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WORLD AT THE CROSSROADS:
FINDING INSTITUTIONALIST PATHWAYS TO SOCIAL, ECONOMIC AND ECOLOGICAL CO-EXISTENCE

Paper Session:

INSTITUTIONAL ANSWERS TO THE UNCERTAINTIES OF SOCIETAL TRANSITION

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B5 (Current Heterodox Approaches)

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AN INSTITUTIONAL FRAMEWORK FOR A SUSTAINABLE ECO-TRANSITION AND FINANCIAL REGULATION

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Agenda

Introduction

Capitalism: Development VS Systemic Instabilities.

1. Institutions as behavior-shapers and social-consistency-insurers

   The primary role of institutions is to provide an appropriate communication/coordination environment through rules and norms that would allow individuals to develop societally consistent behavior.

2. Financing of eco-transition and structural changes

   Financing cannot be obviously provided by financial markets and does require a specific plan of collective action. A relevant transition process that needs a sustainable financing scheme calls for an "***ecologically consistent financial regulation***" that could also change the face of capitalist finance in a positive way.

3. Conclusion.

Introduction

- Various ***ecologic/environmental concerns*** (climate change, energy transition, global warming), persistent social issues (inequalities, poverty, worsened living conditions), and recurrent economic/financial crises result in high ***social*** and ***economic costs***.
- The latest example of evolution is the accumulation of crises in recent decades that have led to an unstable and more uncertain environment, both ecologically and economically.

These concerns point to the limits of market mechanisms and call into question the current regime of accumulation

- Institutional change and collective action are then required to find sustainable transition solutions by ***reframing the behavior of markets in a socially consistent way***.
- This article argues that any transition process to a sustainable ecologic/economic environment, the "**eco-transition**", relies on **specific institutional transformations.**

1. Institutions as behavior-shapers and social-consistency-insurers. Institutions, rules and eco-transition (1)

➔Ostrom and Basurto (2011): Studying institutional change to address the most urgent economic, social and environmental challenges that could threaten the viability of our societies.

→ Some core issues in **institutional analysis:**

- Nature of the rules (rules as habits: Veblen, 1899);
- Rationality of rules for individuals (Hodgson, 2010);
- The way rules are established in society (or community), nature and scope of decision/policy makers, criteria that would lead to rules and their implementation, the way people accept or not the rules in force, how people understand prescriptions in order to decide of appropriate actions in society (Commons, 1924);
- The institutional culture behind the rules (Bremer et al. 2021);
- Evolution of the rules.

1. Institutions as behavior-shapers and social-consistency-insurers. Institutions, rules and eco-transition (2)

➔We need to set up rules and institutions to shape behavior in a consistent way when facing systemic turmoil and viability concerns.

- Transition issues:

✓ energy transition - the transformation of the technologies into non-fossil (clean/green) energy generation;

✓ environmental transition - the transformation of the every-day living practices of populations (consumption) and enterprises (production);

✓ economic transition with the transformation of the regime of accumulation, production and financial relations;

✓ societal transition with the transformation of our dominant inegalitarian cultures and reflexes into more human-and-life respectful rules and practices.

➔ Remodeling institutional framework towards the transition changes – chronology (1)

1. Reports of the Club of Rome, 1972

> *„…Zero economic growth as long as such growth halts the degradation of the human environment". The authors explored that economic growth cannot consist only in the growth of global domestic product (GDP), production, employment or income, but must still at least maintain the existing level of social, relational and natural capital, thus ensuring intergenerational equity.*

2. *Report of the World Commission on Environment and Development: Our Common Future*, 1983.

> *The concept of sustainable development does imply limits - not absolute limits but limitations imposed by the present state of technology and social organization on environmental resources and by the ability of the biosphere to absorb the effects of human activities.*

3. United Nations Conference on Environment and Development, 1992.

> ***Agenda 21** underlined **the role of financial institutions** in the air pollution control and emission control for mobile and stationary sources of air pollution. It was considered that the need of promotion and improving of the rural financial networks that utilize investment capital resources raised locally.*

➔ Remodeling institutional framework towards the transition changes – chronology (2)

4. World Summit on Sustainable Development in Johannesburg, 2002.

> "develop innovative financing and partnership mechanisms";
>
> "…provide a more predictable and secure international financial environment that can contribute to the sustainable development of developing countries, by, inter alia, establishing measures to mitigate the impact of excessive volatility of short-term capital flows".

