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ABSTRACT

In recent times, sustainable development has emerged as a major concern for economy and society. Retooling the economies according to sustainability criteria has become even more important with the COVID-19 pandemic. Accordingly, the European Commission has taken several steps for relaunching the economy, which are intended not to bring the economy back to the *status quo* before the pandemic but to bounce it forward according to social and environmental sustainability criteria.

This article highlights that sustainable development is not just an objective of this specific Commission, but a founding value of the European Union (EU) as set out by the Lisbon Treaty, which well describes the socio-economic model that the EU aims to pursue.

Reorienting the economy towards sustainable development requires rethinking the role of business in society. This article shows that only an entity view of the firm is consistent with the fundamental goals of the EU as defined by the Lisbon Treaty. In doing so, it provides the entity view of the firm with a sound background that goes beyond an academic perspective, making the integration of sustainability criteria into daily life an essential requisite for business to comply with the overall EU institutional setting.

Keywords: Sustainable Development, European Union, Social Market Economy, Theory of the Firm

JEL classification: M10, M20, G30, P10

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1. INTRODUCTION

In recent years, sustainable development has become a major concern for economy and society. On the one hand, financial sustainability has arisen as a key issue after the global financial crisis that hit financial markets and society, leading to dramatic job losses and a rise in inequality and poverty (e.g. Pianta 2015). The financial crisis has revealed the fragility of laissez-faire capitalism, short-termism, and excessive risk-taking in financial markets, calling for alternative ways of doing business. On the other hand, environmental sustainability has emerged as a central political and social item. By adopting the Paris Agreement on climate change and the United Nations (UN) 2030 Agenda for Sustainable Development in 2015, most economies have committed themselves to more sustainable development practices.[1] The transition to a low-carbon, resource-efficient, circular economy, along with social sustainability, have emerged as a core issue for modern societies.

Retooling the economies according to sustainability criteria has become even more urgent with the COVID-19 pandemic. The increase in temperature, due to climate change, deforestation, low air quality, and, more in general, human pressure on the environment, have proved to be significantly correlated with the epidemic (e.g. Bashir, Benjiang, Bilal, Bushra, Bashir, Duojiao and Bashir 2020, Tollefson 2020, Zoran, Savastru, Savastru and Tautan 2020). The coronavirus outbreak has put healthcare and welfare systems under extraordinary pressure, and significantly impacted people's way of living and working. Moreover, lockdowns due to virus containment actions have precipitated the economies into the worst economic crisis since the Second World War (World Bank 2020).

The European Union has taken several steps for relaunching the economy in the post-COVID period. It is widely understood that such initiatives must not bring the economy back to the *status quo* before the crisis but bounce it forward according to social and environmental sustainability criteria (European Commission 2020a). The Next Generation EU Plan, which includes ad-hoc measures to tackle the post-COVID recession, is based on investments in infrastructure, such as healthcare, energy, transport, and communication, along with smart and green manufacturing (European Commission 2020a).

Some significant environmental and social policies were actually launched before the pandemic, among which the European Commission's Action Plan on Sustainable Finance (2018), the European Green Deal (2019a) - which includes the Just Transition Mechanism aimed at assuring that no one is left behind in the green transition -, and the European Action Plan on circular economy (2020b). Clearly, such ambitious policies require consistent financial resources. The EU economy's investment needs for 2021 and 2022 are at least EUR 1.5 trillion

[1] This article uses the terms "sustainable development" and "sustainability" interchangeably (Gray 2010), although it acknowledges that there is a slight difference between the two expressions, as "sustainability" refers to a state, while "sustainable development" refers to the process of achieving said state.

(European Commission 2020a). The green transition alone will require EUR 1 trillion over ten years (European Commission 2019a).

Policymakers acknowledge that such substantial amounts of additional investments can hardly rely only on the public sector or classic budgetary stimulus programs. For this reason, a mix of instruments, including the private sector involvement, are now considered key for scaling up investments (European Commission 2020a).

