

INSIGHT

Mobilizing Green Finance through K-taxonomy



A green taxonomy can direct investments to environmentally sustainable activities. Photo credit: KIF.

Setting the criteria for classifying environmentally sound investments can help the Republic of Korea transition to a carbon-neutral economy.

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Introduction

The Republic of Korea aims to achieve a carbon-neutral economy by 2050 to contribute to global climate action. Korean domestic firms along the global value chain are now shifting toward a low-carbon, eco-friendly paradigm, and are starting to adapt green finance—a sustainable strategy that considers environmental, social, and governance impacts.

For these firms and investments to produce real environmental benefits, the Korean government will establish K-taxonomy, a tool that will define environmentally sustainable industries and economic activities, in the first half of 2021. To efficiently channel financial flows into legitimate green initiatives, specific environmental objectives must be set, alignment with global green financing practice must be ensured, and activities that would inevitably arise in a transition toward a green society must be considered.

Analysis

The Republic of Korea is taking decisive action in harnessing green innovations and advancing digital technologies to achieve carbon neutrality by 2050. One of the key elements of the 2050 Korean vision is scaling up the circular economy to improve industrial sustainability. The continued growth of green industries will accelerate the country's green transition. On the other hand, misplaced investments due to greenwashing—a process of providing investors with misleading information that a particular development project is environmentally sound—could disrupt the country's progress.

A green taxonomy could make investments and lending decisions sound and protect investors from greenwashing.

To establish a green taxonomy, it is important to seek a broad social consensus over environmental objectives, areas of application, and criteria for classifying environmentally sound activities.

The Korean government has mostly focused on a climate change response as mandated by the Paris Accord. The country needs a national consensus on detailed environmental objectives. For example, the European Union (EU) has articulated six objectives when it established its EU taxonomy. These are climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems.

It is critical to align with global practice in terms of the areas and activities covered by a green taxonomy. The Institute of International Finance emphasized that global alignment is important since a green taxonomy is established at a country or regional level, not by international organizations, such as the Financial Stability Board. The EU identifies economic activities by industry and determines whether each activity is sustainable or not. For instance, in the manufacturing sector, nine activities including low-carbon manufacturing are identified as green; five activities including forest restoration are considered sustainable in the forestry industry; while 25 activities including solar power generation are identified as environmentally safe in the electric and gas industry.

Setting criteria for green activities also requires analyzing overseas cases that consider various shades of green instead of a binary approach. In case of the EU, an activity must meet the following:

- make substantive contributions to attaining one of the six objectives mentioned above,
- avoid significant compromise on other objectives,
- observe a minimum level of international safeguards, and
- adhere to technical screening criteria.

Although considered as a good starting point, EU's approach is binary as it fails to acknowledge activities that fall between green and non-green, which inevitably arise in a long transition toward a green society.

The Malaysian taxonomy is drawing attention as the first green taxonomy among emerging markets and

for considering an economic transition stage. It considers an activity to be green if it shows efforts to transition toward an eco-friendly society. It assesses activities based on the following criteria:

- contributes to climate mitigation and adaptation,
- does not make a significant compromise on other environmental objectives,
- shows efforts toward a transition to an eco-friendly economy, and
- it is not prohibited.

Implication

For the Korean government to achieve carbon neutrality by 2050, a nationwide transformation that is supported by a robust and sustainable institutional framework is required. Finance strategies must be laid out to change the course of the economy toward a greener direction. Having a K-taxonomy will help authorities and investors effectively mobilize green finance and make investments socially responsible. The government will be able to get all sectors to support its vision if all are aligned with what is sustainable.

Resources

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Hyoung-Seok Lim

Senior Research Fellow, Consumer Finance Division, Korea Institute of Finance

Hyoung-Seok Lim joined the KIF in 2009 as a research fellow. He previously worked at the Bank of Korea's Institute for Monetary and Economic Research and at the

Policy Planning Bureau. He holds degrees from Seoul National University's International Economics Department and from Ohio State in the United States.

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