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TRANSFORMATION OF THE EU FINANCIAL MARKET TO THE REQUIREMENTS OF THE SUSTAINABLE DEVELOPMENT OF GLOBAL VALUE CHAINS

The article summarises transformations taking place in the EU financial market under the influence of growing requirements for responsible business behaviour in global value chains. The paper outlines the components of the European Green Deal and the interaction between climate protection and green finance in the EU.

Based on an analysis of the evolution and interrelationship between EU climate protection initiatives and the main elements of the European Sustainable Finance Strategy that contribute to achieving the necessary green transition, the authors conclude that the development of standards for 'green' financial products can contribute to the further development of finance focused on ESG market segments, helping investors identify products that, for example, meet low-carbon criteria.

The paper notes that around 70% of international trade is linked to GVCs, through which services, raw materials, parts, and components often cross borders multiple times before entering the final product and being shipped to consumers around the world. Therefore, the existence of environmental and social risks in GVCs, such as greenhouse gas emissions, hazardous waste, poor working conditions, and child labour, raises concerns about how GVCs may contribute to the amplification of these risks. These issues have become important factors leading to increasing calls and initiatives to integrate responsible business conduct (RBC) into business practices and create more inclusive and sustainable global markets. The paper concludes that the EU Sustainable Finance Strategy has significantly improved the regulatory framework for ESG financial products by introducing a precise taxonomy, increasing transparency for corporate and financial institutions, and amending financial market rules.

The authors emphasize the need for rebalancing the relative importance of financial and non-financial goals in the ESG strategy of global value chains, which, along with other goals, have a clear focus on environmental goals.

Keywords: sustainable development, green finance, global value chains, the European Union

JEL classification: F39, F60, F64

У статті узагальнено трансформації, які відбуваються на фінансовому ринку ЄС під впливом зростання вимог щодо відповідальної ділової поведінки глобальних ланцюгів вартості. В роботі узагальнено компоненти Європейської Зеленої угоди, взаємодією між захистом клімату та зеленими фінансами в ЄС.

На основі аналізу еволюції та взаємозв'язку між ініціативами щодо кліматичного захисту в ЄС і основними елементами Європейської стратегії сталого фінансування, що сприяють досягненню необхідного зеленого переходу, авторами зроблено висновок, що розробка стандартів для «зелених» фінансових продуктів може сприяти подальшому розвитку фінансів, орієнтованих на сегменти ринку ESG, допомагаючи інвесторам ідентифікувати продукти які, наприклад, відповідають критеріям низького рівня вуглецю.

В роботі зазначено, що близько 70% міжнародної торгівлі пов'язано з GVC, через які послуги, сировина, деталі та компоненти часто перетинають кордони багато разів, перш ніж увійти до кінцевого продукту і бути відправленими споживачам по всьому світу, тому існування екологічних і соціальних ризиків у GVC, таких як викиди парникових газів, небезпечні відходи, погані умови праці, дитяча праця, викликає занепокоєння щодо того, як GVC може сприяти посиленню цих ризиків. Ці проблеми стали важливими факторами, що призвели до зростання закликів та ініціатив щодо інтеграції відповідальної ділової поведінки (RBC) в бізнес-практики та створення більш інклюзивних і сталих глобальних ринків.

В роботі зроблено висновок, що стратегія сталого фінансування ЄС значно покращила нормативно-правову базу для фінансових продуктів ESG через впровадження точної таксономії, підвищення прозорості для корпоративних і фінансових установ, а також внесення змін до правил фінансового ринку.

Автори роблять акцент на необхідності перебалансування відносної важливості фінансових і нефінансових цілей в стратегії ESG глобальних ланцюгів вартості, які разом з іншими мають чітку спрямованість на екологічні цілі.

Ключові слова: *сталий розвиток, зелені фінанси, глобальні ланцюги вартості, Європейський Союз*

JEL classification: *F39, F60, F64*

1. Introduction.

The Sixth Assessment Report of the Intergovernmental Panel on Climate Change has provided yet another evidence-based study that once again shows global warming of the atmosphere, oceans and land, which is largely caused by human activity [1].

