European Economic and Social Committee

OPINION

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Social taxonomy – Challenges and opportunities

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[own-initiative opinion]

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1. Conclusions and recommendations

1.1 With this opinion the EESC sheds light on the idea of a social taxonomy, with the objective of stimulating the debate. The EESC calls on the Commission to publish the overdue report describing the provisions that would be required to extend the taxonomy's scope to "other sustainability objectives, such as social objectives", as requested in the Taxonomy Regulation[1] (the Regulation). The EESC speaks up for an operationally viable and conceptually sound social taxonomy, to make the opportunities come true, while also mastering challenges. The EU taxonomy should be aligned with a holistic approach including environmental as well as social sustainability. Given the challenges of the green transition, the economic and social impacts of the pandemic, the war in Ukraine caused by Russia's aggression and the resulting geopolitical tensions, the EESC reiterates the demand for a balanced economic policy and an enhanced focus on social goals.

1.2 The Regulation's minimum safeguards are welcome and should be implemented thoroughly. However, they are not enough to ensure social sustainability for workers, consumers and communities. An EU taxonomy would help to meet the urgent investment needs in the social field by channelling investments in that direction. It will even gain importance if it is part of an overall policy geared towards social fairness and inclusion. A just transition requires sustainable social conditions, and a social taxonomy could deliver the long-awaited guidelines. The EESC calls on the Commission to provide an estimation of the needed funds in order to implement the European Pillar of Social Rights. All in all, public investment will continue to play a crucial role in the field of public services. Financing of social welfare by government spending and stable social security systems remain fundamental. Still, a commonly agreed social taxonomy could provide guidelines for investments with positive social impacts.

1.3 The EESC recommends that the multilevel and diverse approach proposed by the Platform on Sustainable Finance[2] (the Platform) should be adhered to in the Commission's report. Integrating a social taxonomy into the EU legislative environment on sustainable finance and governance would be useful, bearing in mind that there is a great deal of work to be accomplished. In particular, the proposed Corporate Sustainable Reporting Directive (CSRD) would be an important complement to a social taxonomy against which the measures could be assessed and evaluated. A well-designed social taxonomy would also contribute to tackling the potential problem of social washing. The EESC recommends starting with simple and clear guidelines, providing for easy and transparent procedures and complementing them step by step at a later state. A close integration of the social and environmental taxonomies should be the final goal, but as a first step mutual minimum safeguards might be practical.

1.4 The EU taxonomy should indicate actions and companies that contribute substantially to social sustainability and constitute a gold standard reflecting a higher level of ambition than provided for in legislation. The EESC welcomes the Platform's suggested objectives of decent work, adequate living standards and inclusive and sustainable communities. While various international and EU principles should serve as a basis, the EESC recommends in particular

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1 Regulation (EU) 2020/852

2 Platform on Sustainable Finance | European Commission (europa.eu)

referring to the European Pillar of Social Rights and the relevant Sustainable Development Goals (SDGs), such as SDG 8 on decent work. In any case, compliance with human and workers' rights must be a condition for being taxonomy-conformant. Adherence to collective agreements and co-determination mechanisms in accordance with the respective national and European law is crucial and should constitute a DNSH[3] principle. Guidelines with positive social impacts, which are based on the agreement of social partners, should be deemed taxonomy conformant. It has to be kept in mind that the level of collective bargaining coverage varies significantly among Member States and has fallen in 22 of them, a problem which has been addressed by the minimum wage Directive.

1.5 The EESC urges legislators to fully involve the social partners and civil society organisations when designing the social taxonomy, both because they are affected and have to meet reporting obligations and in order to safeguard their ownership. The EESC questions the excessive use of delegated acts in the field of the taxonomy, because a wide range of political questions are addressed. The goal of the taxonomy is to provide transparency for investors, companies and consumers. In the future, its potential use by governmental institutions as a reference for aid and funding programmes should be properly assessed and discussed. Any broader use must be subject to an appropriate decision-making process. Undue interference with national legislation and the autonomy of social partners has to be prevented. Finally, the danger of social washing must be excluded. Complaint mechanisms for trade unions, works councils, consumer organisations and other representatives of organised civil society should be provided for and the competent national authorities should be made more responsible to carry out their control tasks.

