

Private Environmental Governance in Hard Times: Markets for Virtue and the Dynamics of Regulatory Change

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The past two decades have witnessed the emergence of corporate-association- and standards-based forms of environmental self-regulation. Private environmental governance is commonly presented as being a market-driven phenomenon. Firms seek to manage their environmental impacts as a means of achieving cost-based or differentiation-based advantages. Yet, these innovations are necessarily embedded in the regulatory policies and institutions of nation states and thus subject to the dynamics of regulatory change. Historically, economic crises have stimulated significant regulatory changes that have, more often than not, resulted in an expansion of public regulation and a diminution of self-regulation. This Article considers the ramifications of the global financial crisis for the development of private environmental governance.

INTRODUCTION

The 1970s witnessed a cross-national proliferation of environmental regulations. Most wealthy democracies created national environmental regulatory agencies between 1970 and 1972, and within the next decade the number of nations with environmental regulators increased from twenty-six to 144.¹ In many cases, the new environmental protection regulations were characterized by a heavy reliance on command-and-control

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¹ JOHN BRAITHWAITE & PETER DRAHOS, GLOBAL BUSINESS REGULATION 257 (2000).

instruments, ambitious timetables, heavy fines, and a seeming indifference to costs. This was particularly the case in the United States, which exhibited a regulatory culture characterized by its adversarialism, expense, complexity, rigidity and redundancy. Although there was significant cross-national variation, regulators and regulated firms seemed to be locked in intractable struggles.² Under the pressures of stagflation, it appeared that the modern environmental era had come to an abrupt end. Indeed, the dominant neoliberal portrayals of the post-1980 period emphasized privatization, deregulation, trade liberalization, and a reliance on market mechanisms more generally. The rise of the market, it was argued, carried with it the diminution of the state (and with it, Keynesianism, social welfare, regulation, and all forms of social engineering). Critics of neoliberalism predicted that the growing reliance on markets, particularly when combined with globalization, would have uniformly tragic consequences for the environment.

Yet, counter-intuitively, the period witnessed a proliferation of self-regulatory efforts on the part of corporations, trade associations, and standard-setting organizations, in some cases generating environmental results that were superior to what could be mandated by public regulations. The dominant explanation focused on the market. The new corporate practices and the emergence of association and standards-based self-regulation were primarily a response to market forces and the recognition that higher levels of environmental performance were consistent with profitability. Market forces, in essence, spontaneously generated an institutional field shaping corporate practices in ways that few would have anticipated in earlier decades.

Despite the role commonly attributed to the market, the rise of private environmental governance did not occur absent the state. The neoliberal account of the period only presented part of the story and often appeared to be more of a normative program than an accurate description of the changes that occurred.³ While there was a broad trend toward privatization and the reduction or elimination of many old-style economic regulations, there was simultaneously an expansion of social regulation and, more importantly, the generation and dissemination of new regulatory strategies and instruments,

2 See Robert A. Kagan & Lee Axelrad, *Adversarial Legalism: An International Perspective*, in *COMPARATIVE DISADVANTAGE: SOCIAL REGULATIONS AND THE GLOBAL ECONOMY* 146 (Pietro S. Nivola ed., 1997); see also DAVID VOGEL, *NATIONAL STYLES OF REGULATION: ENVIRONMENTAL POLICY IN GREAT BRITAIN AND THE UNITED STATES* (1986).

3 See JOHN BRAITHWAITE, *REGULATORY CAPITALISM: HOW IT WORKS, IDEAS FOR MAKING IT WORK BETTER* 4-8 (2008).

many of which harnessed market forces and the self-regulatory capacities of corporations and business associations. In essence, there was a combination of "liberalization with reregulation," what might be interpreted as a Polanyian protective counter-movement that generated "freer markets and more rules," in the words of Steven Vogel.⁴

Students of regulation have sought to make sense of these changes. David Levi-Faur, for example, has referred to these changes as constituting a new "regulatory capitalism."⁵ Regulatory capitalism has a number of distinct features, including the delegation of regulatory duties to non-state actors, the growing role of corporate and association-based self-regulation, and new instruments for monitoring and directing corporate activity. Key features of regulatory capitalism include "the proliferation of regulatory instruments to ensure corporate social responsibility"⁶ and "an exponential increase of tools for integrating social justice and environmental protection issues into the governance structure of corporations."⁷ It has also been characterized by experiments in regulatory design which have involved new combinations of regulatory instruments, "the mobilization of new regulatory actors and third parties,"⁸ and efforts to harness "the enlightened self-interest of individuals and corporations."⁹ All of this marks a sharp departure from traditional models of public regulation. It also forces an analytical shift away from formal hierarchical relationships between the regulator and the regulated to the much more complex and fluid world of governance and the dense and unwieldy network of relations linking states, corporations, trade associations, international standard setting organizations, and a variety of nongovernmental organizations.

Rather than assessing the performance of private environmental governance, this Article explores its permanence. The argument can be easily summarized. First, although the various innovations in private environmental governance have often been characterized as being supranational market-driven phenomena, they are necessarily grounded in national public policies and institutions. This is not to claim that the pressures

4 See STEVEN K. VOGEL, *FREER MARKETS, MORE RULES: REGULATORY REFORM IN ADVANCED INDUSTRIAL COUNTRIES* 3 (1996); see also KARL POLANYI, *THE GREAT TRANSFORMATION* (1944).

5 David Levi-Faur, *The Global Diffusion of Regulatory Capitalism*, 598 *ANNALS AM. ACAD. POL. & SOC. SCI.* 12 (2005).

6 *Id.* at 12.

7 *Id.*

8 *Id.*

9 *Id.* at 21-22.

imposed by consumers, supply chains, capital markets, insurers and various nongovernmental organizations are unimportant. Rather, it is to state that their power in shaping corporate decision-making will be mediated by national regulatory institutions and policies. Second, once we depart from the characterization of private environmental governance as being largely (if not entirely) a market-driven phenomenon, it becomes clear that one cannot adequately conceive of its future development without considering the larger dynamic of regulatory change within individual nation states. Regulatory change will necessarily expand or contract the discretionary authority of corporate managers, shape their incentives to engage in private environmental governance, and alter the self-regulatory options that are in the opportunity set of corporations and their organizational representatives.

With this last point in mind, one must question whether the innovations in environmental governance will endure the global financial crisis. The system of private environmental governance emerged during a period of prolonged economic prosperity and trade expansion that engendered optimism regarding the self-regulatory capacities of corporations and reinforced political support for "third way" solutions and inventive experiments in regulatory design. This crisis will undoubtedly affect the strength of various market forces and thus the incentives of corporate managers to maintain or extend their self-regulatory efforts. More importantly, however, it may precipitate regulatory changes that are not conducive to the ongoing expansion of private environmental governance.

I. THE MARKET FOR VIRTUE AND THE QUEST FOR GREEN GOLD

The case for corporate environmentalism, particularly as developed in the business press, is primarily concerned with the ways in which markets reward firms that successfully reduce their environmental impacts. There are markets for virtue and these markets have redefined the relationship between corporate profitability and social responsibility, thereby allowing firms to "do well while doing good." There is recognition that regulations may play a positive role in stimulating corporate innovations — self-regulation and public regulation are not necessarily seen as incompatible. However, at the end of the day, private environmental governance is understood primarily as a response to market forces. Let us examine this portrayal in greater detail before placing it within the context of public regulation.

