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Green Taxonomy as a Basic Concept of Sustainable Finance Through Green Bond Issuance

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Abstract

The increasing awareness of global issues in the sustainable development goals (SDGs) agenda initiated by the UN, has given rise to green investment in the economic sector, especially in the financial aspect. Referring to capital activities aimed at projects that address global issues. In recent years, green investment practices have begun to increase both in terms of the number of debt securities from individuals and countries participating in supporting the realization of SDGs 2030. In the Indonesian Capital Market there is a new financial instrument called green bonds. Green Bonds are regulated through the Financial Services Authority Regulation (POJK) Number 60 of 2017, as is the authority held by OJK regarding the regulation of the financial services sector in Indonesia. This article will discuss the legal status of green bonds in Indonesia and whether green bonds can be one of the financing schemes in Indonesia. However, interest in green bonds is still quite low considering the obstacles that result in investment risks. The research method with a normative juridical type, using literature and descriptive studies in solving problems, this research is expected to not only answer the risks but also the utility of green bonds in realizing economic and environmentally sustainable development goals.

Keywords : *Green Taxonomy; Sustainable finance; Green Bonds.*

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I. INTRODUCTION

Starting from the implementation of the Paris Agreement initiated by the United Nation Climate Change (UNFCC) in 2015. Becoming the door to open world awareness of the issue of global warming, especially the problems of climate change. The consensus results resulted in an agreement followed by 196 countries, with a message for countries in the world to take part in limiting the greenhouse effect in the current industrial era. The agreement produced was to evaluate every five years, countries that declared themselves in The Paris Agreement were asked to contribute, namely: 1). finance, 2). technical (technology) and 3). capacity development, based on not all countries have sufficient capacity to handle the issue. Financial contributions are needed in an effort to make efforts to reduce global warming a success, as a mitigation and adaptation step for member countries, especially for countries that are vulnerable to the impacts of global warming, especially in cases of climate change.

In September 2023, an international consortium of scientists mapped and measured for the first time the nine limits on the natural resources that Earth can provide to support human life. The results showed that six of the nine limits had been exceeded.[1] The results of this research can be categorized as a form of warning and pressure for countries in the world to immediately make structural changes towards sustainable economic activities. The push for sustainable economic issues is an effect of the post-failure UN Climate Talks in Copenhagen in 2009, when a group of economists thought about using financial power to deal with the climate crisis. Based on climate change, many problems arise in maintaining energy quality, so some scientists have the idea of linking climate change with investment.

The results of the development of this idea gave rise to stranded assets and a carbon bubble, and succeeded in convincing investors and the banking sector of the risk of irrecoverable losses if the climate crisis is not addressed as soon as possible. This momentum is the beginning of the sustainable finance agenda. The climate crisis is the fundamental reason and the most important problem that sustainable finance is trying to solve.[2] Basically, the principle of sustainable finance is an indicator for

[1] Katherine Richardson, et al, "Earth Beyond Six of Nine Planetary Boundaries", Science Advances, Vol 9(37) Sep 2023, 1-16

[2] Molly Scott Cato, Sustainable Finance: Using the Power of Money to Change the World, (London: Palgrave Macmillan, 2022), h. 14

analyzing how funding activities "either through capital placement or providing loans" will affect the environmental, social and economic aspects of business activities.[3]

This principle is used by investors to encourage business activities towards sustainable business practices through the following methods:

1. providing comprehensive information related to the impact of business activities on the environment,
2. supporting efforts to make strategic decisions that balance profits with sustainable goals, and
3. assessing risks and resolving uncertainties related to environmental issues.

