SOME LESSONS FROM THE USE OF ENVIRONMENTAL QUASI-REGULATION IN NORTH AMERICA

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STAFF WORKING PAPER

OFFICE OF REGULATION REVIEW

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PREFACE

This working paper was prepared as part of the background research conducted for the Commonwealth interdepartmental committee on quasi-regulation. The Committee is chaired by the Office of Regulation Review.

The main objectives of the research were:

- to review recent developments in using alternatives to traditional command-and-control regulation;
- to classify the different types of 'quasi-regulation'; and
- derive lessons for Australia for good policy-making and formulation of regulation and its alternatives.

The Office of Regulation Review —within the Industry Commission — has a central role in advising on and administering requirements and processes to achieve more effective, less intrusive regulations.

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> "When used appropriately command and control regulation can provide clarity, certainty and predicability. It allows the general public, the regulated firms and the government to know what is required and whether it is being achieved.
>
> However, governments pay high prices for using traditional regulation. Enforcement costs and the need for almost constant updating of regulations are only two aspects of these costs. Also, command-and-control regulations often impose large compliance costs on businesses - not only consuming financial resources but also having negative effects on dynamic efficiency and structural adjustment.
>
> ... Governments and businesses are seeking to address economic and social problems by using instruments that are more cooperative than adversarial in nature, and that have elements of shared responsibility for achieving results. Instruments such as voluntary agreements, private standards, self-regulation, codes of conduct and process regulation allow the private sector more flexibility and faster response relative to traditional command-and-control type regulation. But the risks in terms of effectiveness and accountability need careful consideration." OECD / PUMA (97)1, pp. 2-3.

1 Introduction

The purpose of this paper is to describe examples of approaches to environmental regulation in the USA (and Canada), and to draw some general conclusions which may be useful to the Commonwealth IDC on quasi-regulation.

The growing interest in quasi-regulation is the result of a number of developments. These include:

- recognition of the limits of command and control regulation (rigidity, lack of cost effectiveness, high enforcement costs etc);
- constraints on fiscal budgets coupled with the growing costs of administering regulations;
- increasing 'regulatory overload' making it harder for business to comply with all regulations; and
- a pressure on business to maintain legitimacy and reduce the risk of more government regulation.

The main responses within the US to these pressures fall within four main categories:

(i) private self-regulatory initiatives developed by industry associations, where often the main benefit to industry is reducing the likelihood of government initiated regulation (2.1 below);

(ii) government initiated voluntary schemes where the main benefits to industry are recognition when performance meets or exceeds set and quantified targets (2.2 below);

(iii) government initiated schemes where enforcement (but not regulatory) discretion and other benefits are given to industry participants with a good environmental record (2.3 below); and

(iv) government initiated programs whereby specific regulatory requirements are waived if the enterprise demonstrates a capacity to deliver outcomes superior to the expected outcomes from existing regulations ('regulatory relief' programs) (2.4 below).

The assessment here focuses on the 'effectiveness' of the quasi-regulatory programs in achieving stated objectives. Many (but not all) of the strategies within categories (ii) to (iv) are a result of the Clinton-Gore 'reinventing government' initiative, which, in the case of environmental regulation, seeks to find ways to get outcomes that are 'cheaper, smarter, cleaner'. These initiatives aim to give greater flexibility to producers and ensure that environmental outcomes at least meet the standards achieved under traditional command-and-control. Accountability and compliance is pursued with enforcement actions targeted at the highest risks and most significant non-compliance problems. These initiatives focus on 'compliance' rather than 'enforcement'.

The particular form of quasi-regulation varies considerably from case to case, and includes: pure self-regulation, voluntary codes of conduct, privately set standards, voluntary agreements to meet certain outcomes or targets, and process oriented regulation which includes management systems. And each of these can vary considerably in the degree to which: internal or external monitoring and enforcement takes place; performance and decision-making is transparent; and there is potential for the form to be used for anti-competitive purposes.

