

Political Regulation Or Market Endogenous Corporate Citizenship: The Case of Greening of European
Energy Industry

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By

Atle Midttun

The Norwegian School of Management
Post-box 580, 1302 Sandvika, Norway
E-mail: atle.midttun@bi.no

Introduction

A central question in the regulatory policy debate is to what extent societal concerns should or can be met by political regulatory intervention and to what extent they might be met by market-endogenous self-regulation or corporate responsibility. Using environmental challenges to European energy industry as a case, this paper explores both regulatory and self-regulatory approaches. The case illustrates classical problems of externalities and collective action ranging from the global climate questions to problems of local pollution

We start out with a presentation/discussion of the two basic regulatory approaches: government regulation and self-regulation. We then discuss the two modes of regulation as applied in the current European greening of electricity industry. A final section draws some analytical and normative conclusions.

Two Approaches to Regulation

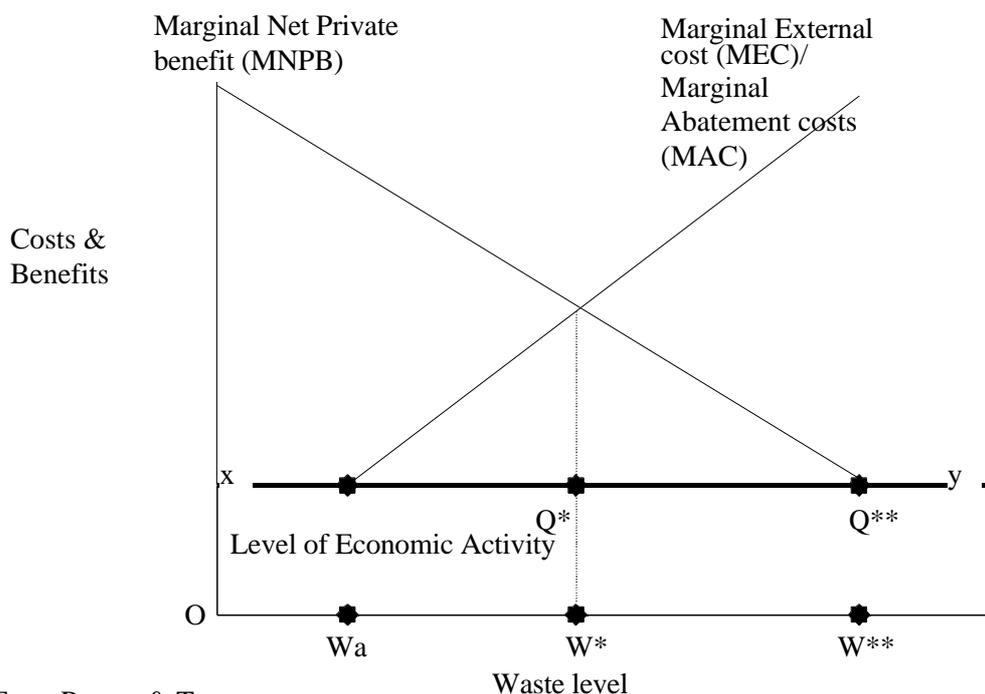
The Political Regulatory model

The traditional theory of regulation focuses on the possibility of correcting market failures through public intervention based on the assumption that the public regulator can monitor the market-development and adequately assesses its deviation from a social optimum. Under competitive organisation of the service, non-commercial goals are externalised to a regulatory agency, outside the boundaries of the firm. The agency must then set explicit and general rules that provide incentives to the parties to fulfil non-commercial public goals under competitive firm behaviour.

In its traditional formulation this model makes strong rationality assumptions. The bulk of theoretical models of environmental regulation assume that regulation is perfect and costless in the sense that, in choosing among a set of available policy instruments, the regulatory objective is maximisation of social welfare (the public interest) and the implementation of the chosen measures is costless (Yarrow....).

The regulatory authorities will typically intervene under the assumption that externalities, such as negative environmental consequences are not properly discounted in an unregulated market. More specifically, regulation of environmental externalities involves deriving a marginal net private benefit curve and a marginal external cost curve as in fig 1. The level of economic activity and pollution output, meaning the ecological/industrial trade-off should be met at the intersection between the two curves (Q^*). As an alternative, the marginal external cost curve may be substituted by an abatement cost curve up to the point where the abatement costs supersede the marginal abatement costs. Furthermore, ecological analysis commonly assumes that the natural environment has an absorption-capacity, which allows a limited level of pollution without noticeable negative externalities (indicated by the intersection of the marginal external costs curve and bold horizontal line (x-y). Below this level it is assumed that there are no noticeable externalities.