The financial system has a primary task of allocating funds for the most productive use. Because finance can play a major role in allocating investments to sustainable companies and projects, thus accelerating the transition to a circular and low-carbon economy.[4] The form of financial contribution is in the form of investment which is then termed green investment, one of the instruments is green bonds. In practice, investment based on global issues requires large amounts of funds, the right strategy and properly structured regulations. In the context of sustainable finance, Indonesia has Law No. 4 of 2023 concerning the Development and Strengthening of the Financial Sector (UU P2SK) which is the current legal framework containing the definition and regulation of sustainable finance. As stipulated in Article 1 number 35, namely:

> "*Sustainable Finance is an ecosystem with comprehensive support in the form of policies, regulations, norms, standards, products, transactions and financial services that align economic, environmental and social interests in financing sustainable activities and financing the transition towards sustainable economic growth*."

Capital market products that are linked to the environment are Environmentally Conscious Debt Securities (green bond), so they can be categorized as one of the products of sustainable finance. Defined as debt securities whose proceeds from issuance are used to refinance part or all of environmentally friendly business activities. As stipulated in Article 4 :

[3] Dirk Schoenmaker dan Willem Schramade, Principles of Sustainable Finance, (Oxford: Oxford University Press, 2019), h. 4

[4] P. Friedlingstein et al., Global Carbon Budget 2023, Earth System Science Data, (2023), h. 5305

> "*Business activities that can be financed with green bonds are business activities and/or activities related to: renewable energy; energy efficiency; pollution prevention and control; management of natural biological resources and sustainable land use; conservation of terrestrial and aquatic biodiversity; environmentally friendly transportation; sustainable water and wastewater management; climate change adaptation; products that can reduce resource use and produce less pollution (eco-efficient); environmentally friendly buildings that meet nationally, regionally, or internationally recognized standards or certifications; and other environmentally friendly business activities and/or activities*".

Furthermore, issuers who will issue green bonds are required to obtain opinions or assessments from environmental experts. Although the involvement of these experts is well-intentioned, there is the potential for misuse of experts to justify business activities that actually have a major impact on the environment and natural resources but are considered environmentally friendly business activities, so that they receive financing.[5] As part of the global effort to address the issue, various countries, including Indonesia, have developed innovations in the financial sector to support the transition to more environmentally friendly development. One of the financial instruments developed to mitigate the impacts of climate change is Green bonds. Green bonds are debt instruments whose proceeds are partly or wholly used exclusively to finance green projects that meet the requirements for eligible green projects.[6]

The adoption of green bonds in various countries continues to show significant developments along with the increasing awareness of the importance of investment to support sustainable development. In 2019, China, Germany, the United States, France, and the Netherlands represented 50% of the world's green bond issuances, with each contributing between USD22 billion and USD27 billion.[7] Projects funded with green bonds vary depending on the policies of the issuing country. Research by

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[5] Marsya Mutmainah Handayani dkk, Kertas Kebijakan Membangun Kembali Kerangka Keuangan Berkelanjutan Indonesia, Jakarta, Indonesian Center for Environmental Law (ICEL), 2024, h.5

[6] Istiqomah Nur Barokah dan Agus Bandiyono, Dinamika Efektivitas Green bond dalam Mewujudkan Pembangunan Berkelanjutan: Studi Komparasi dengan Pendekatan Scoping Review, *Jurnal Akuntansi Dan Ekonomi* Vol 10 No 1 (2025),h.111

[7] Melau, M., dan Hoffmann, V. N. *Green Bonds: Effective Vehicles or False Promises?*Copenhagen Business School,(2020).p.34

Azhgaliyeva and Kapsalyamova [8] stated that green bond issuance in Southeast Asia was mostly allocated for green buildings projects (43%) and renewable energy (32%). However, the $2.5 trillion gap in sustainable development goals (SDGs) investment in 2019, especially on the issue of climate change that threatens economic and environmental sustainability, has made it necessary to transform the financial sector.

Based on the 2019 UN report, green bonds instruments have a significant impact on funding and investment efforts for SDGs projects, in addition, green bonds instruments are also considered as well accepted and qualified financial instruments in funding and investing in SDGs, although in practice this instrument is less able to measure its performance (ROI). This weakness also underlies the transformation and re-adaptation of financial institutions in order to adjust regulations and also increase investor interest in green bonds instruments.