2 Examples of quasi-regulation

2.1 Industry initiated voluntary programs

2.1.1 *Responsible Care: industry self-regulation without a strong government enforcer but with transparency*

The development of Responsible Care, the chemical industry's highly sophisticated self-regulatory program, was a response to the Bhopal chemical disaster in India in

1985, which killed some three thousand people and injured tens of thousands more. The chemical industry faced a crisis in its credibility and public acceptability and anticipated a regulatory backlash, extreme difficulties in persuading communities to accept new chemical installations in their locality and other problems.

Responsible Care now functions in over 40 countries. In the United States, more than 200 scientific and technical experts from member companies of the Chemical Manufacturers Association (CMA) developed six Codes of Management Practices that cover virtually every aspect of the life cycle of chemicals. These are: (1) Community Awareness and Emergency Response; (2) Pollution Prevention; (3) Distribution; (4) Process Safety; (5) Employee Health and Safety; and (6) Product Stewardship.

According to the CEO of one chemical company:

> "The CMA's Responsible Care Guiding Principles and Codes of Management Practices established a clear set of performance standards and expectations for our industry. And the principles and codes derive their strength from the fact that they are member-developed and member-enforced. They are not imposed on us by people outside our industry, they are a product of our industry's conscience and our industry's understanding of what it takes to manage all aspects of a chemical business responsibly and competitively." (Ong 1991)

Evidence from Canada, indicates that Responsible Care has had a substantial impact, with measurable improvements resulting from the program. The Canadian Chemical Producers Association (CPC) issued reports indicating that by 1994 CPC member companies had reduced their total emissions by 50 per cent, compared to 1992. A steady decline in workplace and transportation accidents was also noted. And there have been reports of companies receiving reduced loan rates because they were participating in the Responsible Care scheme.

Factors making Responsible Care much more successful than most self-regulatory schemes include:

- the industry "recognised that it was only as strong as its weakest link - that an ecological or safety disaster involving any one enterprise would tarnish the reputation, and threaten the interests, of the entire industry.." (Gunningham and Rees, forthcoming);
- unity and cohesion amongst members has grown as a result of conscious fostering of social ties and in response to pressure from outside criticism;
- the chemical industry is very integrated in that companies often become each others' buyers and suppliers and over time this means people in the industry know who is capable and who they can trust, which lowers transaction costs and makes collective decision making easier;
- CEOs are heavily involved in governing the association so that decisions made by the association have significant clout;

- so far, the association has achieved the right balance between being 'one of us' to members - being able to understand their problems and responsive to the industry's special concerns - and that of being sufficiently independent to play the role of regulator and not be captured by pressures from within the industry;
- each member is required to have an active community awareness programme to reach out to and respond to community concerns;
- there is external and independent monitoring of a critical and measurable performance variable - toxic releases - through legislation which requires emissions disclosures, called the 'Toxic Release Inventory' (TRI) in the US and the 'Community Right-to-Know Policy' in Canada (and is being developed as the National Pollutant Inventory in Australia); as well as
- a strong body of external monitors and critics - "environmental groups of all kinds, EPA officials, citizen advisory panels, a remarkably vigilant industry trade press, and, most notably, an array of chemical industry executives" (Rees forthcoming).

An assessment by OECD/PUMA of the Canadian scheme emphasises the key role of the 'Community Right-to-Know Policy'. This legislatively enforced program, provides an independent and quantifiable measure of one of the ultimate objectives of Responsible Care, namely to reduce the quantity of dangerous pollutants entering the environment. Additional measures to address public concerns over **transparency and ensuring compliance** have also been implemented by the industry.

Even so, some concerns about transparency remain. For example a non-complying company was eased out of the Canadian Chemical Producers Association (CPC) but its name has never been made public. The general public is not able to learn whether the practices of ex-members might endanger the health or safety of workers or of the general population, or might damage the environment.

A final assessment of Responsible Care must make judgements about its performance relative to the possible alternatives. However, concerns remain about the future success of Responsible Care, including whether the CMA will be able to maintain sufficient independence in its role as regulator. Moreover, it appears that some members are not performing well and there is little that the CMA can do about it unless it gets clear backing from its members. It remains to be seen whether the CMA will be able to deliver on better outcomes for the bottom third of poor performers.