5. Paris Agreement, 2015.

> "…Invites the non-Party stakeholders referred to in paragraph 134 [auth. - …civil society, the private sector, financial institutions, cities and other subnational authorities] above to scale up their efforts and support actions to reduce emissions and/or to build resilience and decrease vulnerability to the adverse effects of climate change".

6. "Transforming our world: the 2030 Agenda for Sustainable Development", 2015.

> "…strengthen the capacity of domestic **financial institutions** to encourage and expand access to banking **insurance** and financial services for all" (p. 20),
>
> - "…to reduce inequality within and among countries, improve the regulation and monitoring of global **financial markets** and institutions and strengthen the implementation of such regulations" (p. 21).

➔ Remodeling institutional framework towards the transition changes – chronology (3)

7. EU *Strategy for Financing the Transition to a Sustainable Economy* (2021) defines 6 steps:

Step 1. *Developing a more comprehensive framework and help the financing of intermediary steps towards sustainability.*

Step 2. *Improving the inclusiveness of sustainable finance.*

Step 3. *Enhancing economic and financial resilience to sustainability risks.*

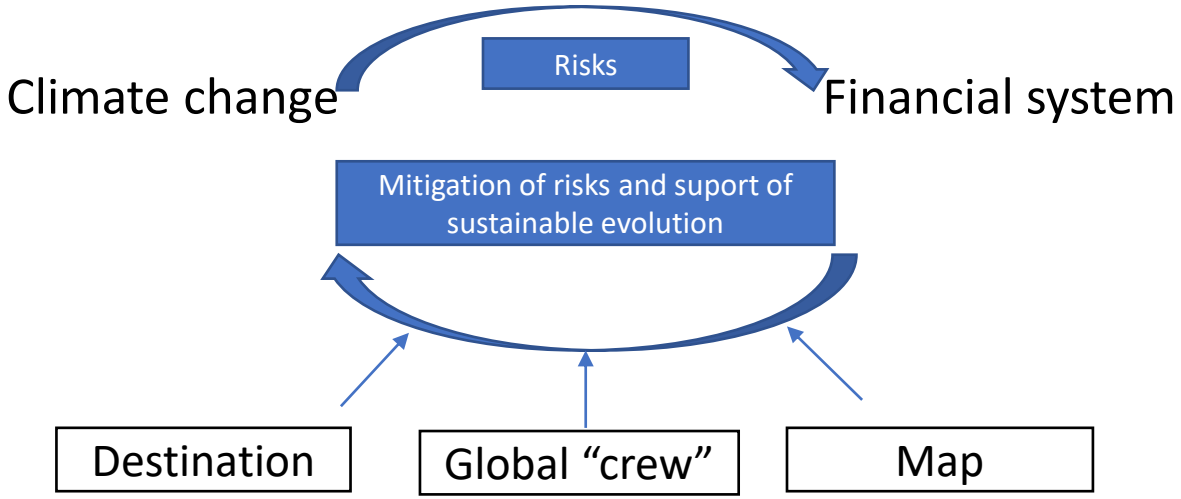
Step 4. *Increasing the contribution of the financial sector to sustainability.*

Step 5. *Monitoring an orderly transition and ensure the integrity of the EU financial system.*

Step 6. *Setting a high level of ambition in developing international sustainable finance initiatives and standards and to support EU partner countries.*

The IPCC (2022a: 174) argues that the transformation is “a collective action challenge among actors with both common and differing values, interests and capabilities interacting over time with a mix of cooperation and competition”.

Role of the organization of financial market regulation



Source: based on Breden (2019)

Private risks vs public concerns &

Private interest vs public interest issues

- Disparity in distribution of costs and benefits (Finnegan, 2019).
- Cost arbitraging between the present and the future (Petterson, 2021).
- If the distribution of the growth in productivity to ensure mass loyalty… (Habermas, 1973).