The classical position, most commonly associated with Milton Friedman, recognized no role for corporate social responsibility. In Friedman's words: "[T]here is one and only one social responsibility of business — to

use resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competitions, without deception or fraud."¹⁰ Shareholders with a preference for any given social cause could use their earnings accordingly, but Friedman cautioned that one should not allow social policy issues to divert attention from the primary role of business. Much of the scholarship on corporate social responsibility (CSR) has not explicitly rejected Friedman's claims about the primacy of profitability. Rather, it has made the claim that social responsibility can be instrumentally valuable in maximizing shareholder wealth. To be certain, other, non-fiduciary values may enter into corporate decision-making. But firms pursue higher levels of environmental performance primarily for its instrumental value. The pursuit of "green gold" reflects enlightened self-interest rather than a shift in the normative proclivities of corporate managers.¹¹

The case for private environmental governance as it emerged in the 1990s was usually grounded in the argument that market forces would promote and reward improvements in environmental performance. Higher environmental standards could provide a means of realizing cost-based or differentiation-based competitive advantages.¹² On the cost side, it was argued that much of what we understand as "pollution" is waste. Its elimination could contribute to the realization of cost savings or so-called "eco-efficiencies."¹³ A quality environmental management system (EMS) could be deployed to identify and eliminate sources of pollution throughout a facility; life-cycle analysis and design-for-environment could provide an intellectual framework for the redesign of products and processes to prevent pollution. The cost-based benefits went beyond the production process. Environmentally responsible firms faced smaller environmental liabilities and thus they could gain preferential access to finance and insurance. As

10 MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962); see also Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970, at 32.

11 Elisabet Garriga & Domènec Melé, *Corporate Social Responsibility Theories: Mapping the Territory*, 53 J. BUS. ETHICS 51 (2004).

12 On cost-based and differentiation-based paths to sustainable competitive advantage, see MICHAEL E. PORTER, COMPETITIVE ADVANTAGE (1985). For an application to corporate environmentalism, see Michael E. Porter & Claas van der Linde, *Toward a New Conception of the Environment-Competitiveness Relationship*, 9 J. ECON. PERSP. 97 (1995); Michael E. Porter & Claas van der Linde, *Green and Competitive: Ending the Stalemate*, 73 HARV. BUS. REV. 120 (1995).

13 See LIVIO D. DESIMONE & FRANK POPOFF, ECO-EFFICIENCY: THE BUSINESS LINK TO SUSTAINABLE DEVELOPMENT (1997).

for differentiation-based advantages, it was argued that environmentally responsible production could provide reputational advantages, allowing firms to claim a price premium among environmentally-sensitive consumers or gain access to critical supply chains. Given sufficient information, green consumers and firms would discriminate against companies that failed to exhibit environmental responsibility.¹⁴

The empirical research on the connections between corporate social/environmental performance and corporate financial performance has generated a variety of results, but as a generalization it has revealed that the two are positively correlated. There is, in fact, green gold. Yet, there are complications. First, the markets for virtue may be more modest than recognized. As David Vogel notes: "[P]recisely because CSR is voluntary and market-driven, companies will engage in CSR only to the extent that it makes business sense for them to do so In most cases, CSR only makes business sense if the costs of virtuous behavior remain modest," thereby limiting "the improvements in corporate social and environmental performance that voluntary regulation can produce."¹⁵ Second, the question of causality remains somewhat opaque. As a recent meta-analysis concluded, the relationship between social and financial performance tends to be "bidirectional and simultaneous." In short, there is a virtuous cycle wherein "financially successful companies spend more because they can afford it" and corporate social responsible performance "helps them become a bit more successful."¹⁶ These are important limitations (see Part IV below). To the extent that profitability leads to increased investments,

14 More recently, the issue of reputation has been expanded through the concept of "social license." Various civil society groups impose demands on corporations that exceed what can be required under regulations (or their "regulatory license"). Although meeting social license demands may provide a basis for price premiums or labor market advantages, they may often exceed what could be justified in strictly in terms of profitability. See Neil Gunningham, Robert A. Kagan & Dorothy Thornton, *Social License and Environmental Protection: Why Businesses Go Beyond Compliance*, 29 *LAW & SOC. INQUIRY* 307, 320 (2004); Robert A. Kagan, Dorothy Thornton & Neil Gunningham, *Explaining Corporate Environmental Performance: How Does Regulation Matter?*, 37 *LAW & SOC'Y REV.* 51, 83 (2003); Madhu Khanna & William Rose Q. Anton, *Corporate Environmental Management: Regulatory and Market-Based Incentives*, 78 *LAND ECON.* 539 (2002).

15 DAVID VOGEL, *THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CORPORATE SOCIAL RESPONSIBILITY* 4 (2005).

16 Marc Orlitzky, Frank L. Schmidt & Sara L. Rynes, *Corporate Social and Financial Performance: A Meta-Analysis*, 34 *ORG. STUD.* 403, 424 (2003).

macroeconomic downturns may interrupt the virtuous cycle and firms may alter their investments in environmental management or production.

One can nonetheless hypothesize that the robustness of private environmental governance may be greater if corporate practices are embedded in larger institutional structures at the level of the industry.¹⁷ Trade associations and standard setting organizations have assumed important roles in the emerging system of private environmental governance that may provide greater stability in corporate practices.¹⁸ In many industries, reputation is a collective good. Firms that seek to benefit from their environmental investments may discover that they are vulnerable to the behavior of firms that have failed to make comparable investments.¹⁹ In the words of Joseph Rees, companies in an industry may discover they are "hostages of each other."²⁰ Weak or poorly designed programs may allow firms that have not met program requirements to free-ride on the investments and reputations of the industry taken as a whole.²¹

In this context, industry associations can play an essential role. Associations have a powerful stake in managing industry reputations. One should not be surprised that salient events like the failure of the nuclear plant at Three Mile Island and the tragic chemical release at Bhopal led to major new association-based self-regulatory efforts in the respective industries. Associations can develop codes of conduct and, optimally, force norms of accountability by requiring third-party auditing and information disclosure, and sanctioning recalcitrant firms (e.g., through

17 See John L. Campbell, *Why Would Corporations Behave in Socially Responsible Ways? An Institutional Theory of Corporate Social Responsibility*, 32 *ACAD. MGMT. REV.* 946 (2007).

18 Oren Perez, *Private Environmental Governance as Ensemble Regulation: A Critical Exploration of Sustainability Indexes and the New Ensemble Politics*, 12 *THEORETICAL INQUIRIES L.* 543 (2011).

19 Poor performance by a few firms can result in the threat or imposition of mandatory regulations on an industry-wide basis. Classic cases include the U.S. nuclear industry following the 1979 accident at Three Mile Island and the chemical industry following the 1984 Union Carbide disaster in Bhopal, India. In each case, heavy media coverage and the potential for catastrophic outcomes created popular demands for expanded attention to risk management and regulation. See JOSEPH G. MORONE & EDWARD J. WOODHOUSE, *AVERTING CATASTROPHE: STRATEGIES FOR REGULATING RISKY TECHNOLOGIES* (1986).