In part, because of these concerns and continuing public scepticism, no government has so far considered making Responsible Care an alternative to government regulation: that is, **Responsible Care remains a voluntary mechanism in addition to, but not instead of, government regulation**. Though it does appear that governments have not introduced additional regulation because of the presence of Responsible Care.

The OECD has said:

> "From the perspective of regulating the industry in the public interest, it seems likely that the degree of improvement in environmental sensitivity obtained through Codes of Practice would not have been achieved through command-and-control regulation. Moreover, the cost of enforcing regulations that would touch as many areas as the Codes of Practice would probably be beyond the current levels of resources available to the public sector." (OECD/PUMA/REG(97)2)

2.1.2 *The Institute of Nuclear Power Operations: industry self-regulation underpinned by a strong government enforcer but with questionable transparency*

The 1979 Three Mile Island accident marked a major transformation of the US's nuclear regulatory system. Nuclear industry representatives created a new industrial association, the Institute of Nuclear Power Operations (INPO), in direct response to the accident. It is a private regulatory bureaucracy with about 400 employees who develop standards, conduct inspections and investigate accidents. It has an annual budget of $54 million and is funded by the large industrial institutions that own and operate all the nuclear plants in the United States.

Rees (forthcoming) attributes the strength of the association and the adherence by the industry to its standards on the "nuclear power's potential for incredibly catastrophic accidents, the relatively small number of organisations involved, plus the lack of economic competition among the nuclear utilities".

In 1984, INPO formalised its safety assessment process and from 1986 each plant was given a numerical ranking from category 1 'excellent' down to category 5 'marginal'. This allowed officials to benchmark and so management could not rationalise away problems, if they were in the bottom groups, as common for the industry. INPO also has a policy of asking for a meeting with a member utility's board of directors if their plant was assessed a category 4 or 5. The CEO of almost any utility would not want to have INPO describe to his/her board members the problems of their nuclear program.

But in the end, greater threats have been needed for some and as a last resort the INPO was prepared to report highly uncooperative plants to the Nuclear Regulatory Commission (NRC) - a government regulator. The NRC followed up with its own inspection and closed down the offender. It was this action which brought other poorly performing utilities into line. As one INPO official said: "it wasn't until we got tough a little bit that some of these people started to respect us and to pay attention to us." (Rees forthcoming)

Since then, NRC's background presence has strengthened INPO's hand, partly because coming under the NRC spotlight is much more public than 'being in trouble' with INPO and because the NRC has the clout of a government regulator.

The nuclear power industry does not have the equivalent of the chemical industry's Toxic Release Inventory(TRI)/Right to Know. It seems that the public is only

informed of the performance of plants with very bad records via the NRC. It could be argued that the role played by the NRC has similar effects to that of the TRI, in making the self regulation effective. It is not clear why the INPO companies have not forbidden INPO from reporting them to the NRC.

2.2 Government initiated voluntary schemes

The US has a number of voluntary, results-oriented programs to reduce pollution and assist business to identify unrecognised losses associated with waste. For example, the Climate Change Action Plan aims to reduce US greenhouse gas emission to 1990 levels by the year 2000. Other programs include: Climate Wise, Motor Challenge, Waste Wi$e, Natural Gas Star, Green Lights, 33/50 and State and Local Outreach Program. The programs are characterised by achievement of specified goals or performance targets and the form of the 'encouragement' is recognition. (Clinton 1995).

The 33/50 Program is illustrative of the approach taken. The 33/50 program targeted 17 highly toxic chemicals for reduction through voluntary partnerships with industry. As the name implies, the goals were to reduce releases by 33 per cent in 1993 and by 50 per cent in 1995.

The incentives for participation by industry included flexibility in the way the emissions were to be achieved, technical assistance from the EPA and publicity for participating firms.

The 33/50 Program has been hailed as a great success by the US EPA:

- the interim goal of a 33 per cent reduction in the 17 chemicals was achieved one year ahead of schedule and exceeded by over 100 million pounds; and
- the ultimate goal of a 50 per cent reduction was also achieved a year ahead of schedule.

