorovMykhailo/status/1497922588491792386>.

48. See e.g., Regulation (EU) No 269/2014 of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, Article 17, and Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, Article 13: "This Regulation shall apply: (a) within the territory of the Union; (b) on board any aircraft or any vessel under the jurisdiction of a Member State; (c) to any person inside or outside the territory of the Union who is a national of a Member State; (d) to any legal person, entity or body, inside or outside the territory of the Union, which is incorporated or constituted under the law of a Member State; (e) to any legal person, entity or body in respect of any business done in whole or in part within the Union."

49. Council Regulation (EU) 2022/394 of 9 March 2022 amending Council Regulation (EU) No 833/2014 of 31 July 2014, Recital 4.

50. Council Regulation (EU) 2022/394 of 9 March 2022 amending Council Regulation (EU) No 833/2014 of 31 July 2014, Article 1(1)(f).

51. Council Regulation (EU) 2022/576 of 8 April 2022 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, Article 31. Article 5b(1) of Council Regulation (EU) No 833/2014 now reads: "It shall be prohibited to provide crypto-asset wallet, account or custody services to Russian nationals or natural persons residing in Russia, or legal persons, entities or bodies established in Russia, if the total value of crypto-assets of the natural or legal person, entity or body per wallet, account or custody provider exceeds EUR 10 000."

52. United Kingdom, Canada, France, Germany, Italy, Japan, and the EU.

53. Joint Statement by the G7 Announcing Further Economic Costs on Russia, 11March 2022: <https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/11/joint-statement-by-the-g7-announcing-further-economic-costs-on-russia/>.

54. US Department of the Treasury website, FAQ 1021: < https://home.treasury.gov/policy-issues/financial-sanctions/faqs/1021>.

55. US Department of the Treasury website, Press release, 20 April 2022: <https://home.treasury.gov/news/press-releases/jy0731>.

56. Joint statement from UK financial regulatory authorities on sanctions and the cryptoasset sector, 11 March 2021:<https://www.fca.org.uk/news/statements/uk-financial-regulatory-authorities-sanctions-cryptoasset-sector>.

57. Statement to cryptocurrency exchange companies from the Ministry of Finance of Japan, 14 March 2022: <https://www.fsa.go.jp/news/r3/sonota/20220314/20220314-1.pdf>.

58. OFAC, "Sanctions Compliance Guidance for the Virtual Currency Industry", October 2021, available at: https://home.treasury.gov/system/files/126/virtual_currency_guidance_brochure.pdf.

59. *Ibid*, p. 1.

Sanctions compliance obligations apply equally to transactions involving virtual currencies as they do to traditional fiat transactions.[60] The OFAC identifies five key components of best practices for crypto actors' compliance with sanctions: commitment of the management, risk assessment, internal controls, testing and auditing and training, and encourages companies in the cryptocurrency industry to "develop, implement, and routinely update, a tailored, risk-based sanctions compliance program."[61] The UK financial regulatory authorities' joint statement, as well as the statement of Japan's Ministry of Finance likewise lists similar best practices for sanctions compliance for crypto companies.

While the genesis of cryptocurrencies such as Bitcoin may have been tainted with infamy because of its use for nefarious causes,[62] that is no longer the case. Cryptocurrencies may be decentralized, i.e., created, transferred and stored outside the purview of the government, but crypto transactions are public and fully traceable on the blockchain.[63] For example, the US Department of Justice and the British police have successfully traced and seized large amounts of Bitcoin stolen or used for criminal means.[64] Just like fiat currency, cryptocurrency can be used for illegal purposes, including to sidestep sanctions. Crypto's infamy of yore has more to do with law enforcement being a step behind in understanding the technology well enough to catch criminals.

Most crypto companies, whether trading platforms or wallet providers, have KYC and AML protocols, as well as precise geolocation and transaction monitoring tools. Sanctions will only apply to crypto companies incorporated or operating in sanctioning jurisdictions, and compliance will depend on the efficiency of each individual company's internal procedures. Provided that crypto companies and actors have enacted and comply with internal procedures and monitor cryptocurrency transactions, and the relevant authorities of sanctioning States efficiently implement legislation, Russia should not be able to sidestep international sanctions by taking advantage of the crypto market.

Crypto's real anti-sanction utility may be found with ordinary Russian citizens who have been cut off from certain services due to the international sanctions against Russia. To take a mundane example: Instagram is no longer available to Russian IP addresses; this problem may be sidestepped via a VPN connection that would relocate the user's actual IP address to one outside of Russia; even though Russian credit cards or other payment methods may no longer work to pay for foreign services, a VPN subscription may be purchased via cryptocurrency. Accordingly, payments to and from non-sanctioned Russian citizens and entities, which would have been impossible due to current banking restrictions and commercial service withdrawals, may still be possible via cryptocurrency.

One way of ensuring that Russia's population is completely cut off from the crypto market would be for the international community to enact sanctions explicitly requiring cryptocurrency exchanges and wallet providers to ban Russian users altogether. The EU's fifth sanctions package has already affected Russian Binance users, whose account activity has been limited to withdrawals as soon as the EUR 10,000 limit is reached.[65] Undeniably, sanctions go squarely against the crypto community's libertarian ideals and decentralized nature. Several crypto companies have confirmed that they will comply with any applicable sanctions by blocking accounts and transactions of sanctioned individuals or entities, but a general ban on Russian parties has been widely rejected.[66] In the words of the world's biggest crypto trading platform, a blanket ban on Russians "would fly in the face of the reason why crypto exists."[67] Only South Korean crypto exchanges have voluntarily chosen to block Russian IP addresses.[68]

Concluding remarks

Economic sanctions are coercive, symbolic and punitive. From a legal perspective, the current sanctions regime should not allow Russia or Kremlin's cronies to escape the wrath of the international community by resorting to crypto. Compliance and implementation will depend on the efficiency and discipline of crypto actors, and the vigilance of law enforcement. The crypto community's aversion to centralized regulation and government interference should be a powerful motivator for the crypto sector to take a proactive role in tracking suspected wallets and transactions – fewer sanctions violations equal less of a chance that States will impose a blanket ban on Russian users in general.

In any event, the recent events in Ukraine have made clear that waging war in the 21st century means not only advanced nuclear weapons but also new financial instruments to reckon with.

60. *Ibid.*

61. *Ibid*, pp. 10-23.

62. e.g., Silk Road, the world's first darknet market, whose users paid for narcotics, falsified documents and even contract killings in Bitcoin. For a history of Bitcoin, see N. Popper, *Digital Gold: Bitcoin and the Inside Story of the Misfits and Millionaires Trying to Reinvent Money* (Harper) (2015).

63. There are a numerous cryptocurrencies such as Monero (XMR) and ZCash (ZEC) that add a layer of anonymity making the currencies virtually untraceable, however the majority of widely popular currencies are traceable.

64. See, e.g., US Department of Justice Press Release, Department of Justice Seizes $2.3 Million in Cryptocurrency Paid to the Ransomware Extortionists Darkside, 7 June 2021; US Department of Justice Press Release, United States Files A Civil Action To Forfeit Cryptocurrency Valued At Over One Billion U.S. Dollars, 5 November 2020: <https://www.justice.gov/usao-ndca/pr/united-states-files-civil-action-forfeit-cryptocurrency-valued-over-one-billion-us>; R. Hart, "British Police Seize $250 Million Of Cryptocurrency In International Money Laundering Crackdown", *Forbes*, 13 July 2021.

65. Binance, Announcement: Changes to Services to Users in Russia, 21 April 2022: <https://www.binance.com/en/support/announcement/4887e569afdf4b1e89e024371d3a49b9>.

66. C. Morris, "Crypto exchanges choose 'financial freedom' and refuse to block Russian users", *Fortune*, 28 February 2022; J. Partridge, "Crypto exchange boss resists calls for ban on all Russia transactions", *The Guardian*, 2 March 2022.

67. A. Kharpal, "World's biggest crypto exchange Binance says it will not block all Russian accounts despite Ukraine request", *CNBC*, 28 February 2022.

68. A. Chaturvedi, "South Korean crypto exchanges move to ban Russian users", *Business Today*, 7 March 2022.

Law, Markets and Inequality

Tsilly Dagan • Professor of Taxation Law, Oxford University; Fellow of Worcester College

Tax Justice in the Era of Mobility and Fragmentation

1. Globalization and the transformation of tax sovereignty

The traditional analysis of tax justice envisions a state that is ruled by a sovereign which is entrusted with exclusive legislative powers concerning tax, seeking (at least ideally) to pursue normatively desirable goals. Zooming out to the global level, however, we realize that the powerful sovereign is only one of approximately 200 sovereigns competing with one another for resources as well as (at least to some extent) for residents. This market of states is decentralized (as each state is setting its own policies) and competitive. Taxation is, to a large extent, the currency of this competition, with states luring investments as well as residents to their jurisdiction with attractive taxing and spending 'deals'. As countries attempt to tailor their sovereign-provided-goods to attract desirable mobile constituents and resources, tax policies almost inevitably become marketized. Two features of such competition are particularly relevant to our understanding of tax sovereignty and particularly the interaction between states and their constituents in the era of globalization: mobility and fragmentation.

1.A Mobility—Competitive Sovereignty

Competition has transformed sovereignty generally, and it has certainly transformed tax sovereignty. Although sovereign states still insist on preserving their formal exclusive authority in tax matters, the truth of the matter is that under conditions of competition, it is all too often the invisible hand of the international market of states, rather than the individual sovereign state, that shapes tax policies. In competing for investments, residents, and tax revenues, states no longer design their own policies in a vacuum, for this competition provides taxpayers with an alternative: to shift their capital, their activities or their residency and, for individuals, even their citizenship to another jurisdiction.

Taxpayers–both individuals and, even more so, businesses–are increasingly mobile. This enables them to choose from among alternative jurisdictions to relocate their places of residence, investments, and business activities. States often encourage such mobility by offering certain privileges and incentives to desirable potential residents and investors. Residents-in-demand relocate to more appealing jurisdictions, as states lure away investors, corporate headquarters, production facilities, R&D as well as young and talented individuals.

With this intensified mobility, sovereign states have found themselves in an unfamiliar position: once defined by their coercive powers and control over their citizenry and territory, they must now try to lure residents and investments away from competing sovereigns and offer competitive terms to their own constituents, assuming they wish to expand or even simply sustain their domestic economies. By providing taxpayers with a viable alternative, tax (and often other regulatory) competition has turned the decision-making process on its head. The state can no longer be perceived as making compulsory taxation demands on its subjects in order to promote the collective goals of a given group of constituents but, rather, it increasingly acts as a recruiter, soliciting investments in order to facilitate increased economic activity and bidding for residents in an attempt to build the best possible team. The legal rules that apply in a certain jurisdiction and the applicable tax rules and rates are important considerations for the globally mobile (certainly for businesses but even for certain individuals) when weighing their residency options and the potential locations for their economic activities. Hence, tax rules and rates have become, to a large extent, the currency of state competition.

Under these conditions of competition, tax has increasingly become a price which taxpayers are willing to pay for residing, investing, and conducting their business in an attractive state as opposed to a civil obligation they should fulfill, while for states, tax rates and public policies have become subject, to a considerable extent, to the rules of supply and demand in the market for states. In its extreme version, tax competition changes taxation from a mandatory regime to a regime that is essentially elective or, to be more precise, elective for some. This is true for individuals but even more so for multinational enterprises ('MNEs'), for which the decision of where to incorporate or otherwise set up residence for tax purposes is often a business decision. In a world where tax competition is prevalent, states increasingly resemble firms offering goods and services that aim to appeal to (and keep) investors and residents, for an attractive tax 'price'.

Consequently, policymakers find it necessary to take into account considerations that are more similar to those weighed by firms competing on the market. To maximize the benefits derived from individuals and businesses residing and investing in their state jurisdiction, policymakers cater to the most 'valuable' taxpayers and those most likely to relocate for tax reasons (and curiously enough, should invest less effort in keeping the ones who are most committed to the country). They pursue taxpayers that will bring the most material benefits to the state, such as jobs, R&D, capital investments, spillover of technological and managerial skills, and simply talent. In terms of tax (and other) policies, this means offering the public goods and services that are most attractive to such constituents and lowering taxes for the most mobile.

In short, competitive sovereignty focuses on assembling the most attractive 'team' of constituents and economic actors by offering the most attractive public services deals at an attractive price. This is very different, of course, from sovereignty that seeks to provide the best possible public services to a set group of constituents who share common goals and aspirations and that wields the power and legitimacy to accomplish this using coercive measures so as to prevent collective action problems.

1.B Fragmentation— Unbundled Sovereignty

The mobility of residents and their resources–and the accompanying marketization of the government-constituent relationships it entails–are only the tip of the iceberg. No less significant, and too often overlooked, is the ability of (certain) individuals and businesses (most notoriously, MNEs) to unbundle and then reassemble packages of sovereign goods tailored to their specific needs. In the current market of states, individuals and businesses are able not only to shop for their jurisdiction of choice but also to buy '*à-la-carte*' fractions of regimes of different state sovereignties. This fragmentation of sovereignty occurs in many areas of state regulation,[1] but tax–formerly the quintessential tight, all-encompassing coercive legal regime–seems particularly amenable to such tailoring by skilled tax-planners.

Contrary to their coercive all-encompassing character under a purely domestic setting, in the era of globalization tax laws have become notorious for being virtually elective (at least for some). The conditions that can trigger the application of tax laws in different jurisdictions vary widely, which has produced a fragmented international tax scene with a diversity of mix-and-match components: differing residency rules; source rules; rules for allowing deductions; withholding rates; and over 3000 tax treaties between jurisdictions. Sophisticated and well-advised taxpayers can pick and choose among these components in ways that do not necessarily overlap with any of the regimes governing their other affairs.[2]

As a result, taxpayers who plan their affairs can simultaneously reside in one jurisdiction (and consume its publicly provided goods and services), incorporate in another (and thus enjoy its corporate governance), do business in a third, use the court system of a fourth, invest in a labor intensive plant in a fifth (and reap the benefits of a publicly-provided services such as an educated workforce), register its IP in a sixth; and be subject to the tax rates, if any, of another jurisdiction altogether. The case of MNEs is an extreme example. MNEs are (or at least used to be until recent attempts to curtail 'base erosion and profit shifting' by the OECD[3]) notoriously able to tax-plan their activities in ways that created what was famously called 'stateless income' - that is income that, due to tax planning and tax competition between countries is subject to extremely low rates across the globe.[4]

Some of the features of this fragmented international tax and regulatory regime are the result of sheer planning techniques - designed solely to manipulate the system in order to avoid certain taxes, duties or regulations. But fragmentation is also a structural phenomenon which is the direct result of the decentralized market of states (and would be present even if profit-shifting-type tax planning would be eliminated). In the absence of coordination, each country is free to tax (and regulate) whatever features it sees fit and adopt whatever tax regime it desires. Hence, some countries can 'sell' their residency very cheaply. Others may be able to collect rents for their natural resources, human talent or their good weather. None of these features should necessarily be bundled with others, although some countries may, certainly, do so.

In contrast to the classic mobility story, which tends to be constructed around a market of states offering take-it-or-leave-it package deals of legal rules, services, and taxes, the fragmentation perspective highlights the electivity and flexibility of these packages. Instead of looking at individuals' and businesses' ability to shift their choice of jurisdiction *en-bloc* by moving their residency to a new jurisdiction, fragmentation stresses their leeway to *mix-and-match* legal jurisdictions. The fragmentation of the state-citizen relationship and the fact that individuals and businesses are not exclusively connected to a single state but, rather, interact simultaneously with many states on various planes, mean that this relationship cannot, and does not, necessarily bundle together all the dimensions of the potential interaction between taxpayers and states. This reality impacts the strategies used by both taxpayers and states. Whereas absent this jurisdictional fragmentation, the optional strategies for residents are essentially either voice (using their political power to shape state policy) or exit (relocating to a jurisdiction that offers a more favorable regulatory package),[5] they now have an array of options that will maximize their benefits; they can *diversify* their state-related interactions.

Thus, in this market for public goods, people–and, even more so, corporations–can choose, not only between juris-

1. Tsilly Dagan, 'The Global Market for Tax & Legal Rules', 21 Fla. Tax Rev. 148, 168 (2017).

2. For a brief description of the tax planning techniques employed by tax planners, see Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* (Cambridge University Press 2017) 27–30.

3. The 'OECD G20 Base Erosion and Profit Shifting Project' is an OECD project to set up an international framework to combat tax avoidance by MNEs using base erosion and profit shifting tools. The project behand in 2013 and is not in its implementation phase. See, https://www.oecd.org/tax/beps/about/.

4. See, Edward Kleinbard, 'Stateless Income', 11 *Fla. Tax Rev.* 699, 706 (2011).

5. Using the concepts developed by Hirschman, see Albert O Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard University Press 1970).

dictions in their entirety, but also from amongst different combinations of fractions of these jurisdictions. States must also adjust their strategies to the reality of electivity under fragmentation. They must internalize the fact that they operate as competitive players in multiple 'markets' simultaneously. Tradeoffs between various aspects of their public services are much harder to pull off. Hence, a state's advantageous geographical location, excellent school system, or strong legal tradition will not necessarily compensate for a high corporate tax rate or strict employment rules, when residents and businesses can often simply choose to opt out of the less desirable features. Sadly, fragmentation, and the creative tax planning it facilitates, also allows taxpayers to free ride on some of the public goods which states offer. Where a state cannot collect taxes from individuals and businesses that find ways to avoid them by tax planning, states cannot ensure the participation of all taxpayers in the financing of such services.

This type of unbundling is often desirable when pure market transactions are at stake, as it increases the competitiveness of the market and allows consumers greater freedom in selecting their desirable goods. But in the context of the interaction between the state and its constituents, unbundling raises serious challenges for both states and their constituents, particularly challenges for justice.

2. The Challenges for Tax Justice

The competitive and fragmented reality of tax under conditions of globalization is transforming tax sovereignty. It undermines the coercive power of the state and threatens to transform the state from a coercive institution designed to enforce the collective will of its subjects into a market-like actor and its constituents into 'clients' that need to be catered for. This transformation of tax sovereignty challenges justice in two important ways: it threatens states' redistributive capacity and it challenges the principle of equal respect and concern for all.

2.A Challenge for States' Redistributive Capacity

Competition has dramatically diminished the coercive power of the sovereign state in tax matters and thereby altered its relationship with its constituents. Although it would be inaccurate to claim that states' taxing power has completely collapsed, due to tax competition, states' inability to enforce taxation equally due to competition has certainly undercut this power, and especially states' ability to enforce a redistributive scheme. Mobility, with the relocation options it opens up, and the opportunities for sophisticated tax planning which fragmentation offers, enable (some) taxpayers to reduce their tax liability using the array of techniques described above. The result is a serious diminishment in states' coercive taxing power. States can de-facto enforce their tax laws predominantly on the immobile segments of society and on those segments that are incapable of effectively tax-planning their operations. They could also collect payments for the public goods which mobile taxpayers are interested in consuming and are willing to pay for. They are unlikely, however, to be able to collect much revenue for redistribution from those who are able to opt out of the system. And since the mobile taxpayers and the ones more likely to tax plan are often also the wealthiest, states are losing their ability to redistribute resources among taxpayers. The outcome of states' struggle to attract investments (by lowering their tax rates) and woo residents (individuals as well as multinational enterprises) with attractive taxing and spending deals is thus a restricted ability of states to redistribute wealth domestically. In the most extreme case, driving down tax rates on mobile residents and on the mobile factors of production will shift the tax burden to the less mobile (and often less well-off) constituents This may lead to a reduction in the state's tax revenues and thereby erode its ability to sustain public goods and services and, in particular, redistribution. As Reuven Avi-Yonah established, 'if capital cannot be effectively taxed, the tax base will generally shift - regressively - toward labor. Thus, tax competition impairs the income tax's ability to redistribute wealth from the rich to the poor.'[6]

In any event, tax competition indisputably brings pressure to bear on states to reduce their taxes and restrict redistribution, or else pay the overall price in terms of the community's welfare. Despite several factors that serve as counterweights to competition's downward pressure on redistribution, the fact of taxpayers' mobility implies that states have no choice but to weigh the benefits of redistribution and the potential costs of driving away wealthy residents and businesses with excessive redistribution. Where tax-planning opportunities are available, they act as further constraints on states' ability to redistribute wealth. For even when a state offers advantages relative to other states, or taxpayers have considerable costs of relocation, the state will find it difficult to convert these advantages or inelasticities into tax revenues that facilitate significant redistribution.

Fragmentation further intensifies the vulnerability of traditional interactions within the state. If, in the past, states were able to bundle together their relative advantages for taxpayers with their preferred political regime and public policies, and thus give weight to principles of solidarity and redistribution, the fragmented international tax field now undermines this ability. Instead of the classic principles of political governance that design bundles of public goods for certain amounts of taxes based on an agreed upon distributive scheme, the interaction between sovereigns and their constituents increasingly follows the market rules of supply and demand, where taxes are determined (for some) by the 'invisible hand of the market'. In a market-like regime, more

6. See Reuven S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', 113 *Harv. L. Rev.* 1573, 1578 (2000). It has been argued that tax competition will drive tax rates down to a suboptimal level, where states will be forced to under-provide public goods. For a formal model supporting this argument, see George R. Zodrow & Peter Mieszkowski, 'Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods', 19 *J. Urban Eco.* 356 (1986). Although it is unclear what exactly constitutes the optimal level of public goods (see John Douglas Wilson, 'Theories of Tax Competition', 52 *Nat'l Tax J.* 269, 270 (1999)), it is pretty evident that redistribution would be reduced.

elastic taxpayers pay lower taxes and are being offered public services that better match their preferences. This might transform the state from a forum for coercive co-authorship of public policies, where justice legitimizes the use of coercion and political decisions are made through mechanisms of voice, into a market actor increasingly constrained by the invisible hand of the market, where taxpayers 'buy' public goods and services and governments 'sell' them for the taxes they collect. This is very close, if not identical to, benefit taxation where taxes serve as prices, not even purporting to support states' duties of distributive justice. In this scenario, tax law might cease to be the main tool for redistribution. Thus, states may find themselves unable to uphold ideals of distributive justice. This may in turn undermine the legitimacy of their coercive powers.

2.B A Challenge for Equal Citizenship

Because of the competitive pressure and the considerable difficulty for states of enforcing their rules on mobile taxpayers, they are pushed to offer mobile constituents–or the ones with better planning opportunities–with either significant tax benefits or increased leeway in planning their world-wide tax operations. Things are very different for the immobile taxpayers (and those who lack any planning opportunities). Hence, the rational choice for a state in a competitive market seems to be a regime that 'price discriminates' among taxpayers based on how elastic their ability to opt out of the jurisdiction is: for some taxpayers, the ones with lower ability or a lower inclination to move, coercive world-wide taxation of their ability to pay would make sense. Yet for others, those with available alternatives, a regime which is more lenient, at times even elective is the more beneficial option in term of tax revenues. In other words, tax competition brings back a unique version of taxation: compulsory taxes *for some*.

More specifically, by adjusting their policies to match them with the varying degrees of elasticity among their constituents, states could increase the tax revenues they end up collecting. Assuming that the marginal costs of providing much of the public services to such mobile taxpayers is zero, or close to zero, elasticity-based taxation could result in net gain for the state. If any taxes thus collected would be used to serve the entire population, and be distributed in a just manner, all of the constituents will be better off: not only mobile residents (who will now pay less tax) would benefit from the divergent taxation, but immobile constituents too stand to gain, too. Although the taxes collected from the mobile constituents are modest, they are still better than the zero amount of tax that would have been collected had the mobile taxpayers left. Whatever taxes are collected from the mobile will pay for increased public goods and services. Where, on the other hand, elasticity is low–as in the case of immobile taxpayers–there is no reason for the state not to collect higher taxes from them. The bottom line seems to be that if the state seeks to maximize the welfare pie, tax should be imposed in inverse relation to how elastic taxpayers are. This would mean that the most inelastic (i.e., immobile taxpayers) would end up paying the highest (coercive) taxes, while the mobile ones (with the greatest elasticity) will get a more lenient treatment.

When viewed from a strictly utilitarian perspective, the choice of such a regime - adjusting rates and rules to the elasticity of taxpayers' choices in order to attract as much revenue and benefit as possible - may seem like an almost inevitable strategy for states. But is it? Is the state free to choose among these strategies, or are there any normative limitations on the state when considering these options?

The answer, I believe, depends on the kind of social contract on which the state is based. Does the social contract follow (or rather should it follow) a utilitarian ideal of maximizing our collective interests (a market-inspired ideal)? Or is it about creating a community of equals (a membership ideal)?[7]

3. Tax Sovereignty at a Crossroad

These challenges for redistribution and for the principle of equal respect and concern dramatically undermine the state's centralized monopolization of the power of taxation and thus alter the relationships of states with their constituents. In this reality, states must decide whether to subject all of their constituents to similar rules and rates of taxation, irrespective of how elastic their choices of residence are, in which case they might lose the ones that are most mobile and wealthy. Pushing the wealthy away may limit the funds available for redistribution. Thus, by imposing equal tax rates and rules, states might be settling for a poorer society, yet less unequal. If, on the other hand, they choose to give weight to taxpayers' varying elasticities, they may enlarge the collective welfare pie, but risk undermining both the redistributive function of taxation *and* equal respect and concern for the immobile ones. Moreover, tailoring tax rules and rates to allow fragmentation may undermine equal respect and concern for the ones unable to unbundle their interactions with the state. Ignoring them may provide the latter with equal respect and concern, but disrespect other constituents by pushing them to make binary choices between staying and leaving.

The significance of this choice for state governance in tax matters cannot be overstated: it juxtaposes two very different ideal-types of state-taxpayer relationships: a utility-maximizing version of the state on the one hand, and a community of equals on the other. Under the first, states surrender to the rules of the market–and operate more like a utility-maximizing organization, which optimizes the tax revenues (and other benefits) they can collect from current and potential residents. To do that, they must give considerable weight to the elasticities of taxpayers' choice of jurisdiction. The result is that exit power prevails over voice and membership. Under the second, the state ignores

7. For more on this choice see Tsilly Dagan, 'Reimagining Tax Justice in a Globalised World' in Dominic de Cogan & Peter Harris (Eds.). *Tax Justice and Tax Law: Understanding Unfairness in Tax Systems* (Hart Publishing, 2020). Digital version available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3602678

such elasticities in the name of equal respect and concern and reinforces an equal membership system where one's belongingness to the state dominates her taxation, pushing her to make binary choices between staying or leaving and potentially undermining collective welfare.

4. Could multilateral cooperation provide an answer?

Given the state's fading coercive power in taxation and the challenges of fragmentation, we can no longer assume that ideals of justice can be realized within the parameters of the state. In many cases, it may be only through a cooperative accord that states could regain these powers. Cooperation thus becomes a promising way for states to regain legitimacy by sustaining their ability to ensure the collective action of their citizens and to treat them with equal respect and concern.

2021 has seen an impressive feat of multilateral cooperation when the OECD-initiated two-pillar accord was signed by almost 140 countries. The most promising part of this accord, entitled pillar two, proposes a 15% effective minimum corporate tax rate to be imposed on the biggest multinational corporations. Thus far, discussion has been limited to corporate taxation only, but a similar effort focused on personal income taxation, though extremely hard to apply, could conceivably be imagined. If successful (and that is, no doubt, a big *if*) a multilateral agreement - operating like a cartel-- could potentially support states' ability to redistribute wealth. Presumably, if states cooperated in imposing a cartelistic 'price' of taxation, they could resolve the tension between 'elastic' taxpayers and those left behind, preserve redistribution and limit price discrimination based on elasticity.

But even beyond the significant barriers to attaining such a cooperative solution, the multilateral arena raises additional concerns for justice - this time, global justice.

The reason is that the cooperative ideal, which sounds like an inevitably happy scenario that can serve the interests of all cooperating parties, is not necessarily desirable for all. In fact, despite a strong intuition to the contrary, (even) the fact that everyone agrees to the solution does not mean it is good for all parties. This is true not only in the obvious case where one is being coerced or tricked into an agreement. Even in the absence of deception or crude power of coercion, cooperation in itself is no assurance for serving the interests of the cooperating parties. Co-operative mechanisms in and of themselves may provide some actors (notably the ones setting the cooperative standard) with excessive power. While leveraging the collective power of the cooperating parties may be beneficial (e.g., in enforcing tax rules on MNEs, mobile resources and mobile taxpayers), it may also provide incentives for some actors to join the cooperative accord even if they would have preferred a different outcome (or no cooperation at all).

In fact, cases where cooperation harmed some of the cooperating parties is no stranger to international taxation. Throughout the years, cooperative accords in the international tax arena tended to promote the interests of developed countries, favoring them over those of developing ones, and at times even undermining the latter. Even seemingly innocuous instruments, such as treaties for the preventions of double taxation negotiated on a bilateral basis, tend to allocate tax revenues in favor of developed countries at the expense of their developing counterparts.[8]

Many have argued that the 2021 two-pillar accord is similarly tilted against poor countries. Thus, if not properly addressed, there is a risk that a similar flaw might plague future international tax agreements as well. This predicament has to do not only with the superior bargaining power that developed countries often enjoy in negotiating international pacts, but also with the network structure of many of these agreements, as well as the fact that the OECD often sets the agenda for multilateral moves.[9] Hence, caution is warranted in celebrating this achievement as inherently justified, or even as inherently desirable simply because it is co-operative.

But even if the international agreement proves to be beneficial for all the countries involved, is a pareto efficient solution, it should be reevaluated, with inter-nation equity and global justice considerations in mind. The current stage of international cooperation on tax matters is unprecedented. As many have observed, we are currently watching the emergence of a new international tax regime, that–if successful–will replace the 100-year old one initiated in the 1920's by the League of Nations. Some of the world's financial leaders have claimed that with this agreement we are entering the age of multilateralism in international taxation. If this is indeed the case, if we are seeing the formation a global tax community, we need to re-visit the question of what duties of justice such a community must adhere to in order for it to be legitimate.[10]

Global justice may demand that countries of the world, and members of the OECD in particular, abide by an active duty of justice towards poor countries or perhaps towards the poor of the world more generally, instead of simply complying with their bargained-for 'deal'. One need not be a cosmopolitan in order to acknowledge that 2021 represents a new level of international institutional cooperation on tax, one that imposes a duty of justice beyond national borders. The current level of cooperation, I claim, does not only allow countries to work together to maximize the global welfare pie, but also demands that the benefits of this cooperation be fairly allocated across the international community.

8. For more on this see eg, Dagan (n 2) 72–119.

9. For more on this see, *ibid* 142–184.

10. For a full analysis of application of the different approaches in political philosophy to international taxation see *ibid* 185–212.

Kevin E. Davis • Beller Family Professor of Business Law, New York University School of Law

Mariana Pargendler • Professor of Law, Fundação Getulio Vargas Law School in São Paulo (FGV Direito SP); Global Professor of Law, New York University School of Law

Contract Law Heterodoxy

There is an ongoing debate about whether contract law has any role to play in addressing economic inequality.[1] The orthodox view is that tax law ought to play the central role in combatting inequality while other areas of law should focus on narrower concerns such as economic efficiency or equality in exchange.[2] On this view, contract law can at most be used to address imbalances of wealth or power between parties to specific transactions, but not to help parties who are disadvantaged relative to other members of the broader society.[3]

In recent years there has been a resurgence of interest in heterodox approaches that allow bodies of law besides tax law to play a role in combatting inequality.[4] Several scholars have argued that contract law ought to be recruited into the battle,[5] resurrecting high-profile earlier debates among U.S. scholars.[6] However, so far, conversations about these heterodox approaches have focused on legal developments in North America and Western Europe. This is unfortunate because economic inequality is a pressing problem in other parts of the world, including in developing countries, some of which may be sites of important legal innovations.

In fact, there is a great deal to be learned about contract law heterodoxy from the jurisprudence of developing countries. There are prominent examples of courts and legislatures in Brazil, Colombia and South Africa openly using their control over the legal effects of agreements between private actors to influence the distribution of wealth. Attention to those heterodox developments promises to enrich the debate about the role of contract law in addressing economic inequality around the world.

We begin this essay by setting out the theoretical foundations of contract law orthodoxy and then discussing the possible objections. Next, we discuss examples of contract law heterodoxy drawn from our research on contract law in Brazil, Colombia, and South Africa. We conclude by discussing what these examples from the developing world might tell us about the viability of contract law heterodoxy in other countries, including more economically developed countries such as the United States or most members of the European Union.

1. The Foundations of Contract Law Orthodoxy

The orthodox view is that contract law generally is not and should not be concerned with the distribution of wealth in society.[7] Part of the underlying rationale is that contract law generally only comes into play when a person enters into a transaction. Moreover, people often alter their transactional behavior to avoid the effects of unpa-

1. This article summarizes arguments presented at greater length in Kevin E. Davis and Mariana Pargendler, "Contract Law and Inequality", 107 *Iowa L. Rev.* (forthcoming).
2. See e.g., Louis Kaplow & Steven Shavell, "Why the Legal System is Less Efficient than the Income Tax in Redistributing Income", 23 *J. Legal Stud.* 667 (1994).
3. In French law, for example, doctrines such as imprévision and lésion appear to reflect concerns about inequality of bargaining power and unfair exchange as between the parties to the contract rather than the overall distribution of wealth in society. Admittedly, systemic disadvantage may be correlated with factors, such as substantive unfairness or asymmetric information, that undermine autonomy, efficiency, or equality in exchange. Within the orthodox position, examples of judicial solicitude for disadvantaged groups may be explained by concern about whether enforcement will promote autonomy or efficiency or equality in exchange, rather than about systemic disadvantage in its own right. Nevertheless, it can often be difficult, in practice, to determine whether a certain form of judicial intervention for the benefit of the weaker party is attributable to orthodox or distributive considerations. Orthodox rhetoric may mask distributive objectives, and vice-versa.
4. Aditi Bagchi, "Distributive Injustice and Private Law", 60 *Hastings L.J.* 105, (2008); Daphna Lewinsohn-Zamir, "In Defense of Redistribution Through Private Law", 91 *Minn. L. Rev.* 326, 396–97 (2006); Hanoch Dagan & Avihay Dorfman, Poverty and Private Law: Beyond Distributive Justice (Working Paper, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3637034 [https://perma.cc/E854-RR2S]; Lee Anne Fennell & Richard H. McAdams, "The Distributive Deficit in Law and Economics", 100 *Minn. L. Rev.* 1051 (2016); Richard L. Revesz, "Regulation and Distribution", 93 *N.Y.U. L. Rev.* 1489, 1489 (2018); Colin Mayer, "The Future of the Corporation and the Economics of Purpose", 58 *J. Mgmt. Stud.* 887 (2021); Zachary Liscow, "Redistribution for Realists", 107 *Iowa L. Rev.* 495, 556–57 (2022).
5. Bagchi, *supra* at 125–30, 135–41; Rory Van Loo, "Broadening Consumer Law: Competition, Protection, and Distribution", 95 *Notre Dame L. Rev.* 211 (2019); Zhong Xing Tan, "Where the Action Is: Macro and Micro Justice in Contract Law", 83 *Mod. L. Rev.* 725, 728 (2020).
6. Anthony T. Kronman, "Contract Law and Distributive Justice", 89 *Yale L.J.* 472, 510–11 (1980); Bruce Ackerman, "Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy", 80 *Yale L.J.* 1093, 1197 (1971); Richard T. Ely, *Property and Contract in their Relation to the Distribution of Wealth* (1914).
7. John Rawls, *Political Liberalism: Expanded Edition* 267–68 (Columbia Univ. Press 2005) (assuming that it would not be "feasible and practicable" to preserve background justice through rules imposed on individuals); Trebilcock, *supra* note 20, at 97–101, 248–261 (arguing that contract law should not be used to address systemic inequalities in competitive markets); Hugh Collins, "Distributive Justice Through Contracts", 49 *Curr. Leg. Prob.* 49, 49 (1992) ("The general view seems to be that the law of contract does not embody as one of its aims the achievement of a particular pattern of distributive justice"); Robert E. Scott, "A joint maximization theory of contract and regulation", in *Research Handbook on Private Law Theory*, 22 (Hanoch Dagan and Benjamin C. Zipursky eds., 2020) ("The contemporary American common law of contracts has largely shed the varied purposes animating its English ancestor, including the pluralist values derived from equity's ex post perspective, in favor of the singular purpose of vindicating ex ante contractual intent"). Cf. Duncan Kennedy, "Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power", 41 *Maryland L. Rev.* 563, 586-588 (1982) (arguing that distributive motives are considered less acceptable than efficiency motives but more acceptable than paternalism).

latable contract law doctrines – for example, by adjusting the price term of the contract or refusing to contract altogether – while the strictures of other fields such as tax, property, and competition law are more difficult to avoid. The lack of comprehensiveness and ease of avoidance of contract law necessarily limit its effectiveness as a means of redistributing wealth.

If contract law is defined narrowly to include only the law applied in disputes resolved by civil courts, then its redistributive potential is even more limited. Contract law in that sense is only guaranteed to affect agreements between parties whose disputes are likely to end up in court if not resolved amiably, and does not apply directly to the enormous set of transactions in which lack of information or resources will keep the parties from resorting to the judicial system for enforcement of their rights.

Finally, there are special grounds for concern about having courts consciously seek to alter the distribution of wealth in society. In the Rawlsian tradition, such efforts arguably are only legitimate when pursued by elected officials, which judges often are not.[8] There are also pragmatic concerns about whether judges have enough information and expertise to predict the distributional effects of their decisions in contract cases on society as a whole, especially taking into account the complex set of factors that limit contract law's effectiveness.

The concerns about lack of comprehensiveness, potential for avoidance, limited judicial powers, legitimacy, information and expertise all support two propositions that are central to what we call contract law orthodoxy, one substantive and the other institutional. The substantive claim is that contract law ought to play little or no role in combatting economic inequality. The institutional claim is that, to the extent that contract law does feature in distributional initiatives, these should be explicitly delineated by legislatures as opposed to courts.

None of the concerns that underpin contract law orthodoxy have any bearing on whether contract law ought to be used to compensate for imbalances of information or power between contracting parties or to influence the relative effects of transactions upon the parties' welfare. Consequently, contract law orthodoxy is consistent with doctrines designed either to limit the effects of asymmetric information or market power during the negotiation of transactions or to limit unfair exchange. To be sure, there are bitter debates about whether fairness in either the negotiation or performance of contracts is an appropriate objective for contract law. But those internecine debates should not obscure the substantial consensus around contract law orthodoxy.

2. The limits of orthodoxy

Although the arguments in favor of contract law orthodoxy are compelling, they are not irrefutable.[9] If we assume that combatting economic inequality is a valid objective of public policy, then the next question becomes what are the best policy instruments for the task. The orthodox substantive claim that contract law should not be one of those instruments depends on the merits of policies that include contract law interventions relative to policies that do not involve contract law. The fact that there are important constraints on the effectiveness and legitimacy of contract law is not enough to rule out the option of resorting to contract law if other policy instruments may have their own limitations.

All of the alternative instruments for combatting inequality have important limitations. For instance, the theoretical benefits of comprehensive tax or land reforms might be unattainable in practice because reforms to those highly salient bodies of law must overcome various forms of legislative inertia and popular biases against redistributive policies. These types of laws are also susceptible to evasion and avoidance.

The institutional component of contract law orthodoxy rests on questionable assumptions about the lack of information, expertise and legitimacy (in relation to distributional matters) of courts. The amount of information and expertise that courts possess relative to legislatures seems likely to be contingent on institutional design. The relative ability of courts' and legislatures' to assess the overall distributive effects of interventions will depend on factors such as the qualifications and workloads of judges, court staff, and lawyers, as well procedures for gathering evidence, compared to the qualifications, workloads and information-gathering processes available to legislators.

The extent to which is legitimate for courts to address distributional questions may also depend on the choices that a society has made about institutional design. In jurisdictions where courts have constitutional mandates to protect economic rights it is difficult to avoid the conclusion that it is legitimate for courts to take into account distributional considerations. Even in countries whose constitutions only explicitly provide for judicial protection of civil and political rights, courts arguably have the authority to ensure that the distribution of wealth secures the economic prerequisites to enjoyment of non-economic rights.

Finally, the argument that distributive objectives are best secured through legislative as opposed to judicial institutions ignores the possibility that legislative institutions will be more susceptible than courts to democratically illegitimate forms of political capture that thwart distributive interventions.

8. Kevin A. Kordana & David H. Tabachnick, "Rawls and Contract Law", 73 *Geo. Wash. L. Rev.* 598, 623–624 (2005).

9. Kronman, supra at 508-510. This section also draws on refutations of the general argument that distributive objectives should be pursued exclusively through fiscal policy set out in Fennell & McAdams and Liscow, *supra*.

3. Contract law heterodoxy in developing countries

The theoretical objections to contract law orthodoxy are well known among scholars in developed countries but the case for deviating from orthodoxy has been undercut by a perception that heterodoxy has little practical appeal. There is a widely held view that contract law around the world has converged on orthodoxy.[10] Our study challenges this view by revealing important examples of contract law heterodoxy in Brazil, Colombia, and South Africa, three large developing countries.

Perhaps the most explicit endorsement of contract law heterodoxy can be found in the Constitutional Court of South Africa' decision in *Paulsen and Another v. Slip Knot Investments 777 (Pt) Limited*.[11] The main issue in the case was whether the interest a creditor could recover on a debt in arrears after the institution of legal proceedings but before the date of judgment should be subject to a rule that limited the amount of prejudgment interest a creditor could recover to the principal of the debt. The majority of the Court decided that the limit should apply. They acknowledged that limiting interest risked encouraging debtors to employ delaying tactics to prolong litigation but observed that allowing interest to accrue without limit during the pendency of litigation would prejudice debtors and inhibit their constitutional right of access to the courts. In the main judgment, Justice Madlanga explicitly based the decision on distributional grounds:

"We need to look at South Africa's socio-economic realities. A large percentage of the providers of credit are large, established and well-resourced corporates. On the other hand, although there may be what the dissenting judgment refers to as "stout-boned" credit consumers, it would be ignoring our country's economic reality to suggest that there is any comparison between these corporates and most credit consumers. To many credit consumers, who fall on the wrong side of this country's vast capital disparities, astronomical interest may mean the difference between economic survival and complete financial ruin. While in some cases creditors may lose money to inflation during litigation, this is very unlikely to have the same catastrophic effect on the creditor compared to what the accumulation of run-away interest will have on the debtor. If I were to be forced to make a choice between the two, it would be an easy one for me."[12]

And:

"It cannot be plausibly gainsaid that for our democracy to be meaningful, it is only fitting that those previously denigrated by racism and apartheid, confined to the fringes of society and stripped of dignity and self-worth must also enter the terrain of meaningful, substantial economic activity. Surely, our hard-fought democracy could not have been only about the change of the political face of our country and such upliftment of the lot of the downtrodden as the public purse and government policies permit. Entrepreneurship and the economic advancement of those with no history of being financially resourced must be given room to take root and thrive. This can hardly happen without finance. The sort of interest to which Oneanate exposes our legal system is deleterious to this necessary economic advancement."[13]

Contract law heterodoxy also features prominently in certain areas of contract law in Colombia. Colombia's Constitution, enacted in 1991, provides that regulation of the provision of public services should take into account the criteria of cost, solidarity, and, most notably for present purposes, income redistribution.[14] Contract cases typically reach the Constitutional Court through *tutela* claims, a type of action guaranteed by the constitution to protect fundamental rights against public authorities, as well as private parties in exceptional circumstances defined by statute.[15] While contract law disputes are generally subject to ordinary jurisdiction and remedies, *tutela* may be invoked by "subjects of special constitutional protection," such as the elderly, the ill, minors, the disabled, female heads of households, and persons earning less than the minimum wage.[16] Contract disputes potentially impinging on fundamental rights such as life, health or the vital minimum are thus subject to *tutela* claims and constitutional review.[17] In cases involving health insurance contracts the Court frequently applies constitutional principles to require expansions of coverage, whether by requiring renewal, barring termination or limiting exclusions. For instance, in one case the Court reversed a denial of health coverage for failure to disclose a preexisting condition and grounded its decision in part on "the protection of the fundamental right to the 'vital minimum' of persons in situation of vulnerability and manifest weakness."[18]

Colombia's Constitutional Court has also appealed to the fundamental rights to human dignity, life, health, and equality to limit a water company's ability to stop the pro-

10. See, e.g., Felipe Jiménez, "Against Parochialism in Contract Theory: A Response to Brian Bix", 32 *Ratio Juris* 233, 236 (2019) ("[T]here is . . . an important level of convergence in the legal texts of different Western systems of contract law" so that "diverse systems of contract law (at least in Western legal cultures, if not beyond) are structurally and functionally consistent").

11. [2015] ZACC 5.

12. *Paulsen* ¶ 66.

13. *Paulsen* ¶ 75.

14. Colombia Constitution, art. 367.

15. *Id.*, art. 86.

16. Gabriela Zarante Bahamón, "Constitutionalización y Protección de Derechos Fundamentales en el Contrato de Seguros", 45 *Rev. Ibero-Latinoam Seguros* 233, 236 (2016).

17. *Id.* at 239.

18. Constitutional Court of Colombia, Sentencia T-027-19, Jan. 30, 2019. For local commentary, see María Paula Gómez Sáenz & Gonzalo Jiménez Triviño, "Novedad Jurisprudencial: La Corte Constitucional Modificó el Precedente Jurisprudencial en Relación com Las Cargas de la Aseguradora Frente a La Declaração de Riego en El Contrato de Seguros", 19 *Univ. Stud. Bogotà* (Colombia) 211, 220 (2019) (describing the decision as highlighting the constitutional duty of insurance companies vis-à-vis persons of clear vulnerability and weakness).

vision of water due to nonpayment by "subjects of special protection."[19] The plaintiff in the case was a 54-year old woman who was the head of her household, physically incapacitated to work, and responsible for two minor sons. While the Court upheld the statutory provision permitting the suspension of supply as a means to promote the efficient, continuous, and uninterrupted provision of public services to all, it also determined that denial of water to subjects of special protection was disproportionate and, therefore, unconstitutional. The Court held that, in response to nonpayment, the company should investigate the credit situation of the user and negotiate payment agreements consistent with their ability to pay. If the payment obligations were still not performed, the company could limit the water supply to 50 liters per person.[20]

We also see heterodox tendencies in decisions from both South Africa and Brazil concerning the rights of people who default on agreements to pay for purchases of real estate in installments, a common practice in countries where financial markets are not well developed and so credit from financial institutions tends to be expensive. The South African Constitutional Court held that allowing the purchaser to cure the default and demand completion of the purchase was required by the constitutional values of "reciprocal recognition of the dignity, freedom and equal worth of others."[21] In Brazil, the Superior Court of Justice held that if consumers who agreed to purchase new homes in installments unilaterally terminated the agreements the construction company could retain no more than 10 or 15 percent of the amounts paid and could not recover either compensatory damages or contractual penalties. One interpretation of these decisions is that concerns about inequality and social justice led courts to effectively shift labor and real estate market risks from lower and middle-class consumers to construction companies.

We make no claim that heterodoxy is the dominant feature of contract law in any of Brazil, Colombia or South Africa. Not only are there many areas of contract law in these countries in which orthodoxy still prevails, but some of the initial heterodox moves were quickly followed by clear steps toward orthodoxy. In 2020, the South African Constitutional Court forcefully rejected the broader proposition that enforcement of a contractual term violates the constitutional right to equality merely because it will prejudice a member of a historically disadvantaged group.[22] In 2018, Brazilian construction companies successfully lobbied for legislation that permits construction companies to retain up to 50 percent of the amounts paid by defaulting installment purchasers.[23] In 2019, the Brazilian Congress enacted a "Law on Economic Freedom," which demands that the interpretation and enforcement of contracts favor economic freedom, respect the parties' allocation of contractual risks, and resort to judicial revisions only in an exceptional and limited manner, though the new rules are largely inapplicable to consumer contracts or other contracts with imbalances in bargaining power.[24] At any rate, these developments reflect ongoing contestation in South Africa and Brazil over the extent to which orthodoxy should prevail in contract law.

4. The global significance of contract law heterodoxy

It is no coincidence that the best examples of contract law heterodoxy we could find come from Brazil, Colombia and South Africa. These are three countries in which the limitations of contract law orthodoxy are especially obvious. First, all three countries are plagued by economic inequality that has proved stubbornly resistant to progressive fiscal policy. Based on the Gini index, South Africa is the most unequal country on earth while, along with Belize, Brazil and Colombia are the most unequal countries outside of Africa.[25] In the face of apparent failure of the tax-and-transfer system in fighting inequality, it is easy to see how judges and lawmakers might be tempted to experiment with alternatives. Second, all three countries' constitutional courts are well known for their embrace of "transformative constitutionalism," which starts from the premise that constitutional law should transform rather than simply reflect the society it governs.[26] Transformative constitutionalism fundamentally rejects the proposition that it is illegitimate for courts to consciously attempt to alter the distribution of wealth in society.

Although conditions in Brazil, Colombia and South Africa might be especially conducive to the emergence of contract law heterodoxy, lawmakers in other countries who are concerned about economic inequality would benefit from paying attention to developments in those countries. Studies of the impact of concrete heterodox initiatives may shed light on the relative effectiveness of redistributive policies that do and do not implicate contract law. At the very least, studying foreign initiatives can help to identify alternatives that might be worth investigating further.

19. Constitutional Court of Colombia, Sentencia T-740/11, Oct. 3, 2011.

20. *Id.*

21. Botha and Another v Rich NO and Others [2014] ZACC 11.

22. [2020] ZACC 13 [*Beadica*], ¶ 101.

23. Lei nº 13.786, de 27 de dezembro de 2018.

24. Lei 13.874, de 20 de setembro de 2019, Art. 1º, par. 2º, and Art. 7º (adding new Arts. 421 and 421-A to the Civil Code).

25. World Bank, https://data.worldbank.org/indicator/SI.POV.GINI?most_recent_value_desc=true

26. In Klare's words: By transformative constitutionalism I mean a long-term project of constitutional enactment, interpretation, and enforcement committed (not in isolation, of course, but in a historical context of conducive political developments) to transforming a country's political and social institutions and power relationships in a democratic, participatory, and egalitarian direction. Transformative constitutionalism connotes an enterprise of inducing large-scale social change through nonviolent political processes grounded in law. I have in mind a transformation vast enough to be inadequately captured by the phrase 'reform,' but something short of or different from 'revolution' in any traditional sense of the word. In the background is an idea of a highly egalitarian, caring, multicultural community, governed through participatory, democratic processes in both the polity and large portions of what we now call the 'private sphere.' Karl E. Klare, "Legal Culture and Transformative Constitutionalism", 14 *S. Afr. J. on Hum. Rts* 146, 150 (1998).

We also hope that attention to contract law heterodoxy in developing countries will spark interest in existing instances of embedded heterodoxy in developed countries. Consider, for example, the United States, where orthodox discourse in contract law is deeply entrenched. Laws that bar discrimination in contracting qualify as part of contract law, broadly defined, and are obviously designed to improve the welfare of disadvantaged groups. In the United States, those laws can be traced back to the Civil Rights Act of 1866, which was enacted in the aftermath of the civil war to improve the status of former slaves.[27] There are also important examples of U.S. laws that have had substantial distributive effects, even if that was not their stated purpose. In the 1930s, moratoria on enforcement of creditors' rights were used to protect struggling farmers. More recently, the regulations of credit card issuers found in the Credit Card Accountability Responsibility, and Disclosure Act of 2009 (the "CARD Act") appear to have had dramatic effects on the welfare of consumers, and particularly the worst off.[28] The same appears to be true of moratoria on evictions and foreclosures adopted in response to the COVID-19 pandemic.

The challenge that these examples pose to contract law orthodoxy should not be underestimated. Sometimes these types of legal interventions are dismissed by narrowing the definition of contract law to exclude antidiscrimination law, crisis-driven interventions, or legislation focused on specific markets. These discursive moves make it easy to dismiss examples of contract law heterodoxy as isolated products of power politics rather than examples of principled efforts to combat inequality through contract law that may be worth expanding and systematizing.")

In the fight against inequality, the role of contract law should be part of the conversation. Academics and lawmakers around the world may find it instructive to study and learn from initiatives in developing countries. This is unlikely to be the only area in which incorporating contributions from developing countries will enrich conversations about the role that law ought to play in the governance of the economy.

27. Act of April 9, 1866, ch. 31, 14 Stat. 27 (reenacted by Enforcement Act of 1870, ch. 114, § 18, 16 Stat. 140, 144 (1870) (codified as amended at 42 U.S.C. §§ 1981-1982 (1987)).

28. Sumit Agarwal, Souphala Chomsisengphet, Neale Mahoney & Johannes Stroebel, "Regulating Consumer Financial Products: Evidence from Credit Cards", 130 Q.J. Eco.111, 114 (2015).

Emmanuelle Barbara • Senior Partner, August Debouzy

Deflagrations in the Universe of Labor Relations

Flashback

The labor society as it has been known for more than twenty years has left the shores of the 20th century and is trying to reach those of the 21st - the least we can say is that the latter are shrouded in mist, and even fog, for one needs to face up to the crumbling of the concepts and categories that served as a basis for its contemporary construction.

Nevertheless, it was necessary to settle on a definition of labor for economic agents. According to sociologist Marie-Anne Dujarier,[1] this polysemous word, with no less than 98 synonyms, serves as a generic noun designating an indefinite tangible thing, as well as a subject followed by a verb, as if labor were animated by intention ('labor is fulfilling') or endowed with a capacity for action ('labor is a source of suffering'). In any case, labor designates 'a spectacular diversity of tasks and occupations'[2] and says nothing about the status of those who undertake it.

In the labor society rebuilt in the middle of the 20th century to serve first the civilization of the factory and then that of the office, labor, understood as a productive economic activity, designates not so much a content as a protected status for those who engage in it. Therefore, the permanent employment contract, described as the 'normal form of labor' in French law,[3] is the cornerstone of the labor society and of employment policies. The permanent employment contract, which is not defined in the French Labor Code, has been for its holder the effective receptacle of a promise of stability and of compulsory and complementary social protections, in return for accepting the subordination link imposed on him. This founding category distinguishes those among the working population who, as holders of a permanent employment contract, have full access to social recognition and to the advantages of the model in terms of access to credit and housing. The fulfillment of this promise has contributed to the structuring of a stable society, behind the walls of the company, within a strong corporate culture where company-level collective bargaining entrusted to the unions offer more favorable arrangements than the law and the branch collective agreement for the benefit of all the company's employees, whether or not they are members of the union or unions. In this context, citizen-employees were able to have a 'passport for life',[4] as Thierry Pech nicely describes it, allowing them to build a long-term life project.

France still has nearly 80% of its workforce in salaried employment. But they are no longer all holders of a stable, i.e. full-time, permanent contract. The use of other, atypical forms of employment contracts has developed and refers to anything that deviates from the norm. This is the case for fixed-term contracts and part-time work contracts, as well as for all State-subsidized contracts. In the course of a succession of economic crises, the term 'precarious employment contract' has gradually come to designate not so much the legal form of the relationship as its abnormal nature. A distortion has been created between these different categories of employees, where the 'insiders', sheltered from the vagaries of the order book and having a long-term job guarantee, are distinguished from those who are employed without these guarantees. It is indeed upholding these boundaries between these types of workers that the promise of stability could be maintained for the benefit of insiders.

Another boundary, separating employees and non-employees, used to seem clear. The latter were listed in clear initial categories, those of craftsmen, tradesmen, liberal professions and (some) company managers. In principle, the French Labor Code is not concerned with the regulation of their activities, but over time and because of the attractiveness of the status of employee, numerous presumptions of employment contracts were added (models, performers, etc.). At the beginning of the century, new border crossings towards salaried status were encouraged. One can convert a contract for the provision of services into a contract of employment for the benefit of the service provider by using the technique of '*portage salarial*';[5] one can also propose a model of cooperative regrouping 'entrepreneurial employees';[6] one can also refer to groups of employers, allowing people to enjoy

1. For a fascinating analysis of the notion of labor see, M.-A. Dujarier, *Troubles dans le travail, Sociologie d'une catégorie de pensée*, PUF, 2021.
2. *Ibid.*
3. Art. L. 1221-2 of the French Labor Code: "the employment contract of unlimited duration constitutes the normal and general form of the employment relationship" (free translation).
4. See, T. Pech, *Insoumissions. Portrait de la France qui vient*, Seuil, 2017.
5. Law n°2008-596 of June 25, 2008 on the modernization of the labor market, art. L 1251-64 of the French Labor Code.
6. Law n°2014-856 of July 31, 2014 on the social and solidarity economy, art. L 7331-2 et seq. of the French Labor Code.

the status of employees,[7] which secures their situation, while sharing their activity for the benefit of its members according to their needs.

In the last century, the physical boundaries in the world of work were also clear. The company was then the place of production protected and reserved for employees, clearly distinguished from the outside world. It was also the space where the working time was passed, while personal time was supposed to be sealed off. In addition to the distinct moments marking the timeline of daily life, the cadence of the entire life was established in three stages, that of initial training, then that of work in the company (i.e., in a stable job), and finally that of retirement.

The employees were themselves organized into categories, ordered within the company according to a classification that controls progression and careers in a linear fashion. The collective agreements trace this classification effort and provide for rights that increase with seniority. This legal construction was possible over the long term and reflected the state of mind of employees who were rather impervious to any injunction to move. The law encouraged them to do so, including in terms of training, since the obsolescence of knowledge was not reached in the course of a career.

Of course, after the *Trente Glorieuses*, this picture no longer corresponded to the challenges brought about by the succession of economic crises. A combination of disruptive factors has had a profound impact on this arrangement. Globalization has favored relocation policies ('stock market layoffs'). The financialization of the economy has, among other things, influenced the way companies operate through massive recourse to subcontracting or outsourcing. These different factors have influenced the French reforms of collective labor law since 2004[8] in the direction of greater flexibility[9] and, ultimately, a withdrawal of the scope of the law, which, apart from public policy provisions, is limited to completing the gaps of company-level agreements. Nevertheless, these changes must now be seen in the light of other causes of complexity arising from the gradual evaporation of the walls that held the structure together.

Two essential parameters have been shattered, the effects of which are perceptible in the work society: the relationship to time is no longer stable, and boundaries have given way to time compression and porosity. Instability has become the norm,[10] and the injunction of permanent adaptation is imposed on everyone. The company becomes a place that opens up to statuses other than employees, it can attempt to create boundaries not inside but outside of itself by organizing half-virtual, half-tangible marketplaces, work and private activities can coexist without drama, the places dedicated to work within the company are no longer exclusive. Not only time, but also status is blurred. The employee status no longer really responds to the univocal definition of vertical subordination, considering the apparent efforts to limit this duty of obedience for the sake of autonomy. As for the self-employed worker, the fact that he is economically dependent on his principal explains the desire to qualify him as an employee, contrary to the principles of the *Bardou* decision,[11] which rejected this criterion in favor of the sole criterion of the subordination link.

Technologies with a strong impact on our personal and professional lives have imposed themselves on all human activities, from consumption to interactions with others. As a result, the individual questions her own 'relationship to work' and seeks to control her destiny without abdicating the fullness of her rights as a person and no longer as a simple worker. The quality of life at work, the meaning, the social and environmental impact and the values deployed by the company have become major factors of engagement. A fertile ground for a substantial evolution of the contemporary conception of the individual at work is underway.

With the technological revolution and the emancipatory aspirations claimed by the individual, the role of the company in society is changing. It is no longer a simple productive agent designed to make profits. The company is opening its doors to the challenges of the time, from the energy transition to social action, inflections illustrated among others in France by the French duty of vigilance.[12]

A new arrangement of our work society is at work: lacking clear boundaries, marked by the quest for individualization of needs and correlatively of job offers, it proposes heterogeneous situations and multiple organizational modes, far from the codes of the past. The flexibility gradually giving way to fluidity would be a radical break with our traditions and would not be devoid of risks of difficulties or injustices.

1. Deflagrations

1.1. The emergence of platforms

The irruption of the service platform undeniably disrupts the functioning of the normal labor markets, and undoubtedly foretells unprecedented changes.

'A strange job': the use of service platforms for self-employed workers has provided an unprecedented and unex-

7. Since the law of July 25, 1985, several legislative evolutions until the law n°2005-882 of August 2, 2005 in favor of small and medium-sized enterprises which allowed its constitution in the form of a cooperative company and the law n°2016-1088 of August 8, 2016 relating to work allowed the access of these groupings to the benefit of aid in terms of employment and professional training.

8. Law n°2004-391 of May 4, 2004 on lifelong vocational training and social dialogue, which opened up the possibility of negotiating overriding collective agreements, even unfavorable ones under certain conditions.

9. Most recently, law n°2016-1088 on labor, the modernization of social dialogue and the securing of career paths of August 8, 2016 and the five Pénicaud ordinances of September 22, 2017 designed to free up energy and protect employees.

10. See N. Colin, *Hedge - A greater safety net for the entrepreneurial age*, CreateSpace Independent Publishing, 2018 for a contemporary and technological history of work.

11. Cass. civ. July 6, 1931, D. 1931, 1, 131.

12. Law n°2017-399 of March 27, 2017 on the duty of care of parent companies and ordering companies. It applies to groups and companies meeting threshold conditions. Its purpose is to prevent social, environmental and governance risks, related to their operations by extending to the activities of their subsidiaries and their subcontractors and suppliers.

pected outlet for the instigators of the *autoentrepreneur* status created by French law no. 2008-776 of August 4, 2008. At that time, the very principle of the service platform was not known. The most symbolic and most contested in principle, despite their undeniable success with consumers, are undoubtedly Uber, which was implanted in France in December 2011, and Deliveroo in 2015. Since 2009, the number of self-employed entrepreneurs has continued to grow to reach almost two million in July 2021,[13] with a notable increase even in 2020 (+4% compared to 2019).[14] Even better, INSEE statistics of December 15, 2021[15] show a record number of business start-ups over the first eleven months of 2021, which already exceeds the previous year's record. An increase of 19% in the number of business start-ups is recorded and in the raw data, the share of micro-entrepreneurs in the total number of businesses created stands at 64.5%. For their part, 'platform workers' in France should not represent more than 1%[16] of the 12.4% of self-employed workers (but no precise data is offered in support of this figure), which is not really followed by public data but which suggests a very substantial increase if we take into account the evolution of the number of the 'new self-employed'.[17]

These intermediation platforms, a 'market-company hybrid'[18] that disrupts the boundaries of the company by substituting a commercial relationship for a labor relationship,[19] address the entire spectrum of economic life, regardless of the quality of the user (employee or not). From e-commerce, social networks, content production hosting sites (Youtube), service exchanges where everyone is in turn a producer and/or consumer of services (Blablacar, Airbnb), or B2C or B2B employment platforms. It is these so-called service platforms that are the focus of attention. The economy of networking platforms,[20] surfing on the technological and sociological evolutions of the time, invests as much in the 'knowledge economy' by targeting the 'freelancers' of the IT intellectual services sector - independent consultants with high added value (Malt, Upwork and dozens of others) - as in the expanding sector of mobility, where the most lively polemics are concentrated as to the true nature of the legal relationship, or even in the social and solidarity economy. For this last sector, it should be noted that thanks to the inclusion in the law[21] of a 5th category of structures for professional integration through economic activity (*structures de l'insertion par l'activité économique* or SIAE), we have come to recognize, on an experimental basis, the enterprise for professional integration through self-employment (*entreprise d'insertion par le travail indépendant* or EITI).[22] The idea that self-employment can be a vector of professional inclusion in place of an employment contract marks a notable cultural evolution, if not a break, to the point that the president of the federation of professional integration enterprises has indicated that EITI is not necessarily synonymous with increased precariousness.[23]

As for the thorny question of the true nature of the legal relationship between professional users of these platforms and the latter, recent analyses remain cautious.[24] This question, which is rich in fundamental political and legal dimensions that have not been sufficiently explored in rational debate, gives rise to opposing ideas over the best course of action, considering that the development of employment outside the employment contract affects low-skilled professional categories. It will be necessary to either impose the single model of an 'all salaried employment' (automatic requalification by the judge or by the force of the law, which would assimilate these activities to salaried employment) or alternatively to create a presumption of salaried employment according to certain fixed criteria (draft European directive of December 9, 2021), or to reinforce the autonomy of the self-employed while entrusting to a form of labor bargaining, modelled on that of salaried employees, the task of organizing the protections for the benefit of the self-employed.[25] French legislation, for the mobility platform sector alone, has chosen the latter option,[26] while case law concerning the recognition or denial of a subordination relationship, regardless of the jurisdiction, offers a variety of decisions that are difficult to reconcile, due to the assessment of the bundle of evidence, the cursors of which vary from one decision to another,[27] with a recent extension before

13. URSSAF observatory published on July 23, 2021: an increase of 17.5% compared to 2019! For 16 billion euros, or +0.8% compared to 2019.

14. INSEE n°1837 published on February 3, 2021.

15. *Informations rapides* n°318 published on December 15, 2021.

16. French Senate Social Affairs Committee report on platform workers of May 20, 2020.

17. Roland Berger 2018 mentions 405,000 freelancers in France and 1.04M new independents.

18. A. Casilli, *En attendant les robots, Enquête sur le travail du clic*, Seuil, 2019.

19. *Les nouveaux intermédiaires du travail B2B*, Rapport d'études, Dares, March 2022, n°27, p. 4.

20. For an attempt to identify the "categories" of online platforms, see the Montaigne Institute's report, Platform Workers, Freedom Yes, Protection Too, April 2019.

21. Art. 83 of the French law n°2018-771 of September 5, 2018 for the freedom to choose one's professional future.

22. 19 EITIs recognized in June 2021, with another 40 to follow, which led to the extension of the experiment until December 31, 2023. Lulu dans ma rue is the first company to be recognized.

23. www.lesentreprisesdinsertion.org/presse/entreprises-dinsertion-par-travail-independant-cap-vers-prolongation-lexperimentation

24. For example, the Frouin Report of December 1, 2020, entitled "Réguler les plateformes numériques de travail" rules out the hypothesis of creating a third status and just as much the legal recognition of the employment contract because not all platform workers are in the same situation of economic dependence, which would exclude this qualification for them, p. 36. French National Digital Council, *Travail à l'ère des plateformes* Update required, 2020. Information report by Mr. Forissier, Ms. Fournier and Puissat, Social Affairs Commission, No. 452 *Travailleurs des plateformes : au-delà de la question du statut, quelles protections ?* - May 20, 2020.

