



Social Taxonomy - Challenges and Opportunities

Key Points

- The EU taxonomy is part of the EU's sustainable finance framework. By providing transparency for investors, it aims to channel investments towards environmental sustainability.
- The Platform on Sustainable Finance published a concept for a social taxonomy proposing a similar structure to the one for the environmental taxonomy. Three objectives should be addressed: decent work, decent living standards and inclusive and sustainable communities.
- A social taxonomy is not even in its infancy. The respective report of the Commission is overdue. The idea of risks death by neglect. But there are good reasons to revive the debate.
- The EU taxonomy should include also social sustainability. A well-designed social taxonomy has the potential to improve the consideration of the social impact of investments, help to prevent social washing, contribute to a fair transition and to enhance social sustainability.
- The involvement of trade unions must be ensured. The success of the taxonomy depends on its credibility and on a conducive social policy environment. Public welfare systems and sound regulation will remain key. A taxonomy designed to promote privatization has to be rejected.
- A social taxonomy should provide a higher level of ambition than provided for in legislation. Respect for human and workers' rights and, in particular, compliance with collective agreements are decisive. The European Pillar of Social Rights and the UN SDGs should serve as references.

Background

The EU's sustainable finance framework aims to steer private financial flows towards sustainable economic activities. Within this framework, the EU has worked on various initiatives and legislative acts. One of them is the EU taxonomy, which plays a key role. It should provide transparency for financial investors and companies and support them in identifying sustainable investments. In that sense, the [Taxonomy Regulation 2020](#) constitutes a classification system, which focuses on six environmental objectives in the areas of climate change mitigation and adaptation, water, biodiversity, pollution prevention and circular economy. A sustainable investment must make a substantial contribution to achieving at least one of these objectives and do no significant harm to any of them (DNSH-principle). It also has to meet social minimum safeguards, which means for example that it has to be aligned with the [ILO Declaration on Fundamental Principles and Rights at Work](#) and the [International Bill of Human Rights](#). The implementation is conducted via delegated acts, which so far focus on climate goals, as for example the contentious [Complementary Climate Delegated Act](#), which includes nuclear and gas activities in the taxonomy.

However, right now a social taxonomy is not even in its infancy. Article 26 of the Taxonomy Regulation 2020 mandates the Commission to publish a report by the end of 2021, to assess the options available for extending the scope of the EU taxonomy to 'other sustainability goals such as social goals'. This report is still overdue and, not least against the background of pressing policy matters due the current crisis, risks death by neglect.

The European Economic and Social Committee (EESC) drew up an [own-initiative opinion](#), which was adopted in September 2022, with the objective to stimulate the debate again. This policy brief is based to a large extent on that opinion.

Main findings

Opportunities of a social taxonomy

The general goal of the EU taxonomy, which is to channel investments towards sustainability by providing a transparent classification system, is welcomed. It is supposed to contribute significantly to the sustainable transformation of the financial sector. However, the EU's sustainable finance concept neglects social aspects. It should be aligned with a holistic approach including environmental as well as social sustainability. A social taxonomy should be developed in order to complement the environmental taxonomy and balance sustainable investments, so that also social sustainability is represented. An operationally viable and conceptually sound social taxonomy could contribute to a better consideration of social aspects. It could, for example, help steer investment towards companies committed to decent work. At the same time, a just transition requires sustainable social conditions, and a social taxonomy could deliver long-awaited guidelines.

Moreover, there is an increasing demand for financial products which address environmental, social and governance (ESG) criteria. This demand is confronted with a lack of clear definitions and standardization, in the social field. Analysis of ESG ratings and related outputs reveals fundamental differences depending on the provider of the ratings. A well calibrated social taxonomy would offer a coherent concept for measuring social sustainability. However, to make the social taxonomy's opportunities come true, various challenges have to be mastered and risks have to be tackled. The detailed design of such a taxonomy will be decisive.

How might it work?

