

# P R A K A R S A *Policy Brief*

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## Indonesia's Green Taxonomy Must Cover Strategic Environmental and Social Goals in Its Criteria



### Key Points:

- The existing Indonesia Green Taxonomy does not explicitly include strategic environmental objectives and social aspects such as inclusion, gender equality, and respect for human rights.
- It is important to outline social aspects in detail in the Green Taxonomy document because they are inseparable and are part of economic activity.
- A Just Green Taxonomy is important as a standard and guidance in financial services institutions' financing, as it can directly contribute to climate change mitigation and adaptation as well as societies' welfare.

### Global Trends in Climate Change and Indonesia Green Taxonomy

In 2009, for the first time, Indonesia submitted a Nationally Determined Contribution (NDC) document containing commitments to emission reductions and strategies for climate resilience to the United Nations Framework Convention on Climate Change (UNFCCC). Indonesia aimed to reduce greenhouse gas emissions by 29 percent independently and 41 percent with international assistance by 2020. This target was increased on the NDC enhance document to 31.89 percent with own contribution and 43.20 percent with international assistance (Ministry of Environment and Forestry, 2021). With the commitment to reduce greenhouse gas emissions by 29 percent independently by 2030, it is estimated that the total need for green funding in Indonesia is 247 billion US dollars or equivalent to 3.461 trillion rupiah (KLHK, 2018). To support this commitment, special financing allocations from various parties are certainly needed other than from the State Budget (APBN).

According to Bank Indonesia (2020), banking sector holds almost 80 percent of total financial assets in Indonesia. This shows that the banking sector has great potential in filling the massive climate finance gap. Considering this great potential, the government also continues to encourage banks to carry out green financing, one of which is through the Indonesian Green Taxonomy document and POJK No. 51 of 2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies.

Green Taxonomy is expected to prevent greenwashing practices or improper reporting of green activities by the financial industry (OJK, 2022). By classifying harmful economic activities, Green Taxonomy is also useful for the financial industry to identify potential non-performing loans and credit failures, while for investors Green Taxonomy can be used to assess their portfolios against the risk of declining or devaluation of assets (stranded assets)

(Fair Finance Asia, 2022). Indonesia Green Taxonomy includes 2,733 classifications of sectors and subsectors that have been confirmed by relevant technical ministries.

### The Gap Between Indonesia Green Taxonomy and the European Union and China

The European Union and China are among countries and regions that had green taxonomy documents. Indonesia was one of the countries in ASEAN that first initiated this document. However, the implementation of the Green Taxonomy is still voluntary. The following summarizes the differences in strategic objectives, feasibility criteria and classification standards between these three Green Taxonomies.

Indonesia Green Taxonomy does not explicitly mention specific strategic environmental objectives, such as what environmental goals are to be achieved with the Green Taxonomy document. In the European Union Green Taxonomy document, the strategic environmental objectives are explicitly to achieve climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, protection and restoration of biodiversity and ecosystems, transition to a circular economy, pollution prevention and control, protection and recovery, and biodiversity and ecosystems. Likewise with the Green Taxonomy document in the People's Republic of China, which objectives as climate change response, environmental improvement (pollution control and ecological conservation), as well as more efficient utilization of resources (circular economy, pollution prevention and waste recycling control and pollution prevention).

Based on standard eligibility criteria, Indonesia Green Taxonomy does not explicitly mention the eligibility criteria used in assessing and determining green economic activity. Indonesia

Green Taxonomy document only mentions eligibility criteria based on the eligible threshold criteria. Compared to Green Taxonomy in the European Union, the document already explicitly stipulates that green economic activity must make a substantial contribution to at least one of the six environmental goals. Indicators related to substantial contributions are based on technical screening criteria for climate change mitigation and adaptation. Furthermore, Green Taxonomy in the European Union also asserts that green economic activity must not undermine any of the other five environmental strategic objectives (Do No Significant Harm/DNSH) and must meet the minimum requirements of compliance with the OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights (UNGPR), including the principles and rights enshrined in the eight basic conventions listed in the International Labour Organization Declaration on the Principles and Fundamental Rights in the Workplace and the International Bill of Human Rights.

The standard eligibility criteria in the Green Taxonomy document of the People's Republic of China has also clearly stipulated that green economic activity must meet one or more environmental strategic objectives, green economic activity must meet the requirements in the Green Industry Guiding Catalogue 2019 edition and adapts to the requirements of the predefined Green Taxonomy. Green economic activities must comply with the fulfillment of scientifically based and consistent actions, respect the development of the current state conditions of the People's Republic of China and must comply with regulations and policies related to safety, environmental protection that meet the relevant quality standards that in force.