Given the importance of green taxonomy, this article is very relevant and worth examining, namely: Should the financial sector also think about and contribute to sustainable development and handling the climate crisis?. Through this article, the author hopes to provide deeper insight into green bond-based funding, as well as being able to serve as evaluation material and recommendations for the government, academics, the private sector and investors, so that the issuance of green bonds can be useful in funding green projects in order to realize sustainable development goals effectively.

II. METHODOLOGY

The type of research used in this paper is normative juridical with a statutory and conceptual approach. This approach was chosen because it is considered to be able to answer legal issues and support the focus of the research.[9] peterGiven that the focus of this research is green taxonomy and the contribution of green bonds to the SDGs, the study of the application of green bonds in the capital market. Through a comprehensive literature review, this study examines in depth the topic of green bond development. In addition, this study also provides practical references for the Indonesian Government and related institutions in optimizing the development of

[8] Azhgaliyeva, D.,dan Kapsalyamova, Z. *Policy Support in Promoting Green Bonds in Asia*. ADBI Working Paper.(2021).

[9] Peter Mahmud Marzuki, *Penelitian Hukum* (Jakarta: Kencana, 2007).

green bonds. It is hoped that the results of this study can be an important basis for decision making and formulating more effective policies in encouraging the transition to a green economy.

III. CONTRIBUTION OF THE FINANCIAL SECTOR TO SUSTAINABLE DEVELOPMENT

The financial sector can play an important role in encouraging transitions to a sustainable and resilient economy, by utilizing the power to divert financial flow from non -sustainable business activities and towards a friendly business model with climate. The position of financial institutions can help the government to achieve sustainable development and contribute thoroughly to the preservation and recovery of natural capital.

In fact, Indonesia has ratified Paris's approval through Law Number 16 Year 2016, which states that Indonesia will contribute to the achievement of the objectives of Paris approval. Article 2 of Paris's approval, the parties agreed to jointly prevent an increase in the global average temperature so as not to exceed 1.5oC. The parties also agreed to try to harmonize all funding flows to be consistent with the development of low greenhouse gas emissions (GHG) and climate resilience (Article 2.1C Paris approval). However, at the global level, the goal is still far behind its discussion in climate negotiations under the United Nations Framework Convention on Climate Change (UNFCCC). On the other hand, funding still requires an additional contribution to funding from other sectors, so that the role of the private sector becomes very important to cover up gaps in funding originating from the public sector. But the reality that occurs, the private sector still has several obstacles in efforts to finance mobilization to finance climate actions.

The Indonesian government to carry out commitments related to more directed and ambitious climate targets, then it has been trying to prepare and utilize the state budget more environmentally friendly. By utilizing public funds to support various projects related to the issue of climate change. For example, the Indonesian government, especially the Ministry of Finance continues to develop various funding initiatives, such as Climate Budget Tagging, Environmental Bonds (Green Bond), Green Sukuk, and Sustainable Development Goals (SDGs) Bond.

In connection with regulations and policies, the government has established a framework of regulations intended for carbon economic value (NEK) or carbon pricing, and formulated Law Number 4 of 2023 with the development and strengthening of the Financial Sector (P2SK) as a key regulation in strengthening the sustainable financial ecosystem. In addition, the government has an active and encouraging energy transition through cooperation with international financial institutions, such as the Asian Development Bank (ADB), through the Energy Transition Mechanism (ETM) initiative. Efforts to attract private investment, so the government has issued a number of fiscal incentives, such as tax holiday, tax allowance, as well as the relief of the Value Added Tax (VAT) and Land and Building Tax (PBB). Although the involvement of the private sector in climate funding is considered still low, there are some actors from the banking sector starting to integrate the issue of climate change in the risk management scenario.

