

# RECLAIM wins positive report from EPA

**Daniel Chartier** reviews the findings of a recent assessment of California's Regional Clean Air Incentives Market

The Regional Clean Air Incentives Market (RECLAIM) in California has been a successful programme for quite some time (see box). However, a sudden increase in Regional Trading Credit (RTC) prices which occurred in the summer of 2000 had a major impact on the ability of affected facilities to comply and led to structural changes that removed electricity generating facilities from the programme, while simultaneously expediting control technology installations at these facilities.

In response to this episode, the Environmental Protection Agency (EPA) began an assessment of the RECLAIM programme, which it has recently completed.<sup>1</sup>

The findings of the EPA evaluation were positive, focusing on the lessons learned and recommendations that could be applied to improve RECLAIM, and by industry and regulators considering using market-based programmes in other jurisdictions.

None of the findings relate to failings of the market system. In fact, as the report highlights, the South Coast Air Quality Management District (SCAQMD) met its environmental targets while saving business \$57.2 million (1987 dollars) annually and preserving 1,147 jobs when compared to command-and-control regulation.

Among the key findings and recommendations<sup>2</sup> of the study are the following:

□ Major changes to existing programmes could be disruptive; therefore changes should be incremental and market-based. Regulatory certainty and predictability are needed by business to allow for effective short- and long-term planning, and to allow facilities to monitor market conditions such as supply and demand, and price. Dramatic regulatory changes can be disruptive to market pricing and can impair the ability of

RECLAIM, the longest running regional cap-and-trade programme, set declining caps for emissions of nitrogen oxides (NOX) and sulphur dioxide (SO<sub>2</sub>) for the largest facilities operating in the South Coast Air Basin (the areas in and around Los Angeles, California). RECLAIM was first adopted in 1993 and included 350 participants in the NOX market and 40 in the SO<sub>2</sub> market. Market participants are able to comply with their emissions caps by installing control technologies or purchasing RECLAIM Regional Trading Credits (RTCs) from other facilities.

facilities to manage compliance effectively. In addition, the study recommends that when system contingency measures are needed they should be market-based adjustments such as allowing payments into non-compliance contingency funds.

□ Regulators should create confidence and trust in the market by making a full commitment to the market and ensuring consistency in the market and their policies. In the case of RECLAIM, some believed the programme would not be sustained. Instead, they believed that when deadlines approached and costs for compliance rose, the state would ultimately withdraw the regulation. While this finding reflected the views of a limited number of industry representatives and may not have been substantiated by actions taken by the regulators, it led some participants to delay the installation of control technology until it was too late to reduce emissions or buy credits from the market.

□ To encourage market efficiency, regulators or third parties should provide market performance information. Stakeholders universally indicated that market and economic information was critical to informing long-term planning and decision-making. To the extent that information was not available on the status of RTC supply, control technology installations at affected facilities and economic indicators that would signal increases or decreases in emission levels, participants may not have had adequate information to make decisions to justify early action at their facilities. One specific recommendation includes having SCAQMD provide detailed information on the

status of permits to install controls at affected facilities and the types of controls expected to be installed. Such information, coupled with economic indicators, would allow participants to estimate future supply and demand patterns for RTCs more accurately, and adjust compliance plans in a timely manner.

□ Designers should consider the needs of small facilities. RECLAIM was unique in that it captured many small businesses. In contrast, the US Acid Rain Program, which is also a cap-and-trade system, captured large emitters from the electricity sector that were well accustomed to complying with complex environmental programmes. The small businesses affected by RECLAIM did not have an in-house capability to analyse market trends or conduct least-cost compliance planning. The report recommends providing small businesses with assistance and information on relevant market conditions and compliance options using conferences, workshops and mailings.

□ SCAQMD could consider serialising credits to allow more accurate tracking. To eliminate conflicts and confusion over ownership and availability of individual emission credits, the credits could be serialised in a manner similar to that used in the Acid Rain Program. Serialisation would also allow credits generated by inter-sector projects to be easily identified. The ability to do this is important since credits from inter-sector projects have an inherently higher risk of later being disallowed.

□ Unforeseen external forces can have a dramatic effect on the market. Programmes must be designed to react effectively to these external factors. Many control technology options have long lead times for planning and permitting. Thus, many of these options cannot be relied upon to deal with a short-term shortage of credits in the market. One suggestion in the report is to allow facilities to submit and gain pre-approval for contingency options. For example, a control technology installation could be approved and actual implementation tied to market conditions. In that way, when credit supply became limited or prices rose above a certain level, construction could begin immediately without the permitting delay. Such an effort could help to stabilise market supply and credit price, while giving business more compliance options.

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The Emissions Marketing Association consists of more than 270 members from 190 companies worldwide. Its aim is to promote market-based trading solutions for environmental control



<sup>1</sup> The complete report is available in PDF format at <http://www.epa.gov/region09/air/reclaim/index.html>

<sup>2</sup> The lessons learned and recommendations summarised in the EPA report represent the researcher's analysis of the findings attributable both to the stakeholders that participated in the evaluation process and the independent findings of the EPA.