This being the context, the European Commission (2018) considers the involvement of financial intermediaries as crucial for transitioning to a more resilient, low carbon society. Sustainable finance, which refers to the integration of environmental, social and governance (ESG) criteria into investors' asset allocation, has become an important objective of political economy. Coherently, in 2018 the European Commission issued the Action Plan on Sustainable Finance (2018), intending to connect finance with the specific needs of European society. Specifically, the Plan includes several actions to reorient capital flows towards sustainable investment; to manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and to foster transparency and long-termism in financial and economic activity. Importantly, increasing infrastructure and green investments in insurers, pension funds, and bank portfolios are relevant also from a financial stability perspective. Studies on transition scenarios to a low-carbon economy suggest that portfolio exposures to carbon intensive-industries will be heavily hit by the transition, with negative effects on supervisory ratios (e.g. Dutch National Bank 2019). Therefore, an asset reallocation towards green and infrastructure investments will help financial intermediaries better react to the transition, thus protecting them from losses due to stranded assets (e.g. Delis, de Greiff and Ongena 2020).

The European Commission also considers a different role in society for non-financial firms, which must inevitably take part in the transition to sustainable development. For the first time, the Commission (2019b) mentions the need for a social license for firms to operate. As a result, it is considering modifying company law to better embed sustainable value creation into corporate governance and to align the long-term interests of management, shareholders, stakeholders and society at large (European Commission 2020c).

All the above-mentioned initiatives represent quite a big change in EU policies, which can pave the way to a new stage in capitalism. As this article shows, sustainable development is not just an objective of this specific Commission. Sustainable development is a founding value of the EU as set out by the Lisbon Treaty (2007), which represents the institutional setting of the EU. Coherently, an entity view of the firm, rather than a proprietary one, better fits the socio-economic model that the EU wants to pursue. Differently from a proprietary view of the firm, which considers business for the only purpose of shareholders, the entity view of the firm conceives business not only for personal enrichment but also a vehicle to serve some larger social good (i.e., Boatright 2008, Freeman 1984). While the proprietary view of the firm is core to the Anglo-Saxon variety of capitalism, the entity view is at the foundation of the Rhenish variety of capitalism typical of Germany and Scandinavian countries (Albert, 1993).

The rest of the article is organized as follows. Section 2 sets the background for discussion. Section 3 discusses the objective of sustainable development within the institutional framework of the EU. Section 4 examines the implication of the sustainable development goal for businesses, and Section 5 concludes.

2. BACKGROUND FOR DISCUSSION: THE FINANCIALIZATON OF THE ECONOMY AS A THREAT FOR SUSTAINABLE DEVELOPMENT

In the last 50 years, neoliberalism and financialization have characterized worldwide economies (e.g. Epstein 2005). The role of governments has diminished, while that of the markets has increased. Financial motives, markets, actors and institutions have played an increasingly prominent role over time in the operation of economies.

A rise in financial investment and incomes to the detriment of investment in the real economy, as well as the growing importance of the 'shareholder value maximization principle' in business management, have been two key features of this landscape (Dumenil and Levy 2004, Epstein 2005, Jürgens, Naumann, and Rupp 2000, Lazonick and O'Sullivan 2000, Nölke and Perry 2007, Stockhammer 2004). Despite being more apparent in the United States, the financialization process has also affected EU countries in a variety of historically and geographically related forms (e.g. Alvarez 2015, Brown, Dillard and Hopper 2015, Dumenil and Levy 2004, Hein, Detzer and Dodig 2016).

Several studies have highlighted a strong relation between shareholder value orientation in business practices, short-termism in corporate governance and an increase in dividends and buy-back at the expense of real investments and wages (e.g. Alvarez 2015, Duménil and Lévy 2004, Lazonick, Mazzucato and Tulum 2013, Onaran, Stockhammer and Grafl 2011). Others have provided evidence of the role of such business practices in the rise of social inequalities (e.g. Sikka 2015). Others still have underlined their potential effects on the varieties of capitalism and social democracies (e.g. Palea 2015, Palea 2018).