25. Françoise Favennec-Héry, "Les frontières de l'emploi : des évolutions ?", *La Semaine Juridique Social* n°14, 12 April 2022, 1105.

26. Law n°2019-1428 December 24, 2019, Ord. n°2021-484 April 21, 2021, Law n°2022-139 February 7, 2022 and Ord. n°2022-492 April 6, 2022 reinforcing the autonomy of self-employed workers of mobility platforms and organizing the sector social dialogue.

27. See e.g., Uber Cass. Soc. March 4, 2020 n°19-13.316, contra Uber CA Lyon January 15, 2021 n°19/08056, Deliveroo CA Paris June 22, 2021 n°19-03685 (requalification), contra Deliveroo CA Paris April 7, 2021, n°18/02846 or CA Paris, February 15, 2022 n°19/12511. Le Cab (refusal to requalify) Cass. Soc. 13 April 2022 n°20-14.870, Click and walk (refusal to requalify as concealed work) Cass. Crim. 5 April 2022 n°20-81.775. For a mapping of the main decisions rendered worldwide, see: I. Beltran de Heredia Ruiz, « Employment status of platform workers: national courts decisions overview», Blog de Derecho del Trabajo y de la Seguridad Social, accessed on 21 April 2022.

the criminal court, based on alleged concealed work[28]. It is obvious that the legal security of the French status of *autoentrepreneur* for the accomplishment of activities proposed by some platforms is undermined.[29] However, despite all the efforts that could be made to strengthen the contours and guarantees of any contract for the provision of services with platforms, in particular under the European Platform to Business ('P2B') regulation, which came into force on July 12, 2020,[30] no legal provision will ever guarantee that such a contract for the provision of services could not be reclassified as an employment contract.

A disturbing development: if one could observe since 2017[31] the extension of the platformization of the economy and its unstoppable character, there is a growing fear that such an eruption of the figure of the platform worker adopting the self-employed status will contaminate the field of what would naturally fall under employment relationship. This evolution is already at work in the B2B intellectual service sector (IT, digital, marketing, design) where digital technologies and the networking of 'freelancers'[32] could lead to unprecedented outsourcing, blurring the boundaries of the company.[33] While claiming to preserve the legitimate development of platforms offering activities to freelancers – which should not be stifled – it is important that the legal qualification of these relationships be better ensured and that the protections of freelancers be better distributed. France has equipped itself with a legal arsenal to begin regulating platforms that put people in contact with each other.[34] It has focused on regulating the mobility sector (VTC/delivery),[35] leaving aside the others, perhaps because it is not possible to understand all the others through this prism or because the controversy over status is less eruptive there. An original approach has been chosen, that of organizing a collective representation of drivers and delivery personnel, empowered to negotiate with the organizations representing the platforms – an eminently complex and delicate subject – on mandatory topics concerning the determination of income, skills, working conditions and the prevention of professional risks. It will be necessary to adapt Article 101 of the Treaty on the Functioning of the European Union (TFEU), which prohibits concerted practices between companies with the aim of restricting or distorting competition. But this is a manifestation of the transgression of the traditional boundaries between employees and self-employed. France's choice regarding mobility platforms, which differs significantly from that of other European countries,[36] constitutes an unprecedented means of regulating a completely new sector which, while borrowing from the collective bargaining of employees, does not alter the principle that the relationship partakes to the world of the self-employed and commercial law.

On December 9, 2021, the European Commission presented a draft directive on platform workers following the resolution of the Parliament in Strasbourg on September 16, 2021.[37] The European Union currently counts 28 million platform workers and projects that they will be 43 million by 2025 – that is, tomorrow. Among them, 5.5 million people would be wrongly classified as self-employed today.[38] The key measure of this draft directive is the introduction of five control criteria to characterize, but only as presumption, a subordination relation - the characterization of any two of them presuming the platform to fall in the ambit of the employment contract vis-à-vis the professional. This presumed employer will be entitled to challenge the presumption, but the burden of proof will be on him. It is a question of harmonizing, within the Union, the approach to a major economic and legal fact, sensitive and highly controversial everywhere, which destabilizes the traditional legal order distinguishing employees from non-employees,[39] while noting that these singular workers borrow characteristics from both categories.

1.2. Disruption in the employee universe

'A strange universe of labor': another phenomenon has come to strike the universe of the salaried worker brutally and massively: the compulsory teleworking, imposed since 2020 during the successive lockdowns. Work invites itself at home on a compulsory basis, in the places as they are, in the family context as it is, with the technological means as they could be anticipated, stirring up at once distortions of individual professional situations by the mechanical effect of the injunction imposed on the whole nation. In terms of borders, ours have been drastically reduced, starting with the right to transport ourselves outside the confines of the home. The importation of the professional world with all its

28. Trial from March 8 to 16, 2022 in the Paris Correctional Court prosecuting Deliveroo and two executives for concealed work. The judgment of April 19, 2022 condemns the platform and two of its managers for concealed work for the period 2015-2017. An appeal has been filed by the defendants.

29. With a tendency to consider that the self-employed in the high-value-added knowledge economy would be somehow excluded from the legal status controversy. See French Senate Report 2020, *op. cit.*

30. Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services.

31. For example, 2017 Annual Study of the Conseil d'Etat, Puissance publique et plateformes numériques : accompagner l'ubérisation, https://www.vie-publique.fr/rapport/36918-etude-annuelle-2017-du-conseil-etat

32. The status corresponds either to an *autoentrepreneur* or to a simplified business form such as SASU and seen as an emerging form of new employment.

33. Dares study report, March 2022, *op. cit.*, p. 6.

34. Art. L 7341-1 et seq. of the French Labor Code from the aforementioned law of August 8, 2016, art. 242 bis of the General Tax Code and art 111-7 of the Consumer Code on the definition of a platform.

35. Loi d'orientation des mobilités of December 24, 2019 n°2019-1428, ordinance n°2021-484 of April 21, 2021 relating to the modalities of representation of self-employed workers using platforms for their activity and to the conditions for exercising this representation, law n°2022-139 of February 7, 2022 ratifying the above-mentioned ordinance.

36. Spain chooses the status of employees for platform workers, the court of Milan has proceeded to the massive reclassification of several platforms, the United Kingdom classifies Uber drivers as workers while a Court of Appeal has maintained the qualification of self-employed for Deliveroo delivery drivers.

37. Draft directive on 'working conditions, rights and fair social protection for platform workers - new forms of employment linked to digital development'.

38. European Commission press release of 9 December 2021.

39. Except for the United Kingdom, which also distinguishes workers, corresponding to economically dependent self-employed people.

inherent constraints has also constituted, for some people, at least for a while, a virtual window on the outside world, by accomplishing a useful activity, the company having become a deserted place, but one still standing. We have experienced a complete inversion of the paradigm where work and personal life were supposed to coexist. With its ups and downs, psychological health has been put to the test, especially due to the imposed isolation and pressures that are sometimes difficult to overcome. However, it must be noted that the loosening of the stranglehold of the pandemic and the regained freedom of movement have not led to the rejection of this work modality.

A disturbing development: the data collected on this vast experiment are still provisional, but it is a real revolution in work models, whereas until now it was only seen as an embryonic mechanism.[40] The impacts on the organization of work go beyond the strict question of the place of professional practice. This experience has proven that salaried labor based on the unity of time, place and action could no longer really prosper. Leaving in its wake a 'scattered company', remote work, if it became a fixture outside of constraints of health or other nature, would lead to disruptions in whole areas of the French Labor Code, from the calculation of working time to policies for the prevention of physical and mental health issues.[41] The figure of the autonomous executive, benefiting from the system of fixed working days, should be extended to teleworkers. If they are not legally autonomous, the rules of supervision and control would be in contradiction with the philosophy of teleworking. All publications on remote work since the beginning of the pandemic refer to trust, a rather new notion or virtue as a management principle. If control and trust are to coexist in this mode of activity, the definition of the subordination relationship could be affected. Already, the activity entrusted to remote work is more likely to be expressed in the form of assignments with an expected result and a deadline, which are characteristics of services provided by a service provider. It follows that, without the condition of presence on a professional site, and thanks to digital tools that increase the capacity for action, the legal link with a single employer could appear insufficiently optimized. In other words, from the employee's point of view, the experience of remote work promotes self-employment and stimulates the entrepreneurial spirit that many workers claim to have, to the point of predicting the advent of multi-activity combining several jobs and several statuses in the same day.[42] On the corporate side, given the management difficulties that the experience gives rise to, it could be a catalyst for accelerating the platformization of certain services.[43]

40. 4% of employees were teleworking in 2019 compared to 27% in January 2021. And 8 out of 10 teleworkers wish to continue it for periods varying between one and five days, Dares, *Télétravail durant la crise sanitaire*, February 2022, n°9.

41. According to a February 25, 2022 Dares study, according to 27% of companies, the majority of employees aspire to telework more, *Activité et conditions d'emploi de la main d'œuvre pendant la crise sanitaire Covid-19 en janvier 2022*, February 25, 2022.

42. Future of Work, 'Comment travaillera-t-on en 2035 ?', Onepoint study, *March* 2022.

43. Interview with J.-E. Ray, 'Ne tuons pas l'élan du télétravail', *Zevillage.net*, 3 September 2020: https://zevillage.net/teletravail/ray-ne-tuons-pas-lelan-du-teletravail/

1.3 Features common to these two explosions

A first common feature of the irruptions disrupting two distinct universes is the obvious: digital technology has a profound impact on the way we act, interact, and even conceive of work.

Another common point is that remote work as a mode of salaried work, as well as the use of services intermediated by digital platforms, are becoming firmly established in lifestyles and creating new habits. In both cases, the pandemic has amplified these practices and revealed their irreversible nature. As far as platforms of all kinds are concerned, everything indicates that they have flourished during the successive periods of lockdown, with remote work having amplified the use of home delivery[44] or the expansion of online work in all sectors.[45]

In times of crisis, service platforms and constrained teleworking emerge in a legal context that is poorly regulated or in the process of being developed, thus revealing the respective shortcomings of the systems. Remote work and access to customers rather than to an employer are globally perceived positively as a promise of emancipation, liberating energies, according to a famous expression, and allowing individual control of one's own life. However, each of these technological innovations raises complex legal issues and potential new sources of injustice. Regarding remote work, not all jobs are concerned – we are talking about a third of the current total – which constitutes a difference in nature creating a new border between those who can do it and those for whom this option is closed. For the workers of certain platforms, particularly the least qualified, the use of the status of self-employed entrepreneur can be interpreted as an expression of circumvention of the rules on the employment contract by the said platforms acting as employers.[46]

Beyond platform workers, it remains that, schematically, the supply of work as built by our social model is expressed as a trade-off between freedom and risk-taking (self-employment), or integration into an organized service in exchange for protection (employment). And this equation is not favorable to self-employment, even if the status of employee is not favored either (see below). Hence the relevance of a hybrid formula allowing each worker to combine these two statuses for distinct activities.

In the current state of our model, these recent developments have in common the risk of isolation, fatigue or atomization of people. But caring for health in the world of labor is one of the essential requirements, whatever the status of the worker, which the experience of the pandemic has made indisputable.

44. Particularly home delivery platforms: Metapack 2022 e-commerce delivery report (online sales are expected to account for 28.2% of total non-food sales by 2025). As for home meal delivery, the market was growing 47% between 2018 and 2020.

45. The Online Work Index (OLI) accelerated from mid-2020 to May 2021 globally (+44%), which an ILO webinar confirms with 5G deployment.

46. See, P. Robert-Diard 'Au procès Deliveroo, un réquisitoire implacable', *Le Monde*, 18 March 2022.

These new work experiences show the extent to which they are part of an individualized relationship, as if only the service contract or the employment contract governed the interactions between the professional and the legal entity, outside of any collective context. In all cases, however, there is a collective. The long-term viability of these hybrid jobs, in the way they are performed or in the status of their holders, depends on the creation or maintenance of new types of collectives or solidarities compatible with the configurations in which the work is performed. This necessary collective process of consultation is at work in the field of mobility platforms,[47] and inventing a specific HRD for the management of corporate freelancers[48] is nowadays suggested. We strayed far away from the distinct boundaries between employee and non-employee acting outside the company.

The time has not yet come to evaluate the impacts of these developments on the development of the productive society. But it is clear that these social, societal, economic and legal changes will require new legal or contractual regulations to facilitate the peaceful coexistence of several modes of production reflecting a vast heterogeneity of situations or conceptions of labor. This is why, in the face of these new split careers favoring the choice of multi-activity or activity succession, its follow-up could be listed in a future 'personal protection account' developed around the figure of the Personal Activity Account found in the French Law n°2016-1088 of August 8, 2016 on labor, the modernization of social dialogue and the securing of professional paths. Extending the contemporary exploration of the personal account, like the personal training account or the time savings account, this Personal Activity Account could be the interconnected receptacle of all the rights acquired as an employee (time savings, employee savings, retirement) and/or as a non-employee (professional training, unemployment rights, health and supplementary retirement ...) allowing its holder, whose legal status varies over time, to organize, to steer by arbitration his rights, according to his professional projects.

In any case, this is the end of the economic and social functioning of a labor market that responds to a monolithic representation of the company and of the accomplishment of work, regulated by an undifferentiated management standard applied to employees previously melted down and listed according to a classification adopted by branch.

2. Emergency in the employee world

If public attention is grabbed by the phenomenon of platforms or, more broadly, the craze for entrepreneurial activity, it is nevertheless in the world of employment relations that everything is changing. Let's make no mistake about it: between the weariness of the subordination link, the health crisis, and the efficiency of communication technologies, the evolution of the employment relationship and its modes of expression must be at the center of reflections, much more than the status of platform workers, which is, at worst for the moment, only an irritant in a labor society designed for the open-ended employment contract. The challenge is to keep the employment relationship as enviable as it has been in the past.

2.1 The ongoing inclusion of the self-employed in the social model does not solve everything

If the characterization of the statuses applicable to workers has been an essential legal issue in the past, one must ask whether this is still the case: would not the essential issue lie in redefining access to social rights open to the working population and their financing, whatever their status?

This process of better harmonization was initiated a few years ago. Maternity for employed and self-employed women lasts the same number of weeks. The rights in kind of coverage for sickness are identical. The French social security system for the self-employed workers (the 'RSI') was joined to the general system. Recently, in the law on the financing of social security for 2022,[49] the principle of complementary social protection by collective bargaining (health, death, disability, retirement) for platform workers was enacted as of January 1, 2023. The law on the self-employed of February 2022[50] provides for a modification and simplification of the unemployment scheme for the self-employed, the self-employed worker's allowance being increased and its obtention facilitated.[51]

Even if the reasons for requalification into an employment contract could be reduced thanks to a harmonization of social benefits for all, holding a salaried job or offering one's services as a self-employed person is a choice of life and action. No one would aspire to a single fuzzy legal status, half-subordinate, half-autonomous, falsely justifying an attraction to the status of salaried employment. It will be necessary to find a distinct legal expression for each of these statuses, considering the evolution of the subordination link which, for reasons of attractiveness of the wage-earner, must be recast into something else.

2.2. Work in the employment world must be reconceptualized

The last two years have clearly changed the relationship to work. Questioning its place in one's life is no longer taboo; it is called the 'relationship to work'. It is up to work to adapt to the priorities of the individual and not the other way around – at least that is the hope of certain categories of workers today.

The fate of the employment relationship and of collective relationships must be rethought in the current

47. See above the legislative elements on the negotiation and social dialogue of platforms.

48. Bertrand Moine, co-founder of Digital Village, proposes the creation of an FRM (freelance relationship management) to provide human support for the "integration of freelancers", Dares Report, March 2022, *op. cit.*, p. 55.

49. Law n°2021-1754 of December 23, 2021 on the financing of social security for 2022.

50. Law n°2022-172 of February 14, 2022 in favor of independent professional activity.

51. See draft decree on the allowance for self-employed workers, draft decree on the amount of the allowance for self-employed workers, transmitted on March 8, 2022 to the CNNCEFP, Liaisons sociales, March 11, 2022, n°18508.

context. Social networks irrevocably modify the place and the relationship of the individual to information and invite him to express his opinion, perceived by himself as useful or necessary to any debate, whatever the private or public forum where he expresses himself. The result is a profound change in personal and professional interactions. The social networks used by employees or professionals in a given sector are changing the way they interact with each other, especially on a collective level, in a new form of ‘community of interest but not of work’.[52] Sometimes internalized, these corporate social networks are multiplying; vectors of fluid communication offering a broader vision of the company,[53] devoid of any hierarchical markers, they serve to organize a more collaborative work where best practices are discussed, or allow to agglomerate direct but punctual or very targeted claims.

The Covid-19 crisis has weighed on the morale of citizens and led to the worrying observation of ‘a tired society’.[54] The feeling of individual powerlessness at work competes with discouragement, which ‘dries up the moral foundations of commitment to the point of mutilating the person in his or her essential convictions’,[55] ‘its perception increasing as individualization in society strengthens’.[56]

When employees make personalized demands, the company must take them into account but preserve social cohesion. The introduction of telework, or ‘hybrid’ work, which involves an organization that intersperses periods outside the company (telework varying from 1 to 3 days on average) and on site (‘face-to-face’), is an illustration of an *à la carte* adaptation of work methods. The hybrid execution of work raises real and complex management issues which may create discriminations against teleworkers, and even towards employees who do not use it. In these conditions, faced with the difficulty of setting up a hybrid mode of operation, many companies prefer to impose a return to the workplace. It is therefore not certain that hybrid work will become the norm when telework is completely free of the pandemic-related fears, as it is so difficult to set up and not without risks for the individuals or the company.[57]

The company is confronted with a profound evolution of the modalities of consultation, adhesion and negotiation to shape the company culture by adopting new professional rites or why not, by inventing its own mechanisms. Without forgetting that these requirements are part of the context of the modification of employee representation resulting from the 2017 reforms on the works council and social dialogue. The assessment of the ordinances proposed by *France Stratégie*[58] indicates first that the new representation schemes are still in the process of being appropriated by the stakeholders. Second, it has not yet given rise to a real big bang in collective bargaining, except for the dynamics of small or very small companies that have been given the right to access it, which was previously prohibited due to the absence of union delegates. There is still much to be done by companies to enrich the themes of reflection in line with the societal commitments of the time[59] and to act in accordance with a demand for greater individual autonomy, diverse in its expression and needs.

It is up to the company to demonstrate that it is taking on all the goals that are now its own – corresponding to an enlarged CSR – so that the employee in turn accepts to become involved.

Let’s recall the wave of ‘Great Resignation’[60] that hit the United States and to a lesser extent in Europe.[61] In France, the labor shortage is more likely to affect the hotel, restaurant and health sectors, which fall prey to their image. If the counterpart to legal subordination has traditionally been the promise of stability, security and progress, what can the citizen-employee expect from his subordinate commitment, devoid of any promise of security or progress, since the company is itself subject to the pangs of instability?

It is therefore up to the company, with its actively implemented *raison d’être*, to propose an adequate work offer to attract talent, some of whom no longer want to be employees.[62] The prospect of a long-term career seems illusory - no one believes in it anymore. But it is on the offer of an experience where the employability of the employee is assured and valorizing, where the latter gains in possibilities of increase of competences, network, know-how, commitment, but also of rights drawn from a fair return of value to his profit, that a new social pact of the 21st century must be built... together with independent workers, and not as a substitute.

52. Prof. Grégoire Loiseau at the Conseil d’Etat conference on December 3, 2021, 'Les réseaux sociaux, vecteurs de transformation'.

53. *Ibid.*

54. 'A tired society', CFDT-Foundation Jean-Jaurès expert committee, Report 26 November 2021.

55. See the article by Emmanuel Hirsch 'une fatigue éthique', *op. cit.*, p. 11-12.

56. See Isabelle Lespinet-Moret’s article 'de la fatigue industrielle au burn out', *op. cit.*, p. 17-18.

57. See for example C. Cavendish, 'It’s time to admit that hybrid is not working', *Financial Times*, January 7, 2022 : https://www.ft.com/content/d0df2f1b-2f83-4188-b236-83ca3f0313df ; G. Roussange, 'Les salariés zombies, nouveau fléau des PME', *Les Echos*, March 22, 2022.

58. Evaluation of the ordinances of September 22, 2017, France Stratégie, Rapport comité d’évaluation 2021, December 2021.

59. Environment, value sharing, health, human rights and quality of life at work, and above all training, the fuel of this century.

60. 'The Big Quit': more than 4.3 million Americans quit in August 2021 revealed the U.S. Department of Labor on October 13, 2021. 40% in retail, hospitality or personal services. 11 million jobs remained unfilled. An unprecedented situation.

61. Increase in resignations in mid-2021, particularly among employees in partial activity - Mid-2021, a high level of CDI resignations linked in particular to the decrease in partial activity, Dares publication, 3 November 2021.

62. Report, 'Les nouveaux intermédiaires du Travail B2B', *Dares*, March 2022 n°27.

Pavlina R. Tcherneva • Associate Professor of economics at Bard College, New York

The Job Guarantee and Economic Democracy: Why a Legally-Enforceable Right to Employment is Needed and How It Can Be Implemented

Twelve years after the Great Financial Crisis of 2008, the world faced another upheaval - a pandemic that had once again laid bare an inescapable reality: the global economy consistently fails to provide basic economic security for all.[1] Whatever crisis a country faces - financial, public health, geo-political, or environmental - jobs are dependably the first casualty. The status quo argues that unemployment is normal and largely inescapable. Worse, the longstanding mainstream view in economics of the 'natural rate' of unemployment (and the related NAIRU concept) argues that unemployment is required for economic and price stability.

Yet in the postwar period, protracted and painful jobless recoveries have become the norm, growth has failed to deliver full employment, labor markets have weakened further, producing increasingly more precarious and more scarce employment opportunities. A jobless reality, where millions fail to secure stable and well-paid employment, is an unequal reality. For economic giants like the US, the labor market weakened significantly since the 70s, when wages stopped keeping pace with productivity, and when labor market 'flexibilization' under neoliberal reforms meant union busting, weakening of labor laws, and the gigification of work. It is during this period that stabilization policy turned its focus away from labor markets and toward financial markets, away from stabilizing the incomes of working families and toward tax cuts for the wealthy. It is no accident that during this time, economic growth systematically delivered the vast majority of income gains to the top 1%.[2] While globally, the middle class increased (as some developing countries - mainly China - lifted large swaths of their impoverished population from poverty), income inequality still worsened, as income gains continued to accrue to the global elite, while countries experiencing extreme poverty continued to be trapped in a vicious cycle of deprivation.[3] According to Oxfam, in 2014, the world's richest 80 people owned as much as the world's poorest half ,[4] while in the following year, only 62 people owned as much wealth. The trend continued over the next few years, and by 2019, only 26 people owned as much wealth as the world's poorest half. The pandemic worsened global inequalities, reducing incomes of 99 percent of the world's population and pushing 160 million more people into forced poverty.[5]

The connection between unemployment and inequality is organic. So is the connection between stabilization efforts and unemployment and inequality. Labor markets and the conditions of work are key mechanisms (albeit not the only ones) of distributing the gains of production and income growth. Full employment, living wages, labor protections are preconditions for more equitable income distribution. Conversely, unemployment, poverty pay, and labor market deregulation are structural forces that help reproduce inequality. Mass unemployment in particular ensures that the global economy rations scarce jobs through race-to-the-bottom labor practices, a process that has eroded the postwar social contract in the Global North, and ensured that it never reached the Global South.

Long gone is the urgent international dialogue of the postwar era on how to secure global full employment—the unqualified precondition for reaping the benefits of free trade. Mass unemployment and precarious employment not only reproduced and fed inequality, but also chipped away at economic democracy and undermined social solidarity within national borders and beyond. None of this was inevitable. Far from being natural or unavoidable, mass unemployment and precarious employment are the product of specific policy commitments. And the global economy has borne the social, economic, and political costs.

In the face of the COVID19 pandemic and perennial economic crises, the world is reengaging in a conversation about reshaping the economy as a whole, and labor markets in particular. A recent call to democratize work has reverberated across the globe,[6] published in 45 papers in 26 languages, and supported by thousands of signatories. In it, guaranteeing the right to decent and remunerative employment was identified as a key demand and the modern Job Guarantee proposal was singled out as a cor-

1. The author develops in further detail the arguments set out in this piece in her book *The Case for a Job Guarantee* (Polity, 2020)
2. Tcherneva, P. (2014). 'Reorienting fiscal policy: a bottom-up approach,' *Journal of Post Keynesian Economics*, 37(1): 43–66.
3. Milanovic, B. (2016). *Global inequality: a new approach for the age of globalization.* Harvard University Press
4. Oxfam. (2015). 'Wealth: having it all and wanting more.' Oxfam Issue Briefing. January. https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/file_attachments/ib-wealth-having-all-wanting-more-190115-en.pdf
5. Oxfam. (2022). 'Inequality Kills: The unparalleled action needed to combat unprecedented inequality in the wake of COVID-19' Oxfam Briefing Paper. January. https://policy-practice.oxfam.org/resources/inequality-kills-the-unparalleled-action-needed-to-combat-unprecedented-inequal-621341/
6. Ferreras, I., Battilana, J., Meda, D. (2020). *Le Manifeste Travail: Democratiser, Demarchandiser, Depolluer*, Le Seuil.

nerstone in the global environmental agenda. The Paris Agreeement had recognized that a green transition is not possible without 'human rights [and] a just transition of the workforce, and the creation of decent work and quality jobs in accordance with nationally defined development priorities'.[7] In the US, the Job Guarantee has been called the most crucial component of the Green New Deal resolution.[8] It is also a core recommendation by a landmark report by the International Labor Organization's Global Commission on the Future of Work,[9] echoing an earlier recognition and recurrent demand that the right to employment is a fundamental human right.

Policy Paradigm Shift

The Job Guarantee policy aims to ensure that the internationally-recognized right to remunerative employment is legally enforceable, and that anyone seeking living-wage work can find it, whenever it is needed. But it is much more than a job creation policy. It is a structural reform that fundamentally reorients macroeconomic stabilization policy away from trickle-down economics and toward bottom-up stabilization that is based on a new social contract.

Some of the components of this new social contract are the following. First, the public sector – by concrete policy action or by omission – underwrites labor market outcomes. It faces two policy options: to continue supporting the *status quo* of job scarcity or to shift to a policy regime that actively creates sufficient employment opportunities for all jobseekers.

Second, the Job Guarantee can center fiscal policy around countercyclical employment and macroeconomic stabilization without sacrificing price stability.[10] This would have the added benefit of stabilizing labor incomes at the bottom and improving the distribution of income.

Third, while private employers create the vast majority of employment opportunities in a market economy, they do not create enough opportunities for all job seekers. The state has a crucial role to play in making up the difference. This can be accomplished by creating additional employment opportunities in the public interest that concentrate on addressing acute social and environmental needs.

Fourth, by virtue of establishing a public option for a basic job, the Job Guarantee would also establish a labor standard, which ensures than no working person (in the public or private sectors) would go without a basic living wage and benefits. This labor standard is a precondition for strengthening social solidarity. Unemployment, and the threat of unemployment, are structural forces that affect the employment conditions of those who have secured paid work. But there is also strong interdependence between people within and people outside the labor force. Poor work and pay conditions, inadequate provisioning of public goods, neglect of environmental and community needs invariably affect the quality of life of all people, irrespective of whether they seek paid employment. To this end, the Job Guarantee aims to marry unmet needs with available resources and improve overall wellbeing through collective action.

Finally, designing an institutional infrastructure to secure the right to employment for all is possible (based both on concrete historical experiences and contemporary evidence discussed below) and urgent (given the existential threats posed by the climate crisis and economic insecurity).

Unemployment as a Special Problem

The centrality of human rights and international coordination to achieve them was revived in 20th century. In 1944, Franklin D. Roosevelt called for an Economic Bill of Rights. The same year, the International Labor Organization Declaration of Philadelphia was centered on the principle that labor is not a commodity, and in 1948, Article 23 of the Universal Declaration of Human Rights reaffirmed that everyone has the right to work. The right to employment has been a recurring demand since at least the French Constitution of 1793, and while early classical political economists did not frame the economic problem of labor in the language of 'rights', economists like Adam Smith premised their analysis on labor being the essential input of production. They also argued that the level of remuneration is distinct from other inputs and should be sufficient to allow labor to reproduce itself.

American Institutionalists have also long argued that labor is uniquely dissimilar from other factors of production in the following sense. Labor (work that could be offered for pay) cannot be separated from the provider (the worker), and thereby cannot be stored.[11] Other commodities which can be warehoused (grain, for example), can generate a future income stream for their producers (eg, for farmers during off season), but workers require on-the-spot remuneration. They are unable to store their work power in a similar way to resell it during recessions. For labor, work is produced in the act of working, thus it generally requires employment on an ongoing basis with some certainty (and, yes, with a guarantee that it will be available when needed), in order to plan for one's personal or family needs.

7. United Nations (2015) Paris Agreement, United Nations Treaty Collection. https://unfccc.int/sites/default/files/engli sh_paris_agreement.pdf
8. Meyer, R. (2018). 'The democratic party wants to make climate policy exciting,' *The Atlantic*, December 5. https://www.theatlantic.com/science/archive/2018/12/ocasio-cortez-green-new-deal-winning-climate-strategy/576514/
9. ILO (2019). 'Work for a brighter future: global commission on the future of work,' Geneva, ILO. https://www.ilo.org/wcmsp5/groups/public/---dgreports/---cabinet/documents/publication/wcms_662410.pdf
10. Tcherneva, P. (2020). *The Case for a Job Guarantee*, Cambridge, UK: Polity
11. Prasch, R. E. P. (2004). 'How is labor distinct from broccoli? some unique characteristics of labor and their importance for economic analysis and policy,' in *The Institutionalist Tradition in Labor Economics*, edited by Dell P. Champlin and Janet T. Knoedler, M.E. Sharpe.

As Harry Hopkins, Franklin Delano Roosevelt's closest advisor and tireless champion for the right to employment, once famously noted 'People don't eat in the long run, they eat every day.' The aspect of self-consciousness also means that living incomes and family-sustaining wages are essential for survival, both from a material and psychological perspective. Agricultural commodities do not 'care' about the conditions of their employment. They may be stockpiled, discarded, or left to spoil, but individuals and their families experience the mental and physical toll of joblessness and poorly paid employment. All of this means that labor more than any other commodity requires income and employment protections that are not inherently necessary for other inputs of production. And yet, grain, oil, and other commodities often enjoy price supports, subsidies, and purchase programs ensuring that the government buys them when private demand falls. In a certain sense, public policies support many commodities through various price supports and demand guarantee programs, in ways that they do not do so for labor. The Job Guarantee would be the missing wage and employment support for working people.

American Institutionalists had also argued that the right to employment is part of a bundle of economic rights[12] and is indeed a 'logical extension of the right to life and liberty, all of which must be secured by government'.[13] While minimum wages are part of the protections required by labor, people unable to secure even minimum-wage employment do not benefit from those protections. For the unemployed the minimum wage is zero. The right to employment must also be guaranteed in order to ensure that the right to a decent wage is firmly secured to all. The fear of deprivation is not just a fear of inadequate pay, but also the fear of losing one's employment altogether. The modern proposal for a Job Guarantee answers this call.

The Job Guarantee Proposal

The Job Guarantee is a proposal for the public sector to create employment opportunities on demand in public service projects at a living wage-benefit package for any person who needs such an opportunity. The program would serve as an employment safety net and a public option for jobs that would run parallel to traditional unemployment insurance or other anti-poverty programs. It is an added program, not a replacement for existing ones. One of the rationales for this approach is that it is a straightforward solution to the problem of unemployment. Consider this: it is well understood that the private sector does not provide adequate education, healthcare, or retirement security to all (to name just a few key components of basic economic security). The public sector typically supplies them as public goods instead and, in many cases, it *guarantees* them. While some countries struggle with securing the safety net, in many cases public policy commits to providing directly certain essentials for economic life. Public education in most countries is guaranteed by governments. Social retirement insurance is a core part of many modern safety nets, even when private retirement insurance exists as a supplement to an individual's retirement income. In most advanced and many developing economies, public healthcare is also guaranteed. So are the access to a public library, public utilities, and public defense and safety. Securing direct access to basic employment opportunities, however, is missing from the traditional economic safety net. And even though decades of neoliberal reforms had privatized many of the public delivery mechanisms and prioritized incentives over direct provisioning for public good and services, the direct approach remains the most effective and efficient method for eradicating economic insecurity.

Housing, education, healthcare, and retirement security are all internationally recognized economic rights, and in the US, they were part of Franklin Delano Roosevelt's 1944 Second Bill of Rights. But so is the right to a job, to the free choice of employment, and to just and favorable conditions of work. For this reason, the Job Guarantee is voluntary and provides a menu of employment options that fit the job to the worker's needs (more below). When there is hunger, governments aim to provide food (however imperfectly). When there is homelessness, they aim to provide public housing. When there is inadequate access to healthcare, governments typically guarantee it, and when there are not enough educational opportunities, governments guarantee public education as well. But when there is a shortage of basic jobs, governments do not provide them directly as with other dimensions of social deprivation. Assistance for the unemployed may include unemployment insurance (often meager, temporary, and punitive) or training opportunities (for jobs which remain in short supply), but not guaranteed jobs. It is no exaggeration to say that the labor market (at a national and international level) is a game of musical chairs.

The public sector can respond to joblessness by implementing an employment safety net. The access to living wage jobs would also mean a reduction in food, housing, unemployment insurance, or other public assistance. Thus, while the expenditures on other anti-poverty programs would naturally shrink, the program would also prevent many of the non-monetary costs and scarring effects of unemployment that affect the unemployed themselves and their families.[14]

Additionally, the Job Guarantee also becomes a springboard for people to more effectively transition to other, better-paid employment opportunities than if they were still trapped in unemployment. This is especially important for youths who face some of the largest unemploy-

12. Commons, J. R. (1899). 'The right to work.' *The Arena* 21 (2): 131-142.

13. Whalen, C. (2019). 'Institutional economics and chock-full employment: reclaiming the 'right to work' as a cornerstone of progressive capitalism', *Journal of Economic Issues*, 53(2). https://doi.org/10.1080/00213624.2019.1594498

14. Tcherneva, P. (2019). 'The federal job guarantee: prevention, not just a cure,' *Challenge*. 62(4): 253-272.

ment rates around the world. Globally, youth unemployment levels are in the double digits (13.1% worldwide in 2017) and have been on the rise since 2007.[15] But according to the International Youth Foundation, accounting for measurement limitations, youth unemployment may be six to seven times higher than the ILO estimates. The ILO reports that in 2017, working poverty among young adults was 37% globally and as high as 71% in developing countries. The pandemic has only exacerbated the job prospects for this generation, leading to a social crisis of global proportions.

Even in developed nations, the barriers to employment are very high for some groups, such as the long-term unemployed in prime-earning years, caregivers desiring to return to paid work, as well as for people with disabilities, who have some of the highest unemployment rates. In other words, the Job Guarantee would serve both as a safety net and an effective transitional program to paid employment. The public sector would provide the missing opportunities, weakening the private sector's ability to use the threat of unemployment as a screening device in hiring and salary negotiations.

The Job Guarantee is also a preventative program, thwarting the social and economic costs of unemployment. It reorients policy from the exclusive focus on income support for the unemployed to preventing unemployment from developing in the first place and directly solving it once it has emerged. Preparedness and prevention would be key guiding principles for such a policy. If the Job Guarantee becomes part of the permanent policy architecture, people who need paid work could avail themselves as needed and not suffer prolonged unemployment and the corresponding consequences. Notably, when unemployment is widespread and job prospects are uncertain, spending patterns are much more unstable, amplifying business cycles. If job seekers knew that a living wage job offer were around the corner, they would likely not curb consumption as drastically, as they do with temporary and small unemployment insurance assistance.

Preparedness and prevention are policy paradigm shifts, away from crisis alleviation and mitigation. This policy approach is broadly consistent with what Mazzucato has called mission-oriented public policy.[16] The mission, in this case, is preventing the worse social and economic outcomes of unemployment and underemployment that workers experience from multiple pandemics, inevitable crises, and recurring economic fluctuations.

The final and, arguably most transformative, aspect of the Job Guarantee is that it replaces the natural rate of unemployment and the NAIRU as economic stabilizers. Unemployment has been normalized by the economics profession's insistence that it is a necessary bulwark against inflation. Because the Job Guarantee is a demand-driven policy, it would expand in downturns and decelerate in expansions, when the private sector resumes hiring above the base wage of the program. The employment safety-net would thus serve as a countercyclical policy that shrinks in inflationary/growth periods, mitigating price pressures. Changes in the program would largely depend on changes in hiring and firing practices in the *private* sector, providing a more robust floor to demand than unemployment provides today. A reserve army of the unemployed would no longer be necessary for the purposes of price stability.

A recent study[17] evaluates the macroeconomic effects of an ambitious Job Guarantee program for the US that would employ 15 million people at living wages (by comparison, official unemployment in December 2020 was 10.7 million people) and found that the program's net budgetary impact would be between 0.98 and 1.33 percent of GDP, not accounting for all the reduced direct and indirect costs on unemployment and poverty alleviation. The study also found that the program would boost GDP by 2 percent, permanently increase private sector employment by 4 million new jobs and would improve state budgets due reductions in anti-poverty programs and increases in local tax revenue. Further, the impact of the program on inflation was a negligible 0.09 percent. An earlier study[18] also demonstrated that a similarly designed Employer of Last Resort program would have strong anti-cyclical effects. By all main macroeconomic measures, this is an effective economic policy.

The Job Guarantee could be a centerpiece of a paradigm shift in macroeconomic stabilization policy that replaces the unemployment stabilizer with a living-wage employment stabilizer. It would help complete the welfare safety net by adding a public employment option that is currently missing. And by doing so, it would establish the minimum labor standard for pay and benefits for the economy as a whole. It would exert important pressure on private employers who pay poverty wages and use the threat of unemployment to impose onerous working conditions. The public option would be an 'out' for the most vulnerable workers, while private sector employers would be incentivized to match the program's pay and benefits in order to retain workers or attract new ones away from the Job Guarantee.

Toward a Green Job Guarantee

One expedient way of making the Job Guarantee a reality is to connect job creation to environmental conservation and other social care needs. As I have ar-

15. ILO (2017). 'World Employment and Social Outlook – Trends 2017', Geneva, ILO. https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_541211.pdf

16. Mazzucato, M. (2021). *Mission economy: a moonshot approach to the economy.* Penguin.

17. Wray, L. R., Dantas, F., Fullwiler, S., Tcherneva, P. and Kelton, S. (2018). 'Public service employment: a path to full employment,' Levy Institute Research Project Report, Annandale-on-Hudson, NY: Levy Economics Institute of Bard College. http://www.levyinstitute.org/publications/public-service-employment-a-path-to-full-employment

18. Fullwiler T. S. (2007). 'Macroeconomic stabilization through an employer of last resort', *Journal of Economic Issues*, 41:1, 93-134.

gued elsewhere,[19] the Job Guarantee is inherently a *green policy,* not only because of its organic connection with the climate conservation movement, but also because it remedies the neglect and squander that come with economic distress, unemployment, and precarious work. Arguably a green policy is one that aims to address all forms of waste and devastation, including both natural and human resources. The Job Guarantee is also part of the US Green New Deal Resolutions, which recognizes that environmental justice cannot be delivered without economic and social justice.

Although the Job Guarantee predates the Green New Deal movement, it has always been green in practical terms too - from the days of Roosevelt's Tree Army to modern proposals like the one outlined here - prioritizing environmental conservation and community renewal. The Green New Deal is a comprehensive and ambitious policy strategy designed to transform the economy and deliver a habitable planet to future generations. The Job Guarantee is the bridge in that transition, the safety-net and preventative macroeconomic stabilization policy, which ensures that while we work to protect the environment and transform the economy, we have a policy that protects working people and transforms the work experience itself.

The Job Guarantee matches unmet needs with available resources. Because it aims to address the social deprivations of people, communities, and the environment, it is not only a *green* policy, but can be viewed more broadly as a *care* policy. Large swaths of the population, even in developed countries, face shortages of vital goods and services. Food deserts, where millions of people lack access to healthy and affordable food, blanket the US. So do medical deserts - nearly a quarter of all residential areas lack acute-care hospitals and 80% of rural areas are designated as medically underserved.[20] This is typical for European nations as well, even though many provide nationalized healthcare. Sustainable agriculture, community health centers, and other basic services are needed even in the wealthiest regions of the world, while in the developing world, these problems are worsened multifold by the lack of basic infrastructure.

All the while, the planet is burning. Perennial fires, floods, hurricanes, droughts are intensifying. Air, soil and water pollution are preconditions for the accelerating and at an unprecedented rate of species extinction, according to a recent UN report.[21] Environmental work is endless and urgent. It includes investment and rehabilitation projects that are small and large. The Job Guarantee is one key mechanism for ensuring that the work is being done. A global tree army can repair the lungs of the planet, provide green infrastructure in dense urban areas, and help restore biodiversity. Rural areas can benefit from sustainable agriculture investments, drought prevention, and other public services. The examples are many.

Global recycling programs can help save the oceans from plastics and other polluters. The climate crisis is an existential threat to fishing communities that help feed the planet. Meanwhile, mangroves, wetlands, tidal marshes, seagrass, seaweeds sequester carbons effectively and up to five times more than tropical forests.[22] Restoring them is an urgent and labor-intensive task. The Job Guarantee can be a springboard for implementing sustainable fishing and regenerative ocean farming practices. Reef reconstruction and habitat restoration can reverse the impacts of coastal development on coastal marine ecosystems and vulnerable (and often indigenous) communities. Wetlands are natural embankments that often provide better protection than seawalls. Coastal communities often suffer mass unemployment and underemployment. The Job Guarantee would employ the unemployed and underemployed to do these critical tasks. And the program would be well targeted, as coastal communities often have some of the highest unemployment and underemployment rates nationwide.

A similar approach would help impoverished rural communities, who have born the ill effects of commercial agriculture. Firm concentration in agriculture (known as Big Ag) has led to some of the most abusive labor market practices of any industry (wage theft, dangerous working conditions, substandard housing for workers) and has consistently produced environmental hazards (methane emissions, water crises, soil erosion), public health concerns (antibiotic resistance, food born illnesses, dwindling nutritional content), and unfair competition wiping out small family farms (raising monopoly pries of patented seed and equipment, while lowering purchase prices for crops and cattle for sale). As noted above, despite the increased agricultural output, food deserts are ubiquitous around the globe. But corporate farms have been especially detrimental for working people. Agriculture has reliably produced some of the most precarious and poorly paid jobs. Big Ag often relies on cheap migrant labor that in many countries is exempt from basic labor protections like minimum wages, work contracts, or collective bargaining. Yet sustainable agriculture is critical from a strategic point of view (communities need to know where their food comes from), from an environmental point of view (sustainable agriculture relies on regenerative farming) and from the point of view of workers (community supported agriculture CSAs create more and better paid local jobs). The Job Guarantee can help multiply CSAs, farm cooperatives, and community garden initia-

19. Tcherneva, P. (2020). *The Case for a Job Guarantee*, Cambridge, UK: Polity

20. KHN (2019). 'Health care deserts: nearly 80 percent of rural US designated as 'medically underserved'', *Morning Briefing*. September 30, https://khn.org/morning-breakout/health-care-deserts-nearly-80-percent-of-rural-u-s-designated-as-medically-underserved/

21. United Nations. (2019). 'Nature's dangerous decline 'unprecedented' species extinction rates 'Accelerating'' The Intergovernmental Platform on Biodiversity and Ecosystem Services Report. https://www.un.org/sustainabledevelopment/blog/2019/05/nature-decline-unprecedented-report/

22. Smith, B., Bowman, J. and Johnson, A.E. (2019). 'Seafood, blue jobs and the green new deal' *Green New Deal Policy Series*: Agriculture, Data for Progress.

tives. Because it is a program that creates jobs where they are most needed, by focusing on sustainable agriculture, it can be an effective method for wiping out food deserts while creating living wage employment opportunities.

The problems with agriculture are connected to the problems of water pollution. Agricultural runoff contaminates underground water tables as well as river, takes and beaches, poisoning marine life and destroying the habitat. Small infrastructure projects in every farming community can help reverse these effects. Fencing cattle appropriately, recycling wastewater, planting vegetation and fortifying wetlands can help with runoff. So can basic landscaping that diverts stormwater in communities where construction has built impervious surfaces (roads, parking lots, sidewalks) and overwhelmed the natural environment's capacity to deal with flooding.

Commercial development in wildfire prone zone have meant loss of life and livelihoods. Building residential communities so close to wildlands has increased the incidents of human ignition and conflagrations (eg, virtually all fires in California - more than 90% - are caused by humans, often along roads or buildings from use of flammable invasive grasses). Meanwhile, fire prevention investments have not kept pace with the rate of construction. A program of massive retrofitting with the latest fire-resistant materials is needed, as well as the construction of effective evacuation routes, and implementing building restrictions in certain areas. In the meantime, while communities are regularly incinerated, the work of fighting the fires and cleanup is daunting. A 21st Century Fire Brigade and Firefighter Reserve can provide well paying jobs in many communities.

The discussion above barely scratches the surface of the kinds of work that could be done with a Job Guarantee. In the US, lack of universal healthcare has been compounded by lack of accessible healthcare. Public health deserts can be remedied by building a network of community health clinics which can provide basic preventative care on ongoing basis for free. These can be important sites for on-the-job training opportunities for Job Guarantee workers and internships for young people, who wish to transition into better-paid employment opportunities in healthcare. Coupled with other educational and certification programs, the Job Guarantee can be a springboard for anyone facing obstacles to paid employment. While there are many easily identifiable areas of critical need, addressing the climate crisis alone, requires an all-hands-on-deck approach. And while the Job Guarantee is a key piece to a comprehensive climate strategy, environmental and community care needs are ongoing, thereby necessitating ongoing public service employment.

Within Reach: Real World Experiences

The examples above are not simply a wish list. They point to critical areas of concern. Experience shows that such initiatives can be launched on short order to yield overwhelmingly positive results. Of the notable large-scale employment programs that have provided direct employment to the unemployed in public service, three stand out.

The first two – the New Deal of the 1930s in the US and *Plan Jefes* in Argentina in the early 2000s – responded to economic crises that produced depression-level unemployment rates. In both cases, the projects were launched within six months. In the US, they were mostly federal projects that built critical infrastructure that still lives on. In Argentina, they were federally-funded but organized from the ground-up, with direct input by community groups and the unemployed themselves, who designed, proposed, and ran the projects.[23]

The third and largest in the world employment guarantee program is in India which, unlike the previous two, was implemented as a permanent program to deal with the ongoing problem of rural poverty. In 2005, India's Mahatma Gandhi National Rural Employment Guarantee Act (NREGA, later renamed MGNREGA) established the legally-enforceable right to 100 days of guaranteed employment to any rural household whose members volunteered to work in a community project.[24] It is the most significant program of this kind in the world, not only due to its sheer size, but also due to its scalability, architecture, implementation, and impact. In 2019-2020, over 55 million households (or nearly 40% of all rural households in India) obtained work through the program. During the pandemic, in the 2020-21 fiscal year, a whopping 75.5 million households had worked in the program and another 71.7 million in 2021-22, prompting widespread demands for extending the guarantee to 200 days.[25] As some newly unemployed workers from urban areas returned to their rural homes, they were able to access employment though the program, while calls for extending the program to urban areas (and unemployed youth, in particular) also grew.

MGNREGA is a bottom up, people-centered, and demand-driven program, where the offer of employment must be provided within 15 days whenever someone seeks it. Payment of wages is also due within 15 days of work. Due to its self-selecting and rights-based design, the program has fostered social inclusion, gender parity, social security, equitable growth, participatory planning, and environmental protection.

It has been a critical lifeline for the unemployed and the underemployed during the pandemic. Note that unemployment is *not* a condition for eligibility, and one could perform other work and still participate in the rural employment guarantee. In other words, communities

23. Tcherneva, P. (2012). 'Beyond full employment: what Argentina's Plan Jefes can teach us about the employer of last resort' in M. Forstater and M. Murray (eds.) *The Job Guarantee: Toward True Full Employment*, Palgrave.

24. Permissible projects also include some works of a more private nature, like building a well on private land.

25. Mukherjee, S. (2020). 'Over 55 million households demand work under MGNREGA this year so far.' *Business Standard*. July 15.

have found safe and effective ways to continue to provide meaningful community work, even as the economy experienced many COVID-19-related work stoppages. A notable implementation innovation is the administration of program payments through the National Electronic Fund Management System (NeFMS), allowing for the direct deposit of beneficiaries' wages into their bank accounts. Nearly 96 percent of all wages are being paid directly through the NeFMS. Note that the government's chronic and willful[26] underfunding of the program has produced unreliable payments of wages within the mandated 15 days - a problem of artificially constrained budgeting rather than payments system design.

The program has both benefited from and strengthened local democratic structures and grassroots governance. For example, any plans for job creation and decisions about rural projects are made in open assemblies in Gram Sabha (a public forum used by the primary administrative bodies of rural villages called Gram Panchayats). People use the forum of the Gram Sabha to discuss local governance and development and make needs-based plans for the village. This system of local self-government of villages in rural India (as opposed to urban and suburban municipalities) is used to propose, plan, ratify, and approve (or deny) projects. Once a project has been accepted by the local assemblies, the decisions cannot be overturned by higher administrative authorities (such as the Ministry of Rural Development), except in cases when the project violates the very basic operational guidelines outlined by the Act, e.g., if it undertakes work that is not in the 261 permissible activities under the scheme (these are revised periodically depending on local needs). The central authorities provide general guidelines on what would constitute 'shelf of projects,' but do not undermine the local authority in creating, designing and implementing them.

MGNREGA is an important break from traditional income relief programs. It also prioritizes guaranteed employment in projects that improve the natural resources of rural communities. It is an integrated program for resource management and economic development. The World Bank has called the program a significant engine of rural development. The rural and so-called 'unskilled' labor (as per government designation) has been productive, generating needed environmental assets and benefits. The government has created maps and databases of green investment initiatives. The program has prioritized natural resource management (NRM) and has become the primary program leading water conservation efforts in the country. Additional activities include investment in water security, road connectivity, tree planting, soil renewal, and irrigation to name just a few high impact investments in rural assets. Notably because the program is demand driven, it fluctuates with economic cycles and throughout the year and with the monsoon season. The experience demonstrates that 'important work' and 'cyclical work' is not an either-or policy dilemma. A Job Guarantee can fulfill needed tasks on ongoing basis and provide jobs on demand.

MGNREGA is the largest (albeit not universal) Job Guarantee program with significant success. It no doubt has its own challenges, including underfunding, irregular payments, and corruption in some communities. Nevertheless, given the program's scale, the large size of households it serves, and the community benefits it has produced, all things considered, it is the largest and arguably most important and effective full-fledged precedent of a Job Guarantee in the world.

There are other programs in other countries that can form the basis for a national Job Guarantee program. For example, the Zero Long-Term Unemployment Areas project in France has been inspired by the goals of social inclusion through guaranteed employment, though it is much smaller in scope than MGNREGA. Nevertheless, in its short life since its launch in 2017, it has yielded positive results, prompting the French government in 2020 to unanimously vote for its extension and expansion. In the first phase, only 10 territories and about 100 communities benefitted from the program. Now 40 more major territories would be able to embark on this program.

The basic principles behind the French pilot rest on the understanding that: 1) no one is unemployable (even people who have been outside the labor force for a long time can contribute with human capabilities and know-how); 2) there is no shortage of tasks (communities have many unmet needs); and 3) there is no shortage of funding (long-term unemployment assistance is a large line-item in local budgets which does not produce needed employment opportunities). Public funds on long-term assistance are re-directed to employ the long-term unemployed with permanent contracts at the minimum wage in social enterprises that address specific community needs. The program is voluntary. In some cases, the long-term unemployed persons are recruited, but they alone must decide to participate and are not deprived of benefits if they choose not to. The public sector creates public employment and social enterprise companies, which provide permanent contracts to the unemployed and employ them 'as they are', irrespective of personal circumstance or disability. The program's projects and activities are in addition to existing activities, and do not compete with ongoing private or public sector work in the community. Another significant aspect of the Zero Unemployment Territories is the co-creation process, which expresses the Job Guarantee's participatory democratic goals. The unemployed participants have the opportunity to create their own jobs on the basis of their own know-how, skills and desires, as well as the needs of the territory.[27] And

26. Ghosh, J. (2015). 'India's rural employment programme is dying a death of funding cuts' *The Guardian*.

27. COVAL. (2018). 'Best practices: zero long-term unemployed territory (TZCLD)' https://www.co-val.eu/case-studies/blog/project/zero-long-term-unemployed-territory-tzcld/

while one of the initial challenges during program launch was securing consent from the territories where the projects would take place, having seen the positive effects of the program, many more municipalities are signing up.

The government has found that the direct expenditures on the program more than offset spending on anti-poverty and unemployment programs, while producing needed social and economic value. Participants report anecdotally that the job opportunity has improved their own personal wellbeing, including their chances for employment opportunities above the minimum wage offered by the program.[28] Meanwhile, city mayors in the pilot regions report that the program is breathing a new life into their communities.

The projects range from community gardens to nursing homes, recycling initiatives, administrative help for city councils or small local businesses, apprenticeships in small manufacturing operations, elderly assistance, helping schoolchildren cross busy intersections, rehabilitation of abandoned structures and lots for use by local enterprises, and many others.

Workplace Democracy, not Workfare

The Job Guarantee is based on democratic principles and should not be confused with punitive workfare programs. FDR's New Deal, Plan Jefes, MGNREGA and Zero Long Term Unemployment Areas, are just a few notable examples that are based on democratic and participatory principles. There are many other programs, such as UK's Future Jobs Fund and Brussel's Actiris Youth Guarantee project or Mierenthal's Job Guarantee Experiment in Austria.

But it is important to note that the direct employment solution is not only available to democracies. Authoritarian and illiberal forms of governments too can avail themselves of direct employment for the unemployment. For example, Victor Orbán has implemented a program in Hungary for hiring the unemployed in rural areas as well. Orbán's program is not a Job Guarantee; it is a Job Obligation because it removes the benefits of the unemployed unless they submit to work on a government-determined project. Program wages are very low and, in some cases, they are lower than the forgone unemployment benefits. The jobs are created top down in projects delegated by the town's mayor or the federal government. The program often provides occasional work (a few hours even) that fails to support workers. The program has spruced up some villages, but that has often come at the real human cost of forced work in poverty conditions. Indeed, the program has solidified support for Orbán by increasing social polarization between the 'haves' and 'have nots'–those who have good jobs and those who have been asked to 'prove' that there are deserving of the government assistance.

28. ATD Fourth. (2019). 'Zero long-term unemployment zones experiment in France: work as a common good.' https://www.atd-fourthworld.org/zero-long-term-unemployment-zones-experiment-in-france-work-as-a-common-good/

It must be strongly emphasized that these are not Job Guarantees, ie bottom up, voluntary employment arrangements that nurture solidarity, self-governance and self-determination. This should be no surprise. Unemployment is a scourge on society and there are two paths to eradicating it. One path is via democratic means and a voluntary Job Guarantee, organized from the ground up with participatory input from the community and the unemployed themselves. The second path is through forced, punitive, and poorly paid mandatory employment. The Job Guarantee is an alternative to existing workfare polices that are based on the falsehood that unemployment is an individual failure rather than a macroeconomic structural problem that is beyond the control of the unemployed.

The Job Guarantee does not ask the unemployed to 'reform' themselves or demonstrate that they are deserving of the state support. It takes people as they are, fits jobs to their needs, and empowers people and communities to co-create their own projects, shape their own destinies, and transform their own communities on collaborative and cooperative principles that empower, rather than punish.

In the midst of multiple pandemics, a climate crisis of existential proportions, and an increasing precarity of all workers, the threat of unemployment remains the most serious affliction in labor markets and the greatest obstacle to social solidarity. At the same time participatory models for employing the unemployed, recognizing the right to employment as a core human right, offer the greatest promise to solving these challenges before us.

Conclusion

The global engine of job creation does not promise stable or well-paid employment. Protracted and painful jobless recoveries from economic crises have become the norm. The COVID-related crisis was an opportunity to democratize work and come out on the other side of the pandemic with better working conditions and access to decent employment to all. While the global pandemic is still rolling through the globe, it is also urgent to address the crises of economic insecurity and climate change. As we are witnessing at present, running the global economy 'hot' does not guarantee either an inclusive economy or environmental sustainability. The last half a century has demonstrated that the structure of the global economy is such that growth-at-all-cost policies damage the environment, create precarious jobs, and increase income inequality. Further, the all-too-popular economic incentives and nudges have failed to address dire social and environmental challenges. This state of affairs had been sustained by a bankrupt conventional view that there is a tradeoff between unemployment and inflation, between good jobs and technological innovation, and between saving jobs and protecting the environment. None of these claims stand up to scrutiny once we consider the implications of reorienting public policy around the Job Guarantee proposal.

These are false choices: jobs need not be sacrificed in the name of inflation control (an anticyclical employment program is a superior inflation anchor), technology is not the villain that threatens jobs (with the guarantee of decent employment, we can enjoy the productivity enhancements technology brings), and creating good jobs for all and environmental sustainability are entirely compatible (environmental stewardship and conservation would be needed even after we have solved the most dire climate threats).

Far from being 'just another jobs program', the Job Guarantee is a structural reform, a better macroeconomic stabilizer, and a labor standard for other jobs as well. It can be the cornerstone of a policy paradigm founded on the principles of economic democracy and global solidarity. It can also ensure that the internationally-recognized right to decent and remunerative employment for all is not just an aspirational statement, but a workable, accessible, and legally-enforceable right.

Flávia Souza Máximo Pereira • Professor of Labour Law at Federal University of Ouro Preto in Brazil

Labour, Love and (De)Coloniality in the Employment Relationship

> Quando eu morder a palavra,
> por favor, não me apressem, quero
> mascar, rasgar entre os dentes, a pele,
> os ossos, o tutano do verbo, para assim
> versejar o âmago das coisas.
>
> Conceição Evaristo

Labour and Love. For me this is an intriguing combination. Is this feeling allowed when we perform labour? When I think about love, it is inevitable to think about the freedom to choose, to feel, to think, to breathe in these suffocating times. This freedom is what makes us human.

In theory, this freedom should be guaranteed by Labour Law, which revolutionized in modernity the concept of freedom of choice. Labour Law made the asymmetry in human liberty intelligible. It underlined how this asymmetry manifested itself in the concreteness of the flesh and how it should be compensated by the legal construction of the employment relationship, so that working bodies could be free, so that working bodies could be humans.

In contrast with the slave and servitude models, the heart of Labour Law is constituted by this freedom in the employment relationship. The employee sells his labour force – not his body – under the directive power of the employer, in a paradoxical combination of *free* and *subordinated*[1] labour.[2] But how free is this working body? Is it possible to separate labour force from the working body? Is there freedom to choose work, to love labour?

We know that Labour Law, in legal relations, is one of the greatest accomplishments of modernity. The employment relationship itself represents a subaltern[3] achievement.[4] It is the result of critical knowledge developed to resist the oppression experienced by the working class. None of this takes place in a space of pure imagination, but of violence experienced as a collectivity.[5]

And yet this achievement is constantly threatened with austerity policies,[6] centered on social fear, blaming the working class for its own poverty. With these constructed lies,[7] the employment relationship is seen an obstacle to economic growth, to entrepreneurship and job creation.[8] Consequently, a state of exception in Labour law is established.[9] These austerity policies can only result in undemocratic[10] measures that strengthen intersectional inequalities in the world of labour.

Therefore, the employment relationship is a counter-hegemonic legal weapon in political and epistemic terms. And that is why we still fight for Labour Law. It is why we still work to defend its epistemology. Because the simple destruction of protected employment, as it has been happening in most jurisdictions, is nothing more than a further deepening of coloniality, racism, sexism and LGBTphobia. These are the bodies that suffer strongly and firstly the effects of precariousness at work. And that is also why when we criticize Labour Law here, pointing out the *legal coloniality of the employment relationship*, we are also defending it. With affection. With love. Despite all its contradictions.

Such contradictions are constantly perplexing me. Perplexity, according to Priti Ramamurthy,[11] is the site of convergence of 'multiple ideologies that constitute subjects – cultural practice, temporalities and place'. This perplexity makes me question my affection for Labour Law. This perplexity makes me wonder: from which epistemic place were the main categories of Labour Law created? How are the core categories of Labour Law translated into different geopolitical contexts? Who is the epistemic subject of Labour Law? What are the relations between the specificities of each worker's body and its legal protection in Labour Law?

1. To expand legal subordination, Brazilian Labour Courts created the structural subordination theory, which is manifested by the insertion of the worker in the dynamics of the employer services, regardless of receiving direct orders. See M.M Mendes; J.E Chaves Júnior. 'Subordinação estrutural-reticular: uma perspectiva sobre a segurança jurídica'. *Rev. Trib. Reg. Trab.* 3ª Reg., Belo Horizonte, v.46, n.76, p.197–218, jul./dez. 2007.
2. See E. Andrade. 'O direito do trabalho na filosofia e na teoria social crítica'. *São Paulo: LTr*, 2014.
3. See G. C. Spivak. 'Can the subaltern speak?' In Cary Nelson and Lawrence Grossberg (eds) *Marxism and the Interpretation of Culture* London: Macmillan, 1988.
4. See F. Máximo; P. Nicoli. 'Labour Law and dissident epistemologies: theoretical demarcations for another-critique'. *Revista Direito e Práxis*, Ahead of print, Rio de Janeiro, 2022.
5. See P. H. Collins. 'Black Feminist Thought: Knowledge, Consciousness, and the Politics of Empowerment'. *Routledge*, New York, 2000.
6. See the latest Labour and Social Security Reforms in Brazil (Law n. 13.467/17 and Constitutional Amendment n. 103/19, respectively).
7. See S. Deakin. 'The contribution of Labour law to economic development & growth'. Centre for Business Research, University of Cambridge, Working Paper No. 4782016, 2016; CESIT, Centro de Estudos Sindicais e de Economia do Trabalho. 'Contribuição crítica à reforma trabalhista'. Campinas: Unicamp, 2017.
8. See P. R. Tcherneva. *The Case for a Job Guarantee.* Cambridge, Polity Press, 2020.
9. See A.C. Ferreira. 'A sociedade de austeridade: Poder, medo e direito do trabalho de exceção'. *Revista Crítica de Ciências Sociais*, 95, 2011, p. 119–136.
10. See I. Ferreras. *Firms as Political Entities: Saving Democracy Through Economic Bicameralism*, Cambridge, Cambridge University Press, 2017.
11. See P. Ramamurthy. 'Material Consumers, Fabricating Subjects: Perplexity, Global Connectivity Discourses, and Transnational Feminist Research'. *Cultural Anthropology* Vol. 18, N. 4 (Nov. 2003), p. 525.

Perplexity is the simultaneity of joy and pains that constitute us.[12] That is how I feel towards Labour Law. Is this love? In order to love someone, it is necessary to undress ourselves. To reveal also what we do not want to show. To reveal our ugly parts. The ones which we insist on hiding even from ourselves. You love someone when you can get into the core of their being. Knowing their innermost secrets. Despite all these contradictions.

But Labour Law insists on keeping its epistemic secrets.[13] Its epistemic subject appears to us devoid of race, gender, sexuality, language, or location in any relation of power.[14] To reveal itself, Labour Law must show its location in terms of geopolitics and body-politics of knowledge.[15] This consists of the recognition of its economic, social, epistemic, and ontological position. As Sumi Madhok put it, the legal production of situated knowledge must consider 'from where you are looking and what/whom you are seeing'.[16]

To love Labour Law, it is necessary to understand why its epistemic body remains so distant from the reality of the labouring body. I need to understand why Labour Law does not reach the brown street vendor, or the black domestic worker who cleans white houses; why it does not speak the language of the waste picker in the Global South, or the transexual who works as a prostitute.[17] Most of those who feel the deepest exploitations of work in their bodies have never experienced the protection of Labour Law. They have never been in an employment relationship. In the eyes of the Labour Law categories all this is 'non-typical' work.[18] However, 'typical' wage work, regulated under the standard employment relationship, has never expressed, and still does not express, the extent of productive relations, especially in the Global South.[19]

How to love and to fight for something unknown? How to love someone who has no color, no identity, no desire? Is this fracture between Labour Law's epistemology and the experience of workers accidental, or is it a deliberate project?

Who loves must tell the truth. So, listen to me. There is a legal coloniality in Labour Law.[20] Labour Law is also centered on the subjection of bodies, under the varnish of legal subordination, which has always sustained the coloniality of power.

Among the central concepts used by decolonial studies,[21] the coloniality of power demonstrates that colonial relations in economy, politics, society, and epistemology did not end with the formal destruction of colonization. Coloniality allows us to understand the continuity of colonial domination forms beyond colonization.

According to Quijano,[22] modernity was characterized by a world power pattern which controlled various forms of social existence. It was a structural power complex, characterized by domination, exploitation, and conflict in the space of labour, of collective authority, of sex and, finally, that of knowledge production.[23]

This modern power pattern imposed, as a way of labour control, the racial capitalism system,[24] to set a difference between the colonized and the colonizer; the Nation-State, as a central form of collective authority; the bourgeois white family, as an institution of sex control;[25] and, finally, the Eurocentrism, as the hegemonic form of knowledge production.[26]

Eurocentrism doesn't refer to all cognitive history throughout Western Europe,[27] but to a specific form of rationality that became worldwide hegemonic and colonized all others and their respective concrete knowledges, both in Europe and the rest of the world.[28]

The decolonial thinking proposes a project of detachment from Eurocentric knowledge.[29] It is not a simple negation of all its categories in yet another perspective of the totality of knowledge.[30] Far from this, decolonial thinking

12. *Ibid.*

13. See F. Máximo; P. Nicoli. 'The epistemic secrets of Labour Law'. *Revista Brasileira de Políticas Públicas*, Brasília, v. 10, n. 2, p. 511–536.