1.6 The EESC wishes to highlight further benefits related to a social taxonomy. Firstly, the rising demand for socially orientated investment should be supported by providing a reliable taxonomy which constitutes a coherent concept for measuring social sustainability. Secondly, socially harmful activities might translate into economic risks, and a taxonomy could help to minimise these. Thirdly, transparency is crucial for capital market efficiency, and could also contribute to the social internal market as set out in Article 3 TFEU. It would foster a level playing field, prevent unfair competition and make companies and organisations contributing to social sustainability more visible. Fourthly, the EU should build on its strengths and strive to become a model and front runner of environmental and social sustainability. The debate on an EU ratings agency should be relaunched. The EESC also renews its call for financial and extrafinancial data providers to be properly regulated and supervised.

1.7 The EESC also highlights challenges and possible solutions. Firstly, concerns of market foreclosure arise. However, investments are also based on other criteria, such as expected return, which might outperform sustainability goals, and there are many cases of synergies between investors and other stakeholders' interests. In any case, not being taxonomy conformant must not be deemed to be harmful, and this should be made clear by the Commission. The focus on the impact of sustainable investment on real economy activities should be enhanced. Secondly, the definition of what should be included in the taxonomy will be controversial. This is exactly the reason why the definition process should be subject to democratic debate and decision making. Thus, a common and reliable idea of sustainability could be developed, to

3 DNSH = Do no significant harm

which individual actors could and should refer. The success of the taxonomy is linked to its credibility, and the activities included must meet a widely accepted definition of sustainability. Thirdly, a social taxonomy could lead to additional reporting requirements. The EESC calls on the Commission to minimise these, while avoiding overlaps. Counselling and the provision of taxonomy-related services by a legally authorised agency might be useful, especially for small and medium-sized enterprises, cooperatives and non-profit business models. In addition, financial institutions should be encouraged to provide assessments of the social impacts of investments, as currently done by value-based banks worldwide.

2. Background to the opinion

2.1 The EU's sustainable finance framework should help steer private financial flows towards sustainable economic activities. The 2018 action plan on sustainable finance consists of a taxonomy, a disclosure system for companies and investment tools, including benchmarks, standards and labels, while the 2021 renewed sustainable finance strategy focuses on financing the real economy's sustainability transition, as well as on inclusiveness, resilience, the contribution of the financial sector and global goals. Within this framework, the EU has worked on various legislative initiatives where the EU taxonomy plays a key role. The EESC points to its respective opinions[4].

2.2 The EU taxonomy should provide transparency for investors and companies and support them in identifying sustainable investments. The Regulation constitutes a classification system, which focuses on six environmental objectives in the areas of climate change mitigation, climate change adaptation, water, biodiversity, pollution prevention and the circular economy. An environmental sustainable investment must make a significant contribution to achieving one or more of these objectives, do no significant harm to any of them (DNSH principle) and comply with performance thresholds (referred to as technical screening criteria). It also has to meet social and governance-related minimum safeguards (Article 18). Therefore, procedures must be implemented by companies to ensure alignment of an activity with the OECD Guidelines for Multinational Enterprises (MNEs), the UN Guiding Principles on Business and Human Rights (UNGPs), the Declaration of the International Labour Organisation (ILO) on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

2.3 Article 26 of the Regulation mandates the Commission to publish a report by the end of 2021 describing the provisions that would be required to extend its scope to "other sustainability objectives, such as social objectives". This reveals an intention to extend its scope, but still does not require the implementation of a social taxonomy. In accordance with the Regulation, the Platform subgroup on social taxonomy was given the task of exploring the extension of the taxonomy to social objectives. Its final report on social taxonomy was released in February 2022[5], later than announced, and the Commission is expected to draw up its report based on that. Moreover, the Platform is asked to advise the Commission on the application of Article 18, i.e. to give guidance as to how companies could comply with minimum safeguards, and on the possible need to supplement the article's requirements.