In 2021, the [Platform on Sustainable Finance](#), which is commissioned to advise the Commission in the context of the taxonomy, presented a [concept for a social taxonomy](#), proposing a similar structure as the one for the environmental area. This means, that a social sustainable investment must make a substantial contribution to at least one of the respective three social objectives, which consist of diverse sub-objectives, and do no significant harm to any of them (DNSH-principle).

Firstly, the decent work objective includes sub-objectives such as strengthening social dialogue, living wages that guarantee decent lives, providing excellent health and safety for workers, programs for life-long learning and providing social protection. Secondly, the objective of adequate living standards includes healthy and safe products, quality health care and quality housing. Thirdly, the objective of inclusive and sustainable communities should also promote

equality and inclusive growth and support sustainable livelihoods. With these objectives, the most important stakeholders of a company should be addressed, specifically the entity's workforce and value-chain workers, the end-users and the affected communities.

Moreover, an investment conferrer with the social taxonomy has to meet minimum safeguards, which relate to environmental, governmental and social goals. That is to avoid inconsistencies, such as for example a company carrying out sustainable activities being involved in human rights abuses, tax fraud or environmental degradation.

A gold standard

The multilevel and diverse structure proposed by the Platform on Sustainable Finance constitutes a valuable basis for a holistic approach. Similar as the environmental taxonomy, also the social taxonomy should constitute a gold standard reflecting a higher level of ambition than provided for in legislation.

While it should relate to various international and EU principles and standards, the [European Pillar of Social Rights](#) and the relevant [UN Sustainable Development Goals](#) (SDGs), all above SDG 8 8 (decent work and economic growth) should play a prominent role. 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 is crucial and should constitute a DNSH principle. Guidelines with positive social impacts, which are based on the agreement of social partners, should also serve as reference.

In addition to the social goals, sustainable management objectives, such as transparent and non-aggressive tax planning, should be incorporated into the social taxonomy. Finally, activities that fundamentally and under all circumstances conflict with sustainability goals and whose harmfulness cannot be reduced should be excluded, such as those involving weapons outlawed by international agreements.

What constitutes a "substantial contribution"?

The Platform on Sustainable Finance proposes three types of "substantial contributions". The first type includes ones which focus on the additional inherent benefits of the activity itself, like housing, health, transport, or telecommunications. Here, criteria such as availability, accessibility, acceptability, and quality (AAAQ) should be fulfilled. The Platform stresses that publicly or privately offered products and services with inherent social benefits can qualify for the social taxonomy if they meet the criteria based on the AAAQ concept. However, this idea must be handled with great caution. In any case, it must not end up being supportive to privatisation of public services.

It is in the very public interest that public investment continues to play the key role in this field.

Moreover, a substantial contribution should exist if negative impacts on the stakeholder groups mentioned above are thereby avoided or addressed. This would include occupational health and safety, training, or collective agreements. The third type of substantial contribution is enabling activities which pave the way for other activities to provide social benefits.

Would a social taxonomy contribute to social progress?

Assessments of a social taxonomy's potential impact range from negligible, as investment decisions would be primarily based on motives such as increasing returns or minimizing risks, to concrete fears that non-compliance with the taxonomy would lead to worse financing conditions. However, a social taxonomy will gain importance if it is part of an overall policy geared towards social fairness and inclusion, accompanied by appropriate rules, for example concerning human-rights due diligence. The best designed classification system for private investments will never replace sound governmental regulation and social policy. Financing of social welfare by government spending and stable social security systems remains fundamental.

On the other hand, the taxonomy has a potential to be used by governmental institutions as a reference for example in the context of public procurement as well as aid and funding programmes. However, any broader use should be subject to a democratic decision-making.

