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Introduction

As businesses and corporates strive to reduce their carbon footprint in their effort towards a net-zero emissions outcome, establishing a carbon trading marketplace has become increasingly crucial. A carbon credit market provides a framework to incentivize and acknowledge climate action by facilitating the exchange of carbon credits obtained from the reduction of greenhouse gases (GHGs). While the carbon credit market in Malaysia is still relatively small, the launch of the Bursa Malaysia Carbon Exchange ("**BCX**") marks a significant milestone in the country's ongoing effort to achieve a more sustainable future. On 16 March 2023, the BCX held the nation's first carbon credit auction. The carbon auction is expected to provide a transparent mechanism for pricing and trading carbon credits in Malaysia, while at the same time potentially reducing and streamlining fragmented markets dominated by the bilateral trading activities.

Carbon Exchange vis-a-vis Carbon Credit Market in Malaysia

The emergence of the concept of carbon exchange is a response to the need for a marketplace to trade carbon credits. The carbon exchange functions as a centralized platform that enables the trading of high-quality carbon credits using standardized carbon contracts with a primary objective to promote transparency, standardization, and liquidity in the carbon credit market. Carbon exchanges can operate either as a regulated or voluntary market. In a regulated market, companies are legally required to reduce their greenhouse gas emissions and purchase carbon credits to offset any remaining emissions. Meanwhile, in a voluntary market, companies purchase carbon credits to offset their emissions on a voluntary basis, often as part of their corporate social responsibility efforts. Thus, demand and supply differ in these two markets.

Malaysia's carbon credit market is still in its infancy stage and the Malaysian plans to establish a domestic carbon market platform in two phases, starting with a voluntary carbon market that will transition to a Domestic Emissions Trading Scheme ("**DETS**") to catalyze the carbon trading sector.[1] DETS is a system where the government sets emission caps for greenhouse gases emitted by primary emission sources. It works on the principle of 'cap and trade' where the government will impose a mandatory limit (cap) on total emissions in one or more sectors of the economy.[2] The DETS is designed to provide a stronger financial incentive for businesses to reduce their emissions and transition towards more sustainable practices.

Bursa Carbon Exchange holds Malaysia's inaugural carbon auction

BCX recently held Malaysia's first carbon credit auction electronically where a total of 150,000 Verra-registered carbon credits were purchased from the Global Technology-Based Carbon Contract (GTC) and the Global Nature-Based Plus Carbon Contract (GNC+). 15 local corporate entities, comprising financial institutions and government-linked companies, emerged as successful bidders in the auction. Both contracts featured carbon credits from climate-friendly projects sourced from abroad and supplied by Vitol Asia.[3] The GTC Contracts contained carbon credits from the Linshu Biogas Recovery and Power Generation Project in China and were oversubscribed and cleared at RM18.50 per contract. Meanwhile, the GNC+ Contracts contained carbon credits from the Southern Cardamom Project in Cambodia and this contract fetched a clearing price of RM68.00 per contract.[4]

Despite much anticipation surrounding the BCX's inaugural carbon auction, it appears that the event fell a bit short of expectations. One notable issue is the apparent lack of interest from the Malaysian market, with only a handful of companies participating. Even more concerning is the fact that one of the few participants was Bursa itself, which raises questions about the level of external interest in the carbon market in Malaysia.

This shrinking pool of domestic participation could be attributed to a variety of factors, one of which is the inadequate regulatory framework. Unlike other countries that have implemented a carbon tax, Malaysia has yet to introduce such a scheme, which could incentivize businesses to reduce their carbon emissions and participate in the carbon market. Additionally, the Malaysian government has even continued to subsidize carbon emissions through petrol subsidies, which may have contributed to a lack of urgency among companies to reduce their carbon footprint.[5] This lack of government support and regulation may have created a sense of uncertainty and reluctance among potential market participants, further hindering the growth and development of a robust carbon market in Malaysia.

