Essay competition

EU-ASEAN synergies for a green and digital world

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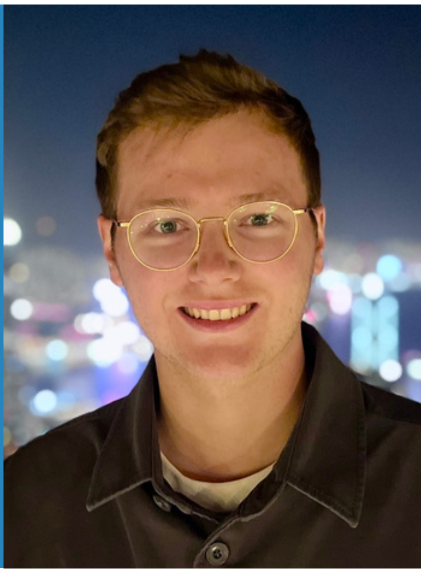

About the author

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Towards a Common EU-ASEAN Taxonomy for Sustainable Finance — How the EU and ASEAN Can Accelerate the Climate Transition

Introduction

With rising sea levels and extreme weather events occurring more frequently throughout Europe[1] and Southeast Asia,[2] climate-related risks are increasing, as showcased by the ongoing prevalence of floods in Europe and super typhoons in Southeast Asia. July 2021 saw heavy rainfall causing one of the largest flood disasters in Western Europe for decades, killing over 180 people.[3] Extreme weather events in Southeast Asia tend to be even deadlier.[4] Sea level rise poses another serious risk. The situation is especially dire in places like Jakarta, home to the ASEAN headquarters, where as much as 40 percent of the urban area has sunk below sea level, putting millions of people in danger.[5] A quick and forceful action to mitigate climate change is clearly needed.

[1] European Environment Agency, "Heavy Precipitation in Europe," November 18, 2021.

[2] Nobuhiko Endo, Jun Matsumoto, and Tun Lwin, "Trends in Precipitation Extremes over Southeast Asia," Scientific Online Letters on the Atmosphere 5 (2009): 168-71.

[3] Frank Lehmkuhl, Holger Schüttrumpf, Jan Schwarzbauer, Catrina Brüll, Michael Dietze, Peter Letmathe, Carolin Völker, and Henner Hollert, "Assessment of the 2021 Summer Flood in Central Europe," Environmental Sciences Europe 34: 107 (2022)

[4] Alberto Bocanegra, "As the Philippines Faces a Rise in Deadly Super Typhoons, Southeast Asia Is Bearing the Burden of Climate Change," South China Morning Post, January 15, 2022.

[5] Brian Clark Howard, "Pictures Reveal Hardship in the World's Fastest Sinking City," National Geographic, December 23, 2017.

The adoption of an EU-ASEAN common ground taxonomy for sustainable finance could help the two blocs to decrease greenhouse gas (GHG) emissions by directing more funding to the decarbonisation of economic activities. This essay will first introduce the role of the transition finance category within the broader framework of sustainable finance, next explain why a common taxonomy is needed, and finally argue why the EU and ASEAN are well positioned to implement a common taxonomy.

Green and transition finance

All EU and ASEAN member states are signatories to the Paris Agreement, vowing to attempt to limit global temperature rise to 1.5 degrees Celsius compared to pre-industrial levels. However, ASEAN member states cannot be expected to bear the same financial burden that is expected from some EU member states whose economic development is based largely on historic carbon emissions. Article 4 of the United Nations Framework Convention on Climate Change (UNFCCC) therefore states that countries share "common but differentiated responsibilities."[6] This differentiation is reinforced by the pressing need for adaptation funding in parts of Southeast Asia to tackle the immediate results of climate change.[7] But, when it comes to funding climate mitigation, governments can only do so much. Pathways to net-zero emissions must therefore unavoidably take the private sector into account.

Recognising this, a growing number of think tanks and financial institutions are starting to pay more attention to the concept of "green finance," while numerous governments have designed taxonomies of sustainable finance aiming to provide lenders a clear framework to invest in sustainable economic activities.

