

## **Speak softly and carry a big stick**

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### Published

2000

### Journal Title

Environmental Planning Law Journal

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### **Speak softly and carry a big stick**

Review of Gunningham, N. and Grabowsky, P. 1998. *Smart Regulation: Designing Environmental Policy*. Clarendon Press, Oxford. ISBN 0-19-826857-2. 494pp, tables, figs, index.

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“Smart Regulation” is the latest offering in the Oxford series on Socio-Legal Studies, intended to “advance understanding of the social reality of law and legal processes”. It takes its place beside previous volumes such as “Sexually Transmitted Debt” - certainly a more eye-catching title than, say, mortgages and divorce law.

Written by Neil Gunningham, Peter Grabowsky and (in part) Darren Sinclair it is a dense tome, difficult to distil to a simple essence. It has nearly 500 pages of small print, each with voluminous footnotes in really tiny print. In fact p. 318 has only 2 lines of text and 50 lines of footnotes. It's very well produced. I found only one typo: in a reference to the Bhopal disaster, “union carbide” is printed in lower case (p. 140). And I found only one loose end: “Golden Carrots and Green Lights” are referred to on p. 47 and again on p. 418, but nowhere are they defined or described. It's a solid and factual presentation, which needs care and concentration to digest, but ultimately the take-home message is clear: speak softly and carry a big stick.

The authors' basic thesis is that environmental legislation which prescribes specific actions that regulated companies must take is not very efficient, but that leaving environmental protection to industry self-interest isn't very effective, so some form of intermediate approach might be better than either. They derive and illustrate this argument from analyses of pollution control in the agricultural and chemical manufacturing sectors.

The reason they think prescriptive regulation isn't efficient is that it is “heavy-handed” and expensive to enforce. I am not entirely convinced by either argument. How is this different from traffic offences? But there are few jurisdictions where speeding motorists are invited to consider self-regulation, continuous improvement and a speed management system as an alternative to speeding tickets, fines and loss of driving licence. In any event, Gunningham and Grabowsky decry the laissez-faire “free-market environmentalism” approach equally. They quote a 1993 book by John Braithwaite (p. 53): “Self regulation is frequently an attempt to deceive the public into believing in the responsibility of an irresponsible industry. Sometimes it is a strategy to give the government an excuse for not doing its job.”

Combinations of policy instruments, in their view, work better than either extreme. “Complex problems defy simple solutions,” they say (p. 292); and their aim is “to provide a framework which enables policy makers to design mixes which substantially improve the status quo.” And in fact, I think they have succeeded: but it will take a very avid and conscientious policymaker to read through to the bitter end.

The overall structure is straightforward. Chapter 2 reviews the various types of environmental policy instrument available. Chapter 3 lists the parties or stakeholders. Chapter 4 examines the chemical industry, and Chapter 5 the agricultural sector. And Chapter 6, co-written by Darren Sinclair, considers the design of instrument mixes.

There seem to be four main themes. The overriding one is that nothing works without a big stick to back it up: a credible threat of major government sanctions (p. 191) or, less commonly, market rejection. (Indeed, I have read elsewhere that US industries don't even begin to take negotiations seriously until government lawyers are actually drafting new legislation). The Institute of Nuclear Plant Operators, INPO, "rides on the shoulders" of the government Nuclear Regulatory Commission (p. 401), to enforce its authority and bring recalcitrant operators into line through prosecutions (p. 256).

In addition, of course, public opinion against nuclear power has at times been so powerful that the entire industry was threatened with closure. This is possible in the energy sector because nuclear power is only one possible power source. It is not realistic in the chemical or agricultural sectors. But the same pressures may work at a smaller scale: the Australian "Cattlecare" scheme, according to these authors, was only introduced after international markets rejected Australian beef as contaminated (p. 308). They quote informants who argue that "command and control has never been used – agriculture is still essentially unregulated" (p. 287); a farmer who told them that "what will attract interest is a prosecution" (p. 327) and an agricultural marketer who said "in the end, you need a big stick."

In the chemical industry, they argue that the industry-led "Responsible Care" scheme does not work alone because it lacks a big stick. They are equally scathing of ISO 14001. And again, Voluntary Conservation Ordinances (VCOs) in the USA only work because the *Endangered Species Act* is there behind them: "voluntarism is only effective against the backdrop of tough government regulations." (p. 205).

As long as the big stick is there in the background, the authors argue for a pyramid or sequence of policy instruments which take effect in turn depending on the severity of the situation. This seems to be their second major theme, referred to at intervals (pp. 214, 333) and expounded in the final chapter (pp. 398, 404-407, 428-429).

Information and education is the lowest-level tool in their pyramid, followed successively by voluntarism (by individual firms), self-regulation (by industry associations), supply-side incentives (e.g. subsidies), broad-based economic instruments (e.g. taxes and tradeable permits), liability laws, property rights, process standards, performance standards and finally prescriptive standards (pp. 428-429). These instruments are listed in a slightly different order earlier in the book (p. 333).