According to the Intergovernmental Panel on Climate Change (IPCC), warming in Europe will continue to grow faster than global warming, meaning that there will be greater risk disparities in Europe in the 21st century.

With a 3°C GWL temperature increase and even with high adaptation, serious risks remain for many sectors in Europe. The main risks are: human mortality and morbidity, and ecosystem disruption due to heat; losses in agricultural production due to combined heat and drought; water scarcity in different sectors; and the impact of flooding on people, the economy and infrastructure [2].

The number of deaths and people at risk of heat stress will increase two to three times at 3°C compared to 1.5°C GWL.

In the summer of 2022, heat waves killed more than 61,000 people across Europe. As climate change increases the intensity of heat waves, countries have to consider new means of protecting their populations.

2. The research aim and object.

The aim of this paper is to summarise transformations taking place in the EU financial market under the influence of growing requirements for responsible business behaviour in global value chains.

3. Analysis of recent research and publications.

The following foreign researchers have studied the problems and practices of sustainable development: A. A. Leizerovich, R. V. Kates, T. M. Parris, A. Hughes.

The foundations of the concept of climate change, which occurs as a result of human economic activity, were laid in the works of S. Manabe and R. Wetherald [3-5], J. Hansen [6], B. Bolin [7], and others.

The issues of climate neutrality and climate leadership are considered in the works of A. Kachi, S. Mooldijk, and K. Warnecke (S. Warnecke) [8], in reports of the Climate Neutral Now Team within the framework of the United Nations Framework Convention on Climate Change (UNFCCC), the UN Environmental Management Group (EMG), the Intergovernmental Panel on Climate Change (IPCC), the European Climate Neutrality Observatory (ECNO), the European Commission, the European Parliament, etc.

The topic of global value chains is covered in the works of many national and foreign scholars. Among the authors who have studied global value chains are O. B. Hirna, H. V. Duhinets, V. I. Shchelkunov, D. O. Yaroshchuk, O. O. Okhrimenko, M. Porter, G. Jereffi, J. Humphrey and others.

The problems of climate neutrality, the European Green Deal, and the concept of Ukraine's economic recovery are the subject of policy documents of the Government of Ukraine, the EU, the UN, intergovernmental and non-governmental (public) organizations.

However, the issues of transformations taking place in the EU financial market under the influence of increasing demands for responsible business conduct in global value chains remain insufficiently researched.

4. Material and methods.

The study used the methods of logical, comparative, systemic, and structural analysis, which allowed for a scientific summarization of the transformations taking place in the EU financial market under the influence of growing requirements for responsible business behaviour in global value chains.

5. Results.

The Paris Agreement, adopted in 2016, was a milestone in the multilateral climate change process, as it committed all countries,

for the first time, to unite in combating climate change and adapting to its effects [9]. Its main goal is to keep the increase in global average temperature well below 2°C above pre-industrial period and to continue efforts to limit the temperature increase to 1.5°C.

In recent years, world leaders have emphasised the need to limit global warming to 1.5°C by the end of this century. This is because, according to the UN Intergovernmental Panel on Climate Change, exceeding this threshold could lead to much more serious consequences, such as more frequent and intense droughts, heat waves and heavy rainfalls. To achieve this goal, greenhouse gas emissions must peak no later than 2025 and be reduced by 43% by 2030.

The European Green Deal (EGD) brings together environmental and equitable transition goals to address the uneven impact of energy transition, reduce greenhouse gas emissions, climate change and other environmental challenges (Fig.1). It aims to respond to climate and environmental challenges by creating opportunities for all regions and ensuring a fair and inclusive transition for everyone [10].

Thus, the European Green Deal promotes integration between the EU's Territorial Agenda [11] and key EU strategies and policies. This, in turn, should help to realise the potential of different regions and ensure territorial balance in Europe (Fig. 1). In addition, the agreement envisages achieving EU climate neutrality by 2050 [10].

The green transformation of almost all economic actors is urgently needed, especially in the areas of energy production and consumption, mobility, industrial production, and agriculture.

According to expert estimates, the investment required to achieve a low-carbon transition ranges from USD 1.6 trillion to USD 3.8 trillion annually by 2050 on the supply side of the energy system [12].