14. See R. Grofoguel. 'Para descolonizar os estudos de economia política e os estudos pós-coloniais: Transmodernidade, pensamento de fronteira e colonialidade global'. R*evista Crítica de Ciências Sociais*, 80, Março 2008, p. 115–147.

15. See G. Anzaldúa. 'Borderlands/La frontera: the new mestiza'. San Francisco: Aunt Lute Books, 1987.

16. See S. Madhok. 'A critical reflexive politics of location, 'feminist debt' and thinking from the Global South'. *European Journal of Women's Studies*, Vol. 27(4), 2020, p. 396.

17. See F. Máximo; P. Nicoli. 'The epistemic secrets of Labour Law'. *Revista Brasileira de Políticas Públicas*, Brasília, v. 10, n. 2, p. 511–536.

18. *Ibid.*

19. *Ibid.*

20. See A. Blackett. 'Decolonizing Labour Law: A Few Comments' In R. Blanpain; F.Hendrickx (eds). *Labour Law and Social Progress: Holding the Line or Shifting the Boundaries? Netherlands*, Kluwer Law BV, 2016; D. Muradas, F. Pereira, 'Decolonial thinking and Brazilian Labour Law: contemporary intersectional subjections'. *Rev. Direito Práx.*, Rio de Janeiro, Vol. 9, N. 4, 2018.

21. See C. Walsh. 'Interculturalidad y colonialidad del poder. Un pensamiento y posicionamiento 'otro' desde la diferencia colonial'. In: S. Castro gómez; R. Grosfoguel. (Ed.). *El giro decolonial: reflexiones para una diversidad epistémia más allá del capitalismo global*. Bogotá: Siglo del Hombre Editores et al., 2007.p. 47 – 62; B. S. Santos M. P. Meneses (ed.). 'Epistemologias do Sul'. São Paulo; *Cortez*. 2010.

22. See A. Quijano. 'Colonialidad del poder, eurocentrismo y América Latina'. *Colonialidad del saber*. Buenos Aires: CLACSO, 2000.

23. *Ibid.*

24. See F. Fanon. 'Black Skin, White Masks'. *New York: Grove Press*, 2008; Robinson, C. J. 'On Racial Capitalism, Black Internationalism, and Cultures of Resistance'. London, Pluto Press, 2019.

25. See R.L. Segato. 'Gênero e colonialidade: em busca de chaves de leitura e de um vocabulário estratégico descolonial'. *E-cadernos CES*, n.18, São Paulo, 2013, p. 106–131; M. Lugones. 'Rumo a um feminismo descolonial'. *Estudos Feministas, Florianópolis*, 22(3): 935–952, setembro–dezembro/2014.

26. See A. Quijano. 'Colonialidad del poder, eurocentrismo y América Latina'. *Colonialidad del saber*. Buenos Aires: CLACSO, 2000.

27. *Ibid.*

28. *Ibid.*

29. See A. Quijano. 'Coloniality and modernity/rationality' In W. Mignolo, A. Escobar (ed.). *Globalization and the Decolonial Option*. Routledge, New York, 2010, p. 22–32.

30. *Ibid.*

wants to depart from the norm of rationality-modernity-coloniality.[31] Ultimately, decoloniality of knowledge seeks to create strategies to restore 'all power not constituted in free decision of free people, [as] [it] is the instrumentalization of reason by the colonial power, in the first place, that produced distorted knowledge paradigms and failure in liberating promises of modernity'.[32]

As we discuss democratizing workplaces, let us remember that more than two billion workers perform activities that are not protected by formal employment relationships at all. 61 percent of the world's workers are engaged in informal relations.[33] Moreover, income inequality between workers from the Global South and North has increased over the past decades.[34] Therefore, democratizing work relations necessarily involves decolonizing Labour Law's knowledge production.

We know that decolonizing Labour Law's epistemology doesn't mean claiming subaltern practices as superior to Eurocentric knowledge. It involves traveling between worlds and being aware of the journey within oneself, with no conciliatory rush. Decolonizing is knowing how to deal with plural epistemologies, without hierarchy. It means confronting different normative life-worlds, knowing that they are going to collide and interact. It is from these normative clashes that contact zones will be created towards a cosmopolitan reason.[35]

Because decolonizing is not diversifying. It's not moving on the surface. It is theorizing in the epistemic bowels. Decolonizing requires asking different questions, with a genuine interest in theory produced in the Global South. It involves giving up places of academic leadership, recognizing privileges of class, race, gender, and nationality. It includes naming the epistemic basis from which one speaks. It requires letting go of non-performative[36] claims of diversity. It involves refusing theoretical partnerships with those who are not engaged in social justice practices in the Global South and the Global North. It requires effort and will to change the epistemic transit of knowledge production. It takes courage to take risks. To change the flows of the social division of scientific work and the very meaning of that work.

Decolonizing Labour Law is a difficult and painful wager because it involves letting go of categories that captivated us and brought us here. If we are here, it is because our affection has brought us to the territory of Labour Law.

However, who loves must tell the truth. So, listen to me. The concrete subjection of bodies that is afforded by the legal coloniality in Labour Law must be denounced. Through legal subordination, Labour Law pretends that freedom for some of the labouring bodies exists in capitalism. And this also means that this concrete subjection is more violent for some bodies than for others in this modern/colonial system.

As Walter Mignolo[37] emphasizes, in the 18th century, European secular philosophers celebrated the abandonment of theology and the advancement in direction of the rational scientific world in modernity. However, this 'new' scientific rationality was a somewhat totalitarian model because it denied the character of science to all forms of knowledge that were not guided by its epistemic Eurocentric principles of 'universality', 'objectivity' and 'impartiality'.[38] Unlike Eurocentric knowledge, forms of scientific production created by colonized people were deemed naive, irrational, and uncivilized.[39] Notwithstanding claiming that its scientific production was universal, Eurocentrism was also located in power relations.[40] And its knowledge production was geared towards itself, maintaining modern capitalist racial-sexual division of labor, including the scientific one.

Therefore, according to Mignolo,[41] the scientific revolution, as well as the Enlightenment, despite its immense contributions, can be considered as a species of a 'homemade revolution', because there is a greater paradigmatic continuity than a rupture: a change within the same white, male Christian, and Western tradition, which continues rejecting other non-European forms of knowledge.[42]

Despite being established in colonization, Eurocentrism is still the reference of world's knowledge production; hence, the term coloniality of knowledge. Labor Law's epistemology, its foundations, and key categories are suffused by this coloniality.

In this Eurocentric context, the idea of the modern labour relations differentiation arises. Free and subordinated labour appears to establish a counterpoint to bury pre-capital forms of work previously experienced, that is, slavery and servitude.[43] The aporia of the free and subordinated labour is also exalted as a form of resistance

31. *Ibid.*

32. *Ibid, p. 31 – 32.*

33. See ILO, 'World Employment and Social Outlook' Trends 2022. Geneva: International Labour Office, 2022, p. 31.

34. *Ibid.*

35. See B. S. Santos. 'Towards a Sociology of Absences and a Sociology of Emergence'. *Revista Crítica de Ciências Sociais*, n. 63, 2002.

36. See S. Ahmed. 'Declarations of whiteness: The non-performativity of anti-racism'. *Borderlands*, v. 3, n. 2, 2004.

37. See W. Mignolo. 'Os esplendores e as misérias da ciência: colonialidade, geopolítica do conhecimento e pluri-versalidade epistêmica'. In B.S. Santos (Ed.). Conhecimento Prudente para uma Vida Decente: 'um discurso sobre as ciências' revisitado. São Paulo: Cortez, 2006, p. 672.

38. See B. S. Santos. 'Um discurso sobre as Ciências na transição para uma ciências pós-moderna'. *Estudos Avançados*, Coimbra, 1988.

39. See A. Quijano. 'Coloniality and modernity/rationality' In W. Mignolo, A. Escobar (ed.). *Globalization and the Decolonial Option.* Routledge, New York, 2010, p. 22–32.

40. See M. Lugones. 'Rumo a um feminismo descolonial'. *Estudos Feministas*, Florianópolis, 22(3): 935–952, setembro-dezembro/2014.

41. See W. Mignolo. 'Os esplendores e as misérias da ciência: colonialidade, geopolítica do conhecimento e pluri-versalidade epistêmica'. In B.S. Santos (Ed.). Conhecimento Prudente para uma Vida Decente: 'um discurso sobre as ciências' revisitado. São Paulo: Cortez, 2006, p. 672.

42. *Ibid.*

43. See A. Quijano. 'Colonialidad del poder, eurocentrismo y América Latina'. *Colonialidad del saber.* Buenos Aires: CLACSO, 2000.

to the idea of pure autonomy of will, embodied in Civil Law: Labour Law was able to recognize the factual asymmetry among subjects, granting legal protection to the employee. Hence, another ideology was forged: the universalization of the capitalist system, with the normative regulation centered on free and subordinated labour.[44]

Latin American Labour Law imported this Eurocentric theory, reproducing the time parallel of slavery and servitude, to exalt the employment relationship as a revolution of freedom in modernity for all workers, for all humans, because all should have the right to choose, to feel, to think, to breathe and to love.

However, in Latin America, the forms of labour control did not emerge from this historical sequence. None of them were a mere extension of old pre-capitalist forms. They were not incompatible with capitalism. Servitude, slavery, and free labour were exercised together in a capitalist world-system.[45] And they were combined with the phenotypical idea of race,[46] associated with the color of the skin, and with gender. This was done with the purpose of granting legitimacy to the relations of domination between colonizer and colonized, naturalizing inferior functions in the social division of labour, and classifying people into human and anti-human. The latter had no right to choose, to feel, to think, to breathe or to love, because they were just flesh.

The 'indigenous'[47] were confined to servitude, 'blacks'[48] were enslaved; European white women were imprisoned in reproductive work; 'black' and 'indigenous' women were sexually objectified, raped and exploited in domestic enslavement; 'black' women were mortified in rural slavery and in mining.[49]

Only white European men could perform free labour. This means that in the colonization of Latin America there was an exclusive association of male whiteness with free and paid-for labour.[50] They were the standard for what meant being human, and this remains the case until today.

The free and subordinated labour, which is at the heart of Labour Law protection, is a legal construction based on a single type of worker, the only one considered to be human and deserving of the illusion of freedom of choice created by legal subordination.

Who loves tells the truth. So, listen to me. There is a legal coloniality in Labour Law. The employment relationship presents itself through a fictitious neutrality that equalizes inequalities. And even today it is this Eurocentric discourse created by and for the white male worker that defines who the epistemic subject in Labour Law is. This naturalizes and legitimizes the sexual-racial division of Labour in the world and in Latin America, through Labour Law itself.

The Labour norm has colour, it has an origin and it is gendered.[51] The Labour Law epistemology is constituted from an anti-black, anti-indigenous and anti-feminine foundation created in modernity. We can affirm, as a result of the reproduction of this Eurocentric discourse of legal subordination, without the proper decolonial translation, that the connection between Labour theory and its application in the Global South is radically fractured.

This is precisely why the mere legal absorption in the employment relationship is insufficient to secure the detachment from the condition of subalternity. It is an extremely complex issue, involving the pluralization of the epistemological fundaments of Labour Law and the epistemic subject in Labour Law, about silent ontological Labour,[52] geopolitics and the body-politics of knowledge.

And this cannot be reduced to the binary modern discourse of formal and informal work, in the exclusive quest for protected employment.

An example comes from Law 150/15 in Brazil,[53] which recognizes all employment relationship rights for domestic workers. It was an immense achievement carried out by the domestic workers themselves, which had no recognized union representation prior to this law. However, the recognition of legal subordination did not overcome colonial inequalities.

Firstly, the informality in domestic work in Brazil did not decrease[54] after Law 150/15. Nowadays, only a third of domestic workers have a formal contract.[55] More than 90 percent of domestic workers in Brazil are women[56] and 63 percent are black women. When these workers access the employment relationship, this does not prevent them

44. See E. Andrade. 'O direito do trabalho na filosofia e na teoria social crítica'. São Paulo: LTr, 2014.

45. See I. Wallerstein. 'The Modern World-System'. New York: Academic Press, 1974.

46. See A. Quijano. 'Colonialidad del poder, eurocentrismo y América Latina'. *Colonialidad del saber*. Buenos Aires: CLACSO, 2000.

47. 'The Indigenous is not a wage worker (...) The Indigenous is not a social class (...). The Indigenous is a race, a person, an oppressed Nation (...). The Indigenous does not fight for wages, which he never knew; nor for social justice, which he doesn't even imagine. The Indigenous fights for racial justice, for the freedom of his race; race enslaved since the West put its hoof in the lands of the Tawantinsuyu. The problem of the Indigenous is not a matter of assimilation or integration into the 'white, civilized' society; the problem of the Indigenous is a problem of liberation'. F. Reinaga. 'Revolución India', La Paz: Minka, 2010, p. 140.

48. 'The colonialist likes to dominate. One of the colonialist's weapons is to give a name. In Africa, we were not called blacks until the colonialist arrived. (...) They called it: they called everyone black. They used this empty word. A lifeless word, which was to weaken us'. A. B. Santos. 'As fronteiras entre o saber orgânico e o saber sintético'. In A.R. Oliva et al (Ed). *Tecendo Redes Antirracistas: Áfricas, Brasis e Portugal*. Belo Horizonte: Autêntica, 2019, p. 25

49. *Ibid.*

50. *Ibid.*

51. See R. Lerussi. 'Orientaciones feministas para un nuevo derecho del trabajo'. *Revista Direito e Práxis*, 11 (04). Rio de Janeiro, Oct-Dec, 2020.

52. See R. Crapo; A.J Cahill; M. Jacquart. 'Bearing the Brunt of Structural Inequality: Ontological Labour in the Academy'. *Feminist Philosophy Quarterly*, v. 6, n. 1, 2020.

53. Brazil, Law n. 150, June 1st, 2015. Available on: http://www.planalto.gov.br/ccivil_03/leis/lcp/lcp150.htm

54. See Instituto de Pesquisa Econômica Aplicada (IPEA). 'Os Desafios do passado no trabalho doméstico do século XXI' : reflexões para o caso brasileiro a partir dos dados da PNAD contínua. Brasília, 2019.

55. See ILO. 'A informalidade do trabalho doméstico'. Brasília: Organização Internacional do Trabalho, 2022.

56. *Ibid.*

from being brutally discriminated, being treated as enslaved people, using separate toilets, dishes, and cutlery in the house so that they do not mix in their white employers' spaces. About 2 out of 10 domestic employees in Brazil work longer than the limits established in Law 150/2015, which allows working hours of up to 44 hours per week or 8 hours per day.[57] Colonial subalternity is not overcome by the protection provided by legal subordination.

Nevertheless, most workers in the Global South, especially those 'non-white', still aim to achieve legal subordination as a privileged place of subjection in capitalism. Because currently they are subaltern flesh,[58] non-human flesh, with no right to choose, feel, think, breathe or love. In Africa, 85.8 per cent of employment is informal.[59] The proportion is 68.2 per cent in Asia and the Pacific, 68.6 per cent in the Arab States, 40.0 per cent in the Americas and 25.1 per cent in Europe and Central Asia.[60] About 93 per cent of the world's informal employment is in emerging and developing countries.[61]

The task of making coloniality in Labour Law apparent is not an easy one, as we do not know what the limit of radical critique is. Nonetheless, it is not enough to denounce the complicity of Labour Law's modern categories with the logic of coloniality. Because decolonial thinking, as love, due to its radical nature, involves practical acts. 'Love is an action, never simply a feeling, which involves assuming accountability and responsibility'.[62] Decolonizing is a process which requires action.

We must act. We must take epistemic responsibility[63] for our knowledge production in Labour Law. Therefore, it is crucial to decolonize its epistemic subject, its modern concept of time and value, based on merely mercantile criteria. We must shift its productive labour centrality, with the demystification of the idea that only those who perform productive labour should be entitled to a minimum income.[64] We must apply the decolonial method in Labour legal education, which involves a disobedient knowledge-praxis; expand the concept of work environment, which goes beyond the employment relationship and the world of work but must be in the scope of Labour Law.[65] We should critically reappropriate techniques of data gathering, of digital platforms and of bio-surveillance at work, and set up feminist intersectional strikes.[66]

This is my research. This is my work. Which is part of me. My body. My subjectivity. My affection. Is this love? Labor and Love. For me this is an intriguing combination. Is this feeling allowed when I am performing my labor? Because to have the right to love, to be considered as a worker, I have, firstly, to be considered human.

Ain't I a human?[67]

I am considered as a white[68] wealthy woman from the Global South. The first part of this sentence makes me be considered as a human, who has the right to love. And the Brazilian society makes me think that I am worthy to be loved. These privileges made me a young Professor. I had the freedom to choose my work.

I work at a University in a city called 'Ouro Preto'. This means black gold. This refers to the value of black flesh in Brazilian colonization, comparable with gold. Every day, I walk by this historical city, build on black labour, to enter a classroom full of white people. This racial gentrification is reflected in an epistemic racism on my own academic work: while people considered to be white - like me - produce Labour Law theory, it is expected that the black periphery - especially from black women - would simply provide case studies: they are our research 'object', with no right to choose, to feel, to think, to breathe or to love.

The colonial legacy of dehumanization of black women at work continues in these pandemic times at my University. They are forced to perform precarious work activities. They are not Professors; they are not researchers. They are not lawyers; they do not exist in the Law doctrine. They are not most of my students, despite being most of the Brazilian population. The ones who were able to be my students are being excluded again. Because they do not have access to the internet, they cannot study at home, they do not have space nor time. They must work, with no right to choose, to feel, to think, to breathe or to love.

57. *Ibid.*

58. Among the many episodes of reducing black people to non-human flesh in Brazil, we highlight the case of the five-year boy Miguel Otávio. He was put unaccompanied in an elevator by his mother's domestic employer. The mother, Mirtes Renata Santana de Souza, who was walking her employer's dog, found her son's body dead on the sidewalk after falling from the ninth floor of the employer's building.

59. See ILO. 'Women and men in the informal economy: A statistical picture'. 3rd edition. Geneva: International Labour Office, 2018.

60. *Ibid.*

61. *Ibid.*

62. B. Hooks. *All about love. New visions.* New York, Harper Perennial, 2001, p. 13: 'Love is an action, never simply a feeling, which involves assuming accountability and responsibility'

63. See L. Herzog. 'Assurer la dignité de chacun, mais aussi agir collectivement pour dépolluer la planète et la sauver'. in I. Ferreras, D. Méda, J. Battilana (ed.). *Le Manifeste Travail: Démocratiser. Démarchandiser. Dépolluer.* Paris, Seuil. 2020.

64. See N. Chandhoke. 'Il n'y a ni production ni service sans investisseurs en travail'. in I. Ferreras, D. Méda, J. Battilana (ed.). *Le Manifeste Travail: Démocratiser. Démarchandiser. Dépolluer.* Paris, Seuil. 2020. About the experience of conditional income transfer programs in Brazil, such as Bolsa Família, see C. B. Correa Júnior *et al.* 'Impactos do Programa Bolsa Família no mercado de trabalho dos municípios brasileiros'. *Rev. Adm. Pública*, vol. 53 n.5 Rio de Janeiro, 2019.

65. See Zbyszewska, Ania. 'Regulating work with people and 'nature' in mind: feminist reflections'. *Comparative Labour Law and Policy Journal*, 40 (1), 2018.

66. See Gago, Verônica. *A potência feminista ou o desejo de transformar tudo.* São Paulo: Editora Elefante, 2020.

67. See B. Hooks. *Ain't I a Woman? Black Woman and Feminism.* London, Pluto Press, 1982.

68. I recognize my social place in Brazil situated on whiteness, despite of being considered 'Latina' abroad. Using Quijano's theory, race is necessary phenotypical and the color of my skin in Brazil was always a privilege to access opportunities, never a mean of oppression. Being considered white in Brazil prevents me from understanding the complexity and violence of being black or indigenous in my country. However, I do not want to reproduce my social location in my epistemic one: I consider that it is my duty to denounce the epistemic racism that occurs in Labour Law. To understand the place of speech in Brazil, see D. Ribeiro. 'O que é lugar de fala'. Belo Horizonte: Letramento, 2017.

Because everything else is a priority at the expense of herself, she does not have the privilege of being taken care of, to love herself, and the Brazilian society makes her think that she is not worthy of being loved, because she is a black poor woman from the Global South, not a human. This is her ontological labour.

Ain't she a human?[69]

I am considered a white wealthy woman from the Global South. The second part of this sentence makes me not a complete human. In this pandemic reality, I - and all my fellow female researchers - worked more, better, without the right to disconnection, but I am less recognized than my male white colleagues. Because I am a woman from the Global South, not a human. This is my ontological labour.

In this pandemic reality, I - along with all my fellow female researchers - am exhausted from performing reproductive labour. This makes me feel far from love; it makes me feel angry at myself for being a professor of Labour Law. Because I cannot stop thinking about its epistemic insufficiencies regarding the concepts of time, of value, of environment, of teaching, of learning, that of being human.

Who loves tells the truth. So, listen to me. When I am criticizing Labour Law here, I am also defending it, with affection and love, despite all its contradictions. Because what I want for Labour Law - and for us - is freedom, the right to choose, to feel, to think, to breathe in these suffocating times; the right to love what we do.

69. See B. Hooks. *Ain't I a Woman? Black Woman and Feminism*. London, Pluto Press, 1982.

Ginevra Le Moli • Assistant Professor of International Law at Leiden University, and Fellow at C-EENRG, University of Cambridge

AI vs Human Dignity: When Human Underperformance is Legally Required

When mathematics Professor John McCarthy and his colleagues introduced the term 'Artificial Intelligence' (AI) in 1956, the AI problem was defined as 'making a machine behave in such a way that would be called intelligent if a human were so behaving'.[1] This definition considered human intelligence as the measure of and standard for what AI does.[2] Today, massive public and private investment is going into AI tools,[3] which are being actively incorporated into a range of decision-making processes in areas such as legal processes and medical diagnosis. Both AI practical achievements as well as AI 'ideological role as a technological paradigm for the reconstruction of capitalism' have attracted interest in advanced capitalist societies.[4] The restructuring of the global capitalist system has indeed been enhanced by technological developments in telecommunications, microelectronics and computers,[5] which, in turn, has reduced the need to rely on human labour.[6]

However, despite AI's increasing use in commercial, military, and scientific applications, AI systems are being deployed in the absence of specific and effective national and international legal regulatory frameworks.[7] Yet, AI does raise important normative challenges in various areas, such as human rights, global health and international labor law, among others. In a time where AI systems are bound to be a key component of capital, this essay examines when is human action normatively required as a matter of human dignity, and this irrespective of whether AI systems may outperform humans in a given task. I argue that delegation of decision-making powers to AI is normatively constrained and that human dignity provides an organizing framework to guide the delegation process.

Whereas AI is being increasingly deployed, from driving vast investment to computational techniques,[8] its public perception is far from uniformly positive.[9] For its enthusiasts, AI will eliminate the need for fallible human intellect, and 'will worry about all the really important problems for us (for us, not with us)'.[10] By extending 'mathematical formalization into the realm of social problems', AI is said to have 'brought with it a sense of newfound power, the hope of technical control of social processes to equal that achieved in mechanical and electronic systems'.[11] Thus, optimists promote the opportunity to democratize legal services and render decision-making more efficient and foreseeable.[12] Others, instead, remain sceptical[13] and denounce a range of risks, including intrusive social control, arbitrariness, and inequality.[14]

From an ethical perspective, AI's systems raise the familiar tension between two forms of normativity: consequentialism, i.e. normativity based on the end-results of an action, and deontologism, i.e. rules-based normativity. This essays highlights that a consequentialist ethics of performance must not undermine the normative reasons why human 'underperformance' is ultimately desirable. There is a pressing need to build what some call a 'good AI society', crafted by the public and private effort to adopt a holistic approach based on universal values and foundations.[15] In this context, human rights have a major role

1. J. McCarthy, M.L. Minsky, N. Rochester, and C.E. Shannon, 'A Proposal for the Dartmouth Summer Research Project on Artificial Intelligence, August, 31, 1955', in (2006) 7(4) *AI Magazine*, 11.
2. *Ibid.* See also S. J. Russell and P. Norvig, *Artificial intelligence: a modern approach*, Prentice Hall, 2009, 3rd ed., 2-5. See also J.A. Perez, F. Deligianni, D. Ravi, G.-Z. Yang, 'Artificial Intelligence and Robotics', *UK-RAS*, 2018, 2-4.
3. See, e.g., W. Alschner, 'The Computational Analysis of International Law', in R. Deplano and N. Tsagourias, *Research Methods in International Law*, Edward Elgar, 2021, 224-228; A. Deeks, 'High-Tech International Law', (2020) 88(3) *Geo. Wash. L. Rev.*, 574-653.
4. B.J. Berman, 'Artificial Intelligence and the Ideology of Capitalist Reconstruction', (1992) 6 *AI & Soc* 103, 103, see also 110. According to Christopher Freeman, 'a technological revolution represents a major change of paradigm, affecting almost all managerial decisions in many branches of the economy', and the new 'techno-economic paradigm' is 'a new set of guiding principles, which become the managerial and engineering 'common-sense' for each major phase of development', see C. Freeman, 'Prometheus Unfound', (October 1984), 16(5) *Futures* 494, 499.
5. Berman, *supra* n 4, 107.
6. See R. Kaplinsky, *Automation: the Technology and the Society*, Longman. 1984; H. Shaiken, *Work Transformed: Automation and Labour in the Computer Age*, Lexington Books, 1985; H. Schiller, *Information and the Crisis Economy*, Oxford University Press, 1986; V. Mosco, *The Pay-Per Society: Computers and Communication in the Information Age*, Garamond Press, 1989; T. Roszak, *The Cult of Information*, Pantheon, 1986, 44-45. See also G. Raunig, *Dividuum: Machinic Capitalism and Molecular Revolution*, MIT Press, 2016.
7. A. Deeks, 'Introduction To The Symposium: How Will Artificial Intelligence Affect International Law?', (2020)114 *AJIL Unbound* 138, 138.
8. J. Kaplan, 'Artificial Intelligence: What Everyone Needs to Know', Oxford University Press, 2016; J. Copeland, 'The Essential Turing: The Ideas that Gave Birth to the Computer Age', Oxford University Press, 2005.
9. Berman, supra n 4.
10. M. Boden, 'The Social Impact of Thinking Machines', in T. Forester (ed.), *The Information Technology Revolution*, MIT Press, 1985, 103.
11. P. Edwards, 'The Closed World: Systems Discourse, Military Strategy and Post WWII American Historical Consciousness', (1988) 2(3) *AI & Society* 245, 252.
12. R. Susskind, *Tomorrow's Lawyers: An Introduction To Your Future*, Oxford University Press, 2017, 2nd ed..
13. H. Dreyfus, *What Computers Still Can't Do: A Critique of Artificial Reason*, MIT Press, 1992. See also Berman, *supra* n 4.
14. See F. Pasquale, 'A Rule of Persons, Not Machines: The Limits of Legal Automation', (2019) 87(1) *Geo. Wash. L. Rev.* 1.
15. C. Cath et al., 'Artificial Intelligence and the 'Good Society': The US, EU, and UK Approach, Science and Engineering Ethics' (2017) 24(2) *Science and Engineering Ethics* 505, 507–508; J. Turner, *Robot Rules. Regulating Artificial Intel-*

to play. As noted by the UN Secretary-General in a 2018 report, 'AI tools, like all technologies, must be designed, developed and deployed so as to be consistent with the obligations of States and the responsibilities of private actors under international human rights law'.[16] Although such role is not always straightforward,[17] the normative concept of human dignity provides a legal key. This essay will focus on this particular perspective and, first, present examples that illustrate cases in which AI is considered to provide better performance, together with related challenges and, subsequently, examine why, irrespective of the high performance that AI can offer, the legal implications of human dignity constrain AI deployment in decision-making.

1. AI Technologies' Performance and Normative Challenges

Despite challenges posed by data-driven machine learning-based algorithms,[18] evidence of better performance has led to an increase use of AI in various sectors.

In the legal sector, AI is adopted more and more by agencies and courts for different purposes.[19] First, AI is used to *organize information*. One example is 'eDiscovery', a method of document investigation used by the courts in the United States and the United Kingdom[20] which is considered faster and more precise than manual file research. Moreover, AI tools are also adopted to *advise professionals*. The Solution Explorer system in the Civil Resolution Tribunal (CRT) in British Columbia, Canada,[21] was set up to deal with disputes relating to strata, subsidised housing and personal injury resulting from collisions. The Solution Explorer is the first step in CRT dispute resolution process. It provides people with clear legal information, as well as free self-help tools to solve their dispute without having to file a CRT claim. Thirdly, AI systems are used to better *predict* possible outcomes in judgments.[22] For instance, the Correctional Offender Management Profiling for Alternative Sanctions (COMPAS) system is adopted by courts in the United States to predict recidivism in criminal cases[23] or, in New Zealand, a computer-based prediction model supports in addressing claims under the accident compensation scheme.[24] In addition, there is a growing use of live facial recognition (LFR) which is considered necessary, for instance, when the nature of the crime requires it, as 'the social needs associated with preventing murder will be much higher than those associated with detecting petty theft.'[25]

Another broad application of AI concerns welfare and healthcare. Governments and private sector organizations are digitalizing the welfare state to 'automate, predict, identify, surveil.'[26] Nudging people's behavior using AI applications has grown in the health care and education areas. For instance, the University of Pennsylvania has set up the Penn Medicine Nudge Unit in 2016, which uses 'default options to increase generic prescribing and reduce opioid prescribing, using active choice to increase influenza vaccination, and using peer comparison feedback to increase statin prescribing and reduce unnecessary antibiotic prescribing.'[27] Similarly, E-learning and EduTech are nudging cognitive technologies in the field of learning and education.[28]

Yet another area where AI-enabled applications are increasingly is intelligence, surveillance and reconnaissance (ISR), including cyber defence.[29] For example, NATO uses AI applications in the ISR context to 'identify patterns and trends in support of situational awareness and operatio-

ligence, Palgrave Macmillan 2019, 209-210. See also M. Latonero, 'Governing Artificial Intelligence: Upholding Human Rights & Dignity', Report, *Data & Society*, 10 October 2018.

16. UN GA, 'Promotion and protection of the right to freedom of opinion and expression', Note by the Secretary-General, A/73/348, (2018, August 29), at paras. 19–20 ; see also UN HRC, Report of the Special Rapporteur to the General Assembly on AI and its impact on freedom of opinion and expression, (2018).

17. See D. Murray, 'Using Human Rights Law to Inform States' Decisions to Deploy AI', (2020) 114 *AJIL Unbound* 158, 158; T.L. Van Ho and M.K. Alshaleel, 'The Mutual Fund Industry and the Protection of Human Rights', (2018) 18(1) *Hum. Rts. L. Rev.* 1.

18. R. Braun, 'Artificial Intelligence: Socio-Political Challenges of Delegating Human Decision-Making to Machines', *IHS Working Paper* 6, April 2019, 3-4. See also T. Gillespie, *The relevance of algorithms*, in T. Gillespie, P. Boczkowski, and K. Foot (eds.), *Media technologies: Essays on communication, materiality, and society*, MIT Press, 2014, 167-193; B. Lepri, et al., 'FairTransparent, and Accountable Algorithmic Decision-making Processes: The Premise, the Proposed Solutions, and the Open Challenges', (2017) 31 *Philosophy & Technology* 611; M. Willson, 'Algorithms (and the) everyday', (2016) *Information, Communication & Society* 137; R.V. Yampolskiy, *Artificial Intelligence Safety and Security*, CRC Press, 2018.

19. A.D. Reiling, 'Courts and Artificial Intelligence' (2020) 11(2) IJCA 8.

20. In the United States: this methodology was considered valid for the first time in *Anti-Monopoly, Inc. v. Hasbro, Inc.*, 1995 WL 649934 (S.D.N.Y., Nov. 3, 1995); *Da Silva Moore v. Publicis Groupe & MSL Group*, No. 11 Civ. 1279 (ALC) (AJP) (S.D.N.Y., Feb. 24, 2012); on the technology assisted review (TAR) of documents, see Rio Tinto PLC v. Vale S.A., et al., 2015 WL 872294 (S.D.N.Y., Mar. 2, 2015); Hyles v. City of New York, et al., No. 10 Civ. 3119 (AT) (AJP) (S.D.N.Y., Aug. 1, 2016). In the United Kingdom, see High Court of Justice Chancery Division, U.K. (2016), *Pyrrho Investments Ltd v. MWB Property Ltd* [2016] EWHC 256 (Ch).

21. British Columbia Civil Resolution Tribunal (2019), <https://civilresolutionbc.ca>.

22. D. Katz et al., 'A General Approach for Predicting the Behavior of the Supreme Court of the United States', (2017) 12(4) *PLoS ONE*; M. Medvedeva, M. Vols, M. Wieling, 'Judicial Decisions of the European Court of Human Rights: Looking into the Crystal Ball, (2018) *Proceedings of the Conference on Empirical Legal Studies in Europe* 1. On possible attempts by parties to get advantage by adopting data-driven legal research and prediction, see Deeks, supra n 3, 600-622; N. Aletras et al., 'Predicting judicial decisions of the European Court of Human Rights: a Natural Language Processing perspective', (2016) 2 *PeerJ Computer Science* 1.

23. B. Green, '"Fair" Risk Assessments: A Precarious Approach for Criminal Justice Reform', 5th Workshop on Fairness, Accountability, and Transparency in Machine Learning, 2018.

24. J. Yoshikawa, 'Sharing the Costs of Artificial Intelligence: Universal No-Fault Social Insurance for Personal Injuries', (2018-2019) 21 *Vand. J. Ent. & Tech. L.* 1155.

25. Murray, supra n 17, 160-161. See Joined Cases C-203/15, C-698/15, *Tele2 Sverige AB v Post-och telestyrelsen* and *Secretary of State for the Home Department v.Watson and Others*, ECLI:EU:C:2016:970, para. 102 (Dec. 21, 2016).

26. Report of the Special Rapporteur on Extreme Poverty and Human Rights, A/74/48037, para. 8 (Oct. 11, 2019) [hereinafter Alston Report].

27. L. Devillers, F. Fogelman-Soulié, and R. Baeza-Yates, 'AI and Human Values. Inequalities, Biases, Fairness, Nudge, and Feedback Loops', in B. Braunschweig and M. Ghallab (eds.), *Reflections on Artificial Intelligence for Humanity*, Springer, 2021, 83; see also J. Harrison, M. Patel, 'Designing nudges for success in health care', (2020) 22(9) *AMA J. Ethics* E796-801.

28. M. Damgaard, H. Nielsen, 'Nudging in education', (2018) *Econ. Educ. Rev.* 64, 313–342.

29. S. Hill, 'AI's Impact on Multilateral Military Cooperation Experience From NATO', (2020) 114 *AJIL Unbound* 147, 150.

nal decision-making',[30] as well as in the cyber defense context, in preemptive patching and taking of corrective action faster and with more accuracy.

The increasing use of AI in these and other contexts is driven by considerations of performance. Yet, even when such higher performance is recognized, the use of AI has come under criticism, sometimes on grounds of occasional underperformance (e.g. rigidity or arbitrariness) but other times precisely because of the normative implications of high performance in performing certain tasks, including discrimination and intrusiveness. As regards the use of AI by courts, there is a potential for arbitrariness and discrimination,[31] together with issues of legal accuracy,[32] lack of transparency over algorithm-based methods and an increase in the justice divide *inter partes*.[33] Moreover, bias in data may produce discrimination,[34] in both predictive policing tools[35] and in LFR applications.[36] Public criticism of LFR uses has led to legal challenges in court, as it happened in the United Kingdom[37] and in the United States.[38] Moreover, the transformation of social protection and assistance such as, for instance, by way of automated eligibility assessments, calculation of benefits, fraud detection, and risk scoring, has given rise to various concerns: [39] lack of accuracy;[40] challenges to the right to social security, whether by reducing welfare budgets, the beneficiary pool, or enhancing sanctions,[41] and access to social services due to digital illiteracy;[42] or loss of reasoning, proportionality and discretion.[43] Similarly, the use of AI technologies in military contexts can pose difficulties, such as 'fueling pressure for inappropriately accelerated action'[44] with the result of going against traditional decision-making processes.

2. Human Dignity as a Legal Constraint on AI Decision-Making

In order to determine the human rights implications of AI decision-making, a human rights assessment would have to encompass an evaluation of AI systems' compliance with fundamental rights.[45] Such risk assessments cover the respect for human dignity, freedom of the individual, respect for democracy, justice and the rule of law, equality, non-discrimination and solidarity and citizens' rights.[46] In particular, even though respect for human dignity today is challenged by the rapid development of new technologies, its general meaning remains intact, i.e. every human being possesses an 'intrinsic value', which should never be endangered or repressed by others. Violations of human dignity are acts 'incompatible with the dignity and worth of the human person'.[47] Such acts are internationally condemned because they are harmful practices, a 'denial of dignity',[48] carrying 'a negative impact' on dignity and moral integrity.[49] In this sense, human dignity is protected in constitutional,[50] regional and international legal frameworks[51] and it can play a central role in constraining the extent of delegation to AI systems, as shown by its uses in various instances.[52]

Human dignity is indeed a guiding principle in international law and it acts as a 'mother-right' (operating as a source of rights and as a qualification of rights) and as a

30. *Ibid.*

31. See D. Boyd, K. Levy and A. Marwick, 'The Networked Nature of Algorithmic Discrimination', Open Technology Institute, October 2014; BW Goodman, 'A Step Towards Accountable Algorithms?: Algorithmic Discrimination and the European Union General Data Protection', 29th Conference on Neural Information Processing Systems, Barcelona, Spain, 2016, 3–4; Green, supra n 23; L. McGregor, D. Murray and V. Ng, 'International Human Rights as a Framework for Algorithmic Accountability', (2019) 68(2) *Int'l & Comp. L.Q.* 309.

32. T. Sourdin, 'Judge v Robot? Artificial Intelligence and Judicial Decision-Making', (2018) 41(4) *UNSW L.J.* 1114.

33. M Langford, 'Taming The Digital Leviathan: Automated Decision-Making and International Human Rights', (2020) *AJIL Unbound* 141, 144.

34. Devillers et al., supra n 27, 81-82. See also E. Pitoura et al., 'On measuring bias in online information', (2018) 46(4) *ACM SIGMOD Record* 16.

35. R. Richardson, J. Schultz, K. Crawford, 'Dirty data, bad predictions: how civil rights violations impact police data, predictive policing systems, and justice' (2019) *NYULR* 192.

36. See also M. Merler, N. Ratha, R.S. Feris, J.R. Smith, *Diversity in faces*, 29 January 2019, arXiv:1901.10436; J. Buolamwini, T. Gebru, 'Gender shades: intersectional accuracy disparities in commercial gender classification', Conference on Fairness, Accountability and Transparency, 2018, 77-91.

37. See *R (on the application of Edward Bridges) v The Chief Constable of South Wales* [2019] EWHC 2341, 4. Sept., 2019.

38. *Janecyk v. International Business Machines* (IBM), Case 1:20-cv-00783 (N.D. Ill.); *Vance v. IBM*, Case 1: 20-cv-577 (N.D. Ill.); *Mutnick v. Clearview AI, et al.*, Case 1:20-cv-00512 (N.D. Ill.); *Hall v. Clearview AI*, et al., Case 1:20-cv-00846 (N.D. Ill). See also Murray, supra n 17, 160-161.

39. Alston Report, supra n 26, paras. 1, 78. J. Redden, 'Democratic Governance in an Age of Datafication: Lessons from Mapping Government Discourses and Practices', (2018) 2 *Big Data & Society* 1; C. Sheppard and J. Raine, *Parking Adjudications: The Impact of New Technology*, in M. Harris and M. Partington (eds.), *Administrative Justice in the 21st Century*, Hart Publishing, 1999, 326-334. See also Langford, supra n 33, 142.

40. See T. Carney, 'Robo-Debt Class Action Could Deliver Justice for Tens of Thousands of Australians Instead of Mere Hundreds', *The Conversation* (Sept. 17, 2019) ; Alston Report, supra n 26, para. 28.

41. UN Comm. on Econ., Soc. & Cultural Rights, General Comment No. 19 on the Right to Social Security, E/C.12/GC/19, para. 11 (Feb. 4, 2008).

42. P. Larkin, 'Universal Credit, 'Positive Citizenship', and the Working Poor: Squaring the Eternal Circle?', (2018) 81 *Mod. L. Rev.* 114; M. Burton, 'Justice on the Line? A Comparison of Telephone and Face-to-Face Advice in SocialWelfare Legal Aid', 40 *J. Soc. Welfare & Family L.* 195 (2018).

43. C. Harlow & R. Rawlings, 'Proceduralism and Automation: Challenges to the Values of Administrative Law', in E. Fisher, J. King and A. Young eds., *The Foundations And Future of Public Law (in Honour of Paul Craig)*, Oxford University Press 2019.

44. Hill, *supra* n 29, 150.

45. Independent High-Level Expert Group (HLEG) on AI, 'Ethics Guidelines for Trustworthy AI', European Commission, 2020, 15–16. See also, 'Algorithms and Human Rights. Study on the human rights dimensions of automated data processing techniques and possible regulatory implications', Council of Europe study DGI, 2017, 12, 40.

46. HLEG AI, supra n 45, 9–11.

47. Vienna Declaration and Programme of Action, Part I, 15 (para 2); Art. 1, UNESCO, Convention Against Discrimination in Education, 14 December 1960, Art. 1, 1(d); Preamble, Supplementary Convention on the Abolition of Slavery.

48. Joint General Recommendation (GR) 31 CEDAW/GC 18 CRC, para 16.

49. *Ibid.*, para 15.

50. See A. Barak, *Human Dignity: The Constitutional Value and the Constitutional Right*, Cambridge University Press 2015.

51. See G. Le Moli, *Human Dignity in International Law*, Cambridge University Press, 2021, 216-260. See also Marcus Düwell, Jens Braarvig, Roger Brownsword and Dietmar Mieth (eds), *The Cambridge Handbook of Human Dignity. Interdisciplinary Perspectives*, Cambridge University Press, 2014.

52. *Ibid.*

source of obligations.[53] In particular, the dignity of the individual is today considered as 'the fundamental guiding principle of international human rights law'.[54] There is an established 'core human rights principle[s] of human dignity'.[55] For this reason, human rights instruments not only equally 'reaffirm', in the words of the UN Charter of the United Nations, 'faith ... in the dignity'[56] of the human person, but also acknowledge human dignity as the foundation of four different concepts. Human dignity, *in primis*, 'is the foundation of freedom, justice and peace in the world', as declared for the first time by the Universal Declaration of Human Rights (UDHR).[57] Moreover, all human beings have 'equality in dignity',[58] in line with Article 1 of the UDHR,[59] and they have the right to pursue their 'spiritual development' in a condition of dignity.[60] For this reason, 'social progress and development' are founded on respect for dignity.[61] Thus, there is an overall recognition that human dignity grounds the concepts and principles of 'freedom, justice and peace', of 'equality', of 'spiritual development' and of 'social progress and development'. Even when an international instrument is silent on this principle, human dignity still remains of 'central importance' for personal autonomy[62] and as a foundational objective. It is generally agreed that respecting human dignity is 'a fundamental and universally applicable rule'.[63]

By way of illustration, the Human Rights Committee has deplored incompatibility with this principle in various contexts, such as with regard to the prohibition of torture and ill-treatment,[64] since '[t]he humane treatment and the respect for the dignity of all persons deprived of their liberty is a *basic standard of universal application*',[65] or the misuse of scientific and technical progress.[66] The ECtHR has instead referred to conduct incompatible with the principle of human dignity in the assessment of infringements, such as discrimination on account of gender,[67] ethnicity[68] or race.[69]

The operativity of the principle of human dignity in legal practice shows that considerations of efficiency and effectiveness justifying resort to AI technologies remain subject to important legal constraints, and that underperformance may be normatively required to ensure the protection of human dignity. Human dignity presupposes that people deserve to be treated with respect. AI systems must be designed and set up in a way that protects human beings,[70] their physical and mental health but also their cultural sense of identity.[71] Importantly, at the EU level, it has been recognized by the Data Protection Authorities that human dignity may be undermined in the context of data processing[72] in various ways. There is a direct connection between data protection and AI systems because the latter are increasingly used to guide or control of information gathering system as well as to process the data. First, human dignity can be endangered by constant and intrusive monitoring, such as video surveillance (or other similar technologies)[73] as well as data-intensive systems gathering mobility data.[74] Second, human dignity is considered harmed when video-surveillance or other monitoring systems are installed in areas where high privacy is instead expected, such as in changing rooms or toilets,[75]

53. See Le Moli, *supra* n 51.

54. General Comment (GC) 13, The right to education (Art. 13 of the Covenant), E/C.12/1999/10, 8 December 1999, CESCR, para 41. See also GC n. 8, The right of the child to protection from corporal punishment and other cruel or degrading forms of punishment (arts. 19; 28, para 2; and 37, inter alia), CRC/C/GC/8, 2 March 2007, CRC, para 16.

55. GR 35, Combating racist hate speech, CERD/C/GC/35, 26 September 2013, CERD, para 10.

56. Preamble, Charter of the UN, 24 October 1945, 1 UNTS XVI (UN Charter).

57. Preamble, para 1, UDHR.

58. The formulation 'all human beings are born free and equal in dignity' can be found in various documents, see Le Moli, *supra* n 51.

59. See also, by way of example, Fifty-first session (1997), GR 23 (XXIII) on the rights of indigenous peoples, CERD, para 4; GC 10 (2007), Children's rights in juvenile justice, CRC/C/GC/10 25 April 2007, para 13.

60. Preamble, C122 Employment Policy Convention, ILO 1964; in an equal wording, see Preamble, Discrimination (Employment and Occupation) Convention, ILO 1958 (No. 111); Preamble, Indigenous and Tribal Populations Convention, ILO 1957 (No. 107).

61. See Art. 2, Declaration on Social Progress and Development, GA resolution 2542 (XXIV) of 11 December 1969; GC 13, supra n 54, para 4.

62. GC 36, Art. 6 of the ICCPR, CCPR/C/GC/36, 30 October 2018, CCPR, para 9.

63. See, for instance, GC 21, Art. 10 (Humane treatment of persons deprived of their liberty), HRI/GEN/1/Rev.9 (Vol. I), 13 March 1993, CCPR, para 4.

64. See GC 20, Art. 7 (Prohibition of torture, or other cruel, inhuman or degrading treatment or punishment), 30 September 1992, CCPR, para 2; *A.H.G. and M.R. v Canada* (CCPR/C/113/D/2091/2011), 5 June 2015, para 10.4.

65. See, for instance, GC 8, Article 9 (Right to Liberty and Security of Persons), 30 June 1982, CCPR, para 1.

66. See, for instance, GC 17, The right of everyone to benefit from the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he or she is the author (Art. 15, paragraph 1 (c), of the Covenant), E/C.12/GC/17, 12 January 2006, CESCR, para 35.

67. *S.A.S. v. France*, [GC], No. 43835/11, Judgment, 1 July 2014, para 120.

68. *Perincek v. Switzerland*, No. 27510/08, 15 October 2015, para 155 and 280.

69. *Abdu v. Bulgaria*, No. 26827/08, 11 March 2014, para 38; see Ananyev and Others v. Russia, No. 42525/07 and 60800/08, 10 January 2012, paras 139–142

70. D.E. Harasimiuk, T. Braun, *Regulating Artificial Intelligence*, Routledge, 2021, 63.

71. E. Hilgendorf, 'Problem Areas in the Dignity Debate and the Ensemble Theory of Human Dignity' in D. Grimm, A. Kemmerer, C. Millers (eds.), *Human Dignity in Context. Explorations of a Contested Concept*, Hart Publishing, 2018, 325 ff.

72. See Council of Europe, Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, ETS n. 108, 28 January 1981, Preamble.

73. On workers' video surveillance, see Information Commissioner's Office (ICO), The employment practices code, 2011, Part. 3; Garante per la protezione dei dati personali (GPDP), 4 April 2013, n. 2439178; GPDP, 30 October 2013, n. 2851973; Commission de la protection de la vie privée (hereinafter CPVP), avis, n. 8/2006, 12 April 2006; Commission Nationale de l'Informatique et des Libertés (CNIL) n. 2014-307, 17 July 2014. On invasive monitoring activities, see GPDP, 25 January 2018, n. 7810766.

74. Such as, for example, GPS, Radio Frequency Identification (RFID) technologies, Wi-Fi tracking devices, 'event data recorder' devices or Intelligent Transport Systems. See Agencia Española de Protección de Datos (AEPD), resolución R/01208/2014; CNIL n. 2010-096, 8 April 2010; CPVP, recommandation n. 01/2010, 17 March 2010; ICO, 'Wi-filocation analytics' (2016); Article 29-Data Protection Working Party (ART29WP), 'Working document on data protection issues related to RFID technology', WP 105 (2005); ART29WP, 'Opinion 03/2017 on Processing personal data in the context of Cooperative Intelligent Transport Systems (C-ITS)', WP 252 (2017).

75. See, for instance, GPDP, 4 December 2008, n. 1576125; GPDP, 24 February 2010, n.; AEPD, expediente n. E/01760/2017; ICO, 'In the picture: A data protection code of practice for surveillance cameras and personal information' (2017); ART29WP, 'Opinion 4/2004 on the Processing of Personal Data by means of Video Surveillance', WP 89 (2004).

due to the personal embarrassment that it may cause. Thirdly, the use of sensitive data can endanger human dignity, as it has been recognized in cases of invasive information requests by employers,[76] of use of wearable and Internet of Things (IoT) devices to collect sensitive data (e.g. health data) or profiling information,[77] and biometric data collection.[78] Finally, human dignity can also be affected by the publication of personal information which can cause distress to affected individuals, like in the case of disclosure of evaluation judgements, such as ratings of employees[79] or exams' results,[80] private debt reports,[81] or the use of services of the so-called reputation economy.[82]

Similarly, there is a risk of discrimination, and a related impact on human dignity, arising from the use of algorithms in different contexts.[83] For instance, an automated algorithmic-based social security system, such as the one implemented in the UK, despite improving the cost-efficiency of the payment system, imposes digital barriers in the accessibility of social security and may thus exclude individuals without (or with low) digital literacy.[84] This, in turn, can affect vulnerable people's fundamental human rights, such as work, food and housing.[85] Moreover, predictive analytics, which may also be adopted in child safeguarding,[86] can raise issues of privacy and discrimination.[87]

Thus, these examples illustrate how compatibility and consistency with human dignity are viewed as benchmarks or standards for the assessment of the compatibility of technology-assisted surveillance. It is therefore directly relevant to understand the consistency of AI technologies with fundamental rights.

Concluding observations

This essay has attempted to show how human dignity can act as a limit and legal constraint in the decision to delegate a task to an AI tool (or not), in order to facilitate human rights compliance. In an AI context, a human dignity-approach balances the tension between consequentialism and deontologism, in favour of the latter and of human action, irrespective of the high performance and results that could in principle be ensured by AI technologies' use. It also allows to guarantee that the AI system's operation does not generate unfairly biased outputs and is as inclusive as possible. Importantly, human dignity sets a standard of deployment and plays a role in the decision-making process, thereby establishing the framework within which possible harm can be assessed.

76. Such as health conditions, religious beliefs, criminal records, and drug and alcohol use. See GPDP, 21 July 2011, n. 1825852; GPDP, 11 January 2007, n. 1381620.
77. See ART29WP, 'Opinion 8/2014 on the on Recent Developments on the Internet of Things', WP 223 (2014).
78. See GPDP, 1 August 2013, n. 384, n. 2578547; CNIL n. 2008-492, 11 December 2008; CPVP, avis n. 17/2008, 9 April 2008; ART29WP, 'Opinion 3/2012 on developments in biometric technologies', WP193 (2012).
79. See GPDP, 13 December 2018, n. 500, n. 9068983.
80. See ICO, 'Publication of exam results by schools' (2014); ART29WP, 'Opinion 2/2009 on the protection of children's personal data', WP 160 (2009); GPDP, 'Scuola: Privacy, pubblicazione voti online è invasiva', n. 9367295 (2020).
81. See GPDP, 28 May 2015, n. 319, n. 4131145; AEPD, procedimiento n. A/00104/2017.
82. For instance, platforms which display and manage product and service reviews, as well as tax or criminal information. See GPDP, 24 November 2016, n. 488, n. 5796783.
83. See *supra* n 31.
84. UN Special Rapporteur on Extreme Poverty and Human Rights Philip Alston, 'Statement on Visit to the United Kingdom', 16 November 2018.
85. *Ibid.*
86. On Xantura's Early Help Profiling System (EHPS), see London Councils, 'Understanding who the most vulnerable people in your locality are', at <https://www.londoncouncils.gov.uk/our-key-themes/our-projects/london-ventures/current-projects/childrens-safeguarding> [last access 20/01/2022].
87. N. McIntyre and D. Pegg, 'Councils Use 377,000 People's Data in Efforts to Predict Child Abuse', *The Guardian*, 16 September 2018.

The Sustainability Challenge

Pierre-Henri Conac • Professor, University of Luxembourg ; Max Planck Fellow, Max Planck Institute Luxembourg

Sustainable Corporate Governance in the EU: Reasonable Global Ambitions?

The European Union (EU) traditionally limited its interventions in the field of corporate governance of companies. Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Although the EU can legislate in the field of company law, including corporate governance, most rules are adopted by Member States (MS) and are complemented in listed companies by soft law, especially corporate governance codes, adopted at national level.

There are political and technical reasons for this non-intrusive approach by the EU. At the political level, Member States failed from the start to agree on a single set of governance rules for companies. The failure to harmonise substantially company law was clear as soon as the first company law directive of 9 March 1968 which provided only for limited harmonisation. Corporate governance proved especially difficult to harmonise as illustrated by the failure of the Council and later co-legislators to adopt the project of the so-called 5th company law directive on public limited liability companies.[1] The proposal was too close to the German model and did not fit Member States which had various models. As a consequence, harmonisation of company law in the European Union was limited to minimum requirements, in the area of cross-border activities or to EU company forms, such as the *Societas Europea* (SE) which was adopted in 2001 after a long process and provided only a very limited level of harmonisation. The failure of the Commission to secure the adoption in the Council of the European Private Company (*Societas Privata Europea* - SPE) which was introduced in 2008 as another EU legal form is another illustration of the difficulty to harmonise Member States company law. As was to be expected, the requirement for unanimity in the Council proved insurmountable. Top-down harmonisation was also complemented by competition among national company laws thanks to the case law of the European Court of Justice which forced Member States to recognize companies incorporated in another Member State. It is also not surprising that the European legislator requested only in 2006 that listed companies refer to a national corporate governance code.[2] At this time, only Luxembourg had not introduced such a code while the United Kingdom and France where the first Member States to do so, respectively in 1992 and 1995.[3]

The reason for this lack of interventionism are threefold. First, company law, and therefore corporate governance, reflects strong national preferences and are deeply rooted in the culture of Member States. Second, Member States are keen to retain their flexibility in organising their types of companies, especially considering that there is an intense degree of competition among national company laws. Company law is considered a competitiveness tool. Finally, the Commission was for an extended period of time liberal and did not want to interfere too much with national company law.

At a more technical level, difficulties to harmonise corporate governance can be explained by the differences of internal structures and especially by the importance of systems of co-determination, such as the German *Mitbestimmung*, which provide for employee participation in the management organs of medium and large companies. Member States were and still are strongly divided on this approach and many did not want to introduce it. In addition, it is quite difficult to harmonise this field. The European Union has competence under article 153(1)(f) of the Treaty on the Functioning of the European Union (TFEU) to adopt directives setting minimum standards in the field of 'representation and collective defence of the interests of workers and employers, including co-determination'. However, unanimity is required within the Council.[4] These opposite views on company law and the need for unanimity in some fields which are closely linked to corporate governance such as workers' participation have made it almost impossible to harmonise anything in this field. This is also why, Germany, among others, opposed for such a long time the proposal of directive of 2012 on gender balance among non-executive directors of companies listed on stock exchanges. It only changed its view in 2021 with the new coalition. The text has been adopted in March 2022 in the Council and is currently under trialogue.

This is not to say that the EU legislator did not have sometimes an impact on corporate governance. The excep-

1. For an in-depth analysis of the various proposals for a Fifth Company Law Directive See. Thomas Abeltshauser, *Strukturalternativen für eine europäische Unternehmensverfassung: eine rechtsvergleichende Untersuchung zum 5. gesellschaftsrechtlichen EG-Richtlinienvorschlag*, Berlin 1990.

2. Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, OJ L 224/1, 16.8.2006.

3. AFEP/MEDEF, Report of the Committee on Corporate governance chaired by Mr Marc Viénot, 1999, 33 pp.

4. Article 153(3) TFEU.

tion to the general rule is the takeover directive of 2004, adopted after more than 15 years of negotiations, whose article 3 (c) holds that 'the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid'.[5] This is an implicit hint at the stakeholder approach and hence corporate governance. Also, the EU Commission supported as soon as 2001 Corporate Social Responsibility (CSR) for European companies.[6] According to the Commission, CSR is a 'a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis'.[7] However, unsurprisingly, this support took only the form of a Communication.

This situation started to change as a consequence of the 2008 great financial crisis. Institutional shareholders were accused of not having monitored enough the banks they were invested in, leading to short termism, excessive risk taking and a financial collapse. The great financial crisis of 2008 also lead to a weakening of liberalism and a call for wider and deeper regulation in all areas of finance. As a consequence, the European Commission also became more active in the area of corporate governance.

Regarding substantive regulation, the banking sector was first subject to reforms designed to reduce risk taking and improve corporate governance. Then, the Commission published in 2011 a Green Paper on 'The EU Corporate Governance Framework' calling for an improvement in the performance of board of directors and shareholders' engagement.[8] The Commission also appointed a 'Reflection Group on the Future of EU Company Law' which issued many recommendations in 2011. Among them was the invitation, often trough options for the Member States, to promote long-term thinking among companies.[9] These reports led, among others, to the amendment of the directive on shareholders' rights in 2017[10] to encourage of long-term shareholder engagement and to the adoption in 2014 of a communication to improve corporate governance.[11]

The Commission became more active at the same time on CSR. It adopted in 2011 'A renewed EU strategy 2011-14 for Corporate Social Responsibility'.[12] A new definition of CSR was provided as: 'the responsibility of enterprises for their impacts on society'. The Commission called on companies to have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders. As part of this agenda, the Commission increased in 2013 and 2014 the disclosures on sustainability required by large undertakings, public-interest companies and listed companies for instance by adopting the Non-Financial Reporting Directive (NFRD).

Since 2018, a strong push has occurred in 'green finance' and sustainable corporate governance. The Commission adopted an 'Action Plan: Financing Sustainable Growth'[13] in 2018, an 'European Green Deal' in 2019,[14] and a Communication on 'Strategy for Financing the Transition to a Sustainable Economy' in 2021.[15] This has led in the area of sustainable governance to the introduction in 2021 of a proposal of Directive on Corporate Sustainability (CSRD) amending the 2014 NFRD and the introduction of a proposal of directive on Corporate Sustainabililty Due Diligence in 2022.

The European Commission is taking the lead globally by launching those initiatives at an incredible pace. The reason for such a speed is that the EU wants to become the global standard in terms of sustainable finance and sustainable corporate governance. This change, from an incremental to an ambitious approach, has several probable causes.

The first reason is Brexit. The United Kingdom (UK) was usually a powerful counterbalancing force pushing against EU legislation, even often softening them ex-ante, when they were deemed too ambitious or not business friendly, especially in finance and company law. This influence disappeared immediately after Brexit. A more ambitious and federalist, agenda especially promoted by France, became more influential in Brussels. As a consequence, the EU started to promote and, more than before, export through extraterritorial application an 'European economic and social model', in opposition to the much more liberal views of the UK and also of the United States.

The second reason is the important level of Euroscepticism. This has led to the appointment of a 'Political European Commission' (2019-2024), led by Ursula von der Leyen, with a very ambitious approach. The EU Commission wants to be seen acting in the most important fields

5. Directive 2004/25/EC of the european parliament and of the council of 21 April 2004 on takeover bids, JO L 142/12, 30.4.2004.

6. European Commission, Green Paper, Promoting a European framework for Corporate Social Responsibility, Brussels, 18.7.2001 COM(2001) 366 final.

7. European Commission, Green Paper, Promoting a European framework for Corporate Social Responsibility, Brussels, 18.7.2001 COM(2001) 366 final.

8. European Commission, Green Paper, The EU Corporate Governance Framework. European Commission, Brussels, 5.4.2011 COM(2011) 164 final.

9. The Reflection Group Report is available on-line at: http://ec.europa.eu/ internal_market/company/docs/modern/reflectiongroup_report_en.pdf and at: http:// papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654.

10. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, OJ L L132/1, 20.5.2017.

11. Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain'), OJ L 109/43, 12.4.2014.

12. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A renewed EU strategy 2011-14 for Corporate Social Responsibility, Brussels, 25.10.2011 COM(2011) 681 final.

13. Communication from the Commission 'Action Plan: Financing Sustainable Growth', COM(2018) 97 final, 8.3.2018.

14. Communication of the Commission, The European Green Deal, COM/2019/640 final, 11.12.2019.

15. Communication from the Commission 'Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final, 6.7.2021

for European citizens and especially on climate change, social issues and human rights. Non-Governmental Organisations (NGOs), various activists as well as the press are putting pressure on the Commission and Member States to do more in those fields. The *Zeitgeist* has changed. In this situation, businesses are having more difficulties to challenge legislative initiatives for fear of reputational damage.

The EU legislator has become very active in the field of sustainable corporate governance (1). However, it is doubtful that these new global ambitions will succeed (2).

1. Developments on Sustainable Corporate Governance in the European Union

The EU legislator is currently very active in the field of sustainable corporate governance. The traditional approach of imposing disclosure (1.1) is also complemented by the adoption of substantive regulations (1.2).

1.1 Disclosure regulation

The EU legislator started to be active on CSR after the burst of the Internet bubble in 2001. In 2003, the Fourth Accounting Directive was amended to provide a requirement that 'To the extent necessary for an understanding of the undertaking's development, performance or position, the analysis (in the Management Report) shall include… where appropriate, non-financial key performance indicators relevant to the particular business including information relating to environmental and employee matters'.[16]

After the 2008 great financial crisis, the EU legislator strengthened non-financial disclosure. The Accounting Directive was amended in 2013 in order to force large companies and public-interest entities active in the extracting and logging of prime forest industries to report payments to governments.[17] The Transparency Directive was also amended in 2013 in order to cover listed companies with the same requirement.[18] These provisions were not designed to inform shareholders but rather civil societies in emerging economies to allow them to fight corruption by giving NGOs access to critical information on the flow of money by concerned EU companies.

In 2014, the EU legislator adopted requirements for large companies to disclose non-financial and diversity information (NFRD).[19] Article 19a on Non-financial statement, and article 29a on Consolidated non-financial statement of the 2013 Accounting directive as amended by the NFRD, request that '1. Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including… (e) non-financial key performance indicators relevant to the particular business.'

As part of the 2018 sustainability agenda of the Commission, the Non-Financial Reporting Directive of 2014 is being subject to significant amendments by a proposal of directive of 2021 on corporate sustainability reporting (CSRD).[20] The proposal deals with the update of the NFRD first because of complaints by investors on issues of quality and comparability. To ensure the reliability of the disclosure, the Commission is proposing an audit requirement for sustainability information. Auditors will have to provide a 'limited' assurance requirement. It is a significant change compared to the current situation but does not go as far as imposing a 'reasonable' assurance requirement. The scope of the information will also be extended. Non-financial statement will need to contain more detailled information relating to environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. The scope of the NFRD will be extended as to companies but special rules have been provided for SMEs in order to reduce the regulatory burden for them. The proposal has been adopted by both the Council and the European Parliament and is currently being discussed in the trilogue. Finally, as part of these reforms, the Commission has adopted in a Communication of 2019 on reporting climate-related information the concept of 'double materiality'.[21] Companies have to report about how sustainability issues affect their business and about their own impact on people and the environment. This concept has been incorporated in the proposed CSRD.

16. Article 46(1)(b) the Fourth Accounting Directive (and now Article 19(1) of Directive 2013/34). Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings, OJ L 178/16, 17.7/2003.
17. Art. 41-48. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182/19, 29.6.2013.
18. Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, OJ L. 294/13, 6.11.2013.
19. Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330/1, 15.11.2014.
20. Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, Brussels, 21.4.2021 COM(2021) 189 final, 2021/0104 (COD).
21. Communication from the Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01), OJ C 209/1, 20.6.2019.

As part of this disclosure agenda, the European Commission is also supporting the development of 'EU Sustainability Reporting Standards'. This task has been entrusted to the European Financial Reporting Advisory Group (EFRAG). EFRAG was set up in 2001 to assist the European Commission in the endorsement of International Financial Reporting Standards (IFRS) by providing advice on the technical quality of the IFRS. The adoption of the first standards is scheduled for 2023. In April 2022, EFRAG published more than ten standards (*European Sustainability Reporting Standards*) for the implementation of the CSRD. Those standards are subject to consultation until 8 August 2022. Among these standards is the ESRS G1 Governance, risk management and internal control which deals directly with corporate governance. In order to have a Common classification system for sustainable investments, the EU legislator has also adopted a 'Green Taxonomy' in 2020.[22] A social taxonomy is expected in 2022.[23] Also the Sustainable finance disclosure regulation (SFDR) of 2019 strengthens the protection for end-investors by standardising and enhancing ESG-related disclosures.[24]

Disclosure is the traditional tool of the EU legislator in order to promote sustainable governance. However, the European Commission is moving towards also imposing substantive requirements on companies incorporated or active in Europe.