However, while the 33/50 Program was initiated in 1991, EPA uses 1988 as the baseline year and includes reductions achieved by non-participants. In fact, between 1991 and 1994, 33/50 chemicals fell by 27 per cent compared to the 51 per cent reduction using 1988. Non-participants also reduced emissions during this period, though not by as much as program participants: 30 versus 49 per cent between 1991 and 1994. As with Responsible Care, the Toxic Releases Inventory, announced in 1988, has had a powerful effect on its own: "For firms that were concerned about their environmental image after TRI data were first made public, the 33/50 Program may have been a vehicle to show their support for corporate environmental management." (Davies, 1996, p.17)

2.3 Government initiated schemes involving enforcement discretion

Under these programs, in return for some commitments by industry, government offers benefits such as positive publicity, expedited and facility-wide permits, reduced reporting requirements, and a reduced number of inspections plus a grace

period where they can identify and correct any transgressions themselves and without penalty. Examples include the EPA audit policy, small business policy, the Environmental Leadership Program and some regional programs. Of these, the 'flagship' is the Environmental Leadership Program (ELP). This program offers participants reduced or modified inspections and possibly, in the longer term, other benefits such as expedited permits, longer permit cycles and streamlined permit modifications.

The program has four major purposes:

1. to examine the basic components of what should be state-of-the-art compliance management systems (eg mentoring, pollution prevention);
2. to identify the verification procedures (eg third-party auditing, self-certification) that ensure that the ELP is working;
3. to establish measures of accountability that will be credible to the public; and
4. to promote community understanding and support for innovative approaches to compliance.

The aim was to identify the characteristics of facilities and organisations which can be regarded as environmental leaders. Industry participants usually become eligible by demonstrating a solid record on compliance; a well developed Environmental Management System (EMS); a compliance and auditing program and provision for consultation with local communities.

Unlike Project XL (see below), ELP attempts to find new ways to ensure compliance instead of relying upon command-and-control enforcement, however, it works *within* existing regulatory requirements, seeking to meet current standards with reduced costs and burdens.

Benefits expected from the scheme include: more and better environmental enhancement activities; an exchange of information; the establishment of best practices for environmental management systems and pollution prevention activities; constructive and productive working relationships among environmental stakeholders - ELP members, regulators and the public; and the redirecting of scarce regulatory resources to focus on 'bad actors' and expanded compliance efforts.

And one goal which could have wide ranging implications has been described by Welks:

> "EPA hopes to evaluate the merit of moving from the position in which inspectors took what was, in essence, a simple snapshot of whether a facility was in or out of compliance at a given moment, to making a video which now views an entire management system to discern why present conditions exist and what mechanisms are in place (or are needed) to insure continued compliance (or prevent recurrences of noncompliance)."

Benefits to industry participants in particular include: formal and public government recognition for leadership status; use of a logo issued by the EPA; better relations with government; reduced and/or modified discretionary inspections; and a self-correction period for any non-compliance identified by the facility itself or through outside auditing or inspection, unless the non-compliance constitutes imminent and substantial endangerment to human health or the environment or the violation conferred significant economic benefit on the facility. Qualifying businesses may also receive some economic benefits from government and (possibly) some reductions in the regulatory burden.

Since the ELP has only just completed its pilot stage, conclusions about its success or failure are premature. However, there have been some criticisms and some uncertainties raised.