Although the amount of finance allocated to tackling climate change has reached record levels, efforts to implement climate actions still fall short of what is required to limit the global temperature

increase to 1.5°C under the Paris Agreement [12].

The European Union estimates that achieving the goal of reducing emissions by 55% by 2030 will require about €350 billion in additional annual investment in the energy system alone [13].

To finance the Green Deal, the EU Commission has announced that a total of €1 trillion will be invested in the green transformation of the European economy. The funds will be accumulated under the Multiannual Financial Framework (MFF) until 2027 and the EU's Next Generation Fund, totalling €750 billion [14].

Today, leading financial institutions, international financial organisations, and banks offer financial products that take sustainability factors into account at every stage of the investment process.

This should be confirmed by the ESG strategies (environmental, social and corporate governance strategies) developed by the entities applying for funds, taking into account green and equitable transition considerations in the investment decision-making process. The environmental component covers aspects such as climate change mitigation and adaptation, biodiversity conservation, pollution control, and the transition to a circular economy.

Professor Volker Brühl, Managing Director of the Centre for Financial Studies, defines green finance as ‘financing investments that provide environmental benefits such as reducing air, water and land pollution, reducing greenhouse gas emissions, improving energy efficiency and mitigating and adapting to climate change’ [17].

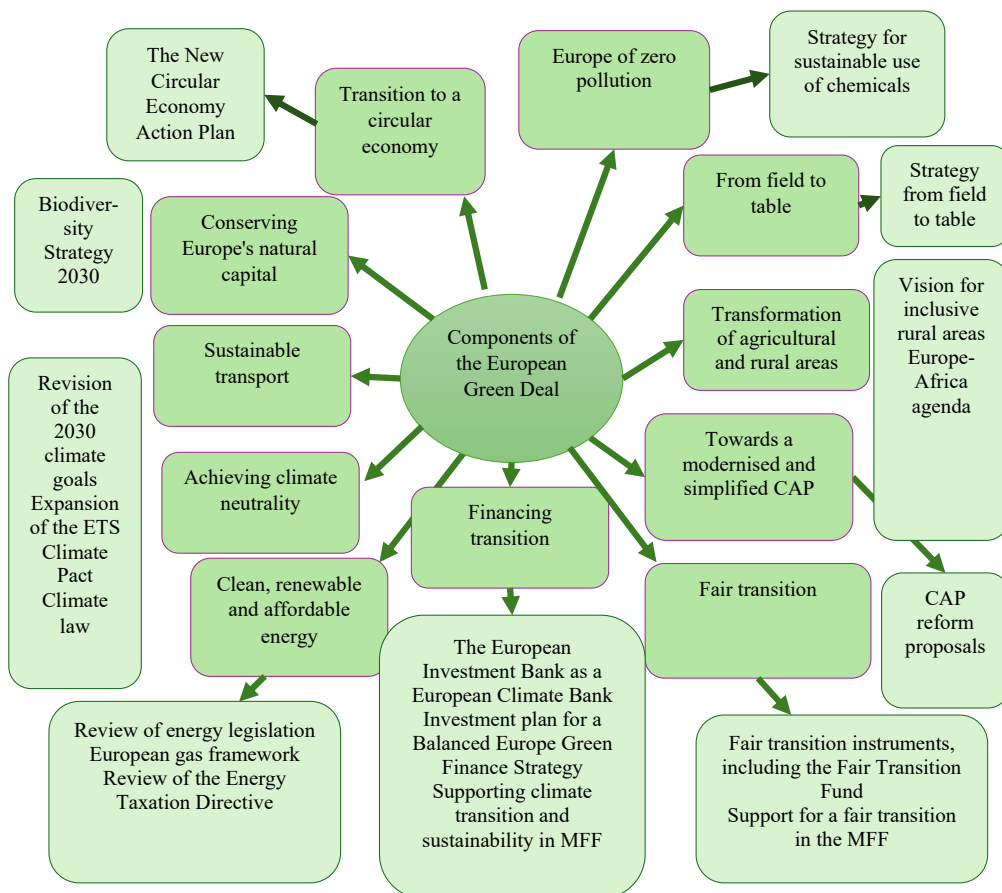


Fig. 1. Components of the European Green Deal
Source: compiled by the author based on materials [10, 13-16]

In this context, climate finance refers to the financing of public and private investments aimed at supporting climate change mitigation and adaptation, and can be considered a subset of green finance [14].