1.2 Substantive regulation

As a way to prepare future actions, a report has been published as part of an EU-funded project on *Sustainable Market Actors for Responsible Trade* (SMART).[25] The report, prepared by a team led by Norwegian academics, identifies shareholder primacy as a major obstacle to sustainable companies. It advocates that companies should have a an overall objective of creating sustainable value within the planetary boundaries and that the board should have a duty to ensure that the company's business model is consistent with this objective. This position is very isolated even in Scandinavian countries. The European Commission also commissioned to Ernst & Young a study on directors' duties and sustainable corporate governance.[26] This study was published in July 2020 and argued that the corporate governance of companies had to be changed in order for them to be 'sustainable'. The report argued that companies were biased towards short-termism. To adress this, the EY report suggested to change directors' duties to include sustainability criteria and duties to stakeholders. This scientific quality of the EY study was heavily contested, and rightly so, by academics such as Harvard professors[27] as well as John C. Coffee from Columbia law school.[28] Nevertheless, the Commission started to work on a proposal of directive on Sustainable Corporate Governance. Political pressure to introduce a proposal of directive came also from the European Parliament through a resolution of 17 December 2020 on sustainable corporate governance.[29]

Because of strong opposition from some Member States as well as a rare two negative opinions by the Regulatory Scrutiny Board of the Commission, the pre-proposal was shelved by the Commission in February 2022. The content of the ante-proposal was not disclosed but could have included apparently mandatory board strategies to set concrete environmental targets by companies.

Therefore the only current proposal of the Commission is a directive on Supply Chain Liability labelled directive on 'Corporate Sustainability Due Diligence' (CSDD) published on the 23rd of February 2022.[30] The European Parliament had drafted and adopted its own proposal in order to influence the future text of the Commission.[31] The Commission text is very much inspired by the French Duty of Vigilance Act of 2017, the German Act on Corporate Due Diligence Obligations for the Prevention of Human Rights Violations in Supply Chains (*Lieferkettensorgfaltspflichtengesetz - LkSG*) of 2021 and the Dutch law on child labour (*Wet zorgplicht kinderarbeidm*) of 2019.

The scope of the directive is wide and includes large and medium sized enterprises since it includes companies with more than 500 employees on average and with a net worldwide turnover of more than 150 million euros in the last financial year for which annual financial statements have been prepared. Companies below this threshold are covered, provided they have more than 250 employees on average and a net worldwide turnover of more than 40 million euros in the last financial year for which annual financial statements have been prepared, provided also that at least 50% of this net turnover was generated in sectors where risks are considered higher such as the textile and fashion industry.

22. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ UE L 198/13, 22.6.2020.
23. Final Report on Social Taxonomy, Platform on Sustainable Finance, February 2022.
24. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.
25. Beate Sjafjell, Jukka T. Mahonen, Tonia A. Novitz, Clair Gammager, Hanna Ahlstrom, 'Securing the Future of European Business: SMART Reform Proposals' (7 May 2020). University of Oslo Faculty of Law Research Paper No. 2020-11, Nordic & European Company Law Working Paper No. 20–08, available on SSRN: https://ssrn.com/ abstract=3595048
26. EY, 'Study on directors' duties and sustainable corporate governance', Final Report dated July 2020.
27. Mark J. Roe, Holger Spamann, Jesse M. Fried, Charles C.Y. Wang, 'The European Commission's Sustainable Corporate Governance Report: A Critique', Law Working Paper N° 553/2020, April 2021.
28. https://www.law.ox.ac.uk/business-law-blog/blog/2020/11/ec-corporate-governance-initiative-series-european-commission
29. European Parliament resolution of 17 December 2020 on sustainable corporate governance (2020/2137(INI)).
30. Proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels, 23.2.2022 COM(2022) 71 final, 2022/0051 (COD).
31. European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL)), 10 March 2021.

Companies within the scope of the directive need to take appropriate measures to identify actual or potential adverse human rights and environmental impacts in their own operations, in their subsidiaries and at the level of their established direct or indirect business relationships in their value chain. The value chain includes their subsidiaries but also contractors with whom exist an 'established business relationship'. The scope is very wide since it covers any business relationship, direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain.

They must take appropriate measures to prevent potential adverse impacts identified and adequately mitigate them, where prevention is not possible. Disengagement is possible if the company cannot influence the behaviour of its suppliers but only as last-resort action. The directive provides for civil sanctions issued by a supervisory authority and for private enforcement through civil liability. In practice, small and medium-sized enterprises included in the value chain will be covered by the Directive.

Three provisions are directly related to corporate governance and might have originated from the failed project of Sustainable Corporate Governance Directive. Article 25 harmonises at the EU level the directors' duty of care of EU companies covered by the directive. When fulfilling their duty to act in the best interest of the company, directors should take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term. Although the Commission presents this definition as a clarification, it is anything but so. This standard does not correspond to any Member State law. It is rather an attempt at a top-down harmonisation in a key area of company law left usually to Member States. Article 26 relates to the setting up and the oversight of due diligence. It requires that the directors take due consideration for relevant input from stakeholders and civil society organisations when putting in place and overseeing the due diligence actions of the company. This calls in practice for an involvement of NGOs into the decision making process of companies. A major shift in capitalism.

Finally, article 15 on 'Combating climate change' requires companies to adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement of 2015. In case climate change is or should have been identified as a principal risk for, or a principal impact of, the company's operations, the company should include emission reduction objectives in its plan. Variable remuneration should be linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.

Furthermore, EFRAG's ESRS G1 *Governance, risk management and internal control standard* could have a substantial impact. Although it provides only for disclosure as part of the new CSRD and is without prejudice to existing Member States' company law, it requires companies to state their position in relation to a governance model that gives a considerable role to stakeholders and sometimes even treats shareholders as just one category among others of stakeholder. This is in fact hard law in being as companies will have to justify on an ongoing basis deviations from the model proposed by EFRAG.

The proposal of directive constitutes an attempt to harmonise corporate governance in the EU and a complete breach with the previous period. It is also a challenge to the traditional liberal view of capitalism. The activism of the Commission and of the EU legislator in the field of sustainable governance is certainly laudable in principle. However, the approach of the Commission on sustainability raises serious issues.

2. Reasonable global ambitions ?

The European Union is aiming at establishing global standards in the field of sustainable corporate governance (2.1). It is not impossible but doubtful that it will succeed in this very ambitious goal. In addition, the risk is that the EU would be putting European companies at a competitive disadvantage with excessive regulations (2.2).

2.1 European law as a global standard on sustainable governance

The EU is aiming at establishing global standards in sustainable governance through extra-territorial application and to influence international standards.

Contrary to the NFRD, the CSRD provides for extraterritorial application. The proposed CSRD disclosure rules would have applied both to EU and non-EU domiciled companies that have any type of transferable securities listed on EU regulated markets. This includes debt securities. Many foreign companies, including banks, have debt listed on EU stock exchanges. This means that, for instance, large third country banks will be subject to the rules as they often have debt securities listed on an EU regulated market. The Commission assumes that such third country companies will prefer to subject themselves to the CSRD rather than lose access to the EU financial markets. This belief might be wat too optimistic and foreign companies may prefer to list their debt securities, even issued in euros, in London. Delisting of shares is even more likely. Equivalence measures are being provided in the CSRD to reduce the regulatory burden but they still imply that the third country legislation is rather similar to the one of the EU. This extraterritorial approach invites reciprocity of extraterritorial treatment on the part of foreign jurisdictions increasing the cost of cross-border business.

The amendments adopted by the EU Parliament's Committee on Legal Affairs (JURI) to the CSRD would extend the scope to large companies to third countries with commercial activities ('*sale of goods*') in the EU. This additional criterion for the extraterritorial application of the CSRD is unlikely to be accepted by the Council in the trilogue because of a strong opposition of several Member States

The CSDD is also aiming at extraterritorial application. First, the directive would apply to third country companies operating in the Union, based on a similar turnover criterion as the European ones. Article 2 of the proposed directive provides that third country companies are subject to this new regime if they generated a net turnover of more than 150 million euros in the Union in the financial year preceding the last financial year or they generated a net turnover of more than 40 million euros but not more than 150 million euros in the Union in the financial year preceding the last financial year, provided that at least 50% of its net worldwide turnover is done in one or more of the high risk sectors. The threshold proposed is very low and will cover a significant number of foreign companies. Those companies will be subject to substantive requirements relating to EU legislation. This is designed at ensuring a level playing field but it is also an attempt at exporting EU standards which might not be appreciated in all jurisdictions. In order to ensure the enforcement of such rules, article 16 of the proposed directive requires that third country firms designate a legal or natural person as its authorised representative, established or domiciled in one of the Member States where it operates. It is doubtful that these 'authorised representatives' will be able to make sure that the requirements of the directive are applied abroad if those companies or countries are not cooperative.

Second, foreign companies that are integrated in the value chain would also be subject to the CSDD. This will pose difficulties, particularly in relation to the number of codes to be applied.[32] Lastly, parent companies of subsidiaries established in the EU and which would be subject to the CSDD will be indirectly covered. However, the US may not appreciate that its parent companies are, even indirectly, subject to EU standards when they have a subsidiary in the EU, as one author has very accurately noted.[33]

The EU was successful in imposing to American companies its approach on Data Protection with the General Data Protection Regulation 2016/679 of 27 April 2016 on data protection and privacy (GDPR).[34] However, there were fewer and larger actors and they could not realistically leave the EU market since they are global in nature and are facing difficult access in some large jurisdictions like India or China as they want to keep their data for themselves out of protectionist or sovereignty reasons. The situation of the CSDD is very different. The GDPR logic might not work for a large number of foreign firm who might feel that it is not worth the trouble to sell goods in the EU.

The EU is also trying to influence global standards in order to export at least some of its standards on sustainable finance and governance. The EU was a strong promoter and the largest jurisdiction to adopt the International Financial Reporting Standards (IFRS). The goal of the EU was to avoid that the US *Generally Accepted Accounting Principles* (US GAAP) become the *de facto* international financial accounting standards for listed companies. The EU did not succeed in having the US adopt the IFRS but the IFRS still became the global accounting standard since it has been adopted in more than 144 jurisdictions for all or most companies. However, this clear and resounding European success was made possible because there was an evident similar interest in other jurisdictions and it was achieved at the price for the EU of becoming a standard taker since it could not afford to deviate from these standards.

As to the International Sustainability Reporting Standards, the EU would like to become a standard giver and not a standard taker. Therefore, it is pushing EFRAG to develop EU Sustainability Reporting Standards as fast as possible even at the price of reducing consultation time to the bare minimum. The EU Commission hopes to set the standards ahead of other jurisdictions and especially ahead of the US and of the IFRS International Sustainability Disclosure Standards. The US have been lagging behind because of the Trump administration whose opposition to multilateralism has also hampered international developments. Therefore, an international window of opportunity has opened for the EU. If this approach is successful, the high quality standards that the EU wishes to develop could become a model for the rest of the world.

In order to develop those international standards, the IFRS foundation, with the strong support of the International Organization of Securities Commissions (IOSCO), established in 2021 an International Sustainability Standard Board (ISSB) to develop IFRS Sustainability Disclosure Standards. The EU is very active in the ISSB. For instance, the chair of the ISSB, since 1st of January 2022, is Emmanuel Faber. Mr Faber was the CEO of Danone and a promoter of sustainable finance and corporate governance. Under its management, Danone became a *société à mission*, a company who has objectives in the social, societal, and environmental fields set out in its by-laws. However, his commitment to sustainability led to poor financial performance and, under the pressure of activists investors, he was removed by the board of directors in 2021. All jurisdictions recognize the need to tackle climate change. However, it might be difficult for the EU to export

32. https://www.law.ox.ac.uk/business-law-blog/blog/2022/05/proposed-eu-directive-corporate-sustainability-due-diligence-why-non

33. https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate

34. Regulation (EU) 2016/of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), JO L 119/1, 4.5.2016.

successfully its standard at the international level as many other jurisdictions might prefer a progressive approach as they want to balance these imperatives with their desire to catch up with developed economies.

It actually already appears that the ISSB standards are less prescriptive than those that EFRAG is starting to disclose. It is also unlikely that the US will endorse the ISSB standards and are developing currently their own approach. Although, this is still work in progress, it seems unlikely at this stage that the international standards will be a reflection of the EU ones.

This ambitious approach by the EU also ignores the need to balance these ambitions with the need to maintain a competitive economy in the European Union.

2.2 The European Union as a competitive economy

The issue of competitiveness was usually key in the EU approach. The Lisbon Strategy of 2000 wanted to make the EU 'the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion'. This time seems far away. Sustainability is becoming the priority, although not the only one. According to a recent academic research, the Sustainable Finance Action Plan has not resulted in measures that can be regarded as the expression of an autonomous sustainable finance objective.[35] International competitiveness is not forgotten but is presented as naturally flowing from the existence of a 'sustainable economy' to be achieved by the European Green Deal of 2019. However, the risks to the international competitiveness of EU companies seems underestimated. The strong opposition from Scandinavian countries, which are not known for promoting non sustainable development, is of particular concern. Contrary to a widespread belief in France, they are very liberal on economic issues and are very open to international trade. This is how they ensure the financing of their generous welfare state. A loss of competitiveness would have consequences for its financing. Their determined opposition is not a surprise and should certainly be noted.

The EU legislator is implicitly admitting the problem. This is actually one of the reasons why several of the proposed directives are imposing an extraterritorial approach. This is supposed to create an international level playing field by forcing EU standards on foreign jurisdictions either through direct application or through an equivalence mechanism controlled by the Commission.

However, this ambitious approach could also back fire. For instance, in the case of the proposed directive on 'Corporate Sustainability Due Diligence', it is envisioned that companies should, as a last resort, terminate the business relationship, if they have failed in their attempt at bringing actual adverse impacts to an end or minimising them without success. This might be easier said than done. For instance, there might not be alternatives for some critical raw materials that would be needed in the EU. The current situation in Europe shows that dependencies cannot always be easily untangled. In addition, issues of European or national sovereignty, including from the civil and military side, might come into play.

As to the model of directors' duties promoted by the European Commission, it would leave directors of European companies subject to the directive in a very uncomfortable situation. First, the list of international standards and treaties that companies will have to abide is extremely wide. It is doubtful that medium sized companies would be able to comply, or even know, those provisions with a sufficient degree of granularity. It is not even sure for the large ones. As one author has noted, these treaties and international standards were designed for states, not for private companies, and might be difficult for them to enforce.[36] This might lead companies to be forced to 're-shore' their value chains within the EU at the price of a loss of competitiveness.

Second, companies would be indirectly tasked with enforcing the Paris agreement although most Member States find it already difficult to uphold it. France was recently condemned for climate inaction by the highest administrative court for failure to act sufficiently.[37] A much more effective tool to establish a level playing field would be a carbon tax.

Third, board of directors will be obliged to consider the short and long term impact on company stakeholders, human rights, the environment and climate when making decisions. Combined with the need to deliver a profit, which should remain their primary goal if they want to be sustainable long term, it will lead them to address potentially conflicting objectives in an impossible way. In addition, these impacts are knowledge that board do not always have as these are complex issues.

These provisions, combined with the drive towards 'green finance', point in the direction of a planned economy. The historical record for such an approach is poor to say the least, apart from after the Second World War where the need for reconstruction would have guaranteed growth anyway. Many Member States are liberal and will oppose this approach.

Conclusion

The EU is moving at an incredible speed in order to develop an European model of Sustainable Corporate Governance and best in class standards in 'Green Finance'. All these developments are built on a political agenda and too often lack or disregard academic evidence and reasonable input from business. This is very clear in the case of the CSDD which incorporates in some part a poor report by

35. See, Veerle Colaert, 'The changing nature of financial regulation Sustainable finance as a new policy goal' Working Paper No. 2022/04 (April 2022).

36. https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/corporate-sustainability-due-diligence-and-shifting-balance-between

37. Conseil d'État, 19 November 2020, n° 427301, *Grande Synthe*.

EY. Also, academics views are split about whether green finance requirements developed by the EU will improve the situation, with some authors recently taking a sceptical view[38] while other being more positive.[39] The need to address climate change is clear. The debate is about the tools and the speed. Those ambitions are legitimate but the EU legislator seem to underestimate the costs and might even backfire on European businesses. Trying to establish a global model for Sustainable Corporate Governance and Finance and export it might not work.

The famed 'Brussels effect', which has worked in certain fields such as GDPR, might not this time.[40]

The EU might discover that it is more isolated than it is thinking as the economic dynamics of the world are shifting. The risk is that Europe might end up protectionist and overregulated compared to other large jurisdictions who are growing fast and might pose ultimately an economic systemic risk.

38. See for instance, J.P. Krahnen, J. Rocholl, M. Thum, 'A primer on green finance: From wishful thinking to marginal impact', SAFE White Paper No. 87, October 2021.

39. See for instance, Sebastian Steuer, Tobias H. Troger, 'The Role of Disclosure in Green Finance', Law Working Paper N° 604/2021, December 2021.

40. Anu Bradford, *The Brussels Effect, How the European Union rules the world*, Oxford University Press, 2020, 404 pp.

Daniel C. Esty • Hillhouse Professor of Environmental Law and Policy, Yale University

Mastering the Labyrinth of Sustainability: Toward a New Foundation for the Market Economy

Debate over how to transform capitalism and deliver a better functioning market economy has broken out on a number of fronts.[1] In this regard, *environmental sustainability* has emerged as one of the areas of greatest focus as current business practices and our economic system more generally produce enormous amounts of pollution and waste - and threaten to transgress critical planetary boundaries.[2] Most notably, the build-up of greenhouse gases (GHGs) in the atmosphere creates a risk of climate change as global warming leads to sea level rise, increased intensity of windstorms, as well as changed rainfall patterns that disrupt agriculture, displace people, and unleash more floods, droughts, and wildfires.[3]

This article challenges the prevailing economic framework, which permits - indeed, *authorizes* through the issuance of regulatory *permits* - levels of pollution, including GHG emissions, that now threaten life on Planet Earth. It calls for a restructuring of our market economy[4] to create a *sustainable capitalism* based on a reinvigorated commitment to the *polluter pays principle*, operationalized through a framework of rules (environmental laws) that prohibit *uninternalized externalities*, thereby forbidding any spillover of environmental harm from private parties onto others or into the shared spaces of the commons at any scale (local, regional, national, or global) without full compensation being paid.

As a first step toward fully internalizing environmental externalities - which will require *harm charges* to be imposed on all pollution damage and natural resource use - I argue for expanded corporate disclosure of emissions and other environmental impacts through better structured reporting by companies on their Environmental/Social/Governance (ESG) performance. Such ESG disclosure (backed by auditing and enforcement rules) would: (1) address information failures in the marketplace; (2) highlight unsustainable business models and expose companies that derive profits from activities that impose costs on society; and (3) promote marketplace transparency - laying the foundation for calculating the requisite harm charges by bringing hidden externalities into the light. Thus, even before regulatory regimes across the world are reframed to fully internalize environmental impacts, more rigorous ESG performance reporting could give sustainability-minded investors and consumers critical data and information to guide their investment choices and purchasing decisions, thereby creating a powerful incentive for corporate sustainability and deterring business practices that generate private gains at public expense.

1. The Sustainability Imperative

The *sustainability imperative*[5] is clear: we must live within the safe operating space of our Earth's ecological and biophysical systems and not inflict environmental damage on the planet that would threaten human development and ongoing prosperity. As the 1987 Brundtland Report (*Our Common Future*) suggests, we should ensure that our economic development "meets the needs of the present without compromising the ability of future generations to meet their own needs." This commitment to *sustainable development*–the elements of which are spelled out in detail in the 2015 UN Sustainable Development Goals – has been ratified by 193 nations across the world.

But the simple idea of living within boundaries has proven easier to define in theory than to execute in practice. Fundamentally, a sustainable future requires an economic framework that promotes conservation of natural resources, protection of critical Earth systems, and economic development that allows humanity to thrive over time. It depends on marketplace rules that respond to market failures, internalize externalities, and address the "tragedy of the horizon" (as former Bank of England Governor Mark Carney calls the too-often-ignored business activities that result in slowly accumulating and often-hidden social costs, such as the build-up of GHG emissions in the atmosphere). All of which requires bringing an end to unsustainable business practices.

1. Thanks to Tyler Yeargain, Nathan de Arriba-Sellier, and Zack Steigerwald-Schnall for research assistance.
2. Johan Rockström & Matthias Klum, *Big World, Small Planet: Abundance within Planetary Boundaries* (2015); Will Steffen et al., "Platenary Boundaries: Guiding Human Development on a Changing Planet", *Science Mag.* (Feb. 13, 2015), https.//www.science.org/doi/10.1126/science.1259855.
3. Intergovernmental Panel on Climate Chance, Climate Chance 2021: The Physical Science Basis (2021): https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_Full_Report.pdf (hereinafter IPCC Sixth Assessment Report).
4. This article accepts the benefits of a market-based economic system, but challenges the free-wheeling capitalism that now prevails in many parts of the world, arguing that this free market has under-attended to market failures -- resulting in unsustainable business practices that inflict significant public health and ecological damage on people and the biosphere more broadly. It calls for a re-invigorated regulatory framework that addresses these market failures – with an aim of fully internalizing environmental externalities, thereby fundamentally shifting the underpinnings of the economy onto a clean-energy foundation and requiring companies to regear their business models toward a sustainable future.
5. David A. Lubin & Daniel C. Esty, "The Sustainability Imperative", Harvard Business Review (May 2010),https://hbr.org/2010/05/the-sustainability-imperative (spelling out the environmental logic and business implications of sustainability as a core 21st century value).

The need for such fundamental change and a revised foundation for capitalism has become ever more widely recognized by government officials, scholars, and business people – but the path forward remains uncharted.[6] This article offers a strategy for how to navigate the labyrinth of sustainability, slay the Minotaur of unsustainable business practices, and lay the foundations for a clean energy future that will enable humans to flourish in the century ahead.

2. Conceptual Foundation for a Sustainable Future: End Externalities

Conceptually, *sustainability* requires a restructured market economy that prohibits externalities–forbidding production or consumption that results in environmental harms being inflicted on others.[7] No longer should pollution be accepted as the necessary byproduct of industrial production and justified on a benefit-cost basis. Nor should the private use of public resources–water, timber, minerals, or other natural resources–be condoned at less than full-price payment to society for the privilege.

As my colleague Don Elliott and I explain in our End Externalities Manifesto, environmental law needs to be recast to prohibit pollution that causes harm to others.[8] In advancing this argument, we propose a new starting point for environmental regulation: legal rules that forbid all damaging emissions as well as any natural resource consumption for which a full price has not been paid. We suggest that the legal requirement to stop all environmental harms be rebuttable in recognition of the fact that some production processes (for instance, making steel or cement) cannot achieve zero emissions without significant economic dislocation and societal burden. In such cases, the legal obligation should be to minimize environmental damage and pay full monetary compensation for any residual impacts including effects on both people and ecosystems. We propose that these harm charges - to be calculated by regulatory authorities - be paid directly to those affected to the fullest extent possible.[9] Likewise, the consumption of natural resources must bear an appropriate price with special attention to the level of societal compensation required for the exploitation of non-renewable resources.

Adoption of such a *no uninternalized externalities* principle backed by a new framework of regulatory rules would lay the foundation for a sustainable economy in a way that existing laws do not. Indeed, the basic structure of environmental protection in most nations in the world (at least as implemented) assumes that some degree of pollution is inevitable. And almost all environmental regulatory frameworks set pollution abatement standards based on benefit-cost analysis. This legal structure permits billions of tons of uncontrolled air and water pollution, waste, and greenhouse gases to be released into the environment every year. As a result, more than 7 billion people across the world–over 90% of the global population–breathe unhealthy air[10] and nearly a billion people lack access to safe drinking water.[11] And all 7.9 billion people on the planet face the risk of climate change as greenhouse gas emissions rise to dangerous levels.[12]

Reconfiguring environmental law around a no uninternalized externalities principle makes sense from a range of perspectives – including: (1) economic theory, (2) conformity to the polluter pays principle embedded in a number of international environmental agreements and domestic legal frameworks, (3) environmental rights and natural law, (4) emerging case law around the world, (5) equity and environmental justice, (6) the need for policies that spur innovation, and (7) changing societal norms related to the role of corporations in society.

2.1 Economic Theory

Economists have long argued–at least since the work of Pigou a hundred years ago – that efficient markets require that externalities, such as pollution, be internalized. But in regulatory practice, the logic of Pigouvian pollution charges with their focus on limiting the spillover of harms has been overshadowed by the *Kaldor-Hicks principle*, which translates into a legal framework that optimizes net social benefits.[13] This sort of benefit-cost efficiency permits externalities – including enormous amounts of pollution – to go unchecked so long as the value of the economic activity causing the damage is judged to be greater than the burden on those suffering the impacts of the externality. But this regulatory approach cannot be sustained in the face of mounting evidence that many externalities have not been fully tracked nor appropriately controlled–and that accumulating environmental harms now threaten planetary boundaries. And while it might once have seemed difficult to trace hard-to-see and widely dispersed emissions, 21st century technologies make

6. Mark Carney, *Value(s): Climate, Credit, Covid, and How we Focus on What Matters* 264-65 (2021). For other examples of this growing literature, see Rebecca Henderson, *Reimagining Capitalism in a World on Fire* (2020); Mariana Mazzucato, *Mission Economy: A Moonshot Guide to Changing Capitalism* (2021); Michael E. Porter and Mark R. Kramer, "Creating Shared Value", *Bus. Rev.* (Jan.-Feb 2011); Paul Polman and Andrew Winston, *Net Positive* (2021); Daniel C. Esty, "Red Lights to Green Lights: From 20th Century Environmental Regulation to 21st Century Sustainbility", 47 *Environmental Law Review* 1 (2017).

7. As a matter of administrative efficiency, some degree of de minimis harm might be ignored.

8. E. Donald Elliott & Daniel C. Esty, "The End Environmental Externalities Manifesto: A Rights-Based Foundation for Environmental Law", 29 *N.Y.U. Env't L.J.* (2021).

9. Elliot and Esty, *supra* at 531. We acknowledge that some scholars and many environmentalists take issue with commodification of the environment and thus reject the possibility that regulators will put an appropriate price on pollution impacts. See, e.g., Doug Kysar, *Regulating from Nowhere* (2010). But the alternative has not been vigorous pollution controls but rather the status quo reality of incomplete regulation, environmental degradation, and serious problems of environmental justice. See, e.g., Gerald Torres, "Who Owns the Sky", 19 *Pace Envt'l L. Rev* (2001).

10. See generally State of Global Air/2020, Health Effects Institute, https://stateofglobalair.org

11. See generally United Nations Children's Fund & World Heath Org., Progress on Household Drinking Water, Sanitation and Hygiene, 2000-2017 (2019).

12. IPCC Sixth Assessment Report, *supra* note 2.

13. See Elliott & Esty, *supra* note 8 at 515 (rejecting Kaldor-Hicks efficiency in favor of the equity of Pareto superiority, which requires compensation to those who are harmed).

such tracking quite straightforward.[14] Likewise, advances in epidemiology, ecosystem ecology, and valuation methodologies make it ever easier to put a price on environmental damage.[15]

The widely accepted *Coase Theorem* has added to the confusion in economic theory by positing that, in the pollution context, no matter whether the underlying rights are lodged with the polluter or pollutee–a factory sending emissions up its smokestack or the neighbors (breathers) next door–the parties should be able to negotiate an optimal outcome. Having assumed away the problem of transaction costs, Coase posits that an efficient level of pollution will be achieved either by the neighbors agreeing to pay the factory to reduce its emissions or the factory compensating the neighbors for their respiratory distress. While this imaginary negotiation might produce an economically efficient outcome, it says nothing about the fairness of the result.

The economic tide has, however, shifted. Economists have come to accept that information asymmetries, differentials in power and influence, and significant transaction costs make real-world pollution control negotiations fraught–and fair and efficient outcomes improbable. Most people have an intuition, moreover, that the rights in Coase's example should be lodged with the breathers. Thus, the need for tighter controls on externalities–tracking the more rigorous parameters of Pareto rather than the weaker Kaldor-Hicks net social benefits construct[16]–has begun to get greater traction in the realm of economics and beyond.

2.2 Polluter Pays Principle

The idea of internalizing externalities has been reflected in widespread adoption of the *polluter pays principle* in both international environmental agreements and domestic legislation around the world. Beginning with a 1972 recommendation from the Council of the Organisation for Economic Co-operation and Development (OECD) and continuing with the Rio Declaration and now many other international agreements, governments have repeatedly signaled that environmental externalities should be internalized and polluters should pay for the harm they cause.[17] The polluter pays principle plays a central role in EU environmental law, with Article 191(2) of the Treaty on the Functioning of the European Union mandating adherence to this rule.[18] And the global community has established a 2050 goal of net-zero GHG emissions in the Glasgow Climate Pact - triggering hundreds of corporate net-zero pledges - and redoubled efforts to bring an end to externalities in the climate change context.[19] The pervasiveness of the polluter pays principle in both international law and domestic legislation (if not always in practice) provides added support for an initiative to make internalizing externalities a foundational element of a transformed global economy.[20]

2.3 Environmental Rights and Natural Law

More than 100 countries have enshrined in their constitutions a right to a healthy environment in one form or another.[21] A growing body of scholarship, from legal theorists and philosophers as well as economists, has strengthened the case for more robust protection of environmental rights, thus reinforcing the logic for internalizing externalities.[22] The premise that environmental rights are human rights has also garnered broad acceptance.[23] Beyond the national constitutional provisions noted above, an ever-lengthening list of international agreements, human rights declarations, and scholarly publications have advanced various forms of this proposition. And a growing number of jurisdictions have moved to codify the idea of environmental rights as fundamental–with some going on to specifically highlight the duty to avoid pollution spillovers or other uninternalized ex-

14. Daniel C. Esty & Quentin Karpilow, "Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation", 37 *Yale Journal on Regulation*, 625 (2019); See also Daniel C. Esty, "Environmental Protection in the Infirlmation Age", 79 *N.Y.U. Law Review*, 115, 140-48 (2004).

15. See Oswald J. Schmitz, "Sustaining Humans and Nature as One: Ecological Science and Environmental Stewardship", in *A Better Planet: 40 Big Ideas for a Sustainable Future* 11 (Daniel C. Esty Ed. 2019); Per-Olav Johansson, "Valuing Environmental Damage", 6 *Oxfo. Econ. Pol.* 34 (1990); Cass R. Sunstein, "Cost-Benefit Analysis and the Environment", 15 *Ethics* 351 (January 2005).

16. Elliott & Esty, *supra* note 8 (discussing the "Kaldor-Hicks fallacy" and rejecting social net benefits as an appropriate foundation for environmental regulation).

17. United Nations Conference on Environment and Development, Report of the United Nations Conference on Environment and Development, Annex I: Rio Declaration on Environment and Development, U.N. Doc. A/CONF.151/26 (Vol. I) (Aug. 12, 1992) [hereinafter Rio Declaration] (Principle 16 highlights both the need for "internalization of environmental costs" and the polluter pays principle).

18. Article 110-1 of the French Code de l'Environnement similarly puts the *polluter pays principle* at the center of the nation's framework of environmental law – although this commitment is often disregarded in practice. See https://www.legifrance.gouv.fr/codes/article_lc/LEGIARTI000043084969 at II- 3°

19. COP 26: The Glasgow Climate Pact, UN Climate Change Conference: UK 2021 (Nov. 2021), https://ukcop26.org/wp-content/uploads/2021/11/COP26-Presidency-Outcomes-The-Climate-Pact.pdf.

20. Svitlana Kravchenko, Tareq M.R. Chowdhury & Md Jahid Hossain Bhuiyan, "Principles of International Environmental Law", in *Routledge Handbook of International Environmental Law* 43, 50–53 (Shawkat Alam et al. eds., 2012).

21. David R. Boyd, David Suzuki Found, "The Status of Constitutional Protection for the Environment in Other Nations" 6 (2013); France offers a notable case in point in Article 1 of the 2004 Charter for the Environment. See https://www.conseil-constitutionnel.fr/en/charter-for-the-environment.

22. See generally *The Human Right to a Healthy Environment* (John H. Knox & Ramin Pejan eds., 2018); Alan E. Boyle, "Human Rights or Environmental Rights? A Reassessment", 18 *Fordham Env't L.J.* 471 (2007); Linda h. Leib, *Human Rights and the Environment: Philosophical, Theoretical and Legal Perspectives* 157–62 (2011); Lavanya Rajamani, "Integrating Human Rights in the Paris Climate Architecture: Contest, Context, and Consequence", 9 *Climate Law* 180–201 (2019); James Salzman, *Drinking Water* (2017) (arguing that access to clean water for basic needs should be understood to be a fundamental human right); Erin Daly & James May, "Comparative Environmental Constitutionalism", 6 *Jindal Global L. Rev.* 9, 24–30 (2015); Christopher D. Stone, "Should Trees Have Standing? Toward Legal Rights for Natural Objects", *S. Cal. L. Rev.* 45 (1972); Doug Kysar, *Regulating from Nowhere* (2010).

23. Dinah Shelton, "Human Rights, Environmental Rights, and the Right to Environment",28 *Stanford J. Int'l L.* 103 (1991–92); Alan Boyle, "Human Rights and the Environment: Where Next?", 23 *European J. Int'l Law* 613 (2012): Hari M. Osofsky, "Learning from Environmental Justice: A New Model for International Environmental Rights", 24 *Stan. Env't. L.J.* 71, 129 (2005); Lavanya Rajamani, "The Increasing Currency and Relevance of Rights-Based Perspectives in the International Negotiations on Climate Change", 22 *J. Env't. L.* 391–430 (2010); Lavanya Rajamani, "Human Rights in the Climate Change Regime: From Rio to Paris and Beyond", in *The Human Right to a Healthy Environment* (John H. Knox & Ramin Pejan eds., 2018).

ternalities.[24]

In the global policy context, the very first principle in the 1972 Stockholm Declaration on the Human Environment recognized: "Both aspects of man's environment, the natural and the man-made, are essential to his well-being and to the enjoyment of basic human rights—even the right to life itself."[25] With more specificity, the 1992 Rio Declaration defines a set of over-arching environmental rights and duties, including a commitment to the *polluter pays principle*. Likewise, in 2010, the UN General Assembly expressly declared access to safe drinking water to be a human right.[26] And the growing interest in a Global Pact for the Environment has added to the consensus around the need for more vigorous protection of environmental rights in general and adherence to the *polluter pays principle in particular.*[27]

Alongside the idea that environmental rights are human rights stands a widely accepted notion that people have a moral duty not to harm others. Versions of this duty can be found in the sacred texts of many religions.[28] In modern times, John Stuart Mill articulated the philosophical logic for such a "harm principle" and concomitant rights and responsibilities in his famous 1859 treatise *On Liberty*. And more recently, philosophers such as William David Ross have further refined the duty not to cause harm to others.[29]

Building on this foundation of nearly universal belief, one might argue (and I do) that access to a healthy environment is essential to human existence and thus should be considered an element of natural law.[30] The recognition of fundamental environmental rights creates reciprocal obligations and duties[31]—and thus provides the cornerstone for holding polluters to account. Indeed, to ensure that environmental rights are respected and pollution control duties upheld, society must establish a legal expectation that all pollution harms will be abated with any unavoidable residual emissions subject to an obligation to pay full compensation to those affected.

2.4 Legal Practice and Positive Law

Commitment to the *no externalities principle* is not merely a matter of philosophical theory; it also has deep legal roots and pervasive (if uneven) application in countries around the world. Indeed, as early as 1610, an English court in *Aldred's Case* granted relief to the neighbor of a farmer whose pigs caused a stench—thereby articulating a common law standard against spillovers of harm. Tort and nuisance law in jurisdictions the world over implement principles that are meant to penalize—with both civil and criminal sanctions—activities that cause harms to others including by means of pollution. In many nations, this legal framework has been supplemented with codes, statutes, and regulations that spell out environmental obligations with more precision. While implementation of these requirements over past decades has been imperfect and incomplete—with a full-throated commitment to the polluter pays principle and comprehensive internalization of environmental externalities often lacking—standards have tightened in many places in recent years.[32]

Indeed, courts in a number of countries have issued decisions in the past decade that have broadened the reach of environmental rights and pollution control duties. In these matters, judges and justices (as a number of the most prominent opinions emanate from supreme courts) have required both governments and companies to reduce emissions. These landmark cases—including *Shell* and *Urgenda* (Netherlands); *Total*, *UIPP*, *Grande Synthe*, *Notre Affaire a Tous*, and *Les Amis de la Terre* (France); *Bundes-Klimaschutzgesetz* (Germany); *Future Generations* (Colombia); *and Leghari* (Pakistan)—have established a rapidly deepening sustainability jurisprudence that might be seen as undergirding a no uninternalized environmental externalities standard in general and creating judicial pressure to address climate change in particular.

2.5 Equity and Environmental Justice

The sanctity of environmental rights and the creation of parallel pollution control obligations find further support in the recent emergence of laws and policies—from

24. See, e.g., Legifrance, Charter for the Environment, art. 1, http://www.legifrance.gouvr.fr/html/constitution/const03.htm; Corte Suprema de Justicia [C.S.J.] [Supreme Court] febrero 12, 2018, Sentencia 4360-2018 (Colom.); Corte Constitutional [C.C.] noviembre 10, 2016, T-622/16, Expediente T-5.016.242 (Colom.); Leghari v. Fed'n of Pakistan, (2015) W.P. No.25501 (HC Lahore) (Pak.); Complaint, Mbabazi and Others v. The Attorney General and National Environmental Management Authority, Civil Suit No. 283 of 2012 (Uganda); Haw. Const. art. XI, § 9; Ill. Const. art. XI, § 2; Mass. Const. amend. art. XLIX; Mont. Const. art. II, § 3; Pa. Const. art. I, § 27; R.I. Const. art. I, § 17.

25. United Nations Conference on the Human Environment, Stockholm, Swed., June 5-16, 1972, Declaration of the United Nations Conference on the Human Environment, U.N. Doc. A/CONF.48/14/Rev.1, Ch. 1 (June 16, 1972)

26. Rio Declaration, *supra* note 9 (Principle 16 states that "[n]ational authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment."); U.N. Econ. & Soc. Council, Comm. on Econ., Soc. & Cultural Rights, Substantive Issues Arising in the Implementation of the International Covenant on Economic, Social and Cultural Rights: NGO Participation in the Activities of the Committee on Economic, Social and Cultural Rights, Note by the Secretariat, U.N. Doc. E/C.12/2000/6, (July 7, 2006), https://www2.ohchr.org/english/issues/water/docs/CESCR_GC_15.pdf.

27. Yann Aguila, "A Global Pact for the Environment: The Logical Outcome of 50 Years of International Environmental Law", 12 *Sustainability* 5636 (2020).

28. Caron E. Gentry, "Religion: Peace through Non-Violence in Four Religious Traditions", in *Palgrave Handbook of Disciplinary and Regional Approaches to Peace* 168–180 (Oliver P. Richmond, Sandra Pogodda, & Jasmin Ramović eds., 2016); Jeffery D. Long & Michael G. Long, *Nonviolence in the World's Religions: A Concise Introduction* (2021); Christopher Key Chapple, *Nonviolence to Animals, Earth, and Self in Asian Traditions* (1993).

29. Anthony Skelton, "William David Ross", *Stan. Encyc. of Phil.* at 4.1 (June 19, 2012); see also Elliott & Esty, *supra* note 4, at 527–28.

30. Michael C. Blumm & Rachel D. Guthrie, "Internationalizing the Public Trust Doctrine: Natural Law and Constitutional and Statutory Approaches to Fulfilling the Saxon Vision", 45 *U.C. Davis L. Rev.* 741 (2012); Scott A. Davison, "A Natural Law Based Environmental Ethic", 14 *Ethics & Env.* 1 (2009).

31. Wesley Hohfeld, "Some Fundamental Legal Conceptions As Applied In Judicial Reasoning", 23 *Yale L.J.* 16, 28–59 (1913) (explaining how the presence of rights creates reciprocal duties).

32. See generally United Nations Env. Programme, Environmental Rule of Law: First Global Report (2019), https://wedocs.unep.org/bitstream/handle/20.500.11822/27279/Environmental_rule_of_law.pdf?sequence=1&isAllowed=y (noting a 38-fold increase in environmental laws worldwide since the 1970s).

Kenya's modified constitution[33] to U.S. President Biden's 2021 Executive Order on the Climate Crisis[34]–that promote *environmental justice*. Underpinned by a growing body of academic theory and empirical scholarship,[35] this framework posits that, under the guise of economic efficiency, a certain amount of pollution has been allowed to persist, but these emissions almost always fall disproportionately on economically disadvantaged or minority communities. This reality belies any suggestion that society as a whole accepts the harm from polluting industries and activities in return for the highly valued goods and services provided. In fact, at the core of the environmental justice movement lies the notion that pollution will almost always unfairly burden certain segments of society and this disparate impact should not be tolerated–adding *equity* claims to the argument for a proscription on uninternalized externalities. Simply put, if efficiency argues for some degree of pollution being tolerated as the price for high-value economic activities being allowed to continue, *equity* requires that the victims of the harm inflicted these activities be fully compensated, thus internalizing the externality.

2.6 Policy Incentives for Innovation

A requirement that all environmental externalities be stopped or paid for in full would also spur *innovation* in pollution control and natural resource management–the importance of which has recently emerged with great force.[36] Indeed, while the world community has committed to net-zero GHG emissions by mid-century, most sustainability experts have come to the conclusion that, even though significant emissions reductions are within sight, no clear path to fully achieving the net-zero goal presently exists.[37] A consensus has thus emerged that deep decarbonization and the creation of a clean energy future will require significant breakthroughs in renewable electricity generation, heating and cooling of buildings, heavy industry practices, and our prevailing modes of transportation–and that price signals would help to induce the required investment in innovation.[38]

2.7 Redefining Corporate Purpose: From Shareholder Primacy to Stakeholder Responsibility

Society's understanding of the role of corporations has also changed in recent years in a manner that reinforces the logic of prohibiting uninternalized externalities. Specifically, Milton Friedman's widely followed teaching that corporations should focus on maximizing of shareholder value[39] has given way to a new theory of corporate purpose centered on *stakeholder responsibility*.[40] While generations of business executives geared their work around the Friedman doctrine of *shareholder primacy*, corporate leaders today recognize that companies are legal constructs of society and thus owe a duty not only to their owners but also to their employees, customers, suppliers, and the communities in which they operate as well as to society more generally. In fact, the unsustainability of our current structure of capitalism and the business practices it promotes can be traced in many regards to the pursuit of profits without regard to other consequences as encouraged by the Friedman doctrine. But this doctrine, as Oxford University management professor Colin Mayer observes: "is not a law of nature. On the contrary, it is unnatural; nature abhors it, if only because it has been the seed of nature's destruction."[41]

Calls for a new foundation for capitalism that promotes more sustainable business practices now abound.[42] The commentators leading this charge universally highlight the need to ensure that companies do not profit from activities that impose costs on others–whether in the form of air pollution up a smokestack, water contamination

33. Constitution ch. 5, pt. 2 (Kenya).

34. Executive Order 14,008, 86 Fed. Reg. 7,619 (2021).

35. Dorceta Taylor, "The Rise of the Environmental Justice Paradigm", 43 *AM. BEHAV. SCI.* 508 (2000); David Schlosberg, *Defining Environmental Justice: Theories, Movements, and Nature* (2009); Paul Mohai, David Pellow & J. Timmons Roberts, "Environmental Justice", 34 *Ann. Rev. Env't & Res.* 405 (2009); U.S. Env't Protection Agency, Climate Change and Social Vulnerability in the United States: A Focus on Six Impacts 4–6 (Sept. 2021), https://www.epa.gov/cira/social-vulnerability-report.

36. William Nordhaus, "Climate Change: The Ultimate Challenge for Economics", 109 *Am. Econ. Rev.* 1991 (2019); Daniel C. Esty, "Red Lights to Green Lights: From 20th Century Environmental Regulation to 21st Century Sustainability", 47 *Env't L. Rev.* 1 (2017); Thomas A. Weber & Karsten Neuhoff, "Carbon markets and technological innovation", 60 *J. of Env't Econ. & Mgmt.* 115–132 (2010); Michael E. Porter & Claas van der Linde, "Toward a New Conception of the Environment–Competitiveness Relationship", 9 *J. Econ. Perspectives* 97 (1995); Ian Parry, William Pizer, and Carolyn Fischer, "How Large are the Welfare Gains from Technological Innovation Induced by Environmental Policies?", 23 *J. Reg. Econ.* 237 (2003); Adam Jaffe & Robert Stavins, "Dynamic Incentives of Environmental Regulations: The Effects of Alternative Policy Instruments on Technology Diffusion", 29 *J. Env't Econ. & Mgmt.* 43 (1995).

37. Sustainable Dev. Solutions Network, America's Zero Carbon Action Plan (2020), https://www.unsdsn.org/Zero-Carbon-Action-Plan; Nat'l Acad. of Sci, Accelerating Decarbonization in the United States: Technology, Policy, and Societal Dimensions (2021), https://www.nationalacademies.org/our-work/accelerating-decarbonization-in-the-united-states-technology-policy-and-societal-dimensions; see also IPCC Sixth Assessment Report, n. 3 *supra*.

38. Daniel C. Esty, "Red Lights to Green Lights: Toward an Innovation-Oriented Sustainability Strategy", in *A Better Planet: 40 Big Ideas for a Sustainable Future 87* (Daniel C. Esty, ed. 2019); William Nordhaus, *The Climate Casino: Risk, Uncertainty, and Economics for a Warming World 225* (2013).

39. Milton Friedman, *Capitalism and Freedom* (1962).

40. Statement on the Purpose of a Corporation, Business Roundtable (Aug. 19, 2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf.; R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (2010); see also Klaus Schwab, Davos Manifest 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution, World Econ. F. (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/.

41. Colin Mayer, *Prosperity: Better Business Makes the Greater Good* 2–3 (2018).

42. Mark Carney, *Value(s)* (2021); Rebecca Henderson, *Reimagining Capitalism in a World on Fire* (2021); Mariana Mazzucato, *Mission Economy: A Moonshot Guide to Changing Capitalism* (2021); Paul Polman & Andrew Winston, *Net Positive: How Courageous Companies Thrive by Giving More than They Take* (2021); John Ruggie, Caroline Rees & Rachel Davis, "Making 'Stakeholder Capitalism' Work: Contributions from Business and Human Rights" (Working Paper No. RWP20-034, Nov. 2020) (on file with Harvard Kennedy School), https://www.hks.harvard.edu/publications/making-stakeholder-capitalism-work-contributions-business-and-human-rights; Michael E. Porter & Mark R. Kramer, "Creating Shared Value", *Harv. Bus. Rev.* (Jan.–Feb. 2011), https://hbr.org/2011/01/the-big-idea-creating-shared-value; Gus Speth: *The Bridge at the End of the World: Capitalism, the Environment, and Crossing from Crisis to Sustainability* (2008).

out an effluent pipe, greenhouse gas emissions released to the atmosphere, or natural resources extracted without full compensation to the broader community. Simply put, private gain at public expense cannot be condoned as a business model.

3. The Labyrinth of Sustainability

With such a strong consensus that uninternalized externalities cannot be tolerated insofar as they privatize benefits and socialize costs, how is it that so many unaddressed environmental harms remain in evidence? Three fundamental explanations can be identified for the persistence of pollution and private extraction of public resources without compensation. Each of them represents a form of *regulatory failure* that permits environmental harms to be hidden or otherwise go uncontrolled. Addressing these failures and the complexity they create emerges as the Ariadne's string of the labyrinth of sustainability—the mechanism by which society can find its way through the current confusion and multiple obstacles that prevent us from slaying the Minotaur of unsustainable business practices that keep us from establishing environmentally solid foundations for a restructured 21st century economy.

3.1 Invisible Harms Deeply Embedded in our Economic Status Quo

Many enduring environmental problems remain unresolved because they have been present for so long that the public no longer questions their existence. In fact, people may not even see them as a problem. Over more than a century, for example, the public was told that belching smokestacks were a sign of progress—and that pollution was the inevitable byproduct of industrialization. But it need not be so.

The ideas that emissions are unavoidable or that natural resources must be offered on the cheap to encourage their productive use are myths from a bygone era. Yet these deeply embedded expectations - reinforced by decades of investment based on these presumptions - have created a path dependency that is now difficult to overcome. These myths narrow our imagination, limit our capacity for innovation, complicate the public's understanding of sustainability, and inhibit efforts to advance the transformative change required to address problems such as climate change. They must be relegated to the dustbin of history in favor of the scientific facts about planetary boundaries and the need to internalize environmental externalities in support of a sustainable market economy built on new conceptual foundations.

Even more challenging are the cases where environmental harms are literally invisible or spread over space and time in a manner that makes them hard to see and the damage difficult to comprehend. Smokestacks have long been used to spread out emissions and thus to make them *seem* to be less of a problem. In the same vein, who ever saw chlorofluorocarbons (CFCs) escaping into the atmosphere and breaking down the Earth's protective ozone layer? At the extreme end of this spectrum are the long-lived and invisible greenhouse gases that blanket the Earth causing climate change. That regulators shy away from addressing *hidden sources* of harm is understandable. The costs of tackling such problems are tangible, and the perceived benefits are obscure. But these environmental externalities are real and must be addressed if a new, sustainable version of capitalism is to be constructed on ecologically secure footings.

Even where the cost of alternative *sustainable* approaches to critical economic activities (such as cement making or air travel) would be high, we should insist that environmental harms be minimized and that the full cost of any residual negative impacts be reflected in the price paid for the product or service. The alternative - assuming the inevitability of ongoing pollution and leaving the resulting externalities uninternalized - underprices those goods and leads to inefficient over-consumption of them. In effect, society sacrifices the health of people everywhere and the integrity of life-sustaining Earth systems to subsidize these items - a practice that can no longer be justified.

3.2 Regulatory Failures

Uninternalized externalities can also be traced to a variety of well-documented governance failures.[43] Some of the underlying problems are structural. Environmental protection efforts are often undertaken in narrow regulatory silos. For example, air emissions and water pollution are frequently addressed separately. This practice results in a legal framework that will often be incomplete or misaligned that allows some harms to slip through the cracks. Regulators may also lack: (a) data and metrics, (b) clarity on the causal pathways of emissions to recognized impacts, (c) epidemiological or ecological understanding of risks, or (d) other scientific information that would allow them to identify harms and price the externalities involved. These difficulties will often be intensified when problems are not visible until they build up to a certain threshold—or where they have long lifetimes that may make the true scope of the harm hard to gauge.

Public choice failures may further complicate efforts to internalize externalities as special interests exert political influence through lobbying, campaign contributions, or public relations efforts to obtain favorable treatment for their industry—inducing elected officials (and the regulators they direct) to overlook emissions or permit natural resource extraction on favorable terms. Once again, these distortions of the policy process obscure externalities that might otherwise be internalized.

3.3 Greenwashing and Sustainability Metrics Gaps

Externalities may also persist because of misinforma-

43. Daniel C. Esty, "Toward Optimal Environmental Governance", 74 *N.Y.U L. Rev.* 1495, 1508–20 (1999).

tion released by companies that hides or diminishes the harm they are causing. Although a rising tide of sustainability-minded investors are now demanding information on the environmental, social, and governance (ESG) performance of the enterprises in which they invest, much of the information in the marketplace is unreliable.[44] While some ESG metrics derive from government sources, a good bit of what is available comes from private data aggregators such as MSCI, Bloomberg, Refinitiv, or Sustainalytics. The emissions data they provide are often self-reported by corporations and not independently verified or validated. As a result, there is little methodological consistency in how companies report–and even disagreement as to basic sustainability definitions. In fact, the top-line sustainability scores of MSCI and Sustainalytics - the two leading ESG data providers - correlate at only 0.32,[45] suggesting serious data discrepancies and/or widely divergent scoring systems.

Much of the sustainability information available also lacks careful screening for relevance or *materiality.*[46] Many metrics are reputational rather than operational, backward-looking rather than forward-looking, and narrowly risk-focused rather than highlighting sustainability-led growth and productivity. The data are often not carefully normalized, underlying assumptions are not made clear, and missing datapoints are not addressed consistently. In light of these many information issues, sustainability benchmarking is difficult to do, and confidence in the reported results remains low.[47] Investors cannot trust that the ESG reporting reveals sustainability leaders and calls out laggards. Likewise, the limits of the present *voluntary r*eporting system mean that the public cannot trust that companies are spelling out the full extent of the environmental harms they cause, and governments cannot build regulatory programs based on the data being disclosed. Indeed, in a number of cases, companies that shade their reporting to create a more favorable picture of their sustainability–i.e., engage in *greenwashing*–appear to outperform their peers. More broadly, the existing ESG framework provides little basis for disciplining unsustainable business practices–and may even reward those enterprises that are most aggressive in externalizing environmental costs.[48]

4. Restructuring the Foundations of Capitalism for a Sustainable Future

To achieve a sustainable future, the regulatory framework within which capitalism operates must be recast to ensure that companies are not profiting at the expense of the environment and thus society. As I explain below, better sustainability metrics and structured ESG corporate reporting offer a path toward limiting uninternalized externalities and thus a sustainable future–although not providing a complete solution to harm-causing business behavior.

4.1 Information as a Public Good Subject to Market Failure

Building a sustainable market economy requires overcoming a classic market failure: incomplete information. Specifically, because ESG data and other information on corporate sustainability performance are public goods, they are systematically underprovided.[49] The existing system of voluntary ESG disclosure with data aggregated by private companies has failed to produce the information required to put capitalism on a sustainable trajectory. What is now needed is a methodologically rigorous, transparent, and reliable framework of ESG metrics that highlights business practices that damage the environment and facilitates inter-company comparisons and benchmarking across the critical sustainability issues.

Such a comprehensive and trusted ESG data framework could be established through a universal business commitment to an agreed-upon sustainability reporting structure. But such voluntary agreement seems unlikely, particularly given the fact that an array of competing ESG reporting frameworks now exist - including data matrices offered by the Global Reporting Initiative (GRI), the Sustainable Accounting Standards Board (SASB), and the World Economic Forum (WEF) - contributing to the chaos in sustainability reporting. A government-defined mandatory sustainability reporting structure backed by the threat of legal penalties for misreporting therefore seems like a better path forward. Governments have begun to take the first steps in this direction with the European Union's Non-Financial Reporting Directive, the French Duty of Vigilance Law, and the Monetary Authority of Singapore's *Guidelines on Environmental Risk Management* all of special note. Other countries–including Kenya, the United States, Switzerland, Germany, Finland, and the Netherlands–have expanded reporting requirements under consideration. But none of these proposals offer the basis for a comprehensive structure of investment-grade ESG metrics. What is now nee-

44. Daniel C. Esty & Todd Cort, "Corporate Sustainability Metrics: What Investors Need and Don't Get", 8 *J. Env'tl Investing* 1 (2017).

45. Ross Kerber & Michael Flaherty, "Investing with "Green" Ratings? It's a Gray Area", *Reuters* (June 26, 2017), https://www.reuters.com/article/us-climate-ratings-analysis/investing-with-green-ratings-its-a-gray-area-idUSKBN19H0DM; Florian Berg, Julian F. Kölbel & Roberto Rigobon, "Aggregate Confusion: The Divergence of ESG Ratings" (MIT Sloan Working Paper 5822-19), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533.

46. Aisha I. Saad & Diane Strauss, "The New 'Reasonable Investor' and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation", 17 *Berkeley Bus. L.J.* 397 (2020); Daniel C. Esty & Todd Cort, "Toward Enhanced Corporate Sustainability Disclosure: Making ESG Reporting Serve Investor Needs", 17 Va. *L. & Bus. Rev.* (forthcoming 2022).

47. Daniel C. Esty, "Creating Investment-Grade Corporate Sustainability Metrics, in Values at Work: Sustainable Investing and ESG Reporting 51" (Daniel C. Esty & Todd Cort eds., 2020).

48. Ralph Thurm, r3.0, The Big Sustainability Illusion – Finding a Maturation Pathway for Regeneration & Thriving (Mar. (2021), https://www.r3-0.org/wp-content/uploads/2021/04/Opinion-Paper-1-Ralph-Thurm-The-Big-Sustainability-Illusion-March-2021.pdf; Tariq Fancy, "Financial World Greenwashing the Public with Deadly Distraction in Sustainable Investing Practices", *USA Today* (Mar. 16, 2021), https://www.usatoday.com/story/opinion/2021/03/16/wall-street-esg-sustainable-investing-greenwashing-column/6948923002/ (in which the former BlackRock chief investment officer of Sustainable Investing calls ESG screening "marketing hype").

49. Daniel C. Esty & Quentin Karpilow, "Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation", 36 *Yale J. Reg.* 625 (2019).

ded is a tightly structured and streamlined ESG reporting framework that builds on the base provided by GRI, SASB, and the World Economic Forum as well as the government initiatives underway - with the goal of providing a common set of core ESG metrics with consensus not just on the categories (indicators) but also on underlying methodologies to ensure true comparability.

4.2 Toward a Sustainable Market Economy

Trustworthy ESG data would create a pathway to a sustainable market economy. Notably, better data on corporate emissions and natural resource use, as well as clear signals about corporate leaders and laggards on climate change and other critical issues, would enable a three-step process toward full implementation of the polluter pays principle and a broad-based commitment to end uninternalized externalities.

First, a comprehensive, government-mandated (and enforced) ESG data matrix would provide the analytic foundation required for full-bore adoption and implementation of a no untinternalized externalities rule. It would make it nearly impossible for hidden externalities to persist. In particular, both individual company disclosures and the aggregation of metrics across industries would offer a database for gauging harms and putting a price on the damage they cause. This transparency would bring to the fore ongoing emissions or privileged resource access, creating a basis for government regulatory action.

Second, by highlighting corporate outliers and other anomalies in environmental protection, better ESG data would address most, if not all, of the regulatory failures enumerated in Part 3 above. A clearer picture of sustainability performance company-by-company and industry-by-industry would help to overcome the tenacity of status quo thinking as well as the challenges presented by invisible harms, incomplete government databases on environmental threats, and public choice distortions of policymaking. Moreover, by establishing a standard reporting framework as well as requirements for third-party assurance (validation by an accredited auditor), governments could unmask and largely eliminate greenwashing. More importantly, the right structure of reporting rules would obligate companies to fill in many persistent pollution control and natural resource management data gaps that today limit the ability of governments to fully internalize externalities. Over time, the transparency created would produce rising pressure for more comprehensive implementation of harm charges as the mere presence of the data–highlighting residual emissions and resource extraction–would throw a spotlight on companies and industries enjoying special interest status and environmental privileges unavailable to others. And if an environment ministry or agency were slow to act, the ESG information made available would provide ammunition to opposition political leaders, the media, NGOs, and competitors who might wish to call out the unfairness of allowing the environmental miscreants to carry on with their damaging practices.

To be clear: better ESG data would not address all of the complexities of internalizing environmental externalities. Putting a price on harms in the face of persistent scientific uncertainties or extended time horizons would continue to be a challenge. But mandatory corporate ESG reporting would put new momentum into the pursuit of better data foundations for environmental policymaking - and ease the transition to full pricing of environmental harms.

Third, an improved ESG framework would enable sustainability-minded investors to screen their stock and bond holdings in a manner that would put pressure on companies to improve their sustainability performance–or risk having their shares divested from a growing number of portfolios. Similarly, better and more easily accessible ESG data would enable green consumers to more readily factor a company's sustainability track record into their purchasing decisions. These market-based disciplines on unsustainable business practices would immediately become a point of leverage for a sustainable future–even ahead of the inevitably slow process of full governmental implementation of *no-uninternalized-externalities* regulation.

Conclusion

Today's structure of capitalism is on a collision course with the emerging sustainability imperative. To ensure that our global society does not crash through planetary boundaries and damage life-sustaining Earth systems in a manner that would diminish the prospect for long-term sustainable development and human progress, the rules of engagement for business must be rewritten and the foundations of our market economy rebuilt.

Transformative change is never easy. But this article charts a path toward a sustainable future, starting with the recognition that: (1) pollution must be stopped and any residual environmental externalities internalized and (2) carefully structured corporate sustainability disclosure offers great promise as a first step toward the end of externalities. A robust corporate ESG data matrix would greatly enhance the ability of governments to regulate environmental harms and enforce a *no uninternalized externalities principle*. Even before that regulatory reform is completed, the existence of reliable ESG metrics would enable sustainability-minded investors and consumers to penalize companies with unsustainable business models that depend for their profitability on privatizing gains and socializing environmental costs. Likewise, they would be positioned to reward enterprises that deliver the clean technology breakthroughs required for a successful response to climate change and create a marketplace reframed to support - and not undermine - sustainability more broadly.

The status quo is difficult to dislodge. And the path through the labyrinth of sustainability has many twists and turns. But this article offers a string to follow on the way to a better functioning 21st century economy.

Wolf-Georg Ringe • Professor of Law & Finance and Director of the Institute of Law & Economics, University of Hamburg; Visiting Professor, University of Oxford, Faculty of Law.

Alperen A. Gözlügöl • Assistant Professor, Law & Finance cluster of the Leibniz Institute for Financial Research SAFE.

A Critique of EU Policymaking on Sustainable Corporate Governance and Finance

1. Introduction

Global consensus has it that corporations and financial markets are to contribute to the goal of sustainability – a view that has been especially driven by the Covid-19 pandemic and the increasingly visible sustainability challenges of our world such as climate change.

Lawmakers are exploring ways of how to foster this trend, and the EU has arguably been a global leader in this arena. The European Green Deal initiated in 2019 is a prominent example.[1] Over the past several years, an increasing number of measures on corporations, financial markets and sustainability have been either adopted or initiated. For example, the Non-Financial Reporting Directive ('NFRD') requires large public-interest entities to disclose non-financial information on certain issues, including environmental, social and employee matters, respect for human rights, anti-corruption, and bribery matters.[2] The recently proposed Corporate Sustainability Reporting Directive ('CSRD') aims to reform the NFRD with more detailed reporting requirements for a larger group of addressees.[3] Another important development that concerns corporations is the recent Sustainable Corporate Governance Initiative by the European Commission, which started with a controversial Impact Assessment[4] and culminated in the recent Proposal for a Directive on Corporate Sustainability Due Diligence ('CSDD').[5]

In the context of sustainable finance, the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation (TR) are landmark developments. The former provides various disclosure obligations for financial market participants and financial advisers against ultimate beneficiaries on sustainability-related issues.[6] The latter, perhaps the most ambitious, classifies economic activities as 'environmentally sustainable' based on certain criteria as well as providing further disclosure obligations for financial players and companies.[7]

Not only capital markets but also banks have been subject to continuing sustainability scrutiny in their financing activities. Disclosure of the 'green asset ratio', namely to what extent banks' loan book is associated with 'green' activities, is a new requirement brought by the TR.[8] Furthermore, risks posed by climate change for banks' resilience and thus financial stability have increasingly been on the European regulators and supervisors' agenda. Accordingly, prudential policy tools such as stress tests and capital requirements have come to include the climate risk as a major threat.[9]

In this piece, we provide a critique of all these efforts in the EU to promote sustainability in corporations and financial markets, especially focusing on climate change as perhaps the greatest sustainability challenge of our time and thus on efforts to achieve a net-zero transition by 2050 in line with the Paris Agreement goals.[10] As the name 'critique' implies, our aim is mainly to draw attention to some negative and undesirable aspects of the EU policymaking on sustainable corporate governance and finance while also highlighting what we think as positive and useful features.

2. A Critique

Our approach is twofold. First, we highlight why some measures or provisions in the relevant EU initiatives are ill-conceived or inconsistent. Second, we draw attention to some unintended consequences of these rules which would arise unless they are supported by policies that make socially undesirable activities more costly for the relevant firm.

1. For further information, updates and developments on the European Green Deal, see, https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en#documents.
2. Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L330/1 (below: NFRD).
3. European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (21 April 2021), COM(2021) 189 final.
4. Inception 'impact assessment' (30 July 2020), Ares(2020)4034032 (below: Impact Assessment).
5. European Commission, Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (23 February 2022), COM(2022) 71 final (below: CSDD Proposal).
6. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability related disclosures in the financial services sector [2019] OJ L317/1, as later amended (below: SFDR).
7. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L198/13 (below: the Taxonomy Regulation or TR).
8. Taxonomy Regulation Article 8, supplemented by the Commission Delegated Act, C/2021/4987 final.
9. See notes 91-92 below and text thereto.
10. Research on 'planetary boundaries' show that there are many environmental issues that can affect the stability and resilience of the Earth system. See https://www.stockholmresilience.org/research/planetary-boundaries/the-nine-planetary-boundaries.html.

2.1 Ill-conceived and inconsistent measures

A primary example of an ill-conceived measure is, in our opinion, the recent Sustainable Corporate Governance Initiative that originally aimed at, among other things, rewriting the law on directors' duties.[11] More specifically, initial documents show that the intention was to empower 'company directors to take into account all stakeholders' interests which are relevant for the long-term sustainability of the firm or which belong to those affected by it (employees, environment, other stakeholders affected by the business, etc.), as part of their duty of care to promote the interests of the company and pursue its objectives'.[12]

As is well known, this aspect of the initiative drew a significant backlash from many academics, although there were supporters as well. A main of point of contention was the underlying EY study that appeared partly erroneous and misleading, which we do not need to recount here.[13]

The proposed CSDD Directive has now opted for a weak provision in this regard, stating that when fulfilling their duty to act in the best interest of the company, directors of companies within the scope of the Directive should 'take into account' the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environment, including in the short, medium and long term.[14] Obviously, this provision does not go as far as the options enumerated in the Impact Assessment. In fact, it amounts to only a 'clarification' and does not require changing existing national corporate structures.[15]

From a broader perspective, the issue relates to the well-known discussion on what corporate purpose should be and accordingly how directors' duties should be shaped: shareholder value vs. stakeholder value.

Given the sustainability challenges of our world, recently, stakeholderism has been touted as a comprehensive solution to put companies on a more sustainable path.[16] There are in fact several Member States in the EU that have long followed a stakeholder approach, partly as a result of path dependency (such as Germany).[17] We however think that stakeholderist-orientation of directors' duties is no panacea for achieving more sustainable companies, especially for reducing their environmental externalities. It is also not without undesirable consequences.

It is important to consider the general (legal and non-legal) framework in which such a scheme would operate in the EU. Directors' duties are notoriously vague and are rarely enforced in Europe, given the low levels of litigation due to the absence of class actions and the prohibition on contingency fees in most Member States.[18] Furthermore, concentrated share ownership is the norm in Europe, whether in private or public companies.[19] The existence of controlling shareholders particularly affects how directors of a company would perform.[20] Controlling shareholders have the power to nominate, elect and remove company directors which are in turn beholden to his or her interests. In addition, controlling shareholders, their relatives and associates are often represented on the board. Combined with little enforcement and liability risk, company directors will generally follow controlling shareholders' interests which may not align with environmental interests. This is especially acute in private companies where opaque board structures without any independent directors dominate.[21] This is important because private companies form a significant segment of the economy in Europe and can impose large externalities[22] – a theme we recurrently pick up throughout this piece.