2. Financing eco-transition and regulation

- Public-private dilemma: Are the finance flows sustainable?

Zhou et al. (2018): in Asia and Africa in 2014-2017 foreign state-owned entreprises invested in fossil fuel-based projects.

- The financial needs of transition are about USD 100 bn/yr (Inter-government Green Climate Fund).
- The role of banks: do they function according to a collective plan?

In the Minskyian approach of endogenous **financial instability**, financial system's working do generate, especially under loose public regulation, serious systemic instabilities that may threaten the viability of the economy, dampening the conditions of debt repayments, bank loans and increasing the likelihood of bank and other financial failures (Ülgen, 2020);

Macro-financial risks are related to financial innovations that mainly seek at enlarging speculative operations in order to realize huge returns through the use of investment vehicules and markets exuberance.

Climate changes do generate 2 types of risk: physical and transition (Feyen et al. 2020; Coelho and Restoy, 2022).

change negatively affecting the conditions of production of many activities because of mass pollution, warming, cyclones, droughts, flooding, etc.

structural risks due to the adaptation costs, technology changes, structural changes, mastering new processes of production, controlling and improving modified activities

“What is a transition process?”: an institutional perspective

- A “creative destruction” process leading to replace old methods, products and technologies by the new and most efficient ones, in the Schumpeterian vein.
- as a process of “rethinking economics and regulation” that calls large enough public and stakeholders involvement;
- those changes will certainly affect the conditions of production of many activities and generate interlinkages between macro-financial and climate related risks with increasing uncertainties.

Changes in **regulatory** measures could encourage shifts in the prive sector’s consumption and investment, and generate significant financing needs and result in structural changes in the transition process.

Changes in the **microprudential** and **macroprudential rules** have to be shaped in order to prevent possible flaws in the market functioning and to deal with the risks that transition-related developments may generate for financial market actors.

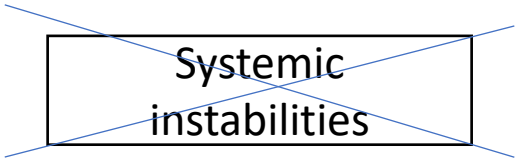
Regulatory framework towards eco-transition (1)

Some general principles for a relevant regulatory framework with regard to the characteristics and needs of eco-transition (Llewelyn, 2011).

The standard regulatory regime has **two main targets**:

1. Lowering the likelihood of bank failures by framing the scope of financial activities and preventing speculative strategies from taking control over the economy;

2. Lowering the cost of possible failures for society by identifying the responsibilities of the players in order to prevent socialization of failure costs and moral hazard incentives in markets.



A society-wide transformation requires society-wide financing that cannot be ensured by market mechanisms. Transition is a long-term process that calls for **long-term stable relations**.

Regulatory framework towards eco-transition (2)

An "**ecologically consistent financial regulation**" can be reframed following the ***precautionary principle*** that *"has emerged as a guideline for managing environmental risks in the face of tremendous complexity and uncertainty"* (Kuntz-Duriseti, 2004: 291).

- Such a regulation might allow policymakers to address environment-related financial risks along with speculation-related market risks in a collectively consistent way (Chenet et al. 2022).

- The precautionary regulation may also be a solution to combine markets innovativeness, macroeconomic/systemic stability and long-term financing of transition projects.

Innovative dynamics prove to be a major source of change on the evolutionary path of economic change that can be shaped according to the needs of the transition process.

3. Conclusion

1. There is a need for financial systems to review the regulatory models in favor of prudential rules and supervision institutions in order to incorporate the implications of climate-related financial risks for financial stability and speculation-related systemic risks for sustainable transition.

2. **Financial stability and transition stability are two sides of the same coin.**

3. **Physical** and **transition risks** threaten the stability of the financial system while speculative activities threaten the stability of eco-transition.

4. Eco-transition is a systemic change that concerns all the resources and allocation processes.

5. As financing of transition is a long-term process that calls for long-term stable relations, financial regulation should be reframed following the **precautionary principle** and market-relying finance should be replaced by a **common-good guided collective action** for the provisioning of a public good: the sustainability of ecologic/economic system.