EU Taxonomy: key to climate neutrality or free pass to greenwashing?

In 2020, the EU Taxonomy was implemented with the goal of helping the EU achieve climate neutrality by 2050. Four years later, the European Commission is facing two lawsuits regarding its climate ambitions. Is the taxonomy living up to its promise and true potential?

By *Nikkie Pelzer* and *Rosl Veltmeijer*

Introduced in 2020, the EU Taxonomy serves as a comprehensive guide that defines which economic activities within each sector can be considered environmentally sustainable. As of 2023, companies with over 500 employees, as well as investors, are required to report their alignment with the taxonomy. This reporting clarifies the extent to which a company, project, or investment portfolio aligns with the EU Taxonomy, providing a measure of its environmental sustainability, or how 'green' it truly is.

The lawsuits the European Commission is now facing are a clear sign that the taxonomy is – at least in the perception of several stakeholders – not (yet) delivering on its intention. The first lawsuit, filed by a coalition of NGOs, challenges its 2030 carbon emission targets, claiming that the latter must be ramped up to bring them in line with the 1.5°C goal of the Paris Climate Agreement. The second lawsuit claims that the sustainable finance criteria are flawed because they label certain fossil investments, such as new planes and ships, as green. They argue that this would encourage banks and pension funds to continue investing in a fossil fleet instead of in real climate solutions.

A catalyst for sustainable finance

The EU Taxonomy is part of the European Green Deal, a comprehensive strategy aimed at transforming the EU into a modern, resource-efficient economy where there are no net emissions of greenhouse gases by 2050. The taxonomy serves as a tool to guide investors, companies, and policymakers in identifying sustainable economic activities that align with the EU's environmental objectives.

To be classified as sustainable under the EU Taxonomy, an activity must contribute to at least one of six objectives:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

Moreover, the activity may not significantly harm any of the other objectives, must meet minimum social safeguards, and comply with technical screening criteria that are continuously updated.

ILLUSTRATION: SHUTTERSTOCK

> ‘The EU Taxonomy actively encourages greenwashing by labeling certain activities sustainable that according to science are not sustainable at all.’

Criticism of the EU Taxonomy is not new. Since its introduction, it has been facing headwinds. A major criticism is the inclusion of controversial sectors, such as nuclear energy and natural gas as sustainable. What’s more, important economic activities that can potentially be green, such as agriculture, are not yet in scope of the framework. The debate over these topics clearly highlights the political complexities inherent in creating a comprehensive sustainability framework.

Moreover, the global nature of financial markets means that the success of the EU Taxonomy also depends on its ability to influence and integrate with similar frameworks in other regions. From our experience so far, some criteria are hard to apply outside the EU because of different standards. In addition, data is not always available, and collaborating with other lenders may complicate the data collection process.

Finally, the need to regularly update technical screening criteria across various sectors has created uncertainty for businesses trying to align with the taxonomy, particularly in industries where the criteria are still under development or where they are contentious. This is especially true for fund-of-fund investments, which involve companies rather than assets and are therefore more complex, as well as for start-ups. As a result of these challenges, funds with an environmental ambition are not necessarily fully aligned with the taxonomy.

Valuable but imperfect

The irony is that the EU Taxonomy aims to eliminate investment greenwashing and to direct more capital towards sustainable projects that contribute to a greener, more resilient European economy. Yet it actively encourages greenwashing by labeling certain activities sustainable that according to science are not sustainable at all, thus lowering the bar for more harmful companies to get ‘a stamp of approval’.

As an impact investor, we support the intention of the EU Taxonomy and acknowledge its potential to be a trailblazer in sustainable finance and in greening Europe. We only invest in companies that contribute to making our society more sustainable. Our assessment of investment opportunities with an environmental objective is based on the taxonomy and we stimulate companies to align their operations with the taxonomy. However, given its current limitations, we do not steer on maximising the taxonomy alignment of our portfolios:

- We exclude investments in activities that we do not, but the taxonomy does consider sustainable, such as natural gas and nuclear.
- And, vice versa, we invest in activities we consider environmentally sustainable but that are not (yet) covered by the taxonomy.
- Moreover, we invest in companies with social objectives, which are not in scope of the current taxonomy framework.
- Where the taxonomy criteria prove difficult to assess, for example in emerging markets or start-ups, we leverage on other assessment methods to determine the sustainable potential of an investment.

All in all, the EU Taxonomy certainly is an important step towards a standardised framework for environmental sustainability. In pursuing and assessing broader impact opportunities around the world, however, it should be used with caution and flexibility.

In the meantime, we continue our lobby for further improvement of the taxonomy and support initiatives that aim to embed the science-based perspective, such as the Independent Science Based Taxonomy[1] (ISBT). Time will tell if the EU Taxonomy indeed proves to be the key to unlocking a greener, more resilient European economy and to achieving the 2050 climate-neutrality target. ■

1 The ISBT aims to create rigorous evidence-based sustainability criteria for investments. It duplicates the EU Taxonomy’s criteria wherever they are robust and only departs from them when they are scientifically weak or unevidenced.

Nikkie Pelzer

Impact Manager,
Triodos Investment Management

Rosl Veltmeijer

Portfolio Manager,
Triodos Investment Management

SUMMARY

Two lawsuits against the European Commissions raise doubts concerning the effectiveness of the EU Taxonomy.

Factors like the inclusion of controversial sectors, the difficulties in applying the criteria outside the EU, and the need to regularly update technical screening criteria across various sectors pose challenges to the EU Taxonomy.

The EU Taxonomy may unintentionally encourage rather than reduce greenwashing.

The EU Taxonomy should be used with caution and flexibility.

PHOTOS: ARCHIVE TRIODOS INVESTMENT MANAGEMENT, ONNO ROOZEN