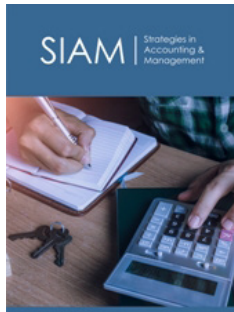


Are the EU's New Green Investment Rules Really Green?

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ISSN: 2770-6648



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Submission:  November 12, 2022

Published:  November 16, 2022

Volume 3 - Issue 5

How to cite this article: Hamed Ghiaie* and Maxim Rudischhauser. Are the EU's New Green Investment Rules Really Green?. *Strategies Account Manag.* 3(5). SIAM. 000574. 2022.
DOI: [10.31031/SIAM.2022.03.000574](https://doi.org/10.31031/SIAM.2022.03.000574)

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Opinion

In 2015 the Paris Agreement on climate change stated that countries should pursue “ambitious efforts” toward keeping global warming below 2 °C. However, talking about climate change cannot be considered enough of an “effort” to avoid irreversible climate effects by 2050. So, what does? The transition from a resource-intensive, wasteful economy to a circular and sustainable one requires structured and practical action plans for all involved stakeholders. With the presentation of the European Green Deal (EGD) in 2019, which outlined the Union’s agenda to reach climate neutrality by 2050, the European Commission has taken the lead in becoming the first carbon-neutral economy. With that said, the required “effort” merely begins now and proves much more demanding than writing action plans. Meeting the EU’s climate ambitions requires the mobilization of substantial investments to finance such a radical economic transition. The European Commission has devoted €1 trillion to finance the transition stipulated by the EGD. Though, alone by 2030, an estimated gap of €2.5 trillion persists. With the realisation that the private sector needs to be involved, the proposed “EU Taxonomy” by the European Commission in 2019 is meant to steer capital towards sustainable projects. This, now partially enacted, framework is nothing less than the most extensive classification system of environmentally sustainable business activities yet. The intent is to prevent greenwashing, to nudge investors toward “greener” investment opportunities, but most importantly to build the foundation for subsequent legislation. The EU Taxonomy fits into a wider agenda aiming to involve the private sector in the fight against climate change, namely the Sustainable Finance Action Plan (SFAP). With the hopes to incentivize sustainable development from within the financial sector, this policy initiative focuses on one hand to increase transparency of investment behaviour from financial institutions and on the other hand to enhance sustainability requirements for companies. The observed deterioration of the environment has led to the rise of “sustainability” as a buzzword to fix it all. In principle, it is the right path toward solving the problem. However, channeling the solution of an imminent global crisis into one word has led to greenwashing, confusion, and a general disempowerment of sustainability claims all together. With a classification system that evaluates the degree of sustainability of economic activities according to technical screening criteria, the European Commission attempts to give assurance and guidance to investors, companies and the general public. Even though its development will most certainly prove to be a significant contribution to sustainable finance initiatives, the EU Taxonomy already begins to unveil complexities and flaws that may endanger its benevolent scope. An ongoing political debate about the potential inclusion of the Waste to Energy sector in the EU Taxonomy serves this article as an indicative example of the present difficulties faced in the creation of this regulation. The Waste to Energy (WtE) sector deals with the recuperation of energy from the incineration of waste that, in theory, cannot be recycled otherwise. By being confronted with widespread criticism from NGOs and members of the European Parliament, the dilemma of including or excluding WtE from the EU Taxonomy helps to estimate the future influence of the EU Taxonomy on companies and even whole sectors. Germany has the most prosperous but with almost 2.5 times the CO₂ emissions of France also the most polluting economy in the EU. The hope for

the EU Taxonomy is that it will steer financial markets towards investing in sustainable innovations and projects that support the net-zero goal. However, according to interviews with the most prominent German WtE companies, a potential exclusion from the EU Taxonomy fails to reduce their confidence in securing future funding. Arguments supporting the untroubled stance include the perceived necessity of the sector in managing waste flows, the ability to transition towards a circular economy and the investors' better judgement.

Not only would a potential exclusion go against investors' perception of the potential of this economic activity, but it also even goes against scientific findings and the EU's previous regulations on the waste management sector. In 2008 the European Parliament and Council published the waste hierarchy which essentially encourages the prioritization of any other viable method of treating waste before disposing it (i.e.: landfilling). As a PwC study rightfully analysed, waste incineration for energy recovery is placed above in this hierarchy. Therefore, the exclusion of this economic activity, as opposed to the much more drastic environmental impact of landfilling, is incoherent with EU legislation. This deviation from objective scientific facts and regulations is explained by the political involvement. While policies within the EU are subject to negotiations between all its members, in the case of an objective classification system, this policy creation process, influenced by lobbies and members of the parliament, can lead to counterintuitive results. This consequently results in confusion for companies on how to orient their sustainability strategies, a further dilution of the idea of "sustainable" activities and a weak policy foundation for subsequent regulations of the SFAP. In a qualitative study on the WtE sector in Germany, the EU Taxonomy has found very few sympathizers. Companies like Remondis and Energy from Waste GmbH had identified themselves as actors in reaching sustainability goals and a circular economy prior to the EU Taxonomy. Counterintuitive to the desired scope, most companies stated that the EU Taxonomy posed an important obstacle towards moving to circularity in their sector. Companies have placed the circular economy at the centre of their strategy (i.e.: Remondis) but the exclusion could now lead to the interpretation that WtE is not part of a transition to a circular economy. Beyond the impediment of future projects for these companies, the consequences of excluding this sector will have EU-wide effects that would oppose a circular economy. Especially in Poland and other Eastern European countries that joined the EU in 2004, the waste management infrastructure is less developed, and landfilling is much more prevalent. According to the German industry association for circular economy (BDE), the exclusion of WtE or worse, the inclusion on a "brown list" of the EU Taxonomy would hinder investments for the expansion of WtE plants in other countries. Mainly in the eastern European countries, this would indirectly incentivize the expansion of landfills which produce high levels of methane gas. Waste to Energy however is a relevant economic activity which produces much fewer emissions while eliminating volumes of waste that are either economically unviable to recycle or not recyclable at all and generating energy