Another potential weakness is the difficulty in balancing different interests when directors need to pursue a stakeholderist approach.[23] Especially, in the context of the net-zero transition, it should be noted that environmental concerns and labour interests may not always be reconcilable.[24] The Volkswagen diesel scandal is a case in point,

11. For background information on the Initiative, see https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en.
12. Impact Assessment (n 4) 2.
13. See Alexander Bassen, Kerstin Lopatta & Wolf-Georg Ringe, 'The EU Sustainable Corporate Governance Initiative – room for improvement', *Oxford Business Law Blog* (15 October 2020), available at https://www.law.ox.ac.uk/business-law-blog/blog/2020/10/ec-corporate-governance-initiative-series-eu-sustainable-corporate; Alex Edmands, Luca Enriques, Jesse Fried, Mark Roe and Steen Thomsen, 'Call for Reflection on Sustainable Corporate Governance' (7 April 2021), available at https://ecgi.global/news/call-reflection-sustainable-corporate-governance; Mark Roe, Holger Spamann, Jesse Fried and Charles Wang, 'The Sustainable Corporate Governance Initiative in Europe' (2021) 38 *Yale Journal on Regulation Bulletin* 133.
14. CSDD Proposal Article 25. It should be also noted that Article 26 involves a specific provision on directors' duties: directors of companies within its scope are responsible for putting in place and overseeing the due diligence actions and the due diligence policy referred to in other articles of the Proposal.
15. CSDD Proposal Recital 63.
16. See for example Colin Mayer, *Prosperity: Better Business Makes Greater Good* (OUP 2018); Leo E. Strine Jr., 'Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy A Reply to Professor Rock' (2021) 76 *The Business Lawyer* 397.
17. Katharina Pistor, 'Codetermination: A Sociopolitical Model with Governance Externalities' in Margaret M. Blair & Mark J. Roe (eds), *Employees and Corporate Governance* (Brookings Institution Press, 1999) 163.
18. Bassen et al. (n 13) 3-4.
19. For a recent study, see Gur Aminadav & Elias Papaioannou, 'Corporate Control around the World' (2020) 75 *Journal of Finance* 1191.
20. See Alperen Afşin Gözlügöl, 'Controlling Shareholders: Missing Link in the Sustainability Debate?', *Oxford Business Law Blog* (16 July 2021), available at https://www.law.ox.ac.uk/business-law-blog/blog/2021/07/controlling-shareholders-missing-link-sustainability-debate.
21. On the corporate governance of privately held companies see generally Joseph A. McCahery & Erik P.M. Vermeulen, *Corporate Governance of Non-Listed Companies* (OUP 2008); Holger Fleischer, 'Comparative Corporate Governance in Closely Held Corporations' in Jeffrey N. Gordon & Wolf-Georg Ringe, *The Oxford Handbook of Corporate Law and Governance* (OUP 2018) 679.
22. See Alperen A. Gözlügöl & Wolf-Georg Ringe, 'Private Companies: The Missing Link on the Path to Net Zero' (ECGI Law Working Paper No. 635/2022, available at https://ssrn.com/abstract=4065115).
23. See also Lucian A. Bebchuk & Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106 *Cornell Law Review* 91, 116-23.
24. See generally, Alperen A. Gözlügöl, 'The Clash of 'E' and 'S' of ESG: Just Transition on the Path to Net Zero and the Implications for Sustainable Corporate Governance and Finance' (SAFE Working Paper 325) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3962238.

demonstrating that worker-oriented governance may not always produce best results for the environment.[25]

Lastly, wide discretion under the stakeholder value approach for company directors can be used to increase insulation and reduce accountability to institutional investors as shareholders.[26] This may also adversely affect the net-zero transition as institutional investors are increasingly concerned with green transition as part of their risk calculus or green preferences.[27]

Therefore, although it is ironic that after all the fundamental discussion and efforts, the Proposal arrives at rather an anticlimactic point and aims to provide only a legislative 'clarification', which can even be deemed as a waste of legislative resources, it is to be welcomed that Member States have the ultimate choice in how to shape directors' duties, which will be surely affected by the idiosyncratic legal and non-legal elements in the relevant Member State.[28] Still, the language of the relevant provision on directors' duty of care (article 25) needs to streamlined. Otherwise, it can even be interpreted in a way that defeats the purpose of the whole endeavour: directors of companies not within the scope of the provision (those outside of Article 2(1)) can be deemed to be given a blank cheque to disregard human rights and environmental matters.

Another problematic example is the Non-Financial Reporting Directive (NFRD), which brought non-financial information disclosure requirements for large, listed companies. Overall, we are in favour of mandatory disclosure of sustainability information. Such disclosure satisfies the growing information needs of investors in this regard as well as sheds light on the environmental (or generally social) impact of the relevant companies for various stakeholders. Although a conclusive cost-benefit analysis has remained elusive, extant literature shows the beneficial effects of mandatory disclosure in terms of filling information gaps in public markets and improving sustainability performance.[29] Therefore, the NFRD is a positive step in theory.

In practice, however, various shortcomings of the NFRD have been exposed. Although supported by the European Commission's several guidelines, the Directive has largely failed to provide a standardized and comprehensive disclosure regime and prevent greenwashing – the main benefits that were expected from a mandatory disclosure framework.[30] Furthermore, the lack of assurance or audit requirements reduces the reliability of the disclosed information considerably, at least in comparison to traditional financial disclosures.[31]

It is worth noting another important but largely overlooked defect of the NFRD: it does not require *private companies* to disclose sustainability information. Only public-interest entities (that are large and have more than 500 employees) are subject to disclosure requirements, which means that private companies are out of scope (unless they issued bonds traded on a regulated market in the EU).[32] As stated, private companies form a significant segment of the economy across many Member States. Furthermore, these private companies can be quite large in size and impose important (environmental) externalities.

For example, in Germany, which is the highest emitting country in Europe,[33] according to a recent report, a private company (LEAG) owns four of the highest emitting power plants.[34] Similarly, under the EU emissions trading scheme, a private company (EPH) has been among the top three emitters in the EU since 2016.[35]

It is worth pointing out that the goal of the NFRD is not solely investor-facing disclosure. In other words, it follows a so-called 'double materiality' approach.[36] It avowedly declares that by requiring disclosures on company impact

25. See Martin Gelter, 'Employee Participation in Corporate Governance and Corporate Social Responsibility' (ECGI Law Working Paper No. 322/2016) 25-28 at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2798717.

26. See Bebchuk and Tallarita (n 23) 164-68.

27. Climate risk may have a substantial adverse impact on the portfolio returns of institutional investors, giving them incentives to engage for climate change mitigation. See notes 54-55 below and text thereto. Green preferences indicate the willingness of investors to give up financial returns for positive sustainability impacts. See notes 50-52 below and text thereto.

28. For a brief commentary on other aspects of the CSDD Proposal, see Wolf-Georg Ringe & Alperen A. Gözlügöl, 'The EU Sustainable Corporate Governance Initiative: Where are We and Where are We Headed?, *Harvard Law School Forum on Corporate Governance* (18 March 2022), available at https://corpgov.law.harvard.edu/2022/03/18/the-eu-sustainable-corporate-governance-initiative-where-are-we-and-where-are-we-headed/.

29. For a review of the literature, see Hans B. Christensen, Luzi Hail & Christian Leuz, 'Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review' (2021) 26 *Review of Accounting Studies* 1176.

30. See The Alliance for Corporate Transparency, 'Research Report 2019: An analysis of the sustainability reports of 1000 companies pursuant to the EU Non-Financial Reporting Directive' at https://corporatejusticecoalition.org/resources/alliance-corporate-transparency-2019-research-report/; European Securities and Markets Authority (ESMA), 'Report: Enforcement and regulatory activities of European enforcers in 2020' (6 April 2021) at https://www.esma.europa.eu/press-news/esma-news/esma-publishes-2020-report-enforcement-corporate-disclosure.

31. The NFRD only requires that the statutory auditor or audit firm checks whether the non-financial information has been provided. It is the Member States' choice to further require that the non-financial information be verified by an independent assurance services provider. For how Member States have transposed these provisions into national law, see Accountancy Europe, 'Towards Reliable Non-Financial Information Across Europe: Factsheet' (February 2020) at https://www.accountancyeurope.eu/wp-content/uploads/Accountancy-Europe-NFI-assurance-practice_facthseet.pdf.

32. NFRD Article 1. Public-interest entities are defined under the Article 2 of the Accounting Directive (Directive 2013/34/EU) as entities 'governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State'.

33. On the EU Member States' GHG emissions, see EEA greenhouse gases – data viewer (13 April 2021) at https://www.eea.europa.eu/data-and-maps/data/data-viewers/greenhouse-gases-viewer.

34. See Deutsche Emissionshandelsstelle, 'Greenhouse Gas Emissions in 2020: Stationary Installations and Aviation Subject to Emissions Trading in Germany (2020 VET report)' (May 2021), 7 at https://www.dehst.de/SharedDocs/downloads/EN/publications/2020_VET-Report_summary.pdf?__blob=publicationFile&v=3 (Lausitz Energie Kraftwerke AG (LEAG) owns the second, third, sixth and seventh highest emitting power plants, which is in turn owned by EPH, a Czech private utility company, and PPF Investments, a private equity firm; on the ownership, see https://www.leag.de/de/unternehmen/).

35. See Carbon Market Data Press Releases on the EU ETS Company Rankings at https://carbonmarketdata.com/en/news.

36. See Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490, 4 ('the Non-Financial Reporting Directive has a double materiality perspective').

on climate, it aims to inform consumers, civil society, employees, *and* investors.[37] Therein lies the primary inconsistency of the NFRD. If the sole aim was to disclose 'financially material' climate-related information, it would make sense to require such disclosures only from companies in public markets where information asymmetries are acute and prohibitively costly to overcome for investors. But since the aim is to generate an understanding of the external impacts of the company for a broader audience, then disclosure should also be required from private companies that are relevant from the societal impact perspective. To be sure, the universe of private companies is huge and it would not be prudent to cast the net too wide as that can be too costly; but 'large' private companies can be justifiably included in terms of their societal impact.[38]

Importantly, putting spotlight and related scrutiny only on public companies while allowing private companies to operate in the shadows and without market/stakeholder discipline can contribute to the phenomenon of brown-spinning. The latter denotes the passing of highly polluting assets from public to private companies. While it helps public carbon majors to appease environmentally conscious investors and comply with their climate targets, there is no net benefit in terms of climate action when private companies continue highly polluting activities. Climate-related disclosure for private companies can alleviate this form of reputational and regulatory arbitrage to a certain extent[39] – an issue we will come back to below.

The NFRD's sole focus on public companies can be rather explained as a result of path dependency, as regular public-facing disclosure has long been a requirement largely for these companies. The newly proposed CSRD seeks to correct some of the deficiencies we recounted above. It intends to bring more detailed and granular disclosure standards with a requirement of independent assurance to ensure verifiability.[40] Importantly, it extends the disclosure requirements to large private companies as well. However, we should also note that whether this expansion of scope would survive is highly uncertain. Member States where a significant number of private companies would be affected by this expansion are likely to water down the proposed rules. The industry is also likely to lobby for a light- or no-touch approach for private companies. For example, an influential industry organization from Germany, Bundesverband der Deutschen Industrie (BDI), objects, in its statement, to this expansion of scope, noting that 15,000 companies in Germany that were previously not subject to reporting will fall under the new reporting requirements.[41]

37. ibid 4-5.

38. Gözlügöl and Ringe (n 22).

39. ibid.

40. (n 3).

41. See BDI, 'Stellungnahme zum Richtlinienvorschlag der Europäischen Kommission "Corporate Sustainability Reporting Directive" (CSDR)' (4 June 2021) at https://www.bmj.de/SharedDocs/Gesetzgebungsverfahren/Stellungnahmen/2021/Downloads/0604_Stellungnahme_BDI_CSRD.pdf?__blob=publicationFile&v=3.

2.2 Unintended consequences

In this part, we identify how some EU sustainability initiatives can cause unintended but adverse consequences while endeavouring to put companies and financial players on a more sustainable path. First, we argue that EU actions that stir institutional investors' engagement with companies on sustainability and address related market failures are commendable. But the increasing pressure in public markets can cause assets to shift to private players unless supported by other initiatives that alleviate or remove arbitrage opportunities. Second, we point to the danger of a 'green asset bubble' as a result of the efforts to reorient capital flows to green assets. Third, we indicate that going beyond climate-related risks perspective in banks' capital requirements to directly affect financing of brown or green activities can threaten financial stability. A fundamental question that business law scholars have long grappled with is what role corporate law and finance has in addressing the externalities companies impose? A Friedmanesque answer is well-known and simple: corporations are (justifiably) run for profit and it is the role of external regulation to set boundaries for company conduct.[42] More than 50 years after Friedman's famous article first appeared in the New York Times, the echo of his statement is still live and powerful.[43]

But the corporate landscape has shifted considerably since then. Massive assets have accumulated in the hands of institutional investors, and the rise of modern portfolio theory ensured that these assets have been invested across a substantial segment of the economy.[44] Consequently, shareholder engagement (or activism) has become mainstream. Shareholder apathy has been replaced with institutional investors being more willing to use their voice and team-up with activists[45] or taking up the role of systematic stewards.[46] Activist hedge funds have also changed and refined their strategy. The aim was no more (only) the pursuit of short-term gains through financial gimmickry but long-term strategies that needed the support of fellow shareholders, namely institutional investors.[47]

The role of institutional investors in sustainability and climate action is also now a prominent point of discus-

42. Milton Friedman, 'A Friedman doctrine - The Social Responsibility Of Business Is to Increase Its Profits' *The New York Times* (13 September 1970) at https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html.

43. See for example Tyler Cowen, 'Milton Friedman Is More Relevant Than Ever' *Bloomberg* (18 November 2021) at https://www.bloomberg.com/opinion/articles/2021-11-18/milton-friedman-is-more-relevant-than-ever.

44. See generally Alejandra Medina, Adriana De La Cruz & Yung Tang, 'Owners of the World's Listed Companies' (OECD Capital Market Series, 2019) at www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm.

45. See Ronald J. Gilson and Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 *Columbia Law Review* 863.

46. See Jeffrey N. Gordon, 'Systematic Stewardship' *The Journal of Corporation Law* (2022, forthcoming).

47. Gilson & Gordon (n 46); Wolf-Georg Ringe, 'Shareholder Activism: A Renaissance' in Jeffrey Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018), chapter 15.

sion.[48] Two influential papers have shown that shareholder welfare is not the same as shareholder value.[49] Shareholders may have other preferences that they may be willing to trade against financial returns. Overall, this suggests that institutional investors may have green preferences, and as shareholders, they may be willing to give up financial returns for the green transition.[50] The rise of ESG investing and environmentally conscious groups of beneficial owners confirm this assertion.[51]

Furthermore, many large institutional investors are subject to climate change as systematic (financial) risk. Although the theory is still in contention, this means that as universal (or common) owners (ie as investors that have stake in a wide range of asset classes broadly diversified across the economy, meaning that they effectively own a slice of the broad economy),[52] they would be willing to reduce climate externalities imposed by individual investee companies at the expense of immediate profits if this helps the overall portfolio in the long run.[53] Empirical evidence also associated institutional investors (especially the 'Big Three', ie BlackRock, Vanguard and State Street) with better environmental performance and specifically less greenhouse gas emissions in the investee companies.[54]

In this regard, we welcome the EU efforts that facilitate institutional investors' engagement and overall address market failures. Crucial issues include the agency problems between asset owners and asset managers, and rampant greenwashing. Although we acknowledge that they are not magic bullets and are fraught with some problems,[55] the TR and SFDR aim to address these problems with wide-ranging disclosure obligations while the former also provides a general framework in determining what is in fact 'green'. If successful, sustainable finance initiatives can unleash the potential of financial markets to allocate capital to socially desirable activities.[56] Furthermore, in an attempt to facilitate and encourage shareholder engagement, the Shareholder Rights Directive II requires (on a comply or explain basis) institutional investors and asset managers to develop and publicly disclose an engagement policy, describing how they monitor investee companies on relevant matters including environmental and social issues.[57] This would help beneficial owners to understand how their assets are managed and take action, if necessary, in accordance with their preferences. Moreover, the European Securities and Markets Authority (ESMA) has recently proposed to revise its *White List* with activities that do not count as 'acting in concert' under disclosure and takeover rules, and add an explicit reference to coordination activities among institutional investors in the area of ESG, to stimulate engagement in this field.[58] This move holds the promise of significantly facilitating and encouraging coordinated action for sustainability engagement and is to be welcomed.[59]

ESG ratings and indices play also an increasingly important role in this investor-led sustainability in companies: while the former help companies and investment firms measure and demonstrate the ESG performance of their activities and investments, the latter indicate an investable portfolio of companies that are compliant with certain ESG criteria. Growing mistrust in such tools due to dubious and untransparent methodologies can hamper market-led sustainability.[60] Therefore, it is vital to address certain issues associated with ESG ratings and indices. With regard to the latter, the EU has already made some amendments to the Benchmark Regulation to enhance the ESG transparency of benchmark methodologies and to put forward standards for the methodology of low-carbon benchmarks.[61] The landscape for ESG ratings is also likely to change as the European Commission, in its Strategy for Financing the Transition to a Sustainable Economy, stated that it would take action to improve the reliability,

48. See generally Wolf-Georg Ringe, 'Investor-led Sustainability in Corporate Governance' (ECGI Law Working Paper No. 615/2021, November 2021) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3958960.

49. See Oliver Hart & Luigi Zingales, 'Companies Should Maximize Shareholder Welfare not Market Value' (2017) 2 *Journal of Law, Finance, and Accounting* 247; Roland Bénabou and Jean Tirole, 'Individual and Corporate Social Responsibility' (2010) 77 *Economica* 1.

50. See for example Samuel M. Hartzmark & Abigail B. Sussman, 'Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows' (2019) 74 *The Journal of Finance* 2789 (finding evidence consistent with nonpecuniary motives influencing sustainable investment decisions).

51. See Ringe (n 49) 10-14. See also Michal Barzuza, Quinn Curtis & David H. Webber, 'Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance' (2020) 93 *Southern California Law Review* 1243, 1283 ff. (part III.).

52. See Robert Monks & Nell Minow, 'Watching The Watchers: Corporate Governance' In *The 21st Century* 121 (1996)

53. See Madison Condon, 'Externalities and the Common Owner' (2020) 95 *Washington Law Review* 1; John C. Coffee, Jr., 'The Future of Disclosure: ESG, Common Ownership, and Systematic Risk' (2021) *Columbia Business Law Review* 602; Gordon (n 47). Cf. Roberto Tallarita, 'The Limits of Portfolio Primacy' *Vanderbilt Law Review* (Vol. 76, 2023, forthcoming).

54. See for example Jose Azar and others, 'The Big Three and Corporate Carbon Emissions Around the World' (2021) 142 *Journal of Financial Economics* 674; Alexander Dyck and others, 'Do Institutional Investors Drive Corporate Social Responsibility? International Evidence' (2019) 131 *Journal of Financial Economics* 693.

55. See for example Georg Zachmann, 'Europe's sustainable taxonomy is a sideshow', *Bruegel Blog*, 22 February 2022 at https://www.bruegel.org/2022/02/europes-sustainable-taxonomy-is-a-sideshow/.

56. For a discussion in this regard, see Sebastian Steuer and Tobias H. Tröger, 'The Role of Disclosure in Green Finance' *Journal of Financial Regulation* (2022, forthcoming).

57. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L132/1.

58. ESMA, Report: Undue short-term pressure on corporations, ESMA 30-22-762 (December 2019) 69-70.

59. See Ringe (n 49) 42.

60. See for example Florian Berg, Julian F Kölbel and Roberto Rigobon, 'Aggregate Confusion: The Divergence of ESG Ratings' (Working Paper, 2022) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533; Florian Berg, Kornelia Fabisik and Zacharias Sautner, 'Is History Repeating Itself? The (Un)Predictable Past of ESG Ratings' (ECGI Finance Working Paper 708/2020, August 2021) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3722087.

61. Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks [2019] OJ L317/17.

comparability and transparency of ESG ratings.[62]

However, institutional investors and activist hedge funds are largely present and powerful in public companies. They increasingly put pressure on public carbon majors to take climate action via individual engagements, say-on-climate initiatives and even proxy fights for board election. This leads to an arbitrage opportunity for private companies that have been immune to that pressure. As we noted above, private companies have increasingly been buying carbon-intensive assets (that remain highly profitable) from public companies: the phenomenon of brown-spinning. Notable examples from Europe include public-private deals between TotalEnergies and Neo Energy,[63] Ørsted A/S and Ineos,[64] OMV and Siccar Point Energy,[65] and Engie and Riverstone Holdings.[66] On the supply side, we can expect more disposals from public carbon majors under the pressure to accelerate their green transition and fulfil their climate pledges. A recent report from an industry insider writes that the oil and gas assets up for sale across the industry amount to more than $140bn.[67] On the demand side, this phenomenon of brown spinning is largely driven by private equity. In a recent issue, *The Economist* noted that '[i]n the past two years alone these bought $60bn-worth of oil, gas, and coal assets, through 500 transactions – a third more than they invested in renewables.'[68]

Discounts imposed on carbon-intensive assets in financial markets linked to sustainability factors rather than underlying financials cause mispricing which private players can exploit.[69] Overall, these private buyers are apparently betting on two conditions: (i) the demand for these assets will contract less slowly than supply and (ii) the green transition will take longer than intended.

These conditions are most likely to continue to exist unless relevant rules or taxes are in place or stringent/sufficient enough to prohibit socially undesirable activities or make responsible groups internalise their externalities. If this is not the case, well-intended measures to increase sustainability pressure in public markets can unintendedly shift polluting assets to private players. As we argued above, levelling the playing field between public and private players in terms of disclosure will help us understand to what extent this is happening and harmful as well as providing a certain disciplining mechanism for private players. This would also complement certain disclosure obligations for private equity funds in terms of 'adverse sustainability impacts' under the SFDR.[70]

Asset shifting might not only happen in companies. As stated above, the TR requires banks to disclose their green asset ratio, providing transparency on to what extent credit institutions finance activities aligned or not-aligned with the TR. A single metric on the green credentials of banks' balance sheet would improve comparability and mitigate the risk of greenwashing. Yet, a side effect is that to polish their green credentials, banks may only transfer their 'brown' loans to private-debt funds. While this improves the green asset ratio, similar to the effects of brown-spinning in companies, there is no adverse impact on the financing conditions of the underlying activities. A recent example is the sale of the entire portfolio of North American oil and gas loans by ABN AMRO, a Dutch Bank to Brookfield, an alternative asset management company based in Canada.[71]

To be sure, the EU has also put in place a carbon pricing system that attaches financial consequences to carbon emissions. Rather than being based on a public/private divide, this system is activity-based, thus encompasses every player active in sectors covered by the emissions trading system (ETS).[72] As economists indicate, taxation is the primary way to internalize an externality, and a carbon tax scheme is therefore the most lauded method in climate change mitigation.[73] The EU is one of the few global players that operates a carbon tax scheme, and the ETS is being gradually expanded to cover more greenhouse gasses and sectors.[74] Yet, the success of this system has been questionable, especially in terms of to what extent carbon prices reflect the true social cost of

62. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final (6 July 2021) 16. This followed the Commission's own study and ESMA's letter to the Commission on ESG ratings, respectively available at https://op.europa.eu/en/publication-detail/-/publication/897bee11-509d-11eb-b59f-01aa75ed71a1/language-en and https://www.esma.europa.eu/document/esma-letter-ec-esg-ratings. ESMA also recently published a call for evidence to gather information on the market structure for ESG rating providers in the EU. See, https://www.esma.europa.eu/press-news/esma-news/esma-launches-call-evidence-esg-ratings.

63. See TotalEnergies Press Release, 'Total Closes the Sale of Non-Core UK Assets to NEO Energy' (6 August 2020) at https://totalenergies.com/media/news.

64. See Ineos Press Release, 'INEOS to buy the entire Oil & Gas business from DONG Energy A/S for a headline price of $1.05 billion plus $250m contingent' (24 May 2017) at https://www.ineos.com/news/ineos-group/ineos-buy-entire-oil-and-gas-business-from-dong-energy/.

65. See Blackstone Press Release, 'Siccar Point Energy announces acquisition of OMV (U.K.) Limited' (9 November 2016) at https://www.blackstone.com/news/press/siccar-point-energy-announces-acquisition-of-omv-u-k-limited/.

66. See Engie Press Release, 'ENGIE to sell its German and Dutch coal assets and boosts the implementation of its strategy' (26 April 2019) at https://www.engie.com/en/journalists/press-releases/sell-german-dutch-coal-assets.

67. See Anjli Raval, 'A $140bn Asset Sale: The Investors Cashing In On Big Oil's Push To Net Zero' *Financial Times* 6 July 2021 at https://www.ft.com/content/4dee7080-3a1b-479f-a50c-c3641c82c142 (citing energy consultancy Wood Mackenzie).

68. See 'Who Buys the Dirty Energy Assets Public Companies No Longer Want?' *The Economist* 12 February 2022 at https://www.economist.com/finance-and-economics/who-buys-the-dirty-energy-assets-public-companies-no-longer-want/21807594.

69. ibid.

70. SFDR Article 4 (transparency of adverse sustainability impacts at entity level) and Article 7 (transparency of adverse sustainability impacts at financial product level).

71. 'Who Buys the Dirty Energy Assets Public Companies No Longer Want?' (n 69).

72. On how this system works and the sectors covered, see https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets_en.

73. Ian Parry, 'Putting a Price on Pollution' (2019) 56(4) *IMF Finance & Development* 16, at https://www.imf.org/external/pubs/ft/fandd/2019/12/the-case-for-carbon-taxation-and-putting-a-price-on-pollution-parry.htm.

74. See, https://ec.europa.eu/clima/eu-action/european-green-deal/delivering-european-green-deal/increasing-ambition-eu-emissions-trading_en.

carbon.[75] Establishing an effective carbon pricing system is highly challenging as distributional consequences loom large, and the lack of international coordination paves the way for legal arbitrage and carbon leakage.[76] In comparison, sustainable finance can be powerful with its cross-border effect of closing the money tap for brown assets or activities: even states that have undiversified economies and are consequently unwilling to join global climate action would be hesitant to forego foreign direct investment that comes with sustainable finance. Yet, ultimately, it remains crucial that there is really no trade-off between maximizing profits and green activities/investing, which is unlikely as long as the externalities created by polluting firms are legal and untaxed.[77] Otherwise, there will always be some parties undertaking those polluting activities and investors attracted to high returns on those assets.

Another unintended consequence that relates to the detachment between fundamentals and sustainability imperatives is what is called a 'green bubble'. A bubble, in economic terms, indicates that certain asset prices are much higher than what the underlying fundamentals can reasonably justify.[78] A recent asset bubble burst was experienced during the mortgage crisis and following the global financial crisis during 2007-08.[79] Some are also arguing that climate risks are not sufficiently priced in markets, which can create a 'climate bubble' and lead to a 'Minsky moment'.[80] Greenwashing can also create a situation where asset values can change too suddenly. When over-exaggerated green credentials are exposed, asset values can plunge. Therefore, sustainable finance initiatives that aim to prevent mispricing of climate risk and greenwashing contribute to financial stability. EU initiatives such as NFRD, CSRD and SFDR all involve provisions to this effect.[81]

However, from another perspective, where, as a result of the efforts to reorient capital flows to green assets, investments accumulate in these assets without any risk assessment or justifying fundamentals, we can find ourselves in a 'green assets bubble', as the Bank for International Settlements (BIS) recently warned and likened it to parts of the mortgage-backed security market in the run up to the global financial crisis.[82] Price-to-earnings ratios are very high for 'green' companies (the prominent example being Tesla) that increasingly attract the interest of short-sellers.[83] A study by *The Economist* finds that a portfolio of companies that stand to benefit from the energy transition, with a total market capitalisation of $3.7trn, has risen by 59% since the start of 2020, twice the increase in the S&P 500.[84] We experience a huge surge of interest in green investing; however, depending on the pace and shape of net-zero transition (as well as macroeconomic and sector-based trends), 'green' assets can go through a significant price correction like 19th-century railroad stocks and the dot.com bubble.[85] Fortunately, the BIS concludes that there is currently not too much a danger for financial stability yet.[86] But it still provides a cautionary tale in terms of the limits of what sustainable finance can and should do. Rules and transparency on investment in ESG assets will provide a clearer picture of to what extent assets cumulate in certain segments. Further nudges for green investment without a risk perspective or with a detachment from fundamentals can do more harm than benefit. A conceivable option in this direction could be, for instance, as the Commission consulted on as part of the Renewed Sustainable Finance Strategy, to offer retail investors sustainable investment products as a default option if they are available at a comparable cost and meet the suitability test.[87] In its Strategy for Financing the Transition to a Sustainable Economy that followed the consultation,[88] the Commission seems to have dropped the option, which is to be welcomed due to certain dangers associated with it.[89]

A similar situation can arise when banks' financing turns away from brown to green assets or activities. Stress tests are a useful way to understand how and to what

75. See for example Joseph E. Aldy and Robert N. Stavins, 'The Promise and Problems of Pricing Carbon: Theory and Experience' (2012) 21(2) *Journal of Environment and Development* 152; Nicholas Koch et al, 'Causes of the EU ETS price drop: Recession, CDM, renewable policies or a bit of everything? – new evidence' (2014) 73 *Energy Policy* 676.

76. See for example Itzhak Ben-David et al, 'Exporting Pollution: Where Do Multinational Firms Emit CO2?' (2021) 36 *Economic Policy* 377; Söhnke M. Bartram, Kewei Hou and Sehoon Kim, 'Real Effects of Climate Policy: Financial Constraints and Spillovers' (2022) 143(2) *Journal of Financial Economics* 668. In response to this problem, the EU wants to adopt the so-called Carbon Border Adjustment Mechanism. On the initiative and how it works, see https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661.

77. See also 'Green Investors' Filthy Secret: The Truth about Dirty Assets' *The Economist* 12 February 2022 at https://www.economist.com/leaders/2022/02/12/the-truth-about-dirty-assets.

78. See Burton G. Malkiel, 'Bubbles in Asset Prices' in Dennis C. Mueller (eds), *The Oxford Handbook of Capitalism* (OUP 2012).

79. ibid.

80. See Madison Condon, 'Market Myopia's Climate Bubble' (2022) *Utah Law Review* 63; Mark Carney et al, 'The Financial Sector Must Be at The Heart of Tackling Climate Change' *The Guardian* (17 April 2019) at https://www.theguardian.com/commentisfree/2019/apr/17/the-financial-sector-must-be-at-the-heart-of-tackling-climate-change.

81. While the NFRD and its successor CSRD aim to provide disclosure on climate risk at the company level, the SFDR covers disclosures at the investment fund or manager level.

82. See, Sirio Aramonte & Anna Zabai, 'Sustainable finance: trends, valuations and exposures' (BIS Quarterly Review, September 2021) at https://www.bis.org/publ/qtrpdf/r_qt2109v.htm.

83. ibid.

84. See 'A green bubble? We dissect the investment boom' *The Economist* (20 May 2021) at https://www.economist.com/finance-and-economics/2021/05/17/green-assets-are-on-a-wild-ride. See also Billy Nauman, ''Green bubble' warnings grow as money pours into renewable stocks' *Financial Times* (19 February 2021) at https://www.ft.com/content/0a3d0af8-7092-44c3-9c98-a513a22629be.

85. Aramonte & Zabai (n 83).

86. ibid.

87. See European Commission, 'Consultation on The Renewed Sustainable Finance Strategy' (8 April 2020) 21, at https://ec.europa.eu/info/consultations/finance-2020-sustainable-finance-strategy_en.

88. (n 62).

89. See also Veerle Colaert, 'The Changing Nature of Financial Regulation: Sustainable Finance as a New Policy Goal' (on file with authors), pp. 18-19.

extent banks are exposed to climate risk (both transition and physical risk).[90] Climate risk can also be taken into account in capital adequacy when calculating risk-weighted credit exposures and corresponding asset holding requirements.[91] However, a further step where banks' capital requirements change depending only on to what extent the loan book is 'green' or 'brown' can be harmful. To be sure, brown assets can involve financial risk in relation to climate change mitigation and this can be reflected in default risk and thus in capital requirements. But, further than that, treating these assets less favourably and allowing banks to apply a lower risk weight to green assets just because they are 'green' can be disastrous.[92] It can strip banks' balance sheets of a true risk assessment. As the ECB conducts a climate risk stress test in 2022, there are fears that capital requirements can be affected by the ambitions to allocate financing from brown to green assets.[93] An amendment to the Capital Requirements Regulation mandated the European Banking Authority (EBA) to assess whether a dedicated prudential treatment of exposures related to assets, including securitisations, or activities associated substantially with environmental and/or social objectives would be justified.[94] EBA is to deliver its report by June 2025.[95] We would welcome the efforts to reflect the growing concerns about climate risk in the traditional risk framework but caution against more ambitious attempts.

3. Conclusion

The EU has become an international pacesetter in pursuing sustainability initiatives, in particular for corporations and financial markets, with a large array of policy actions, directives and regulations on different issues. In this contribution, we took stock of main initiatives and provided a critique.

Some initiatives such as the 'sustainable corporate governance' agenda with its ambition to reform directors' duties were ill-conceived. Furthermore, while the imperative to disclose non-financial information was commendable, the relevant measures showed inconsistency, leaving out an important segment of the economy in the form of private companies. Encouragingly, the latest developments regarding both initiatives address the relevant concerns.

Financial markets currently go through a significant shift towards sustainability. And the EU, understandably, endeavours to use the power of financial markets to bring about socially desirable changes. Actions to support institutional investors' engagement as shareholders and addressing emerging troubling issues such as greenwashing are steps in the right direction. However, the EU should be mindful of arbitrage opportunities. Growing pressure in public markets and banks may only bring the unintended consequence of carbon-intensive assets shifting to private players (such as private companies and private-debt funds): the so-called brown-spinning. To address potential detrimental outcomes, we advocated disclosure obligations for private players. Strengthening the EU ETS can also alleviate the mispricing that private players thrive on.

Lastly, we would caution against the danger that sustainability imperatives can create when they are too ambitious, in other words, too detached from the fundamentals. Two examples are the 'green bubble' in financial markets and banks' balance sheets not reflecting true risk assessments as a result of differential capital treatments for green assets. While climate risk should certainly be reflected in prudential and supervisory tools, further actions that the EU signalled in different measures can do more harm than benefit.

90. See Patrizia Baudino & Jean-Philippe Svoronos, 'Stress-testing banks for climate change – a comparison of practices' (BIS FSI Insights on policy implementation No. 34, July 2021) at https://www.bis.org/fsi/publ/insights34.htm.

91. Ivana Baranović et al, 'The Challenge of Capturing Climate Risks in the Banking Regulatory Framework: Is There a Need for a Macroprudential Response?' (ECB Macroprudential Bulletin, Issue 15, October 2021) at https://www.ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/index.en.html.

92. Cf. Colaert (n 90) 21-22 (distinguishes between green supporting factor and brown punishing factor and states that the latter does not pose any danger).

93. Nicholas Comfort & Frances Schwartzkopff, 'ECB Has Banks Bracing for Capital Hit as Climate Risk Tested' *Bloomberg* (8 February 2022) at https://www.bloomberg.com/news/articles/2022-02-08/ecb-has-banks-bracing-for-capital-hit-as-climate-risk-is-tested.

94. Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/1 (as amended), Article 501(c).

95. ibid.

Judith Rochfeld • Professor of Private Law at the Sorbonne Law School, Université Paris 1 Panthéon-Sorbonne, IRJS

Capitalism and Future Generations

Climate litigation has become the forum for resounding controversies over our economic growth models. Because these debates don't happen elsewhere - as attested again by the virtual absence of questions regarding our economic model during the April 2022 French President election debates - they are held before courts, which, over the past years, have indeed taken on the responsibility of hosting them.

In the Netherlands, Austria, Belgium, Germany, the United Kingdom, Ireland, Norway, the United States, Canada, Australia, New Zealand, the Philippines, Pakistan, Colombia, Nigeria, and so on, lawsuits are being filed by associations, citizens, local authorities or companies challenging government policies on climate change or the consequences of the activities of certain companies, in particular the 'carbon majors', the hundred or so large cement or oil companies.[1] Doomed to failure at their inception (since 2017, following the December 2015 Paris Agreement), these lawsuits started bearing fruits since the *Urgenda* decision of the Dutch Supreme Court dated 20 December 2019 that issued an injunction to the Dutch government to comply with the greenhouse gas (GHG) emissions reduction targets it committed to for 2020.

With respect to France, one could refer to the decisions of Council of State (*Conseil d'Etat*) in the case initiated by the commune of Grande-Synthe (joined by the cities of Paris and Grenoble as well as environmental associations), as well as to those of the Paris Administrative Court. On November 19, 2020 and July 1, 2021,[2] to the general surprise, the Council of State issued an injunction to the French government to comply with the emissions reduction targets spelled out in binding legislation (notably Article L. 100-4 of the French Energy Code), in relation to the objectives set by the nation within the 2015 Paris Agreement and the equally binding European requirements (the '2020 Climate & Energy Package'; the requirements have since been raised to -55% by 2030).[3] We are now expecting the third phase of this litigation and the 'sanction' that would be imposed on the governmental in view of the insufficiency of its efforts. On February 3 and October 14, 2021,[4] at the request of four associations joined in the '*Affaire du Siècle*' and supported by nearly 2.3 million citizens, the Paris Administrative Court held the French State liable for omission to act, due to the delay in pursuing an effective climate policy, a failure that the Court deems to be the cause of an 'ecological damage' consisting in the degradation of the climate system.

One can readily see, therefore, that there is now a global context of challenges to the climate policies of States (at least where such challenges are permitted and possible), as well as to the activities of companies involved in the extraction, production and consumption of fossil fuels. In an informal and polycentric manner, through a 'reterritorialization of the global',[5] a global discussion is emerging over the energy model to be favored, if not, more broadly, over the sustainability of the 'extractive' model (ie relating to the extraction of 'natural resources') to support economic growth: absent an international court and an engagement in these debates in the major forums of international trade, these scattered legal challenges, through which unprecedented arguments are being disseminated extremely rapidly and on a global scale, serve as a forum for the discussion over the future of our growth model.

It is important to realize that every decision in the Netherlands, the United Kingdom, Norway, New Zealand, Australia, Colombia, or France not only gives rise to commentaries and detailed scrutiny in many parts of the world, but also provides governments and companies with hints of what 'climate' policies and activities can still be undertaken. Granted, one must not exaggerate the real impact of these litigations. If they are no longer purely symbolic, as they were deemed at their beginning, they

1. Note however that they are not the only ones, since companies in the agri-food sector, involved in crops that lead to deforestations in the Amazon, for example, are also on trial.
2. CE, 19 nov. 2020, n° 427301, *Commune de Grande-Synthe, Recueil Lebon* ; *Énergie – Env. – Infrastr.* 2020, étude 17, M. Torre-Schaub ; *Énergie – Env. – Infrastr.* 2021, dossier 12, C. Huglo ; *AJDA* 2021. 2115, note H. Delzangles ; *RFDA* 2021. 777, concl. S. Hoynck.— CE, 1er juill. 2021, n° 427301, Énergie – Env. – Infrastr. 2021, comm. 77, S. Hoynck ; *JCP A* 2021, 2264, note F.-X. Fort and C. Ribot ; *JCP G* 2021, 795, obs. B. Parance and J. Rochfeld.
3. Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law'). *Adde* Regulation 2021/783 of the European Parliament and of the Council of 29 April 2021 establishing a Programme for the Environment and Climate Action (LIFE), and repealing Regulation (EU) No 1293/2013.
4. TA Paris, 3 févr. 2021, *Association OXFAM France et autres, n° 1904967, n° 1904968, n° 1904972*, and n° 1904976/4-1, *D.* 2021. 240, obs. J.-M. Pastor ; *AJDA* 2021. 239; *JA* 2021, n° 634, p. 12, obs. X. Delpech ; *AJDA* 2021. 2228, obs. J. Bétaille, commentary by H. Delzangles ; *AJDA* 2021. 2115, C. Cournil and M. Fleury, '*De "l'Affaire du siècle" au "casse du siècle"?*', *Rev. dr. homme* 7 févr. 2021, n° 35.— TA, 14 oct. 2021, n° 1904967, 1904968, 1904972, 1904976/4-1, *Assoc. Oxfam France et a.*, *Énergie - Environnement - Infrastructures* n° 11, Novembre 2021, al. 67, L. Erstein.
5. The expression is that of B. Latour, *Face à Gaïa. Huit conférences sur le nouveau régime climatique*, Paris, La Découverte, 2015.

will, obviously, not be able to change on their own the development trajectories. Moreover, the timeframe of judicial actions is not that of the 'climate emergency' and all the decisions will not be handed down in the three years that the IPCC has set to radically reorient climate policies and activities in order to prevent the climate disruption from getting out of control...[6] Still, these litigations provide forums for raising citizens' awareness and putting pressure on governments and companies, if only considering that significant sanctions start being issued (many of the former immediately change their policies or reorient them, irrespective of the success of the litigation; the latter cannot ignore the impact of these debates on individual and collective consumer choices. Their effects are therefore far from being negligible in practice.

At a deeper level, from a legal standpoint, they constitute an extraordinary laboratory for new arguments, a weaving of notions used in one jurisdiction and acculturated elsewhere, and that, in an extremely reduced timeframe due to the worldwide circulation of arguments mentioned above. These litigations start leading to paradigm shifts and questionings over part of the growth model on which we have long relied. We would like to substantiate this claim by taking the example of the French litigation, on the one hand, regarding the assessment of lawful business activities, on the other hand. However, in addressing these issues, we will also take account of the influence that arguments debated in other jurisdictions might have.

We will show that, based on the legal tools available under French law, it would no longer be exactly possible to govern, produce and consume, even legally, while ignoring the material finiteness of the world and the disruptions that it is currently undergoing (1), all the more so as new 'creditors' of the perennity of the world take center stage, projecting the legal arguments at an intergenerational scale, ie taking account of future generations (2). However, the use of the conditional tense is still warranted when addressing these developments, for while these legal tools do indeed exist, it is not granted that they would be applied strictly to all relevant companies and would engender changes in the short term.

1. The reintegration of the world: the duty of vigilance

One of the major contributions of the litigation against companies is the reintegration of considerations about the physical world into our economic growth model. But why talk about *reintegration* rather than *integration*? The reason lies in the fact that numerous economists had in the past pointed to the finite nature of 'natural resources' and concluded that it would be impossible to craft a sustainable growth model without taking it into account.[7] The Meadows Report of 1972, although debated in some respects (notably for having linked 'development' and 'sustainable'), has early on made this hiatus official.[8] The level of the reaction engendered by this warning was proportional to the changes it implied: it consisted in one of the strongest reaffirmations of the existing economic models... and a relegation of those who were questioning the 'dematerialization' of the economy (an economy that disregarded the physical world).

It is precisely the return of this question, extended to encompass the questions of pollution and climate change, that one sees in the issues raised before courts that are requested to assess the climate policies of governments and (even more so) the activities of companies involved in the extraction production and marketing of fossil fuel and its derivatives: while the discussion before courts was initially concerned with the enforceability of the commitments undertaken by States under the Paris Agreement or other international treaties, as well as with the type of constraints that these texts created for public authorities,[9] it has now moved to assessing the feasibility of continuing perfectly legal operations in a finite and polluted world, the limits of which are pointed out by converging international expertise.[10]

Moreover, while the conditions for challenging legal activities (albeit sometimes subject to authorizations) before courts seemed to be settled, they are now undergoing a significant evolution. Under normal circumstances, such challenges are not available: the legal system used to defer to classical ways of distribution of risks and 'negative externalities', ie the 'social costs' of these activities, and to rely on traditional tax tools (taxes on emissions aiming to make apparent these costs in the price signal and incentivize emission reductions), or the allocation of greenhouse gas emission allowances (tradable rights understood as circulating assets and supposed to constrain some of the uses of the atmosphere); in a liberal framework, an authorized activity is supposed to pay these social costs through such traditional means. Therefore, many lawsuits brought against companies aiming to force them to reduce or halt their emissions, enact preventive measures, or repair damages presumably resulting from their activities have not succeeded in the United States (including because the causal link between the activities of particular companies and

6. IPCC, *Climate Change 2022: Impacts, Adaptation and Vulnerability*, accessible at: https://www.ipcc.ch/report/sixth-assessment-report-working-group-ii/.

7. N. Georgescu-Roegen, *The Entropy Law and the Economic Process*, Cambridge, Massachusetts: Harvard University Press, 1971 ; some extend this framework by addressing largely polutions and climate change, see eg (in French) E. Chiapello, A. Missemer and A. Pottier, *Faire l'économie de l'environnement*, Paris: Presses de l'Ecole des Mines, 2020.

8. D. Meadows, D. Meadows, J. Randers and W. B. Behrens, *The limits to Growth*, Universe books, 1972, 205p.

9. See eg, M. Torre-Schaub, 'Justice et justiciabilité climatique : état des lieux et apports de l'Accord de Paris', in *Bilan et perspectives de l'Accord de Paris*, Paris, IRJPS, 2017, p. 107.

10. See eg, the concept of 'planetary boundaries', discussed by J. Rocktrëm *et al.*, 'A safe operating space for humanity', *Nature* 461, p. 472-47, sept. 2009, which refers to a certain level of climate change, of ocean acidification, ozone depletion, biodiversity erosion, disruption of biochemical cycles of nitrogen and phosphorus, chemical pollution, air pollution, water use and land use change.

their presumed consequences is not always direct…).[11] But this steady approach has recently started showing cracks, on one hand because debates now involve certain anticipation duties falling on particular companies; on the other hand, because the bar set by these anticipation duties is on the rise, and could soon be sufficient to substantiate claims of faults of anticipation. We are therefore witnessing a profound reconceptualization of the distribution of risks and 'negative externalities', although the relevant extractive and productive activities are still authorized.

1.1 Anticipatory duties: vigilance and planification

First, a duty of vigilance is currently emerging in France and in Europe. At a first glance, this may involve a mapping of the risks to which the company's operations give rise, as well as of the measures required to control them. Some see this as a duty of 'planning' rather than acting.[12]

As a case in point, it should be noted that France initiated this evolution with its Law no. 2017-399 of March 27, 2017 'on the duty of vigilance of parent companies and instructing companies' (adopted based on the model of the German law on parent company liability). This text required large companies headquartered in France to draw up a 'vigilance plan' setting out, on one hand, the 'reasonable vigilance measures suitable for identifying risks (…) to human rights and fundamental freedoms, the health and safety of people and the environment, resulting from the activities' of their entire value chain. This included the risks arising from their own operations, from the operations of their subsidiaries, as well as those of their subcontractors and suppliers with which an instructing company has established business relationships.[13] To this end, parent companies and instructing companies are required to draw up a map of the risks arising from their activities, aimed at identifying, analyzing and prioritizing them. On the other hand, these companies must set out the 'reasonable vigilance measures suitable for (…) preventing serious violations' of human rights and fundamental freedoms, and the jeopardizing of personal health and safety and the environment. The plan must include 'appropriate actions to mitigate risks or prevent serious harm'. It must also set out the procedures used by the company for the regular assessment of the situation of its subsidiaries, subcontractors or suppliers, as well as the procedures aimed to alert to the existence or realization of risks and to monitor 'the implemented measures and to evaluation their effectiveness'.[14] Failure to undertake all these measures could lead to injunctions, if the company does not set up such plans or does poorly, or even to tort liability if the company's failure gives rise to damage for other stakeholders.

But France doesn't hold a monopoly over this idea; in other legal systems, companies are sometimes subject to duties of care of various origins: in the Netherlands, Canada, New Zeeland, among others, such duties of care are regularly used against companies in climate litigation. On February 23, 2022 European commission has also presented a 'Proposal for a Directive on corporate sustainability due diligence and annex', in line with the French law: the duty of care would apply not only to European companies with more than 500 employees and a turnover in excess of 150 million euros (these thresholds being subsequently lowered to 250 employees and 40 million euros respectively), but also to foreign companies with a turnover in excess of 150 million euros in the EU.[15]

Granted, the scope of application of this duty is very limited. The duty only applies to a limited number of companies, which are not the only ones to cause 'negative environmental externalities', ie joint-stock companies (*sociétés anonymes*)[16] that have at least 5,000 employees in France (including through their subsidiaries), or 10,000

11. On these obstacles, see D. A. Grossman, 'Warming up to a not so radical idea, Tort-Based Climate Change Litigation', *Columbia Journal of Environmental Law*, vol. 28, I, 2003, p. 3. For a recent example in the US, see K. Silverman-Roati, 'In a first for climate nuisance claims, a Hawaii's State Court allowed Honolulu to proceed with its case against fossil fuel companies', *Climate Change Blog*, February 23, 2022, https://blogs.law.columbia.edu/climatechange/ ; and in French, see L. Canali, 'Les contentieux climatiques contre les entreprises : bilan et perspectives', in C. Cournil and L. Varison (dir.), *Les procès climatiques. Entre la national et l'international*, pref. M. Delmas-Marty, Pedone, 2018, p. 67.

12. The expression is borrowed from A. Danis-Fatôme during an intervention at the French *Cour de cassation*, January 31, 2022, in *Les grandes notions de la responsabilité civile face aux mutations environnementales. Le fait générateur*, (forthcoming 2023).

13. Precisely, for the activities of 'companies that it controls in the sense of point II of Article L. 233-16, directly or indirectly, as well as activities of subcontractors or suppliers with which it has an established business relation, where these activities relate to this relationship' (free translation from the original French), see Article L. 225-102-4, I., al. 3, of the Commercial Code, and, regarding the difficulties with the scope of this Article, D. Gallois-Cochet, *op. cit.*; S. Cionnaith, G. Jazottes and S. Sabathier, 'Délimiter le périmètre de la vigilance : entre concepts de soft law et hard law', *RLDA* 2017, n° 3, p. 25.

14. Article L. 225-102-4, I, 1°, 3°, then 2°, 4°, 5°, of the Commercial Code. For more details, see S. Schiller (dir.), *op. cit.*; B. Parance, 'La consécration législative du devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre', *Gaz. Pal.* 18 avr. 2017, p. 16; S. Schiller, 'Exégèse de la loi relative au devoir de vigilance des sociétés mères et entreprises donneuses d'ordre', *JCP E* 2017, 1193; A. Reygrobellet, 'Devoir de vigilance ou risque d'insomnies ?', *RLDA* 2017/128, n° 6275 ; C. Malecki, 'Devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre : la France peut-elle faire cavalier seul ?', *Bull. Joly Sociétés* 2017. 298; J. Heinich, 'Devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre : une loi finalement adoptée, mais amputée', *Dr. sociétés* 2017, n° 78. On liability and causality, see A. Danis-Fatome and G. Viney, 'La responsabilité civile dans la loi relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre', *D.* 2017. 1610. On the parliamentary debates and different versions of the text, see C. Hannoun and S. Schiller, 'Quel devoir de vigilance des sociétés-mères et des sociétés donneuses d'ordre ?', *RDT* 2014. 441; N. Cusacq, 'Le devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre : Acte II, scène 1', *D.* 2015. 1049; A. Pietrancosta and E. Boursican, 'Vigilance, un devoir à surveiller', *JCP G* 2015, 553; A. Danis-Fâtome, 'La proposition de loi relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre : une avancée modeste pour les victimes !', *LPA* 17 déc. 2015, p. 3.

15. Comm. EU, Feb. 23, 2022, doc. COM(2022) 71 final.

16. The tendency is indeed to limit the scope of regulation to joint-stock companies, the relevant texts being contained in a chapter of the Commercial Code dedicated to such corporations. See, D. Gallois-Cochet, 'Le périmètre du devoir de vigilance', *in* S. Schiller (eds.) *Le devoir de vigilance*, Paris, LexisNexis-Dauphine, 2019, p. 45; *contra* see E. Daoud and S. Sfoggia, 'Les entreprises face aux premiers contentieux de la loi sur le devoir de vigilance', *RJSP* n° 16, janv. 2019, 14, I, A.

employees abroad.[17] There is no official count of such companies, but it is estimated that there are between 200 and 300 of them. However, despite this very reduced scope of application, the heated discussions during the parliamentary debates showed that this duty didn't only amount to a recognition of the important role played by some multinational undertakings in globalization, and a decision to impose on them an extraterritorial responsibility with respect to their entire value chain but was also the sign of a possible question of, and interference with, the way in which they create value.

On the one hand, legislators were acknowledging the loss of power of States compared with these powerful groups of 'multilocalized' companies and tried, through the very contemporary tool of compliance, to incentivize the latter to endorse regulation through a 'logic of accountability'.[18] On the other hand, legislators were setting red lines that these companies couldn't cross, notably regarding 'serious harm' to the 'environment'. It should be noted that the behavior of companies that pay little attention to the activities of those to whom they delegate profit-making operations was brought to the fore (and subject to increased media scrutiny) following the disaster of the 2013 collapse of Rana Plaza in Bangladesh: 1,130 people died, who worked on behalf of large international groups but without being bound to them by any contract, not even subcontracting (even though the building has been inspected, and some cracks were known).

But it is precisely for not having established this kind of plans that companies were targeted at first (and not directly to change their operations), hence the idea of a lack of 'planning'. Indeed, the enforcement of this text was not long in coming: the first legal cases were initiated as soon as it became possible, criticizing the insufficiency of the plans, notably in their environmental aspect. This is precisely the point of the first litigations targeting the largest French 'carbon major', Total,[19] which is also one of the six 'supermajors': the mayors of thirteen cities and local authorities, as well as four associations (*Notre affaire à tous, Eco Maires, Sherpa* and *Libérons l'Océan!*) initially requested clarifications from its president in a later dated October 22, 2018, in which they stigmatized the absence of any reference to climate risks and to actions able to reduce them in the company's first plan;[20] since no legal action could be initiated prior to 2019, some of these parties waited until the second plan was published in March 2019 and, once again dissatisfied, notified Total to request that it fulfill its due vigilance obligations on June 19, 2019; the notice having been left without a satisfactory response (from their point of view), they summoned the company before the civil court of Nanterre after the three-month period set in the law, ie on January 28, 2020.[21] At the time of writing, only the question of the jurisdiction of the court has been discussed (the choice being between the civil court and the commercial tribunal),[22] a question which was settled by the legislator in favor of the civil court.[23]

It is apparent therefore that, for the time being, it is the lack or the imprecision of the vigilance plan that prompts climate litigation in France. This has an impact on business models but doesn't change them immediately. But an additional step has just been taken in another jurisdiction, towards the emergence of a real liability for anticipation failure.

1.2 The anticipation failure: vigilance and duty of care

Pursuant to a resounding decision rendered in May 26, 2021, the Hague Tribunal has the reshuffled the deck.[24] Obviously, this being a first instance decision, the new direction is not yet final. Nevertheless, it should be remembered that one of the most emblematic rulings, which marked a turning point in the kind of obligations can be imposed on Stats regarding their climate policy, was that of December 20, 2019 issued by the Supreme Court of the Netherlands, in the *Urgenda* case initiated in n2015 by a foundation joined by 886 citizens… However, the case began before the same Hague Tribunal. Therefore, this new decision is at least of great interest, especially since the parallels with the 2019 decision are quite palpable: similarly to the injunctions issued against the Dutch State, the court enjoins the national 'carbon major', Royal Dutch Shell (RDS), as parent company, to reduce its greenhouse gas emissions by at least 45% by the end of 2030 (com-

17. More precisely any company 'that at the end of two consecutive financial years, employs at least five thousand employees itself or through its direct or indirect subsidiaries whose registered office is in France, or at least ten thousand employees in its own company and in its direct or indirect subsidiaries whose registered office is in France or abroad', see Article L. 225-102-4, I, al. 1, Commercial Code, usually interpreted as meaning a threshold of 10,000 employees applying only if subsidiaries of the French company are registered in other jurisdictions, see eg, B. Parance, *art. cit.*, p. 16-17. For more details, see E. Daoud and S. Sfoggia, *art. cit.* For a criticism of this threshold and a proposal for its lowering, see French *Assemblée Nationale*, *Rapport d'information sur l'évaluation de la loi du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*, Feb 24, 2022, available at: https://www.assemblee-nationale.fr/dyn/15/rapports/cion_lois/l15b5124_rapport-information.

18. X. Boucobza and Y.-M. Serinet, 'Loi "Sapin 2" et devoir de vigilance : l'entreprise face aux nouveaux défis de la *compliance*', *D.* 2017. 1619, n° 3, n° 6 et n° 22 *et seq.*

19. In connection with the climate, legal actions are also aimed at about twenty French companies in the food sector and large-scale distribution; these were initiated starting in March 2018, by three associations (Sherpa, Mighty Eath and France Nature Environnement), for not having eliminated from their supplier circuits Latin American soy farmers practicing large-scale deforestation.

20. M. Hautereau-Boutonnet, 'Le risque de procès climatique contre Total : la mise à l'épreuve contractuelle du plan de vigilance', *RDC* 2019, n° 1164, p. 95.

21. Total has also been summoned before the Nanterre civil court for the insufficiency of its presentation of the cartography of risks and actions regarding its oil operations and the construction of a heated oil pipeline in Uganda; but the court held that it did not have jurisdiction on January 30, 2020, considering that ruling on the plan was tantamount to ruling on 'management acts', which fell under the jurisdiction of the commercial court.

22. Cass. com. 15 déc. 2021, n° 21-11.882, *Bull. civ.* IV, (forthcoming) ; *D.* 2022. Actu. 7 ; Rev. sociétés 2022. 173, note Reygrobellet ; *JCP E* 2022. 1067, note Dondero ; *Dr. sociétés* 2022, no 30, note Hamelin.

23. COJ, art. L. 211-21.

24. The Hague Tribunal, May 26, 2021, C/09/571932/HAZA19-379, *Bull. Joly* juill. 2021, p. 6, obs. J.-M. Moulin; *JSS* 2021, n° 59, note C. Lepage, V. Saintaman and B. Denis; *Gaz. Pal.* 2021, n° 28, p. 24, obs. M.-P. Maître; Énergie - Environnement - Infrastructures n° 11, November 2021, comm. 86, F.-G. Trébulle ; *D.* 2021. 1968, obs. A.-M. Ilcheva ; *RFDA* 2021. 957, obs. C. Cournil.

pared to 2019), both direct and indirect emissions, ie even those caused by the use of the oil or gas bought by third parties, the consumers of these goods (as a response, the company has since relocated to the UK... where it is also facing the wrath of the British judicial system).

For this purpose, it was first necessary to identify the relevant duty, as well as a reference norm setting its content and rendering the emission activities objectionable...[25] This is what the court tried to do, based on what it considered to be the international consensus on climate, set either scientifically or legally.[26]

From a scientific standpoint, the IPCC's expert reports are relied upon as evidence for the emission reductions that have to be achieved.

From a legal standpoint, reference is made to soft law texts – such as the United Nations Guiding Principles on Business and Human Rights – as well as international treaties, notably the Paris Agreement (whose 'justiciability' has been at the heart of previous litigation). Based on these grounds, the court infers a 'general obligation to reduce greenhouse gas emissions' (!), which it considers to be 'a performance obligation insofar as emissions result from Shell group's own activities' and 'a best-efforts obligation regarding the emissions resulting from the group's commercial relations with the end users of the oil and gas sold by the group'.

The reasoning doesn't leave too much room for the economic interests of the group...: 'the compelling common interest advanced by the compliance with the emission reduction obligation outweighs the negative impact that Royal Dutch Shell may face as a result of the reduction obligation as well as the commercial interests of the Shell group, which are advanced by an unrestricted preservation of the carbon emitting activities'.[27] As pointed out by our colleague Laurence Dubin, 'the quoted paragraph shows a completely different conception of private companies, that of an entity whose profit-making activities must not result in abusive use of common goods, in this case the climate. From the model of the Fordist corporation, the sign of the rise of the industrial capitalism, to that of the limited liability corporation, the sign of neo-liberal capitalism, the corporation traversed the different ages of capitalism; the post-modern model requiring the regulation of the activities of multi-national companies and of their negative externalities is, for its part, underway'.[28] The reference to a global 'common good' (or a common asset, in the absence of any appropriation) with respect to the climate system seems to us accurate, and is related here with a duty of care that is quite effective. All the more so since, in other jurisdictions, the community benefiting from its enjoyment (or interdependence, using less reifying language), ie future generations, has taken shape at the same time.

2. The 'reintegration' of the interdependency community: the 'justiciability' of future generations' entitlement to protection

The interests of future generations received a resounding judicial concretization through the admission of an entitlement to protection in its favor. This solution is in line with the initial idea of there being a community entitled to the protection of the climate system, ie humankind, but gives it a legal force that the latter has never acquired.

2.1 Climate protection, a common concern of humankind

Indeed, when question of climate change became important in public international law, starting at the end of the 1980s and the beginning of the 1990s, it is the idea of the climate system being a 'common concern of humankind' that became the official banner. The preamble of the United Nations Framework Convention on Climate Change, signed at the Rio Summit and following up on the discussions undertaken in Montreal (1987) and Toronto (1988-1989),[29] states that 'change in the Earth's climate and its adverse effects are a common concern of humankind'. This statement draws the contours of a global 'beneficiary' community, taking the form of humankind,[30] and of a 'common' resource (while also minimizing, nevertheless, by this very formulation, the principles that would have been applicable if reference was made to a 'common heritage of humanity'[31]). In this way, the text also gave 'substance' to the intuitive 'risk community' theorized by Ulrich Beck in the early 1980s, which was supposed to be anchored, united and consensual, responding to an

25. To rule against the Dutch State in 2019, the Supreme Court based its reasoning on obligations undertaken by the State (prior to the Paris Agreement), on the respect for the right to life and private life (pursuant to articles 2 and 8 of the ECHR and the Constitution), as well as on a duty of duty found in the Constitution.

26. *Contra*, the recent Full Federal Court of Australia, March 15, 2022, *Sharma and Others v. Minister for the Environment*, *Climate Law Blog,* March 21, 2022, obs. M. A. Tigre: https://blogs.law.columbia.edu/climatechange/.

27. The Hague Tribunal, idem., § 4.4.54.

28. L. Dubin, in V° *Entreprises multinationales*, *Répertoire de droit international*, Dalloz, Nov. 2021, n° 108.

29. On this, see A. Dahan, 'L'impasse de la gouvernance climatique globale depuis vingt ans. Pour un autre ordre de gouvernementalité', *Critique internationale* 2014/1, n° 62, p. 21-37, no 2 ; S. Maljean-Dubois and M. Wemaëre, *La diplomatie climatique de Rio (1992) à Paris (2015)*, Paris, Pedone, 2015; S. C. Ayuk, 'Chapitre 30. Le climat et l'Anthropocène. Cadrage, agentivité et politique climatique mondiale après Paris', *in* R. Beau and C. Larrère (eds.), *Penser l'Anthropocène*, Paris, Presses de Sciences Po, 2018, p. 499-522, esp. n°7. The 1992 convention was ratified by France in 1994, see Law n° 94-106, Feb. 5, 1994.

30. C. Le Bris, 'L'humanité, victime ou promesse d'un destin commun?', *RJE* 2019/HS18, p. 175-191, n° 6, referring to the ICJ citant les propos de la Cour internationale de Justice (CIJ), *Avis consultatif du 8 juillet 1996, Licéité de la menace ou de l'emploi d'armes nucléaires*, *Rec. CIJ* 1996, p. 241-242, §29, as well as its judgment dated September 25, 1997, *Projet Gabcikovo Nagymaros* (Hungary v. Slovakia), *Rec. CIJ* 1997, p. 41, §53, pursuant to which 'the environment is not an abstraction but represents the living space, the quality of life and the very health of human beings, including generations unborn'.

31. This notion is supposed to refer to a peaceful and reasonable use of common environments that cannot be appropriated, to a fair distribution of wealth, as well as to objectives of conservation and equal access to resources, see A. Kiss, *La notion juridique de patrimoine commun de l'humanité*, Académie de droit international, Recueil de cours n° 175, 1982.

awareness of the major risk to be faced together.[32] Also exposed here was the articulation that would preside over the pursuit of a preservation policy: according to quite classical attired, '[t]he Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities' (Article 3, first principle).

On one hand, therefore, the abstract beneficiary of the enjoyment and preservation of this common 'resource', ie this 'humankind' that embodies the inter-generational and spatial solidarity; on the other hand, the entities that were entrusted with the preservation of the common resource, ie each of the States, which remain sovereign in the application of preservation policies on their territory. In fact, this articulation persists, as attested by the Paris Agreement, which reiterates that 'climate change is a common concern of humankind' (11th) and delegates to the States the task of responding to it. Yet, as is well known, beyond this assumption of the humankind being the 'beneficiary' of this common resource, it has never been possible for this entity to take shape, to have dedicated representatives and identified interests, even though proposals have been put forward in this respect, such as that of creating the function of a mediator or ombudsman, a person or group entitled to speak on its behalf and to defend its interests;[33] it has never gained an organized form and could never act on its own behalf. As pointed out, for instance, by Catherine Le Bris, this reference amounted 'more to a starting point rather than an end point', meaning that 'this concept provides guidance on the way forward - a collective way forward - but does not in itself imply any precise substantive standards'.[34] It could only be understood as an incentive for States to cooperate in a multilateral approach, for the benefit of the designated global community.

Consequently, the climate system has obviously not been conceptualized as a 'commons' in the sense given to this term in the influential account of Elinor Ostrom and her Bloomington school,[35] ie the articulation of three components: a resource environment or domain from which it is difficult to effectively exclude other users ('non-excludable'); control rights allocated amongst different parties, notably access, use, management and exclusion rights, composing bundles of rights - a familiar idea in the US theory of property, composed of different 'sticks' rather than the absolute control over the asset by a single owner; a collective governance, set up by the identified members of a medium-sized community (a hundred people at most).[36] Faced with a global 'commons' (to which this theory was extended by Ostrom) implying a multi-level governance, ie the articulation of the different levels of governance,[37] it naturally fell to the major historical actors, ie the States, to organize themselves, through the pursuit of their classic policies of regulation and planning.