- "... some facilities have indicated that they may not want reduced inspection levels even if they have a comprehensive management system in place or are considered an environmental leader. They appear to feel that continuing governmental vigilance provides additional legitimacy to their position in the community as environmentally conscientious citizens. This may provoke an interesting dialogue with regulators who hope to use innovative measures such as leadership designations as ways to conserve inspection resources. In a fascinating role reversal, an agency may find itself trying to persuade a facility to accept fewer inspections while the facility argues for more frequent inspections!" (Welks, 1996)
- So far the development of the ELP pilot projects has cost rather than saved resources. It is not yet demonstrated that ELP will achieve EPA's long-term goal of saving resources or at least deploying existing assets in a more effective manner.
- In developing some of the pilot projects, regulators have worked closely with facilities, in a way quite unlike their traditional enforcement role. If in the future, enforcement action is contemplated against one of the ELP leaders, there is the risk that these regulators will be, or will be seen to be, captured by the facility.
- Another risk from working closely with officials, is that of officially induced error if the regulated entity can demonstrate that its violation of a standard can be attributed to some official government action that led it to commit the violation.
- It is claimed by some that transparency and community involvement has been inadequate.
- There is a concern that while enforcement forbearance or amnesty offered to audit disclosures may encourage the correction of any current violation it may increase the likelihood of violations in the future, simply because any future non-compliance will also be given an amnesty.
- There is concern about the ambiguity of the criteria used to determine whether violations are exempt or subject to the full force of the law:

> "For example, the central concept of auditing is not self-defining. ... Does the discovery of a violation have to be made in the precise context of a process that meets the endorsed definition to invoke the protection of an amnesty program? ... Such questions acquire great significance because complete protection from enforcement under these programs turns on their resolution." (Welks, 1996, p.18)

Some of these concerns reflect the peculiar circumstances applying in the US, where a highly legalistic approach is taken to regulation and where resort to prosecution is frequently made.

2.4 Government initiated 'regulatory relief' programs

Programs within this category involve the waiver of specific regulatory requirements if the enterprise demonstrates a capacity to deliver outcomes superior to the expected outcomes from existing regulations. Here, the main program is Project XL (standing for eXcellence and Leadership).

Under Project XL (currently at the pilot stage), the US EPA is investigating opportunities to replace existing regulatory requirements with alternative environmental management strategies, if a company can demonstrate that its proposal will achieve better environmental results than expected under existing law. As EPA staff put it "if its legal it isn't XL". This contrasts with ELP which remains firmly *within* the existing regulatory system.

The US EPA has said:

> "The offer is simple: if you have an idea that promises superior environmental protection to what would be achieved under the current regulatory system, and if you use a meaningful stakeholder process, then we will work with the relevant state and local agencies to grant the flexibility needed to put those ideas to the test." (EPA 1997, p.1)

So far much attention has been given to replacing 'command and control' requirements that limit emissions to specific media (air, water and land) with facility-wide 'bubbles' and 'caps' that allow companies to trade emissions among pollutants and among media. For example, a company might propose increasing its total emissions of volatile organic compounds above the levels allowed in existing permits in exchange for reductions in emissions of sulfur dioxide or nitrogen oxide below permit levels." (Steiner 1996, p. 10528)

As with the ELP, Project XL is still at the experimental stage, and firm conclusions about its success are premature. A number of problems have emerged.

XL has been criticised for the uncertainties created by the difficulty of evaluating the environmental implications as well as the costs and benefits of trading decreased emissions of one aggregate class of pollutants for increased emissions of another class of pollutants. It has also been criticised because it could cause anti-competitive effects by freeing some companies from significant environmental compliance costs while continuing to impose those costs on their competitors.

(This will be cancelled if the experiments are successful and subsequently extended to an entire industry.)

Other problems include the lack of clarity as to what constitutes a potential XL project (what does the requirement of 'superior' environmental performance mean and how do you define the baseline for measuring improvement?). It has also been unclear what types of variance under 'regulatory flexibility' would be tolerated and there have been complaints that stakeholder involvement has not been adequate. There is also a serious concern that the process involves too much effort for business (ie that costs exceed benefits in some cases).

Also, current statutes do not actually give the EPA the ability to allow facilities to be 'in violation' of existing statutes and regulations. So the Program does not shield participants from third-party suits nor from agency enforcement actions. In a litigation happy country, there is no incentive for firms to place themselves in such risk. Possible remedies range from a complete statutory overhaul to passage of a bill granting the EPA and individual states the ability to formally sanction innovations such as trades of emissions from one media to another. (Davies 1996)

Yet the project also holds out the promise of considerable benefits. For government, these include increased flexibility to adopt innovative solutions to environmental problems; increased and more cost effective environmental protection; improved compliance; expanded use of waste minimisation and pollution prevention strategies; and a more cooperative relationship between regulators, the facility and the community.