[6] United Nations, "United Nations Framework Convention on Climate Change," 1992.
[7] Herminia A. Francisco, "Adaptation to Climate Change: Needs and Opportunities in Southeast Asia," ASEAN Economic Bulletin 25, no. 1 (2008): 8.

The EU, for example, published its Taxonomy Regulation in 2020, establishing the basis for an EU taxonomy for sustainable activities.[8] ASEAN launched its Taxonomy for Sustainable Finance in 2021.[9]

Although green finance is doing much to allow the private sector to contribute to the energy transition, not every company in every sector can completely switch to renewables or take the step to net-zero immediately. Sectors that are strongly locked into carbon emissions are often referred to as "hard-to-abate" sectors, and include energy-intensive industries such as steel, petrochemical, aluminium, and cement. Together they account for around 22 percent of global CO2 emissions.[10] Hard-to-abate sectors are often unable to raise funds for decarbonisation, because green finance is usually protected by rigorous standards that guarantee financiers that the economic activities they fund are indeed green, not greenwashing.

However, a growing number of experts recognise that hard-to-abate sectors have an important role to play in the transition of the global economy to net-zero emissions. Even if those sectors have no place in a zero-emissions future, in many cases they can already do much to decrease their emissions – if they can attract the funding to do this. For example, according to the International Energy Agency, coal-fired power plants can be retrofitted to capture up to 99% of their carbon emissions.[11]

This is where the concept of transition finance comes in. The Hong Kong Green Finance Association (HKGFA) has defined transition finance as the funding of "partially satisfactory technologies and activities."[12]

[10] Max Åhman, "Unlocking the 'Hard to Abate' Sectors," World Resources Institute, accessed June 12, 2022.
[11] International Energy Agency, "Zero-Emission Carbon Capture and Storage in Power Plants Using Higher Capture Rates," January 27, 2021.
[12] Hong Kong Green Finance Association, "Navigating Climate Transition Finance: The China & Hong Kong SAR (China) Context," (2020), 2.

According to HKGFA, while these activities may not be able to become entirely sustainable today, they constitute a significant portion of the trajectory towards a net-zero economy. Products of transition finance can include transition bonds as well as sustainability-linked bonds (SLBs) and loans (SLLs). Transition bonds differ from green bonds because green bonds are only designed for green industries, including renewable energy and non-polluting transportation.[13] Transition bonds are also available for partially satisfactory solutions, such as the retrofitting of a coal-fired power plant to decrease carbon emissions.

Common ground taxonomies

Whereas parts of the EU have developed into post-industrial, service-based economies, ASEAN member states such as Indonesia, and Vietnam are strongly dependent on coal combustion for their economic development.[14] Traditional industries such as manufacturing (responsible for nearly one third of Southeast Asia's energy-related CO_2 emissions)[15] are notoriously difficult to decarbonise, making it hard for these industries to attract green finance. Transition finance could provide a feasible option to partially decarbonise Southeast Asia's hard-to-abate sectors.

Much like other strategic sectors, interoperability and comparability are key to the success of international finance. The International Platform on Sustainable Finance (of which the EU is a member, as well as ASEAN member states Singapore, Malaysia, and Indonesia) has released a comprehensive comparison between the commonalities and differences between the EU's and China's taxonomies for sustainable finance.

[14] Jens Marquardt, Laurence L. Delina, and Mattijs Smits, "How Southeast Asia Governs Climate Change," AsiaGlobal Online, April 21, 2022.
[15] ASEAN Taxonomy Board, "ASEAN Taxonomy for Sustainable Finance," 12.

This comparison, titled EU-China Common Ground Taxonomy, aims to increase the interoperability between the European and Chinese taxonomies.[16] According to French investment bank Natixis, searching for common ground can mitigate the fragmentation between different taxonomies and boost interoperability, which would be “quite welcome.”[17]

The EU and ASEAN need to search for common ground too. By establishing a common EU-ASEAN taxonomy that includes transition finance, it would be easier to direct European funds to the partial decarbonisation of Southeast Asia’s hard-to-abate sectors including manufacturing and energy generation. With a common framework of green and transition finance in place, European investors could be more confident in investing in Southeast Asian projects that accelerate the climate transition. This would allow hard-to-abate sectors to partially decarbonise, making a vital contribution to ASEAN member states’ compliance with their Nationally Determined Contributions (NDCs) to the Paris Agreement.