Sustainable finance is one of the prerequisites in realizing the success of sustainable development. The sustainable development is an economic development process that is harmonized with social development and environmental sustainability.[10] Incatuctors on the achievement of the development of state sustainability can be seen from the value and ranking of Sustainable Development Goals (SDGs). Sandberg et.al put forward differences in culture and ideology between regions, differences in values, norms and ideologies are one of the determinants of sustainable development.[11]

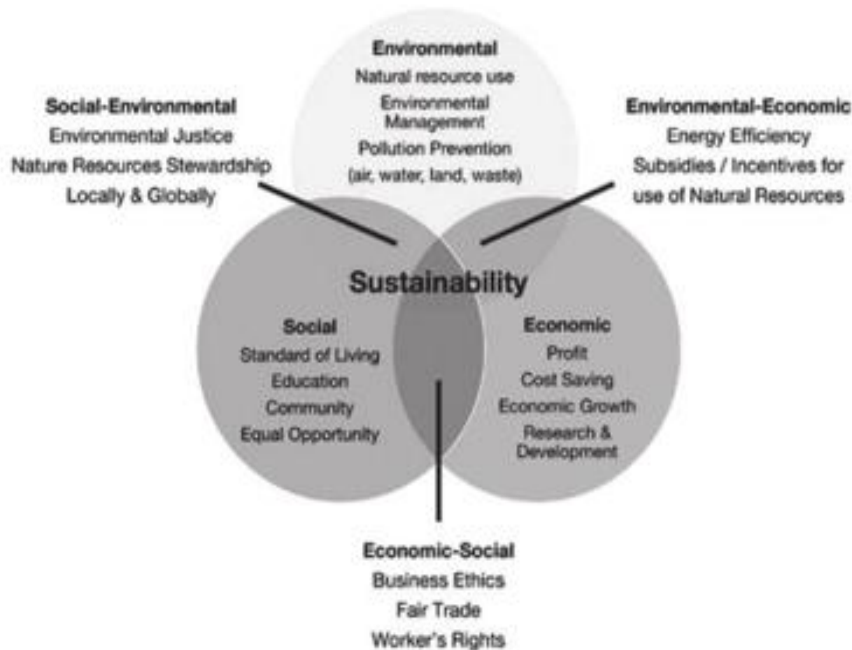
In sustainable environmental development cannot be separated from several pillars, namely: 1). Social pillars (people) focus on business social impacts on various parties, which include aspects of human rights, decent working conditions, and contribute to the welfare of the community; 2). Environmental pillars (planets) that prioritize aspects of corporate responsibility towards the environment; 3). Economic pillars (profit) emphasize the importance of profits as the main goal of business. Stable

[10] Lydia Ivana Kumajas Dkk, Kontradiksi Sustainable Finance: Sebuah Literatur Review*, Jurnal EMBA* Vol.10 No.2 April 2022, h. 1034-1041

[11] Sandberg, J.; Juravle, C.; Hedesström, T.M.; Hamilton, I. The heterogeneity of socially responsible investment. J. Bus. Ethics 2009, 87, 519

financial profits allow companies to continue to operate on a sustainable manner.[12] By adopting the Triple Bottom Line concept, the company can manage its operations more sustainably, minimize the negative impacts on the environment, and have a positive impact on the community.[13]

Pictures. Element of the Concept of Triple Bottom Line



According to Zak[14] as the picture above, the Triple Bottom Line emphasizes the importance of achieving balance between the three sustainability elements. So ideally that all business decisions must be at the intersection of the three elements, where all goals (social, environment, economy) are met. But in practice there is often a contradiction or tension between the three aspects. For example, some decisions may sacrifice environmental aspects for short -term economic profit, so that systemic thinking is needed in decision making.[15]

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[12] Nurhidayat, E., Junaid, A., & Kamase, J. (2020). Penerapan Akuntansi Lingkungan Berdasarkan *Triple Bottom Line* pada RSUD HM Djafar Harun Kabupaten Kolaka Utara. *Jurnal Ilmu Akuntansi*, *2*(2), 38–80