For industry the prime benefits are: "saving money on compliance with existing regulation, achieving rapid review of alternative compliance plans, and winning freedom from constant revaluation of pollution control strategies so that companies can respond to competitive challenges in national and international markets." (Steiner 1996, p. 10528).

Unfortunately, industry has become increasingly dissatisfied with XL. A year ago it seemed a highly promising program to many business people, but it has more recently been declared as 'collapsing' by a prominent businessman. Only ten facilities of extremely large US market-leaders are implementing XL project plans.

A report to GEMI, a US organisation of 21 leading corporations dedicated to helping business achieve environmental and health and safety excellence, stated:

> "While XL has fallen short of its original goal of providing firms flexibility within the existing system, the initiative still presents a tremendous opportunity for EPA, firms and interested citizens to test what types of innovations work. In order to answer such questions, firms, regulators and the US citizenry need a set of measurement and decision-making tools to evaluate whether such efforts improve environmental and economic performance." (Davies 1996, p.42)

3 Assessments and conclusions

3.1 Advantages

There are a number of potential **benefits** provided by quasi-regulation:

- in the face of 'regulatory overload', it is a way to avoid highly detailed and prescriptive regulation;
- it lowers the cost to government of the formulation, administration and sometimes the monitoring and enforcement of standards;
- it makes more extensive use of the expertise of industry;
- it enables industry to more fully 'own' the standards or code adopted;
- it is usually more flexible and cost effective than government regulation; and
- because it does not include laws that have to be revised, it is usually more responsive to the needs of the market place, allowing for product innovation, diversification and development.

3.2 Disadvantages

There are potential costs and risks in using quasi-regulation:

- in general, there are no legal remedies for breaches of a voluntary code or agreement unless it is written into contracts;
- it could be used to promote anti-competitive behaviour, analogous with the problem where professional associations set standards in order to protect the consumer but which also raise costs and reduce competition;
- it may promote barriers to trade, for example by setting standards that do not conform to international standards, thus favouring local producers in the domestic market;
- it shifts administrative and monitoring costs from the public to the private sector and these costs are not reflected in budgets;
- there is the risk of industry capture of whichever group is monitoring and enforcing, although this is also a risk when a government agency has these roles;
- if the code is voluntary, there is the risk of free-riding and non-compliance by some;
- if the code is voluntary and there is no public reporting of non-compliance and some industry members do not meet the standards, then there are potentially big risks, exacerbated by government (and the community) not knowing which companies they are; and

- to date, their development has involved much time and effort by industry, government and the community with little to show for it except perhaps for Responsible Care, INPO and the 33/50 program.

3.3 Success factors

Whether quasi-regulation succeeds in delivering net benefits depends largely upon the design of the particular quasi-regulatory initiative. Many of the various US initiatives are still at an early stage, and not all the lessons are yet clear. Nevertheless, some broad principles do emerge (Davies 1996). Successful programs:

- have objectives that are relatively simple and clear both to government and to business and enable participants to have a major voice in the establishment of goals;
- grant significant flexibility to business to engineer the means for implementing program objectives (flexible regulations with accountability provide greater protection at a lower cost);
- mandate performance goals rather than technology;
- establish trust among the participants and stakeholders;
- quantify and independently measure 'success';
- use a collaborative process, rather than an adversarial one; and
- provide incentives to industry that are clear and substantive.

Davies and Mazurek also identify absence of a statutory base as a characteristic of unsuccessful programs. This is because public servants have limited time, so they tend to give higher priority to programs grounded in law. Moreover, "without a legal mandate, decisions must be made by some sort of consensus, which is rarely efficient or effective in an atmosphere as contentious as environmental management. The lack of a statutory base can be ameliorated by clear objectives, maximum participation in developing these objectives to ensure buy-in, and flexible implementation tailored to the self-interest of the participants. Absent these process commitments, non-statutory programs almost always fail" (1996, p3).