Stockhammer (2004), among others, shows that the focus on shareholder value maximization has over time reduced the rate of capital accumulation and undermined economic growth. Under the pressure of shareholder value, firms tend not to reinvest gains in their productive assets, but to distribute them to shareholders through dividend payouts and share buy-back (Baud and Durand 2012, Crotty 2005, Lazonick and O' Sullivan 2000, Milberg 2008). The shareholder value maximization paradigm has also led to more conflictual relationships between enterprise managers, employees, and other stakeholders. Van der Zwan (2014) reports evidence of the unequivocal impact of shareholder value policies on industrial relations, which is a fairly big issue in those countries where companies have grown based on consensual corporate governance arrangements. Other studies show how the 'shareholder value maximization principle' makes shareholders and managers rich to the detriment of workers (Fligstein and Shin 2004, Lazonick and O'Sullivan 2000, Lin and Tomaskovic-Devey 2013). This strand of research presents a dramatic picture in which the pursuit of shareholder value is directly linked to a decline in working conditions and a rise in social inequality for large segments of the population. Interestingly, a few studies further show that the financialization process has also affected the environment, with an increasing process of commodification of agriculture and land resources (Clark and Hermele 2013).

MacKenzie (2006) highlights the fundamental role played by economic theory in this process. Modigliani and Miller (1958), among others, looked at the corporation from the 'outside', i.e. from the perspective of the investors and financial markets, and considered corporate's market maximization as the main priority of management. Accordingly, shareholder value maximization became a central feature of the corporate governance ideology, which spread across the whole private sector (Froud, Haslam, Sukhdev and Williams 2000, Lazonick and O'Sullivan 2000). The agency theory (Jensen and Meckling 1976) also provided an academic source of legitimacy for a greatly increased proportion of corporate executives' rewards in the form of stocks and stock options, with the specific purpose of aligning the interests of shareholders and managers. In this financial conception of the firm, corporate efficiency was redefined as the ability to maximize dividends and keep stock prices high (Fligstein 1990).

There is no reason to think that financial economists saw themselves as acting politically in emphasizing shareholder value. Nonetheless, for scholars in this body of work, shareholder value was not a neutral concept but an ideological construct that legitimized a far-reaching redistribution of wealth and power among shareholders, managers and workers (e.g. Van der Zwan 2014). Over time, their theories became the cultural frame for economic actors and intrinsic parts of the economic processes (Fligstein and Markowitz 1993). By paraphrasing Milton Friedman, economic models were an engine transforming the economy, rather than a camera for reproducing empirical facts (MacKenzie 2006).

After years of a laissez-faire approach, the European Commission's policies now provide a new scenario for businesses and a chance for public actors to reorient the economic system according to sustainability criteria. As mentioned above, for the first time the European Commission mentions the need for a social license for firms to operate (European Commission 2019b). It requires financial investors, after years in which they have taken profit from - and at the same time perpetuated - the shareholder value ideology (Perry and Nölke 2006), to incorporate and disclose sustainability in their strategies (European Commission 2018). It also considers modifying laws at the EU-level to pursue the general objective of fostering more sustainable corporate governance and value creation (European Commission 2020c). Such policies represent a big change for the EU, which recognizes the need for new forms of business and cooperation among social actors for the sake of the common good.

3. SUSTAINABLE DEVELOPMENT AS A FUNDAMENTAL VALUE OF THE EUROPEAN UNION

Sustainable development is not just an objective of this specific Commission. It is, rather, core to the European integration project. The Lisbon Treaty (2007), which defines the inspiring values and founding principles of the Union, gives specific recognition to sustainable development as a main goal of the EU.

The Lisbon Treaty has been the outcome of a lively debate on the future of the EU, which had started in 2001 at the Laeken European Council with the establishment of a Convention on the Future of Europe. The Convention was based on the Habermasian idea of multilevel constitutionalism in a pluralistic society (e.g. Habermas 2001), which represented the theoretical basis for integrating multiple countries into a supranational discussion based on common values and norms. The Convention was grounded in understanding actions in Habermasian meaning and represented an important effort in reducing plurality to unity based on shared laic values. Understanding actions aim at reaching consensus, which, in Habermas' vocabulary (1987), is the opposite of compromise. The consensus is based on agreement motivated by common convictions, and therefore the only actions compatible with democracy.