Then when viewed based on classification standards, Indonesia Green Taxonomy uses the Indonesian Business Field Standard Classification (KBLI) system by the Indonesian Central Statistics Agency. Meanwhile, the European Union green economy uses the NACE (Nomenclature of Economic Activities) classification system. Meanwhile, the People's Republic of China uses six categories in classifying green economic activities, including energy-saving and environmental protection industries, clean production industries, clean energy industries, ecological and environmental-related sectors, sustainable infrastructure, and green services.

Indonesia Green Taxonomy applies eligibility criteria based on threshold criteria. Indonesia Green Taxonomy also still applies three classifications, namely, green for all economic activities that contribute to the protection, improvement and repairment of environmental quality; yellow for all economic activity that meets only a few green criteria/thresholds; and red for economic activity that damages the environment.

The consequence of applying the classification is that yellow labels are still applied to some sectors that pose a high risk to the environment and social, such as in coal mining and fossil fuel power generation sectors, which shows that this sector does no significant harm. The yellow criteria are given on the condition that they have a PROPER green or gold rating or meet criteria such as environmental

permits and air pollution control including complying with emission quality standards (BME) and conducting emission monitoring.

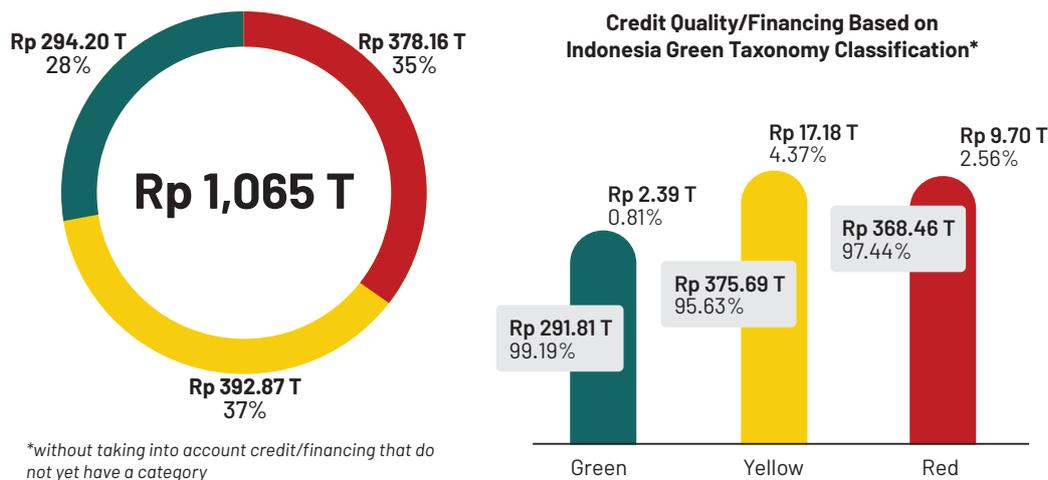
## Green Taxonomy Implementation Mechanisms and Strategies

The right strategy is needed so that Green Taxonomy implementation run smoothly and in accordance with the expectations of the stakeholders. OJK made a strategy to implement the reporting (OJK, 2022):

1. The pilot project aims to obtain preliminary information about the portfolio from the reporter, done manually using an excel file. The target of the first phase is the Bank Group based on Core Capital (KBMI) 3 and 4 with data coverage in the form of productive and consumptive loans (Non-MSMEs and MSMEs) from individual debtors which are reported in stages and consist of 2 reports, namely the Indonesia Green Taxonomy report and thematic report.
2. Short-term strategy as a temporary solution before the ideal version of the report. Conducted through the OJK Online Reporting Application (APOLO) reporting system, provided that KBMI Bank 1,2,3,4 (KBMI 3 and 4 begin to report in full through APOLO, while KBMI 1 and 2 will be piloting through APOLO (indicative starting March 2023) and a meeting will be held with KBMI banks 1 and 2 for preparation. The scope of data includes productive and consumptive loans (Non-MSMEs and MSMEs) from individual debtors which are reported gradually consisting of 2 reports: THI report and thematic report.
3. The long-term strategy aims to complement the reporting that has been running and carried out in a systematic manner where THI has been embedded with the existing reporting (full implementation / ideal plan). Reporting includes a sustainability report and a Sustainable Finance Action Plan (RAKB). The required whistleblowers include Financial Service Institutions, Issuers, and Public Companies with the data that has been submitted will be further processed through the OJK application. Data coverage in the form of productive and consumptive loans (Non-MSMEs and MSMEs) from the individual debtor that is reported in stages.

Based on the framework reporting on the implementation of Indonesia Green Taxonomy in 2022, it is reported that the implementation of credit/financing based on the Green Taxonomy classification reached IDR 1,521 trillion in June 2022. There are 17 banks (KBMI 3 and 4) that have reported the top 100 debtors based on THI with a total debit balance of IDR 1,521 trillion and a total reported data of 11,254 data (credit accounts/facilities). About 70% of them have a classification (red/yellow/green) based on the assessment report conducted by banks, while the rest 30% have no information, which means IDR 372.16 trillion (24.5%) have not been mapped into any economic sector in Green Taxonomy while the data of IDR 83.7 trillion (5.5%) have not been completed by banks.