Fig. 2 illustrates the evolution and interdependence between climate protection initiatives in the EU and main elements of the European Sustainable Finance Strategy to enable the necessary green transition. In 2018, the European Commission established a High Level Expert Group on Sustainable Development Finance, which presented its final report. These recommendations formed the basis of the European Action Plan on Sustainable Finance, which has been further developed through the Updated Sustainable Finance Strategy [15] and the April Package presented in early 2021 [16].

The development of standards for ‘green’ financial products can help to further develop ESG-oriented finance by helping investors to identify products that, for example, meet low-carbon criteria.

An important example is the European Green Bond Standard, which is a first step towards a wider range of green financial products [18].

The EU eco-labelling project for retail financial products can contribute to sustainable investment decisions for retail investors.

The green bond market has continued to grow, particularly in the last five years. According to estimates, the total issuance reached US\$270 billion, showing annual growth rate of 60% since 2015.

The European Green Bond Standard aims to create a voluntary, high quality European standard available to all issuers to help finance sustainable investments. In order to overcome the weaknesses of existing market labels, bonds that qualify as green, must meet the following criteria:

- ‘the funds raised by the bonds must be fully attributed to economic activities that are sustainable in accordance with the Taxonomy Regulation;
- the issuer must report annually on the use of funds in the European Green Bonds Allocation Report;
- compliance with the standards should be monitored by external experts registered and supervised by the European Securities and Markets Authority;

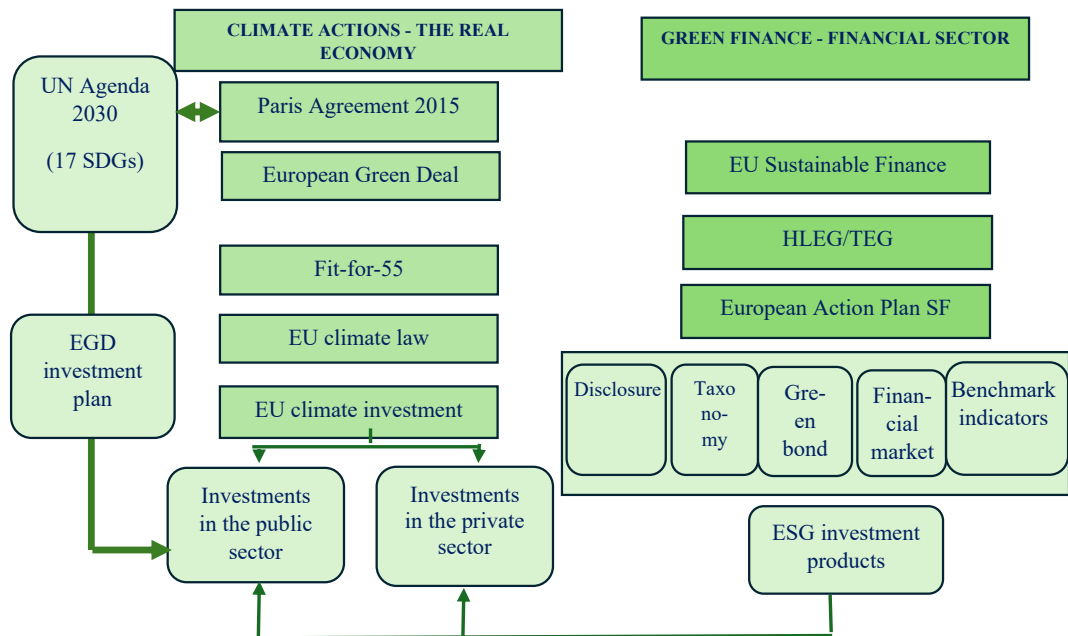


Fig. 2. Interaction between climate protection and green finance in the EU [17]

- external reviewers should publish pre-issue reviews and post-issue reviews of the use of proceeds;

- in addition, at least once during the maturity of the bond, a report on positive and potentially negative environmental impacts of the activity must be prepared' [18].