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4 OJ C 517, 22.12.2021, p. 72

5 Final Report on Social Taxonomy (europa.eu)

2.4 The Platform proposes a structure for a social taxonomy within the present EU legislative environment on sustainable finance and governance. In the case of the implementation of a social taxonomy, further provisions would provide a regulatory landscape, including the proposed Corporate Sustainable Reporting Directive (CSRD) which will replace the Non-Financial Reporting Directive (NFRD) and introduce mandatory, EU sustainability-reporting standards; the Sustainable Finance Disclosure Regulation (SFDR); and the Directive on Corporate Sustainability Due Diligence (CSDD). In particular, the proposed CSRD requires companies to also address a bundle of information on social topics and reporting on governance factors and is expected to improve disclosure in relation to social matters. Therefore, it would be an important complement to a social taxonomy against which these matters can be measured and evaluated.

2.5 Despite some differences, the Platform suggests following the structural aspects of the environmental taxonomy. It proposes three main objectives accompanied by sub-objectives. The decent work objective includes sub-objectives such as strengthening social dialogue, promoting collective bargaining, and living wages that guarantee decent lives. The objective of adequate living standards includes healthy and safe products, quality health care and quality housing, and the objective of inclusive and sustainable communities should also promote equality and inclusive growth and support sustainable livelihoods. The suggested minimum safeguards refer to environmental, governmental and social goals in order to avoid inconsistencies, such as a company carrying out sustainable activities being involved in human rights abuses. Moreover, the relevant stakeholders should be addressed, specifically the entity's workforce and value-chain workers, the end-users and the affected communities. Social-related DNSH criteria and the listing of harmful activities are also suggested.

3. General comments

3.1 The EESC calls for an economic policy consistent with the objectives set out in Article 3 of the EU Treaty and with the SDGs. A balanced focus on key policy objectives is needed, specifically environmental sustainability, sustainable and inclusive growth, full employment and high-quality work, fair distribution, health and quality of life, gender equality, financial stability, price stability, balanced trade based on a fair and competitive industrial and economic structure, and stable public finances. The EESC also points to the competitive sustainability agenda, which puts its four dimensions – environmental sustainability, productivity, fairness and macroeconomic stability – on an equal footing in order to achieve reinforcing effects and a successful green and digital transition[6]. Given the war in Ukraine caused by Russia's aggression, the EESC stresses its call for a balanced economic policy that helps to mitigate its economic and social impacts, and points to the statement in the ILO's 1919 Constitution whereby "universal and lasting peace can be established only if it is based upon social justice".

3.2 The EESC sheds light on the concept of a social taxonomy, with the objective of stimulating the debate and raising awareness. The EESC speaks up for a well designed, operationally viable and conceptually sound social taxonomy to verify the considerable opportunities while also

6 OJ C 275, 18.7.2022, p. 50

overcoming challenges (see below). Just like economic policy as a whole, the finance-related sustainability concept and, in particular, the EU taxonomy should be aligned with a holistic and multi-dimensional approach where we should strive for putting environmental and social sustainability on equal footing. Moreover, the green transition can be harmful in social terms. Therefore, the protection and improvement of standards in the social area is needed, with a focus on leaving no one behind. A just transition requires sustainable social conditions, and a social taxonomy could deliver guidelines.

3.3 The EESC perceives a social taxonomy as an important and necessary complement to the EU's social dimension, and calls on the Commission to publish the report as requested in Article 26 in due time. The multilevel and diverse approach of the Platform's report should be adhered to. However, striving for perfection and the inclusion of all aspects of social sustainability at once might lead to huge delays in the social taxonomy's implementation and even the risk of the project being abandoned as a whole. Therefore, the EESC recommends starting the process with simple and clear guidelines as well as easy transparency procedures in a timely manner and then continually complementing this step by step. Concerning the relationship between the environmental taxonomy and a social taxonomy, striving for coherence and a close integration of the two approaches should be the goal. Still, as a first step, mutual minimum safeguards might be practical.

3.4 The EESC is pleased that the Platform has published a draft of its report regarding Article 18 of the Regulation in order to advise companies on how to implement the article's requirements and possibly allow for it to be amended. In particular, in the context of social sustainability it is crucial to assess a company's actual performance on human rights, industrial relations and decent work. However, while the environmental taxonomy's minimum safeguards are highly welcome and should be implemented thoroughly, they would never replace a social taxonomy. They are not nearly enough to ensure social sustainability for workers, consumers and communities[7]. Moreover, the EESC recommends cooperating with local social partners, civil society organisations and social enterprises in order to monitor and promote the positive impact of economic activities on stakeholders.