20 See JOSEPH REES, *HOSTAGES OF EACH OTHER: THE TRANSFORMATION OF NUCLEAR SAFETY SINCE THREE MILE ISLAND 2* (1994).

21 The best single example is Responsible Care in its early years. See Andrew A. King & Michael J. Lenox, *Industry Self-Regulation Without Sanctions: The Chemical Industry's Responsible Care Program*, 43 *ACAD. MGMT. J.* 698 (2000).

expulsion). At the extreme, by focusing managerial attention on larger norms of corporate activity, associations can contribute to the development of an "industrial morality."²² Unfortunately, this ideal is rarely realized. Association-based programs often exhibit considerable weakness, inviting problems of adverse selection. That is, firms with poor records may gravitate toward undemanding programs to enhance their reputations without changing their practices, creating a Gresham's Law of self-regulation: Weak participants drive out firms committed to credible efforts.²³

International standards have also emerged to play a central role, in particular, the International Organization for Standardization's ISO 14001 EMS standard.²⁴ The growth in ISO 14001 certification is often explained through reference to globalization.²⁵ The expansion of international trade exacerbates informational asymmetries, creating distinct problems for businesses hoping to convey information about their environmental commitment to potential customers, suppliers, and investors. This creates a demand for mechanisms, like international certification, that can serve an important signaling function. As Nicole Darnall and Joann Carmin explain: "Similar to process and branding, environmental signals can provide information to external parties about a firm's otherwise ambiguous environmental activities and policies, thus reducing information asymmetries."²⁶ Even if ISO 14001 functions, in Olivier Boiral words, as a "rational myth" that provides a "reassuring image of rationality, formalism, and intellectual rigour" that may be "only loosely connected with real activities," the proliferation of certification has been nothing short of astounding.²⁷ By the end of 1996 — the year ISO 14001 was released — 1491

22 See Neil Gunningham & Joseph Rees, *Industry Self-Regulation: An Institutional Perspective*, 19 LAW & POL'Y 363 (1997).

23 See Michael J. Lenox & Jennifer Nash, *Industry Self-Regulation and Adverse Selection: A Comparison Across Four Trade Association Programs*, 12 BUS. STRATEGY & ENV'T 343 (2003); see also Andrew J. Hoffman, *Institutional Evolution and Change: Environmentalism and the U.S. Chemical Industry*, 42 ACAD. MGMT. J. 351 (1999).

24 INTERNATIONAL STANDARDS ORGANIZATION (ISO), ISO 14001: ENVIRONMENTAL MANAGEMENT SYSTEMS (1996); see also TOM TIBOR & IRA FELDMAN, ISO 14001: A GUIDE TO THE NEW ENVIRONMENTAL MANAGEMENT (1996).

25 See Aseem Prakash & Matthew Potoski, *Racing to the Bottom? Trade, Environmental Governance, and ISO 14001*, 50 AM. J. POL. SCI. 350 (2006).

26 Nicole Darnall & Joann Carmin, *Greener and Cleaner? The Signaling Accuracy of U.S. Voluntary Environmental Programs*, 38 POL'Y SCI. 71, 74 (2005).

27 Olivier Boiral, *Corporate Greening Through ISO 14001: A Rational Myth?*, 18 ORG. SCI. 127, 128 (2007).

organizations in forty-five countries were certified. By December 2008, this number had grown to 188,815 organizations in 155 countries.²⁸

Thus, it is claimed, we have witnessed the power of markets to generate a spontaneous order of self-regulating firms. Markets have redefined the relationship between profitability and corporate responsibility. They have created incentives for firms to seek out new managerial systems to reduce or prevent environmental externalities. They have given rise to a host of novel forms of associational and standards-based governance to coordinate the behavior of firms, protect against free riders, and reduce problems of information scarcity. None of this could have been predicted at the dawn of the modern environmental era. Seemingly, we may be on a path to a stateless world without government regulation.

II. BRINGING PUBLIC REGULATION BACK IN

Much of the business literature on corporate environmental practices presents the changes described above as stemming from the logic of the market or, related, a logic of globalization. If this position is correct, then the emerging patterns may be viewed as relatively autonomous from policy decisions within individual nation states. It is difficult, however, to treat private environmental governance and public regulation as being analytically or empirically distinct. In response to the claims that participation in private governance initiatives is a market-driven phenomenon and thus insulated from state regulatory decisions, one might note that there is no distinct and autonomous logic of the market. As political economists and economic sociologists have long recognized, the market is not a self-constituting and self-regulating entity functioning according to its own intrinsic logic. Rather, it is embedded in public policy and institutions.²⁹ The core actors in the economy — corporations, financial institutions, trade associations, labor unions — are legally constituted entities. The law facilitates corporate behavior and determines the range of permissible forms of behavior and interactions between economic actors.³⁰ In the end, as Fred Block notes, "what

28 ISO CENTRAL SECRETARIAT, *THE ISO SURVEY OF CERTIFICATIONS 2008*, at 12 (2009).

29 See Tim Bartley, *Transnational Governance as the Layering of Rules: Intersections of Public and Private Standards*, 12 *THEORETICAL INQUIRIES L.* 517 (2011).

30 As Richard Swedberg notes:

Law, in modern society, is *constitutive* for most economic phenomena, meaning by this that it is an indispensable as well as an organic part of them. Social scientists may separate out the non-legal part of economic

we generally call 'the economy' is always the product of a combination of state action and the logic of individual or institutional economic actors."³¹ To the extent that institutions mediate the relationship between economic conditions and corporate behavior, an adequate account of corporate social responsibility cannot be constructed in a political-institutional vacuum.³²

Certainly, globalization adds additional complexities. But in the end, corporations and trade associations are chartered under the laws of nation states; they produce and execute transactions within real jurisdictions and thus they remain subject to the constraints imposed by national (and sub-national) laws and regulations.³³ As Ian Bartle and Peter Vaas have argued persuasively, although the "decentering" of regulation suggests a movement "from hierarchy to 'heterarchy'" in which the state shares authority with other organizations and institutions, "the enduring and central role of the state in self-regulation . . . belies the notion of a pure heterarchy . . . the state still retains a special place. In a self-regulatory world, that place, at the very least, is *primus inter pares*."³⁴ As a result, the various forms of private governance are best understood as "an embedding of self-regulation within the late twentieth and early twenty first century regulatory state."³⁵

In addition to creating the institutional environment within which firms operate, regulators have increasingly sought actively to promote and shape private environmental governance and with good reason. From a technical perspective, self-regulation may provide a means of achieving the kinds of environmental improvements that are simply beyond the reach of existing statutes and traditional regulatory instruments or exceed

phenomena from their legal part in their analyses. In reality, however, they are inseparable.

Richard Swedberg, *The Case for an Economic Sociology of Law*, 4 THEORY & SOC'Y 1, 4 (2003); see also Lauren B. Edelman & Mark C. Suchman, *The Legal Environments of Organizations*, 23 ANN. REV. SOC. 479 (1997); Neil Fligstein, *Markets as Politics: A Political-Cultural Approach to Market Institutions*, 61 AM. SOC. REV. 656 (1996).

31 Fred Block, *Political Choice and the Multiple 'Logics' of Capital*, 15 THEORY & SOC'Y 175, 180 (1986).

32 See Campbell, *supra* note 17.

33 See Theodore J. Lowi, *Our Millennium: Political Science Confronts the Global Corporate Economy*, 22 INT'L POL. SCI. REV. 131 (2001).

34 Ian Bartle & Peter Vass, *Self-Regulation Within the Regulatory State: Towards a New Regulatory Paradigm?*, 85 PUB. ADMIN. 885, 901-02 (2007).