In addition to a sequence of instruments, they argue for "buffer zones" so that successive instruments are triggered well before the environmental harm they are designed to prevent (pp. 404-407). They also suggest "circuit breakers" – transitional provisions when new and initially unpopular approaches are introduced.

In an interesting conceptual addition to existing literature, the concluding chapter by Gunningham and Sinclair suggests that the pyramid model first proposed by Braithwaite in the form of a flat triangle, can be expanded to a 3-dimensional pyramid: policy can progress from the (lax) base to the (stringent) apex along any of three ascending faces, representing government control, industry initiatives, and third-party processes respectively (p. 398). This parties include both public and community groups, and commercial interests such as investors, lenders, insurers and other companies in a product supply chain or life-cycle.

Ways in which third parties may be involved, and ways in which governments can encourage their involvement, form a third major theme throughout the book. On p. 114, the authors note that the 20 largest US pension funds have combined assets of US\$620 billion, and that in some jurisdictions they are required to invest preferentially in companies complying with

the CERES principles. On p.113 they say that in 1993, Greenpeace and green fund managers in the UK prevented the public float of an Indonesian company accused of “irresponsible” logging practices. Interestingly, they also note that the Quakers were the first ethical investors, refusing to profit from slavery or war.

On p.115 they note that the risk of lender liability is at least as powerful as investor choice, and that the Australian Stock Exchange apparently requires company annual reports to include a statement on management of environmental risks. For the chemical industry, they quote proponents of the Responsible Care scheme who claim that in Canada, firms who adopt Responsible Care can obtain finance at “several points” lower interest rates (p. 225). It is generally the largest companies which gain most from the public relations value of Responsible Care, however, and banks will typically offer larger firms lower interest rates simply because the loans are large and defaults less likely. Hence I would question whether this is really a causal effect or an incidental association.

Ways in which governments can promote third-party involvement (p. 411) include: funding NGOs, providing NGOs with legal standing, implementing community right-to-know (CRTK) laws, increasing lender liabilities, requiring insurance as a condition of licensing, and extending requirements for environmental management systems (EMS) throughout entire supply chains.

Third parties can only play an effective role if they have access to accurate information, and this is an important subsidiary theme. In general, says this book (p. 113) it is hard for consumers or investors to track the environmental performance of individual corporations. When such information is available, the market - and the firms - respond. For example, when INPO published a safety ranking of individual nuclear plants, every CEO became “acutely aware of the relevant status of their plants” (p. 255). The authors strongly support CRTK legislation (p. 65) but are much less enthusiastic about ecolabels. Consumers do pay attention to such labels, they say, but they tend to provide misleading information (p. 65), are expensive to set up (p. 432), and are far less effective than publication of raw data such as the Toxic Release Inventory in the USA (p. 432). One of the essential prerequisites for effective regulation (p. 191) is community access to information, and one of the main shortcomings of voluntary industry codes is that community groups find it very difficult to get such information (p. 205). Again (p. 144), “Responsible Care and ISO 14001.. share a.. fundamental limitation: the failure to independently measure and report on environmental performance.”

Independent and transparent verification of environmental performance is also essential to any form of “green track” regulation (p. 247); another subsidiary theme. Some jurisdictions allow firms with a demonstrated record of good performance and high compliance, considerable latitude to determine their preferred environmental management and monitoring measures, whilst firms with a poor performance and compliance record are subject to more prescriptive rules and more stringent audit. This two-track approach, described as “regulatory flexibility” has the support of Gunningham and Grabowsky but only if (a) green-track firms go beyond basic compliance, and this can be measured; (b) independent and transparent data and audit are available, and (c) there is a big-stick regulatory backup if firms abandon the green track (p. 247).

The last major theme is the need to remove “perverse incentives” before any bundle or sequence of light-handed policy instruments can function. Perverse incentives are particularly prevalent in the agricultural sector, mainly in the form of government subsidies which promote unsustainable practices. Third parties can also introduce perverse incentives, however. For example, Canadian insurers apparently refuse to provide crop insurance unless farmers undertake to use agricultural chemicals which government environmental agencies

are trying to eliminate (p. 288). In fact (p. 321), apparently 90 cents of every dollar spent on biodiversity conservation is consumed in undoing the effects of perverse incentives, including countervailing subsidies applied under international trade agreements.

So at the end of the day, is it a good book? Yes, if you have the perseverance to plough through to the end. And if you don't, I see that its authors have set an interesting precedent (p. 388): in referring to the book by Opschoor and Turner on "Economic Incentives and Environmental Policies" they cited not the book itself, but a review of it by Swanson in RECIEL. So if you only want the major themes, you can just quote this review. But if you want to know the details you'll have to buy the book!