3.5 The social taxonomy will gain importance if it is part of an overall policy geared towards social sustainability accompanied by appropriate rules, for example concerning human-rights due diligence. However, it will never replace sound governmental regulation and social policy. Financing of social welfare by government spending and stable social security systems remains fundamental. The taxonomy should not serve as an instrument for crowding-out or privatisation. Public investment continues to play a crucial role in the field of public services and also often stimulates further private investment. However, the social taxonomy could provide sustainability criteria in the field of infrastructure, health, education and training and social housing for any investors to enable socially sustainable investments in the real economy and avoid social washing. In the future, the taxonomy might also be used by governmental institutions as a reference for aid and funding programmes. This will have to be properly assessed and discussed.

7 OJ C 152, 6.4.2022, p. 97

3.6 A social taxonomy would provide a detailed structure of the positive and negative social impacts of economic activities. Many points under consideration relate closely to matters traditionally debated between social partners and among civil society organisations. The EESC calls for organised civil society to be fully involved when designing the social taxonomy, in particular the (sub)objectives, DNSH criteria and safeguarding principles. Employers, employees, consumers, further stakeholders and communities are affected by the design of the objectives and/or have to meet reporting obligations. The EESC also points to pension funds as an example of employees being the beneficiaries of investments. The involvement of stakeholders is crucial to safeguard ownership. The EESC expects that a social taxonomy might be implemented by revising the Regulation, hence an ordinary legislative procedure would be carried out. The excessive use of delegated acts in the context of sustainable finance and in particular when implementing the taxonomy is questionable because a wide range of political questions are addressed, going far beyond technical specifications.

3.7 The EESC stresses the importance of enhancing the quality of information in the field of socially sustainable investments and preventing disinformation on the social situation, in order to avoid negative impacts on all stakeholders. A well-designed social taxonomy would contribute significantly to solving such problems by clearly indicating activities and entities that contribute substantially to social sustainability. It should constitute a gold standard and reflect a higher level of ambition than already provided for in legislation, while striking the right balance between being too global and too narrow. While environmental criteria are based more on science, a social taxonomy as proposed by the Platform would rely more on standards and globally-agreed frameworks, which might not be prescriptive but act as guidelines to encourage social sustainable activities.

3.8 Compliance with human and workers' rights must be a condition for being taxonomy-conformant. Likewise, adherence to collective agreements and co-determination mechanisms in accordance with the respective national and European law is crucial and should constitute a DNSH principle. Moreover, guidelines providing for easy and transparent procedures with positive social impacts, which are based on the agreement of social partners should constitute a taxonomy conformant economic activity. It is important to keep in mind here that the level of collective bargaining coverage varies significantly among the Member States, from only 7% in Lithuania to 98% in Austria. Since 2000, collective bargaining coverage has fallen in 22 Member States and it is estimated that at least 3.3 million fewer workers are now covered by a collective bargaining agreement. An important role in the implementation of the social taxonomy is played by the new Directive on minimum wages and the extension of the application of collective bargaining agreements[8]. Moreover, the EESC recommends providing clear advice on the implementation of minimum safeguards in the proposed legal act itself, possibly relying on the Platform report on Article 18 of the Regulation.

3.9 Various international and EU norms and principles can serve as a basis for the social taxonomy. Concerning the (sub)objectives, the EESC recommends referring to the European Pillar of Social Rights and the associated action plan and the relevant SDGs, specifically SDG 8 (decent

8 Directive on adequate minimum wages in the EU, Art. 4.2., provisional agreement. The 80% collective bargaining coverage threshold set there for requiring Member States to take measures to increase the rate should be supported in a social taxonomy.

work and economic growth), SDG 1 (no poverty), SDG 2 (zero hunger), SDG 3 (health and well-being), SDG 4 (education and training), SDG 5 (gender equality), SDG 10 (reduced inequalities) and SDG 11 (sustainable cities and communities). Frameworks agreed on by the social partners could also provide an important source. The EESC considers that the Platform's idea of implementing minimum safeguards based on the UNGPs and OECD guidelines is crucial. Moreover, the European Social Charter, the EU Charter of Fundamental Rights, the European Convention on Human Rights and the proposed CSDD would also constitute valuable reference points for a social taxonomy. Lastly, activities which are deemed to be significantly harmful, that is, activities which are fundamentally and under all circumstances opposed to any sustainability objectives and leave no way to render them less harmful, should be excluded. Weapons condemned by international agreements, such as cluster bombs or antipersonnel mines, should be included here. The EESC also recommends developing a concept on how to deal with aggressive and belligerent regimes.