Another reason attributable to the lack of interest in the BCX's inaugural carbon auction could also stems from the limited range of eligible carbon credits that can be traded on the exchange. Currently, only Verified Carbon Standard (VCS) credits are eligible for trading, which may limit the opportunities for market players to engage in the carbon market. Other types of carbon credits, such as Gold Standard or Climate, Community and Biodiversity (CCB) credits, which are increasingly popular in the global carbon market, are not yet eligible for trading on the BCX.

The other factor that could further perpetuate the lack of interest and participation in the exchange is the limited project pipeline available. The carbon credits that were eventually auctioned off originated from projects abroad specifically from Cambodia and China. The exchange's success would hinge on the availability of carbon credits from projects that are willing to take part in trading. Without a robust pipeline of eligible projects, market players may not see the value in participating in the carbon market, as there may be limited opportunities for buying and selling carbon credits.

Nonetheless, it is important to acknowledge that BCX is still in its infancy, and as such, there is great potential for growth and expansion. As market players become increasingly acquainted with the exchange and its offerings, there may be a gradual shift towards conducting more transactions through it, potentially leading to a more dynamic and thriving carbon market in Malaysia.

Malaysia's Way Forward

While the RM10 million seed funding announced by the Malaysian government is a step in the right direction, it may not be sufficient to drive the necessary change towards catalysing the carbon market in Malaysia.[6] To truly incentivize green investments across all sectors, a more comprehensive approach is needed. In order to drive potential carbon credits into a thriving carbon market, Malaysia could focus on three key elements.[7]

Firstly, is the demand for carbon credits. Encouraging companies to adopt emission-reduction targets and supporting them in assessing the role carbon offsets could play in their decarbonization journey. There is already a growing demand for carbon credits from companies committed to net-zero targets, with a projected 15-fold increase by 2030.[8] The country's highest-emitting sectors, such as energy and heavy industry, may benefit from carbon offsets despite in-sector abatement. It is important to note that a voluntary market-based mechanism like the BCX relies heavily on market forces and the willingness of companies to voluntarily participate in emissions reduction measures. While this can still incentivize companies to invest in emissions reduction measures, the lack of a legal obligation may result in slower progress towards national emissions reduction goals.

Secondly, is a robust ecosystem to supply carbon credits. Malaysia currently lags behind neighbouring countries such as Indonesia and Thailand in terms of nature-based carbon projects. New entrants in this market may face challenges in raising upfront financing for carbon projects. Additionally, Malaysia's constitution stipulates that land use is a state matter, which means the individual states can pursue their own strategies to allocate land and resources for carbon projects. Thus, close coordination between state and federal governments is required to encourage and facilitate nature-based carbon projects, create clarity for market participants, and pool resources and expertise across states.

Thirdly, is also a need for an alignment between a voluntary based and compliance carbon market. As Malaysia considers multiple carbon-pricing mechanisms, stakeholders require clarity on how carbon credits can be utilized in both voluntary and compliance markets domestically and internationally. Policymakers should provide clarity on any constraints on credit usage in compliance markets, along with the time frame for their application.9 Once the carbon credits from the voluntary market are approved for use in compliance carbon markets, they can generate strong demand signals for the carbon project ecosystem and expedite the development and implementation of carbon projects. This is especially true as Malaysia aims to transition to a compliance market through the Domestic Emissions Trading Scheme in the near future.

Conclusion

To conclude, Malaysia has the potential to leverage a robust carbon market to achieve its climate ambitions, but not all the necessary elements are in place. The country needs to address the demand-supply imbalances and hyperinflation of carbon credits by implementing a rules-based marketplace for trading. The lack of nature-based projects and carbon project developers also poses a challenge, which can be addressed by encouraging and facilitating nature-based projects through close coordination between state and federal governments. From the Bursa inaugural carbon auction, it is clear that the carbon market in Malaysia has yet to gain significant traction, and much work remains to be done in order to establish a robust and thriving carbon market. With concerted efforts and coordinated actions, Malaysia can establish a thriving carbon market that benefits the environment, businesses, and the economy.

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