The taxonomy identifies six environmental objectives that can be used to classify economic activity as sustainable (Fig. 3).

Low-carbon benchmarks are important in financial markets, as they serve as references for the pricing of financial instruments and transactions, such as those in credit, debt, and derivatives markets across various asset classes. In addition, benchmarks are used to evaluate the performance of financial instruments and to determine financial liabilities arising from financial contracts.

'Firstly, climate change mitigation involves measures that reduce greenhouse

gas emissions in line with the goals of the Paris Agreement, for example, through increased use of renewable energy sources.

Secondly, climate change adaptation includes measures aimed at significant reduction of the negative impact of current and future climate change on people and nature (e.g., reforestation)' [19].

According to the Taxonomy Regulations, three types of economic activity are considered sustainable: 'activities that directly contribute to the identified Sustainable Development Goals; activities that support the achievement of such goals through the provision of technology or services; and transitional activities that contribute to the transition to a CO₂-neutral economy until technological alternatives are available' [19].

The taxonomy is a key element of the European Sustainable Finance Strategy, as it influences the regulation of disclosures by both financial institutions and companies, as well as the green bond standard.

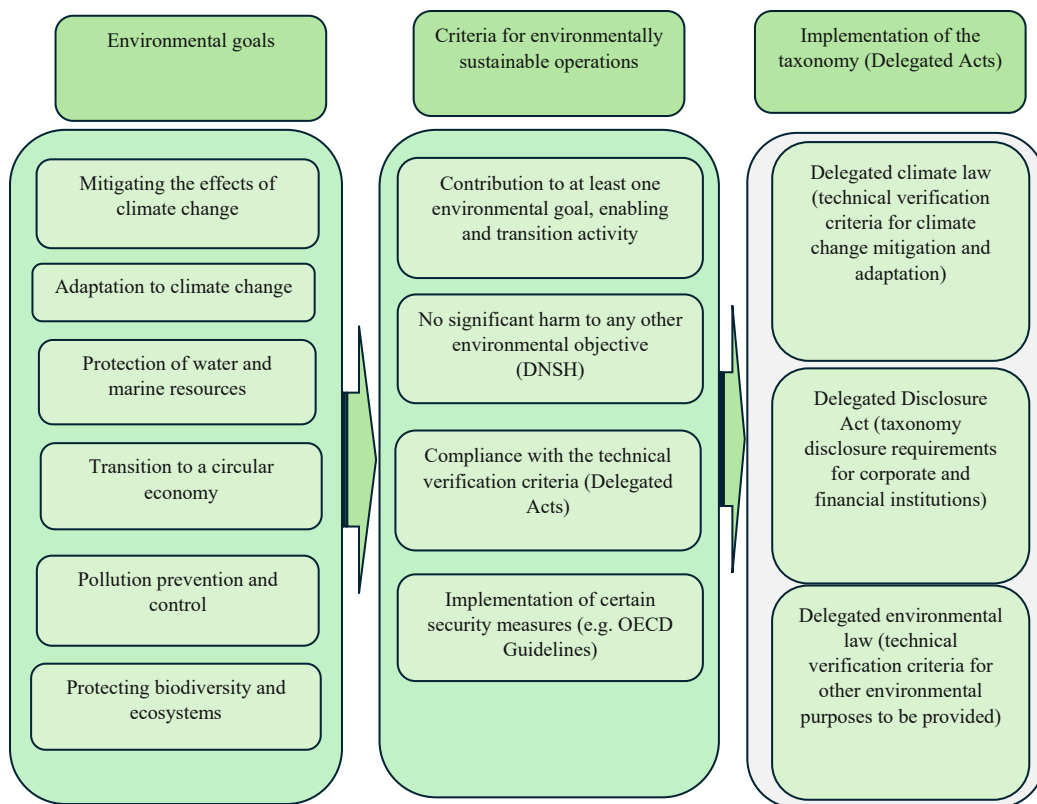


Fig. 3. The mechanism of taxonomy regulation [19]

The second pillar of the Sustainable Finance Strategy relates to disclosure requirements for financial institutions and corporates, which allows investors to make better investment decisions and provide other stakeholders with sustainability-related information.