Figure 1. Implementation of Indonesia Green Taxonomy by Classification



Source: OJK, 2022

The credit/financing portfolio in the economic sector that has a Green classification (green credit/financing) has a relatively low value, amounting to Rp294.20 trillion or 28% of the total credit/financing classified compared to the Red (Rp378.16 trillion) and Yellow (Rp392.87 trillion) classifications. Although lending to the red and yellow economic sectors dominates, green credit/financing has the lowest percentage of Non-Performing Loans (NPLs) (0.81%) when compared to credit/financing to the yellow (4.37%) and red (2.56%) economic sectors.

### Indonesia Green Taxonomy, Room for Improvement

Indonesia Green Taxonomy has considered economic, social, environmental, and governance factors in the economic activity. However, the document does not explicitly regulate inclusion, gender, and human rights aspects. Gender is an important issue that must be considered because the prerequisites for a green economy are expected to involve the role of women not only in formal economic activities but also in non-formal economic activities or unpaid workers, such as housewives.

The economic transition to the activities that are more concerned with the environment and social will certainly change the business model and social conditions of the society. In drafting the Green Taxonomy, the determination of criteria and conditions not only based on the regulations at the national level and best practice standards. Business activities defined in the Green Taxonomy should not only contain green criteria and conditions, but should ensure that a project or business activity continues to protect and respect social rights including inclusion, gender equality, and human rights.

In addition, discussions and controversies have arisen regarding the inclusion of the business sector with fossil fuels/coal as a yellow criterion in the green taxonomy document (do no significant harm). Another discussion about coal, which is still considered a pillar of the country's economy, brings up the term transition finance. This term is feared to be a perfect promotion of coal as a financed commodity that appears to contribute to low-carbon economic activities. Despite the fact that numerous studies

have shown that coal is the primary source of greenhouse gas emissions in Indonesia. Furthermore, other power sources, such as gas and nuclear, are being debated, for example, the European Union's green taxonomy, which includes this sector in the document. Following that, many civil society organizations and investors rejected it. This is because, of course, it will be a setback and will contradict the established emission reduction targets.

The Indonesian Green Taxonomy Document continues to use sectoral categorizations with minimum standards to allow for business model adjustments. Furthermore, no regulatory requirements have been imposed on the financing alignment reporting mechanism used by banks and other financial institutions that are aligned with the Green Taxonomy. Due to the lack of regulations, the industry has been forced to rely solely on market mechanisms. In the future, OJK must regularly develop a monitoring mechanism for banks and financial service institutions. This mechanism, of course, needs to be participatory and involve all related stakeholders.

The green criteria in the Indonesian Green Taxonomy document should put the justice principles by incorporating not only environmental but also social criteria. The Sustainable Development Goals (SDGs), particularly SDGs 1, 5, 8, and 10, can be used to determine social indicators. Furthermore, in terms of human rights, refer to Presidential Regulation No. 53/2021 concerning the 2021-2025 National Action Plan for Human Rights, which focuses on vulnerable groups such as women, children, people with disabilities, and indigenous peoples. There is no known taxonomic document that incorporates social aspects. However, the social taxonomy, which includes guidelines for business sectors that contribute to social aspects, is still being debated in the European Union, particularly at the Technical Expert Group (TEG) level (Final report of the Technical Expert Group on Sustainable Finance, 2020)..

### Policy recommendations for Incorporating Social Aspects into the Indonesian Green Taxonomy Document

The incorporation of social aspects is required to ensure that the business contribute to environmental and social

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welfare improvements. The following policy recommendations:

- OJK provide systematic references on developing green criteria and standards for inclusion, gender equality, and human rights protection into the taxonomy documents. Criteria referring to national regulations or by adopting international standards and initiatives. Several regulatory references that can be used in the preparation of these criteria include Law No. 11 of 2005 on Ratification of the International Covenant on Economic, Social, and Cultural Rights; the Convention on the Rights of the Child (UNCRC); the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW); and the United Nations Guiding Principles on Business and Human Rights.
- OJK increasing the context of sustainability beyond environmental aspect, but also inclusivity, gender equality, and human rights. As a result, the Green Taxonomy can be developed in terms without leaving the context, evolving into a Just Green Taxonomy or even a Sustainable Taxonomy.
- OJK provide a reference for various parties to use in order to grow and increase innovation and investment in economic activities that have a positive impact, upholding inclusivity, promoting gender equality, human rights, and improving the quality of the environment in Indonesia.
- OJK improving the reference standards explicitly for national and local governments, investors, business people, and financial sector players on the criteria for Green Taxonomy (Red, Yellow, Green) regarding environment, inclusion, gender equality, human rights enforcement, and categorizing companies that commit environmental, gender, and human rights violations into red classification.

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