With the Convention, the European community discussed their project focusing on two main issues. The first one was to set the economic and social model that the EU would pursue; the second was to define the powers which were to be transferred to the EU. The Convention long debated and eventually proposed their best representation of European society, setting sustainable development at its foundation.

Importantly, the Lisbon Treaty went further beyond Maastricht's view of the EU as a simple economic and monetary union, providing the basis for a new economic and social governance. It also enshrined a Charter of Fundamental Rights in the European Union's constitutional order for the first time, thereby establishing not only economic but also political and social rights for citizens and residents of the European Union. According to the Treaty, the European Union "shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress [. . .] it shall combat social exclusion and discrimination, and shall promote social justice and protection" (Lisbon Treaty 2007, art. 3). Sustainable development and social market economy emerged as a guiding idea of the European Union, therefore setting the framework within which European policies must be defined and their outcomes discussed. As is clear, the view of society emerging from the Treaty is quite different from the neoliberal one.

It is widely shared that the concept of sustainable development has three strictly linked dimensions: economic, social, and environmental (e.g. Kahn 1995). A common definition of economic sustainability refers to the long-run maintenance of capital. This is about, and in theory ensures, the ability of the economy to maintain a defined level of production over the long term (e.g. Goodland 2002). Social sustainability is defined as a positive condition marked by a strong sense of social cohesion and equity of access to key services, including health, education, and housing (e.g. McKenzie 2004). Finally, environmental sustainability aims to preserve natural ecosystems (Bruntland Report 1987).

As Von Hauff (2009) notes, social market economy and the sustainable development paradigms have often co-existed, and numerous experts have even found it impossible to draw a clear substantive distinction between them. Social market economy in fact emphasizes the social aspects of sustainable development, bringing social factors into the mix for sustained economic growth consistent with natural ecosystem preservation.

It is also well-known that in setting social market economy as a fundamental objective of the EU, the Lisbon Treaty looked at the German socio-economic model (Muresan 2014, Šmejkal 2015, Velo 2018). The term 'social market economy' indeed originates from the post-World War II period when the shape of the 'New' Germany was being discussed. Social market economy theory was developed by the Freiburg School of economic thought and received major contributions from scholars such as Eucken (1951, 1990), Röpke (1941, 1944, 1946, 1969) and Rustow (1932, 1960).

In the definition of Muller-Armack (1966), a social market economy is primarily a normative value system that is not unique and seeks to combine market freedom with equitable social development. It is a process, as opposed to something static, which changes form while keeping its essential content. Social market economics shares with classical market liberalism the firm conviction that markets represent the best way to allocate scarce resources efficiently, while it shares with socialism the concern that markets do not necessarily create equal societies (Marktanner 2014). Market efficiency and social justice do not, therefore, represent a contradiction in terms, as is proven by Germany's post-World War II economic success (Pöttering 2014, Spicka 2007). According to social market economics, a free market and private property are the most efficient means of economic coordination and of assuring a high dose of political freedom. However, as a free market does not always work properly, it should be monitored by public authorities who should act and intervene whenever the market provides negative outcomes for society. The social dimension is essential not only for society but for the market to work well. Public authorities set out the rules and the framework, acting as the referees that enforce the rules. A strong public authority does not assume a lot of tasks but yields power for the sake of general interest (Gil-Robles 2014). Glossner (2014) notes that a social market economy is not a dogmatic, but a pragmatic concept, which implies that conscious and measured state intervention is contingent on economic and social circumstances.

To work effectively, a social market economy shall regulate the state-citizen relationship along with two principles: the organization of the state according to subsidiarity and the division of the government from special interest groups (Eucken 1952). Both these ideas have been included in the Lisbon Treaty, which states that the Union competences are governed by the principles of subsidiarity (art. 5). The Treaty of Lisbon indeed clarifies the division of competences between the EU and EU countries. These competences are divided into 3 main categories: exclusive competences, shared competences and supporting competences. The EU has exclusive competence, for instance, in the area of monetary policy for euro area countries and in the area of common commercial policy. Shared competences between the EU and EU countries apply in areas such as the internal market, some aspects of social policy, economic, social and territorial cohesion (regional policy), the environment, consumer protection and energy. Finally, supporting competences imply that the EU can only intervene to support, coordinate, or complement the action of EU countries. Supporting competences relate to the protection and improvement of human health, industry, culture, tourism and civil protection.

