

# How can the EU taxonomy be implemented meaningfully?

## Introduction

To support the European Green Deal, the EU Commission is pursuing its Sustainable Finance Agenda. The centrepiece is the introduction of a classification system that defines the criteria for sustainable economic activities – the EU taxonomy. This legislation should contribute to greater transparency on the capital market and steer financial flows towards sustainable investments, thus promoting the ambitious transformation of the economy towards European climate neutrality by 2050.

A sustainable economic activity is defined as

- substantially contributing to at least one environmental objective,
- doing no significant harm to any other environmental objectives and
- complying with minimum social safeguards.<sup>1</sup>

The six environmental objectives 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 as well as
- protection and restoration of biodiversity and ecosystems.<sup>2</sup>

This position focuses on climate taxonomy, covering the first two environmental objectives.

With three key figures – turnover, capital expenditures (CapEx) and operating expenditures (OpEx) – companies are obliged to disclose what proportion of total economic activities is covered by the EU taxonomy (taxonomy eligibility) and what percentage meets the various sustainability criteria (taxonomy alignment).

VCI has prepared a critical review of the current EU taxonomy legislation supplemented with various examples. It is based on the analysis of the extensive legal requirements<sup>3</sup> as well as numerous consultations, including stakeholders from the financial sector and auditing. With eight concrete areas for improvement, this paper shows how the practical implementation could be facilitated for companies from non-financial sectors as well as how the positive impact of the EU taxonomy could be significantly increased and broadened.

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<sup>1</sup> [regulation \(EU\) 2020/852](#), page 8.

<sup>2</sup> [regulation \(EU\) 2020/852](#), page 5.

<sup>3</sup> [regulation \(EU\) 2020/852](#) and respective delegated acts as well as FAQs.

## Analysis and areas for improvement

### General analysis and assessment

With a tremendous number of innovative products and the adaptation of various production processes towards sustainability, the chemical industry makes a decisive contribution to a successful transformation and to achieving environmental objectives – not only within its own industry but also as a manufacturing industry of basic materials for many downstream sectors of the overall economy.

In principle, the current EU taxonomy requirements regarding climate objectives classify only a small proportion of the economic activities of the chemical industry as taxonomy eligible.

The hurdles to achieve taxonomy alignment are extremely high or insurmountable for various activities – not only technically, but also chemically. There are two major reasons, the broad concept but at the same time very narrow criteria to avoid harming other environmental objectives ("Do no significant harm principle") and very restrictive technical screening criteria. Consequently, there is a significant contradiction between the substantial contributions of the chemical industry to the environmental objectives and the relatively low proportion disclosed as taxonomy eligible and aligned.

**The initial idea of making sustainable economic activities visible to the capital market and financing the transformation of the economy in a forward-looking manner is currently not being achieved.**

### Eight concrete areas for improvement

#### 1. Include all contributions from the economy to achieve climate and environmental protection objectives

The current legislation focuses on the environmental objectives of climate change mitigation and adaptation (climate taxonomy). Therefore, the taxonomy eligibility is currently limited to activities that cause about 80% of greenhouse gas emissions in the EU, which in turn only covers about 40% of the economic activity of listed companies within the EU.<sup>4</sup> The lack of capturing economic activities is particularly problematic when crucial pre-products/processes are left out that make a substantial contribution to the transformation of our economy and society.

One example of these "enabling activities" is the production of polysilicon, which is an essential precursor for manufacturing solar panels. A lack of coverage in the EU taxonomy also applies to the production of isocyanates, which are important precursors for building insulation. Energy-efficient building refurbishment offers a high CO<sub>2</sub> reduction potential. In this respect, the EU

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<sup>4</sup> EU-Commission: [Questions and Answers: Taxonomy Climate Delegated Act and Amendments to Delegated Acts on fiduciary duties, investment and insurance advice](#), 2021.

taxonomy contradicts the recommendations of the Federal Environment Agency (Umweltbundesamt)<sup>5</sup>.