According to a recent survey, ‘many investors plan to double their sustainable assets over the next five years, with the “environment” factor being a top priority’ [20]. At the same time, investors note that ‘the poor quality of ESG data is one of the biggest obstacles to increasing investment in this area’ [20]. Therefore, establishing an effective regulatory framework for non-financial reporting for both companies and financial institutions is an important step to transform the growing investor interest into real investment decisions.

The Sustainable Finance Disclosure Regulation (SFDR), which entered into force in the EU on 10 March 2021, establishes ‘mandatory ESG disclosure requirements for asset managers and other financial market participants’ [21]. The SFDR is a regulation that extends the existing disclosure requirements for financial market participants under relevant sectoral laws. It requires asset managers and financial advisers to disclose how they integrate sustainability risks into their investment strategies.

The Delegated Disclosure Act defines specific sustainability-related KPIs for banks, asset managers, investment companies, and insurance and reinsurance companies [21]. This allows investors and other stakeholders to assess what proportion of economic activity meets the requirements of the Taxonomy.

The main indicator of credit institutions’ performance will be the green asset ratio, which reflects the share of risks associated with taxonomic activities in comparison with total assets. In addition, banks must disclose ‘the distribution of their trading portfolio, as well as the share of income from fees and commissions derived from the taxonomic activities of their clients’ [21]. Similar requirements apply to insurance and reinsurance companies, in particular, to disclose the taxonomic share of their underwriting and investment activities.

Due to the extensive additional reporting requirements, financial and non-financial firms have to implement them gradually. From 1 January 2022 to 31 December 2022, non-financial firms only had to disclose the share of taxonomically consistent economic activities in their total turnover, capital, and operating expenses. More detailed disclosure obligations were applied from 1 January 2024, and for some parts of the accounts these obligations will come into effect from 1 January 2026.

Calls for the implementation of responsible business conduct (RBC) in global value chains (GVCs) have been powerful drivers of economic growth and development in recent decades [22]. Since the early 1990s, GVCs have transformed and accelerated international trade and investment by strengthening economic ties between countries and creating new opportunities for optimising production processes [22; 23].

Today, about 70% of international trade involves GVCs, whereby services, raw materials, parts and components often cross borders multiple times before being incorporated into a final product and shipped to consumers around the world [24]. The growth of GVCs has brought important benefits, including increased productivity, technology diffusion and poverty reduction. Over the past 30 years, the sharpest falls in poverty rates have occurred in the countries that have become an integral part of the GVC, enabling the convergence of living standards as developing countries and emerging economies have grown faster on average than developed economies. According to the latest World Bank estimates, 1% increase in GVC participation increases per capita income by more than 1%, and is much higher than the 0.2% increase in income from standard trade [24].

The growth of GVCs is considered one of the most important features of economic globalization in the 21st century, not only enabling global firms to achieve greater economic efficiency, but also helping both developed and developing countries to exploit their comparative advantages and gain added value, income and employment

opportunities. However, along with creating value through the global distribution of production, GVCs have also generated massive greenhouse gas emissions and pollution as a by-product in energy-intensive production stages in different countries. Moreover, the increasing complexity and uncertainty of GVCs, characterized by numerous and frequent cross-border transactions in intermediate products and foreign direct investment (FDI), have made it difficult to understand “who is emitting for whom”, which poses major challenges for the design of environmental policies (including domestic and international regulation, taxation, carbon pricing, etc.) that allow countries, industries and firms to clearly define their responsibilities for climate change.

The existence of environmental and social risks in GVCs, such as greenhouse gas emissions, hazardous waste, poor labour conditions, and child labour, has led to further backlash and concerns about the potential role of GVCs in exacerbating such risks. These considerations have played an important role in the growing calls and initiatives to apply responsible business conduct (RBC) in business operations and make global markets more inclusive and sustainable. Over the past decade, the concept of risk-based due diligence has become an important tool for mitigating the negative environmental and social impacts of business operations, particularly in supply chains.