[13] Pandin, M. Y. R., Prisilia, S., Pribadi, A. F., & Larissa, C. (2023). Analisis Penerapan *Triple Bottom Line* sebagai Kunci Keberlanjutan bagi Perusahaan *Food and Beverage*. *Journal of Social and Economics Research*, *5*(2), 579–586

[14] Żak, A. Triple Bottom Line Concept in Theory and Practice. *Social Responsibility of Organizations Directions of Changes*, (2015). *387*(1), 251–264

[15] Hammer, J., & Pivo, G. (2017). The Triple Bottom Line and Sustainable Economic Development Theory and Practice. *Economic Development Quarterly*, *31*(1), 25–36

As we understand that Environmental, Social, and Governance is a set of evaluation standards for the Company's operations that include three main criteria for measuring the sustainability and impact of an investment on the Company. In practice, ESG began to be applied in 1970, when investors began to show concern for reporting on social and environmental practices implemented by companies. Reporting on social and environmental practices by companies is important to show transparency and accountability. Companies report these activities through CSR reports, which include various non-financial performance indicators, such as the social and environmental impacts of business activities. This reporting helps stakeholders, such as investors and consumers, to assess the efforts of a Company.

Furthermore, in 2006, the UN determined that responsible investment is one of the important aspects in decision-making related to Company cooperation. ESG practices involve three main aspects that are important indicators in risk management, financial and non-financial performance, and the Company's managerial competenceEnvironmental aspects relate to efficient and responsible management of natural resources, such as energy management, natural resource protection, and carbon emission reduction. Social aspects include responsibility for human rights, fair business principles, product safety, and gender equality. Meanwhile, Governance aspects focus on internal company issues, such as leadership, corporate control, and protection of shareholder rights. Good governance criteria include transparency in decision-making, accountability in financial reporting, and fair and ethical management of all stakeholders.

Green bonds as a capital market product are a type of bond whose proceeds will be used exclusively to finance some or all of environmentally friendly projects. The projects that are financed or funded can be new projects or existing projects as long as they meet the four main principles, namely the Green Bond Principle (GBP). Green bond specifications are different from ordinary bonds because they have a "green" label given by the bond issuer. The code or label is a form of commitment from the issuer to use funds for green projects that meet the Climate Bond Initiative (CBI). Meanwhile, the Climate Bond Initiative is a non-profit organization that focuses on investment by setting project specifications and assets funded by green bonds in accordance with the Paris Agreement.

In addition to green bond products, there are other products, namely green sukuk as another form of innovation in funding that is oriented towards environmental sustainability. Green sukuk product specifications are part of a funding instrument based on Islamic principles that aim to protect the environment from the negative impacts of climate change. Green sukuk is used to facilitate efforts to reduce carbon emissions and achieve carbon neutrality. Fundraising from this green sukuk focuses on waste management, renewable energy, transportation, green buildings, and water management.

IV. GREEN FINANCE OPPORTUNITIES OF GREEN TAXONOMY-BASED CLIMATE ACTION FINANCING IN INDONESIA

One of the steps to finance climate action in Indonesia is to increase the green financing portfolio. This step has been taken by one of Indonesia's state-owned banks with the hope of supporting decarbonization efforts in sectors that produce high carbon emissions. Through climate scenario analysis, the bank has set targets for each sector, supported by portfolio management with debtors in implementing decarbonization efforts.

Another initiative taken by private banks is to shift financing from high-emission sectors to environmentally friendly sectors and to start financing in the green sector. In addition, one of the private banks also showed a commitment to sustainability at the regional level. The commitment aims to implement sustainable finance, improve household welfare, and achieve Net Zero Emissions (NZE) by 2050.

Sustainable Finance is committed to reducing the impact of climate change by shifting the focus from maximizing profits to creating economic, social, and environmental value and corporate governance. The activities of these companies are reported in the form of sustainability reports. The success of a country in achieving its sustainable development goals (SDGs) is highly dependent on the flow of funds received by the private sector to improve the operations of ESG-focused companies.