4. Opportunities of a social taxonomy

4.1 The EESC highly recommends using the taxonomy's potential to channel investment towards socially sustainable activities and entities and create decent jobs. Well over 20% of EU citizens are at risk of poverty; the pandemic has exacerbated inequalities and the war in Ukraine will further increase economic and social tensions. Globally, it is estimated that roughly USD 3.3 to 4.5 trillion a year needs to be mobilised to achieve the SDGs. Goods produced by violating labour-related human rights are linked to the EU market to which they are imported. In the EU, there is also a pressing need for social investment, for example in poverty reduction, life-long learning and health[9]. The minimum gap in social infrastructure investment was estimated at around EUR 1.5 trillion from 2018 to 2030[10]. The EESC calls on the Commission to provide an updated estimate of investment needs in order to comply with the European Pillar of Social Rights and achieve the 2030 EU headline targets. Considerable public and private funds are needed to enforce social sustainability.

4.2 With the help of a social taxonomy, investors and companies could assess the social impact of their investment or activity and voluntarily consider this as an essential objective. The EESC points to the rising demand for socially orientated investment and embraces investors' openness to socially sustainable finance. In contrast, there is a lack of definition and standardisation, and analysis of ESG ratings and related outputs also reveals fundamental differences depending on the provider of the ratings, which makes socially sustainable investment difficult. A social taxonomy would constitute a coherent concept for defining and advancing social sustainability and measuring progress. It has the potential to enhance accountability and to provide clear guidance. It would therefore decisively support investors' ambitions and might constitute incentives for further market participants to invest in this area, while at the same time helping to prevent social washing.

4.3 Socially harmful activities might also translate into economic risks. There are risks of boycotts if a business is associated with the violation of human rights, and a company runs the risk of

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9 Final Report on Social Taxonomy (europa.eu)

10 European Commission, Boosting Investment in Social Infrastructure in Europe, Discussion Paper 074/January 2018

being excluded from public contracts should it neglect human-rights due diligence. It could also become entangled in expensive litigation due to human rights abuses, or supply chains could be disrupted due to strikes. The economic and political risks due to a growing gap between rich and poor could also afflict investments. This set of risks could be minimised by investment decisions based also on a social taxonomy. The EESC also draws attention to the ECB's work on strengthening the monitoring and management of systemic risks due to the neglect of sustainability factors. The EESC highlights that environmental risks are often accompanied by social risks, for example where people lose their homes due to a flood. All in all, social sustainability risks should be explicitly addressed and be part of the ECB's action on sustainability risks.

4.4 The EESC further points out that transparency is an essential element of market efficiency. This refers not only to capital markets. A social taxonomy could also serve as a tool to support a balance between economic freedoms and social and labour rights[11]. By enhancing transparency, it might contribute to the social internal market as set out in Article 3 TFEU and promote fair competition. Moreover, the social taxonomy would also foster a level playing field and increase the visibility of companies which abide by human and workers' rights and substantially contribute to social sustainability, helping them to attract investors. The taxonomy's potential transformative role would be enforced by making it more widely known. In that context, the EESC again points to the positive role that financial instruments can play in the development of social impact companies[12].

4.5 Finally, the EU has established itself as a leader in environmental sustainable finance internationally and is actively contributing to this global effort. The EESC welcomes these efforts, but reminds the Commission of the need to also advance social sustainability and promote the SDGs. Also in the context of social sustainability, the EU should strive to serve as a role model and become a front runner by raising the topic in international forums. Particularly in times of war and international tensions, an international sustainable finance architecture also has to take on board social sustainability.

5. Challenges and possible solutions

5.1 Financial investors' intentions to conduct socially and environmentally sustainable investments are highly welcome and must be supported. However, financial market participants in general base their investment decisions on expectations about return, risk, liquidity and maturity. These motives might contradict the interests of other stakeholders and counter or even outperform environmental or social objectives. However, the EESC also points to many possible synergies between investors' and other stakeholders' interests, for example when improvements in workers' participation enhance companies' productivity or when an economic activity contributes to the wellbeing of communities. In any case, economic activities or entities which might not be taxonomy-conformant must not automatically be deemed harmful. In that context, concerns about market foreclosure arise, and the EESC asks the Commission for clarification

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11 OJ C 275, 18.7.2022, p. 50

12 OJ C 194, 12.5.2022, p. 39

and a well balanced approach. The focus on the impact of sustainable investment on real economy activities should be enhanced.