It should also be noted that the potential success for various forms of quasi-regulation is likely to be culture-specific. The highly adversarial, legalistic approach which has characterised environmental policy in the United States, is unlikely to be fertile ground for quasi-regulation although we can learn from their mistakes. In contrast, there are likely to be greater opportunities in Canada and Australia.

3.4 Balancing costs and benefits of quasi-regulation and determining its nature

Just as with traditional regulation, the case for quasi-regulation must rest on the assessment of the extent to which the free market fails to deliver the optimum outcomes. This will be determined by the particular features of the industry, the nature of any externalities, the degree of asymmetric information and the size of any adverse outcomes arising from the free market situation or if non-compliance occurs. Assuming some form of intervention is justified, the crucial question becomes: what *form* is most appropriate? And what role should the government play, if any?

To the extent that intervention is justified, then in determining whether it should be primarily public or primarily private, much will depend on the characteristics of the particular industry and the problems being addressed. Particularly in the problematical area of environmental regulation, successful cases of pure self-regulation without any form of government involvement are rare. Successful examples of co-regulation are much more common.

Factors that will influence the appropriate form of co-regulation and the roles played by the private and public sector are covered by the following list of questions.

(1) What is the risk of anti-competitive behaviour?

(2) What is the overlap between public and private interests?

The need for government intervention will largely depend upon the extent to which there is a strong natural coincidence between the public and private interest or the extent to which this has been created by private external pressures, such as a well organised consumer or environmental group. This can be very effective especially when the enterprises are concerned about their public image and if the public has access to information.

Where significant negative externalities remain, what is the best way to make the industry accountable for them? There must be some form of external constraint on industry behaviour. The government's role could just be to ensure full public access to relevant information, such as occurs with the Toxic Release Inventory in the US. Alternatives include economic instruments (such as taxes) to internalise the externalities, monitoring industry performance and traditional regulation.

(3) How effective is any existing external pressure?

This question relates to the preceding one. There are three ways to classify the external pressure:

(i) apparent that survival of the industry dependent on successful self-control

(ii) the likelihood of government regulation if industry does not improve

(iii) the threat of consumer reaction

The threat of consumer reaction such as boycotts can lead to changes in industry behaviour:

> "... the effectiveness of external pressures brought to bear by consumers or the broader public, will necessarily vary depending on the type of product, the type of market (eg the number of players, their size, import / domestic considerations, stability) the extent of public concern (or outrage) and whether there is some natural affinity between consumer and industry interests. Of course, where a combination of various external forces can be brought to bear, then the chances of successful self regulation are likely to be higher than otherwise." (Gunningham and Rees, forthcoming)

The stronger the external pressure, the less the need for other forms of government involvement.

(4) What is the scope for free riding to take place?

The likelihood of free-riding decreases: the fewer the **number of players**; if enterprises can **detect non-compliance**; if there is a **history of cooperative actions** such as through an existing association; if **non-compliant behaviour can be penalised**; and if **consumers value compliant behaviour** and can identify compliant and non-compliant firms and bring market pressure to bear.

Where a large number of players free ride, especially if they refuse to join the program, then quasi-regulation can only work if government intervenes directly to curb the activities of non-participants.

(5) Has there been genuine participation by all affected stakeholders to help ensure credible standards or processes? Has the development and implementation process been transparent?

This is important if the outcome is to have legitimacy with the community. As well as industry participants, stakeholders might include consumer organisations, environmental groups, government and labour. It is important that the quasi-regulation does not solely serve business interests.

(6) How transparent will the performance of industry be? Are there effective monitoring and transparency mechanisms in place?

The greater the chances of identifying breaches, the more acceptable the quasi-regulatory program is likely to be, both to governments and the public. Monitoring will have greater credibility the further it is removed from program participants.

(7) Is there a strong industry association to manage self regulation and does the proposal have the explicit commitment of the industry's leaders? Is the industry association prepared to make compliance with its standards a condition of membership?