Without financial support, efforts to achieve sustainable development will be very difficult. Realizing this, in 2017, the Financial Services Authority in Indonesia issued regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies.

Through this regulation, issuers are encouraged to implement sustainable finance in corporate governance.[16]

In Indonesia, Sustainable Finance is defined as the comprehensive support of the financial services industry to achieve sustainable growth, which is the result of the alignment of economic, social and environmental interests. Issues related to sustainable development in the business sector require a deep understanding of sustainable finance. There are three main reasons why this is important for financial institutions: first, the potential for significant risks; second, many activities are challenges to sustainability; third, there are substantial income opportunities. Other issues related to sustainable investment may vary between countries and regions.[17]

Differences in Socially Responsible Investment (SRI) include cultural and ideological differences in various regions, as well as differences in values, norms, and views among SRI stakeholders and the SRI market. Therefore, understanding among all parties will be one of the key factors in achieving sustainable development. In general, green financing can be defined as the procurement and use of funds for activities that aim to protect the environment and provide fair returns for investors or lenders. Green finance covers the financing of green investments in both the public and private sectors. Green finance projects provide economic benefits that support a sustainable environment.[18]

Green finance includes all investments in sustainable products and services as well as investments in activities that reduce negative impacts on the environment and climate change. In addition, in the public policy framework, green finance includes funding for public policies that support the implementation of environmental protection projects or initiatives as well as environmental damage mitigation projects.

The purpose of green financing activities is to increase the flow of funds from financial institutions to economic actors involved in projects and activities that support environmental conservation, in order to achieve sustainable development goals. Green

[16] Ozili, Peterson K,. Green finance research around the world: a review of literature, International Journal of Green Economics, 2022April

[17] Faryal Fahim, Batiah Mahadi, 2022. Green supply chain management/green finance: a bibliometric analysis of the last twenty years, *Environmental Science and Pollution Research* volume 29, pages84714–84740

[18] Chris den Heijer, Tom Coppens 2023, Paying for green: A scoping review of alternative financing models for nature-based solutions, Journal of Environmental ManagementVolume 337, 1 July 2023, 117754

financing supports the development of smart cities in the long term as well as economic growth. Investments in green projects will reduce carbon emissions in both the short and long term. Green financing will primarily attract institutional shareholders. Green financing also provides diversification benefits for investors in the corporate and securities markets. Increasing green financing can reduce funding for activities that use fossil fuels that are detrimental to the environment and climate.

The demand to reduce the negative impact on the environment due to emissions from fossil fuels has driven the need to withdraw investment from activities that depend on fossil fuels and shift to investment in low-carbon projects and activities that sustainably protect the environment. This situation applies both at the national and international levels.

Awareness to start integrating sustainability principles in various aspects is increasing along with the emergence of a period where the global economy is considered to be entering a condition called by experts as ecological debt. This condition occurs when the extraction of natural resources and pollution exceeds the capacity that can be accommodated by the planet Earth, causing an ecological deficit that continues to increase from year to year.[19] This ecological debt burden is in line with what von Weizsacker expressed [20] regarding the failure of global capital markets to demonstrate "ecological truth", resulting in market-determined prices not reflecting the true costs arising from ecological or environmental factors.

The legal aspects of sustainable investing were first translated into regulation by the UK in 1999, through the issuance of the Socially Responsible Pension Funds Regulations. These regulations added new requirements for UK private sector pension funds to prepare a Statement of Investment Principles (SIP).[21] Previously, SIP only included information on the type of investment and the balance between investment, risk, return and realization. However, the new regulation requires all private pension fund managers to add two aspects that must be considered and reported in their SIP.[22]

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[19] Mirjam Staub-Bisang, *Sustainable Investing for Institutional Investors: Risk, Regulations and Strategies*, (2020),h. 10.