Figure 1 Tradeoffs in Environmental Regulation



From Pearce & Turner

This model assumes that the public regulatory authorities are in a position to find the trade-off between marginal abatement costs and marginal external cost and eventually internalise these costs through taxation, so as to reduce the marginal net private benefits in such a way that MNPB is maximised at Q^* . Public authorities must therefore be able to map the economic activity of the polluter and his pollution and of pollution concentration in the environment as well as pollution exposure of the population and critical environmental area. Public authorities must also be able to transform these resources into monetary value so as to evaluate them up against the net private benefits from energy-generation.

Furthermore, regulatory authorities should create incentives to install abatement measures until marginal abatement costs exceed marginal externality costs. Abatement can here be seen as an alternative to reducing output (Pearce & Turner 1990).

The Market-Endogenous, self-regulatory model

A competing concept of market-endogenous self-regulation has, however, co-existed in critical dialogue with the political regulation approach ever since the classical debate between proponents of

planned and market economy at the beginning of this century. Much of the theoretical anchoring of this tradition has been with the so-called Austrian school of economics. More recently, self-regulatory initiatives have also come from the so-called stakeholder-perspective in business strategy and the movement towards "Corporate Citizenship" or "Corporate Social Responsibility" within the business community with an emerging academic support.

While the Austrian position offers the "negative" argument for non-political interference, the stakeholder- and corporate social responsibility perspectives offer "positive" theories of how social responsibility can be incorporated into business practice in a non-authoritatively self-regulatory model.

The market-endogenous, self-regulation approach is very much still in the making, and to some proponents pr. definition defies rigid specification. Nevertheless it has gained considerable support and popularity, particularly in the Anglo-Saxon world, but is also spreading worldwide with recent EU- and UN initiatives such as the European Green Paper on Corporate Social Responsibility and UN's Global compact.

The Austrian Tradition

As shown by Vaughn (2001) the Austrian attitude toward government involvement in the economy has been developed almost exclusively in opposition to would-be interventionists: first Marxists and then neoclassical planners and regulators. Ludwig von Mises clearly profiled an Austrian position, on both frontiers: Against Marxism, Mises argued that pure planning was impossible, because there would be no market prices to aid in economic calculation. Against the economic interventionism in the mixed economy, Mises argued that such intervention would create unforeseen problems that again would motivate further intervention, and successive interventions would thus seriously hamper market prices, which would cease to convey useful information.

The Austrian tradition's critical skepticism to government intervention or regulation is epistemologically motivated. Von Mises' student Friedrich Hayek e.g. emphasized the detailed, local and often tacit nature of economic knowledge based on trial and error of market experiments. Competition, Hayek argued was a discovery procedure that allowed human beings to test out new ideas and practices in a system that provided accurate feedback (1978). Building on Hayek's work, Kirzner focused on the relative capabilities of markets and government to solve problems where knowledge only emerges in a dynamic process of discovery.

As argued by Vaughn (2001) the continually changing circumstances of and knowledge about market phenomena therefore render even the possibility of arriving at equilibrium beyond the pale. Government may perceive an economic inefficiency, but it is by no means certain that the remedy it designs will be any better than what will eventually emerge from the market itself.

With no theory of market perfection to attempt to duplicate with carefully designed regulation, it is difficult to identify a practice that has inefficient consequences. The Austrian position, therefore remains that when government tries deliberately to create economic value by bypassing or interfering with the markets, it is likely to do more harm than good.

The Stakeholder Approach

Since the early 1980's the so-called stakeholder approach within business strategy pointed to mechanisms within the firm and between the firm and its environment that represents a potential anchor for socially responsible business behaviour.

Following Freeman's (1984) publication of his landmark book "Strategic Management: A Stakeholder Approach", this tradition broadens management's vision of its roles and responsibilities beyond the profit maximisation function to include the interests and claims of non-stockholding groups. The stakeholder perspective recognises that the modern corporation has a responsibility to serve the interests of multiple stakeholders, including its stockholders, but also its employees, communities, customers, suppliers, and the broader society in which it is located. A stakeholder model, therefore, argues for development of new forms of corporate governance where the multiple interests are represented in organisational decision-making.