Company law and corporate governance are included in internal market competences. The European Union has therefore adopted several directives and regulations to regulate the way of doing business. EU law covers issues such as company formation, capital, disclosure requirements, and operations (i.e. mergers and divisions). It also addresses corporate governance rules focusing on relationships between a company's management, board, shareholders and other stakeholders, and therefore, on the ways the company is managed and controlled. Importantly, according to the hierarchy of laws, European regulations and directives rank lower than the European Treaty. This implies that reorienting business according to sustainability criteria is not a political choice of this Commission but a requirement to comply with the Treaty.

Furthermore, the Treaty contains a 'social clause' requiring the European Union, in conducting its policy, to observe the principle of equality of its citizens, who shall receive equal attention from its institutions, bodies, offices and agencies. Coherently, European Union rules in company law and corporate governance shall protect all the parties with an interest in the company, including creditors and employees beyond shareholders. The Treaty also highlights the importance of social dialogue, which is an important pillar of the European social model (art. 152). Social dialogue has indeed proved to be a valuable asset during the economic crisis triggered by the subprime crisis: it is no mere coincidence that the member states that better resisted the crisis, such as Germany and Sweden, enjoy strong and institutionalized social dialogue between businesses and trade unions (Andor 2011).

4. BUSINESS AND SOCIETY IN THE EU'S VIEW: A NEW STAGE IN CAPITALISM?

It is well established in the literature that economic policies are deeply ideological (e.g. Solomon 1986, Weatherford 1987). Different policies correspond to different views of business in society as well as to different notions of capital (e.g. Cooper 2015, Müller 2014, Zhang and

Andrew 2014). This, in turn, implies that different levels of priority are given to societal stakeholders. Likewise, it is widely shared in the literature that neoliberalism has an elective affinity with the proprietary theory of the firm, according to which the firm is an exclusive vehicle for its proprietors to increase their wealth (e.g. Aglietta and Rebérioux 2005). The proprietary theory of the firm considers investors as the most relevant stakeholder group and the capital market as the most relevant financial source for the economy (Friedman 1970). Businesses are run for the shareholders' enrichment, and investments are evaluated from a short-term, market perspective rather than by their contribution to the productive activity. This is quite a big issue for investments in sustainable development that require time to yield results (e.g. Aglietta and Rebérioux 2005, Aspara, Pajunen, Tikkanen and Tainio 2014, Boyer 2007).

In contrast, short-termism and shareholder orientation are banned from an idea of society based on sustainable development and social market economy. As mentioned above, in social market economy social welfare dominates and societal stakeholders are all on the same level. A social market economy keeps distributional considerations, such as economic equality and social justice, central to the political agenda. This view of society is quite different from neo-liberalism.

A social market economy requires an entity view of business, which is not only a private association for the purpose of personal enrichment but also a vehicle to serve some larger social good. The European Commission's Action Plan (2018) clearly entails this view of business. Based on the "social institution" theory of business, the entity view of the firm considers business as embedded into a socio-economic environment with multiple social and economic long-term relations to its stakeholders (i.e., Boatright 2008, Freeman 1984). Importantly, this view of the firm does not involve any sort of philanthropy; rather, it represents a new way to achieve economic success. Profit remains the material part of businesses (Frémeaux, Puyou and Michelson 2020). However, there is a stronger connection between firms, economic goals and societal progress (i.e. Mazzucato 2018).

In the wake of the global financial crisis, many scholars have called for a more radical paradigm shift in the foundations of contemporary capitalism, which could better meet society's broader challenges. Porter and Kramer (2011), for instance, talk of shared value, which involves creating value in a way that also creates value for society by addressing its needs and challenges. This new concept of capitalism, which supports the common good and multiple value creation, fits well into the EU's view of society.

