January 19, 2001

FACT SHEET

GUIDANCE FOR IMPROVING AIR QUALITY USING ECONOMIC INCENTIVE PROGRAMS

TODAY'S ACTION

! The Environmental Protection Agency (EPA) today released guidance for states that want to use economic incentive programs to improve air quality and visibility. This guidance is also useful for other stakeholders in determining what questions need to be addressed in designing economic incentive programs.

! Economic incentive programs include a variety of measures designed to increase flexibility and efficiency, while maintaining accountability and enforceability of traditional air quality management programs. EPA drafted the guidance issued today to encourage cost-effective and innovative approaches to achieving air pollution goals. Equally important, states and local areas can use these programs to achieve targeted air pollution reductions in areas with low income or minority communities if a local area or State is interested in doing so.

! The new guidance document outlines economic incentive programs that states may incorporate in their strategies for meeting air quality standards. Such strategies are known as state implementation plans, or SIPs. States also may use economic incentive programs to address visibility impairment in national parks and wilderness areas.

! The guidance has no direct regulatory consequences. It is designed to help states incorporate economic incentive programs as they develop or revise state implementation plans. The guidance provides advice on choosing an appropriate type of incentive program, what emission sources to include in that program and how to make a program successful.

! Today's guidance document updates earlier guidance EPA has issued on economic incentive programs, including the Agency's 1994 Economic Incentive Program rule and its 1995 proposed model rule for open-market trading.

KEY ELEMENTS & PRINCIPLES

The guidance outlines four main types of economic incentive programs:

< *Emission trading programs* create transferable emission reductions. The cost of emission reductions may be relatively low for some sources but may be high for others. In these situations, both types of sources may benefit by trading emission reductions.

< *Financial mechanism programs* include fees paid by emitters for each unit of emissions. A source may decide to reduce emissions in order to avoid paying the fees (usually to a regulatory agency), thereby lowering costs. Financial mechanisms also may include subsidies that promote pollution-reducing activities or products.

< *Clean air investment funds* provide cost relief for sources when the cost of emission reductions is high. Sources pay into the fund in lieu of reducing emissions; the fund manager procures emission reductions elsewhere.

< *Public information programs* include educational programs such as product certifications, product labels, announcement of "ozone action days" or other information people can consider when making choices that affect air quality.

! The guidance also outlines key principles that must be incorporated in an economic incentive program in order to receive EPA approval.

< Emission reductions obtained through economic incentive programs must have "integrity," meaning they must be quantifiable, enforceable and permanent. The reductions also must be "surplus," meaning they were not already required under another program.

< Each program must seek to protect all segments of the population equally from health and welfare damage caused by emissions.

< Each program must achieve an environmental benefit, such as reducing emissions faster than traditional regulatory approaches, achieving an emission reduction of 10 percent or more, or other environmental management improvements

BACKGROUND

! The guidance released today is rooted in provisions of the Clean Air Act that encourage the use of incentive-based approaches to control air pollution. Examples of Clean Air Act programs using such approaches include EPA's acid rain emissions trading program and the nitrogen oxides (NOx) budget trading program.

! Under the Clean Air Act, each state is required to meet the national ambient air quality standards for ozone, carbon monoxide, lead, sulfur dioxide, nitrogen dioxide, and particulate matter (both coarse and fine). States must submit to EPA state implementation plans, or SIPs, that outline the means and measures for attaining these standards.

! The Clean Air Act encourages the use of economic incentive programs in state implementation plans, and even requires their use under certain circumstances.

- In 1994, EPA issued rules for three types of economic incentive programs: emission limiting strategies; market response strategies; and public information/directionally sound strategies. The rules were mandatory in some states that missed milestones and served as guidance for all other states voluntarily adopting incentive programs.

- In 1995, in support of White House regulatory reinvention initiatives, EPA proposed a model rule for open market trading. The proposed program provided a voluntary compliance option for trading emissions of volatile organic compounds and nitrogen oxides – both precursors to ozone, or smog.

- On July 1, 1999 EPA issued its regional haze rule to address visibility impairment caused by pollution in national parks and wilderness areas. This program, which will require states to develop implementation plans to achieve "reasonable progress" toward improved visibility, includes options for emissions trading.

- The National Environmental Justice Advisory Committee and the Clean Air Act Advisory Committee reviewed earlier drafts of this guidance and provided comments for the draft guidance that was made available to the public in September 1999. The National Environmental Justice Advisory Committee is a federal advisory committee created to advise EPA on environmental justice issues. The Clean Air Act Advisory Committee, representing major groups concerned with air pollution regulation, is the principal external advisory body to EPA's assistant administrator for air and radiation.

- A draft version of this guidance was made available to the public for review and comment in September 1999. EPA modified the draft guidance to address these comments. Today's guidance also reflects knowledge and experience from economic incentive programs that states developed in recent years.

<u>KEY CHANGES SINCE THE 1994 GUIDANCE DOCUMENT</u>

- EPA and other stakeholders have learned more about designing, implementing and running economic incentive programs since 1994, and EPA has incorporated those lessons in this document. The guidance released today provides greater safeguards for human health and the environment than EPA's 1994 EIP guidance, while providing more flexibility for states to develop and implement creative approaches to reducing air pollution.

- The document released today includes guidelines on addressing number of issues, such as:

    - **Considering environmental justice in designing volatile organic compound (VOC)**

economic incentive programs. EPA encourages VOC economic incentive programs because they have the potential to result in greater progress towards ozone reductions at lower costs than traditional programs. These programs can be used as a tool for addressing community concerns about air pollution levels in low-income and/or minority communities. The new guidance lays out specific issues that should be considered in designing these VOC economic incentive programs.

- **Involving the public.** This guidance highlights the need to involve all stakeholders in the design, implementation and review of economic incentive programs. While it will not ensure a program's success, participation by interested stakeholders increases the likelihood that a program will succeed.

- **Providing more economic incentive tools.** Since 1994, several new economic incentive concepts have been explored by EPA and others as creative methods of reducing air pollution in an environmentally responsible manner. For example, Open Market Trading programs, when properly designed, can provide incentives for emission reductions for facilities whose emissions are below regulatory limits. Facilities whose cost of reducing emissions is comparatively cheap can sell these emission credits to others who have higher costs of reduction. Thus, an area still can meet its emission reduction target while the overall cost is reduced.

- **Eliminating variances.** Occasionally, facilities have demonstrated to a state regulatory authority that it is too costly to reduce emissions. This new guidance creates new avenues for reducing emissions by providing incentives for firms to get these reductions elsewhere. EPA now recommends that state regulatory authorities no longer allow such variances, and instead require these firms to purchase reductions once programs are available.

- **Rewarding good planning.** When a state has an air pollution problem, it must develop and implement a variety of plans to show how it will reduce pollution to acceptable levels. For those areas that have done their planning and have approved attainment demonstrations, where required, this guidance provides greater flexibility in the design and implementation of economic incentive programs.

- **Encouraging regional planning**. Many air quality problems need multi-state solutions. This guidance contains measures that allow multi-state cooperation in developing and implementing innovative programs.

FOR MORE INFORMATION

- The final guidance are available on EPA's World Wide Web site at the following address: http://www.epa.gov/ttn/oarpg/t1main.html.

- These documents are also available through EPA's Air and Radiation Docket and Information Center (Docket Number A-97-27) by calling 202-260-7548 or FAX 202- 260-4000. A fee may be charged for copying.

- For technical questions about the economic incentives program guidance, contact Eric Crump at 919-541-4719.