It is therefore useless to recall the failure of the 'universalist' version of humanity: it was supposed to be non-contentious and to pursue a univocal common interest; but it fizzled in the face of dissent.[38] From one COP to another, the climate system evolved towards a 'tragedy of the commons', popularized in 1968 by Garett Hardin, who described the way in which, open and ungoverned, common resources can give rise to over-exploitation and free-rider problems, considering that the long-term negative effects of these actions are not felt, nor incurred by current users.[39] As pointed out by Mireille Delmas Marty, 'it is not enough to invent new concepts like those developed in the last century: the 'common heritage of humanity', which appeared in the 1960s [...]; or the 'global public goods', or 'global commons', borrowed from economists in the 1980s [...] to designate goods that are both non-excludable (which can be used by all) and non-rivalrous goods (their use does not compromise the use by others). It is well known that these terminological innovations have not succeeded in changing the balance of power. International law remained the quasi-monopoly of States defending their national interests.'[40] Or, to put it in Bruno Latour's terms, this construct has not succeeded in 'unifying the Anthropos as an actor endowed with any moral or political consistency'; it has not resulted in a unified 'human species' that could have endorsed a responsibility, the human being having remained 'decomposed in several distinct peoples with conflicting interests

32. U. Beck, *La société du risque. Sur la voie d'une autre modernité*, (French trad. L. Bernardi), Flammarion, coll. « Champ », 2004 (original 1986 text), esp. pp. 56 et seq.; 'Climate for change, or how to create a green modernity?', *Theory, Culture & Society* 2010, 27, p. 254-266. See also, H. Jonas, *Le principe responsabilité, une éthique pour la civilisation technologique*, Cerf, 1979.

33. E. Brown Weiss, *Justice pour les générations futures*, Le sang de la terre, 1993; E. Gaillard, *Générations futures et droit privé : vers un droit des générations futures*, LGDJ 2011 and '*Le patrimoine commun de l'Humanité*', *in* B. Parance and J. de Saint-Victor (dir.), *Repenser les biens communs*, Paris, Editions du CNRS, 2014, pp. 148-149.

34. C. Le Bris, see 'Humanité', *in* M. Cornu, F. Orsi and J. Rochfeld (dir.), *Dictionnaire des biens communs*, PUF, Quadrige, 2017 (free translation from the original French).

35. The approach is different, and the concept is used in singular form, in P. Dardot and C. Laval, *Commun. Essai sur la révolution au XXIe siècle*, Paris, La Découverte, 2014.

36. E. Ostrom, *La gouvernance des biens communs. Pour une nouvelle approche des ressources naturelles*, Bruxelles, De Boeck, 2010, p. 301 (French translation of *Governing the Commons: The Evolution of Institutions for Collective Action*, Cambridge-New York, Cambridge University Press, 1990). The efficient governance of the commons is supposed to be based 'emerging' norms reflecting eight design principles, see B. Coriat, V° Design principles, in *Dictionnaire des biens communs*, *op. cit.*: matching rules governing use of common goods to local needs and conditions, define clear group boundaries; ensuring that those affected by the rules can participate in modifying the rules; making sure that the rule-making rights of community members are respected by outside authorities; developing a system, carries out by community members, for monitoring members' behavior; using graduated sanctions for rule violators; providing accessible, low-cost means for dispute resolution.

37. E. Schlager and E. Ostrom, 'Property-Rights Regimes and Natural Resources: A Conceptual Analysis', *Land Economics*, 1992, 68, 3, pp. 249-262.

38. On the failure, its reasons and its stages, see A. Dahan, *art. cit.* ; A. Dahan and S. C. Aykut, *Gouverner le climat. 20 ans de négociations internationales*, Paris, Presses de Sciences-Po, 2014, esp. p. 399 et s., evoking a 'schism of reality'.

39. G. Hardin, 'The Tragedy of the Commons', *Science* 1968, vol. 162, p. 1243, who concludes that only private property or public regulation could ensure that the long term is properly taken into account.

40. M. Delmas-Marty, 'Avant-propos : la COP 21, un pari sur l'avenir', *in* M. Torre-Schaub (dir.), *Bilan et perspective...*, *op. cit.*, p. 1.

and conflicting territories'.[41]

This concept is currently undergoing a reformulation, on a re-territorialized scale and following a new articulation between the individual rights of present generations and the projection of the interdependence of future generations with the ecosystems.

2.2 The 'duty to protect' the climate, an entitlement of future generations

It is hardly surprising to see the fundamental rights of the individuals making up the current generations being relied upon in climate litigation, especially against economic activities.

First, they are omnipresent in the philosophical approaches to climate ethics: the latter enumerates the 'basic rights' that condition the use and enjoyment of all other rights, and which must therefore be recognized for every human being;[42] these rights would be undermined by the lack of action on climate matters by States or by the activities of certain businesses. Their protection should therefore trump any other type of principles or imperative, notably economic and development ones, and implies correlative duties (although no one denies the difficulty of identifying the subject of these duties, and their precise content[43]).

Second, from a legal standpoint, the link between the protection of fundamental rights and the protection of the ecosystem figured as early as 1972 in the Stockholm Declaration and was extensively relied upon in the climate litigation field, be it in its 'classic' version - regarding the protection of the rights to life, to food, to water (more rarely the rights to surety and health), or even the right to private life, which would be undermined absent climate action - as well as in more modern versions, regarding rights of the third and fourth generation.

The right 'to live in a balanced and healthy environment' (France), in 'that is consistent with the human dignity and wellbeing of citizens' (Ireland), in a 'natural environment whose productivity and diversity are maintained' (Norway), are regularly argued for, as are, in an even more specific manner, the 'right to a stable climate'[44] or to a portion of the atmosphere. In doing so, it is through the 'I of us', through individual rights that the protection of the common interest is most effectively asserted... (notably considering the question of the standing to sue and substantive effectiveness of the arguments).[45]

For instance, the emblematic legal actions carried out since 2015 by the association Our Children's Trust in the United States to push federal or state governments towards more offensive policies in defense of the climate are based on the fundamental rights of the 21 young people represented in the case: their right to the respect of their dignity, to life and to health. Arguments based on the respect for fundamental rights also underpinned the 2015 decision of the Lahore High Court in Pakistan, upholding a farmer's claim against the State.[46] In the same vein, the guarantee of fundamental rights was the basis of the unsuccessful 'People's Climate Case' initiated by some associations (CAN-Europe and Germanwatch) as well as by 36 applicants and their families before the General Court and the ECJ with, in this case, the great originality of not only relying on the 'basic' rights mentioned above, but also on those relating to economic activity: 'climate inaction', the argument goes, would threaten certain crops and animal species (bees in particular) and, consequently, the right of property and the freedom of enterprise.[47] It is also based on the protection of the rights of six young Portuguese people - to life, to food, etc. - that convinced the ECHR to hold admissible their action against 33 States for climate inaction...

This reliance on individual rights has just undergone a major development, with the revolutionary decision of the German Federal Constitutional Court of March 24, 2021.[48] In order to hold the National Climate Protection Act of December 12, 2019, unconstitutional and to decide that the legislator should adjust its reduction targets until December 31, 2022, the Court first identified a 'State's duty of protection against the risks posed by climate change' (recital of principal 1 and paras. 143 *et seq.*) or an 'objective duty to protect'. Then it considers that, on the one hand and by lack of precaution, *all* of the fundamental rights and freedoms would be undermined by a climate change making human life on Earth impossible (the plaintiffs relied on precise rights, ie their rights to life, physical integrity, as well as rights of property, together with the 'natural foundations of life' referred to in article 20 of the Basic law: paras. 117 and 183 *et seq.*).

This is quite an offensive take on the 'anticipatory

41. B. Latour, *Face à Gaïa*, *op. cit.*, pp. 160-161, p. 172 et p. 187.

42. H. Shue, *Basic Rights: Subsistence, Affluence and U.S. Foreign Policy*, [1980, 1st ed.], Princeton, Princeton University Press, 2nd ed., 1996. See also. S. M. Gardiner, S. Caney, D. Jamieson, H. Shue (ed.), *Climate ethics. Essential readings*, Oxford University Press, 2010; D. Bell, 'Climate Change and Human Rights', *WIREs Clim Change* 2013, 4:159–170; M. Bourban, *Penser la justice climatique*, Paris, PUF, 2018, p. 71-74.

43. D. Bell, 'Does Anthropogenic Climate Change Violate Human Rights', *Critical Review of International Social and Political Philosophy*, vol. 14, n° 2, 2011, p. 99-124.

44. For more details depending on the litigation, see C. Cournil, 'L'intégration de l'approche fondée sur les droits de l'homme dans le régime du climat', in M. Torre-Schaub (eds.), *op. cit.*, esp. p. 65 et seq. See also, Human Rights and Climate Change Working Group.

45. T. Morton, *The Ecological Thought*, Harvard University Press; Reprint edition 2012.

46. http://edigest.elaw.org/sites/default/files/pk.leghari.091415.pdf.

47. General Court of the European Union, August 13, 2018, *Carvalho e.a./Parlement et Conseil*, Aff. n° T-330/18, JOUE, C-285.

48. German Federal Constitutional Court, March 24, 2021, BVerfG 1 BvR 2656/18, 1 BvR 78/20, 1 BvR 96/20, available in three languages: https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/FR/2021/03/rs20210324_1bvr265618fr.html. For commentaries from a German perspective, see *Verfassungsblog* : https://verfassungsblog.de/category/debates/der-klimabeschluss-des-bverfg/, not. C. Calliess, '"Elfes" revisited ?', *VerfassungBlog*, May 25, 2021, https://verfassungsblog.de/elfes-revisited/; J. Berkemann, DOV 2021. 701; S. Schlacke, *NVwZ*, 2021, p. 912 ; E. Hofmann, *NVwZ* 2021, p. 1587 ; C. Calliess, ZUR 2021. 355; L. Muckel, *JA* 2021. 610; C. Möllers, N. Weinberg, *JZ* 2021. 1069; R. Sinder, *JZ* 2021. 1079. From a French perspective, see *AJDA* 2022. 166, obs. A. Gaillet and D. Grimm.

effect' of fundamental rights, ie not only their protection before the ultimate threat is realized, but also protecting them in their entirety. The Court then points out the poor distribution of risks: to postpone the burden of the necessary actions to 2030, as the law did because of the absence of stringent obligations prior to 2031 (the reduction targets was drastic from that date), was tantamount to placing the burden on younger (present) generations; this, for the Court, was unbalanced between generations and couldn't guarantee 'freedom over time and across generations' (para. 142). Above all, by making the accomplishment of the necessary actions uncertain, this failure of the law obliterates the future of future generations, which are also 'entitled to protection': based on article 20a of the Basic law, the Court therefore imposed a duty of protection of the environment (or an objective duty of care) 'including a responsibility for future generations'; there is a 'necessity to treat the natural foundations of life with such care and to leave them in such condition that future generations who wish to carry on preserving these foundations are not forced to engage in radical abstinence'. This entitlement, and these generations, have suddenly become, after many unsuccessful attempts,[49] 'actionable'...

Therefore, if one crosses the phenomenon of the emergence of a reinforced duty of care, incumbent on companies, with that of the 'legal concretization' of future generations as a community benefiting from climate protection and embodying a long-term projection, one realizes the explosive potential of such a bundle: any activity that undermines the conditions of life on Earth in the long term could be caught up in the vortex. But we are getting carried away, for all jurisdictions are not as offensive as the German Federal Constitutional Court;[50] even the latter has only found the State to be subject to such a duty to protect. Nevertheless, first, this court sets the European standard for fundamental rights and may well set the standard for others. Second, some arguments that had hit the nail on the head regarding States are sometimes successfully shifted to companies, the 'Shell' decision of the Hague tribunal being a case in point... only the future will tell whether this judicial cross-fertilization will take place and will be able to shake the 'extractive capitalism' to its core, by pushing for a reintegration of 'matter' in our growth models. We wait to see... but time is running out.

49. We refer here to an emblematic case which could have recognized the legal standing of these future generations: a case over deforestations brought before the Supreme Court of Philippines in 1993. See, T. Allen, 'The philippine Children's Case: Recognizing Legal Standing for the Future Generations', *Georgetown International Law Review*, vol. 6, 1994, pp. 713-741. Generally, see E. Gaillard and D. Forman (eds.), *Taking Legal Actions on Behalf of Future Generations*, Peter Lang, 2020, 496p.

50. For comparison purposes, see the French Constitutional Council, August 13, 2021, np. 2021-825 DC, delivered in a similar context regarding the French law 'to combat climate change and increase resilience' of August 22, 2021, noting that (the court) 'did not have the power to enjoin the legislator' to respond to the complaint of 'inaction leading to the failure of France to comply with its greenhouse gas reduction targets'. For more details and some nuances, see F. Savonitto, 'Le Conseil constitutionnel et le contentieux climatique. Un acteur au milieu du gué', *AJDA* 2022. 152.

Jeffrey D. Sachs • University President, Columbia University and President, UN Sustainable Development Solutions Network

Lisa E. Sachs • Director, Columbia Center on Sustainable Investment, Columbia University

Financing Decarbonization

Accelerating clean energy transitions around the globe is essential to avoid catastrophic global warming and to achieve universal access to clean and affordable energy.[1] Decarbonization hinges on the rapid transformation to zero-carbon electricity, mainly through the deployment of wind, solar, hydroelectric, geothermal, and other non-carbon primary energy sources. This transformation depends substantially on the terms of finance for zero-carbon energy. If finance for decarbonization is ample and at low cost, decarbonization will proceed rapidly – not only because it is desirable for climate change, but also because it is a low-cost, and often the lowest-cost, source of electricity. If finance for decarbonization is at high cost, the burden of decarbonization is much higher – because fossil-fuel-based power is then typically cheaper and easier to finance.

Although the need and technological pathways for decarbonization are now relatively well understood, the financing terms for zero-carbon power are not yet supportive of this transition. In the analysis below, we explain why decarbonization hinges on the financing terms, how financial market regulations can help to tip the balance, and the limits of financial sector initiatives alone to decisively accelerate decarbonization. Clear government policies are vital to guide financial decisions towards decarbonization.

Zero-carbon electricity and the cost of capital

The transformation globally to zero-carbon electricity is critical to meet global decarbonization targets. This is for five reasons. First, zero-carbon electricity directly reduces emissions by replacing fossil-fuel-based electricity. Second, zero-carbon electricity enables zero-carbon electric vehicles. (If electric vehicles are charged with fossil-fuel-based electricity, the reduction of emissions is small or non-existent). Third, zero-carbon electricity enables zero-carbon heating and cooking in buildings. Fourth, zero-carbon electricity can replace fossil-fuels in many industrial applications. Fifth, zero-carbon electricity can be used to produce green fuels, such as hydrogen, which can then be used to replace fossil-fuels in ocean transport, aviation, steel-making, and other industrial applications.

The institutional arrangements for generating electricity differ substantially across jurisdictions, involving a range of public and private actors: regulators, public utilities, regulated companies, independent power providers, and others.[2] Whether energy systems decarbonize from fossil-fuel based to renewable sources depends on the comparative costs of energy technologies and on public policies. In cases in which regulators mandate a shift to renewables, public or regulated utilities may decarbonize by passing on higher costs to consumers. In many cases, however, utilities or other regulated power companies are incentivized or even required by regulation to provide electricity at the lowest possible cost to the customer base. In those cases, the transition to zero-carbon energy depends on the comparative costs of zero-carbon energy and fossil-fuel based energy. Decarbonization and the terms of finance are thus intimately connected.

While the costs of zero-carbon electricity have decreased substantially over the past decade,[3] bringing the levelized cost of zero-carbon energy within reach of fossil-fuel based energy in many locations, fossil-fuel based electricity often remains more affordable. The difference in comparative costs depends importantly on the costs of finance.

Here's why:

With most forms of zero-carbon electricity, such as wind and solar power, the cost of production is upfront, in the form of investment outlays for wind turbines, photovoltaic modules, hydroelectric dams, and so forth. There are no variable fuel costs as with fossil-fuel based power – only annual maintenance and operations expenses. With fossil-fuel based power, by contrast, the up-front investment costs for building the power plants are typically lower, and much of the expense is pay as you go, as the variable inputs of fossil-fuels (coal, oil, gas) are burned at the power plant. This obvious difference is illustrated in Figure 1, comparing a 30-year onshore wind power plant versus a 30-year natural-gas combined cycle plant, using illustrative data from the US Energy Information Agency.

The basic data are the following (see appendix). To generate 1MWh (10^6 Wh) of onshore wind power, the capital costs are \$514 upfront and \$9.91 per year. To generate the same amount of power using a natural-gas combined cycle plant, the capital costs are \$142 upfront and \$29.33 per

1. IEA (2021), Financing clean energy transitions in emerging and developing economies, IEA, Paris https://www.iea.org/reports/financing-clean-energy-transitions-in-emerging-and-developing-economies

2. *Ibid*, p. 65.

3. International Renewable Energy Agency, *Renewable Power Generation Costs in 2020* (Abu Dhabi, 2021).

year. Comparing the two projects, the lower-cost option over 30 years depends on the cost of capital. If the cost of capital is low, the onshore wind plant is lower cost; if the cost of capital is high, then the gas-fired plant is lower cost.

This can be verified in two (equivalent) ways. The first way is to calculate the net present value (NPV) of the total costs of producing 1MWh per year over the 30-year period. The second is to calculate the levelized cost of electricity (LCOE), which is a transformation of the NPV.

For purposes of illustration, let us consider a low real (inflation-adjusted) cost of capital, 3% per annum, versus a high cost of capital, 6% per annum. At the low cost of capital, the NPV of the wind project is $714, and of the gas project is $734. At the high cost of capital, the NPV of the wind project is $659, compared with $570 for the gas project. Thus, as was explained intuitively above, the wind project is less expensive than the gas project at a low interest cost, but more expensive at a high interest cost.

The LCOE is the annualized cost of 1 MWh of power assuming a constant annual outlay over 30 years to finance the upfront investment costs. To calculate the LCOE we simply multiply the upfront investment cost by an appropriate Capital Recover Factor (CRF), and then add the annual variable costs for fuel plus the annual operating and maintenance costs.[4] For a 30-year project with 3% cost of capital, the CRF is 0.0495; and with a 6% cost of capital, the CRF is 0.0685. At 3%, the LCOE of a MWh wind power is $35.37, lower than $36.36 for gas. At 6%, the LCOE of wind power is $45.14, greater than $39.06 for gas. (See appendix for details.)

These calculations suggest that profit-oriented utilities or other power producers, or those required to produce energy at lowest cost, will be strongly influenced by the cost of capital in their choice of technology. With a low cost of capital (e.g., a low market interest rate), renewables tend to be the lower cost option; with a high cost of capital, fossil fuels tend to be the lower cost option.

Three key distortions in market financing of zero-carbon power

Three key cost distortions currently weigh against the adoption of zero-carbon power, and hence against decarbonization more generally.

The first distortion is the subsidization of fossil fuel use, which may be introduced in a variety of ways, including: price controls and/or public subsidies on the domestic sale of fossil fuels; subsidies for the domestic production of fossil fuels (often through accelerated depreciation allowances for oil and gas production); and favorable tax treatment for the utility that biases the choice towards fossil-fuel-based technologies.

A second and related distortion that artificially depresses the cost of fossil-fuel based energy relative to renewable energy is the general failure of the marketplace to include the *Social Cost of Carbon* (SCC) in the calculation of costs. The SCC refers to the environmental damages (mainly anthropogenic climate change and ocean acidification) associated with rising CO2 concentrations in the atmosphere.[5] When a utility or power producer burns fossil fuel and emits CO2, the social costs of the CO2 should be included in the annual fuel costs, yet this is rarely the case.

The United Nations calculated global fossil fuel subsidies, "defined as both explicit monetary subsidies and implicit environmental and social costs that are not reflected in fossil fuel prices," to be around $5.9 trillion in 2020, or 6.8 per cent of global GDP.[6]

The most straightforward means for addressing the above two distortions are to end subsidies for fossil fuel use, both upstream and downstream, and to impose a social cost of carbon in cost calculations, for instance through a direct CO2 tax or through a regulation that obliges the utility to *impute* a specified SCC as part of its cost calculations in making choices on technology.

Consider the previous example. While the wind power plant emits no CO2 in its operations, the gas combined cycle plant emits roughly 0.39 tons of CO2 per MWh of power transmission. Suppose that the company must pay a tax of $50 per ton of CO2. That tax adds $19.46 per MWh to the annual costs of the natural gas combined cycle plant. In that case, the LCOE of the gas project will be $55.8 at a capital cost of 3% and $58.5 at a capital cost of 6%, in both cases far higher than the comparable cost of wind power. Thus, even at high capital costs, the zero-carbon option would be selected.

The third major distortion is the high cost of capital facing developing countries relative to developed countries. Sovereign and corporate borrowers from developing countries pay a risk premium of several hundred basis points (several percentage points) compared with the borrowing costs paid by comparable borrowers from the high-income countries.[7] (Sovereign ratings act as a 'country-level ceiling' for corporate borrowing as well, so they affect both public and corporate borrowing.[8]) The simple fact is this. The credit-rating system systematically punishes poor countries, literally giving poorer nations

4. In the simple case shown here, with one cost of capital and no tax corrections, the relationship is: LCOE = CRF*INV + VC + O&M, where INV is the upfront investment cost, VC is the variable (fuel) cost, and O&M is the operating and maintenance costs. CRF is the capital recovery factor. For a 30-year project with cost of capital r, the CRF = $[r/(1+r)]/[1-(1+r)^{-30}]$.

5. See, e.g., The Social Cost of Carbon Initiative, Resources for the Future, for more on the Social Cost of Carbon, https://www.rff.org/topics/scc/social-cost-carbon-initiative/

6. United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2022*. (New York: United Nations, 2022), available from: https://developmentfinance.un.org/fsdr2022, p. 41.

7. IEA (2021), Financing clean energy transitions in emerging and developing economies, *op.cit.*, https://www.iea.org/reports/financing-clean-energy-transitions-in-emerging-and-developing-economies, p. 44. ("Economy-wide nominal financing costs in EMDEs range some 700 to 1 500 basis points - up to seven times - above values for the United States and Europe, with higher levels in riskier segments.")

8. United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2022, op.cit.*,https://developmentfinance.un.org/fsdr2022, p. 23.

a lower score simply because of their lower income per capita and their smaller share of the world economy.

The situation is summarized in Table 1, where we summarize the credit ratings assigned by Moody's to 136 sovereign borrowers, classified by their income level according to the World Bank. None of the 27 low-income countries (LICs) has an investment grade credit rating, and only 3 of the 53 lower-middle income countries (LMICs) do. By contrast, 10 of the 54 upper-middle-income countries (UMICs) have an investment grade credit rating, and 44 of the 59 high-income countries have an investment grade credit rating. The global population living in countries with a sub-investment grade rating is 2.9 billion, or 38.6 percent of the world population. (Note that while only 57 of 193 UN member states has an investment grade, this includes the biggest countries – China, India, and Indonesia – so that 61.4 percent of the world population live in countries with a Moody's investment grade rating.)

The sub-investment grade ratings of all of the LICs and most of the LMICs mean that capital costs in these sub-investment-grade countries are far higher than in the UMICs and HICs. According to our earlier analysis, the high costs of capital mean that the poorer countries will prefer fossil-fuel projects to renewable energy projects unless the means are found to reduce the capital costs for these countries of investing in zero-carbon power.

It might be argued that the high borrowing costs facing the sub-investment grade borrowers is not a market distortion per se, but rather is a reflection of the high risks of lending to borrowers in poorer countries. We believe that this common belief is not accurate for the following reason. Poor countries indeed are more vulnerable to defaults than richer countries, but this is mainly because of the pervasiveness of sudden panicked reversals of international capital flows to these countries in response to short-term shocks in the poorer countries. The sudden drying up of lending to a poor country because of a heightened fear of default is often the cause of a subsequent default, because the poor country is suddenly unable to refinance its debts as they come due, even though such refinancing would be routine for richer countries. In other words, the poor countries are indeed more prone to default, but as the result of self-fulfilling panics by lenders rather than fundamental economic risks.

Can 'sustainable investing' repair the market failures?

The massive expansion of interest in "sustainable investing" in recent years reflects, and in turn fuels, the hope that climate-aware investors can shift the market financing from fossil-fuel based projects to zero-carbon based projects. The growth of sustainable investing is indeed impressive, as shown in Figure 2. Sustainability-themed funds saw a net inflow of roughly $600 billion in 2021, a 62% increase on the prior year, amounting to more than $2.7trillion in total assets by the end of the year.[9] Although not all approaches designated as 'sustainable investing' are focused on addressing climate change, a proliferation of climate-aligned initiatives and alliances boast the membership of the largest banks, asset owners and asset managers. Just one such alliance – the Global Finance Alliance for Net Zero (GFANZ), launched at COP26, boasted a total AUM of $130 trillion.

Yet there are at least four reasons to doubt that sustainable investing will fundamentally shift the basic economics of decarbonization unless governments also adopt basic policies to address the market distortions outlined above. (There are many other reasons to doubt the impact of sustainable investing strategies on improving social and environmental outcomes, but for this analysis, we limit ourselves to those influencing the economics of decarbonization.)

The first reason for doubt is that for many if not most 'sustainable' funds or portfolios, the investment or financing goal remains to maximize returns or the value of the investment portfolio; indeed, many investors in those funds "believe integrating environmental, social and governance (ESG) issues into their investments could lead to greater financial returns or will not affect returns while providing a feel-good sentiment. In other words, ESG investment strategies were not designed to go beyond financial returns."[10] The integration of ESG factors in that context merely means that the investor takes into account ESG considerations in forecasting the future trajectory of profits and costs. When such a "sustainability fund" (or an "ESG fund") invests in a utility, the investor will still prefer that the utility choose the least-cost options consistent with the utility's regulatory environment. In other words, sustainable investing for this category of investors does not mean channeling investment funds to higher cost, less profitable projects. At best, it means that investors will consider the possibility of future climate regulations or future carbon pricing when making informed investment decisions today.

The second reason for doubt is that even when some investors are prepared to make investment choices based on ethical principles rather than wealth maximization, other investors will be happy to take up the slack. Thus, some institutional investors (such as universities, religious groups, and selected pension funds) may divest from fossil-fuel stocks or bonds out of core values, and are even willing to do so at some financial cost. While divestment may meet other goals (including values alignment but also potential signaling to policy makers and others), it is unlikely to influence the cost of capital facing fossil-fuel projects, thereby tilting the investment decisions of utilities (and other energy-related enterprises) towards zero-carbon technologies. The problem is that other investors, who are investing for wealth maximization rather than

9. *Ibid*, p. 65-66.

10. *Ibid*, p. 66.

values, will be ready to purchase the shares or debt. Some have estimated that at least 86% of shareholders in a company would have to divest in order to impact the cost of capital by at least 1%.[11]

The third reason to doubt that sustainable investing will – by itself – influence the fundamental economics underpinning decarbonization is, even for those investors who are proactively investing in clean energy or in public sustainability-linked bonds, most will still not invest in or loan to the poorer countries that lack investment grade credit ratings. Many investment funds, such as pension and insurance funds, face regulatory limits on investing in sub-investment grade securities (even if the fund wants to invest in such securities for sustainability-related motivations). Thus, for all of the excitement around GFANZ, there is no evidence to date that much if any of the $130 trillion in AUM will find its way to the poorer half of the world.

We have little doubt that private capital markets will fund most of the forthcoming investments in decarbonization.[12] Publicly owned utilities, privately owned utilities and independent power producers around the world will have to tap the private capital markets for the enormous investments ahead, amounting to hundreds of billions of dollars per year. Government revenues, including both taxes and retained earnings of state-owned utilities, will cover part of the decarbonization costs, but only a modest proportion.

Yet investor strategies, including of sustainability funds or portfolios, will not be sufficient (or indeed even influential) in shifting the market fundamentals that must underpin the massive transformational challenges of decarbonization.

The most important role will be played by public policies, nationally and internationally, as outlined below.

Two practical solutions to the financing challenges

We suggest at least two overarching solutions to the market-financing challenge. The first is to factor in a robust SCC into the consideration of public and private actors, and to end the implicit and explicit subsidization of fossil fuels that is pervasive in economies around the world. The second is to take practical steps to reduce the risk of self-fulfilling liquidity crises facing the poorer nations, so that those nations too may access private capital on terms close to those paid by the richer nations.

<u>Incorporating the SCC through quantities and prices, and ending distorting fossil fuel subsidies</u>. In order to induce investors to choose zero-carbon over fossil-fuel-based technologies, it is important both to lower the cost of capital and to introduce the SCC into production cost calculations. As mentioned above, the SCC may be introduced in several ways. Economists tend to prefer the most straightforward method: a tax on CO2 emissions equal to the SCC. Financial firms tend to prefer an emissions trading system in which the price of the emissions permit equals the SCC. The trade in emissions permits generates additional business for the financial sector (and typically added administrative costs compared with an upstream tax on fossil fuels). The third way to introduce the SCC is through regulation that requires utilities to incorporate the SCC in their rate setting and choice of technology. A fourth way is the most straightforward, and that is to prohibit new investments in fossil-fuel power generation altogether. In this case, the SCC is introduced implicitly, as a shadow price equal to the incremental cost (if any) incurred by the utility by investing in zero-carbon power compared with fossil-fuel-based power. Many states in the US, for example, have imposed zero-carbon standards for their utilities as of certain future dates. In New York, for example, the state regulator has set 2040 as the date for reaching a zero-carbon grid. It is accomplishing that through a combination of pricing and quantity standards. Introducing a SCC ends implicit subsidization of fossil-fuel power, but ending explicit fossil fuel subsidies (in direct subsidies, tax provisions, price controls, and other means) is also imperative.

<u>Increased development finance for poorer nations</u>. The poorer countries will be both unwilling and unable to decarbonize unless they have access to much larger flows of financing at far more favorable terms than at present. The rich countries committed a decade ago to ensure at least $100 billion per year of climate financing for developing countries by the year 2020, of which roughly half was to go towards mitigation (decarbonization) and the other half to adaptation. In fact, the rich countries fell woefully short of this target, even with a decade of lead-time to fulfill the commitment. The extent of the shortfall is debated. The OECD Development Assistance Committee (DAC), effectively overseen by the donor countries, put the 2019 climate financing at $79.6 billion.[13] By contrast, Oxfam claims that the OECD vastly overcounts the actual financing, placing it a mere $19 - $22.5 billion in 2018.[14] Either way, the shortfall was significant, and even more alarmingly, the $100 billion target was a small fraction of the overall financing needs of the developing countries.

We see two major channels for increased funding at the scale of hundreds of billions of dollars per year. The first is to enhance the creditworthiness, and hence the credit ratings, of the poorer nations. The second is to increase the flow of development financing supplied by international institutions, most importantly the multilate-

11. Berk, Jonathan B. and van Binsbergen, Jules H., "The Impact of Impact Investing," Stanford University Graduate School of Business Research Paper, Law & Economics Center at George Mason University Scalia Law School Research Paper Series No. 22-008 (August 21, 2021), Available at https://ssrn.com/abstract=3909166.

12. IEA (2021), Financing clean energy transitions in emerging and developing economies, *op.cit.*, https://www.iea.org/reports/financing-clean-energy-transitions-in-emerging-and-developing-economies, p. 43.

13. https://www.oecd.org/newsroom/statement-from-oecd-secretary-general-mathias-cormann-on-climate-finance-in-2019.htm

14. https://oxfamilibrary.openrepository.com/bitstream/handle/10546/621066/bp-climate-finance-shadow-report-2020-201020-en.pdf

ral development banks (MDBs), including the World Bank and the regional development banks (RDBs).

The creditworthiness of the developing countries could be enhanced through a better matching of their financing needs and growth prospects with the terms of financing. We suggest two complementary factors. First, developing countries need *long-term loans* to give them sufficient time for economic growth to generate the incremental GDP needed to repay the loans. By extending the maturities of the loans to the poorer countries, their creditworthiness would rise, since there would be little chance of a self-fulfilling credit crisis in the short term. With long-term lending, it would be prudent for the lenders to increase the magnitude of lending, and prudent for the borrowing countries to take on more debt to finance their infrastructure needs. Second, we need a review and overhaul of the credit-rating systems. The G20 and the IMF could develop a new credit-rating system that accounts for a country's growth prospects, long-term debt sustainability, and "a country's efforts to invest in the SDGs, including in resilience and climate adaptation."[15] If revised ratings incorporated "the positive effects of SDG investment, long-term ratings could also create incentives for such investment and help countries raise long-term capital for that purpose."[16]

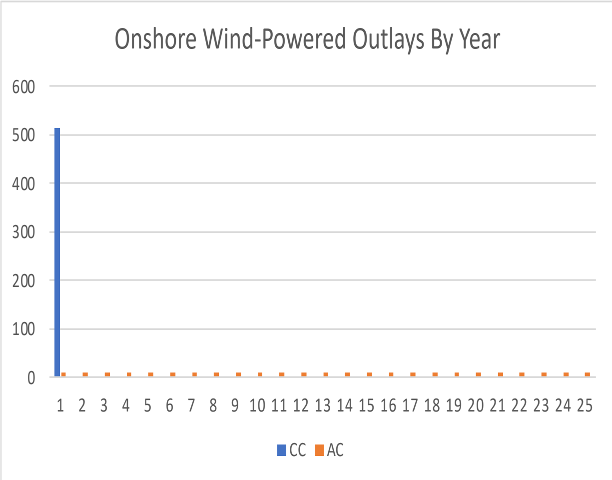
The other main way to increase the flow of decarbonization financing to the developing countries is to increase the loan flows from the MDBs, which are "well placed to fund SDG investments because of shared objectives and long time horizons."[17] Currently, the MDBs lend around $100 billion per year (for all purposes), of which roughly half comes from the World Bank. Various studies have indicated that even with their current balance sheets, the MDBs could prudently increase their lending by several hundred billion dollars without impairing their balance sheets or risky their high credit rating. If the balance sheets are augmented with increased paid-in capital, then obviously the scope for increased MDB lending would be even more greatly increased.

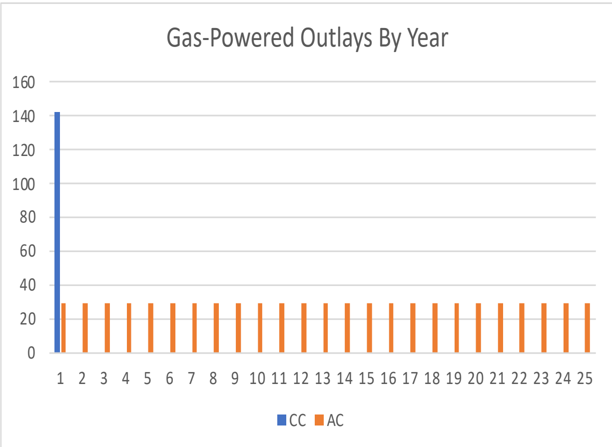
Conclusions

The global challenge of decarbonization is fundamentally a challenge of technological change backed by adequate terms of financing. The estimates are that trillions of dollars will be needed each year to 2050 to finance the energy transformation by mid-century. Global saving, currently around $25 trillion per year, is certainly sufficient to finance the decarbonization process. Yet we've seen that the financing falls far short of what is needed. The costs are too high for many countries, and the market incentives to decarbonize are currently insufficient.

We identified three main obstacles: the failure to incorporate the SCC in investment decisions; the ongoing subsidization of fossil fuels; and the insufficient flows of financing to the poorer nations. We argued that these deficiencies will not be solved by sustainable investing, since such approaches are insufficient to change the underlying economics that will enable and accelerate energy system decarbonization. To accomplish the transformation will require fundamental changes in public policy. We have highlighted the three most important changes: proper pricing of the social cost of carbon; ending direct fossil-fuel subsidies; and measures to direct increased capital flows to the poorer nations.

Figure 1. Costs Per Year for Onshore Wind and Natural Gas Combined Cycle (30-year project)



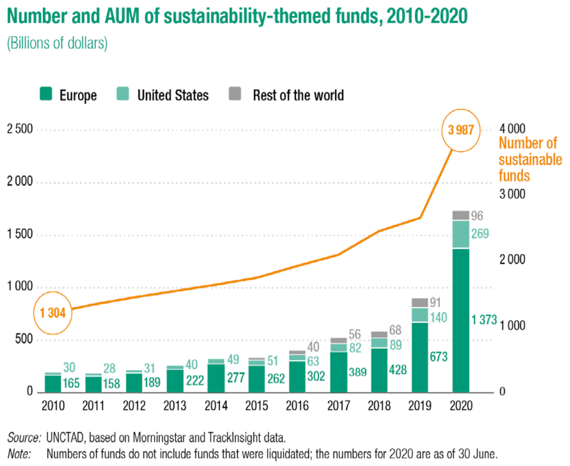


15. UN DESA Policy Brief No. 131: Credit rating agencies and sovereign debt: Four proposals to support achievement of the SDGs, 21 March 2022, https://www.un.org/development/desa/dpad/publication/un-desa-policy-brief-no-131-credit-rating-agencies-and-sovereign-debt-four-proposals-to-support-achievement-of-the-sdgs/. See also Jeffrey D. Sachs, "Time to Overhaul the Global Financial System," *Project Syndicate*, December 3, 2021. https://www.project-syndicate.org/commentary/global-financial-system-death-trap-for-developing-countries-by-jeffrey-d-sachs-2021-12

16. UN DESA Policy Brief No. 131: Credit rating agencies and sovereign debt: Four proposals to support achievement of the SDGs, 21 March 2022, https://www.un.org/development/desa/dpad/publication/un-desa-policy-brief-no-131-credit-rating-agencies-and-sovereign-debt-four-proposals-to-support-achievement-of-the-sdgs/.

17. United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2022. op.cit.*, https://developmentfinance.un.org/fsdr2022, p. 18.

Figure 2



Source: UNCTAD, World Investment Report 2021: Investing in Sustainable Recovery (United Nations: 2021)

Table 1. Creditworthiness of Countries According to World Bank Income Category

	Number of UN Countries	Number with Moody's Ratings	Number with Investment Grade Rating	% Countries with Investment Grade	% Population in WB Income Category with Investment Grade
LICs	27	9	0	0	0
LMICs	53	35	3	8.6	52.9
UMICs	54	40	10	25	72.5
HICs	59	52	44	84.6	97.3
WORLD	193	136	57	41.9	61.4

Source: Moody's (December 2021) and World Bank

Appendix: Costs of Wind Power and Natural Gas Combined-Cycle Power

According to the US Energy Information Agency,[1] overnight investment costs per kW are the following:

Combined cycle: $1,082 per kW

Onshore wind: $1,846 per kW

The combined cycle capacity factor (share of the year that it generates electricity) is 87%, and the capacity factor for onshore wind is 41%. There are 8,760 hours in the year (24 x 365). Therefore, 1 kW of installed capacity of natural gas combined cycle generates 0.87 x 8,760h = 7621 kWh/year = 7.621 MWh/year (1 MWh = 1,000 kWh). Similarly, 1 kW of installed capacity of onshore wind generates 0.41 x 8,760h = 3.592 MWh

The capital cost of 1 MWh of combined cycle power is therefore $1,082/7.621 = $142

The capital cost of 1 MWh of onshore wind power is therefore $1,846/3.592 = $513.9

The annual costs include operation and maintenance (O&M), variable costs (VC), and Transmission costs (TC). Variable costs are mainly the cost of fuel. Data are also from EIA.[2] For natural gas combined cycle, the annual costs are: $29.33, equal to $1.61 (O&M) + $26.68 (VC) + $1.04 (TC). For onshore wind, the annual costs are $9.91, equal to $7.47 (O&M) + $0 (VC) + 2.44 (TC)

1. Energy Information Agency, U.S. Department of Energy, "Electricity Market Module 2021," February 2021.
2. Energy Information Agency, US Department of Energy, "Levelized Costs of New Generation Resources in the Annual Energy Outlook 2021," February 2021.

Simon Sharpe • Director of Economics, UNFCCC Climate Champions ; Policy Associate, Institute for Innovation and Public Purpose, University College London

Freeing Sisyphus: New Rules of Thumb for Policymaking on Decarbonisation

Every day, governments around the world make laws, regulations, taxes, and investments that influence future emissions of greenhouse gases. While public debate on climate change often focuses on countries' national emissions targets, it is these specific policies that determine whether targets are missed, met, or exceeded.

Progress so far has been underwhelming, to put it mildly. Since the international agreement thirty years ago to 'prevent dangerous anthropogenic interference with the climate system',[1] annual global emissions of greenhouse gases have continued to rise. To have a reasonable chance of meeting the goals of the Paris Agreement – limiting global warming to below 1.5 degrees C – we now need to decarbonise the global economy roughly five times faster over the course of this decade than we managed during the last two decades. Experts are beginning to say that this is implausible. Meanwhile, scientists are telling us that the risks of catastrophic changes are greater than they thought, even at low levels of warming.[2]

In this context, it matters greatly how the policy decisions that influence emissions are made. Most are considered to be questions of economic policy, since they affect economic interests and involve the reallocation of resources. They are typically informed by economic analysis – whether formally, through modelling and calculations, or informally, through the application of rules of thumb based on widely-accepted theory.

In a recent study of outstanding examples of success in decarbonisation in China, India, Brazil and Europe, researchers found that the policies most critical to these successes were generally implemented 'despite, not because of, the predominant economic analysis and advice.'[3] This must surely be cause for concern. I argue here that a different approach to economic decision-making is possible, one that will help governments act more effectively, more often. This has implications not only for national policy, but also for international cooperation.

Changing the foundational assumption

Much of the economic analysis and advice that informs climate change decision-making is based, whether consciously or not, on the assumption of equilibrium.[4] In economics, equilibrium is defined as 'a situation in which nobody has any immediate reason to change their actions, so that the status quo can continue, at least temporarily.'[5] This foundational assumption underlies the structure of economic models, the design of decision-making frameworks such as cost benefit analysis, and the formation of normative rules of thumb for policymaking.[6]

This assumption contrasts markedly with the challenge we face. Meeting climate change goals requires rapid and deep 'system transitions' in the global economy in each of the emitting sectors.[7] A system transition is anything but a continuance of the status quo. It involves the creation and spread of new technologies, markets, business strategies, infrastructure, institutions, and cultural norms – providing many reasons for people to change their actions.[8] If system change is our goal, then by definition we are dealing with the economy in disequilibrium. That must be our new starting assumption.

A body of theory that can describe, explain and predict the behaviour of the economy in disequilibrium already exists, though it is not yet widely or systematically applied to policy.[9] Disequilibrium models have been built,

1. United Nations Framework Convention on Climate Change (1992)
2. In its 2018 'Special Report on Global Warming of 1.5°C', the Intergovernmental Panel on Climate Change revised upward the assessments of risk in four of its five 'Reasons for Concern' compared to its previous report four years earlier. Very high risks to unique and threatened systems were judged to occur between 1.5°C and 2°C of warming, instead of at 2.6°C. High risks in terms of global aggregate impacts were estimated to arise between 1.5°C and 2.5°C, instead of at 3.6°C. High risks of large-scale singular events were thought likely at 2.5°C, instead of at 4°C. See Chapter 3, p.181. https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Chapter3_Low_Res.pdf
3. M. Grubb et al, 'The New Economics of Innovation and Transition: Evaluating Opportunities and Risks', 2021 https://eeist.co.uk/downloads/
4. N. Stern, 'Public economics as if time matters: climate change and the dynamics of policy', 2018 https://www.sciencedirect.com/science/article/abs/pii/S004727271830046X
5. Oxford Dictionary of Economics, 2002
6. J. Mercure et al, 'Risk-opportunity analysis for transformative policy design and appraisal', 2021 https://www.sciencedirect.com/science/article/pii/S0959378021001382
7. Intergovernmental Panel on Climate Change, 'Special Report on Global Warming of 1.5°C', Summary for Policymakers, 2018, p.15 https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf
8. See F. Geels and J. Schot, 'Typology of sociotechnical transition pathways', 2007 https://www.sciencedirect.com/science/article/abs/pii/S0048733307000248?via%3Dihub
9. Early proponents of disequilibrium theories of the economy include John Maynard Keynes and Joseph Schumpeter. Richard Nelson and Sidney Winter developed disequilibrium thinking into 'An evolutionary theory of economic change' in 1982. Many of these strands of thinking come together in complexity economics, which is described by Brian Arthur in 'Complexity economics: a different framework for economic thought', 2013 https://www.santafe.edu/research/results/working-papers/complexity-economics-a-different-framework-for-eco Eric Beinhocker gives an overview of the development of complexity economics in 'The Origin of Wealth', 2006.

although there are few instances yet of their being put to use by governments. Empirical evidence of how decarbonisation policies work is accumulating, in many cases contradicting traditional assumptions. From this relatively new body of theory, models, and observational evidence that apply to the economy in disequilibrium, I attempt here to describe a new set of rules of thumb for policymaking on decarbonisation.

Rules of thumb are important because they influence what questions we ask; what options we compare; what evidence we seek; and what models we build. They help us decide, in situations of uncertainty. They shape the views of those whose support for a decision may be needed, but who may not have time to consider the evidence in detail themselves. Their influence on the policymaking process is profound. We need to ensure this is a helpful influence, and not one that is actively unhelpful.

Rule 1: Focus on feedbacks

A common approach to decision-making in contexts of equilibrium is to compare expected outcomes of different policies at one or several fixed points of time in the future. In contexts of disequilibrium – where our aim is to effect change in the economy – this 'comparative statics' approach is insufficient.[10] We need to understand how policies will affect processes of change in the economy: in which direction they will drive change; with what magnitude, and at what pace.

The behaviour of a complex system such as the economy in disequilibrium can be understood by analysing its feedback loops. Reinforcing feedbacks create self-amplifying change; an example in the climate system being how higher temperatures result in less Arctic sea ice, causing less sunlight to be reflected, leading to further heating. Balancing feedbacks are self-limiting, tending to slow or prevent change; a thermostat in the home is the classic example. If our aim is to drive rapid change in the economy, we should look to create reinforcing feedbacks that accelerate change in our desired direction (towards zero emissions), and to break any balancing feedbacks that stand in our way.

A simple example of where feedbacks have often been overlooked is in carbon pricing policy. Traditionally, it has been thought that the two alternative forms of carbon pricing – a tax, and a cap-and-trade scheme – are equivalent in their economic efficiency, differing only in the detail of their implementation.[11] Governments have often chosen to implement cap-and-trade systems, and activists have urged them to do so, because this approach offers certainty about how much emissions will be reduced over a given period of time. However, as the climate scientist James Hansen first pointed out, a cap-and-trade system creates a balancing feedback: if one actor finds a way to reduce emissions, this reduces demand for emissions permits; since the supply of permits is fixed, this reduces the price of a permit, and so reduces the incentive for other actors to reduce their emissions.[12] A carbon tax has no such self-limiting effect: if it causes me to reduce my emissions, that does not lessen the incentive for you to reduce yours. Consistent with this understanding, a simulation of the alternative policies using a disequilibrium model shows that a carbon tax can reduce emissions more quickly, and at lower cost, than a cap-and-trade scheme.[13]

The next rule shows how a focus on feedbacks could have large consequences over the course of time.

Rule 2: Targeted investment is more efficient than carbon pricing

Traditionally, carbon pricing has been thought to be the most efficient policy for decarbonisation. This has been reflected in advice to governments from the World Bank, the International Monetary Fund, and many authoritative economists.[14]

In the study of successful examples of decarbonisation mentioned above, the policies that made the most important contributions were those that involved targeted investment in the deployment of new technologies. The growth of solar power, once seen as infeasibly expensive but now hailed as providing 'the cheapest electricity in history',[15] was driven largely by subsidies, notably first in Germany, and later in China. Similarly, Brazil used subsidy and cheap public finance to grow the share of wind in its power generation mix more quickly than any of the other large emerging economies, while creating an industry supporting 150,000 jobs. The UK used subsidised fixed-price contracts to bring down the cost of offshore wind by 70% within a decade. India used massive public procurement to drive a transition to efficient LED lighting, bringing down its costs by over 90% in less than a decade, while increasing its deployment by a factor of several hundred and bringing electric lighting to hundreds of millions of households for the first time.

Stephane Hallegatte and Julie Rozenberg, two of the World Bank's leading economists on climate change, wrote in 2019 that 'Today, renewable energy is cheaper than coal in many places in the world, all major car ma-

10. N. Stern (n4).

11. R. Stavins, 'The future of US carbon-pricing policy', 2019 https://www.nber.org/system/files/working_papers/w25912/w25912.pdf

12. J. Hansen, 'Storms of my grandchildren', 2009, p.212

13. E. Chappin, 'Simulating energy transitions', 2011, p.109 http://chappin.com/ChappinEJL-PhDthesis.pdf

14. See for example World Bank advice that carbon pricing provides the 'least-cost way' for society to meet its environmental goals: https://www.worldbank.org/en/programs/pricing-carbon
Similarly, the International Monetary Fund has advised that 'of the various mitigation strategies to reduce fossil fuel CO_2 emissions, carbon taxes - levied on the supply of fossil fuels… - are the most powerful and efficient, because they allow firms and households to find the lowest-cost ways of reducing energy use and shifting toward cleaner alternatives.' https://www.imf.org/en/Publications/FM/Issues/2019/10/16/Fiscal-Monitor-October-2019-How-to-Mitigate-Climate-Change-47027

15. International Energy Agency, 'World Energy Outlook', 2020

nufacturers are working on several electric car models, and cities are starting to switch to electric buses. All of this was achieved with policies focussed on new investments, not with carbon taxes.'[16]

From a disequilibrium point of view, this is not surprising. The development and diffusion of new technologies is driven by reinforcing feedbacks – processes of self-amplifying change. These include learning-by-doing (the more something is made, the better it can be made), economies of scale (the more it is made, the more cheaply it can be made), and the emergence of complementary technologies (the more something is used, the more technologies emerge that make it more useful).[17] It is these reinforcing feedbacks that can lead to exponential growth in the market share of a new technology, in the early stages of a transition. Targeted investment in the deployment of new technologies channels economic resources towards them, directly creating or strengthening these feedbacks. Early in a transition, a carbon price does not have the same effect: the pressure it applies can most easily be absorbed by operating fossil fuelled systems more efficiently, without directing any resources to the creation of a new system. Consequently, in terms of its dynamic effect, investing in the new is a more efficient approach than taxing the old.

Like any rule of thumb, this one does not always hold. Once the new technologies have become competitive with the old, a combination of tax and subsidy can be highly effective at tipping the scales in favour of the new. Once an old technology such as coal power has been reduced to a minority share of the market, a tax may be an effective way to activate the reinforcing feedbacks of its destruction (where divestment raises costs, leading to further divestment). Examples of these exceptions are given under rule 4.

Rule 3: Technology choice should be deliberate, not accidental

A traditional principle for decarbonisation policy has been that of 'technology neutrality'. A 'technology neutral' policy is thought to allow the market to decide which technology best provides the desired function, tending to maximise economic efficiency.

In a disequilibrium economy, there is no such thing as technology neutrality. Change in the economy is path dependent: past decisions constrain current choices, and current choices affect future options. Every decision will, unavoidably, advantage some technologies over others, changing the shape of the future economy. For example, a government that wishes to incentivise the purchase of zero emission vehicles may decide that as a 'technology neutral' policy, it will offer consumers the same subsidy when they buy a battery electric car or a hydrogen fuel cell car. However, the effect of this policy on the two technologies will not be the same. The battery electric technology starts at an advantage: electricity has been widely used as an energy carrier for the last century whereas hydrogen has not; consequently, electric charging infrastructure is more readily available than hydrogen refuelling infrastructure. Giving the two technologies equal subsidy is, de facto, a decision to maintain the dominance of the one that is already ahead.

If neutrality is impossible and choice is inevitable, it is surely preferable to choose deliberately rather than accidentally. In our example, the two options have different pros and cons. A transition to battery electric vehicles could support the decarbonisation of the power sector, by allowing millions of car batteries to store and release energy in a way that helps balance supply and demand in the electricity grid. The hydrogen option could instead support the decarbonisation of industry, by bringing down the cost of hydrogen technologies through mass production. A third option for low emission vehicles, biofuels, would be less disruptive for the car industry, but would cause higher levels of local air pollution and would compete with agriculture for the use of land. Each of these options could give a country better or worse prospects for developing its own car industry and exporting to the global market, depending on the technology choices of other countries.

Often the right technology choice will not be obvious, and there may be advantages in experimenting with different options, particularly in the early stages of a transition. But even then, these options will have to be chosen. The illusion of neutrality is a dangerous one. An unconscious choice is most likely to be a choice in favour of incumbent technologies – those that are already ahead. When the aim of policy is system change, that may be the opposite of what is needed.

Rule 4: Regulation can reduce costs

In an equilibrium economy where resources are perfectly allocated, any intervention that creates change will necessarily create costs. Theory admits for exceptions, and additional costs may be considered acceptable if the regulation solves a social problem. However, the rule of thumb that 'regulation increases costs' and so should be avoided if at all possible has been repeated so often that it is ingrained in the mental models of many decision-makers, and even incorporated into institutional mandates. The UK's Better Regulation Executive, for example, has a mandate to 'monitor the measurement of regulatory burdens and coordinate their reduction.'[18] A statement on climate change issued in 2019 by several thousand economists, including 28 Nobel Laureate economists and four former Chairs of the US Federal Reserve, urged governments to implement carbon pricing so that they

16. S. Hallegatte and J. Rozenberg, 'All hands on deck: mobilizing all available instruments to reduce emissions', 2019 https://blogs.worldbank.org/climatechange/all-hands-deck-mobilizing-all-available-instruments-reduce-emissions

17. W. Arthur, 'Competing technologies, increasing returns, and lock-in by historical events', 1989 https://academic.oup.com/ej/article-abstract/99/394/116/5188212?redirectedFrom=fulltext

18. See https://www.gov.uk/government/groups/better-regulation-executive

could avoid the need for 'cumbersome regulations' that are 'less efficient'.[19]

Steven Chu, Energy Secretary in the US under President Obama from 2009 to 2013, was so frustrated by the economists in his own department advising against the regulatory policies he knew were needed that he conducted his own study. He found that contrary to the predictions of traditional theory, the imposition of energy efficiency regulations did not add to the costs of appliances such as refrigerators, washing machines and air conditioners; instead, by stimulating innovation, they accelerated those appliances' reduction in cost.[20] A systematic review of relevant academic literature by Grubb et al found evidence of regulations being a major driver of innovation in lighting and building energy efficiency, and a significant driver of innovation in road transport.[21]

Disequilibrium theories of the economy help us understand why regulations can have such a positive effect. In the constantly evolving ecosystem of a competitive market, laws or regulations set the rules of the game: they determine which technologies, products or strategies are the 'fittest', and which less so. A regulatory change that introduces stringent new requirements immediately makes many products less fit for their environment than they were before, incentivising businesses to shift resources from exploitation (extracting value from current assets) to exploration (creating new assets).[22] The result is an acceleration of innovation, performance improvement, and cost reduction.

In situations where there is strong resistance to a low carbon transition, such that subsidies struggle to incentivise the desired change, regulations may be the most efficient of all policy options. There is evidence to suggest that this is the case in the road transport transition, where taxes and subsidies have had relatively little impact, but regulations are proving highly effective at forcing car manufacturers to shift investment from petrol cars to zero emission vehicles. The introduction of the EU's latest regulations on 1 January 2020 saw electric vehicles' share of car sales jump to 11% in that year, up from 3% in 2019.[23] California's zero emission vehicles mandate has helped it achieve an electric vehicle share of car sales that is four times as high as that of the US as a whole.[24] The faster this shift of investment takes place, the more it strengthens the reinforcing feedbacks that improve the new technology, bring down its costs, and expand its market share.

Rule 5: Tax should target tipping points

The traditional rule of thumb for tax, or more specifically carbon pricing, is that it should be applied at a level that reflects the economic cost to society of each tonne of carbon. In this way, the 'externality' of dangerous climate change is brought within the market. A carbon price at this level is thought to maximise economic efficiency, by ensuring the optimum allocation of economic resources.[25]

There are two problems with this approach. First, the total cost to society of climate change includes factors that are fundamentally uncertain, potentially catastrophic, and inherently subjective. Consequently, there is no meaningful objective value for the 'social cost of carbon.'[26] Second, in a low carbon transition - a context of disequilibrium - the aim of policy is not simply the efficient allocation of existing resources; it is the creation of new resources and new structures. In other words, the aim is dynamic efficiency, not allocative efficiency.[27] In this context, the efficiency of a carbon price depends not on its absolute level, but on its *relative* level. A carbon price that significantly alters the competitive balance between old and new technologies is likely to be more efficient than one that does not.

When the problem is understood this way, we can imagine a new role for tax. When clean technologies have been developed enough to begin to compete with fossil fuelled incumbents, tax - or tax together with subsidy - can tip the scales, helping the new to outcompete the old. In dynamic systems, a tipping point is where a small intervention can lead to a disproportionately large change in behaviour.[28] This can happen because passing the tipping point activates new reinforcing feedbacks that create self-accelerating change. In policy terms, this means getting a lot of bang for your buck.

There is evidence that tipping points have played a role in the world's fastest low carbon transitions in the power and road transport sectors.[29] In the UK's power sector (decarbonising height times faster than the global average), a fixed carbon tax made coal more expensive than gas at a time when both were being squeezed by the growth of

19. See: Economists' Statement on Carbon Dividends, available at https://www.econstatement.org/
20. R. Van Buskirk et al, 'A retrospective investigation of energy efficiency standards: policies may have accelerated long term declines in appliance costs', 2014 https://iopscience.iop.org/article/10.1088/1748-9326/9/11/114010/pdf
21. M. Grubb et al, 'Induced innovation in energy technologies and systems: a review of evidence and potential implications for CO2 mitigation', 2021 https://iopscience.iop.org/article/10.1088/1748-9326/abde07
22. For a discussion of the dynamics of exploitation and exploration, see E. Beinhocker, 'The origin of wealth', 2005, p.211
23. H. Cui et al, 'Update on the global transition to electric vehicles through 2020', 2021 https://theicct.org/publication/update-on-the-global-transition-to-electric-vehicles-through-2020/
24. S. Rokadiya and Z. Yang, 'Overview of global zero-emission vehicle mandate programs', 2019 https://theicct.org/publication/overview-of-global-zero-emission-vehicle-mandate-programs/
25. R. Stavins (n11).
26. For a discussion of the unavoidable uncertainty and subjectivity involved in counting the costs of future climate change, see S. Funtowicz and J. Ravetz, 'The worth of a songbird: ecological economics as a post-normal science, 1994 https://www.sciencedirect.com/science/article/abs/pii/0921800994901082
27. R. Kattel et al, 'The economics of change: policy and appraisal for missions, market shaping and public purpose', 2018 https://www.ucl.ac.uk/bartlett/public-purpose/publications/2018/jul/economics-change-policy-and-appraisal-missions-market-shaping-and-public
28. T. Lenton et al, 'Tipping elements in the Earth's climate system', 2008 https://www.pnas.org/content/105/6/1786
29. S. Sharpe and T. Lenton, 'Upward-scaling tipping cascades to meet climate goals: plausible grounds for hope', 2021 https://www.tandfonline.com/doi/abs/10.1080/14693062.2020.1870097?journalCode=tcpo20

renewables; as a result, coal crashed out of the system. In Norway's road transport sector, a combination of tax and subsidy makes electric vehicles cheaper at the point of purchase than equivalent petrol or diesel cars. The share of electric vehicles in Norway's car sales is around twenty times as high as the global average.

Many more tipping points can be envisaged: such as when electric aeroplanes outcompete jet fuelled planes in short haul aviation; when hydrogen from renewables outcompetes hydrogen from gas; or when lab-grown meat outcompetes beef from cows.[30] Well targeted taxes can help us cross these tipping points more quickly, leading to rapid growth in clean technologies' market share, faster performance improvement, and faster cost reduction.

Rule 6: When trading carbon, the narrower the scope, the better

Under Rule 1, we noted that a cap-and-trade scheme for carbon pricing creates a balancing feedback, which has a self-limiting effect. In principle, this is undesirable when the aim is to stimulate rapid decarbonisation. How much it matters in practice will depend partly on the scope of the scheme.

A widely accepted rule of thumb about cap-and-trade schemes is that the broader their scope, the greater the efficiency. This is derived from the presumption that a cap-and-trade scheme allows emissions cuts to be made wherever they can be made most cheaply. The broader its scope – the more companies, sectors of the economy, or countries that are covered by the scheme – the more opportunities to cut emissions at low cost will be found, and the greater the overall economic efficiency will be.

The mistake of this logic is to assume that we are dealing with an economy where nothing changes; where the objective is to discover the opportunities for least cost emissions cuts that have been left lying around. On the contrary, our challenge is to *create* change in the economy, and this includes creating opportunities for low-cost emissions reduction that did not exist at the outset. (Again, our aim is dynamic, not allocative, efficiency.) There is no reason to assume that taking the least cost opportunity to reduce emissions at each moment in time will lead to the least cost transition over the course of time. In fact, there is every reason to assume the opposite. Early in a transition, the cheapest emissions reductions come from operating fossil fuelled technologies more efficiently (e.g. making a coal power plant more efficient, or switching from coal to gas). This merely delays the investment that is needed to replace the entire stock of fossil fuelled capital assets with zero emission substitutes.

If a cap-and-trade scheme covers a single sector in a single country, and has a steep trajectory forcing rapid emissions reductions, the opportunities to cut emissions in ways that are cheap but only delay the necessary transition may be exhausted relatively quickly. The broader the scope of the scheme, the more opportunities there will be for the carbon price to be absorbed by (ultimately wasteful) marginal adjustments to the existing system, and the longer it will take for resources to be focused on creating and improving the new system.

Rule 7: More is different

Our decision-making processes sometimes assume that we can change one thing without changing anything else. Cost benefit analysis, for example, is most appropriate for analysing the effect of a policy in situations 'where the broader environment (e.g. the price of goods and services in the economy) can be assumed to be unchanged by the intervention'.[31] In such situations, we may be able to choose between policy options by considering them independently, one at a time.

However, the aim of decarbonisation policy is not to leave the broader environment unchanged. It is not merely to change the price of goods and services in the economy, but to create new goods and services, and new markets for them. In such situations of disequilibrium, the behaviour of a system depends not only on the behaviour of its components, but on the interactions between them.[32] We will be best able to choose an effective set of policies if we consider them in combination, rather than individually.

An example is provided by a disequilibrium modelling study of the road transport transition, by Lam and Mercure.[33] This simulation suggested that in China, the combination of a zero emission vehicle mandate, energy efficiency regulations, and a tax on petrol would achieve emissions reductions around 20% greater than the sum of the emissions reductions achieved by each of these three policies individually. Meanwhile, other combinations of policies were found to yield an effect less than the sum of their parts. If we remember that 'more is different', it may remind us to always look for policy combinations that achieve more than the sum of their parts, and not less.

Rule 8: Sooner is better than later

In an equilibrium economy, any change comes at a cost. If decarbonisation is necessarily a net cost, then it makes sense to do the minimum required to meet our

30. For an overview of potential tipping points in energy and industrial systems, see Systemiq, 'The Paris effect: COP26 edition https://www.systemiq.earth/the-paris-effect-cop26-edition/ For a discussion of tipping points in land use, see T. Smith et al, 'Accelerating the ten critical transitions: positive tipping points in food and land use systems transformation', 2021 https://www.foodandlandusecoalition.org/wp-content/uploads/2021/07/Positive-Tipping-Points-for-Food-and-Land-Use-Systems-Transformation.pdf

31. HM Treasury, 'The Green Book – central government guidance on appraisal and evaluation', 2018

32. This rule cites the title of the 1972 paper 'More is Different' by P.W. Anderson https://www.science.org/doi/10.1126/science.177.4047.393 which made the stronger point that not only is system behaviour more than the sum of its parts, it is qualitatively different. This is why it makes sense to study technology transitions as a phenomenon of interest, and to consider the potential effectiveness of policy options from this perspective.

33. A. Lam and J. Mercure, 'Which policy mixes are best for decarbonising passenger cars? Simulating interactions among taxes, subsidies and regulations for the United Kingdom, the United States, Japan, China, and India', 2021 https://www.sciencedirect.com/science/article/abs/pii/S221462962100044X?via%3Dihub

goals. If our emissions need to follow a downward path, we may assume that we should make the smallest, easiest and cheapest cuts first, and leave the larger, more difficult and expensive changes as late as possible - especially if we assume that the economy grows (increasing our resources) and technologies improve over time.

Equilibrium-based models have sometimes depicted decarbonisation as the task of Sisyphus. They have assumed that any emissions reduction achieved one year needs to be paid for again the next, if it is to be repeated.[34] And they have assumed that the cost of reducing emissions at any time is independent of whatever has been done before.[35] So each year, policy pushes its boulder up the hill of decarbonisation, only to see it return endlessly to its starting point. As larger emissions reductions are needed over time, the boulder is pushed higher each year, incurring ever greater costs that are only partially offset by technological improvement (assumed to happen by itself), and still it rolls back to its starting point. Such would be our fate in an economy without structural change.

Our experience of the transition to clean power already paints a different picture. Solar and wind power are cheaper than coal or gas, becoming ever more so, and the transition to clean power can be made with a net economic benefit. We can see that the same will be true of road transport, as electric vehicles move towards undercutting fossil fuelled cars. Policies that put these zero emission technologies in place lead to emissions reductions that are permanent, not just temporary. Disequilibrium modelling suggests that the entire transition to a zero emission economy could be made with a large net economic benefit, rather than a cost.[36]

This new picture is one in which the hill of decarbonisation is not endless: it has a summit. In each emitting sector, we can push the boulder up the hill, starting with research and development, then with targeted investment and regulation, and maybe some tax near the top. Then we can push it over the top and watch it accelerate down the other side, as the reinforcing feedbacks of the transition take over. Sisyphus can be free at last.