The production of additives and catalysts is also not taxonomy eligible as "enabling activity", but facilitates ecological improvements of various production processes, both within the chemical industry and to a significant extent in other sectors of the economy.

Taxonomy eligibility ☑	no taxonomy eligibility ☒
Solar panels	production of polysilicon as essential precursor for manufacturing solar panels
Energy-efficient building refurbishment	production of isocyanates as important precursors for building insulation
Specific manufacturing processes	Additives and catalysts that reduce greenhouse gas emissions from product manufacturing and/or use

**The EU taxonomy has significant "blind spots". A tremendous number of chemical activities that substantially contribute to the transformation are currently not in scope.**

## 2. Ensure comparability across different sectors of the economy

Based on the cases illustrated above, the methodological consistency along value chains seems questionable. For example, the production of many chemical precursors is practically denied taxonomy alignment via the "Do no significant harm" (DNSH) principle, even though these precursors play a pivotal role in the transformation of countless economic activities. It is not yet clear from latest company disclosures whether downstream activities also do not achieve the taxonomy alignment if essential precursors are denied this status.

Expected taxonomy alignment ☑	Limited taxonomy alignment ☒
Battery-powered electric vehicles <sup>6</sup>	Production of battery materials required for battery-powered electric vehicles
Wind turbines <sup>7</sup>	Special coatings and paints that ensure the stability and durability of wind turbines
Synthetic building insulation materials	Naphtha-based chemical precursors for building insulation materials

<sup>5</sup> „13 Thesen für einen treibhausgasneutralen Gebäudezustand“, [https://www.umweltbundesamt.de/sites/default/files/medien/1410/publikationen/pp\\_13thesen\\_treibhausgasneutraler\\_gebaeudezustand\\_bf.pdf](https://www.umweltbundesamt.de/sites/default/files/medien/1410/publikationen/pp_13thesen_treibhausgasneutraler_gebaeudezustand_bf.pdf) (only available in German), 2020.

<sup>6</sup> C(2021) 2800 final, Annex 2, 3.3 Manufacture of low carbon technologies for transport.

<sup>7</sup> C(2021) 2800 final, Annex 2, 4.3 Electricity generation from wind power.

Without a consistent taxonomy alignment for the end products required for the transformation as well as their fundamental precursors and intermediates, there is no incentive to continue to produce or use these critical and often large-volume precursors and intermediates.

Additionally, in some industries, the technical screening criteria only consider the application of the product whereas in other industries only the manufacturing of the product is considered. As a result, company disclosures along value chains are inconsistent.

**Key figures of different sectors of the economy/ industries are not directly comparable. It is questionable whether required detailed knowledge and corresponding data are available in the financial sector to be able to interpret the EU taxonomy figures.**

### **3. Technical screening criteria need to be practically applicable**

With the sensible intention of effort reduction, the EU taxonomy refers to established procedures and calculation methods for many technical criteria. However, there is a lack of congruence in the scope of the application areas and specific objectives between the individual regulations referred to and the EU taxonomy. This leads to considerable obstacles in the practical implementation as well as corresponding conflict of goals.

For example, the EU emissions trading system (ETS) does not cover all production processes that are defined as taxonomy eligible. As a result, some activities – such as certain production processes for soda ash or organic raw materials and chemicals – cannot achieve taxonomy alignment because the technical screening criteria of the EU taxonomy simply cannot be met due to the lack of coverage in the ETS.

**Gaps in definitions need to be closed. Technical screening criteria must be practically achievable and verifiable for companies.**

### **4. Ensure global applicability by acknowledging comparable non-European legislation and approvals**

The reference to the "best available techniques"<sup>8</sup> makes technical screening criteria practically non-achievable for activities outside of Europe. Instead of certifying non-European production facilities according to European standards, there are often only nationally valid references. Due to the lack of international standards or the possibility of accepting comparable procedures, a taxonomy alignment for non-European production facilities is practically excluded.

**Comparable calculation methods already established in practice should be allowed. The congruence between EU taxonomy and global reporting standards needs to be strengthened.**

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<sup>8</sup> [Directive 2010/75/EU](#).