Room for cooperation

As two of the most prominent success stories of regional integration,[18] the EU and ASEAN could set an example for the international community on how common governance can set the world on the trajectory to climate mitigation. The EU and ASEAN are well positioned to adopt a common taxonomy for sustainable finance including a category of transition finance. Both blocs have a classification of sustainable economic activities in place, and there is room for complementarity. In November 2021, the ASEAN Taxonomy Board (ATB) released their ASEAN Taxonomy for Sustainable Finance, aiming to accelerate the climate transition and foster sustainable finance adoption by ASEAN member states.[19]

[18] Suthiphand Chirathivat, Natthanan Kunnamas, and Paul J.J. Welfens, “Regional Integration in the EU and ASEAN in the Period of Declining Multilateralism and Corona Shocks,” International Economics and Economic Policy 17 (2020): 556.
[19] ASEAN Taxonomy Board, “ASEAN Taxonomy for Sustainable Finance,” 8.

The ASEAN Taxonomy provides a mechanism to classify economic activities into green, amber, and red, based on the activities' contributions to environmental objectives.

The ATB's "amber" classification would correspond most closely with the EU's and other international conceptions of transition activities, as it includes "interim solutions" that generate lower GHG emissions than business as usual and need to be implemented for a limited period before eventually being replaced by zero-emission alternatives.[20] Retrofitted coal-fired power plants are one example of an interim solution. The EU considers economic activities to be "transitional" if they do not yet perform in a way that is consistent with net-zero ambitions, but if they do contribute substantially to climate mitigation.[21] An example would be the use of buses for interurban transport that emit less than 50g CO_2/km (whereas zero-emissions transport would qualify as a sustainable activity).[22]

The two categorisations can be brought together, as Principle 2 of the ASEAN Taxonomy states that the ASEAN Taxonomy "will take into consideration other widely used taxonomies and other relevant taxonomies."[23] Bridging the gap between ASEAN's "amber" category and the EU's "transitional activities" would have considerable advantages in terms of decreasing GHG emissions by incentivising cross-border flows of transition finance. Adopting a common EU-ASEAN taxonomy for sustainable finance would fit well into the EU-ASEAN Strategic Partnership: sustainable financing, climate change, and clean energy transition are all designated as "main areas of cooperation" between the EU and ASEAN.[24]

[23] ASEAN Taxonomy Board, "ASEAN Taxonomy for Sustainable Finance," 20.
[24] European External Action Service, "EU-ASEAN Strategic Partnership," December 1, 2020.

If the two blocs can adopt a common taxonomy for sustainable finance, the results could potentially bring the world closer to a global standard for sustainable finance by remedying the current fragmentation of green taxonomies.

Conclusion

The EU and ASEAN share the common goal to mitigate climate change rapidly and forcefully. A common EU-ASEAN taxonomy for sustainable finance could direct European finance to high-GHG emitting industries in Southeast Asia and increase the flow of funding to sustainable economic activities. This essay has recommended that a common EU-ASEAN taxonomy for sustainable finance could be adopted, including a category of transition finance, allowing hard-to-abate sectors to attract funding to partially decarbonise. These sectors are currently unable to attract green finance, but increased funding of partially satisfactory solutions could significantly decrease GHG emissions. This could make a valuable contribution to climate mitigation efforts of EU and ASEAN member states, helping them to comply with their NDCs. Additionally, this could have knock-on effects beyond Europe and Southeast Asia by remedying the existing fragmentation of taxonomies and bringing us closer to a globally harmonised sustainable finance taxonomy.

[23] ASEAN Taxonomy Board, “ASEAN Taxonomy for Sustainable Finance,” 20.
[24] European External Action Service, “EU-ASEAN Strategic Partnership,” December 1, 2020.