Voluntary carbon market outlook

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The state of play

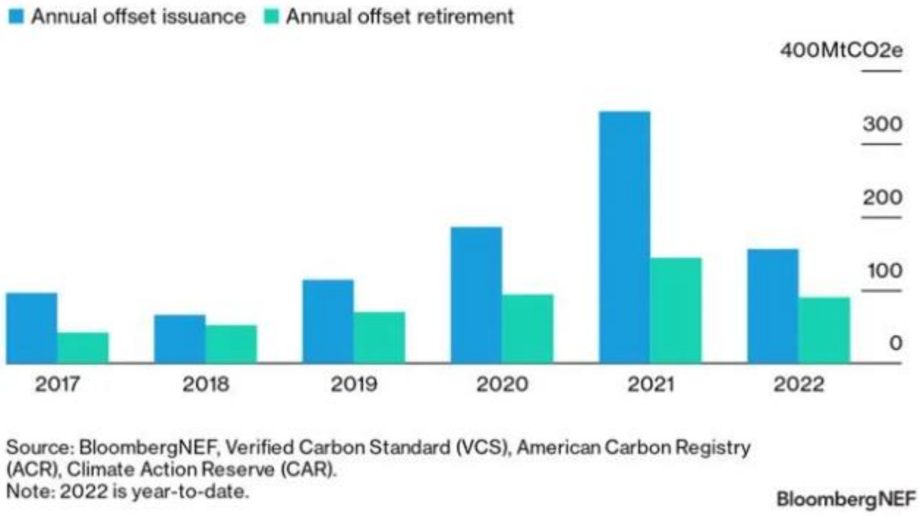
After explosive growth between 2019 to 2021, the growth of voluntary carbon markets (VCMs) started to slow down over the past year, attributable to factors including:

- **The Russia-Ukraine conflict**: The conflict and the resultant energy crisis created a bearish sentiment in VCMs, as market participants found the volatile and lucrative oil and gas markets more attractive.

- **Uncertainties over greenwashing**: VCMs have been caught up in controversies involving cheap and low-quality carbon credits that do not avoid or remove greenhouse gas emissions. Verra, a global leading carbon standard, was criticised for phantom rainforest offsets. These allegations have caused concern over whether carbon offsets are more beneficial or detrimental to global decarbonisation. With increased scepticism amongst market participants regarding the legitimacy of carbon offsets, the price of REDD+[1] credits plunged to as low as ~US$1.70/t in Feb 2023 as buyers retreated.

- **Oversupply of carbon credits**: The carbon offset market is oversupplied with energy generation and avoided deforestation offsets (*Figure 1*), many of which are of low-quality, that has also contributed to low prices.

Figure 1: Oversupply in the carbon offset market



Source: BloombergNEF

[1] According to Sylvera, REDD+ stands for Reducing Emissions from Deforestation and forest Degradation, where '+' represents activities related to the sustainable management and conservation of forests. REDD+ is a type of avoidance credit that finances activities in these areas.

The road ahead

1. VCMs are a growing market despite uncertainties

The market value of VCMs was valued at ~US$2bn in 2021 and is estimated to grow by at least 5 times to US$10 – 40bn by 2030, according to a report by BCG and Shell. While it is concerning that some credits do not deliver the benefits they claim, VCMs are still an important funding mechanism for the conservation of carbon sinks and valuable ecosystem services through REDD+ projects. Nature-based solutions are becoming a priority in the low-carbon transition, with growing awareness of increasing nature risks because of global dependencies on natural capital.

2. Urgent VCM framework required under Article 6 of Paris Agreement

At the 27th United Nations Climate Change Conference (COP27) last year, texts on Article 6.2 (guidance on international trade of carbon credits) and Article 6.4 (set-up of a centralised carbon market overseen by the UN) saw some progress but countries pushed back to 2023 a decision for project types that can produce credits, as well as definitions on what constitutes a high-quality carbon credit.

To enable stakeholders to confidently engage in VCMs without risking greenwashing accusations, these are urgent but complex issues to tackle. Stakeholders remain hopeful that there will be some progress in Article 6 negotiations at COP28 in Dubai this year.

Nonetheless, countries have begun to operationalise Article 6 through international collaboration on initiatives related to carbon markets. From 2024, carbon tax-liable facilities in Singapore will be able to use high-quality international carbon credits to offset up to 5% of their taxable emissions. To facilitate this, Singapore's National Environmental Agency (NEA) has signed agreements with organisations including Verra and Gold Standard to allow credits issued by them to help Singapore's carbon tax-liable facilities meet part of their carbon tax obligations. Singapore has also signed agreements with Peru and Papua New Guinea to facilitate collaboration on carbon credit projects, to collectively advance global climate action towards the Paris Agreement goals.

With the demand for carbon offsets from corporates anticipated to increase with policy developments and greater net-zero commitments, a clear and mandated VCM framework can enable the VCM to thrive and genuinely contribute towards net-zero goals.

3. High-quality carbon credits as part of broader decarbonisation strategy

Despite uncertainties and criticism, corporates can consider VCMs as part of a more holistic decarbonisation strategy. The urgency of the climate crisis and 2030/2050 climate commitments do not give us the luxury of time to wait for the development of a perfect market. Corporates can navigate through the uncertainty by prioritising high-quality carbon credits to mitigate reputational risk and offset residual emissions in hard-to-abate sectors.

Conclusion

With increased scrutiny on the legitimacy of VCMs, there is pressure amongst nations and authorities to develop a consistent framework for the international trade of carbon credits as the market grows. This will be important to enable market participants to confidently engage in VCMs. While carbon offsets are important, they should not be used as a substitute for genuine emissions-reduction efforts. Corporates should prioritise achieving reductions in absolute emissions, before using carbon offsets for residual and unavoidable emissions for hard-to-abate sectors to complement existing decarbonisation strategies.

Sources: S&P, Bloomberg Green, BloombergNEF, Guardian, Bain & Company, BCG, Shell, Ministry of Sustainability and the Environment (Singapore)

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