Prevent "social washing", ensure fairness and provide clarity

A well-designed social taxonomy plays a crucial role in combating "social washing", which disguises and blandishes socially negative impacts of economic activities on workers, consumers, and communities, and therefore makes it even more difficult to tackle them. The focus on the activity, rather than the company as a whole, can offer a loophole for 'social washing' if corporate structures and working conditions do not correspond to the positive image the company promotes. Complaint mechanisms for trade unions, works councils or consumer organisations should be provided for and the competent national authorities should be made more responsible for carrying out their control tasks.

The debate in the EESC clearly showed that mainly the employer's side rejects a social taxonomy. For example, there are concerns of complex information requirements and costly audit procedures. These

could however be countered by taking advantage of the overlap with other reporting requirements, such as those required by the future Corporate Sustainability Reporting Directive (CSRD) and the planned Corporate Due Diligence Directive on sustainability. Conversely, the taxonomy would offer an assessment and classification of these data based on the criterion of social sustainability. Advice and provision of services related to the taxonomy could be provided by a public law agency, especially for small and medium-sized enterprises, co-operatives, and non-profit business models. Moreover, a social taxonomy would also foster a level playing field and prevent unfair competition.

All in all, the taxonomy should constitute an orderly and consistent set of rules without excessive complexity and duplication. Also, transparency and the avoidance of loopholes is of importance. While the very goal of the taxonomy should be a holistic and comprehensive approach, striving for perfection and the inclusion of all aspects of social sustainability at once might lead to huge delays. Therefore, it should be started with simple and clear guidelines, providing for easy and transparent procedures and complementing them step by step. The objective of decent work should be prioritised.

Democratic debate about "social sustainability"

Finally, the definition of what should be included in the taxonomy will be controversial. The categorisation of nuclear power and gas as taxonomy conformant was strongly rejected by many people. Currently, the debate seems come to nothing. However, there are good reasons why the definition process of what is deemed "sustainable" should be subject to democratic debate and decision making. This is the only way to develop a common and reliable idea of sustainability, to which individual actors could and should refer. The development of a common idea of sustainability is also a precondition for averting green and social washing.

The success of the taxonomy is linked to its credibility and the activities included must meet a widely accepted definition of sustainability. Therefore, in particular trade unions and workers' representations should be fully involved when designing the social taxonomy. In that context, the excessive use of delegated acts in the field of the taxonomy is highly questionable, because a wide range of fundamental political questions are addressed.

Demands

- The debate about a social taxonomy should be revived. The Commission should publish the overdue report, which should be subject to transparent public debate. The activities included must meet a widely accepted definition of social sustainability. A comprehensive involvement of trade unions and the workers' representation must be ensured from its development to the control structures.
- A social taxonomy must serve to prevent social washing. Therefore, a common idea of social sustainability should be developed, the rules and procedures should be easy and transparent, the focus should be on the company level and complaint mechanisms should be provided for trade unions and works councils.
- The taxonomy should represent a gold standard. Respect for human and workers' rights should be a prerequisite to be taxonomy conformant. Compliance with collective agreements and codetermination procedures—at company and group levels—should be a cornerstone.
- A social taxonomy will work best if it is part of a comprehensive social policy approach. Public welfare systems and sound regulation will continue to play the key role to boost social progress.
- A social taxonomy designed to promote privatization of public services has to be rejected. Public investment has to continue to play a key role in the field of public services.
- Excessive complexity should as well be avoided as striving for perfection. To promote the implementation of a social taxonomy, it should be started with simple and clear guidelines, providing for easy and transparent procedures and complementing them step by step. Decent work should be prioritised.
- Finally, the actual impact of sustainable investment on real economy activities should be carefully evaluated.

Literature

EU Taxonomy for sustainable activities: [EU taxonomy for sustainable activities \(europa.eu\)](#)

Platform on sustainable finance: [Platform on Sustainable Finance's report on social taxonomy \(europa.eu\)](#)

EESC initiative opinion: [Social taxonomy – Challenges and opportunities | European Economic and Social Committee \(europa.eu\)](#)

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December 2022

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