5. Conclusions

Sustainable finance plays a key role in achieving the goals of the European Green Deal, as well as the EU’s international commitments to achieve sustainable development and climate change goals. The mechanism for achieving the goals is to redirect private investment to projects that meet the criteria of sustainable development, climate neutrality, and climate change resilience.

Accordingly, the financial sector can reorient investments towards more sustainable technologies and businesses; finance economic growth in line with the principles of sustainable development on

a long-term basis; and contribute to the creation of a low-carbon, climate-resilient and circular economy. Since 2017, the largest European companies and capital market-oriented financial institutions have been required to report on certain non-financial aspects of their business activities.

Market-oriented companies, banks, insurance companies, and other large unlisted firms with more than 500 employees are required to report on, among other things, environmental, human rights, and anti-corruption issues. Companies are required to disclose the impact of their business activities and how they are working to achieve non-financial goals in each of these areas.

The EU’s Sustainable Finance Strategy has significantly improved the regulatory framework for ESG financial products by establishing a precise taxonomy, increasing transparency for both corporate and financial institutions, and amending financial market rules. However, in order to accelerate the implementation of the European Green Deal, additional financial incentives should be introduced to support environmental investments. One aspect could be the establishment of tax incentives for green investments in the corporate sector, such as accelerated depreciation for green capital expenditures in industry.

These developments are expected to lead to a reconfiguration of the structure of the dominant GVCs. While the transformation may continue, many directions of it emerge in the academic literature, among which four are noted as the most likely: replication, diversification, regionalization, and reshoring [25]. In general, the direction that will be prevalent in a particular industry will depend on the starting point of the archetypal configuration of international production.

While RBC and ESG criteria already play a role in boardroom remuneration in a number of large, mostly public companies, the goal setting is often very vague, qualitative in nature, and of little overall significance compared to KPIs that measure financial performance.

Thus, there is a need to rethink and revise the hierarchy of goals that determine

the functioning of global value chains, in particular in terms of shifting the emphasis from predominantly financial benchmarks to comprehensive non-financial goals, among which the environmental aspects of sustainable development should occupy a key place. This approach involves the integration of environmental factors into the process of strategic planning, risk management, and the assessment of the effectiveness of the activities of global value chains. One of the promising tools for implementing this task is the introduction

of technical criteria for compliance with the ecological taxonomy, which will allow the creation of a unified system for assessing environmental performance. The use of such criteria makes it possible to clearly identify strategic environmental goals, formalize the appropriate quantitative and qualitative indicators of their achievement, and also ensure transparency and objectivity in the process of monitoring environmental performance at all stages of the functioning of value chains.

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TRANSFORMATION OF THE EU FINANCIAL MARKET TO THE REQUIREMENTS OF THE SUSTAINABLE DEVELOPMENT OF GLOBAL VALUE CHAINS

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The article summarises transformations taking place in the EU financial market under the influence of growing requirements for responsible business behaviour in global value chains. The paper outlines the components of the European Green Deal and the interaction between climate protection and green finance in the EU.

Based on an analysis of the evolution and interrelationship between EU climate protection initiatives and the main elements of the European Sustainable Finance Strategy that contribute to achieving the necessary green transition, the authors conclude that the development of standards for 'green' financial products can contribute to the further development of finance focused on ESG market segments, helping investors identify products that, for example, meet low-carbon criteria.

The paper notes that around 70% of international trade is linked to GVCs, through which services, raw materials, parts, and components often cross borders multiple times before entering the final product and being shipped to consumers around the world. Therefore, the existence of environmental and social risks in GVCs, such as greenhouse gas emissions, hazardous waste, poor working conditions, and child labour, raises concerns about how GVCs may contribute to the amplification of these risks. These issues have become important factors leading to increasing calls and initiatives to integrate responsible business conduct (RBC) into business practices and create more inclusive and sustainable global markets. The paper concludes that the EU Sustainable Finance Strategy has significantly improved the regulatory framework for ESG financial products by introducing a precise taxonomy, increasing transparency for corporate and financial institutions, and amending financial market rules.

The authors emphasize the need for rebalancing the relative importance of financial and non-financial goals in the ESG strategy of global value chains, which, along with other goals, have a clear focus on environmental goals.

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