



Bursa Carbon Exchange: A Step Forward Towards a Green Economy in Malaysia?

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Abstract. To combat the climate crisis, Article 6 of the Paris Agreement revives the implementation of the carbon credit market which was initiated by the European Union under the Kyoto Protocol with the overarching goal of reducing emissions of greenhouse gases through financial incentive. As a party to the Paris Agreement, Malaysia strives to achieve carbon neutrality by 2050 through the greening of the economy. One of the major commitments is the launch of the first Shariah-compliant carbon exchange by Bursa Malaysia Berhad under the collaboration of the Ministry of Finance and the Ministry of Environment and Water. This initiative is similar to the emissions trading system created in the European Union which provides a platform for companies to trade carbon credits generated from green projects. It is undeniable that Malaysia is relatively new in this project, hence the market is still prone to loopholes. Therefore, the Malaysian government needs to enforce hard policy and regulation to accommodate the carbon credit market as a way of fulfilling Malaysian climate change commitments. This paper aims to explore the feasibility of the carbon credit market in Malaysia to balance the goal of tackling climate change through financial incentives. While elaborating on the proposed concept of carbon market in Malaysia, a doctrinal approach was adopted to prepare this paper by analysing the implementation of this market with the reference to some other selected jurisdictions to know the challenges and possible considerations behind this market.

Keywords: Paris Agreement; Carbon Neutrality; Carbon Market; Bursa Malaysia Exchange; Carbon Pricing Tools.

1 Introduction

The rapid acceleration in climate change, including rising temperature, unpredictable weather patterns and ecosystem disruption, is a global threat to the entire human mankind, hence immediate attention is required on this issue. It was reported by the World Health Organisation (WHO) that approximately 250 000 additional deaths per

annum are expected to be the result from climate change due to malnutrition, heat stress, malaria, and diarrhoea alone [1].

The urgency of this climate issue is highlighted in the Paris Agreement formulated in the UN Climate Change Conference (COP21) in Paris. As the signatory to the Paris Agreement, Malaysia is committed to the transition to a green economy, which is highlighted as the key theme of the 12th Malaysian Plan of ‘advancing sustainability’ [2]. In promoting the green economy, the government has outlined the plan for ensuring sustainability in businesses. Aside from the financial incentives for companies such as tax allowance for green investment [3], the most significant initiative by the Malaysian government is the launch of the first voluntary carbon market. Known as Bursa Carbon Exchange (BCX), it is the first Shariah-compliant carbon exchange in the world introduced by Bursa Malaysia Berhad under the vision of the Ministry of Finance and the Ministry of Environment and Water (KASA) [4]. Nevertheless, as compared to other jurisdictions which already have a mature framework in place, Malaysia is still in its infancy in terms of the implementation.

As the first step towards achieving a green economy and fulfilling the nation’s obligation of net-zero commitment by 2050, it seems that the Malaysian government should create a legal environment to cater the carbon credits market, such as carbon taxes and penalties for exceeding emission limits. Therefore, this paper will focus on research questions in terms of the potentiality of the carbon credit market in Malaysia to fulfil the obligation under the Paris Agreement of achieving a low-carbon economy. The discussion will include the review of the concept of BCX in Malaysia and the reference to other jurisdictions in terms of the implementation of this market. Furthermore, several recommendations have been proposed in implementing the carbon credit market in Malaysia.

In completing this paper, a doctrinal approach was used as the topic on the carbon market in Malaysia is still in a developmental stage. Hence, the exploration of this topic dives deep into its academic aspect to enable further understanding of the intricacies and nuances of the subject. Firstly, the literature on the historical background of the carbon credit market was studied to have a general idea on this concept. Secondly, the Malaysian current framework on the efforts towards the decarbonisation goal was covered while looking into the resources on the implementation of this market in other jurisdictions in order to find out the loopholes and necessary considerations that need to be taken note by the domestic market. Thirdly, several countries, such as Singapore and Denmark, that have adopted the carbon credit market have been studied, including Singapore and Denmark, have been referred to in order to come up with recommendations for improving the existing framework in Malaysia with the ultimate aim of optimising the potential of the carbon market in reaching the vision of decarbonisation in Malaysia.

2 **Emergence of Global Carbon Market**

Carbon market, also known as emission trading for carbon dioxide, generally comprises of the trading of the emissions of the six major GHG, namely carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF₆) [5]. With the overarching goal of promoting a sustainable green economy, this mechanism puts a price on carbon and creates a new marketplace with sale and purchase of carbon credits [6].