35 *Id.* at 902.

the analytical capabilities and informational resources of regulators.³⁶ In theory, self-regulatory systems should be more flexible and adaptable than government regulations, which must be developed in accordance with legally prescribed procedures that can be quite time consuming. Moreover, these initiatives allow for some of the costs that would otherwise be borne by the state to be placed onto regulated parties.³⁷ By delegating authority to firms, policymakers can assign responsibility to the actors who possess the best information, thereby reducing the analytical and resource demands of regulators. Ultimately, if regulators could fully exploit the self-regulatory capacity of private associations — turning them into surrogate regulators — and integrate private and public regulations to create a genuine system of co-regulation, they could focus scarce resources on the subset of firms that persistently run afoul of regulations or lack the institutional capacity to manage their environmental impacts.³⁸

There is a strong intellectual case for the movement toward a tightly integrated system of co-regulation.³⁹ Ideally, it could combine the benefits of corporate- and association-based self-regulation with the transparency and accountability of public regulation. It could draw clear distinctions between organizations with the capacity for self-regulation and those that are organizationally incompetent or unwilling to comply with regulation and thus must be subjected to traditional policy instruments. But despite the merits of co-regulation, in practice it has proven to be a highly elusive goal. Let us explore briefly some of the difficulties by turning to the case of the United States.

There have been regulatory efforts to promote private environmental governance through the introduction of various government-initiated voluntary environmental programs. The case of the United States is suggestive because, even if the nation has arguably shown the greatest embrace of market processes in recent decades, the efforts to incorporate

36 Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management to Achieve Public Goals*, 37 *LAW & SOC'Y REV.* 691 (2003).

37 Natascha Just & Michael Latzer, *Self- and Co-Regulation in the Mediamatics Sector: European Community (EC) Strategies and Contributions Towards a Transformed Statehood*, 17 *KNOWLEDGE TECH. & POL'Y* 38, 45-46 (2004).

38 Neil Gunningham, Martin Phillipson & Peter Grabosky, *Harnessing Third Parties as Surrogate Regulators: Achieving Environmental Outcomes by Alternative Means*, 8 *BUS. STRATEGY & ENV'T* 211 (1999).

39 See Edward J. Balleisen & Marc Eisner, *The Promises and Pitfalls of Co-Regulation: How Governments Can Draw on Private Governance for Public Purposes*, in *NEW PERSPECTIVES ON REGULATION* 127 (David Moss & John Cisternino eds., 2009).

self-regulation into the regulatory state has proven most difficult. During the 1990s, the Clinton administration embarked on a process of "regulatory reinvention" or REGO that placed a heavy emphasis on public-private collaboration and the enlightened self-interest of corporations. The administration framed the case for REGO in terms that should be familiar by now. In one document entitled "Reinventing Environmental Regulation," the administration explained:

We have learned that pollution is often a sign of economic inefficiency and business can improve profits by preventing it. We have learned that better decisions result from a collaborative process with people working together, rather than for an adversarial one that pits them against each other. And we have learned that regulations that provide flexibility — but require accountability — can provide greater protection at a lower cost.⁴⁰

Over the course of the 1990s, the Environmental Protection Agency (USEPA) introduced a plethora of public-private partnerships to promote collaboration between the agency and some 11,000 organizations, including businesses, citizen groups, research centers, trade associations, and state and local governments. Some of these programs were designed to prevent pollution through changes in product and process design (for example, Energy Star, the Green Chemistry Challenge). Others were created to compensate for the USEPA's limited regulatory capacities (for example, the HPV Challenge, which enlisted firms to voluntarily develop screening-information datasets for high production volume chemicals to assist in the agency's implementation of the Toxic Substances Control Act).⁴¹ The USEPA also co-chaired the Technical Advisory Group responsible for the development of ISO 14001. In 2000, it introduced a national green track (the National Environmental Performance Track or NEPT) that provided a host of benefits (e.g., a lower inspection priority, flexible permitting) for high-performing firms with a quality EMS. Most of these initiatives were continued and in some cases expanded upon over the course of the Bush presidency. But tellingly, even if regulators could make a compelling theoretical and practical case for voluntary initiatives and public-private collaboration — even if they were actively advocated by the White House and received bipartisan support — they were never integrated with or had a transformative effect on standard

⁴⁰ Quoted in MARC ALLEN EISNER, *GOVERNING THE ENVIRONMENT: THE TRANSFORMATION OF ENVIRONMENTAL PROTECTION* 96 (2006).

⁴¹ *Id.* at 185-88.

forms of regulation. The kinds of innovations described above were simply appended onto pre-existing regulatory structures.

In the United States, the developmental trajectory for environmental regulation was shaped by a series of statutes passed in the 1970s to control pollution on a media-specific basis.⁴² The USEPA, created in 1970, was shaped by the demands of implementing the new legislation. These early statutes and the patterns of bureaucratic action they engendered created significant barriers to integration and innovation. To understand why, it is important to note that the modern environmental era coincided with a growing critique of regulation grounded in arguments about bureaucratic life cycles and capture, and the Chicago School's economic theory of regulation that modeled regulation as mutually beneficial exchanges between profit-maximizing firms and vote-maximizing politicians.⁴³ Although this research focused almost exclusively on old-style economic regulations, the debates nonetheless shaped the legislative strategies in environmental protection. Advocates were convinced that exhaustively detailed legislation that delegated minimal discretionary authority to regulators, imposed ambitious implementation timetables, and prohibited the consideration of compliance costs would minimize the vulnerability to agency capture and insulate the new environmental policies from an uncertain future.⁴⁴ But these same expedients sacrificed flexibility and adaptiveness. The core statutes continued to structure environmental protection regulations, setting hard limits on the extent to which regulators could pursue innovative strategies and forms of public-private collaboration.

Because these statutes delegated minimal discretionary authority to the USEPA, even bureaucrats who embraced the innovations in environmental regulation worked under substantial constraints. In the words of Daniel J. Fiorino, ultimately the reinvention efforts were little more than "a

42 See Clean Air Act Amendments of 1970, Pub L. No. 91-604, 84 Stat. 1676 (codified at 42 U.S.C. §§ 1857-1858a (1970)); Federal Water Pollution Control Amendments of 1972, Pub. L. No. 92-50086, 86 Stat. 816 (codified at 33 U.S.C. §§1251-1378 (1972)); Resource Conservation and Recovery Act, Pub. L. No. 94-580, 90 Stat. 2795 (codified at 42 U.S.C.A. §§ 6901-6987 (West Supp. 1977)).

43 George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). On the consumer movement's impact on these debates, see RICHARD A. HARRIS & SIDNEY M. MILKIS, *THE POLITICS OF REGULATORY CHANGE* (1989). On the issue of bureaucratic life-cycles, see MARVER H. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* (1955).

