The EU Taxonomy for sustainable investments: An analysis of its alignment with greenwashing assessment tools

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Identification of the subject

In recent years, there has been a growing focus on sustainable investments, along with increasing concerns regarding their authenticity, commonly referred to as greenwashing. A major challenge in identifying greenwashing is the lack of a clear understanding of what constitutes green investments. In this context, I consider different greenwashing assessment tools and examine their alignment with the EU Taxonomy, a framework providing a common definition for environmentally sustainable activities.

Personal motivation and rationale

Sustainable investments have grown in popularity, driven by increasing awareness of environmental and social issues. Thus, companies often feel pressured to portray their activities as more sustainable than they truly are. As a potential investor, I do not wish to be misled by such greenwashing practices and am interested in how the literature tries to tackle this problem. The EU Commission attempts to address this issue through its EU Taxonomy. Hence, I ask myself if the EU and the literature can collaboratively address this issue, aiming to enhance transparency in sustainable investments.

Research question

My central question is to what extent existing greenwashing assessment tools can be aligned with the EU Taxonomy´s understanding of environmentally sustainable activities. I hypothesise that greenwashing assessment often lacks a normative grounding, which the taxonomy could provide.

Literature review

Sustainable investment is addressed by the literature using numerous terminologies such as Socially Responsible Investment or Environmental, Social and Governance (ESG) investing, the preferred generic term (Kapil and Rawal, 2023). Nevertheless, sustainable investment is still surrounded by ambiguity, presenting a significant issue, particularly in the context of identifying greenwashing (ibid). Comprehending what qualifies as environmentally sustainable is essential for addressing greenwashing (Hale, 2023; Dorfleitner and Utz, 2023). In addition to the literature, which offers different instruments for assessing greenwashing, various jurisdictions are developing taxonomies of sustainable investments, frameworks standardising green activities (Dusík and Bond, 2022). One of their primary aims is the protection of investors

from greenwashing (ibid). The EU Taxonomy is the framework developed by the European Commission and the focus of my research. Specifically, my research project entails a two-step approach to investigating the alignment of greenwashing assessment tools with the taxonomy. Firstly, I explore how the taxonomy defines environmentally sustainable activities. Secondly, I examine the extent to which different greenwashing assessment tools could incorporate this framework.

In December 2019, the EU introduced the European Green Deal, a growth strategy intending to promote sustainable investments (European Commission, 2023). Within this framework, the EU Taxonomy Regulation provides a common definition and classification system of environmentally sustainable activities (ibid). Thus, the EU helps alleviate the ambiguity surrounding the terminology of sustainable investment, thereby supporting investors in identifying genuine sustainable investments. In order to qualify as environmentally sustainable, an economic activity must substantially contribute to at least one of six environmental objectives (climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems) while not causing significant harm to any of the others (European Commission, 2023). Furthermore, the activity must comply with technical screening criteria and adhere to minimum social safeguards (ibid). However, despite the taxonomy's intentions, there's opposition over classifying technologies such as nuclear power as sustainable energy sources. Dorfleitner and Utz (2023) and Egres and Sarlós (2024) highlight differing interpretations of sustainability, noting that proponents, especially EU citizens, view nuclear power as green due to its low carbon emissions, while opponents, notably environmental groups, emphasise the long-term issues of radioactive waste. This indicates a contentious divide in opinions regarding the taxonomy´s view on sustainability.

Several tools have been developed to measure greenwashing. My research analyses three of them in relation to the EU Taxonomy. Dorfleitner and Utz (2023, p.9) developed a conceptual framework to measure greenwashing on firm level, what they define "as the discrepancy between a firm´s green appearance and its actual green performance". They argue that a fundamental requirement for evaluating a firm's environmental integrity is the establishment of a normative basis, i.e., a clear understanding of what constitutes environmental sustainability. They assume multiple dimensions of environmental sustainability within the chosen standard. As the taxonomy defines green activities, it could serve as the normative basis for this framework, with its six objectives representing the dimensions. Another tool was developed by Nemes et al. (2022). They suggest that evaluating greenwashing requires identifying potentially misleading claims and comparing them against indicator questions outlined in their

framework. However, their tool lacks a normative basis. Integrating the taxonomy could provide this foundation, aligning the framework with the taxonomy´s six environmental objectives. Furthermore, certain companies, particularly large public interest entities, are required to disclose information regarding taxonomy alignment (European Commission, 2023), which could be used to answer the indicator questions and enhance the reliability of greenwashing assessment. Hu et al. (2024) argue that investors can assess the prevalence of greenwashing by examining the readability of ESG disclosures, given their result that companies with clearer ESG information are generally less involved in greenwashing. The taxonomy could enhance this readability as it establishes a clear understanding of environmentally sustainable activities, enabling companies to provide more transparent data on their sustainability performance. However, the tool developed by Hu et al. (2024) may be restricted in its applicability because of their narrow focus on companies within the Chinese market.

In summary, none of these three tools provides a normative basis by itself. The EU Taxonomy could serve as this foundation, thereby improving greenwashing assessment and thus the identification of genuine sustainable investments. Nonetheless, further research is necessary to evaluate the level of taxonomy support from potential investors to determine whether it is appropriate to integrate its definition into these frameworks.

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Keywords

Greenwashing: Misleading disclosure of information that creates a false impression of an organisation´s environmental performance (Nemes et al., 2022).

Circular economy: A model of production and consumption that focuses on extending the life cycle of products through sharing, leasing, reusing, repairing, refurbishing, and recycling existing materials and products (European Parliament, 2023).

Technical screening criteria: Criteria that specify thresholds or performance levels an economic activity must achieve in order to qualify as environmentally sustainable under the EU Taxonomy.

Public interest entity (PIE): A company with significant public interest due to its size, number of employees, corporate status, or the nature of its business.