The international participation in carbon markets was sparked considering the commitment of reducing emission of GHG under the Kyoto Protocol, which is the first legally binding climate treaty approved in the 3rd Conference of the United Nations Framework Convention on Climate Change (UNFCCC) [7]. With the exacerbation of climate issues, the Paris Agreement was later adopted at the 21st Conference of UNFCCC as a footprint of global climate action. Unlike the flexible nature of the Kyoto Protocol, Article 6 of the Paris Agreement binds the countries together and encourages voluntary cooperation between the countries to achieve net-zero carbon targets set out in their Nationally Determined Contributions [8]. As such, the carbon market has become one of the key tools in reducing carbon footprints by producing a pricing mechanism on the carbon emission, which can be categorised into two types: Compliance Carbon Market (CCM) and Voluntary Carbon Market (VCM).

2.1 **Compliance Carbon Market (CCM)**

CCM, also known as regulated markets and emissions trading schemes, imposes the participation of carbon markets subject to mandatory targets of emission [9]. This mechanism is regulated by the government under the enforcement of law that encompasses a mandated cap-and-trade system and carbon tax policy, which complement each other [10].

The EU Emissions Trading System (EU ETS) is one of the largest CCM worldwide with coverage of roughly 40% of the EU-27's GHG emissions [11]. It imposes mandatory participation for companies in the sectors covered by the scheme by allocating GHG emissions allowances to the companies, where one allowance is equivalent to the right of emitting one tonne of carbon dioxide. It is then followed by the distribution of the allowances for the installation in the scheme in an amount equal to the cap. Once the companies are allotted an allowance, the companies can either reduce GHG emission through green technology and market the surplus carbon allowance or purchase carbon allowance to cover the excessive emission in the secondary market. After each calendar year, the installations must surrender the number of allowances equivalent to the verified carbon dioxide emissions for that year, in which the allowances will be cancelled. However, for the installations that fail to surrender the allowances to cover the exceeding emissions would be penalised by fine which equals to the emission of each excess tonne of carbon dioxide.

2.2 Voluntary Carbon Market (VCM)

VCM is an unregulated carbon market which allows the companies to trade carbon offsets to meet their obligations towards the green economy by achieving carbon net-zero transition for 2050. While the voluntary programme is more flexible and has less limitations, its operation is the same as the compliance one. The only difference is that, unlike CCM which trades carbon allowance, VCM involves the trading of carbon offsets which is basically a certificate awarded for the green projects and initiatives that reduce the emission of GHG [12].

3 Bursa Carbon Exchange (BCX) in Malaysia

In fulfilling the obligation under the Paris Agreement towards climate goals, Malaysia launched BCX on 9 December 2022. It is a VCM and is the world's first shariah-compliant carbon market operated by Bursa Malaysia under the supervision of the Ministry of Environment and Water and Ministry of Finance [13]. According to the Chief Executive Officer of Bursa Malaysia, Datuk Umar Swift, BCX is a breakthrough of realising the country's aspiration of reaching net-zero GHG emissions and encouraging the private sector's voluntary climate commitments and decarbonisation journey [14].

3.1 Operation of Bursa Carbon Exchange (BCX)

As the first Shariah-compliant carbon market, BCX allows the trading of standardised contracts with underlying carbon credits released from green projects, which facilitates the companies in offsetting emission footprint while creating climate-friendly products. In ensuring the integrity and transparency of carbon trading, BCX adopts the Verified Carbon Standard, which is the most recognised standard in VCM and accounts for issuing nearly 70% of voluntary carbon credits globally, encompassing both nature-based and technology-based activities [15]. Under this standard, the verified carbon units are generated from the agriculture, forestry and other land use projects that have resulted in the GHG emission reductions. These verified carbon units are measured in terms of one tonne of CO₂-equivalent GHG emissions reductions or removals (tCO₂-e) and are tradable in international voluntary carbon markets [16]. According to Bursa Malaysia, Verra has come up with transparent, credible, and robust methodologies with a wide array of climate-friendly activities [17].

3.2 Modes of Carbon Trading

The BCX is proposing to provide three avenues of carbon trading, namely auction, spot trading for standardised contracts of carbon credits and spot trading services for off-market transactions.