If the clean economy on the other side of the hill is more economically attractive than the fossil fuelled economy we are leaving behind, then the gains of this transition will be enjoyed in perpetuity. There are many nuances, but to a first approximation, the sooner we are able to start enjoying these gains, the better. Faster deployment of clean technologies leads to faster cost reduction, and earlier arrival at the point where the transition begins to yield net benefits. For this reason, a recent study finds a fast global transition would cost less (and achieve greater net gains) than a slow transition.[37]

Rule 9: Assess opportunities and risks, not just costs and benefits

We are likely to make good policy decisions more often if we use decision-making frameworks that are appropriate to the context. Cost benefit analysis can be useful in the special circumstances when the costs and (future) benefits of a policy can be predicted and quantified with reasonable confidence, and when any changes provoked in the economy are expected to be marginal (having no effect on the economy's structure).[38]

Decarbonisation policy takes place in a different, and more general, context. Many important effects of policies - such as their ability to create new technologies and markets - cannot be predicted quantifiably with reasonable confidence. Limiting analysis to quantifiable factors would therefore be misleading; it is essential to broaden the scope of analysis from costs and benefits to risks and opportunities.[39] Since the intent of policy is to create transformational (not marginal) change, this 'risk opportunity analysis' must compare policy options in terms of their effects on processes of change within the economy, not simply in terms of expected outcomes at a moment in time. This analysis can be informed by models and theory that simulate and explain the behaviour of the economy in any of its possible dynamic states, not limited to the special (and in this context inapplicable) case of equilibrium.

With some help from hindsight, it is possible to see how the application of a 'risk opportunity analysis' approach could have led to recommendations in favour of the decarbonisation policies that turned out to be so successful in China, India, Brazil and the UK, where cost benefit analysis had generally advised against.[40]

Rule 10: Work together to make progress faster

When decarbonisation was assumed to come at a net cost, the diplomacy of climate change could only be a negative sum game. Much effort was expended seeking to agree a division of the finite global carbon budget, with countries individually aiming to maximise their share of the remaining 'carbon space'. As a global agreement along these lines proved impossible, the attempt was abandoned after the Copenhagen climate change conference of 2009. The Paris Agreement restored confidence in the collective effort by allowing each country to set its emissions targets unilaterally.

34. A. Vogt-Schilb et al, 'When starting with the most expensive option makes sense: optimal timing, cost and sectoral allocation of abatement investment', 2018 https://www.sciencedirect.com/science/article/pii/S0095069617308392

35. M. Grubb and C. Wieners, 'Modelling myths: on the need for dynamic realism in DICE and other equilibrium models of global climate mitigation', 2020 https://www.ineteconomics.org/uploads/papers/WP_112-Grubb-and-Wieners-Climate-Change-2.pdf

36. The New Climate Economy, 'Unlocking the inclusive growth story of the 21st century: accelerating climate action in urgent times', 2018 https://newclimateeconomy.report/2018/

37. R. Way et al, 'Empirically grounded technology forecasts and the energy transition', 2021 https://www.inet.ox.ac.uk/files/energy_transition_paper-INET-working-paper.pdf

38. S. Sharpe et al, 'Deciding how to decide: risk-opportunity analysis as a generalisation of cost-benefit analysis', 2021 https://www.ucl.ac.uk/bartlett/public-purpose/publications/2021/jan/deciding-how-decide-risk-opportunity-analysis-generalisation-cost-benefit

39. *Ibid*. For a longer and more theoretical explanation see J. Mercure et al (n6).

40. M. Grubb et al (n3).

The new understanding that decarbonisation can bring a net economic gain creates the potential for a new kind of climate change diplomacy. Cooperation can be positive sum. Coordinated international action can bring faster innovation, stronger incentives for investment, larger economies of scale, and level playing fields where they are needed, making decarbonisation faster, easier, lower cost and greater gain for all countries.[41] Since each of the emitting sectors is different in its political, financial, technological and industrial structures, most of these coordination gains can only be accessed through targeted cooperation in each sector.

This was the vision of the leaders of more than 40 countries, covering over 70% of global GDP, that at the COP26 climate change talks in Glasgow signed up to the Breakthrough Agenda - committing to work together to make clean technologies and sustainable solutions the most affordable, accessible and attractive option in each emitting sector before the end of this decade.[42] Creating and strengthening institutions to support the strong, targeted and sustained cooperation that is needed in each sector must now be a high priority for the international community.

Keeping our hopes alive

It may be too late to achieve the international community's original goal of 'preventing dangerous anthropogenic interference with the climate system'. We have already interfered, and it has already proved dangerous. But perhaps the 1.5 degree goal, while outrageously difficult given our slow start, is not altogether impossible. The great variation in the pace of transition between countries in a given sector suggests that if more countries put the most effective policies in place, a much faster global transition is possible. The potential gains from cooperation in each sector, so far relatively unexplored, could yield a significant further acceleration.

The assumption underlying the approach proposed here is not that we have any greater political will for achieving decarbonisation. It is only that we are dealing with the economy in a state of change, rather than a state of equilibrium. This understanding can guide us to better choices, so that the same political will and financial resources can be deployed to considerably greater effect.

41. D. Victor, F. Geels & S. Sharpe, 'Accelerating the low carbon transition: the case for stronger, more targeted and coordinated international action', 2019 https://www.energy-transitions.org/publications/accelerating-the-low-carbon-transition/

42. COP26 World Leaders Summit statement on the Breakthrough Agenda, 2021 https://ukcop26.org/cop26-world-leaders-summit-statement-on-the-breakthrough-agenda/

Rethinking the Foundations of Capitalism

Hanoch Dagan • Stewart and Judy Colton Professor of Legal Theory and Innovation and Director of the Edmond J. Safra Center for Ethics, Tel-Aviv University

Liberal Property and Just Markets

Property is one of the core building blocks of the market economy. Therefore, assessing the current as well as any possible reconfiguration of the market necessarily invokes, explicitly or implicitly, a conception of property. Too often, however, both defenders of existing markets and their critics take this premise of their accounts for granted. Both tend to implicitly rely on what in property theory is known as the Blackstonian conception, in which ownership implies "sole and despotic dominion."[1] Property, however, need not and should not be shaped around this (in)famous understanding.

In this short Essay I offer a sketch of a competing conception of property, which I develop in my new book, *A Liberal Theory of Property*.[2] Property on this view is an autonomy-enhancing institution; one of the major legal tools that serve the primary commitment of every liberal polity to secure and facilitate people's foundational right to self-determination (not to be confused with their negative liberty). As such, liberal property requires law to facilitate in each important area of human action and interaction a diverse set of stable frameworks of private authority (property types, as I call them) so that people can set up – on their own or with the cooperation of others – long-term plans. Property can be legitimate, I argue, if (1) the private authority constituted by these property types is properly circumscribed in line with their service to people's autonomy; (2) they all comply with relational justice; and (3) law's background regime both assures ownership for everyone and secures to us all the material, social, and intellectual preconditions of self-authorship.

The Blackstonian conception of property fits – or, more precisely, is presupposed by – certain visions of the market. But once it is supplanted by this conception of liberal property, these attendant visions, which perceive markets in either libertarian (or "neoliberal") or welfarist terms, no longer follow. In their stead a genuinely liberal conception of the market emerges, in which markets are structured so as to serve their liberal, namely: autonomy-enhancing, *telos*.

Neither the liberal conception of property nor the liberal conception of the market is a panacea for at least two reasons. First, as noted, liberal property and liberal markets necessarily rely on a robust autonomy-enhancing background regime. This means that true friends of property and the market must be committed to safeguard the continuous functioning of this regime. Furthermore, while the liberal conceptions of both property and the market present themselves as charitable interpretations of the laws in modern-day market societies, these laws fall short – at times quite significantly short – of these ideals. This means that rather than reaffirming the status quo, these liberal conceptions point out to these pitfalls and offer directions for their remediation.

The challenge on both fronts is admittedly awesome. For the vast majority of people here and now property and markets generate and perpetuate inequality and dependence. Critics of property and markets are thus correct to resist the quietism that threatens overfriendly accounts. But they should also be careful not to miss out on the great humanistic promise of genuinely liberal property and markets. These liberal ideals can and should be our lodestar for critically and constructively examining our disturbing reality by providing a normative vocabulary for evaluating central doctrines and offering directions for urgent reforms.

Liberalism

The terms "liberal" and "liberalism" have different connotations in different intellectual and public settings, so I should begin by briefly clarifying what I take them to mean. Liberalism, in my understanding, is premised on the conviction that people – all people – are entitled to act on their capacity "to have, to revise, and rationally to pursue a conception of the good."[3] They deserve to have some control over their destiny, "fashioning it through successive decisions through their lives."[4] Free individuals should be able to plot their own course through life – to have some measure of self-determination.[5]

To be sure, taken to its extreme, a conception of self-authorship (or self-determination; I use these terms interchangeably) in which one constructs in advance a "narrative arc" for one's life is a form of unfreedom. But that does not lead to the conclusion that freedom

1. William Blackstone, *Commentaries on the Laws of England* *2, (Univ. of Chi. ed. 1979) (1765-69).
2. Hanoch Dagan, *A Liberal Theory of Property*, Cambridge University Press, 2021.
3. John Rawls, *Justice as Fairness: A Restatement* 19 (2001).
4. Joseph Raz, *The Morality of Freedom* 369 (1986).
5. This commitment requires that we respect each person's right to self-authorship; it does not denigrate a choice of a non-deliberative life, and it emphatically does not suggest that such respect is conditioned upon the accomplishment of a worthy life plan.

requires making freestanding decisions at every fork in the road. Our life story is neither a script fully written in advance nor a set of unrelated episodes. Rather, autonomous people characteristically make decisions in a piecemeal fashion, choosing both long-term and short-term pursuits. Self-determination allows – to some extent even requires – opportunities for people to alter their plans and even, sometimes, to replace them completely.

Autonomy requires appropriate mental abilities. It also necessitates a measure of independence. But autonomy is not guaranteed by merely a structure of negative rights.[6] As Joseph Raz famously argued, autonomy is also dependent upon both material conditions and a sufficiently heterogeneous inventory of alternatives.[7] This lesson explains why in a liberal polity people are entitled to a system of law *supportive* of their ability to shape a life they can view as their own, rather than merely one that respects their capacity for uncoerced choice.

Liberal Property

Property is intimately related to autonomy, because property is not just about provision, although that is also important. Rather, property is first and foremost about having some *authority* over resources, namely: the normative power to determine what others may or may not do with the resource. This means that property both empowers people and disables them, enhances their self-determination while also rendering them vulnerable. Therefore, the liberal conception of property focuses on both property's autonomy-enhancing service and the vulnerabilities it generates.

First, the happy side. Property is conducive to people's self-determination because, as noted, self-determination is an intertemporal achievement; it consists in planning and carrying out projects, which requires a temporal horizon of action. Property follows suit by conferring upon people some measure of private authority over resources; a normative power to determine what others may or may not do with their resources. This temporally-extended authority over things (both tangible and intangible) dramatically affects people's ability to plan and carry out meaningful projects, either on their own or with the cooperation of others.

Liberal law further augments property's autonomy-enhancing potential because it constitutes a *variety* of stable frameworks of interpersonal cooperation, that is: different property types which support divergent forms of interpersonal relationships that people can choose from. Thus, properly configured, property law functions as an empowering device for self-authorship, enabling people to act upon their own goals and values, their objectives, and their life plans. By conferring on individuals the power to invoke differing property types and to employ them in the service of their life plans, a liberal property law makes a crucial contribution to people's ability to realize their right to self-authorship.

Alas, indispensable as it is, this autonomy-enhancing service is also the source of property's daunting legitimacy challenge. By proactively empowering owners, property law generates new normative powers, which imply new liabilities. Because it is the law which renders non-owners vulnerable to such powers, law must be accountable to the subjects of the powers it instantiates. Property's legitimacy challenge is therefore onerous. With no good justification, law's demand that non-owners defer to owners' authority regarding what to do with an object seems arbitrary and indeed unjust.

* * *

The ambition of *A Liberal Theory of Property* is to show that this drama of property need not be a zero-sum game. For this to be the case, I argue, property's architecture must closely follow its justification.

Liberal property justifies the private authority it vests on owners *only insofar as* it is indeed critical to people's self-determination, which the state is obligated to facilitate and everyone must respect. Non-owners are justifiably subjected to these powers of property because *as such* – that is, as crucial means of self-determination – these powers deserve respect from our fellow human beings due to our foundational right of reciprocal respect for self-determination.

This means, however, that the legitimacy of any given property system at any given time and place hangs on its performance as to property's autonomy-enhancing *telos*. A genuinely liberal property law *proactively augments people's opportunities for both individual and collective self-determination, while carefully restricting their opportunities for interpersonal domination*. This is why the notion of private authority, which fairly characterizes property simpliciter, cannot possibly exhaust the idea of liberal property.

* * *

This complicated nexus between property and self-determination also implies that liberal law cannot adopt the familiar "division-of-labor approach," in which property is supplemented by a background mechanism of tax-and-redistribution that is supposed to take care of its autonomy-reducing potential. To be sure, such a background regime, which secures the fundamental preconditions of personal self-determination, such as health, education, and means of subsistence, is (as I argue shortly) indispensable for property's legitimacy. But it is insufficient. Because property has an irreducible role in structuring people's interpersonal interactions, which in turn have a freestanding significance in their self-determination, a genuinely liberal law must shape its property regime in accordance to property's autonomy-enhancing *telos*.

6. See H.L.A. Hart, "Between Utility and Rights", 79 *Columbia Law Review* 828, 836 (1979).
7. See Raz, *supra* note 4, at 372, 398.

Thus, a liberal property system cannot be contented with one form of property. In order to foster autonomy-enhancing pluralism, property law offers a variety of frameworks for both individual and communal self-determination from which prospective owners can choose.

By the same token, a truly liberal property law is also always attentive to the concerns of non-owners. It ensures both that no private authority can be claimed that is in excess of what is required for owners' self-determination, and that such authority must be consistent with the self-determination of others.[8]

Hence, the three pillars of liberal property, which render it dramatically different from its Blackstonian counterpart: carefully delineated private authority, structural pluralism, and relational justice.

Carefully Delineated Private Authority

The first, and maybe most dramatic, feature of liberal property, is that the private authority it confers on people is carefully delineated, so that it is properly tailored to its service to people's autonomy. There are two aspects to this constitutive element of liberal property law.

The first addresses the concern of under-inclusiveness, and thus requires that property's empowerment potential must not be limited to some. This requirement implies that property law rely on a robust background regime, which should guarantee *everyone* the material, social, and intellectual preconditions of self-authorship.

Such a background regime is indispensable because property's justificatory challenge is not limited to the moment of its creation. Rather, it continuously resurfaces, haunting property throughout its life in law. The reason for this is partly due to certain features of property – notably accession – which imply that property leads to more property and thus tends to generate greater inequality and vulnerability; and it is also due to the dynamics of the market, which further exacerbate this predicament.

Reference to this background regime does not mean that a theory of liberal property is a theory of everything just, of course. But because this onerous justificatory challenge is property's starting point, liberal property does point out to some of the features of a *just* background regime necessary for property's legitimacy.

Thus, to give one example, since – as with money and utility – the marginal autonomy-enhancement of each additional unit of property is likely to be diminishing, liberal property requires law to impose the costs of the ongoing maintenance of this background regime on those who are particularly well-off. The duty of the well-off to cover these costs is not only grounded in their (Rawlsian) obligation to support just institutions; it is also a precondition to the legitimacy of their own property rights.

* * *

The second feature of the requirement that property's private authority be carefully delineated addresses the worry of over-inclusiveness, namely: the concern of generating forms of private authority that cannot be justified by reference to their service to self-determination. It thus prescribes that owners' private authority should be *circumscribed in line with its potential contribution to owners' self-determination*.

In other words, in a truly liberal regime, property's *telos* is important not only for justifying owners' authority, but also for delimiting its scope and prescribing its content. Thus, where property's contribution to autonomy is indirect – as in commercial property types – owners must not have an exacting private authority.

This prescription entails dramatic implications for anti-trust law: it implies its reorientation from focusing on consumer welfare to targeting concentrations of private authority and capital accumulation.

A similarly critical upshot reconceptualizes the content of ownership of the means of production and thus the notion of the workplace. Employers' ownership of the means of production is conventionally understood to entail the management's power to govern, to justify a hierarchical structure of employees' subordination, and to preclude claims for worker's voice. But for liberal property, all these inferences are both wrong and misleading. This lesson will be critical to my remarks on labor markets.

Structural Pluralism

Property law as we know it does not follow the monistic picture of a Blackstonian dominion. Rather, law persistently offers a deeply heterogeneous inventory of relatively stable property types. Different types are governed by differing animating principles, so that each offers a distinctive balance of property's intrinsic and instrumental values: independence, personhood, community, and utility.

For liberal property, this observation is not a discretionary add-on, but rather an essential design principle. Property should be structurally pluralistic, because this architecture is necessary for property to fulfill its autonomy-enhancing function. We should cultivate the heterogeneity of our existing property law since a multiplicity of property types facilitates the rich diversity of interpersonal relationships needed for adequate self-determination.

Such a repertoire of property types creates a menu of viable opportunities for both individual and collective self-determination. Law's facilitation of this pluralism is crucial, because collective action problems, bounded rationality, and cognitive failures imply that a lack of proactive legal support undermines many types of interactions, and, thus, people's ability to pursue their own conception of the good.

8. Both prescriptions require the application of qualitative judgment and both must (as is usually in law) apply to broad categories. See further Dagan, *supra* note 2, at 128-42, 159-73.

Liberal property law is therefore appropriately heterogeneous, and it pays close attention to the design of these property types' inside affairs, and thus to their governance regimes. Such governance mechanisms are needed in order to facilitate a variety of forms of interpersonal relationships in ways not possible without such enabling legal infrastructure. This is particularly true for common property types, which offer important contributions - both instrumental and intrinsic - to people's self-determination.

Indeed, liberal property requires law to instantiate and support, for each major category of human action and interaction, a diverse repertoire of property types, each governed by a distinct animating principle, meaning a different value or balance of values.

The ideal form of liberal property law secures *intra-sphere multiplicity*, namely: enough and sufficiently distinctive property types within each familiar category of human activity. (Think of condos, co-ops, common-interest communities, joint tenancies, leaseholds, and trusts as examples of the existing inventory of land-ownership.) For property types to be autonomy-enhancing, they *should be partial functional substitutes* for each other. They need to be substitutes because choice is not enhanced with alternatives that are orthogonal to each other; and their substitutability should not be too complete because types that are too similar also do not offer meaningful choice.

Relational Justice

Just as property's structural pluralism relies on its autonomy-enhancing *telos*, so do the many manifestations of liberal property's third pillar of relational justice - namely: *reciprocal* respect for self-determination.

Thus, fair housing rules that prohibit discrimination in the sale or rental of residential dwellings are not external to property law, as they are often presented. Interpersonal discriminatory practices are objectionable *per se*, regardless of whether the state takes care of its obligations of distributive justice and democratic citizenship. Refusing to consider a would-be buyer of a dwelling merely because of her skin color, for example, fails to respect the individual on her own terms. Property law must not authorize social relationships that reject the equal autonomy of the person subject to discrimination.

Accordingly, liberal property follows the prescription of relational justice and sets limits on owners' right to exclude. Relational justice cannot be adequately grasped within the formal conception of equality that underpins Blackstonian property, which abstracts away the particular features distinguishing one person from another. Respecting the other's self-determination *necessarily* requires respecting their characteristics, constitutive choices, and circumstances, thus summoning a substantive, rather than formal, conception of equality.

By the same token, reciprocal respect for self-determination is not limited to a negative duty of non-interference that is the correlative of others' right to independence. Respect for others' self-determination is hollow without *some* attention to their predicament. This is what explains and indeed justifies many of the affirmative duties and burdens that accompany ownership in numerous contexts.

Notice that again all these implications of law's commitment to relational justice are *not* exogenous impositions on liberal property; quite the contrary. Owners' claim of legitimate private authority and recruitment of the coercive power of the state for its vindication is premised, as I've contended, on people's obligation to reciprocal respect for one another's self-determination. Therefore, compliance with this obligation is the *sine qua non* for property's legitimacy. Relational justice is thus part and parcel of property's liberal raison d'être.

Just Markets

The three pillars of liberal property, which I've just sketched, undermine the Blackstonian conception of property and its concomitant conceptions of the market. In *A Liberal Theory of Property*, I attempt to go a bit further than that. Building also on my work-in-progress on liberal contract,[9] this book offers a preliminary vision of the market, which does not rely on markets' putative efficiency and is surely divorced from its neoliberal understandings. Just like its building blocks of property and contract, I argue, the market can be legitimate, and can even be just, if - but only if - it is structured as to best enhance its contribution to autonomy.

Markets are complex social institutions heavily dependent on, if not strictly constituted by, a thick legal infrastructure. This infrastructure facilitates the regular production and distribution of goods and services through contracts, in which money, property rights over goods, and entitlements regarding services are transferred between agents. Markets are potentially conducive to people's self-determination, because they allow individuals the mobility that is a prerequisite for self-determination, and they expand the options available to individuals to function as the authors of their own lives.

Markets, more specifically, enable the liquidation of existing holdings and thus facilitate people's right to exit: to withdraw or refuse to further engage, to dissociate, to cut themselves out of a relationship with other persons. Exit, in turn, is crucial to autonomy because open boundaries enable geographical, social, familial, professional, and political mobility, which are prerequisites for a self-directed life.

Markets further extend this autonomy-enhancing function by broadening the scope of choices between differing projects and ways of life. They facilitate people's ability

9. See Hanoch Dagan & Michael Heller, "Choice Theory: A Restatement" in *Research Handbook on Private Law Theory* 112 (Hanoch Dagan & Benjamin Zipursky eds., Edward Elgar 2020).

to legitimately enlist one another in the pursuit of private goals and purposes and create a structure that multiply the alternatives people can choose from. Genuinely liberal (that is: autonomy-based) markets would enable the individual to act – on her own or with the cooperation of others – upon her own goals, values, objectives, and her plan of life, without subordination to any other individual or subjection to any collective decision-making procedure.

* * *

Markets with the primary goal of autonomy enhancement will have several characteristics, and (as usual) my aim is to draw the liberal ideal of the market that can serve as our lodestar of criticism and reform. So let me conclude this Essay with a brief description of what a properly liberal market looks like.

Autonomy-enhancing markets must allow universal participation since exclusion and discrimination would undermine their raison d'être. They should also set limits on the power to alienate whenever it erodes – as, for example, some noncompetes do – our ability to rewrite our life story and start anew. Such markets should proactively ensure meaningful choices in each major sphere of human action and interaction. However, this injunction of intra-sphere multiplicity must be curtailed where cognitive, behavioral, structural, and political economy reasons imply that more choice may actually reduce autonomy.[10]

Moreover, when markets are structured to serve autonomy, market relationships are governed by rules that require reciprocal respect for self-determination, meaning that market interactions must be governed by relational justice. Furthermore, since preference satisfaction is understood to be instrumental to the markets' ultimate value of autonomy, the law of the market must avoid the commodification of people and interpersonal relationships. It should thus employ, in some subsets of the settings it governs, the techniques of incomplete commodification, which ensure that these market interactions retain a personal aspect.

These last prescriptions are particularly pertinent to labor markets, which are often – and justifiably – presented as Exhibit A to the injustices property and markets generate and perpetuate. They imply that the law of the market must promote and support workers' collective bargaining as well as ensure workers' inalienable rights dealing with topics such as workplace safety, minimum wage, working hours, and non-discriminatory treatment. They also require that the authority of owner-employers must not include excessive powers that may impinge upon these basic workers' rights. For example, ownership of factories, farms, and other types of both tangible and intangible property that serve as means of production *must not* include a right to exclude labor organizers and activists, insofar as such an exclusion might jeopardize the workers' right to unionize.

Finally, just as with the idea of liberal property, the idea of a liberal market is particularly careful not to marginalize the broader picture, in which the justice of the market is partially dependent upon a background regime that guarantees the conditions of individual self-determination. Rather than striving to exclusivity, the law of the market, in this view, is attuned to its distinct autonomy-enhancing tasks of enabling mobility and expanding choice, while acknowledging the indispensable role of other social institutions in enabling these vital functions.

The success of liberal property is by no means guaranteed. But it is not bound to fail. I understand the caution; both property and liberalism have failed us before, so some suspicion is in place. But property is not going anywhere and its liberal ideal is empowering. If failure is not preordained, then a jurisprudence of hope may well be in place.

10. On these substantive limits on multiplicity (and why they must be considered), see Hanoch Dagan & Michael Heller, *The Choice Theory Of Contracts* 128-30 (2017).

Jean-Philippe Robé • International Lawyer and Lecturer at Sciences Po

Taming Property

> Whoever wants to know what is hidden behind the law will discover, I fear, neither the absolute truth of a metaphysics, nor the absolute justice of a natural law. He who lifts the veil and does not close his eyes, will only find the hideous face of the Gorgon of power staring at him.
>
> Hans Kelsen[1]

A proper understanding of the concept of property is at the heart of the effort to develop a new capitalism through law. Law has a constitutive power,[2] and the evolution of the legal notion of property has played a fundamental role in the development of liberalism and capitalism as governance systems.[3]

Property, in the Lockean tradition, is treated as a spontaneous institution originating from labor.[4] Most economists start their analyses of the development of a market economy with some notion of hunters and gatherers acquiring "property" by hunting rabbits or gathering berries. Then the hunters and gatherers meet and barter. They agree on the quantity of berries required to get one rabbit in exchange. Then money is introduced in the system to facilitate transactions.[5] The market economy is born.

With such a starting point, what "property" means is never really addressed. It appears as being merely the possession of things: rabbits or berries, obtained via labor or exchanged via barter prior to the advent of the market economy with prices and money. The whole development process is presented as being purely gradual and "natural".

With rare exceptions, economists consign a secondary or epiphenomenal role to law in their analyses.[6] The four major schools of economic thought (classical economics, neoclassical economics, Keynesianism, and new institutional economics) generally confuse property and possession.[7] They treat as synonymous the *de facto possession* of things (what civil law lawyers call *détention*), the *legitimate possession* of things (what is called *possession* in civil legal systems) and property - the *legal title* to property. Yoram Barzel goes as far as considering that "you own today even the apples you intend to steal from your neighbor's tree tomorrow".[8] The existence of "economic property rights" is proclaimed and (no-doubt…) opposed to "legal property rights".[9]

For my purposes, these analyses are inherently limited; if not useless. They ignore the historical fact that the evolution of the legal system has been instrumental in the institutionalization of market and now capitalist societies. This is particularly the case for the evolution of modern property which is one of the cornerstones of the legal system and of liberal and capitalist societies.[10] The key *constitutional moment* in this regard has been the institutionalization of the modern concept of property, at the end of the eighteenth century. For France, the detailed study of Rafe Blaufarb is illuminating. When the French Revolution of 1789 remade the property system, it: "laid the foundations of France's new constitutional order and crystallized modern ways of thinking about polities and

1. *Die Gleichheit vor dem Gesetz Im Sinne des Art. 109 der Reichsverfassung [Aussprache]*, 3 VVDStRL pp. 54-55 (1927).
2. On the constitutive role of law, see generally Simon Deakin, David Gindis, Geoffrey M. Hodgson, Kainan Huang and Katharina Pistor, 'Legal institutionalism: Capitalism and the Constitutive Role of Law', 45 *Journal of Comparative Economics* pp. 188-200 (2017); Simon Deakin, David Gindis, Geoffrey M. Hodgson, 'What is a Firm? A Reply to Jean-Philippe Robé', *Journal of Institutional Economics* pp. 1-11 (2021) and Jean-Philippe Robé, 'Firms Versus Corporations: A Rebuttal of Simon Deakin, David Gindis, and Geoffrey M. Hodgson', *Journal of Institutional Economics*, pp. 1-9 (2021).
3. A large proportion of the developments in this article derive from my recent book, *Property, Power and Politics – Why We Need to Rethink the World Power System*, Bristol: Bristol University Press (2020).
4. For example, Steve Pejovich, one of the gurus of the property rights analysis of economics, starts his "foreword" to *The Elgar Companion to The Economics of Property Rights*, Cheltenham: Edward Elgar (2004) edited by Enrico Colombatto with the sentence "From the beginning of recorded history, people have understood the importance of property for their survival". Armen Alchian, Harold Demsetz, Henry Manne, Douglass North, Richard Posner and Oliver Williamson are then listed among the founding fathers of the discipline.
5. The fact, however, is that in anthropology, no example of a barter economy has ever been described, let alone the emergence of money from it. *E.g.*, David Graeber, *Debt – The First 5,000 years*, Brooklyn and London: Melville House (2011, 2012, 2014), pp. 21-41.
6. Geoffrey M. Hodgson, 'Much of the "economics of property rights" devalues property and legal rights', 11(4) *Journal of Institutional Economics* pp. 683-709 (2015), p. 685. For a review of property rights economics, see Kirsten Foss and Nicolai Foss, 'Coasian and Modern Property Rights Economics', 11(2) *Journal of Institutional Economics* pp. 391-411 (2014).
7. Sabine Hoffmann, 'Property, possession, and natural resource management: towards a conceptual clarification', 9(1) *Journal of Institutional Economics* pp. 39-60 (2013), p. 40. See also Gunnar Heinsohn and Otto Steiger, *Ownership Economics – On the foundations of interest, money, markets, business cycles and economic development*, London & New York: Routledge (2014).
8. Yoram Barzel, *A Theory of the State. Economic Rights, Legal Rights, and the Scope of the State*, Cambridge: Cambridge University Press (2002), p. 15.
9. See Yoram Barzel, *Economic Analysis of Property Rights*, Cambridge: Cambridge University Press (1989) and *A Theory of the State. Economic Rights, Legal Rights, and the Scope of the State*, Cambridge: Cambridge University Press (2002). Douglas Allen, who fiercely defends the importance of an economic approach to property rights, also considers that "possession is essentially another term for economic property right"; see also Allen who writes that "contrary to Hodgson's claim that 'it is impossible to understand capitalism … without an adequate conception of [legal] property', it is quite the opposite"; Douglas W. Allen, 'Comment on Hodgson on Property Rights', 11(4) *Journal of Institutional Economics* pp. 711-717 (2015), p. 712.
10. See also Hanoch Dagan, 'The Limited Autonomy of Private Law', 56 *The American Journal of Comparative Law* pp. 809-833 (2008), at p. 814.

societies. This revolution in property brought about a Great Demarcation: a radical distinction between the political and the social, state and society, sovereignty and ownership, the public and the private. ... The Great Demarcation left a legacy that extends far beyond the history of the French Revolution. It created a distinctly modern way of seeing."[11]

In the old property system, what is understood today as prerogatives[12] being either "public" or "private" were mixed.[13] Most "private" property (real-estate especially) entailed public duties and many "public" offices could be purchased. Most of the Old-Regime complex corporate system of intertwined "public" and "private" rights and duties was destroyed during the night of August 4th, 1789, with the abolition of "privileges". A *tabula rasa* ensued.[14]

Then came the necessity to build the institutional structure of a new society. The revolutionaries had to pry apart "power" (public) and "property" (private) and replaced tenurial landholding with absolute, individual ownership. In so doing, they created modern property.[15] The French revolution created the conceptual matrix within which modern political forms will be built and understood.[16] But it is only a legal matrix, with no particular political form imposed upon the polity.[17] Here lies the possibility to invent a new capitalism through law.

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There are three ways of understanding modern property as it operates in the social system. There is first the day-to-day conception of property as a right over things. There is then the civil or common law understanding of property. There is finally the constitutional dimension of property.

In the **day-to-day understanding of property**, property is a direct relationship of the owner towards the object of property. But even at this crude level of understanding, property is differentiated from possession. It is widely accepted, for example, that if a thief effectively has the physical possession (*détention*) of the stolen good, she does not own it. The dispossessed owner does. Conversely, a tenant paying her rent *legitimately* possesses the rented apartment, but she does not own it. The landlord does. In both examples of illegitimate and *legitimate* possession, the *owner* does not have possession. This shows how little possession has to do with property, contrary to the view shared by most property rights theorists and economists.

There is then **the private lawyer's understanding of property**. In the civil law tradition, the crowning achievement in the institutionalization of modern property in France is the Civil Code. The Code enshrined many of the fundamental principles of the French Revolution embodied in the 1789 Declaration of the Rights of Man and Citizen. The disentanglement of "property" and "power" and the notion of full, absolute, property is pervasive throughout the Code.[18]

Article 544 of the French Civil Code provides that: "Property is the right to enjoy and dispose of things in the most absolute manner, provided it is not being used in violation of laws or regulations".[19]

The article appears contradictory. The enjoyment and disposition in "the most absolute manner" can be seriously eroded by "laws and regulations". Is property still an "absolute" right, then? In fact, the drafter of the Civil Code had to balance the constitutional rights of the property-owner with the needs of the polity.[20] What is meant by the article is that property, as a right of autonomy, entitles the owner to decide about the use of her property as a matter of principle, "laws and regulations" providing exceptions to this principle. The principle is autonomy, the exception is legislative and regulatory heteronomy. With the rise of the "social question", the need to protect consumers and the environment, this heteronomy has gradually but substantially increased. But property remains the same: a right of autonomy as a matter of principle with (changing) exceptions.

In the *common law* tradition, property is now viewed as a "bundle of rights". It is a set of rights (to possess, to use, to manage, etc.[21]) of the owner against others in con-

11. Rafe Blaufarb, *The Great Demarcation – The French Revolution and the Invention of Modern Property*, Oxford: Oxford University Press (2016), p. 1, 11 and 14.
12. The word "prerogative" meaning here in a general sense an exclusive or special right, power, or privilege.
13. Rafe Blaufarb, *The Great Demarcation – The French Revolution and the Invention of Modern Property*, Oxford: Oxford University Press (2016); Rutger Claassen, "Property and Political Power: Neo-Feudal Entanglements", in John Christman (ed.) *Positive Liberty: Past, Present, and Future*, Cambridge: Cambridge University Press (2021).
14. Stéphane Rials, *La déclaration des droits de l'homme et du citoyen (présentée par)*, Paris : Hachette (1988), p. 60.
15. Rafe Blaufarb, *The Great Demarcation – The French Revolution and the Invention of Modern Property*, Oxford: Oxford University Press (2016), p. 5.
16. Rafe Blaufarb, *The Great Demarcation – The French Revolution and the Invention of Modern Property*, Oxford: Oxford University Press (2016), p. 11; François Furet, 'Nuit du 4 août', in *Dictionnaire critique de la révolution française*, pp. 126-133, Paris: Flammarion (1988).
17. When reviewing the decision of the Mitterrand administration to nationalize banks and certain industrial groups, the French Conseil Constitutionnel decided that (recital 20) "it has not been established that the transfers of property and enterprises currently effected would restrict the scope of private property and freedom of enterprise to the point of disregarding the aforementioned provisions of the Declaration of 1789." (Considérant 20) « il n'est pas établi que les transferts de biens et d'entreprises présentement opérés restreindraient le champ de la propriété privée et de la liberté d'entreprendre au point de méconnaître les dispositions précitées de la Déclaration de 1789. » (Décision n° 81-132 DC du 16 janvier 1982 | Conseil constitutionnel (conseil-constitutionnel.fr). Implicitly, this means that, beyond an undetermined level of nationalizations, the right to private property would be undermined and the nationalizations would be unconstitutional, i.e., not in compliance with the fundamental matrix of private and public prerogatives which can vary, but to a point only.
18. Frédéric Zenati-Castaing, "La propriété, mécanisme fondamental du droit", *Revue trimestrielle de droit civil*, juillet-septembre, pp. 445-466 (2006), p. 446.
19. *La propriété est le droit de jouir et disposer des choses de la manière la plus absolue, pourvu qu'on n'en fasse pas un usage prohibé par les lois ou par les règlements.*
20. Rafe Blaufarb, *The Great Demarcation – The French Revolution and the Invention of Modern Property*, Oxford: Oxford University Press (2016), p. 209.
21. Geoffrey M. Hodgson, 'Editorial introduction to 'Ownership' by A.M. Honoré (1961), followed by 'Ownership' by A.M. Honoré', 9(2) *Journal of Institutional Economics* pp. 223-255 (2013), pp. 231-242.

nection with the object of property. It is more sophisticated than the day-to-day perception and makes it possible to better understand the centrality of the concept of property in liberal and capitalist societies. But it fundamentally misrepresents how property effectively operates in our world. With property, what is finite at any point in time is *not* the set of prerogatives, the "bundles of *rights*". What is finite is the set of *limitations* to the right to property, to the autonomy it entails. The autonomy of the property owner is *the rule*; the limitations of this autonomy via contracts or laws or other norms created via the political system limiting the uses of property are *the exceptions*. Property is a *right as a matter of principle* with "bundles of *limits*", bundles of exceptions. These limits change when the law evolves, depending on the demands made on the political system and its eventual reaction to these demands.[22] Property is a default rule and is a one of the keys to the "private" and "public" decision-making processes in our society. The owner is the decisionmaker *as a matter of principle* towards the use of his goods.

For many objects of property, the impact of their use on others is rather limited. What I do with my toothbrush is really of no importance or interest for anyone. But for other objects of property, the autonomy of the owner translates into heteronomy for the non-owners. It is particularly the case for productive assets, such as a farm or a factory. The owner will determine who can work using the assets, i.e., who gets hired. He will set, as a matter of principle, the production process, the rules to follow to use the property and, indirectly, their consequences over the workforce, society at large and the natural environment.

Property is usually understood as a right of autonomy. In reality, in numerous cases, *this autonomy* of the owner translates into *heteronomy* for the non-owners. As a matter of principle, owners rule.[23] They set the mandatory rules to be abided by others when they use their property. It is particularly the case for productive assets. It is via property that it is possible to create formally "private" legal orders[24] which we call "enterprises", at the local, and now global level.[25]

As a governmental system, capitalism thus translates legally into a specific form of legal pluralism.[26] "Private" governmental structures operate enterprises and rule the activities of those falling under their jurisdiction. This is specifically the case for employees who, as sub-ordinates, see their activities ordered by the enterprises' hierarchies. Capitalism has been built on this prerogative conveyed by property. It has now evolved into financial capitalism with the advent and spreading of the business corporation as the main legal instrument used to concentrate productive assets. Most large productive assets are now owned by corporations, individuals owning only derivative rights (shares or claims against funds directly or indirectly owning shares) issued by corporations.[27] It is this evolution in the structuring of the ownership of property which is at the origins of most of the issues requiring a new capitalism through law.[28]

It is interesting to note how the ordering power of property was totally missed by *private law* lawyers trying to make sense of the development of large business firms as governmental organizations. With industrialization, the size and issues created by enterprises increased. In 1947, Paul Durand investigated the notion of "enterprise" from a juristic point of view. In his view, the absence of a legal concept of the business firm - the enterprise - came from the fact that the drafters of the Civil Code imagined that the legal relationships arising from economic life would be constructed by free and equal individuals based on contracts.[29] They only anticipated economic liberalism and not corporate capitalism. They did not, and could not, anticipate the future emergence of the large-scale business firm, which was built thanks to the business corporation, this "wonderful instrument of capitalism" in the words of Georges Ripert[30]. Durand's conclusion was that the advent of the firm made it difficult to analyze it within a legal framework that did not anticipate it. But in his analysis of the power relations within the firm, he was the victim of a simplistic understanding of property as a right over things. He did not realize that what is concentrated within firms - property - amounts to a concentration

22. See also Thomas W. Merrill, 'The Property Strategy', 160 *University of Pennsylvania Law Review* pp. 2061-2095 (2011-2012), p. 2069.

23. This is true on the "private side" of the Power System; on the "public side", owning property was a requisite to citizenship under most of the constitutions between 1791 and 1848. In all but 5 of the 57 years between 1791 and 1848, holders of property had greater political rights. William H. Sewell, *Work and Revolution in France – The language of labor from the old regime to 1848*, Cambridge: Cambridge University Press (1980), p.138.

24. Santi Romano, *L'ordinamento giuridico – Studi sul concetto, le fonti e i caratteri del diritto*, Pisa : Tipografia editrice Cav. Mariotti (1917), translated into *The Legal Order*, New York and London: Routledge (2017).

25. Jean-Philippe Robé,'Multinational Enterprises: The Constitution of a Pluralistic Legal Order', in *Global Law without a State*, pp. 45-77, G. Teubner (Ed.), Dartmouth (1997); 'Enterprises and the Constitution of the World Economy', in 2 International Corporate Law, pp.45-64, Fiona Macmillan (Ed.), Hart Publishing (2003); 'Conflicting Sovereignties in the World Wide Web of Contracts – Property Rights and the Globalization of the Power System', in *Soziologische Jurisprudenz, Festschrift für Gunther Teubner*, pp. 691-703, Graf-Peter Calliess, Andreas Fischer-Lescano, Dan Wielsch and Peer Zumbansen (Eds.), Berlin: De Gruyter Recht (2009); 'L'entreprise et la constitutionnalisation du système-monde de pouvoirs', in Baudoin Roger (Ed.), *L'entreprise, formes de la propriété et responsabilités sociales*, pp. 273-344, Paris : Editions Lethielleux/Collège des Bernardins (2012); 'Les entreprises multinationales, vecteurs d'un nouveau constitutionnalisme', 56 *Archives de Philosophie du Droit* pp. 337-361 (2013) ; *Le temps du monde de l'entreprise – Globalisation et mutation du système juridique*, Paris : Dalloz (2015); 'Globalization and constitutionalization of the world-power system' in Jean-Philippe Robé, Antoine Lyon-Caen and Stéphane Vernac (Eds.), *Multinationals and the Constitutionalization of the World Power System, with a Foreword from John Gerard Ruggie*, Routledge (2016).

26. Nikita Aliprantis,'L'entreprise en tant qu'ordre juridique', in *Le droit collectif du travail. Etudes en hommage à H. Sinay*, pp. 185, Nikita Aliprantis et F. Kessler (Ed.), Francfort : Peter Lang (1994). Jean-Philippe Robé, 'L'ordre juridique de l'entreprise', 25 *Droits* pp.163-177 (1997).

27. See generally Jean-Philippe Robé, 'The Legal Structure of the Firm', 1(1) *Accounting, Economics, and Law* (2011). https://doi.org/10.2202/2152-2820.1001.

28. See generally Jean-Philippe Robé, *Property, Power and Politics – Why We Need to Rethink the World Power System*, Bristol: Bristol University Press (2020).

29. Paul Durand,"Rapport sur la notion juridique d'entreprise », in 3 *Travaux de l'association Henri Capitant* pp. 45-60 (1947), p. 45.

30. Georges Ripert, *Les aspects juridiques du capitalisme moderne*, Paris, L.G.D.J. (1951), p. 109.

of rights of decision- and rulemaking towards the use of the objects of property. When searching for the origin of the power exercised by and within firms, Durand ruled out that property could play any role: "property, being a right in rem over things, cannot explain a commanding power over people".[31] Similarly, Michel Despax, analyzing the business firm as a "nascent legal person", wrote that one could not see how property, being a *right over things*, could explain the existence of a commanding power over people. He continued working with the illusion that the source of this power lies in the employment contract, while acknowledging without explaining it the inherent contradiction between a contract among equals and the subordination created.[32] As a consequence, these authors and many others trying to improve firm governance adopted the *theory of the institution* developed by Hauriou in public law. They treated the power of managers in firms as "inherent" to their role, the firm being understood as an "institution", a kind of *community*, a "collective" in need of leaders.[33] The leaders of these communities, of these groups of contracting parties having common interests, were then understood as overseeing the pursuit of the common good. Given the state of present-day capitalism, it is hardly necessary to insist on how these intellectual constructions are inadequate. They are merely legitimating corporate power by its "inherent" existence.[34] They ignore the fact that the power in the business firm does not emerge from the needs of a "community" and that, combined with *common interests* in the management of the enterprise, there are also *interests in conflict*.

In fact, it is the notion of modern property which is at the core of the institutional structure of our Power System (something one can call "capitalism"), including the power of and within enterprises.[35] The easiest way to perceive how this came about is by considering the legal structure of a workshop before and *after* the d'Allarde Decree and the Le Chapelier Statute of 1791. These texts are part of the Great Demarcation identified by Rafe Blaufarb.

In the Old Regime *arts et métiers* system, the master's productive capital (tools and equipment, raw materials, finished goods, etc.) were his individual property. But he could not use and dispose of them as he saw fit. Their use was subject to detailed regulation and discipline imposed by the relevant corporation. The ability to use these productive assets derived from the *mastership*, not from *property*. Property was necessary but insufficient to empower the owner to use these assets to produce and offer goods falling within the corporation's monopoly. A mastership was required, and it amounted to a share of the public authority granted to the corporation by the King.[36]

This radically changed in 1791. The d'Allarde Decree (March 2, 1791) abolished all the "maitrises et jurandes". The *Ancien Régime* corporations were abolished, and the authority of the *master* disappeared overnight. In our workshop, the *same* tools and equipment, raw materials, finished goods, etc. were still in place and operated by the *same* individuals. But the former master was now able to dispose of his property freely, without any of the restrictive rules of the corporation. And the former master's authority towards the workers now derived from the *ownership* of the means of production. With no duty to provide minimum salaries, decent working conditions, limited working hours, and so on. Of course, technically, employees now had *contracts* with their employer. But they had no *status*, no collective rights. Individual contractual bargaining was putting them in an inherently disfavored position.[37] Somehow, it was believed that free contracts among "equal" individuals would lead to an equilibrium. But this disregarded the *inequality* in property rights - in rights of decision-making as a matter of principle towards means of production.

The immediate effect of the disappearance of corporations was a serious erosion of wages. Certain Parisian workers imagined they were free to collectively organize themselves to get higher salaries by creating unions. They collectively agreed on the minimum pay they would ask their employers. A few weeks later, on June 14, 1791, Le Chapelier went up to the podium of the Assembly to denounce "a contravention of the constitutional principles which abolished corporations". The Le Chapelier report insists on the key political dimension of this forced individualism: "In the State, there is only the particular interest of each individual and the general interest. No one is permitted to inspire citizens with an intermediate interest, to separate them from the public good by a corporate interest.... It is up to individual-to-individual free

31. Id., p. 48. On the combined evolution of the notion of property under civil and constitutional French law, see François Luchaire, 'Les fondements constitutionnels du droit civil', *Revue trimestrielle de droit civil* pp. 245-382 (1982).

32. Michel Despax, *L'entreprise et le droit*, Paris : Librairie Générale de Droit et de Jurisprudence (1957), p. 226.

33. Paul Durand, 'Rapport sur la notion juridique d'entreprise', in 3 *Travaux de l'association Henri Capitant* pp. 45-60 (1947), p. 56.

34. But these views still have currency with the so-called 'doctrine de l'entreprise'. See Claude Champaud, *Manifeste pour la doctrine de l'entreprise – Sortir de la crise du financialisme*, Larcier (2011). Champaud perceives the enterprise as a "fundamental societal cell" (p. 91), "a team and equipment" (p. 102), or even "the enterprise is, in essence, a material community, certainly but also human, that is to say a united social and cultural community and not just an economic entity" (p. 136). It is a "socio-economic cell" (p. 158), "a place of collective life" (p. 159), a "societal community" (p. 150 and 288). The firm is a form of community, a smooth place without asperities, "a symbiotic community of human interests...a place of daily and collective life, of collaboration, of common interests and shared hopes...a community of men and women united by collective interests" (p. 224). And in the firm, "the CEO ... is able to synthesize and prioritize information, to foresee, to feel the wind before it has come. ... He is a thinker who acts, a man whose charisma is enough to secure power and reassure those around him. ... no science or management technique is foreign to him" (p. 162). For a critical review, see Jean-Philippe Robé, 'L'au-delà de la doctrine de l'entreprise', *Cahiers de droit de l'entreprise*, n°2, pp. 23-31 (2013).

35. On the notion of Power System, see generally Jean-Philippe Robé, *Property, Power and Politics – Why We Need to Rethink the World Power System*, Bristol: Bristol University Press (2020).

36. William H. Sewell, *Work and Revolution in France – The language of labor from the old regime to 1848*, Cambridge: Cambridge University Press (1980), p.117.

37. See also Rutger Claassen, 'Property and Political Power: Neo-Feudal Entanglements', in John Christman (ed.) *Positive Liberty: Past, Present, and Future*, Cambridge: Cambridge University Press (2021).

agreements to fix the wage for each worker".[38]

Article 1 of the Le Chapelier Statute proclaims this clearly: "The annihilation of all kinds of Corporations of the same status and profession being one of the fundamental bases of the French Constitution, it is forbidden to re-establish them under any pretext and in any form whatsoever." [Emphasis added]

And article 2 insists: "Citizens of the same status or profession, entrepreneurs, those who have open shops, workers and companions in any art whatsoever may not, when they find themselves together, appoint themselves either president, or secretaries, or trustees, hold registers, issue decrees or deliberations, form regulations on their alleged common interests."

Here again, we clearly see the effect of the Great Demarcation. In the post-revolutionary era, the economy is a purely contractual matter with no possibility to "form regulations on ... alleged common interests". The target is the corporatist pluralism of the Old Regime. The new society must be built by contracts among individuals, each armed with their freedom of contract. They were deemed to be equal in rights. And their inequality in property rights was in no way perceived as legal inequality. Still today, the intellectual laziness of understanding property as a right over things leads to serious mistakes in the analysis of the operation of the Power System by implicitly negating the legal inequality it is hiding.

Property, however, is not a right over things: it is a right of decision-making as a matter of principle in connection with things with mandatory effects upon the non-owners. It is a right making it possible for the owner to regulate the use of things without "deliberations". It is the concentration of such rights into large corporate organizations which has led to a new configuration of the Power System, to a new form of capitalism. But our understanding of its operation has not evolved accordingly. This is in great part due to our poor understanding of the role of property in a constitutional perspective.

The **constitutional dimension of property** is thus the most important one when considering the possibility of institutionalizing a new capitalism through law. Property is part and parcel of a specific Power System within which sovereign rights are allocated internally via the constitutional dimension of property. In this governmental system, owners are the decision makers as a matter of principle towards objects of property. The mandatory rules applying to them are only derogations to this principle. Today, however, property has been reconfigured at the global level via corporate structures (groups of corporations and value chains) which are being used as the legal backbone for the structuring of enterprises. This translates into a new World Power System which is unbalanced. Public and private prerogatives in connection with the uses of objects of property are, in fact, supposed to work together. Public rules (laws, regulations) come *as derogations* to the owner's principle of autonomy. But there must be some authority able to adopt these rules, these derogations to be able to *tame property*. The distinction made in classical jurisprudence between private and public law, between private and public prerogatives, between economics and politics, has led to a reification of the underlying social ontology as consisting of a "market" to be regulated by a "State".[39] But in a globalized economy, confronted with powerful "private" economic actors, there is no State; there is only a "States system" made of competing States. The difficulty of the time is a lack of understanding that global capitalism amounts to the self-institutionalization of a new global legal pluralism evading this dichotomy between "public" and "private". Modern property has been institutionalized as a right of autonomy, a component of the freedom of the *individual* (owner) against the world at large. But due to its concentration into large organizations via business corporations, it is now a major producer of *heteronomy* imposed on individuals, society, the State system, and the natural environment.

To understand the role of property in the Power System, one must draw the consequences from the fact that, in a modern constitutional system of government protecting property rights, there are two sets of interacting rules. One of the purposes of the Constitution is to define the operation of the branches of *public government*, usually via democratic institutions. This is the most traditional way of understanding what a "constitution" is. But the constitution also aims at protecting individual persons and minorities against potential governmental abuses.

There is therefore a set of constitutional rules defining fundamental rights; rights of autonomy initially designed to protect individual persons. These rights - freedom of thought, of movement, of religion, of association, the *right to property* and so on – are to some extent *out of the reach* of the *political institutions* created by the Constitution. One of the Constitution's purposes is to provide protection against unrestrained majorities obtaining control of the legislative and/or executive branches of government which otherwise would have minorities or individual persons at their mercy. Constitutions are conservative in this respect. They are written in such a way that even democratically elected *majorities* do not have total freedom to adopt any kind of legal or regulatory rules. In the rules they adopt, majorities must preserve the fundamental rights which are placed out of their reach. Courts, and Supreme Courts in particular, are here to ensure that such is the case. All democratic liberal constitutional States thus combine both democracy *and* distrust for democracy.[40]

38. See generally Alain Plessis (Éd.), *Naissance des libertés économiques - Le décret d'Allarde et la loi Le Chapelier*, Paris : Histoire Industrielle (1993).

39. See e.g., Rutger J. G. Claassen and Lisa Herzog, 'Making Power Explicit: Why Liberal Egalitarians Should Take (Economic) Power Seriously', 47(2) *Social Theory and Practice* pp. 221-246 (2021), p. 231.

40. John Hart Ely, *Democracy and Distrust. A Theory of Judicial Review*, Cambridge: Harvard University Press (1980). See also Léon Duguit, for who individuals' rights limit the State's sovereignty; *in* Léon Duguit, *Les transformations du droit public*,

In this way, *fundamental rights* are somehow placed out of the reach of the public political institutions. Individual persons benefit from a combination of freedoms and rights of autonomy allowing them to pursue their individual purposes. The key point regarding property rights in a constitutional perspective is that they provide the legal basis for *private governments* in connection with the use of the objects of property.[41] The introduction of modern property was an instrument to ensure individual autonomy, the ability to *govern* oneself and to make and implement one's personal choices. More appropriately, modern property has granted autonomy to *owners* to make use of their properties as they saw fit, without the constraints of a wealth of rules inherited from feudal and corporatist society. The heteronomy of property rule was still there for *non-owners*,[42] but they had the theoretical possibility of becoming owners and thence access to more autonomy. Whatever the merits of this construction, it has been grossly invalidated by the advent of the corporate economy. Gigantic organizations structured using business corporations now concentrate so much property, so many rights of autonomy into "private" world governments, that the whole liberal construction is in total disconnect with the realities of the existing World Power System.

Modern property rights lead to a very strange structure of the legal system, both domestically and internationally. As a right of autonomy, property leads to an ability of rulemaking in connection with the use of the object of property. Users of the object of property must abide by these rules made by owners. But because they derive from a right of autonomy, these rules are not incorporated into the legal hierarchy of norms and are not subject to review. They are binding and final for the users of property, with no possibility to challenge the use made of these *subjective* rights by the owner.[43] Because enforced constitutional rules protect property rights and property rights enable rulemaking, the rules created by owners are part of the constitutional *legal system* while *escaping* legal review, unless of course they are in breach of otherwise applicable rules applying as a matter of exception. Rules of the house, factory rules, students' rules,[44] corporate codes and so on are *law proper*, *mandatory*, and *enforceable* rules created by owners because of their constitutionally protected property right over the factory or the house or any other object of property imposing heteronomy on the users of property. At its roots, each constitutional legal system protecting property rights is *necessarily pluralistic*. Beyond the law of the State, the law in the law books, the official law, the law taught in law schools, there are myriads of small-scale legal orders creating law because of constitutionally protected rights of autonomy, including property rights. And this is "hard law". But these "private" legal orders are autonomous, thanks to the content and meaning of modern property which, in final analysis, was just the instrument of the substitution of one form of legal pluralism to another one.

With globalization, some of these legal orders have now succeeded at conquering their autonomy with regards to both national and international laws. It is their operations which lead to the emergence of a new World Power System in need of constitutionalization.[45]

Being part of the constitutional structuring of society, property must be thought about in conjunction with the way *legal persons* operate in the legal system.[46] The relationship between "property" and "persons" is so central that, in his opening discourse presenting the draft of the *Code civil* to the French *Conseil d'État*, his main drafter, Portalis, stated that "all laws either relate to persons or to property, and to property for the utility of persons".[47] But the persons then contemplated were *individuals*, physical persons. Modern business corporations, which now benefit from most of the legal prerogatives of *individuals*, have never been contemplated in the constitutional structuring of society. Business corporations were introduced into the legal system *subsequently*. And they are essentially treated as being private persons having the same prerogatives as individuals. The rights of decision-making as a matter of principle towards (large) concentrations of productive assets, however, are not the property of individuals anymore; they are the ones of corporations, of purely legal constructions, of artificial legal persons. Individual shareholders only have derivative rights. Of course, one easy way out of this serious issue is to consider that corporations are merely associations of individual persons, as the US Supreme Court does, for example.[48] But this goes against all the modern corporate law practice and jurisprudence. This is so much the case that, in the words of Margaret Blair, "this raises questions about the Court's understanding of what corporations are"[49]. In-

Paris: Hachette Livre (1913 edition), p. 27. See also Jacques Chevallier, *L'État de droit*, Revue de Droit Public pp. 313-380 (1988), p. 365 and Stéphane Rials, *La déclaration des droits de l'homme et du citoyen (présentée par)*, Paris : Hachette (1988), p. 373.

41. See generally Larissa Katz, 'The Regulative Function of Property Rights', 8(3) *Econ Journal Watch* pp. 236-246 (2011), 'Governing Through Owners: How and Why Formal Private Property Rights Enhance State Power', 160 *University of Pennsylvania Law Review* pp. 2029-2059 (2012), 'Property's Sovereignty', 18 *Theoretical Inquiries in Law* pp. 299-328 (2017).

42. See in this issue Hanoch Dagan, 'Liberal Property and Just Markets, 4 *Revue européenne du droit* pp. 157-161 (2022).

43. Morris R. Cohen, 'Property and Sovereignty', 13 *Cornell Law Quarterly* pp. 8-30 (1927), Robert L. Hale, 'Coercion and Distribution in a Supposedly Non-Coercive State', 38(3) *Political Science Review* pp. 470-494 (1923), and 'Force and the State: A Comparison of "Political" and "Economic" Compulsion', 35 *Columbia Law Review* pp. 149-201 (1935).

44. Simon Whittaker, 'Public and Private Law-Making: Subordinate Legislation, Contracts and the Status of "Student Rules"', 21(1) *Oxford Journal of Legal Studies* pp. 103-128 (2001).

45. Jean-Philippe Robé, 'Multinational Enterprises: The Constitution of a Pluralistic Legal Order', in *Global Law Without a State*, pp. 45-77, Gunther Teubner (Ed.), Dartmouth (1997).

46. See generally Meir Dan-Cohen, *Rights, Persons and Organizations: a Legal Theory for Bureaucratic Society*, Berkeley: University of California Press (1986).

47. In François Ewald (Ed.), *Naissance du Code civil*, Paris : Flammarion (1989), p. 48.

48. As done by the US Supreme Court in the *Citizens United* (558 U.S. 310 (2010)) and *Hobby Lobby* (573 U.S. 682 (2014)) decisions.

49. See e.g., Margaret M. Blair, 'Of Corporations, Courts, Personhood, and Morality', 25(4) *Business Ethics Quarterly* pp. 415-431 (2015), p. 422.

deed. The US Supreme Court's position is in total contradiction with the effective operation of modern corporate law,[50] modern corporations being in no way associations of individuals. But there are veils some manifestly prefer not to lift... And the US Supreme Court is not alone in its reluctance to address the difficult constitutional issue raised by the existence of the "private" power of business firms. Accordingly, the most significant productive assets are managed by world private governments without any of the constitutional constraints which would be imposed by a world State. These private governments fully benefit from fundamental rights initially designed for individuals only. And at the same time, the ability of State governments to adopt laws to limit the damaging uses of property is being eroded by globalization.

Two strands of thought have developed to try circumscribing this issue: Stakeholder Theory,[51] whose proponents attempt to improve the position of stakeholders in the decision-making processes of the firm. The other is Corporate Social Responsibility (CSR).[52] Its promoters attempt at improving the realization by enterprises that they have an impact over society and the natural environment and that it creates a duty for them to act responsibly.

Both these developments rightly point at the major governmental issue we face. But they are way below what is required to address it. They try to cure the symptoms but do not address the disease. The reason for this is simple: corporate property rights are secured via formal, hard, constitutional law, whilst corporate duties towards stakeholders or society or the environment are expressed in soft and unenforceable terms.[53]

The concentration of property rights via corporate vehicles may very well be legitimated for utility reasons. But as a right of autonomy, these property rights do not deserve the same respect as a right of autonomy designed for *individuals*.[54] The chink in the armor of corporate property rights is precisely the fact that these rights were originally given constitutional status for *individuals* only. In the context of corporate power and of its control, it is perfectly admissible to make them lose their *subjective* dimension and give them the objective dimension of what they are: sources of power.[55] The strong autonomy provided by property still makes sense when we are dealing with individual property. But since property has become concentrated thanks to the introduction of limited liability corporations into the liberal legal system, we changed system and moved to a capitalist society. It is a capitalism in which prerogatives originally designed to ensure the autonomy of *individuals* have been converted into prerogatives *subjecting* individuals to the heteronomy of "private" organizations. Property in this context may very well take on a more objective dimension and be subjected to norms circumscribing the use which can be made of it.

Several strands of thought present themselves to address this issue at its root.

The first one is the notion of *constitutionalization*. To develop a new capitalism through law, a hint is offered by article 16 of the 1789 Declaration of the Rights of Man and Citizen: "Any society in which the guarantee of rights is not assured, nor the separation of powers determined, has no Constitution."[56]

The constitution is not merely an instrument regulating the State's activity. A proper constitution must be a constitution of "any society".

Today's society is global in many respects, and certainly with regards to the economy. A Global State, however – and a global constitution – are nowhere in sight, and probably for the best. Remains the possibility to think about alternative forms of constitutionalism, at the level of the firms themselves. Constitutionalization would then appear as a welcome evolution in all the organizations exercising power, whether formally "private" or not. In this perspective, the *constitutionalizing process* would be extended to the *legal pluralism* of legal orders deemed to be "private" but which in fact have a mixed nature.[57] The new constitutional question would then be clear: how can we subject firms to constitutional norms, making sure that they do perform their activities in compliance with the common interests of those affected, addressing fairly the interests in conflict, while preserving the rights of the individuals and environments involved?[58] How is it possible in this new context to *assure the guarantee of rights* and a relevant and effective *separation of powers*?

This approach must be differentiated from the avant-garde sociological theory of "societal constitutionalism". It treats constitutions as being merely State-centered "political constitutions" which are deemed to be

50. *Id.*

51. See R. Edward Freeman, *Strategic management: A stakeholder approach*, Cambridge: Cambridge University Press (1984) and the subsequent literature.

52. See, for example, Reuven Avi-Yonah, 'The Cyclical Transformation of the Corporate Form: A Historical Perspective on Corporate Social Responsibility', 30 *Delaware Journal of Corporate Law* pp. 767 (2005).

53. A. Claire Cutler, 'Legal Pluralism and the "Common Sense" of Transnational Capitalism', 3(4) *Oñati Socio-Legal Studies* pp. 719-740 (2013), p. 730.

54. On this issue, see generally Meir Dan-Cohen, *Rights, Persons and Organizations: a Legal Theory for Bureaucratic Society*, Berkeley: University of California Press (1986).

55. See generally Emmanuel Gaillard, *Le pouvoir en droit privé*, Paris : Masson (1985).

56. "*Toute société dans laquelle la garantie des droits n'est pas assurée ni la séparation des pouvoirs déterminée, n'a point de Constitution.*"

57. See also Benoît Frydman, looking for "the possibility to build a kind of decentralized and necessarily pluralistic global public order". E.g. Benoît Frydman, 'Rapport de synthèse : la fragilisation de l'ordre public économique et le contrôle des acteurs privés dans un environnement globalisé', Revue Internationale de droit économique pp. 123-130 (2019), p. 128. See also Gérard Farjat, 'Le droit, l'économie et le fondamental', 19(4) *Revue international de droit économique* pp. 431-455 (2005), p.447.

58. Jean-Philippe Robé, Antoine Lyon-Caen & Stéphane Vernac (eds.), *Multinationals and the Constitutionalization of the World Power System*, with a Foreword from John Gerard Ruggie, Routledge (2017). This is not a fantasy. The CEO of a global enterprise (Veolia) considers that the constitutionalization of firms' governments would be an appropriate evolution; see Antoine Frérot, 'Inviter toutes les parties prenantes à la gouvernance', *Le Monde*, 17 juin 2013.

"limited to the political system".[59] This is accurate if one understands property rights as being part of the political rights guaranteed by the "political" constitution. But this is not the position of the proponents of societal constitutionalism who consider that there is "a multiplicity of societal constitutions, which are neither wholly public nor private [and] emerge in the various spheres, into which contemporary society is differentiated: economy, science, technology, media, medicine, instructions, transports etc."[60] These "societal constitutions" are treated as radically autonomous from "political constitutions".

World Power System analysis and societal constitutionalism clearly have a lot in common.[61] But with regards to the institutions of capitalism, considering that there is, on the one hand a "political constitution" and on the other "a constitution of the economy" is a restrictive view of modern liberal constitutions as they are effectively operating.[62] The ruling power of property owners, now concentrated into large world "private" organizations, has its roots in the provisions of the so-called "political constitution".

The second strand of thought is linked to, but goes beyond, constitutionalism. It suggests going as far as democratizing firms, proposing in particular the insertion of bicameralism to represent both labor and capital in firms' government.

It certainly provides food for thought on the possibility to develop a new capitalism through law.[63] The challenge here is to identify the right equilibrium between more democratic government and the necessary constraints imposed by utility considerations.

A third path is the possibility of granting *legal personality* to global firms under international law. It would facilitate making them accountable for their actions at the global level, being understood that the groups of corporations and firms as such do not have legal personality under domestic laws and that, for a wealth of reasons, granting them legal personality under such laws is virtually impossible.[64]

Finally, *accounting rules* can be improved to integrate the cost of externalities in the measurement of the performance of the firm.[65] These rules, leading to the identification and measure of the costs imposed by the accounting entity over society and the natural environment could clearly be connected to the constitutionalization (and, possibly, democratization) duty. The integration of externalities via improved accounting mechanisms should logically lead to increased stakeholder participation.[66]

In conclusion, a proper understanding of the constitutional role of modern property and of its restructuring via corporate law leads to numerous fruitful strands of thought. A new capitalism through law could surge from them.

59. Angelo Golia Jr. and Gunther Teubner, *Societal Constitutionalism: Background, Theory, Debates*, Max Planck Institute for Comparative Public Law and International Law (MPIL) Research Paper No. 2021-08, pp. 7-43 (2021), p. 19.

60. Angelo Golia Jr. and Gunther Teubner, *Societal Constitutionalism: Background, Theory, Debates*, Max Planck Institute for Comparative Public Law and International Law (MPIL) Research Paper No. 2021-08, pp. 7-43 (2021), p. 19.