A strong association can act as catalyst to the development of self regulation, as information broker (for example diffusing information about new technologies or best management practices) as channeller of peer group pressure, and as nurturer

of mutual trust between participants. The association may also limit the potential to free ride if it can design a program so that only members of the program will benefit from it.

(8) Is the enforcement effective? Is there a well-understood set of inducements for compliance and sanctions for non-compliance?

The OECD has commented:

> " It is clear that transparency, accountability and consultation are not primary objectives of the private sector. ... In a voluntary programme such as the Responsible Care Initiative the issue of accountability is a difficult one. Why should a business be held accountable for the obligations that it took upon itself voluntarily and without government intervention? An attempt to answer that centres on the point that most likely the government would regulate differently (or even not regulate) when such a voluntary commitment on the side of industry has been made. Therefore, ensuring accountability where public interests are concerned should be a major concern in the design of a voluntary programme." (OECD / PUMA / REG(97)2, p.9)

(9) Are there regulatory safeguards in place for those companies which do not comply with the codes, management systems or whatever and are these satisfactory or is it necessary to establish some?

These are the questions that government must ask in determining the form of quasi-regulation. Ultimately, there may need to be some form of government involvement because: "Shaming cannot work against firms with no reputation to protect. Expulsion cannot work where firms can still operate effectively outside the industry association. " (Gunningham and Rees, forthcoming)

3.5 Summary observations

1. Government intervention may be necessary when the pursuit of private gain does not coincide with the pursuit of public interest. The challenge with quasi-regulation is to ensure that the pursuit of private gain does not replace the pursuit of public interest. If quasi-regulation primarily protects the industry rather than corrects market failure, then it has failed.

2. It is very rare for the policy issue to be a black and white choice between pure self regulation on the one hand and highly interventionist command-and-control type regulation on the other hand. Rather, once a case for intervention has been established, the policy issue usually concerns the form and degree of government involvement, sometimes a *combination* of instruments is optimal.

3. In contrast to command-and-control regulation, voluntary codes and other forms of quasi-regulation can be easier to develop and understand, cheaper and faster to implement and more quickly adapted to changing circumstances. They can also support innovation and increased competitiveness in industry. Compared to redress using traditional legal

mechanisms, consumer redress can also be faster, more accessible, more effective and less expensive.

4. However, quasi-regulation is not necessarily an easy or cheap option. Codes can take years to develop and implement and can use many of the industry's resources - notably its expertise. Perhaps this option is less costly and provides other benefits such as greater flexibility than the alternatives such as restrictive government regulation and shut downs.

5. Some quasi-regulation can create confusion such as is occurring with Project XL where there appears to be considerable uncertainty about how regulatory freedoms will fit in with traditional regulation. Are these problems avoidable in Australia?

6. With purely voluntary codes, there may be inadequate redress available against non-compliers and it is therefore important to evaluate the risks involved with non-compliance. The greater the risks, the more appropriate it is to use stringent and regulatory enforcement mechanisms, or at the very least, to underpin self-regulation with some form of direct government involvement.

7. Where market outcomes are sub-optimal, at the minimum quasi-regulation must include some external constraint on industry behaviour by an effective interest group, and possibly by government .

8. The forms of government involvement can range from traditional regulation, to co-regulation, information based strategies (such as the National Pollution Inventory), educational and advisory instruments. Government roles can also take many different forms ranging from catalyst to facilitator to broker to rule-maker to participant to endorser to direct regulator.

9. One apparently effective role for government is to ensure public access to reliable information on relevant business behaviour. For example, the US Toxic Release Inventory has arguably had a greater impact on improving the pollution performance of industry than any other single program.

10. There are many examples of quasi-regulation co-existing with traditional regulation; rather than replacing existing regulations it may just pre-empt the introduction of additional command-and-control regulations.

11. Government initiated programs are more likely to succeed if: objectives are simple and clear; participants have a major say in setting goals; business can choose the means for implementing objectives; performance goals, not technology, are used; trust exists among participants and stakeholders; 'success' is quantified and independently measured; a collaborative not an adversarial process is used; and the incentives to industry are clear and substantive. (Davies 1996)

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