

To meet the goals of the Paris Agreement and address the biodiversity crisis, the flow of global investment needs to be rapidly redirected from unsustainable to sustainable economic activities. Yet, it remains difficult for governments, investors and businesses to determine what green economic activity is. One way to address this is via a green finance taxonomy which provides a transparent and common language framework of sustainable economic activities to help guide investors, business and public sector alike.

Green taxonomies to date have had a predominant focus on low carbon and climate adaptation activities. Yet to truly address both the climate and biodiversity crises, it is also necessary to identify which economic activities reduce the environmental impacts associated with natural resource consumption which is responsible for 50 per cent of global carbon emissions and up to 90 per cent of terrestrial biodiversity loss.

The transition to a circular economy is a critical requirement to reducing the environmental pressures associated with industrial resource use and consumption and should therefore be integral to any taxonomy. Yet, given the systemic nature of the circular economy, the activities of which cut across every sector of the economy, the question remains as to how best to incorporate circularity into a taxonomy framework.

***The aim of this dialogue series is to address this question particularly focussing on integration of circular economy into EU and UK's taxonomies.***

### Background

Finance is an essential enabler for the transition to a net zero and circular economy. Despite growing recognition of the important role of finance, the stark reality is that investment in sustainable economic activities remains far below the necessary level to deliver a transition within a suitable timeframe.

To put this into context, out of the \$14.6trillion of spending by [50 leading economies](#) on the COVID-19 recovery in 2020, only \$368 billion was directed to green activities while, in the EU alone, an [investment gap](#) of EUR 350 billion per year exists to help meet the climate goals and an additional EUR 100–150 billion per year is required to meet its broader environmental goals.

It is increasingly recognized that more needs to be done to redirect the flow of capital and green financial taxonomies offer a promising tool with which to do this. A green finance taxonomy provides a common classification system for identifying activities, assets and project categories that deliver on key climate, green, social or sustainable objectives with reference to identified thresholds and targets. A common classification system creates security for investors, protects private investors from greenwashing, help companies to become more climate-friendly, mitigates market fragmentation and helps shift investments where they are most needed.

Several countries have developed [green finance taxonomies](#) including China, Bangladesh, Mongolia, Singapore and South Africa while others are in the process of developing their own versions including Canada, Australia, Colombia, the UK and the EU.

But, despite the development of these taxonomies being largely promising, concerns have been raised that the establishment of country or region specific taxonomy approaches could serve to hinder a global green

transition due to varying methodologies, structures and localized technical screening criteria (TSC) resulting in harmonization difficulties and challenges for investors and companies to align with each taxonomy.

## UK Green Taxonomy

In 2019, the UK developed a [Green Finance Strategy](#) to align private sector financial flows with clean, environmentally sustainable and resilient growth and to ensure the UK's long-term competitiveness. The UK government subsequently announced in November 2020 that it would become the first major economy to introduce mandatory reporting of climate-related financial information across the economy by 2025 with the vast majority of requirements to be in place by 2023.

In June 2021, Chancellor Rishi Sunak announced that the UK would implement a green taxonomy. At the same time, the UK government published the [Green Financing Framework](#) in which it is expected the green taxonomy will align.

Following this announcement, the UK government established the Green Technical Advisory Group (GTAG) to provide independent advice and oversee the government's implementation of a green taxonomy. The work of the GTAG is expected to run for at least two years and will provide initial recommendations on the taxonomy to the government in September 2021.

## EU Green Taxonomy

Perhaps the most ambitious taxonomy under development is the [EU Taxonomy for Sustainable Activities](#). Development of the taxonomy commenced in 2018 as a cornerstone of the EU Green New Deal. The [Taxonomy Regulation](#), which establishes the basis for the EU taxonomy, was published on 22 June 2020 and entered into force on 12 July 2020 and established six environmental objectives to be covered by the taxonomy:

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

To date, the primary focus, in terms of detailed development of the taxonomy, has been on Objectives 1 and 2 on mitigation and adaptation. In July 2018, the European Commission established the [Technical Expert Group \(TEG\) on sustainable finance](#) to develop recommendations for technical screening criteria (TSC) for economic activities that defined what a substantial contribution to climate change mitigation and adaptation entailed with the [final report](#) being published in March 2020.

Following the report, the [first delegated act on sustainable activities for climate change adaptation and mitigation objectives](#) was formally adopted on 4 June 2021 for scrutiny by the co-legislators before, the [Delegated Act supplementing Article 8 of the Taxonomy Regulation](#) was adopted on 6 July 2021. The act specifies the content, methodology and presentation of information to be disclosed by financial and non-financial undertakings concerning the proportion of environmentally sustainable economic activities in their business, investments or lending activities. A second delegated act covering mainly the remaining environmental Objectives 3 to 6 will be adopted in the first half of 2022. In preparation for this act, the Platform for Sustainable Finance (PSF) – in particular the Technical Working Group (TWG) which is a

subcommittee of the PSF – has been tasked by the European Commission with outlining a proposed goal and TSCs for Objectives 3 to 6 as well as refining the TSCs for Objectives 1 and 2.