[20] Freshfields Bruckhaus Deringer*, A Legal Framework for the Integration of Environmental, Social and Governance Issue into Institutional Investment*, (2019),h.30

[21] Organisasi Internasional Komisi Pasar Modal, *Sustainable Finance and the Role of Securities Regulators and IOSCO: Final Report*, IOSCO, (2020), h. 3

[22] Kevin Sebastian Josua L. Tobing, Wenny Setiawati, Tinjauan Yuridis Terhadap Efek Bersifat Utang Berwawasan Lingkungan (Green Bond) Sebagai Instrumen Investasi Dalam Penerapan

These two aspects are how they consider social, environmental, and ethical factors in the process of selecting, retaining, and realizing investments, and reporting policies related to these. Thus, the regulation on Socially Responsible Investment in the Pension Law does not emphasize obligations, but rather considerations and disclosures.

Sustainability and green bonds are two crucial aspects in improving corporate performance. Corporate performance is not only focused on profit, but must also involve activities that support projects that contribute to environmental sustainability, so an environmentally friendly funding policy is needed. In the process of transitioning to a sustainable economy, companies are increasingly adopting long-term value creation objectives that integrate financial, social and environmental values. To overcome the challenges in obtaining investment sources for green bonds issued by companies in Indonesia, there is an opportunity to utilize the Environmental Funding Instruments regulated in Article 20 paragraph (1) of Government Regulation No. 46 of 2017 concerning Environmental Economic Instruments, which includes Environmental Recovery Guarantee Funds, Pollution and/or Damage Mitigation and Environmental Recovery Funds, and Conservation Trust/Assistance Funds.[23]

This environmental funding instrument has the potential as a source of investment that can be allocated to green bonds, which are related to projects that are partially or fully related to environmental services, environmental emergency response activities in business areas, and environmental recovery after operations in those areas. The classification of environmental services, emergency response, and post-operational environmental recovery as green projects can utilize the provisions of Article 4 letter k of the POJK concerning Green Bonds, which provide room for interpretation of business activities and/or other environmentally oriented activities.

V. CONCLUSION

Sustainable investment is an investment approach that has been developing for a long time along with the push to integrate and apply sustainability principles in

Sustainable Investment Di Pasar Modal Indonesia, *Technology And Economic Law Journal*, (2022),Vol.1 No.1,h.18-35

[23] Rolf D. Hassler, "Bond", *In Sustainable Investing for Institutional Investors: Risk, Regulations and Strategies*, ed. Mirjam StaubBisang, (2020),h.136

investment sectors and activities at the international level. Currently, the Paris Agreement and the Sustainable Development Goals (SDGs) are the main references for investors who pay attention to investment activities that consider environmental, social, and governance aspects, as well as sustainability principles known as sustainable investment. Sustainable investment products or sustainable instruments are also available in the form of fixed income investment products or instruments.

One of the fixed income investment instruments that supports the implementation of sustainable investment is green bonds. In the context of capital market law, the International Organization of Securities Commission (IOSCO) in its report Sustainable Finance in Emerging Markets and The Role of Securities Regulators has compiled eleven recommendations regarding the regulatory framework for sustainable investment, where for green bonds as a sustainable investment product, it is necessary to clearly regulate the definition, types of businesses or projects that qualify, provisions for offering documentation, provisions for periodic disclosure, appropriate use of offering proceeds, and evaluation by third parties. Therefore, in order to implement sustainable investment through green bonds in the capital market, the relevant regulator or capital market authority must establish regulations regarding sustainable instruments such as green bonds within the framework of sustainable investment regulations, in accordance with the needs and conditions in the jurisdiction of the capital market authority.

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B. Article Journal

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C. Statutory Regilations

Law No. 4 of 2023 concerning the Development and Strengthening of the Financial Sector

Government Regulation Number 46 of 2017 concerning Environmental Economic Instruments

The Financial Services Authority in Indonesia issued regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies