Green Deal and Degrowth

Creating a sustainable economy within environmental limits

The European Green Deal's focus on decoupling economic growth from environmental pressures is essential. But Europe can also increase its resilience by reducing its dependence on economic growth. Governments have a vital role in enabling this change.

By Mike Asquith and Pantelis Marinakis

The idea that the European economy should grow within environmental limits is at the core of the EU policy. The European Green Deal aims to create an economy "where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use", while acting "to protect, conserve and enhance the EU's natural capital".

This awareness of the environmental limits to economic activity is not new. It was an important part of the thinking of the early economists in late 18th century Europe. But it has risen to prominence again in recent decades due to the 'great acceleration' of economic activities and environmental pressures since the mid-20th century. While this process has undoubtedly raised living standards in many parts of the world, economic growth has brought with it an immense increase in environmental and climate pressures.

Increasingly, these pressures threaten the foundations for human prosperity and well-being. It is now clear that sustaining growth of gross domestic product (GDP, i. e. the monetary value of all production in an economy) while operating within environmental limits will require Europe to achieve an unprecedented decoupling of economic activity from environmental pressures and impacts. What is not yet clear is whether decoupling at this scale is actually feasible.

In this context, there are growing calls for governments and societies to reduce economic activity or at least take a more 'agnostic' approach to GDP growth. That means setting aside their focus on increasing economic output and instead concentrating more directly on promoting well-being within environmental limits.

This sounds very appealing but presents some difficult practical problems. Economic growth is hardwired into the structures and incentives that drive forwards commerce and innovation, as well as consumer culture. Perhaps even more importantly, employment levels and tax revenues are also closely linked to growth in GDP. If GDP is shrinking, it would have major implications for financing the welfare state, public health and education, and social justice. It could also make it very hard to finance public debt or the huge investments needed to achieve sustainability transitions or restore ecosystems. These realities highlight an important truth: The fact that GDP growth has been harmful for the environment does not necessarily mean that declining GDP would be good for the environment.

Reducing GDP could be deeply socially disruptive

Governments therefore face a difficult dilemma. As Tim Jackson has argued, economic growth in its current form is unsustainable. But declining GDP is likely to be deeply socially disruptive, at least within the existing socio-economic systems.

The European Green Deal provides a clear and logical response to this dilemma. It adopts a strongly pro-growth stance, providing a basis to sustain employment levels and secure the resources needed to increase public welfare, promote social cohesion, and make necessary investments. But it also aims to transform our systems of production and consumption so that economic growth becomes sustainable.

The European Green Deal's promotion of green growth clearly makes sense in our current socio-economic system, which depends heavily on GDP growth for stability and social cohesion. Nevertheless, there are risks in only relying on a growth-promotion strategy to achieve sustainable development. In addition to uncertainties about the feasibility of achieving decoupling, other forces threaten future economic growth. Population ageing, for example, will reduce the workforce while also increasing health and pension expenditure, thereby squeezing investments in innovation and systemic change. Meanwhile, global crises may well become more frequent as international systems become more closely intertwined and ecological resilience diminishes. The financial crisis of 2008 and the COVID-19 pandemic vividly demonstrate the risks. Climate change impacts are also sure to worsen in coming decades.

These downward pressures on economic output certainly do not imply that a green growth strategy is doomed to fail in coming decades or should not be pursued. Whatever happens, we need to decouple economic output from environmental pressures to the greatest extent possible. The European Green Deal's transformative agenda is therefore essential, and Europe needs to find ways to make it the greatest possible success. Nevertheless, the uncertainties about future growth imply some risks. They suggest that as the EU and its Member States look

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to extend and build on the EGD, they should also explore ways to adjust our socio-economic systems so that potential future GDP reductions are less destabilising.