61. Larry Cata Backer, 'The concept of constitutionalization of the multi-corporate enterprise – From body corporate to sovereign enterprise', in Jean-Philippe Robé, Antoine Lyon-Caen & Stéphane Vernac (eds.), *Multinationals and the Constitutionalization of the World Power System*, pp. 170-189, with a Foreword from John Gerard Ruggie, London and New York: Routledge (2017).

62. See also David Kennedy, 'The Mystery of Global Governance', 34 *Ohio Northern University Law Review* pp. 827-860 (2008), p. 854.

63. See Isabelle Ferreras, *Firms as Political Entities – Saving Democracy through Economic Bicameralism*, Cambridge: Cambridge University Press (2017) and Hélène Landemore & Isabelle Ferreras, 'In Defense of Workplace Democracy: Towards a Justification of the Firm-State Analogy', *Political Theory* pp. 1-29 (2015). See also Hanoch Dagan, 'Liberal Property and Just Markets', 3 *Revue européenne du droit* pp. 157-161 (2022).

64. See generally Régis Bismuth, « La responsabilité (limitée) de l'entreprise multinationale et son organisation juridique interne – quelques réflexions autour d'un accident de l'histoire » in *L'entreprise mutltinationale et le droit International*, SFDI, pp. 429-447, Paris : Pédone (2019).

65. See generally Richard Barker & Colin Mayer, 'How Should a "Sustainable Corporation" Account for Natural Capital?' Saïd Business School Research Papers, RP-15 (2017).

66. Jean-Philippe Robé, 'The Shareholder Value Mess (and How to Clean It Up)', *Accounting, Economics, and Law: A Convivium* | Volume 10: Issue 3, pp. 1-27 (2019).

Philippe Aghion • Professor of economics,
College de France

A Better Regulated Capitalism

The last two years have been marked by an extremely dense literature inviting us to reinvent or rethink capitalism and, more broadly, our social models. What do you think the current crisis says about our economy and our social model?

Covid-19 has pointed to a number of existing dysfunctions that affect capitalism as it is practised around the world. In particular, the crisis has highlighted the failure of the US social model to protect the most vulnerable of its members. Many Americans lost their jobs as a result of the pandemic, lost their health insurance at a critical time and fell into poverty. In Europe, and in France in particular, the pandemic highlighted a cruel innovation deficit: the country of Pasteur, François Jacob and messenger-RNA proved unable to produce a vaccine against Covid-19, the only way out of the crisis, and the vulnerability of an economy that had gone too far in delocalising its value chains, including in strategic sectors such as health. In China, Covid-19 showed the limits of a capitalism without freedom of expression, where the withholding of information and self-censorship delayed awareness of the danger of the new virus, which greatly contributed to its proliferation. These limits have thus brutally reminded us of the need to define the features of a more innovative, protective and inclusive policy by combining the strengths of American and European capitalism without accepting the necessity of a dichotomy.

Is capitalism under threat today?

Capitalism is facing an identity crisis like it has never experienced before. No one can deny that capitalism, especially when unregulated, has several negative consequences: it exacerbates inequality and allows the strongest to inhibit the weak; it can lead to fragmented societies and a loss of a sense of community; it makes work more precarious, increasing stress and deteriorating the health of individuals; it allows incumbent companies to prevent the entry of new innovative companies through lobbying; it aggravates global warming and environmental deterioration; it causes financial crises which then generate major recessions such as those of 1929 and 2008.

However, getting rid of capitalism is not the solution. In the last century, we have experienced an alternative system of central planning in the Soviet Union and the communist countries of Central and Eastern Europe. This system did not allow these countries to move beyond an intermediate level of development because it did not provide the freedom and economic incentives for individuals to push the frontiers of innovation. We have also recently experimented with degrowth, but do we really want to sustain the way of life that was ours during the first lock-down? Capitalism is a spirited horse: it can easily run away, out of control. But if you hold the reins firmly, it goes where you want it to. Despite favourable developments, the United States is still far from a system that protects individuals against the risks of job loss or illness, against macroeconomic shocks such as the 2008 or Covid-19 crisis, or against climate risk. As for the European countries, they have not yet been able to create the ecosystem – universities, institutional investors, venture capitalists, patrons, DARPA – that would allow them to be initiators and not followers in the technological revolutions to come, and they are in great danger of being overtaken by China. I believe in the convergence of these models rather than in the overcoming of the capitalist system.

Faced with the 'rise in inequality', the 'concentration of rents', the 'casualisation of work' and the 'deterioration of health and the environment', you call in your latest book[1] for a better regulation of capitalism in order to direct creative destruction towards the objective of fairer and greener growth. What would be the essential features of this?

We must seek to better regulate capitalism rather than trying to overcome it at all costs. Creative destruction, which is its driving force, has enabled a considerable growth in our living standards since the first industrial revolution. Our main challenge today is to better understand the drivers of this power and then to direct it towards the goal of greener and fairer growth: new innovations are constantly occurring and rendering existing technologies obsolete, new businesses are constantly competing with existing businesses, and new jobs and activities are being created and are constantly replacing existing jobs and activities. On the one hand, there is a need to *protect*: to support viable companies in order to save jobs and preserve accumulated human capital, but on the other hand, there is a need to *reallocate* resources, in order to encourage the entry of new companies and new activities, either more efficient or more responsive to consumers' needs.

The state, business and civil society form an essential triangle to accompany, rather than halt, the process of creative destruction.

1. P. Aghion, C. Antonin and S. Bunel, *The Power of Creative Destruction*, Harvard University Press, 2021 (originally 2020).

State intervention is essential to redirect technical change towards green innovation, and thus avoid an environmental disaster: without substituting itself to private firms, it must act on affecting the latter's incentives. In the absence of state intervention, companies will spontaneously choose to innovate in polluting technologies and will do so more and more intensively over time because of the path dependency effect. A recent study[2] showed that car companies that innovated in combustion engines in the past tend to innovate in combustion engines in the future, to the detriment of green innovation. The consequence will be an increase in pollution, and an acceleration of global warming. The introduction of a carbon tax or a subsidy for green innovation has the effect of making the change of technology less costly and redirecting the innovative forces of car companies towards electric engines. But the state cannot be the only actor in the ecological transition. There are limits to what the state can achieve on its own, as Roland Bénabou and Jean Tirole explain.[3] On the one hand, governments are often exposed to lobbying by different interest groups. On the other hand, global warming is a global problem, over which the government of a particular country has little control.

Civil society may also be able to play a role, and in particular consumers, who appear to be increasingly willing to integrate social and environmental considerations into their product choices. Indeed, consumers have the power to greatly influence the choices of firms.[4] For example, in countries where consumers express genuine concern for the environment, increased competition in the automotive market is leading companies to innovate more in green technologies, such as electric engines. The idea here is intuitive: Since competition leads firms to innovate more to improve their price-performance ratio and escape competition from rival firms, in an economy where consumers value the environment and innovation is oriented, increased competition leads firms to innovate to lower the ratio between the price and the environmental cost of the product, ie to innovate in the discovery of new, greener products to escape competition. Conversely, in an economy where consumers are more concerned about the price of goods than their environmental cost, increased competition will not encourage green innovation and will exacerbate the environmental problem. This is the 'China Syndrome': increased competition lowers prices and increases consumer demand; production increases and so does pollution.

You also see civil society as playing an important role in the implementation of an 'incomplete contract'.

Constitutions are 'incomplete contracts', there is no guarantee in reality that these instruments will actually be implemented or activated. The role of civil society is to give substance to traditional checks and balances and to move executive control from the notional to the actual. As Bowles and Carlin have shown,[5] civil society has been the necessary complement to the 'state-market' pairing to stem the pandemic. The decisive role of the market and competition in encouraging the discovery of new treatments and vaccines, the irreplaceable role of the state in managing the health crisis in the short term, particularly through the 'whatever it takes' approach, and in enabling the economy to recover in the medium term, must not overshadow the role of civil society as the third - and indispensable - pillar of an exit strategy from the epidemic. Korea's good performance during the epidemic owes much to the self-discipline and civic spirit that prevailed in that country and that made it possible to implement social distancing measures and care for infected individuals very early on, without relying solely on the power of the state and on coercion.

The mobilisation of civil society thus continues to move the capitalist system towards a better regulated, more inclusive and protective, and more environmentally friendly system.

What seems to undermine the cohesion of civil society today is inequality. Traditionally, it is considered that fiscal policy is the tool of choice for the redistribution of wealth, so that all stakeholders benefit from the economic system. Would you say that tax policy is still the main instrument for reducing inequality today?

The fiscal tool is certainly essential to stimulate growth and make it more inclusive: both because it allows the state to invest in the levers of growth such as education, health, research and infrastructure; and because it allows the state to redistribute wealth and insure against individual (job losses, illness, deskilling) or macroeconomic (wars, financial crises, pandemics) risks.

However, taxation is an essential lever but should not be considered as the only lever for making growth fairer. Innovation is certainly a source of inequality 'at the top' of the income distribution, but the innovative company is a formidable lever for social mobility insofar as it enables its employees, particularly the least qualified, to be trained and promoted. A recent study[6] based on British data for the period 2004-2015 showed that at any age, the salary of a low-skilled individual is substantially higher if he or she is employed by an innovative firm than if he or she is employed in a less innovative firm. It can also be seen that wages increase significantly with age in an innovative firm. The State can in turn stimulate social mobility by encouraging innovative companies to create sustainable and qualified jobs, ie

2. P. Aghion, A. Dechezleprêtre, D. Hémous, R. Martin, J. Van Reenen, 'Carbon taxes, path dependency and directed technical change: Evidence from the auto industry' *Journal of Political Economy*, 2016, 124 (1) p. 1-51.
3. R. Bénabou, J. Tirole, 'Individual and corporate social responsibility', Economica, 2010, 77 (305), pp. 1-19.
4. P. Aghion, R. Bénabou, R. Martin and A. Roulet, 'Environmental preferences and technological choices: Is market competition clean or dirty?', *NBER Working Papers*, April 2020, No. 26921.
5. S. Bowles and W. Carlin, 'The coming battle for the COVID-19 narrative', *Voxeu*, 10 April 2020.
6. P. Aghion, A. Bergeaud, R. Blundell and R. Griffith, 'The innovation premium to soft skills in low-skilled occupations', *mimeo*, Collège de France, 2019

good jobs, and to really invest in the professional training of their employees, in particular the less qualified.

The calls for the development of a new industrial policy is becoming increasingly strong in Europe. Should European competition policy be reviewed to meet these new ambitions?

Competition and industrial policy are not necessarily mutually exclusive. In the aftermath of the Second World War, national champions were the spearhead of industrial policy in many countries. This was the case in France, where industrial policy was a pillar of the reconstruction and growth that characterised the *Trente Glorieuses*. In the United States, it proved to be a determining factor, particularly in the fields of defence, aeronautics and aerospace, in gaining supremacy over the Soviet Union. Although the various sources of state inefficiency – linked to information asymmetries or the possibility of collusion between the state and certain private actors – have led to a decline in industrial policy, they do not disqualify it.

Beyond horizontal policies, intended to stimulate innovation and growth in all sectors of the economy (via investments in the knowledge economy, vocational training, or reforms of the goods and labour markets), a vertical industrial policy can be justified by certain rigidities, such as the weight of habits or the high cost of change (ie, path dependency).

State intervention can also solve coordination problems and accelerate the entry of new actors into strategic sectors when such entry requires significant costs. This is precisely the reason for the success of state intervention in the aeronautics sector (Boeing, Airbus) where fixed costs are high and demand uncertain, or the Defense Advanced Research Projects Agency set up in the United States in 1958 to facilitate the transition from fundamental research to applications and marketing for breakthrough innovations (Internet, GPS, etc.).

These state interventions, which are necessarily limited in number, must focus on the economic and social priorities that dictate government choices (energy transition, health, defence) in competitive sectors with high added value. Industrial policy therefore retains a role, provided that it is compatible with competition and, more generally, with growth through innovation.

Beyond the case of industrial policy, do you think that competition law needs to be more widely reformed to take into account the new characteristics of our economies?

While affirming the need for a strong competition policy in Europe, as led by Commissioner Vestager, it is indeed necessary today to review our competition standards. Our policy has remained too focused on the concepts of 'market definition' and 'market shares' and on a set of standards of proof that are too rigid. We need to encourage a shift from an overly passive and static view of competition to a more dynamic view that encourages innovation and large-scale industrial projects. Measures of competitive intensity need to be reviewed. Highly concentrated sectors, in which only one company operates, are nevertheless highly competitive insofar as they have contestable markets, insofar as any new supplier would be able to enter freely or to leave at no additional cost: in these markets, any price increase by the incumbent company would immediately provoke the entry of another company producing the same product. The much-maligned Alstom Siemens decision should be a wake-up call on these issues.

The work on the *Digital Markets Act* also shows the challenges raised by the digital economy and the so-called structuring power of a number of digital platforms which, because of their size, are able to significantly limit the ability of users to carry out an economic activity or communicate online. The first criterion must be whether or not a player prevents the entry of a new player into the market and therefore prevents innovation. By their nature, some segments of the economy may host fewer firms than others, hence the need for a segmented analysis incorporating the notion of vertical integration.

Olivier Blanchard • Solow Professor Emeritus at the MIT, Former Chief Economist of the IMF

Hélène Rey • Lord Bagri Professor of Economics at London Business School

Joseph Stiglitz • Professor at Columbia University, 2001 recipient of the Nobel Memorial Prize in Economic Sciences and Former Chief Economist at The World Bank.

Jean Tirole • Honorary President of Toulouse School of Economics, 2014 recipient of the Nobel Memorial Prize in Economic Sciences

Maarten Verwey • DG for Economic and Financial Affairs at the European Commission

Forging a New Economic System [1]

Olivier Blanchard: While preparing the report on 'The major future economic challenges', commissioned by the French President and published in June 2021,[2] we were asked to think about major future challenges, and we chose three. We left out COVID because we started working before the pandemic, and even afterwards we were not sure how to assess how it should be handled. So, we chose to work on climate change, economic inequality, and demographic change.

I will quickly cover some of the conclusions of the report. Climate change is an existential challenge, which has to be thought of as a war. It is maybe not surprising that the conclusion of the panel is that it needs to be fought on many fronts. There are many issues around green R&D, and at this stage we do not have the technology that would allow us to win the war on climate change. We will need standards; we will need bans. But the point I want to insist on is that we are going to need carbon pricing done well. The reason is that this is the only way to minimize the costs of responsible action, which will be high. Without a yardstick like a carbon price, many decisions lowering the carbon footprint will be very costly for the decision-maker, when they shouldn't be.

There are billions of decisions that need to be made both by consumers – whether to buy an electric car or not for example – and people in the R&D process, by firms, and by governments in terms of what to ban or not. In the absence of a yardstick, the cost of fighting the war against climate change will be gigantic. We have examples in the report that show for example that the cost of saving 1 ton of CO_2 can vary from €30 to €1,000 or more. While we insist on adopting a universal carbon price system, it is only a part of the set of measures which needs to be taken, and it raises the issue of the distribution of losses. The essence of a carbon price is that it is regressive. The share of the budget for energy in low budget households is larger, and we have to take this into account. For this reason, we tried to think about compensation schemes which would need to be put in place. States shouldn't enact a carbon pricing system and then think about compensation, but should address both concerns at the same time: when a carbon pricing system is proposed, it should be accompanied by a compensation scheme good enough to convince a sufficient portion of citizens that carbon pricing should be enacted.

I insist on this because the Biden administration, for example, has decided not to have a carbon price in its infrastructure program, and I think they are very scared of the opposition to it. That seems like the wrong way to go: carbon pricing is actually necessary. The same is true of the French President, who must also decide to accept the recommendations issued in Brussels on this issue.

The second topic we took on is economic inequality, which is not as bad in France as it is in the US, by a long shot. This being said, we conducted a survey and it is clear that inequality is very high on the list of what people worry about in France, and when pressed to share the things they dislike, the lack of access to good jobs and careers appears to be the biggest concern. We decided to focus on access to good jobs and careers, as well as other dimensions of economic inequality. Here you need a holistic approach, and we followed something that Dani Rodrik had put in place, namely to think about this issue in three dimensions: you can intervene pre-production (equalize chances as much as possible), post-production (redistribute to compensate at least partially the losers), or during production (changing the process in some way). Much of the current discussion surrounds post-production (redistribution), so we focused on the other two.

In terms of pre-production stage measures, there are two relevant dimensions. One is obviously education, and the other is financial. On the education front, France–along with many other countries–has very unequal education. The good news, though, is that if governments are willing to spend money, they can decrease inequality and France has been active on this front in the recent past, with good results. The policy will be very costly, but we think that it is essential, and nearly non-controversial.

What was more controversial was the agreement in the commission that we need to think about the inheritance

1. This article is an edited version of the transcript of a conversation between Olivier Blanchard, Joseph Stiglitz, Hélène Rey, Maarten Verwey and Jean Tirole at a GEG Weekly Seminar organized by *Groupe d'études géopolitiques* on September 23, 2021 and moderated by Sébastien Lumet.

2. In January 2020, the French President Emmanuel Macron asked Olivier Blanchard and Jean Tirole to chair a commission of renowned international experts, supported by France Stratégie, to address the major future economic challenges, granting them free rein in choosing the commission's members and full independence in stating the panel's conclusions. The report was submitted in June 2021, and can be consulted online (see in English, https://www.strategie.gouv.fr/english-articles/major-future-economic-challenges-olivier-blanchard-and-jean-tirole). For a synthesis of the report written by Olivier Blanchard and Jean Tirole for *Le Grand Continent*, see in English https://geopolitique.eu/en/2021/09/13/forging-an-economy-for-tomorrow/.

tax. Much inequality across generations goes through the channel of inheritance. It seemed to us that, rather than thinking of inheritance tax as a way of taxing the rich –which is the typical idea–we should think of it as a transfer program from rich kids to poor kids. When one thinks of it this way, one is led to design the system rather differently than it currently is. First, one can focus on the beneficiaries – the kids – and not on people who contribute. Second, one no longer focuses on what a parent gives when they die, but rather on what kids receive throughout their life, all the donations along the way. Third, as can be imagined, the inheritance tax is very unpopular. People want to be able to give something to their kids so there needs to be a fairly high threshold. We have suggested that this is a discussion that has to take place: it is rather unpopular, but absolutely necessary.

Concerning production-stage policies, the question is whether one can increase good jobs and access to good jobs beyond education and beyond professional training. Can firms be incentivized to help and create more good jobs and give better careers, in particular to low skilled people? We didn't come up with solutions in this matter but pointed to possibilities and questions. Can we create incentives, such as financial incentives to promote and keep people? A question we dealt with, but which does not have a good answer, is whether one can also bend technological progress and subsidize R&D to create new technologies that complement rather than substitute for human skills. The question is clear, but the answer is difficult, and we are not ready to make a policy recommendation yet.

On demographic change, some issues are common. With the increase in life expectancy – which is the major demographic change in France and many other countries – you need an increase in the retirement age. This is arithmetic. But there is a choice: you can increase retirement age and keep benefits the same, or some combination of both raising the retirement age less and lowering benefits compared to what they would be otherwise. We think that this should be subject to democratic decision-making. One of the problems in France is that it is a very mechanical decision, and not a clear one, and people feel that technocrats are deciding for them.

The other point is holistic. If the age of retirement is increased, but nothing is done to increase both the supply and the demand for senior workers, then people will want to continue to retire early and there will tend to be tremendous political opposition to the reform. There are all sorts of measures on the supply side and the demand side which can be taken. Dealing with chronic illnesses is a very important issue on the supply side. On the demand side, pushing or allowing firms to be more flexible are good ways to go. But one needs to do all three: increase supply, increase demand, and then only increase the retirement age.

Joseph Stiglitz: Regarding climate change, I agree strongly that there needs to be a comprehensive approach which includes regulations, but I would have emphasized more public investments like public transportations systems, or public investment in R&D. We have managed to lower the cost of renewable energy enormously with little encouragement from the government, and we could have done even better with more of it.

I also note a theme that is also relevant for the second point of economic inequalities. I believe there is a lot of room for steering innovation. So much innovation is directed at replacing labor when we already have too high of an unemployment rate among unskilled labor. And too little innovation is directed at saving the planet. One of the advantages of a carbon pricing system is that it encourages more green innovation.

I do think we have underemphasized the importance of regulations. Regulations are a nonlinear price system, and they can have low burdens while being very effective. A simple regulation is to ban all coal-fired power plants. It's not hard to administer or write down and if we had had that regulation 10-20 years ago, we would be in better shape today.

I think that economists using overly simple models invoke what you might call the Pigou theorem: that market failures are associated with a gap between marginal social benefits and marginal private benefits, and marginal social cost and marginal private cost, and that an incentivized intervention can get you to a first best allocation. But in the presence of other market failures, like an incomplete set of risk markets, imperfect and asymmetric information, and distributive consequences which cannot be fully undone, a single price intervention is not, in general, optimal. One wants to use a broad array of instruments including nonlinear prices and regulations. So, I agree with what Mr. Blanchard is saying, but I want to put a little more emphasis on regulations. The broader point is that if we have good public investment and good regulations, the price of carbon that we need to get to will be much lower. Therefore, the adverse distributive effects may be more easily managed. We need to think carefully about these types of packages including thinking about distributive consequences so you don't have the kinds of problems France had with the Yellow Vests.

I would like to highlight the long history of tax avoidance on either inheritance or request taxes, and the importance of including lifetime donations– in the States we call it a lifetime tax. But by doing that, the tax system becomes more difficult to administer and in terms of transferring money to help with education, very hard to monitor. We should be aware of abilities to avoid and evade these taxes, and that means there is a need to complement that with very strong progressive wealth and capital gains taxes.

We should recognize that the first step is finding the holes we have in our existing inheritance taxes. If this could be done in the U.S. and most other countries, there would be less inequality. There are particular gaps, especially in the U.S., that we have in the step-up basis at death; for instance, the basis of the capital gains when you subsequently sell it is higher.

The other thing I would like to highlight is that education is very important to prevent inherited inequalities of opportunity. But getting equal access to education is really hard and we don't put enough effort into it. In the U.S. right now, there is a big effort at the kindergarten level, reflecting the realization that inequality starts before kids get to school. It will take a great effort to get true equality of educational opportunity.

The final two remarks I would like to make focus on sources of inequality. This may be a very American view, but a big source of inequality is corporate market power – the exploitation of consumers – on the one hand, and on the other hand a lack of worker market power which results in wages being lower than they should be. We need better worker protection and better antitrust laws. I view those as an important ingredient that I didn't see emphasized in the report. I also think there is lots of potential for steering innovation in ways that will lead to better distribution of income.

On the issue of demographic change, one of the concerns of those of us who have been trying to get a more progressive retirement program concerns the distinction between blue collar workers and white-collar workers. The problem lies in the fact that for blue-collar workers, life expectancy at 65 is not as great as that of a white-collar worker. The question then is what is an equitable system and how do we implement it? We have an intuitive grasp of what the scope of the notions of blue- and white-collar workers: one involves people who do Zoom and the other involves people who work physically, with a high toll on their life expectancy. So, when it comes to the age of 65, there are indeed very big differences! I do not know a good way to implement a fair system that reflects these differences, but I do think it is important to embrace progressivity and I like the idea of partially indexing on wages and not prices. The U.S. social security system is partially indexed on wages, it has elements of both. People have to adjust to changes in prices, but their relative position will be affected by how wages are changing, so both elements should appear in indexing.

Hélène Rey: On the climate part, both Olivier and Joseph embrace the idea of carbon pricing and emphasize the need to compensate the losers, and the need for green R&D, as well as complementary measures such as bans and regulations. I agree with all these proposals. But I would like to point out that our profession has not been very good in the past at thinking about implementation, and in particular about the functioning of such compensation schemes. If we go back to the consensus on international trade – economists have more or less embraced the idea of free trade – we have put forward arguments on efficiency and the need to compensate the losers of free trade, but not such scheme was implemented. There is a clear danger that something similar would happen with carbon pricing, because the scheme is regressive: we need to think about the necessary complementary policies, and make them really work this time.

Regarding the compensation of losers, there are three big issues. First, redistribution is actually quite hard. Think about coal miners, a category of workers which will be hurt; think about low-income households: they have high energy share in consumption, relatively inelastic demand, and their real income is affected directly by carbon price increase. But there are also some possible important equilibrium effects. Low-income households tend to work in more cyclical sectors which tend to be more affected by carbon pricing via lower demand, and so their income will decline as a result of this equilibrium effect. Their employment, their income will be affected, and these effects could be quite large. Redistribution policy would have to take this into account, and this already poses a high degree of complexity.

Second, redistribution is insufficient. Demand for some carbon intensive products – such as transportation – is very inelastic: no substitution is available for car transportation outside of cities. It is not enough to say that public transport infrastructure will be developed, because this policy is too expensive: the cost/benefit analysis of carbon reduction versus infrastructure-building has to be done almost on a case-by-case basis; more serious thought should be given to this issue.

Third, carbon pricing helps only if it brings about structural changes. Under current estimates, we would need a much higher carbon price to reach the EU's net-zero target in 2050, but by the same estimates, this would be fatal for the economy if its structure does not change. So, this is not a sustainable path, and net-zero can only be brought about through changes in production. How can these changes happen? Some redistribution policies will go against structural changes: we are not going to subsidize inelastic demand for carbon intensive products. That may slow down structural changes and we must think carefully about this as a set of complementary policies.

The report underlines that France is a small part of Europe, which is the right scale of action, and that Europe itself is small in the world and accounts for only about 9% of carbon emissions. This raises a big question: how to incentivize the others? The carbon tax adjustment mechanism can act as a bit of an incentive given the size of the European market, but how can this be negotiated and put in place? Good European policy is just not enough.

On inequality, I agree with Joseph that attention should be paid to the evasion from existing inheritance tax. Historically, we have not been very successful, so how can this be dealt with? Authors suggest that we are maybe getting better at taxing multinational corporations but again, what about the implementation of these policies? It is far from clear that the global multinational tax will be implemented without many loopholes, so how can collaboration be generated on this?

Finally, regarding demographic change, there are many useful proposals, particularly the democratic clarification made by Olivier. I will point out that the debate on public finances in France is really not well informed, and not very present. It's quite symptomatic that when we look at the public institutions dealing with finance in France, they usually do projections for five years whereas Canada projects for 75 years, the U.K for 50 years, and the U.S. for 30 years, and there is no independent council in France with any teeth which can discuss these issues. In the context of a commission on the future of French public finances to which I collaborated, we conducted a survey of French people on debt, and I think some of their answers are very relevant to this issue. When asked, 37% of people did not know how much French public debt there is, and when asked about expenditures to cut in priority, very few – about 13% – thought about cutting social spending or pensions. A number of important issues would need to be if we want an informed, democratic debate.

Maarten Verwey: When it comes to the big questions – and the discussion so far has born this out – the biggest challenges may not be finding the perfect technical solutions to these problems but how to convince policy makers and the general population to opt for the proposed solution.

Regarding climate change mitigation, the report sees an important role for carbon pricing: this is not the only possible policy, but an indispensable one. I share this conviction, and the European approach with the 'Fit for 55' legislative package also plays a central role.

I subscribe to the observation in the paper that measures with a visible impact are much less popular than measures whose impacts are invisible. This is apparent from the discussions currently taking place in the EU against the backdrop of the increase in energy prices. Some are already calling for replacing measures related to the extension of the ETS by more invisible measures, even though they are probably less efficient. But given the scale of the challenges, we really need to look for cost efficient solutions and carbon pricing is really a part of that.

That brings me to the issue of cost. It is crystal clear that there will be big costs for certain sectors, but when it comes to the aggregates, the picture is less clear. Consulting the impact assessment that the Commission has done for the 'Fit for 55' package, aggregate impacts are relatively modest in 2030, but there are major differences across sectors. Saying that there is an aggregate cost – whether it is true or false – seems to imply that there is an alternative which is less costly. This is my question: admittedly, by postponing certain measures that may help in the short-term, we could find ourselves in a few years with an economy that is obsolete with all the technologies developed elsewhere. So, the issue of cost is important, but I think it probably merits further exploration.

The economic cost of transition will depend on the speed of development and application of new technologies: the real issue is how to make sure we get technological development going on a faster scale than we have seen so far. Public investment can be part of it – and the EU is contributing through budget resources – but the way in which regulations are structured will impact this as well.

We must also deal with the challenges of redistribution. If we do not get this right, there will be no transition because people simply won't approve it. For this purpose, the EU commission proposed as a part of the 'Fit for 55' package that a special fund be created. But this is not just a question of money: one also needs to determine how to shape redistribution in a good way.

On the international dimension, I have no easy solution. Cooperation with like-minded countries is very important: if a critical mass is prepared to move in a certain direction, it will be easier to bring others along. As much as we would like to, Europe alone will not solve this issue. It can only be done in cooperation with others. Europe – but also the U.S. and others – must live up to the pledges made to developing countries to help in the transition. There is a long-standing commitment to provide finance for €100 billion per year: this is critical, but not enough.

Jean Tirole: I will focus first on climate change. Talking about green R&D, we have two kinds. There is the more rocket science kind, the kind that makes us succeed in the future, and we have a proposal for EU-style projects where specific projects could be selected for investment. But, crucially, this needs right governance structures. One of the chapters of the report describes this in detail, and in particular the proposed creation of two independent agencies, if possible at the European level: one to fund high risk/high reward R&D projects; another to inform citizens and public officials of the cost of alternative ways of achieving the same environmental impact.

Then there is learning by doing, ie the important technical progress that comes from experience with new technologies. This is challenging. What we have done with wind and solar technologies has been extraordinary, but we are still on a learning curve. If you ask me today whether we should have taken on that learning curve for nuclear, I don't know. Sometimes the effects of the learning curve are small, sometimes they are huge, and we cannot always know in advance.

On appropriate regulatory interventions, coal is not a good example because everyone agrees that it should go.

Sure, we could just ban it, but a price of €40 per ton will achieve the same result. The issue is political reluctance, not regulation versus prices, and in the end, compensation.

I would like to focus more on identifying instances of asymmetric information. Joseph argued that the price of regulation would be lower if we had good regulation. But we should not forget that these regulations are very expensive and very regressive. People who have solar panels on their roofs and drive electric cars are not destitute, so these regulations are regressive as well. We should not forget that the price per ton is very high.

I completely agree with earmarking and with the issue of redistribution, which is very difficult to do. Compensation doesn't happen for two reasons. The first is that sometimes people forget about it, as was the case with the Yellow Vests. We had the carbon price go up without thinking about compensation, and there is a little bit of that in the Green Deal. The Green Deal is very ambitious, much more ambitious than what is happening in the U.S., and this is wonderful, we should all be in favor. Except that the compensation package is not there, or at least not present enough. In the report we propose something that economists don't like to do, which is earmarking as a commitment to actually compensate the losers, but the structure of compensation is very hard to design.

Tax avoidance is also an important subject, but we didn't have enough time to get estimates of long-term elasticities, which are very hard to compute. People don't move across countries for a year or two. It's a long-term decision so it makes it very difficult economically to measure.

Lastly, the issue of education. In my view education – at least in Europe and in France – is the biggest factor driving economic inequality. France does very poorly in terms of redistribution on the education dimension. We are the penultimate country in the developed world on that. There are some interesting reforms in that regard, though. We see some of the same trends toward younger pre-kindergarten and primary school, but we need to do much more.

Joseph Stiglitz: I used the example of coal regulation just to illustrate that you can have simple regulations that are not hard to enforce and implement and to make a general point that one needs to implement nonlinear price systems, and not just a carbon price. One can think of regulations as a way of approximating certain types of nonlinear interventions, as a simple way of implementing those regulations. It seems to me that one wants to have a comprehensive package and take into account all the distributive effects.

Hélène Rey: I want to emphasize and build on what Joseph said. Education is key for many reasons, and I think one of the practical issues we have in the EU is that when we think about investment in education – or other types of investments that are tremendously important – we are not able to account for these investments, according to the public finance and accounting rules that we have, as investments that will decrease our indebtedness later on. Because they increase our potential for economic activity, we should be able to take them out of budget rules, but we cannot do that. Regarding the investments that are used – and they always have to do with investment in buildings or roads for example – we cannot have workable rules where we say we're not going to count this investment in education in the deficit right now because that is building our potential growth and that will help with climate, inequality, etc. So, there are some practical issues like that that we don't usually discuss in our theories but really get in the way when we talk about policy implementation.

Maarten Verwey: To react to the last point, let me say that at the current juncture the rules are not overly restrictive because at the moment the general escape clause is activated and continues to be active. The fiscal space is also enlarged quite a bit in a number of countries with the Next Gen EU package, which provides a lot of financing for green investment. That said, we were against relaunching the debate on fiscal rules that has been announced by Ursula von der Leyen, and there are questions around how to deal with investments. This will certainly be on the table.

Olivier Blanchard: Joseph raised the important issue of life expectancy. There is an 8-year difference in terms of life expectancy at 60 between the top and bottom decile of income. That is an enormous inequality. The EU commission couldn't decide on how to deal with it, but it is a central issue that needs to be dealt with.

Jean mentioned the need for earmarking, but I think it is more general than that. Earmarking can help get reforms through. In the case of inheritance tax, if you know that some of what is taken from you will be given to poor kids you might be more open. If citizens know that if they give €100 to their children, they will have to pay €10 to a fund which will help disadvantaged children, it may be one way to decrease opposition to the inheritance tax.

The last point I would like to make is about professional training, which we didn't talk about, but is covered a lot in our report. To me, it is just as important as standard education and here we have a long way to go before we have a good professional training system. If you take people close to the retirement age, there is no professional training for middle aged and older workers, and there should be because this is the only way they will be able to continue to work and be productive. This is a major issue that governments need to think about and invest in.

Jacques Attali • Writer, president of the Positive Planet Foundation, president of the of Attali et Associés, Honorary member of the French *Conseil d'Etat*

A War Economy at the Service of an Economy of Life

Among all the threats that weigh today on our communities, we can name at least seven, in decreasing order of probability, without any chronological order, nor hierarchy of seriousness.

A climate crisis: it is not a risk, it is a certainty: in three years, humanity will have reached a point of no return and will no longer be able to control the dynamics of the evolution of the planet's temperature. And the same will soon be true for a large number of other aspects of life on Earth, whose very specific conditions of existence are now being widely undermined. It is therefore vital for all the world's leaders to take, separately as well as jointly, major, radical and revolutionary initiatives to ensure that our planet is still habitable in thirty years' time.

A world famine: here again, world famine is not a mere possibility, but an announced catastrophe, which has begun in certain regions of Africa and Asia, and which has recently become much worse, in particular because of the war in Ukraine, which, irrespective of what happens with weapons, will deprive humanity of a very important part of its food supply, and of its fertilisers, for at least two years. If nothing is done, this famine will lead to the death of millions of people on all continents and will provoke huge population movements, which no populist barrier to entry will be able to hold back if we do not take the lead in helping these populations to develop autonomous means to feed themselves.

A shortage of strategic raw materials: some raw materials (such as graphite, lithium, titanium, nickel, cobalt, manganese, and magnets) are becoming increasingly scarce; they are being consumed more and more, and they are particularly vital for the industries of the future. For example, batteries (on the use of which are based many hopes of mitigating climate change) and wind turbines depend on materials that are only widely available in one or two countries with unpredictable political behaviour, such as China (for magnets) and Russia (for titanium): for the moment there is *no alternative*. What will happen then when a large part of the production lines for batteries, computers, solar panels, wind turbines and vehicles of all kinds is interrupted worldwide due to a blockage? What is being done to prepare for this? To break this deadly dependence?

A nuclear war with Russia: the current horrendous, monstrous conflict, in which an army deports, tortures, rapes, kills and denies the very existence of a brotherly and neighbouring people, is probably just beginning. It could, as it escalates, lead democracies to increasingly support this martyred people, not only through weapons supplies, but also by becoming more and more clearly involved in the conflict. Especially if, in a few weeks' time, it should worsen by Russia using chemical weapons on Ukrainian territory or bombing chemical or nuclear plants, or even using tactical or strategic nuclear bombs. Such a scenario, however crazy, is perfectly plausible. In particular, one could fear that, as victory in Ukraine becomes out of reach, Russia decides to widen the battlefield to some other neighbouring countries in Europe. And that would be World War III: the real first thermonuclear war. Humanity would not survive it. What to do to prevent it?

A new global pandemic: no expert excludes (and some even consider it very likely) that a new variant of this or another virus will one day attack humanity on a massive scale again. In fact, the one that is still attacking us today is far from being defeated. Will we be ready to make the best use of science to protect ourselves from a new epidemic tsunami? Will we be able to defend ourselves by uniting and preserving democracy, where it exists?

A global financial crisis: for the past fifteen years, we have not solved any crisis, be it economic, social, financial, health or ecological: all we have done is to increase the burden of expenditure necessary to keep our societies in working order, by rolling forward a ball of ever larger debts. The consequences have been foreseeable for a long time: a return of major inflation, aggravated by the preceding events; increasingly high levels of public and private debt, bearing ever higher interest, until the most indebted nations, cities, companies and households become insolvent. We will then have to close schools and hospitals and halt essential policies aiming to mitigate global warming. Does anyone prefer this scenario? What is being done to prepare for it, or better still, to avoid it?

A global political crisis could then arise from a realisation of the inability of leaders to tame these problems, to save the world. Leaders would be swept away; a very dark period would begin. Again, what is being done to improve global governance before this crisis begins?

What is democracy threatened by?

If such crises materialise, they will primarily affect democracies.

The first reason is that one can growing demands for protection, autonomy, isolation, authority, and consideration of long-term threats, which no current democratic government can assume without undermining its very essence. We can already see democracies in Poland, Hungary, India, Indonesia and Ethiopia falling into what is modestly called 'illiberalism': it is the antechamber to totalitarianism.

Second, everything is falling into place, as has long been expected, for the largest global companies to become independent of the States, and in particular the democracies, from which they originate. Tomorrow, the market will be increasingly global, while democracy, where it exists or will still exist, will remain local. This will make the so-called authority of the States, including the most powerful ones, increasingly derisory. This was easily foreseeable: companies are, by nature, borderless (geographically and in terms of their scope of action), whereas nations are defined by borders and States cannot easily change their scope of action. Thus, we are increasingly seeing very large companies, in particular the large platforms (known as 'Big Tech'), escape the rules set by democratic States. The latter still have the means to control them, as the Chinese leaders have done with their companies, the 'BATX'. But very shortly these global companies will escape from the reach of the States, which will only be able to ensure the rule of law, at best, within their territory, leaving vast and numerous spaces where it can be bypassed. These companies will only be accountable to their shareholders for the messages they promote, and the products they put on the market. They will then organise a generalised hyper-surveillance of workers and consumers for their own needs, by controlling the behaviour of their employees, their customers, their investors: they will find benefits in this market servitude, which will promise, as always, a longer life, with much less pain and much more love.

Finally, there is nothing more dangerous than a globalised market without a corresponding global rule of law. It will engender the reign of absolute short-termism, of corruption, of the commodification of all social relations, the halting of all efforts against crises, where the latter can generate profits. It will be the continuation of the evolution that began with the emergence of the market economy, something like ten thousand years ago, which transforms all services exchanged between humans into mass-produced goods, including the humans themselves. And it is this artificialization that destroys nature, disrupts its laws, instils in each human being thousands of prostheses, to avoid illness, pain, insecurity, ignorance. To distract her. To make ger forget that she is mortal.

If humanity does not destroy itself first through war, environmental disruption, or some other crisis that lies in the future, we will witness the total artificialisation of life; humanity will become an artefact produced by artefacts, a collection of reproducible objects. It will not be able to survive. And yet, it will die from fear of death...

What else is Europe specifically threatened by?

In this maelstrom, Europe today is a relative haven of peace and happiness. It is a continent of immense diversity, united by a love of democracy, a temperate climate, considerable resources, one of the richest regions in the world, if not the richest and most powerful. It enjoys political freedoms unknown anywhere else, the most advanced democracies, some of the best hospitals in the world, outstanding researchers, leading companies in all fields, and unique cultural activities. And it is in Europe that we are experimenting, with considerable success, despite the difficulties, with what could one day be a world governance system that is respectful of the diversity of peoples and nations.

For all these reasons, no one outside of this continent has an interest in its success; and its very survival is threatened.

By its economic and geopolitical competitors, who will want to take all its treasures, steal all its markets and deny it any means of power. We will witness the main European companies being bought up by investment funds or competitors from elsewhere. We will see non-European powers, enemies in other respects, agreeing to prevent the Union from acquiring the real means of industrial, political and military power and sovereignty.

By those who will not be able to tolerate that the success of a democratic model gives ideas to their own citizens, pushing them to rebel, and to their vassals, pushing them to escape their orbit. This is what is already happening today in Ukraine, whose adherence to European values is intolerable for Russia, which is losing its cradle of identity, and which cannot tolerate the prospect of a democratic society on its doorstep, holding out to its inhabitants the prospect of economic success and political freedom unknown in Russia since its foundation.

In total, almost all countries outside the Union, from China to the United States, from Russia to Great Britain, cannot tolerate the prospect of its success and will do everything to oppose it, to destroy it. In every possible way.

There is a great danger that, in the great maelstrom of the world, Europe will end up being subjected to foreign laws, set in Washington, New York, California or Shanghai, and will end up dissolving into a great global market, where it will no longer have a say, of which it will be no more than a museum, and from which all young people in search of success and freedom will leave.

In such a Europe, France would also lose the last shreds of its sovereignty and would continue to unravel, forced to adopt the language, culture, legal system, values and procedures of Anglo-Saxon communitarianism.

For all these reasons, and precisely because these threats are multiplying, the European project has never been more important. If this small democratic flame were to be extinguished, there would be little hope for democracy on the planet: the flame could not be passed to the American caricature. Moreover, if Europe fails, how can we hope to achieve one day on a global scale what we could not achieve with one-twentieth of the world's total population?

We should urgently remind ourselves that history is tragic; that it obeys laws that can be grasped, that many events over the next five years will be part of these trends, will threaten the standard of living, the well-being and the public freedoms in democratic States; and that, in order to confront them, we will have to choose leaders who are aware of this reading of history and of the importance of constant cooperation between all those who will be seated, for some time, in Europe, in the cockpit of the plane flying us towards our future.

A strategic concept: the life society

We could then discuss a succession of measures to be taken to try to avoid these predictable disasters. This would be meaningless and pointless if we do not first define a clear strategic concept and an effective method for carrying out these battles.

The strategic framework cannot be liberalism, which would only lead to leaving our future in the hands of the deadly laws of the market. Nor can it be social democracy, which is still limited to thinking about the best ways to protect the victims of capitalism's hard laws. Nor can it emerge from an absolute rejection of capitalism, a rejection that could in theory be justified by the urgency of halting the process of artificialisation of life. Nor can it be born of a negation of democratic principles, on the pretext that they only protect short-term interests. Both the market and democracy are still irreplaceable processes.

The market is the least tragic way to manage the scarcity of private goods and democracy the least totalitarian way to manage the scarcity of public goods. But to prevent the market from overtaking democracy, clear boundaries must be drawn between what can and cannot be traded, it must be made clear which market activities are to be encouraged and which are to be banned, and a way must be found to give a say to future generations, largely forgotten by current decision-making mechanisms.

Electoral procedures in market democracies should be constrained by regulatory mechanisms that protect the interests of future generations. For this purpose, a part of the living world must be made untouchable, and productive activities must be redirected to that which is most useful to future generations.

For such a society to function, it must first preserve and develop non-market activities (sharing, sports, artistic and political activities, the practice of living together, learning, conversation, transmission), which clearly increase the well-being of future generations.

The market must then be reoriented towards the production of goods and jobs in sectors that, in one way or another, have the defence of life as their mission: health, food, hygiene, education, research, innovation, sustainable energy, information, culture, art, democracy, defence, security, logistics, trade, sustainable finance. These sectors form what I call the 'life economy'. Until very recently, they were mainly made up of services, and therefore did not carry the potential for growth – which implies an increase in productivity resulting from the industrialisation of a service. Recently, they have also been made up of industries capable of innovating and constantly improving their capacity to fulfil their mission.

It is also necessary to convert the other sectors, constituting the 'economy of death', which today, in all countries, represent the bulk of market production: no small task, since it will be necessary to change all activities that require the use of fossil fuels (the oil and gas industry, the automobile industry, chemicals, plastics, fashion, tourism) or artificial sugars and other drugs (a large part of our food supply).

Finally, the wealth thus produced should be fairly distributed: this is essentially the role of the tax policy, which can only be truly effective if it is implemented worldwide.

All of this together will form a 'life society'.

How to act? A war economy at the service of the life society

During the recent crises, each of us, personally or collectively, has felt the urgency of taking back control of our lives, of becoming sovereign again. In particular France and Europe have felt how dependent they are on the rest of the world, in essential areas: on the United States for defence, on Russia for energy, on China for rare earths and so many other things.

We should not be under any illusions: no mortal being can, by nature, be sovereign, since it does not control the essential, i.e. the date of its death. And even within the limited temporality of our lives, no one living in even the most democratic society can be fully sovereign, since he or she must take into account the sovereignty of others. This is true of the individual, the family, the commune, the nation, the world, and even of humanity as a whole. And nature itself, of which man is not the sovereign, is not sovereign either, since its evolution is determined by cosmological constraints. So, what is left for us, other than try, throughout our lives and history, to tear down the walls of our prison?

Many obstacles have stood in the way of this great historical movement. Religious, ideological, and political systems have done everything to prevent this from happening. Even today, a very large number of people, especially women, have no control over their own lives.

To achieve this, we must build a society of life, transforming our industrial apparatus into a war economy, to foster the means of the economy of life and reorient the sectors of the economy of death in a forced march.

For example, it is an open secret that our armies, like those of all other European countries, will soon be sorely lacking in ammunition and weaponry; especially if they continue, to their credit, to find and provide the means to defend and counterattack to those who, in Ukraine, are resisting the advance of dictatorship on our behalf. At the present rate, our forces will soon be, if they are not already, in no condition to exert a dissuasive influence, let alone engage in offensives if misfortune were to require it. It would therefore be urgent, very urgent, to put the industrial companies of the defence sector to work; to make them produce weapons and ammunition 24 hours a day, 7 days a week, 'whatever it takes'. By reinforcing the industry through the reconversion, temporary or definitive, of companies, or at least of factories perfectly adaptable to these new needs: for example, the entire automobile industry could produce armaments.

This urgency is also justified for all the other sectors of the economy of life, to be developed; and for those of the economy of death, to be reconverted. For example, the tourism sector must become, as soon as possible, the sector of hospitality, in all the meanings of the word. And it will be exciting. This conversion must be done very quickly, taking into account the imminent crises that are mentioned above.

Moving to a war economy to promote the life society will require a real mobilisation of public opinion, and radical decisions: paying much more for work, and in particular overtime, in order to produce the tools necessary for the energy and agri-food transition at breakneck speed; granting unlimited subsidised loans to any industrialist who credibly embarks on production of this type or converts production lines from the economy of death. We are far from it.

More generally, the 'whatever it takes' should no longer concern demand but also and above all supply. And especially the supply of goods from all sectors of the life economy.

This requires preparation, organisation, recruitment, a liberalisation of practical and technical initiatives at all levels in the organisations, an administrative and above all political will, of all and at all times. This should also be a common project for all members of the European Union, calling on the continent to give itself the means of its sovereignty, which is a condition, as we can clearly see today, for the safeguarding of its way of life and its standard of living. This would not be easy, of course, especially at this moment in history, when Europe is facing a great moment of truth: will we have to go to war outside our borders? And how can we take such a decision together when only France, in the Union, has an army worthy of the name, without having the means to ensure the protection of its neighbours alone? How can we think of a European project when, in the face of all the emergencies, all we have had in Germany for the last fifteen years is a chancellor who was stubbornly convinced of her right to be the most economically powerful country in the region without having the slightest obligation to ensure her own defence? How can we think of a common project for the protection of that which unites us, when each one of us only thinks of taking shelter under the umbrella of a non-European army, whose guarantee of protection is increasingly illusory?

Some concrete proposals for a 'European life society'

This is what needs to be changed and it will not be easy.

We must be able to give ourselves the means for a genuine policy for life. This would mean ensuring and financing jointly our common security and defence, in a holistic conception of a 'European society of life'.

This implies a redirection of all national defence and security policies, health, education, agricultural and industrial policies of the Union according to this strategic concept; transforming the EIB, the largest public bank in the world, into the 'Bank of the Life Economy' and not only into a climate bank; and making people aware of the need to work together in a war economy, in order to achieve our sovereignty as soon as possible.

Many institutional reforms will follow from this strategic framework. First of all, the Union must be able to impose its own laws at home and elsewhere; it must have its own anti-corruption regulations; it must promote the use of its currency and European payment services; it must control foreign investments in the sectors of the life economy; it must put in place a carbon tax at its borders, at a credible level; it must reinforce the power of its Parliament; it must really elect those who lead it by universal suffrage, a condition for legitimate governance.

France will only be able to play a full and complete role in this transformation if it becomes an industrial power in the sectors of the economy of life, if it strengthens its military power and if it relies on the French-speaking world, which is the source of its identity.

This will not only be a matter for governments: Europeans are beginning to understand that the future depends on them much more than on their elected representatives; if the school system is doing badly, it is largely due to the parents, teachers and pupils, and not only to the budgets and programmes; if the health system is doing badly, it is not only because of the negligence of the ministries but also because of the lack of hygiene, the lack of sports practice, a disastrous diet, and waste of all kinds; if integration is going badly, it is not only because of the insufficient means of public policies, but also because the richest refuse to share their schools with the children of other social classes. If the country's external deficit is so catastrophic, it is not only the fault of a non-existent industrial strategy or a suicidally prudent banking system, but also the fault of an entire country incapable of producing what it wants to consume; if our democracy is threatened, it is not only the fault of those who, at the top, do not respect it, but is also due to the fact that too few of us have the courage on a daily basis not to lower their eyes in front of those who threaten our democracy and to defend its core values and principles, including that of secularism.

All this defines a strategy: a society of life through an economy of war. The transformation would require continuous action, starting now and lasting at least twenty years. That is, the duration of four presidential terms.

Will they dare?

Alain Minc • Essayist, President of A.M. Conseil, author of *Ma vie avec Marx*, Gallimard, 2021

A Page in the History of Capitalism is Turning

There have been many calls to rethink capitalism since the onset of the pandemic and the economic crisis it brought about. Do you think we are on the verge of a change of our economic model?

The current situation is both very serious, but also in some ways paradoxically more reassuring than the 2008 crisis. In 2008, the capitalist system could have died. Today, this is not an issue: the capitalist system will not die. Economic crises such as the one we are experiencing with covid are not signs of weakness of the capitalist system but, on the contrary, they strengthen it and accelerate major changes and progresses: digital globalisation is increasing, financial globalisation continues unabated with staggering stock market levels. Governments and central banks have also been able to respond better to the challenges they faced.

Nevertheless, a page in the history of capitalism is turning with the economic crisis arising from the pandemic. The extent of the macroeconomic changes that are taking place has not been measured. The coming revolution is both immense and very difficult to conceptualise. If capitalism remains inescapable, 'the worst economic system except for all the others', it is important to save it from its old demons.

Among these 'old demons', economic inequalities, which have been reinforced by the crisis, now seem to be at the heart of all challenges.

There is at the heart of capitalism an unbearable paradox: our societies are becoming richer and richer in appearance, but social inequalities only get worse. The dream of the post-war period is becoming more and more distant: we believed in a great policy of redistribution of the benefits of growth, succeeding in reducing economic, educational and cultural inequalities, with the corollary of promoting a huge middle class that would progressively absorb most of the social groups into it. This process of social change worked perfectly from 1945 to the 1980s.

All forms of inequality have increased since then, after the long period during which social democracy shaped Western societies. The market economy produces efficiency and inequality at the same time; when it is running at full speed, with the help of globalisation, it generates maximum efficiency and simultaneously results in maximum inequality. Today, the gains are divided in a leonine way to the benefit of income from capital and at the expense of income from labour. To remedy this, it is necessary either to increase wages or to transform employees into capitalists. The first path is quickly constrained by globalisation and the difficulty for the European economy to maintain a suitable level of competitiveness with the rest of the world. The second path is more promising because it is likely to allow an intelligent distribution of wealth without weighing on business decisions. It is not just a question of modifying the mechanisms of profit-sharing and participation, as the French Pacte bill has attempted to do in a non-coercive way, ie the distribution of profit without changing the structure of ownership, but of allocating shares to employees and making them owners of 10 or 20% of the capital of their employers.

This would reinforce a specificity of French capitalism resulting from a Gallic desire for an association between capital and labour with the presence of a sometimes-significant employee shareholding. Eiffage, Bouygues, Vinci and Saint-Gobain now have their employees as their main shareholders and the quality of the governance of these companies is not diminished by this, nor is the social climate deteriorated, on the contrary. What is easy to put into practice in listed companies requires some gymnastics in private companies: it is enough to issue shares without voting rights.

Aren't these inequalities at least partly the result of a weakening of traditional counterpowers?

The real problem is that the labour game is unbalanced. Normally the labour game is played between the state, the employers and the trade unions. In a country as unionised as Germany, it is still the trade unions of the old industries (car industry, steel industry) that set the tempo of the split between wages and capital profits in the traditional areas of the economy, with repercussions being felt across all areas of social life. But this match between capital owners and labour force owners for the distribution of the surplus value is becoming more and more unbalanced with the de-unionisation and uberisation of the economy, which undermines the traditional dialectic in labour bargaining.

For this lumpenproletariat – which is only employed in very low-skilled, very low-paid and very unproductive jobs – progress can only come from government decisions. It is then up to the state to take the place of the weakened trade unions, for example, to give basic rights to the drivers and deliverymen of Uber or Deliveroo. We go back to a Bismarckian pattern, in which it was up to the Iron Chancellor to enact the first social rights in Germany.

This observation is not unique to Europe: globalisation suffers from the lack of trade unions in Shanghai, strikes in São Paulo, social compromises in New Delhi, and trade union activism in Moscow.

Aren't these social – and environmental – concerns taken into account by the markets themselves?

Having supplanted managerial capitalism, patrimonial capitalism - a model born of globalisation and the technological revolution - is now being challenged by the rise of *a stakeholder* capitalism, whose main features are still difficult to define. Two visions are now confronting each other. The traditional one defends the idea that the firm belongs to its shareholders; its vocation and duty is to yield profit on their behalf. The other, which is on the rise, believes that beyond its shareholders, the company must take into account the interests of all its stakeholders - employees, customers, local residents, suppliers and, even more so, the future of humanity itself, by contributing to the fight against global warming. This is a far cry from the traditional social-democratic approach, based on the classic compromise between the three players, employers, trade unions and public authorities.

The two approaches are contradictory: doing good, while achieving the same profitability as in a pure form of capitalism, is a fantasy. Therefore, it is necessary to recognise that the profit objective must be reduced, which has to be honestly conveyed to the market. This is where the problem lies, and Emmanuel Faber understood this the hard way when he was running Danone, promising financial results that did not correspond to the purpose-driven company he had proposed to implement. No company manager can reasonably assume such a choice when doing the biannual road show, where he meets the investors and pension funds of all kinds. Managers first talk about company's performance in a traditional sense, then engage separately in issues related to the company's ecological, societal and moral responsibilities, but are careful not to admit that the latter will necessarily weaken the former.

The fact remains that a new philosophy of power, originating in the Anglo-Saxon world, dominates economic life, built on concepts of 'governance' and 'accountability', for which - an involuntary admission of the difficulty for France to act in this new reality - the French language has not yet found perfect translations. The place of institutional investors in the shareholding of the main French companies nevertheless forces an alignment with Anglo-Saxon governance practices. This phenomenon takes shape in particular through a greater ideologization of economic markets: the state is today far below the level of requirements imposed by the market on companies and their managers. The importance of so-called 'responsible' investments bears witness to this, as does the pressure on banks to stop financing certain sectors of activity, such as those linked to fossil fuels or the defence sector. The strong commitment of business leaders to these issues is explained less by the constraints that governments place on their activity than by their concern to improve their relationship with their financial environment, ie their shareholders and bondholders. This is an extremely strong pressure that weighs on company managers today. This ideologization, through which the new impulses that drive Western societies are transferred to companies via the market, is the ultimate burden of the current stage of capitalism, and we are only at the beginning.

Aren't courts also a profound lever for change?

The consideration of environmental requirements, compliance with health standards, employee protection, among many other regulatory concerns, has gradually moved from the orbit of the administration to that of the courts. The latter practice the broadest possible interventionism in relation to companies, no doubt because they are convinced of the powerlessness of the state, the inefficiency of the trade unions and an increased power of capitalist actors, which is rarely contested, except by the courts. These same ulterior motives explain why courts resort to the sledgehammer of criminal law, which is more restrictive, more mediatised, and therefore more infamous. Nothing attests in a clearer way to this evolution than the rise of the criminal liability of legal persons: first intended to replace the personal liability of a company's managers, it ended up instead complementing it, with the company joining its managers in the dock. Judges are often satisfied with the indictment of those who appear to be responsible and are indifferent to the subsequent proceedings: the real sanction, the media pillory, will have been pronounced at this stage.

Examined case by case, civil trial by civil trial, indictment by indictment, judicial intervention may seem fussy, sometimes iniquitous, often uneconomic. Seen from above, from a panoramic approach to the balance of power, it appears more justified, since in the name of the principles of the balance of power, an omnipotent market needs counterbalances, overconfident company directors need a minimum of disquiet, in addition to that imposed by financial markets, and capitalism itself needs regulators. But the fact remains that in a democracy, the overall effectiveness of judicial intervention does not justify individual blunders and procedural excesses.

Isn't public opinion just as decisive?

Judges can steadily confront markets because their actions are rooted in the movement of public opinion. But we can note again, with, Tocqueville, that public opinion becomes 'a kind of immense pressure of the mind of all on the intelligence of each', that 'faith in common opinion will become a sort of religion, with the majority as its prophet', or that 'common opinion is the only guide which private judgment retains amongst a democratic people'.

For more than two centuries, France has lived to the rhythm of a confrontation between the market and the state, as if these two antagonistic forms of organising society and the economy were the only ones that existed. Under the ideological pressure of communism, left-wing myths, the Bonapartist tradition, and the social ambiguities of Gaullism, it was more often than not the state that extended its reach at the expense of the market. With the emergence of patrimonial capitalism, it is the market that has taken historical revenge, forcing the state to retreat everywhere in the face of a new order that is deemed irresistible, irreversible and unsinkable. But new balances of power are now emerging. It is no longer an antagonistic couple, the market and the state, that structures reality, but a new 'Holy Trinity' that brings together the market, the law with its high priest, the judge, and public opinion. The Montesquieu triptych – executive, legislative, judicial – has been replaced by another. Public opinion is increasingly asserting itself through NGOs which, thanks to their dynamism and incredible ability to use the fluidity of the Internet to their advantage, are posing as interlocutors for the major capitalist and political players, like general interest lobbies.

Under these conditions, a new logic is at work: it changes the management criteria of companies; it changes their mode of government; it raises questions about their very nature. We are discovering that a multinational is at least as subject to collective passions as a government. But business leaders are less experienced in this game than politicians and still struggle to play their role in a media society where the democracy of opinion has taken precedence over traditional representation. They will have to learn. The market and opinion are the two masters of contemporary society: should managers forget this, reality will remind them.

In your latest book, you present yourself as 'the last French Marxist'. Why?

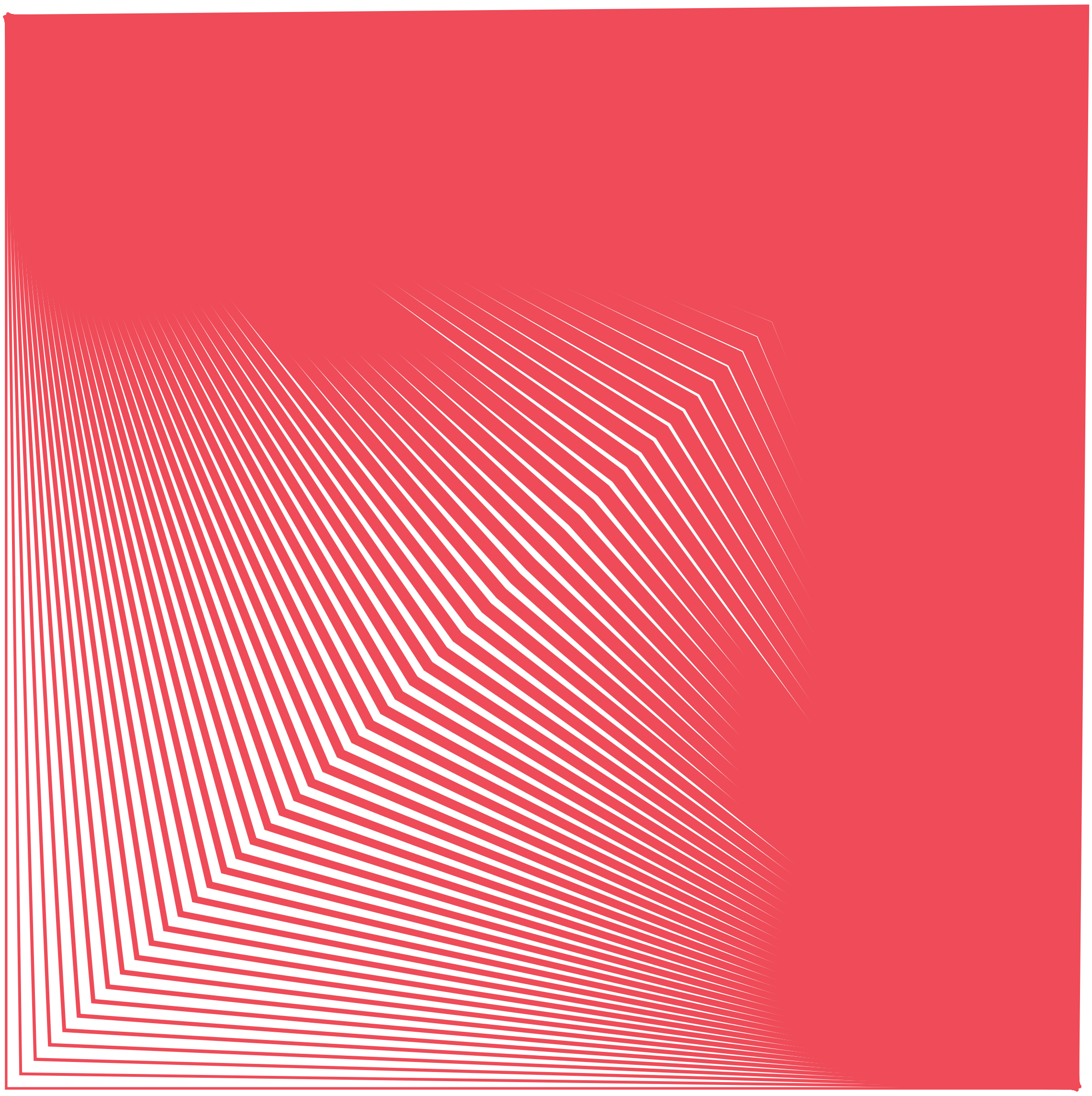
The Marxist heritage is a plural heritage. The Marxism that led to Bolshevism, Leninism and the absolute failure of communism is dead. On the other hand, the Marxist heritage also gave birth to social democracy, a consensual mode of managing class conflicts, of which the 'whatever it takes' was undoubtedly the apogee. Beyond that, a synthesis between capitalist dynamics, the weight of history and the functioning of society was achieved. No figure in history has thought simultaneously about history, philosophy, economics, and society. Marx is also the thinker who has best thought about, described, and praised the market economy, its power, progress, the rise of the bourgeoisie, but also the profound movements of society that are undoubtedly linked to it. After decades of success, of which the Scandinavian countries and continental Europe in general were an undisputed example, social democracy got bogged down. It has allowed itself to be dominated by corporatism, which neglects common interest in favour of private interests. It has created huge bureaucratic machineries whose efficiency has proved to be much more rapidly decreasing than the rates of profit, contrary to Marx's prophecies It has seen whole areas of economic activity escape the reach of trade unions. It has not always turned technological change to its advantage, and, above all, it has not been able to establish itself in the non-Western world. This is undoubtedly the reason why the world economy is out of balance.

In *The Communist Manifesto*, a supposedly revolutionary book, Marx praises capitalism in the highest possible terms: he shows its virtues in terms of competitiveness, globalisation, and technological progress. He pays tribute to the transformative power that capitalism has given rise to in the bourgeoisie. But he was wrong on two counts. He underestimated the ductility of the capitalist system. If capitalism has a monopolistic propensity, it was also able to correct itself at the beginning of the 20th century with the dismantling of Standard Oil of New Jersey in 1911, the starting point of anti-monopolistic policies. His second error concerns the tendency of the rate of profit to fall. It was annihilated by technical progress, which allowed for productivity gains: the rate of profit was maintained or even increased during certain periods.

Is this ductility of the capitalist system not undermined by the power of Big Tech?

The immense contribution of liberalism, which is not sufficiently praised, lies in the inseparable coupling of the market and the rule of law. The market without the rule of law is the capitalist jungle; the rule of law without the market is bureaucratic communism. There is no better illustration of this situation than the regulation of Big Tech companies (Google, Apple, Meta, Amazon, Microsoft) in the contemporary world. Left to their own devices, they represent the ultimate point of the capitalist dynamic praised by Marx. The technological revolution, the expansion of markets worldwide, the creation of de facto monopolies: these are all illustrations of capitalism in action, in its Marxist version: we are now aware of the systemic nature of certain firms. The Big Tech are challenging public authorities in a different way because, in addition to the question of monopoly, they also raise issues related to public freedoms (through the issue of personal data), freedom of expression and freedom of the press, which are new and unprecedented problems.

Hence a cardinal choice. Either the American and European regulatory institutions impose behavioural limits on these behemoths, hypothetical disinvestments, and play the same game on a larger scale than they did in the 1980s in connection with the break-up of ATT, which followed seventy years later the dramatic dismantling of Standard Oil. Or they are incapable of doing so, inhibited by the weight of lobbies, the blackmail of innovation actors, and the intermingling with state powers. We cannot rule out that some of them, such as Google, could be dismantled, and all of them subject to a legal framework akin to the one currently being discussed by the European Parliament, which could be subsequently taken up the the Biden administration if it has a majority in the US Congress.



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