44 EISNER, *supra* note 40, at 53-62; see also Terry M. Moe, *The Politics of Bureaucratic Structure*, in *CAN THE GOVERNMENT GOVERN?* 267 (John E. Chubb & Paul E. Peterson eds., 1989).

tinkering with specific elements of a highly complex system."⁴⁵ They aimed "to graft flexibility onto parts of an inflexible whole"⁴⁶ and thus "rarely, except rhetorically, deliver[ed] the systematic change" implied by the term "reinvention."⁴⁷

Moreover, the existing regulatory structure created disincentives for firms to participate in programs that are commonly portrayed as being market-driven. Consider the case of ISO 14001, the international EMS standard. As noted above, the growth in certified firms has been nothing short of striking. But the certification rate of U.S. firms has been far less impressive. Although the United States is responsible for approximately a quarter of the world's output, it can only claim 2.6% of the ISO 14001 certified firms.⁴⁸ It is commonly argued that U.S. firms are ISO laggards because they rationally respond to the disincentives created by existing regulations. Under the USEPA's audit policy, for example, firms are required to self-report regulatory violations discovered during the auditing process. Corporate managers anticipate that such disclosures would be used by regulators to prosecute or penalize companies and would increase their vulnerability to civil law suits.⁴⁹ In recognition of this fact, even if the USEPA played a central role in the development of ISO 14001, it nonetheless refused to require ISO 14001 certification for NEPT participants. Regardless of the value of ISO certification in signaling environmental responsibility to market actors, the decision to engage in self-regulation was made in the long shadow cast by the existing regulations.

III. THE DYNAMICS OF REGULATORY CHANGE

The argument thus far has been relatively straightforward. Although the novel innovations and patterns of relationships subsumed by the concept of private environmental governance can be portrayed as market-driven

45 Daniel J. Fiorino, *Rethinking Environmental Regulation: Perspectives on Law and Governance*, 23 HARV. ENVTL. L. REV. 441, 442 (1999).

46 *Id.*

47 *Id.*

48 ISO CENTRAL SECRETARIAT, *supra* note 28, at 30, 32 (calculations by author).

49 See Magali A. Delmas, *Barriers and Incentives to the Adoption of ISO 14001 by Firms in the United States*, 11 DUKE ENVTL. L. & POL'Y FORUM 1 (2000); see also Magali A. Delmas, *Environmental Management Standards and Globalization*, in DYNAMICS OF REGULATORY CHANGE: HOW GLOBALIZATION AFFECTS NATIONAL REGULATORY POLICIES 202, 216-19 (David Vogel & Robert A. Kagan eds., 2004).

phenomenon, we cannot understand them in isolation from national regulatory institutions. For all their novel features, the new forms of regulation, self-regulation, and associational governance exist, in Levi-Faur's words, "in the shadow of the state."⁵⁰ Regulations necessarily determine the extent to which corporate managers can exercise discretionary authority over their environmental activities. They can reinforce, mute, or vanquish market incentives. This being the case, any consideration of the future of private environmental governance must be grounded in some understanding of the dynamics of regulatory change.

Let us preface the discussion of regulatory change with a few comments about policy and institutional change more generally. "Path dependence" is central to most historical accounts of institutional and policy change. To present things in simplified terms, consider a point in time when actors seek to design institutions or introduce significant new policy initiatives. Several alternatives may be considered, but at a critical juncture, they must make a decision to adopt one alternative over the others. Once this decision is made, a path has been chosen that may shape the trajectory of future development if there are factors that increase the costs of reversing course. Ultimately, some decisions are, in effect, "locked in" such that even if actors discover at some future point that initial choices were suboptimal, this realization alone is often insufficient to permit movement to an alternative path.⁵¹

Several kinds of factors can increase the costs of reversing course or changing the trajectory of policy and institutional development. First, because institutions and public policies affect the power, resources, and investment decisions of social and economic interests, these interests have an important stake in their preservation. Industries that enjoy subsidies or protection via regulatory barriers to entry, for example, have powerful incentives to mobilize electoral and financial resources to insulate their favored policies from change. Groups that benefit from transfers readily form alliances with legislative committees and administrative agencies, creating what have been variously referred to as "iron triangles" or "policy monopolies."⁵² These arrangements create an institutionally

50 Levi-Faur, *supra* note 5, at 13.

51 For a detailed discussion of path dependence, see PAUL PIERSON, *POLITICS IN TIME: HISTORY, INSTITUTIONS, AND SOCIAL ANALYSIS* 17-53 (2004); *see also* Andrew Bennett & Colin Elman, *Complex Causal Relations and Case Study Methods: The Example of Path Dependence*, 14 *POL. ANALYSIS* 250 (2006).

52 Frank R. Baumgartner & Bryan D. Jones, *Positive and Negative Feedback in Politics*, in *POLICY DYNAMICS* 3 (Frank R. Baumgartner & Bryan D. Jones eds., 2002).

induced equilibrium that can be remarkably stable for extended periods of time. Second, bureaucratic agencies specialize in executing a limited set of functions that are embedded in organizational routines, decision-making procedures, staffing decisions, and patterns of interest group relations. When administrators encounter challenges, they address them within the constraints and capabilities of the agencies they occupy and this, necessarily, narrows their discretion. Third and related, there are cognitive constraints. Public policies embody a given understanding of policy problems and the underlying causal structures. They privilege certain theories and bodies of knowledge as being inherently applicable to policy problems, and this, in turn, shapes organizational decisions (e.g., agency professionalization, the development of analytical resources) and the cognitive lens through which new policy problems are understood.⁵³

As a result, in many policy areas, long periods of stability are the norm. But, arguably, the most interesting episodes involve the moments when the stable equilibrium that forms around policies breaks down. Punctuated equilibrium arguments contend that institutions lock in a certain configuration of institutions and actors until they are upset by some exogenous shock. These shocks force new issues on to the policy agenda, mobilize new interests, or raise profound concerns about the adequacy of the prevailing approach to, and understanding of, policy.⁵⁴ Most of the time, changes occur on a policy-specific basis as the result of some salient event, often following the pattern identified by Anthony Downs as the issue attention cycle.⁵⁵ Alternatively, shocks can be of such a magnitude as to force rapid and dramatic changes in multiple policy areas more-or-less simultaneously, affecting broader institutional change and significant revisions in the governing philosophies regarding in the role of the state in the economy.

53 To make an argument that development is path dependent is not to make a far stronger claim that it results in stasis. Incremental change continues to occur, and overtime, the aggregate effects of these changes can be substantial. See B. Guy Peters, Jon Pierre & Desmond S. King, *The Politics of Path Dependency: Political Conflict in Historical Institutionalism*, 67 J. POL. 1275, 1278 (2005). But even if we stipulate that conflicts and change occur within path dependent processes, the key point remains: decisions that are made at key moments begin a movement along a particular developmental trajectory that increasingly narrows the range of options open to policymakers.