at the same time. With these contradictions and unprecedented dangers for a whole sector the question of how companies deal with the EU Taxonomy's developments arises. The consensus of companies and industry experts tells us that the general strategic orientation of WtE companies has not changed due to already existing sustainability initiatives. However, the possible exclusion from the Taxonomy has sparked concerns. With increasing efforts, WtE companies are reporting about their contributions to reduce emissions in the waste management sector in order to fight for the recognition of their role in a circular economy at EU level. While increased efforts in public affairs departments rather than continuing business as usual are upsetting some industry players, it nonetheless becomes clear that the EU Taxonomy and its potential effects on future policy initiatives may already have an impact by putting pressure on these companies to accelerate the execution of their roadmap to climate neutrality.

The degree of detail the EU Taxonomy strives to achieve proves to be a double-edged sword. On one side its approach could make the Taxonomy a strong foundation to instrumentalise the financial sector for the EU's climate goals while on the other side unveiling the complex and diverging political, scientific, and legal opinions on defining sustainable activities. The intention of reaching climate-neutral economic growth as stipulated by the EGD and enabled by the EU Taxonomy ultimately serves as a global competitive advantage. To secure the economic benefits of being a first mover, it is in the best interests of the EU and its member states to ensure that the EU Taxonomy, as a reference for sustainable investments and development, becomes a solid foundation. Consecutive regulations will lean on this framework to provide the necessary market signals for an economic shift towards resource-decoupling and long-termism. As only a part of the EU Taxonomy is officially enacted since January 2022, the process can still be shaped, and flaws remediated.

Excluding a sector from the EU Taxonomy which is assessed by industry experts as a sustainable solution in the transition of the economy towards net-zero demonstrates a lack of expert involvement at EU level. Even though the Technical Expert Group (TEG) and the Platform on Sustainable Finance assist in delivering a fair and scientifically guided EU Taxonomy, the lack of knowledge of industry-specific features and political involvement can endanger this classification system. If the Taxonomy becomes more politically influenced than scientifically guided, it may cause the dilution of its effectiveness and questioning of its accuracy. This is reaffirmed by the events of the 6th of July 2022. The inclusion of nuclear and gas activities will now, due to a vote of the Parliament, find their way into the EU Taxonomy and lead to a disempowerment of this regulation and sustainability assessments as a reliable measure for investments. To ensure a coherent policy creation process, the goal of this regulation in creating transparency on what is deemed as sustainable economic activities should be safeguarded. Furthermore, adding to the possible dilution of the EU Taxonomy is its contradiction with other EU regulations. The

EC has implemented a waste hierarchy which places WtE in front of landfilling. However, in case of the exclusion of WtE, the EU Taxonomy would support the more cost-efficient but highly harmful alternative, namely landfilling. In line with the assessment of PwC, such a legal contradiction of the EU Taxonomy poses challenges for further policies and questions the EC's consistency. Coherence between EU regulations should therefore be maintained. Lastly, the debate around the Waste to Energy sector has shown that the observed zero-waste ideology by NGOs and EU officials may lead to destructive consequences. Around 20% to 30% of waste cannot be recycled in an economically feasible way for the foreseeable future. Even though the approach to foster innovation through financial incentives is right-minded, the EU Taxonomy needs to account for transitional activities which are the "least harmful" alternative. As the BDE underlined in an interview, the EU Taxonomy can have a domino effect on future policy initiatives and therefore the exclusion of debatable activities should be treated carefully. WtE should be classified as the best viable transitional solution and still requires market incentives to replace landfills in less developed EU states.

To conclude, this article evaluates the EU Taxonomy as a policy that not only assists the subsequent implementation of financial instruments for the Sustainable Finance Action Plan (SFAP) but essentially builds the foundation to enable the transition towards

circularity of an entire economy. This analysis highlights that in absence of expert assessments and realistic approaches to circularity, the EU Taxonomy can lead to more harm than good. A feasible and realistic approach has to be found to incorporate "transitional activities" like WtE in order to ensure the time-sensitive transition. In congruence with this, the classification of sustainable activities should be based on scientific assessments rather than political involvement and in coherence with previous EU legislation to not dilute and question its efficacy. As a building block of an economic transition until 2050, the EU Taxonomy will affect funding conditions and market signals. It should therefore be considered relevant for upper management and strategic business development departments for the possible adaptation of business orientation. By assessing market trends and competitive landscapes it becomes clear that soon enough companies will either be labelled sustainable or not, and its effects will determine a business's prospects. For policymakers at EU level continuous efforts in the presented areas should be made to ensure the EU Taxonomy's fair and effective guidance in nudging financial institutions and companies towards supporting a sustainable transition. While the initiative of the EU Taxonomy is ground-breaking and can have significant effects on redirecting capital flows, the degree to which the scope of this regulation is reflected in its implementation will determine the effectiveness of the SFAP.