## **5. To promote the electrification of production processes, the use of renewable energies must be included in the technical screening criteria**

Neglecting the actual energy mix in the technical screening criteria is one of the biggest contradictions in the practical implementation of the EU taxonomy. For example, for basic organic chemicals, the technical criteria require emissions to be calculated in accordance with the EU Emissions Trading System.<sup>9</sup> There, in turn, the electricity consumed is subject to fixed CO<sub>2</sub> emissions, regardless of the actual type of electricity generated.<sup>10</sup> As a consequence, taxonomy eligible activities cannot be classified as taxonomy aligned even if the required electricity comes entirely from renewable sources and the greenhouse gas emissions in reality are significantly below the threshold.

Also, for other activities such as the production of plastics in primary form the electrification and the switch from fossil fuels to renewable energies does not lead to a taxonomy alignment.

**The electrification of production processes requires considerable investments and innovation but is a significant lever for reducing greenhouse gas emissions. Unfortunately, this lever is currently ignored in the EU taxonomy.**

## **6. Chemicals need to be classified in a consistent manner with existing EU chemicals legislation**

In December 2022 the EU Commission published FAQs<sup>11</sup> confirming a strict interpretation of the DNSH principle regarding pollution caused by the use and presence of certain listed chemicals.

**Implicitly, this is a partial anticipation of the European Chemicals Strategy for Sustainability or the revision of the REACH Regulation, which creates legal uncertainty.**

The DNSH principle forces economic operators to check whether their taxonomy eligible products contain substances from reference lists or whether these are used in production (e.g. persistent organic pollutants, ozone-depleting substances, substances of high concern or very high concern<sup>12</sup>). For most substance lists, it is not clear at which concentrations such substances should be taken into account (thresholds).

To be consistent with other DNSH criteria, it is recommended to refer to and apply already defined lists of substances and thresholds from established chemicals legislation (including CLP

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<sup>9</sup> [C\(2021\) 2800 final](#), Annex I.

<sup>10</sup> [delegated regulation \(EU\) 2019/331](#).

<sup>11</sup> EU Commission: [technical screening criteria for economic activities that contribute substantially to climate change mitigation or climate change adaptation](#) and [Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets](#), 2022.

<sup>12</sup> [European Chemicals Agency \(ECHA\)](#): Substances that may have serious effects on human health and the environment can be identified as substances of very high concern (SVHCs). These are primarily substances which are carcinogenic, mutagenic or toxic to reproduction as well as substances with persistent and bio-accumulative characteristics.

or REACH regulation). A quantitative assessment of ingredients below the defined thresholds is not practicable, neither in the chemical industry nor other branches of the economy.<sup>13</sup> For the reporting year 2022, companies have developed individual, practicable approaches, resulting in legal uncertainty. In addition to a possible inconsistency in the current reporting of various companies, we are concerned about explicit thresholds below legal labelling requirements in draft regulations for future environmental goals.

The use of a large number of potentially critical chemicals exclusively in closed and monitored production facilities also leads to non-alignment with DNSH requirements, although their usage is regulatory approved, and their safe use is ensured by established production processes. **DNSH requirements should only lead to non-alignment if their use is outside controlled conditions or if the critical chemical is still present in the final product.** VCI therefore welcomes the envisaged adaptation of the legal requirements in accordance with the published draft amendments of 05.04.2023<sup>14</sup>.

## **7. Disclosure requirements and obligations to provide evidence must be manageable for reporting companies**

To disclose economic activities as taxonomy eligible a substantial contribution to at least one environmental objective needs to be proven. In many cases, the preparation of a Life Cycle Analysis (LCA) is required for this purpose. For example, the reduction of greenhouse gas emissions in production processes are to be demonstrated by means of clearly described reference methods<sup>15</sup>. In addition, the calculation of the savings needs to be reviewed by an independent third party. In current practice, LCAs are mainly prepared when the greenhouse gas footprints of entire value chains are to be illustrated or when customer benefits drive this creation for a dedicated sustainable product. The EU taxonomy's reference to an independent third-party review is partly interpreted as requiring individual certificates for each product. This exceeds the capacity of appraisers and leads to unreasonably high efforts & costs for disclosing companies.