54 See FRANK R. BAUMGARTNER & BRYAN D. JONES, *AGENDAS AND INSTABILITY IN AMERICAN POLITICS* (1993).

55 See Anthony Downs, *Up and Down with Ecology: The Issue Attention Cycle*, 28 PUB. INT. 38 (1972).

Drawing once again on the regulatory history of the United States, there is much evidence to support the contention that great crises (e.g., the depression of 1890s, the Great Depression of the 1930s, and the stagflation of the 1970s) have been the primary drivers of significant regulatory change and political change more generally. In each of these examples, the crises forced changes in the partisan control of national institutions, thereby giving voice to political and economic interests that may have borne the costs of previous policies. In each case, economic dislocations punctuated the equilibrium that had formed around key policies, precipitated rapid and substantial changes in policies and institutions, and thus altered the trajectory of political-economic development. Because the changes occurred across multiple regulatory issue areas and were shaped by a common set of political-economic ideas and administrative reform doctrines, one can understand the resulting configuration of policies and institutions as constituting distinct regimes.⁵⁶

There are some complications to this story of regime change that are worth noting. First, crises are not self-interpreting. In each case, there were heated contests over how one might explain the underlying causes of the crisis, the limitations of the existing regime, and the ramifications for public policy. Although regime change necessarily involved vigorous intellectual debates, competing ideas or arguments were tightly bound with interests. They justified alternative policy proposals that had very different implications for the core questions of politics: who gets what, when and how. The Great Depression generated a wave of regulatory changes that dramatically expanded the role of the state in the economy and provided new protections and benefits to a host of interests (e.g., industrial workers, farmers). In sharp contrast, the stagflation of the 1970s was successfully used to frame arguments in favor of deregulation, welfare state retrenchment, trade liberalization and the discrediting of Keynesian demand management, even if there were compelling arguments to the contrary.⁵⁷ Although this comparison would suggest that crises are completely indeterminate,

56 Elsewhere, I have defined the term "regime" as "a historically specific configuration of policies and institutions which structures the relationship between social interests, the state, and economic actors in multiple sectors of the economy." MARC ALLEN EISNER, *REGULATORY POLITICS IN TRANSITION* 1 (2000).

57 See Charles S. Maier & Leon N. Lindberg, *Alternatives for Future Crises*, in *THE POLITICS OF INFLATION AND ECONOMIC STAGNATION: THEORETICAL APPROACHES AND INTERNATIONAL CASE STUDIES* 567 (Leon N. Lindberg & Charles S. Maier eds., 1985).

state expansion is decidedly the norm.⁵⁸ As Colin Scott notes: "Disasters and scandals of one kind or another routinely call forth responses which emphasise more prescriptive rules, more powerful regulatory authorities and related features." There appears to be a tendency of "governments to resort to 'command and control' regulation."⁵⁹

Second, although popular periodization creates the impression that there is a sharp break between historical periods, following regulatory regime change, new policies and institutions are, more usually, superimposed upon the old, creating what amounts to a path-dependent layering process. Because the accumulation of policies and institutions represent disparate interests and models of state-economy relations, this layering can give rise to a host of tensions and conflicts that compromise the extent, rapidity, and coherence of institutional change.⁶⁰ Although the events of the past two decades do not in my judgment rise to the level of constituting a regime change, they do provide a compelling example of the kinds of difficulties that arise as a result of this path-dependent layering. The new organizational routines, inter-organizational relationships, and patterns of state-corporate relations promoted during the regulatory reinvention of the 1990s proved difficult to reconcile with the policies and institutions within which they were embedded. The former demanded flexibility and the delegation of authority to the regulated; the latter guaranteed rigidity and permitted minimal delegation even to USEPA bureaucrats. If the contemporary period is one of "freer markets and more rules," it is also one of thicker institutions that embody irreconcilable understandings of the role of the state in the economy.

58 See ROBERT HIGGS, *CRISIS AND LEVIATHAN: CRITICAL EPISODES IN THE GROWTH OF AMERICAN GOVERNMENT* (1987).

59 Colin Scott, *Regulation in the Age of Governance: The Rise of the Post-Regulatory State*, in *THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR THE AGE OF GOVERNANCE* 145, 166-67 (Jacinct Jordana & David Levi-Faur eds., 2004).

60 ERIC SCHICKLER, *DISJOINTED PLURALISM: INSTITUTIONAL INNOVATION AND THE DEVELOPMENT OF THE U.S. CONGRESS* 16 (2001); see also Karen Orren & Stephen Skowronek, *Beyond the Iconography of Order: Notes for a 'New' Institutionalism*, in *THE DYNAMICS OF AMERICAN POLITICS: APPROACHES AND INTERPRETATIONS* 311 (Larry Dodd & Calvin Jillson eds., 1994).

IV. THE CURRENT CRISIS

Now that we have established that many of the key changes in private environmental governance and the patterns of state-economy relations described above are embedded in public policies and institutions and, consequently, vulnerable to the dynamics of regulatory change, we turn to consider the ramifications of the current financial crisis. Crisis, as argued earlier, has played central causal role in regulatory regime change. Under conditions of crisis, regulatory change commonly spreads across multiple substantive policy areas, even those that have no causal relationship to the events in question. As a generalization, crises have been used to justify a more expansive role for the state. If history is any guide, a crisis comparable to the current global recession may carry significant consequences for the policies and institutions that have shaped many of the innovations that are subsumed by the concept of regulatory capitalism.

The financial crisis of 2008 and the subsequent recession were products, in part, of what was arguably the greatest regulatory failure in U.S. history. The general description of what occurred from the mid-1990s to the collapse of the financial markets is relatively straightforward. During the period, great demand for housing facilitated by low interest rates, changes in the tax code, and permissive lending standards, created a significant asset bubble in real estate. Home ownership rates in the United States expanded dramatically between 1998 and 2006 (from sixty-four to sixty-nine percent). Real estate markets showed signs of stress in the second quarter of 2006, and as prices declined, mortgage defaults increased dramatically. By 2007, the effects spread into a financial system with large investments in mortgage-backed securities. Fear over the value of collateral used in sale and repurchase agreements (the "repo" market) stimulated a run on financial firms by large institutional investors, forcing the fire sale of assets and freezing up of capital markets.⁶¹

The immediate aftermath of the collapse was significant. It forced the failure or near failure of major investment houses and commercial banks, some of which were only saved via large infusions of public funds. The federal government was forced to adopt extraordinary measures to save the

⁶¹ See GARY GORTON, *SLAPPED BY THE INVISIBLE HAND* (2010) (discussing the events leading up to the financial collapse, and emphasizing the importance of the "repo market" and the problems that occur when uncertainty renders information insensitive assets information sensitive).

government sponsored enterprises that had securitized mortgages to add liquidity to housing markets — the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) — and the American Insurance Group that had insured the mortgage-backed securities through the issuance of credit-default swaps. The Federal Reserve stepped in to rescue several institutions, most notably Bear Stearns and Citigroup. The Federal Deposit Insurance Corporation (FDIC) increased deposit insurance from \$100,000 to \$250,000 and extended a guarantee to all senior unsecured bank debt. The combined costs of the bailout and stimulus package required the largest one-year issuance of debt in U.S. history (as a proportion of GDP, the largest since World War II). In terms of direct expenditures, it was larger than the dual wars in Iraq and Afghanistan and the Savings and Loan bailout of the late 1980s combined.⁶²

After a period of sustained economic growth and prosperity, the magnitude of the economic collapse had a sobering effect on even the staunchest advocates of deregulation and free markets. Alan Greenspan, the former head of the Federal Reserve who had been one of the single greatest promoters of self-regulating markets, admitted that the collapse left him in a state of "shocked disbelief." The "whole intellectual edifice" had "collapsed."⁶³ Indeed, a period that began with a seemingly unflappable faith in the marvels of the market ended with earnest discussions of the merits of nationalization and myriad proposals for new regulatory statutes. Although the crisis began with the collapse of the U.S. housing bubble, it spread rapidly across the globe, giving rise to the deepest global recession since World War II. Unemployment, which averaged 7.2% for OECD countries at the end of 2007, approached 10% in 2010. As conditions deteriorated, many observers undoubtedly shared the conclusions drawn by French President Nicholas Sarkozy, who proclaimed that the crisis revealed that "self-regulation as a way of solving all problems is finished. Laissez-faire is finished. The all-powerful market that always knows best is finished."⁶⁴

At first glance, one might question what possible connections might exist between a financial collapse and the future of private environmental

62 See Roger D. Congleton, *On the Political Economy of the Financial Crisis and Bailout of 2008*, 140 PUB. CHOICE 311 (2009); see also David Moss, *An Ounce of Prevention: The Power of Public Risk Management in Stabilizing the Financial System* (Harv. Bus. Sch., Working Paper No. 09-087, 2009), available at www.hbs.edu/research/pdf/09-087.pdf.