There has, however, been extensive discussion over how wide the stakeholder-set should be defined. Freeman's now-classic definition: "A stakeholder in an organisation is any group or individual who can affect or is affected by the achievement of the organisation's objectives" is among the broadest. In contrast Clarkson (1995) offers one of the narrower definitions of stakeholders as voluntary or involuntary bearers of risk related to the firm's operations.

Among the more thoughtful and comprehensive discussions of the stakeholder concept are Mitchell, Agle and Wood (1997). Departing from Ceyert and March's (1963) notion of organisations as coalitions of individuals and organised "sub coalitions", Mitchell et al (1997) develop the concept of stakeholder salience reflecting the power, legitimacy and urgency various stakeholders have with respect to influencing the firm's decisions.

The Corporate Citizenship perspective

In the 1990s the so-called Corporate Social Responsibility (CSR) or Corporate Citizenship (CC) perspective has inspired a lot of work on strategies for industrial self-regulation. This tradition has sought to codify principles and procedures for societal responsibility in industry, based on a combination of industrial self-interest through branding and reputation effects, NGO intervention and media focus. The argument is that it is in industry's self interest, in the context of an increasingly brand-based competition, to develop environmentally sustainable and socially responsible practices. As governments are beginning to recognise the extensive self-regulatory potential with industry, CSR and CC has also come increasingly in public policy focus.

In line with the Austrian perspective, the CC/CSR tradition recognises that many of the most creative responses to ecological and social challenges come from within the business sector itself. The focus is therefore to work with industry in a self-regulatory mode rather than against industry at arms length distance.

A part of the CSR/CC approach has focused on developing generally applicable accounting principles for sustainability that embrace social, environmental and economic aspects. This is done to enable comparative organisational performance in these spheres to be measured and communicated. Initiatives like the Dow Jones Sustainability Index and FTSE4GOOD and GRI (global reporting initiative) are increasingly providing tools for such benchmarking of environmental and social performance

As argued by Zadek (2002), corporate Citizenship will need to involve collective processes that move beyond individual initiatives and seek to forge progressive alliances between business, government and NGOs in raising the global performance bar, where potential financial rewards to corporate citizenship needs to be created for corporations to be successful.

As a means to establish environmental and social responsibility in an increasingly globalised economy the CC/CSR community seek to promote rules under WTO, which promotes or mandates social labelling. International conventions and UN initiatives such as the Global Compact are increasingly impacting directly on the policies and practices of global corporations. Nevertheless, CSR/CC initiatives remain controversial in the global context. Governments of countries with export-based development strategies such as China, Brazil and India oppose any social or environmental clauses in international trade arrangements, arguing that such clauses will do more development damage than good by restricting their economic growth.

An Empirical Illustration from the European greening of electricity industry

The discussion of policy-based versus market-based /corporate citizenship-oriented regulation will be grounded in the European greening of electricity industry case. This case represents an attempt to internalise environmental concerns into management of electricity industry, thereby obliging this industry to take more direct responsibility for its societal impacts. The case exhibits both attempts at classical regulation by political dictate and endogenous, market regulation and/or corporate citizenship.

The case discussion falls into four sections. A first section discusses the attempts at greening electricity industry through regulatory policy initiatives at the European level, with selected discussion of some EU member states. A second section discusses market-based/ corporate citizenship based greening initiatives in the European electricity markets with a focus on selected models and national examples. A third section discusses the interplay between the policy and market-based approaches. A fourth and final section and draws some analytical and normative implications for regulation and environmental policy.

Greening Through Regulatory Policy Initiatives

- The European CO2 tax policy
- The attempt to establish a common EU regulatory policy for renewable energy
- Various national green el oriented regulation policies in selected EU member states

Greening Through Market-based/ Corporate Citizenship-based Initiatives

- Green labelling in Sweden
- BP's emissions trading
- Diffusion of market-based green power in Switzerland, the Netherlands and Germany

Dynamic interplay between Policy-based and Market-based Approaches

- Mutual triggering effects across markets and politics

- Politics unleashing markets
- Markets unleashing politics
- Markets undermining politics
- Politics undermining markets

Implications for Regulation and Environmental Policy

- Strengths and weaknesses of the political regulation
- The strengths and weaknesses of self-regulation
- The case for interplay and mixed models.