Auction

On 16 March 2023, BCX successfully conducted the nation's inaugural carbon credit auction. It was conducted electronically and witnessed the purchase of 150,000 Verra-registered carbon credits by 15 buyers from different industries [18]. Since Malaysia lacks active Verra-registered carbon credit projects, this first auction has adopted carbon credits from the green projects overseas, namely the Global Technology-Based Carbon Contract (GTC) and the Global Nature-Based Plus Carbon Contract (GNC+). GTC contracts underlying carbon credits generate from the Linshu Biogas Recovery and Power Generation Project in China while the GNC+ contracts feature carbon credits from the Southern Cardamom Project, a Cambodian REDD+ (Reducing Emissions from Deforestation and Forest Degradation) project emphasising on the climate, community and biodiversity standard, which were cleared at RM18.50 and RM68.00 per Contract respectively at the auction.

Standardised Contracts of Carbon Credits

Spot trading for standardised contracts underlying carbon credits only allows the trading of the carbon credits embodied in the contracts that have met specified characteristics. According to Bursa Malaysia, each carbon credit that has satisfied the specification will be onboarded on exchange after being categorised into standardised contracts based on fit with contract specifications. With that, each carbon credit will retain its unique serial number as on the registry to be used to fill orders by companies based on price and quantity [19], allowing the buyers to better evaluate and assess the quality and suitability of carbon credits while making a purchase.

Off-Market Transactions

Like bonds, off-market transactions are also allowed in carbon trading through private dealing of carbon credit transactions between the buyers and sellers outside the system. This kind of transaction is carried out when the buyers and sellers want to utilise Bursa Malaysia's onboarding as well as clearing and settlement services for their direct carbon credit transactions [20].

3.3 Other Carbon Pricing Mechanisms

The kickstart of BCX with its inaugural public auction is a steppingstone towards other carbon pricing mechanisms, such as domestic emissions trading scheme (DETS) and carbon tax, to better provide a legal environment for the initiative of decarbonisation.

Domestic Emissions Trading Scheme (DETS)

DETS is the second initiative proposed by the Government of Malaysia to impose the mandatory GHG trading programme for the local companies. Its announcement was made in the “National Guidance on International Voluntary Market Mechanisms” published by the Malaysian Ministry of Environment and Water in September 2021 [21] in the 12th Malaysian Plan as part of the 2050 carbon neutral goal, which will be developed in phases to formulate a single transaction platform as a complement to BCX. Although Malaysia has not officially commenced the implementation of DETS, this scheme is similar to the system adopted by most countries, including China, India and South Korea, which works on the concept of ‘cap-and-trade’ by setting an emission cap for GHG emitted by heavy industries.

Carbon Tax

In facilitating both BCX and DETS, the imposition of carbon tax is also proposed by the Ministry of Finance in the 12th Malaysia Plan 2021-2025 as part of the carbon pricing tools to supplement the initiatives of BCX and DETS.

Although Malaysia has plans to implement a carbon tax by imposing a fixed charge on the carbon emissions, however, up to date, there is still no announcement of a proper carbon tax framework. Moreover, in February 2023, the incumbent Finance Ministry expressed the non-possibility of implementing a carbon tax in the near future [22]. The Organisation for Economic Co-operation and Development (OECD) has strongly encouraged all countries to implement environmental tax to mitigate environmental issues and achieve various economic and sustainable growth [23]. Besides, many countries have proven the effectiveness of carbon tax as the strategy to mitigate environmental issues, such as Denmark which has achieved the highest scores (77.90) in the Environmental Performance Index 2012, as compared to Malaysia which has only scored 35.00 [24].

In 1992, Denmark implemented the carbon tax to fulfil the Kyoto Protocol’s obligation in decarbonisation by imposing carbon tax on coal, oil, gas and electricity with the initial tax rate at USD16.91 per tonne of carbon dioxide [25]. It has a twofold aim of encouraging the use of green technology to replace carbon products and using the revenue from carbon tax to provide subsidies for improvement of green technology. Within a span of 12 years (from 2005 to 2017), Denmark managed to reduce 27.7% of direct and indirect GHG emissions, a significant achievement in protecting the environment [26].

4 Possible Considerations by Government Behind Bursa Carbon Exchange (BCX)

As compared to other countries such as China and South Korea which already have a developed carbon market in place, VCM in Malaysia in the form of BCX is still in its

infancy. We have identified a few most apparent issues that need to be solved in ensuring the efficiency of greenwashing through the carbon market.