What does this mean in practice? At the heart of this challenge is the issue of fiscal sustainability: How can governments secure revenues and manage expenditures in ways that meet society's needs, even if the economy is shrinking? Certainly, there are some opportunities for governments to secure sustained tax revenues by shifting towards new sources, such as increased taxation of pollution, resource use, corporate incomes, and property or land. Yet there are numerous challenges in reconfiguring the tax base, including inequitable distributional impacts, concerns about competitiveness and offshoring of industries, and resistance from powerful vested interests. Environmental taxes have the added disadvantage that their success in driving behavioural change also has the effect of reducing revenues, which makes them an unreliable foundation for fiscal sustainability. Perhaps most importantly, if the overall economy is shrinking then reorganising the tax base will only provide a partial and short-term response. As such, it is also necessary to find ways to reduce the demand for state spending. In practice, this means going beyond efficiency improvements in public service delivery to reflect more deeply on our underlying socio-economic paradigm.

Transforming the economic system

The economic system in operation today is an engine for innovation and wealth creation but clearly also generates tremendous environmental and social harm because that is the way it is designed. Economic actors at all scales have strong incentives to focus on short-term, private gains and externalisation of environmental and social costs. In this context, much government activity is devoted to correcting and offsetting the risks and harms generated by the economic system.

This interaction has a long history. As Karl Polanyi noted in *The great transformation* (1944), the emergence of the welfare state and the growth of the public sector in 19th century Europe was necessitated by the devastating social impacts of industrialisation and laissez faire. These same processes are still at work, fuelled by the liberalisation of economies since the 1980s. Calls for government action are just growing more urgent: For basic incomes and job guarantees, for responses to climate and health crises. Essentially, we have created a system that is self-defeating. The growing dominance of markets and governments during the Industrial revolution had another important implication in leading to a steadily declining role for local communities. This represents a problem. As Raghuram Rajan has argued, communities stand alongside markets and governments as an essential 'third pillar' sustaining society. They have an essential role in responding to social needs. Yet today they often lack the resources and agency to fulfil that role.

In this context, a growing number of high-profile economists and international organisations are calling for a new economic paradigm, in which the choices and actions of economic actors at all scales – corporations, small businesses, entrepreneurs, consumers, communities – are guided by society's collective and long-term interests.

This obviously presents a major challenge. The primacy of profit maximisation is today firmly embedded in existing laws, institutions, mindsets and public discourses. With their performance benchmarked against expectations for short-term gains, individual business leaders face significant constraints on their ability to drive change. Public policies and institutions therefore have an essential role to play in reorienting corporate behaviour, for example using regulations to coordinate actions across whole industries; creating the legal frameworks and metrics that can transform corporate governance; and rewiring financial flows throughout the economy.

There is also a need to reorient innovation processes and mobilise society to find solutions to social needs. At present, far too much human ingenuity and financial capital is invested in creating wasteful or actively harmful products and services. Innovators, entrepreneurs and communities need to be mobilised to think creatively about new approaches to delivering social care and health care, new modes of providing work and welfare, or new ways to utilise society's resources – both physical and human. Channelling the transformational potential of innovation and entrepreneurship towards sustainable development and providing the needed financial support to good ideas will require experimentation and learning, backed up by harmonised evidence about social and environmental impacts. Governments have a vital role in creating the enabling conditions for sustainable innovation, including facilitating the needed flows of finance and knowledge, and developing relevant legal frameworks and skills.

Encouragingly, the seeds for this transformation are already emerging in policy and practice, for example in the EU's *Sustainable Finance Agenda* and its new *Action Plan for the Social Economy*. The EU and national governments need to build on these foundations, taking them much further and much faster.

Annotation

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AUTHORS + CONTACT

Mike Asquith is Expert in Economic Analysis of Sustainability Transitions at the European Environment Agency.

European Environment Agency, Kongens Nytorv 6, 1050 Copenhagen, Denmark.
Email: mike.asquith@eea.europa.eu

Pantelis Marinakis is Expert in Sustainable Finance at the European Environment Agency.

European Environment Agency, Kongens Nytorv 6, 1050 Copenhagen, Denmark.
Email: pantelis.marinakis@eea.europa.eu