63 Quoted in ROBERT SKIDELSKY, *KEYNES: THE RETURN OF THE MASTER* 168 (2009).

64 Steven Erlanger, *Sarkozy Stresses Global Financial Overhaul*, N.Y. TIMES, Sept. 26, 2008, at C9.

governance. The response has two components: economic and regulatory. Although this Article is concerned primarily with the regulatory implications, let us briefly address the potential ramifications for what have been identified as the key economic drivers. As noted above, corporate participation in environmental programs has been attributed to a host of attractive benefits, ranging from cost- and reputation-based advantages to the preemption of mandatory regulations. Although social scientists have demonstrated a link between socially responsible production and profitability, there remains considerable ambiguity as to the underlying causal mechanism.⁶⁵ To the extent that profitability leads to investments in environmental management or there is a virtuous cycle that is contingent on ongoing profitability, then the positive trends exhibited in recent decades may prove highly vulnerable to the sharp economic contraction, particularly if corporate programs are not reinforced by association codes or integrated with public regulations. Firms that are less profitable simply may not have the resources necessary to continue or expand their voluntary environmental programs.

We can also view this from the demand side. Firms invest in environmental management to respond to the pressures created by consumers, suppliers, and other institutional actors. The durability of the commitment, one would surmise, will be partially a function of the intensity and robustness of these pressures over time. A key question, then, is whether the demand for environmental performance among key economic stakeholders is itself a product of good times. There are theoretical reasons for concluding this is the case. Whether one draws on the connections between affluence and post-materialist values or the dynamics of the environmental Kuznets curve, prosperity affects the formation and ordering of preferences for environmental quality.⁶⁶ As households battle long-term unemployment, manage excessive debt, and liquidate their assets — as they face growing economic insecurity — one should expect waning concern

65 See Jean B. McGiorie, Alison Sundgren & Thomas Schneeweis, *Corporate Social Responsibility and Firm Financial Performance*, 31 *ACAD. MGMT. J.* 854 (1988); see also Ronald M. Roman, Sefa Hayibor & Bradley R. Agle, *The Relationship between Social and Financial Performance: Repainting a Portrait*, 38 *BUS. & SOC'Y* 109 (1999).

66 On post-materialist values, see RONALD INGLEHART, *THE SILENT REVOLUTION: CHANGING VALUES AND POLITICAL STYLES AMONG WESTERN PUBLICS* (1977); see also Ronald Inglehart, *Post-Materialism in an Environment of Insecurity*, 75 *AM. POL. SCI. REV.* 880 (1981). For a critical discussion of the environmental Kuznets curve, see Susmita Dasgupta, Benoit Laplante, Hua Wang & David Wheeler, *Confronting the Environmental Kuznets Curve*, 16 *J. ECON. PERSP.* 147 (2002).

over the environmental attributes of the goods they consume.⁶⁷ This, in turn, could lead corporations to reassess the potential returns from their voluntary environmental efforts.⁶⁸

The evidence, although fragmentary at this point, appears to support the contention that environmental performance is becoming a secondary concern during the current recession (e.g., for the first time, a 2009 Gallup poll found a majority of respondents supporting economic growth above environmental quality).⁶⁹ More important, the results of a survey of eight hundred global managers led Booz & Co. to conclude that corporate social responsibility would be a

likely casualty of the economic crisis Forty percent of respondents said their industries won't be able to accomplish as much as they had expected with respect to energy efficiency, the environment, and community service. The pullbacks will be especially pronounced among transportation and energy companies . . . two of the industries in which broad environmental or community-oriented initiatives were expected to have the biggest impact.⁷⁰

Strikingly, "28 percent of respondents at financially strong companies said CSR agendas in their industries will be affected by the economic downturn."⁷¹

If the demand for environmentally responsible behavior is simply a product of prosperity, then one might conclude that the proliferation of private programs in the past several decades may be a short-term phenomenon. Yet, to the extent that institutional pressures reinforce these

⁶⁷ Inglehart found clear evidence that populations across age cohorts and Western democracies gravitated toward materialist values during sharp economic downturns. See Ronald Inglehart, *Public Support for Environmental Protection: Objective Problems and Subjective Values in 43 Societies*, 28 PS: POL. SCI. & POLITICS 57, 61 (1995).

⁶⁸ Of course, the extent to which managers respond to changes in the demand for environmental attributes will depend on the extent to which the goal of promoting environmental responsibility has been integrated into the corporation. See John A. Quelch & Katherine E. Jocz, *Can Corporate Social Responsibility Survive Recession?*, 53 LEADER TO LEADER 37 (2009).

⁶⁹ See Andrew C. Revkin, *Environmental Issues Slide in Poll of Public's Concerns*, N.Y. TIMES, Jan. 23, 2010, at A13.

⁷⁰ Shumeet Banerji et al., *Recession Response: Why Companies are Making the Wrong Moves* 12 (2009), BOOZ&CO., http://www.booz.com/media/file/Recession_Response-FINAL2.pdf.

⁷¹ *Id.*

programs, they may prove far more resilient. The institutional field that has emerged in the past two decades — the dense network of linkages connecting firms, trade associations, standard setting organizations, financiers, and nongovernmental organizations — will limit the rapidity and extent of change. But we have yet to consider the regulatory ramifications. As argued earlier, regulatory policies and institutions play a fundamental role in shaping the opportunity set open to corporations. To the extent that regulatory capitalism exists in the shadow of the state, changes in public policy will inevitably shape the trajectory of future development.

Although the current crisis finds its origins in finance and the failure of financial regulation more generally, there is every reason to anticipate that the implications may spread through multiple regulatory arenas that have little or no connections to the crisis in question. During past crises, as argued above, regulatory change moved through multiple industries. The Great Depression of the 1930s may have been exacerbated by the wave of bank failures, for example, but within a decade of the crash a new regulatory regime covered commercial and investment banking, communications, surface and air transportation, electricity generation, agriculture, and industrial relations. Crisis created a window of opportunity for regulatory change, even in industries that bore no casual connection to the depression. Similarly, although the stagflation of the 1970s had but tenuous connections to regulatory policies, it was used to justify deregulation in multiple industries.⁷² One should not presuppose that the regulatory changes that will emerge out of the current crisis will be restricted to financial services.

Indeed, one might go further to argue that the financial collapse may prove far more relevant given that it brought into question the efficacy of self-regulation. By way of background, the regulatory regime for finance imposed during the New Deal had some disparate elements. Regulatory statutes (most notably, the Glass Steagall Banking Act of 1933⁷³) created distinct financial sub-industries, each defined by the products and services it offered, each with its own set of regulators. The New Deal system provided stability in commercial finance, a clear departure from the earlier history of financial turmoil. As Thomas H. Hammond and Jack H. Knott observe, financial regulations, like other economic regulations, established "a cartel-like regime with state and federal regulatory agencies

⁷² See MARTHA DERTHICK & PAUL J. QUIRK, *THE POLITICS OF DEREGULATION* (1985).