5.2 Incompatibilities might arise because social matters are regulated at Member State level and between social partners, while organised civil society as a whole strives to be involved in social, environmental and other policy matters. However, the EESC welcomes the Platform's report regarding the risks of infringements of other regulations, and also assumes that the Commission's proposal will take care to avoid contradictory overlaps and interference with national social systems, industrial relations and regulations. Moreover, a social taxonomy would rely on common international and European declarations and principles - such as the European Pillar of Social Rights - and constitute a basis for voluntary decision making without stipulating a particular social policy. However, any broader use of the taxonomy as referred to above must be subject to an appropriate decision-making process. Undue interference with national legislation and the autonomy of social partners has to be prevented, and differences in national labour-market models and collective bargaining systems have to be recognised.

5.3 Developing a social taxonomy, and therefore a structured overview of socially sustainable activities and sectors, also touches on political values. It will be challenging to define which economic activity and/or sector is deemed taxonomy-conformant. However, this is exactly the reason why drawing up a taxonomy should be subject to a political debate and democratic decision making[13]. Only under these conditions can a common idea of social sustainability be developed which individual actors could and should rely on and refer to. The EESC highlights that in the social sphere as well, the success of the taxonomy depends on its broad acceptance. The activities and sectors included must meet a widely accepted definition of sustainability and be based on generally recognised values, such as human dignity, gender equality, fairness, inclusion, non-discrimination, solidarity, affordability, well-being and diversity. Safeguarding the taxonomy's credibility is key in order not to jeopardise the project as a whole.

5.4 Further concerns are that a social taxonomy might lead to an overburdening of companies with additional reporting requirements and the need to provide complex and difficult information combined with expensive auditing procedures. The EESC calls on the Commission to minimise these burdens and to draw up simple and easily observable criteria, while also building on overlaps with other reporting requirements. The EESC welcomes the Platform's approach to structuring the objectives of the social taxonomy in a similar way to the proposed structure of the CSRD. All in all, the EESC calls for an orderly and consistent set of rules without excessive complexity and duplication so that it works in practice, while also providing the necessary amount of transparency. Counselling and the supply of taxonomy-related services by a specialised legally authorised agency for companies and other organisations which want to become taxonomy-conformant might also be useful. This would also ensure that companies with fewer reporting resources have access to the taxonomy. However, financial institutions can still provide assessments of the social impact of investments as currently done by value-based banks worldwide.

13 See above chapter 3.

5.5 Although the aim of the taxonomy is to provide a reliable framework for socially sustainable investment, the danger of green or social washing cannot be excluded. The EESC agrees with the Platform that merely checking commitments and policies does not ensure effective implementation and safeguard human rights, nor does it support the development of socially sustainable activities. There are severe difficulties in supervising and enforcing a company's compliance with the proclaimed social sustainability objectives and in assessing its performance along today's often highly complex supply chains. On the other hand, the Platform points to promising developments in the field of quantifiable social data, such as in the context of the revised Social Scoreboard and the SDGs. All in all, the social taxonomy must be transparent, reliable and constantly updated. The EESC also proposes that workers' councils and civil society organisations, for example, be taken on board in these regards.

5.6 The EESC proposes that the debate on an EU ratings agency, which might now focus on sustainability, should be relaunched and thereby consolidate the EU's pioneering role in this field. It also renews its call for financial and extrafinancial data providers to be properly regulated and supervised. Complaint mechanisms for trade unions, workers councils, consumer organisations and other representatives of organised civil society should be provided for in the event of false claims of taxonomy conformity. The EESC acknowledges that in the Regulation, the measures and penalties applicable to infringements are left to the Member States. In any case, the competent national authorities[14] should be made more responsible to carry out their control tasks, supplemented with obligations to report to their parliaments and civil society.

Brussels, 22 September 2022

Christa Schweng
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14 See Taxonomy Regulation, Article 21.