There is no doubt that the proprietary view and the entity view of the firm are neither reducible to each other nor reconcilable; while the entity view better suits the circuit of industrial capital, the proprietary view is for the circuit of money capital (Bryer 1999, Marx 1978). These two different views of business in society reflect not only clashes between economic performance but between social models, too (Richard 2012). The entity view of the firm focuses on the social relationship between management and employees, and between the company and the community, which give the firm not only financial but also social goals. Stakeholders, from capital providers to employees, are all the same, and what counts is the generation of revenue from which to meet their claims. In this view, people are regarded not just as inputs but also as essential contributors to value creation, which is a collective process.

As a matter of fact, in many countries in Continental Europe where social market economy already applies, shareholder wealth maximization has never been the only – or even the primary – goal of the board of directors. In Germany, for instance, firms are legally required to pursue the interests of parties beyond the shareholders through a system of co-determination in which employees and shareholders in large corporations sit together on the supervisory board of the company (Rieckers and Spindler 2004, Schmidt 2004). Austria, Denmark, Sweden, France, and Luxembourg also have systems of governance that require some kind of co-determination (Ginglinger, Megginson and Waxin 2009, Wymeersch 1998). While the specific systems of governance in these countries vary widely, the inclusion of parties beyond shareholders is a common concern. As a result, workers play a prominent role and are regarded as important stakeholders in firms. For this reason, it is common to refer to the Rhenish variety of capitalism as 'stakeholder capitalism'.

Importantly, Allen, Carletti and Marquez (2009) highlight that stakeholder capitalism is beneficial for company value and investors, too. Hillman and Keim (2001) and Claessens and Ueda (2008) find that greater stakeholder involvement in the form of stakeholder management or employment protection improves efficiency and firm value. Likewise, Fauver and Fuerst (2006) and Ginglinger, Megginson and Waxin (2009) find that employee representation on the board increases firm value as measured by Tobin’s Q and profitability. Besides, stakeholder governance may reduce the probability of failure, increasing debt capacity and consolidating a close relationship between banks and firms, which is important in highly bank-oriented financial systems (Allen, Carletti and Marquez 2009).

5. CONCLUSIONS

In recent times, the European Commission has launched several initiatives to target the objective of sustainable development. This article highlights that sustainable development is not just an objective of this Commission. It is, rather, one of the founding values of the EU as set out by the Lisbon Treaty (2007), which represents the institutional setting of the EU.

Reorienting the economic system towards sustainability requires rethinking the role of business in society. A new vision of a firm is needed in such a new context; one that supports the common good and multiple value creation. This article underlines how an entity view of business, rather than a proprietary one, better fits the socio-economic model that the EU wants to pursue. Importantly, it shows that the Lisbon Treaty provides this view of the firm with a sound legal basis, which goes beyond a simple academic perspective, thereby linking the European Union's sustainability policies to its founding values.

A recent update of the European corporate governance directive is indeed moving in the direction of requiring companies to develop a view on long-term value creation and to formulate a strategy in line with it. On the other hand, the Action Plan on Sustainable Finance (European Commission, 2018) is directed to reorient financial resources towards socially and environmentally sustainable businesses.

Indeed, the forces that can lead to a significant change in the role of business in society are manifesting. These are a proper context, committed leadership and democratic support. The context, which Machiavelli (1988) would call *fortuna*, is given by increasing environmental and climate change risks and related healthcare risks – among which the COVID 19 pandemic stands out. The leadership in tackling climate issues, which Machiavelli would call *virtù*, is provided by the EU's policies, strongly oriented to relaunching the economy according to sustainability criteria. Finally, democratic support is offered by public opinion that is increasingly concerned with environmental problems and the dramatic economic and social consequences of the pandemic.

It is also the responsibility of academics not to let the progressive principle of sustainable development become an empty phrase. From an environmental perspective, researchers are putting a big effort into climate change understanding and are providing policymakers with indications to support business ecological transition (e.g., Battiston et al., 2021). Discussion on the transition to more socially sustainable businesses, instead, lags behind. In this respect, cooperative enterprises theories (e.g., Meade, 1990) should be rediscovered for the purpose, thus providing significant contribution to the debate.

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