⁷³ See Banking Act 1933, Pub. L. No 73-66, 48 Stat 162 (amended at 12 U.S.C. §§ 24, 78, 377-378 (1994 & Supp. 1997)) (repealed 1999).

acting as the enforcers."⁷⁴ Regulations defined markets and imposed barriers to entry. Interest rate regulations eliminated price competition while the FDIC prevented bankruptcies. The regulatory model was quite different in industrial finance, however. The Securities and Exchange Commission (SEC) imposed a system of government-supervised self-regulation.⁷⁵ That is, it oversaw private associations, which in turn served as surrogate regulators to govern their members. Indeed, the SEC used its authority to force a reorganization and professionalization of the New York Stock Exchange and to promote the self-regulation of the over-the-counter market through the National Association of Securities Dealers, which "assumed the functions and structure of a regulatory agency."⁷⁶

While the system of financial regulation proved remarkably stable for several decades, the high inflation of the 1970s and resulting problems of disintermediation precipitated a process of deregulation. The regulatory firewalls established in the 1930s became increasingly porous, even if many of the regulatory policies remained in place. Financial institutions were given far greater discretion over the products they offered, the prices they charged, and the investments they made (in some cases, like the savings and loan industry, the results were catastrophic). Ultimately, Congress passed the Gramm-Leach-Bliley Financial Services Modernization Act in 1999,⁷⁷ permitting the consolidation of commercial banks, investment banks, securities firms and insurance companies in financial holding companies, thereby eliminating the last vestiges of Glass Steagall. More recently, investment banks — which had leveraged some four trillion dollars in assets — were given far greater authority to manage their own capital levels and levels of risk on the theory that they had the knowledge, expertise, and incentives to govern their own behavior with a minimum of regulatory supervision.⁷⁸ Regulators, moreover, increasingly deferred to the decisions of private credit rating agencies, whose role expanded in importance as the securitization process generated financial instruments of unprecedented complexity. As a

74 Thomas H. Hammond & Jack H. Knott, *The Deregulatory Snowball: Explaining Deregulation in the Financial Industry*, 50 J. POL. 3, 15 (1988).

75 See EISNER, *supra* note 56, at 106-11.

76 Thomas K. McCraw, *With the Consent of the Governed: SEC's Formative Years*, 1 J. POL. ANALYSIS & MGMT. 346, 359 (1982).

77 Pub. L. No. 106-102, 113 Stat. 1338 (codified as amended at 15 U.S.C. §§ 6801-6809 (2000)).

78 Stephen Labaton, *Agency's '04 Rule Let Banks Pile Up New Debt*, N.Y. TIMES, Oct. 2, 2008, at A1.

result of this deregulatory process, much of the financial services industry participated in some form of self-regulation.

The financial collapse carries a multitude of lessons, most of which are beyond the scope of this Article. But the financial collapse revealed, among other things, the weakness of self-regulation and the fragility of the shadow banking system that emerged in the gaps created by deregulation. Financial institutions, left to their own devices, assumed far too much risk, maintained far too little in reserves, employed questionable accounting techniques to avoid regulatory oversight, and developed financial instruments that were far too complicated for even the most sophisticated organizations to control. Although it is impossible at this juncture to predict precisely what kinds of regulatory remedies will emerge ultimately from the legislative process, it is clear that they will embody a far more state-centered model of regulation and a reduced scope for self-regulating organizations. There is, in short, a strong skepticism about the self-regulatory capacities of corporations and a renewed belief that the state has an obligation to provide certainty of results and higher levels of accountability and transparency.

Will this change in regulatory philosophies carry implications for environmental regulation and private environmental governance more generally? Once again, it is too early to arrive at a definitive answer. But in 2009, the new Obama administration terminated the USEPA's National Environmental Performance Track, the Clinton era green track for high performing firms with a quality EMS, and placed other voluntary initiatives and partnerships under review. Subsequently, the administration moved forward with a far more aggressive enforcement agenda and is promoting the first statutory expansion of environmental protection regulation in two decades. Since the 1990s, the USEPA addressed climate change through a number of voluntary initiatives like Climate Leaders, a government-industry partnership. While Climate Leaders remains in place, in the wake of a 2007 Supreme Court decision that held that greenhouse gases constitute "air pollutants" and thus fall within the authority granted the EPA by the Clean Air Act, the USEPA has initiated new far reaching regulations to address carbon emissions which are slated to go into effect in 2011.⁷⁹ A similar scenario is unfolding at the Occupational Safety and Health Administration. The Obama administration has suspended the voluntary protection programs — efforts that were initiated or expanded as part of the "regulatory reinvention" efforts of the 1990s and subsequently during the Bush presidency — while significantly

⁷⁹ *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497 (2007); *see also* Coral Davenport, *Power Struggle*, *NAT'L J.*, Sept. 25, 2001, at 59.

increasing the resources for traditional enforcement efforts and introducing new legislation (e.g. the Protecting America's Workers Act) to increase civil and criminal penalties and authorize felony prosecutions.⁸⁰

It is impossible at this moment to predict how far the regulatory changes will proceed. This Article necessarily ends on a speculative note. But it is clear that, in each case, regulatory change is being framed by the argument that the process of deregulation and regulatory reform initiated decades ago vested corporations, trade associations, and self-regulating organizations with far too much discretionary authority. Policymakers assumed, incorrectly, that the alignment of market incentives and enlightened self-interest rendered a more direct role for the state unnecessary if not counter-productive. If the changes in regulatory philosophies that accompanied the neoliberal agenda created the space within which many of the innovations in private governance evolved, a reassertion of public regulatory authority may have profound consequences for the durability of these innovations.

CONCLUSION

The emergence of the system of environmental governance has been one of the more fascinating occurrences of the past several decades. Neoliberals and their critics assumed that the expansion of markets would necessarily result in the diminution of the state. The auction block would displace the polis; efficiency would trump all competing values. Few would have anticipated the expansion of public and private regulation and the complex institutional changes that would re-embed markets. For all of its disjointedness, redundancy, and unwieldiness, the emerging system has had positive ramifications for environmental quality and generated changes that would have been impossible under traditional models of regulation.

But whether the changes subsumed by the concept of regulatory capitalism constitute a permanent transformation has yet to be determined. The recent innovations in private environmental governance may have had some economic drivers, but they evolved in the shadow of the state. Under conditions of extended prosperity, policymakers and analysts shared

⁸⁰ Protecting America's Workers Act, H.R. 2067 [111th]; see also Peter R. Spanos, *There Is a New Sheriff in Town: What Employers Need to Know About OSHA Compliance Today*, WORKFORCE MANAGEMENT ONLINE (July 2010), <http://www.workforce.com/section/legal/feature/there-is-new-sheriff-town-employers-need-know/>.

an optimism regarding the self-regulatory capacity of corporations, trade associations, and standard setting organizations. Cooperation, collaboration, and partnerships — to the extent permitted by existing laws and regulations — proliferated. But the economic collapse and the global recession may have important ramifications for the trajectory of development. To the extent that they result in a reassertion of public authority and skepticism regarding self-regulation, the emergent system may prove to be far less robust than first imagined.