**Procedures for demonstrating the substantial contribution to an environmental objective should be based on the current practice of comparable obligations to provide evidence.**

To achieve a taxonomy alignment compliance with the minimum social safeguards is required. Companies should ensure this compliance not only for their own business areas, but also within their supply chain (direct and indirect suppliers). For suppliers in a direct business relationship, this requirement can only be met with great effort. However, there is no direct business

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<sup>13</sup> This would require both large-scale analytical measurement programs and a corresponding lowering of the thresholds of global legal labelling requirements so that the required information would be passed on along the value chains.

<sup>14</sup> [Sustainable investment – EU environmental taxonomy \(europa.eu\)](https://ec.europa.eu/economy_finance/sustainable-investment-eu-environmental-taxonomy_en).

<sup>15</sup> Reference methods according to [regulation \(EU\) 2018/2001 article 28\(5\)](https://eur-lex.europa.eu/eli/reg/2018/2001/oj), ISO 14067:2018 or ISO 14064-1:2018.

relationship between companies and indirect upstream suppliers that would form the basis for an exchange of information. Large corporations have up to 100,000 direct supplier relationships and many times more indirect suppliers. Separate assessments or risk analyses for this tremendous number of indirect suppliers are simply too overwhelming and not manageable.

**The legislator should clarify that a company can only ensure compliance with the minimum social safeguards with its direct business partners.** Globally steered and managed processes within global industrial cooperations should be recognized. At the same time, the level of detail of disclosure obligations must be clarified.

The experience of collecting the data for the reporting years 2021 and 2022 has shown that - in addition to the large internal personnel expenses - further cost items are generated by the EU taxonomy. These costs arise, for example, for auditors, for the documentation obligations associated with the audit and for separate certifications to prove taxonomy alignment. In addition to the costs of such certifications, the existing capacities of appraisers must also be considered as an obstacle, especially since the drafts for the four other environmental objectives provide for even more certification requirements as a prerequisite for taxonomy alignment.

**The significant burden on companies to meet the overwhelming reporting requirements and obligations to provide detailed evidence must be reduced.**

The obligation for independent data verification is only applicable from 2024. Nevertheless, it is already being implemented voluntarily by many companies. **External audits make an important contribution to quality assurance. Consequently, the disclosure of all detailed data is not creating additional value.**

## **8. The original aim – fostering investments into a transformation path towards sustainability targets – needs to be strengthened.**

The disclosed key figures revenues, capital expenditure and operating expenses provide information on the status quo of a company about taxonomy eligibility and taxonomy alignment in the corresponding reporting year. It is therefore a rear-mirror view. At best, the development over several years allows conclusions about the transformation path a company is taking.

The VCI does not consider the current possibility for companies to publish concrete investment plans and measures in a forward-looking manner to be practicable. Since substantial changes to complex chemical production processes take several years, the time horizon during which investments increase taxonomy alignment within taxonomy eligible economic activities should be increased from 5 to 10 years. In addition, the required level of data detail should be significantly reduced so that strategic competitive advantages over competitors and thus the returns from investments can be realized. Due to the lack of maturity of the EU taxonomy as a governance tool, we welcome the voluntary publication of investment plans in accordance with the EU Taxonomy Regulation.

**To strengthen the original goal of directing financial flows towards sustainable investment a more comprehensive and at the same time more pragmatic disclosure of transformation enabling expenditures and economic activities is required.**

## Summary

Mapping branched value chains across different sectors of the economy into one set of rules is a complex and extremely large challenge. **The current weaknesses in the EU taxonomy illustrate the need for improvements** to achieve the goal of providing meaningful data to the capital market.

Until the improvements are implemented, the VCI considers it as **essential that the players in the financial sector are aware of the limitations of the current EU taxonomy legislation in the assessment of companies from the chemical industry.**



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