4.1 Fulfilment of Local Green Projects to Verra Criteria

BCX is adopting the standard of Verra in verifying the carbon credits generated from green projects that can be traded. The project must fulfil the criteria under Verra to be certified and eligible for carbon trading. The requirements of Verra include GHG reduction that are real, measurable, permanent, additional, independently verified and transparently listed. According to Bursa Malaysia, it takes two to five years for a project to be certified by Verra as Verra requires the activities to have actually taken place in order to assess its effectiveness in reducing GHG emissions [27], which is evidenced in the adoption of carbon credits from green projects overseas during the inaugural public auction.

However, although Malaysia is relatively new to the concept of VCM, the resources in Malaysia allow the country to grow into a competitive player in carbon trade as Malaysia can supply carbon credits generated from nature-based sustainability solutions, such as reforestation and renewable projects of solar and hydro. Therefore, Malaysia should maximise the resources available in the country and formulate a comprehensive legal framework and policies to support the decarbonising initiative to encourage the market participation in BCX market.

4.2 Absence of Legal Framework in Malaysia

In terms of governing laws, the Environmental Quality Act 1974 (EQA 1974) is the landmark legislation governing environmental issues [28]. EQA 1974 is responsible for safeguarding sustainable development in environmental protection. Despite the rising of new environmental issues and concerns over these 49 years, including climate change, the existing EQA 1974 is not revised to cater with the new issues, meaning that environmental laws and policies in Malaysia are still underdeveloped due to the inadequate resources and expertise [29]. After including the formulation of climate change legislation in September 2020 as part of the 12th Malaysian Plan to boost the effectiveness and coordination of climate change actions, the Ministry of Environment and Water has announced its completion of the climate change legal framework in December 2021 which will be the foundation of the Climate Change Bill [30].

Since the framework of the bill is still unclear, it is highly encouraged for the coverage of the introduction of carbon pricing tools, like Singapore. The Singaporean Carbon Pricing Act 2018, which comes into force together with the implementation of carbon tax, focuses on the tax payment in relation to GHG emissions [31].

4.3 Issue of Carbon Leakage

Carbon leakage refers to the shifting of GHG emissions from a country with tight standards to another country with less stringent rules. This issue arises from the Paris Agreement which allows every country to have its own defined reduction targets and policies to achieve the goal. The differences in the Nationally Determined Contributions would pose the risks of carbon leakage from countries with absolute reduction targets to countries with relative reductions targets, lack of resources and lack of commitment [32].

One of the measures of addressing carbon leakage is carbon border adjustments [33], which is coordinated with the carbon tax and emission trading system. It is the incentive introduced by the EU Member States to cater for carbon leakage by imposing a tariff on carbon intensive products. This Regulation will enter into application on 1 October 2023, with its first reporting period for traders ending 31 January 2024 [34]. It requires the EU importers to purchase certificates equivalent to the weekly EU carbon price to be applied to the imports in the main sectors with highest GHG emission, such as cement, iron and steel, aluminium, fertilisers, and electricity [35]. The importers are required to pay the price difference between the one paid in the country of production and the one of the EU ETS for carbon allowances. This carbon levy can solve the carbon leakage issue, where the money can also be channeled to less developed countries to assist their decarbonisation commitments.

5 Conclusion

The carbon market is a framework that allows carbon credits trading between corporations with the overarching aim of reducing the GHG emissions to meet the climate commitment. In fulfilling the commitment under the Paris Agreement, Malaysia has come up with the carbon pricing tools, consisting of VCM, DETS and carbon tax. Undeniably, considering the abundance of natural resources in Malaysia, Malaysia has the potential of becoming one of the major carbon hubs in Asia, which would bring Malaysia towards the commitment of carbon neutrality by 2050 while providing new economic opportunities to the country. Undeniably, as compared to the neighbouring countries, Malaysia is rather slower in its progress of carbon pricing policy as Malaysia has only kickstarted the implementation of BCX in March 2023 with its inaugural public auction, while there is still no progress in DETS and carbon tax, which are essential in supplementing BCX. To better equip Malaysia towards the goal of carbon neutrality by 2050, it is high time for Malaysia to revisit its current policies and legal framework on environmental issues.

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