As a result the work of the PSF, and in preparation for the ongoing public consultation on the TSC for Objectives 3 to 6, the [‘Taxonomy pack for feedback’](#) was published compiled with the support of 100 experts. This document outlines 102 Technical Screening Criteria spanning 20 sectors primarily for Objectives 3 to 6 and, as such, it has achieved significant strides in terms of outlining a potential structure and methodology for each objective, in particular, the objective on the circular economy which is one of the most complex of all of the objectives.

## Circular economy and green taxonomies

The circular economy is a critical enabler to addressing the climate and biodiversity crises. It is therefore imperative that the circular economy is embedded within any green taxonomy. Taxonomies so far have built on clearly defined long-term objectives, reliable metrics, specific economic activity descriptions – all of which make it complicated to effectively integrate the circular economy concept.

First, unlike climate mitigation or pollution control, which have definitive and objective metrics and legal requirements with which to compare activities such as gCO<sub>2</sub> or BOD levels, the circular economy does not yet have such clear metrics with which to develop TSCs and, in many cases, it is difficult to determine which activity results in greater ‘circularity’ than another.

Second, achieving circularity requires the transformation of the entire economy and therefore cuts across all sectors and activities. It also involves new activities which are not traditionally classified under existing codes. In many cases the application of circular practices will provide substantial contribution to all other objectives, for example, reuse of construction materials significantly reduces a buildings carbon footprint as well as minimising its pollution.

Third, there is no overarching legal requirement for achieving circularity – decoupling environmental impact from resource consumption – with which to align TSCs with nor even a legal definition of the circular economy.

Fourth, the recently published report by Chatham House, [‘Financing an inclusive circular economy: De-risking investments for circular business models and the SDGs’](#), highlights that circular economy solutions remain severely underfunded thereby demonstrating particular need for circularity to be explicitly included in the taxonomy.

**In recognition of these unique challenges, it is necessary for the stakeholder community to consider how the challenges associated with integrating the circular economy into green taxonomies could be addressed so the full potential of the circular economy can be realized.**

## Objective of the ‘Circular economy and green taxonomy’ dialogue series

Recognizing that both the EU and UK green taxonomies are under development, there is an opportunity to bring together from both parties of stakeholders, as well as circular economy experts and practitioners, shared learning and expertise with the aims of effectively embedding the circular economy within a taxonomy and identifying areas for harmonization and potential divergence – harmonization being particularly important given the interconnectedness between the two markets.

Chatham House, through funding from the Laudes Foundation, will conduct a series of three dialogue sessions from September 2021 to June 2022 which will convene a wide range of EU, UK and relevant global taxonomy stakeholders.

### Date, time and programme

The dialogues will be organized to coincide with key milestones in the development of the EU and UK taxonomies.

Dialogue 1: Thursday 16 September 2021, 13:00-15:30

Register: <https://chathamhouse.cplus.live/event/circular-economy-in-the-eu-and-uk-taxonomies>

The first session is scheduled for Thursday 16 September. This coincides with the open consultation on circular economy criteria in the EU taxonomy, the upcoming recommendations of the Green Technical Advisory Group on a UK taxonomy to the UK Treasury, as well as international negotiations with the G20 on a global 'common grounds' taxonomy framework.

- **13:00-14:20: Panel event**

The first half of Dialogue 1 will include a combination of presentations and a panel discussion hosted by E3G and open to the public. The discussion will focus on the status of the EU and UK taxonomies including lessons that can be learned from the EU experience, dynamics at the global level regarding the creation of a common framework for existing taxonomies and their role in accelerating the circular transition.

- **14:20-15:30: Policy dialogue**

The second half will be an invitation-only policy dialogue, facilitated by Chatham House, for 20-25 key stakeholders from the EU Platform on Sustainable Finance, UK Green Technical Advisory Group and the wider expert community on circular finance. For more information on this second half of the event, please contact [kwetterberg@chathamhouse.org](mailto:kwetterberg@chathamhouse.org).

The event will be led by Kate Levick from E3G and Dr Jack Barrie from Chatham House and is funded by the Laudes Foundation.

Dialogue 2: January 2022

The second dialogue is planned to take place in January 2022 to occur around the time when the common grounds taxonomy framework has been announced, and the UK GTAG will have worked through another round of recommendations to the UK Treasury. Date and time to be confirmed.

Dialogue 3: June 2022

The last dialogue is planned for June 2022 and will coincide with the end of the GTAG's first year and will give an opportunity to dialogue stakeholders to plan for knowledge dissemination and joint messaging. Date and time to be confirmed.

