Regulatory experiments, legitimacy, and emergency

Jose A. Bolanos draws attention to the challenge of determining what an emergency is and finding appropriate ways of response

After high school, I spent three years as a firefighter. Naturally, I was very excited about the opportunity to reflect on my academic work in the context of the study of regulatory emergencies. There is no established definition of a regulatory emergency, but here I define it as an unexpected threat that calls for urgent action by a regulator. Two seemingly disconnected anecdotes from my firefighting experience came to my mind when drafting this article: first, that cats in trees most likely will not constitute an emergency; and, second, that fire engines go much faster once a fire is confirmed. While seemingly disconnected, these anecdotes refer to a joint challenge, namely, that of determining what an emergency is and defining appropriate ways of response. This joint challenge points to a puzzling paradox in dealing with regulatory emergencies. Below I examine this paradox in reference to the case of the Chicago Climate Exchange (CCX), a regulatory experiment that failed.

The CCX, and legitimacy

The CCX was launched in the US in 2003 as the world's first voluntary greenhouse gas emissions reduction and trading system. While private, the CCX aimed to make, monitor and enforce rules in the context of climate change. So, although not a state 'regulator', the CCX sought to guide the activities of others in a way similar to a regulator (indeed, making, monitoring, and enforcing regulations). Therefore, it is possible to think of it as, at least, a regulatory experiment.

Legitimacy is a concept that arises often in the context of regulation. In a way, everyone 'knows' that legitimacy matters. Accurately defining legitimacy, and explaining why, when, and how it matters in different circumstances and to different actors, however, is challenging. It needs to be clear, that thoroughly discussing legitimacy is impossible here, as legitimacy is a multi-faceted concept with many different components. For example, it is possible to speak of input (i.e. participation by relevant stakeholders) and output (i.e. results) mechanisms (Scharpf, 1999), or of pragmatic (i.e. self-interested evaluations), moral (i.e. normative evaluations), and cognitive (i.e. evaluations based on what is expected or comprehensible) mechanisms (Suchman, 1995). Regardless of its many facets, at a general level, legitimacy can be described in terms of approval by audiences, following Suchman's (1995: 574) definition of legitimacy as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions'. It is agreed that legitimacy is important for public and private regulators, and I will focus here on its importance for a regulatory experiment like the CCX.

Voluntary regulatory experiments like the CCX cannot enforce rules. This fact differentiates such initiatives from state regulators, because it means that users that do not see a benefit in them will simply not participate, whereas state regulators can impose rules on the said type of users. However, for their services to deliver any benefit, initiatives like the CCX need at least some sort of approval by audiences, or buy-in, i.e. legitimacy, as defined above. What kind of legitimacy, and how much, is an open question and is likely to differ, if we take an experiment like the CCX or a state regulator. But the fact is that both need some means that events that lead to a loss in legitimacy can represent a threat to their existence and hence lead to a regulatory emergency (at least from the perspective of the regulator and its interest in continued survival). The CCX is an interesting case in this context because it faced various legitimacy-losing events that eventually led to its demise.

A series of emergencies, or maybe not

The CCX started as a promising experiment. It supported itself on calls for action in the context of the US's backing away from the Kyoto Protocol, which would have led to the creation of a regulatory framework for carbon trading (as it did in the EU with the Emissions Trading System). Accordingly, the CCX aimed to begin filling in the gap left by the non-signing of the Kyoto Protocol, hoping to deliver emission reductions while catalysing action to help the case for launching a US-specific legally enforceable regulatory framework to compel US actors to engage in emissions trading (a compliance framework). Additionally, the CCX had support from prominent US figures, such as Richard Sandor, a renowned name in finance, and presidential ex-candidate Al Gore. Even Barack Obama allegedly had a part, as he was a board member of the Joyce Foundation, CCX's first financer. Moreover, the CCX launched with impressive performance, certifying over ten million carbon offsets per year between its launch and 2008. Around 2008, however, the market began pricing CCX offsets down, bringing average prices from $4 per offset to less than $1 per offset. Two years later, the CCX exited the market with near-zero scale and almost-negative prices.

While the CCX launched with momentum, the experiment rapidly faced criticism. Leading civil society organizations criticized the programme for being too friendly to industrial interests. In 2006, 18 of them signed a 'boycott' letter. For many regulators, a boycott from leading civil society organizations would be a nightmare, an emergency, indeed. The CCX, however, was willing to sacrifice legitimacy with this audience for the sake of gaining participants for the programme, typically large businesses with significant emissions. Criticism was, of course, not ideal, but the CCX's management, at that time, was focused on gaining momentum and growth. In other words, the CCX most likely did not see these events as emergencies, and it most certainly did not act with urgency towards them.

Yet, over time the volume and severity of criticism faced by the CCX increased. A particularly troubling event, for example, came in the context of an Oscar ceremony. Acting and directing nominees for the Oscar receive a gift bag. In 2007 a company known as TerraPass decided to include a certificate for CCX offsets in the said bag. However, the offsets in the said bag were traceable to one of the most polluting companies in the US, which set the bed for poignant criticisms. Some companies pay millions of dollars to get a second-long corner-screen spot in the context of the Oscars. The CCX got much more attention for free. Only, in the CCX's case, the publicity was negative. Yet, the debacle did not end the CCX. While the ceremony in question took place in 2007, a member of the CCX's staff noted in an interview with me that the final decision to close operations happened only around 2009. The CCX had continued to justify its course of action with the need for achieving scale as a pre-compliance step.

The CCX's justification strategy lost some power over time. Initial legitimacy-losing events did not seem to have had much impact, but one of the experts I interviewed recalled that the Oscars situation made a dent. Regardless, the CCX managed to survive this event. Up until that point, the CCX's ability to discern between ordinary events (cats in trees) and 'real' emergencies, and its ability to respond with the appropriate level of urgency was at least marginally adequate. The adequacy of the strategy is hardly surprising. The CCX 'had a demonstration effect' (Meckling, 2011: 142) that enabled its livelihood.

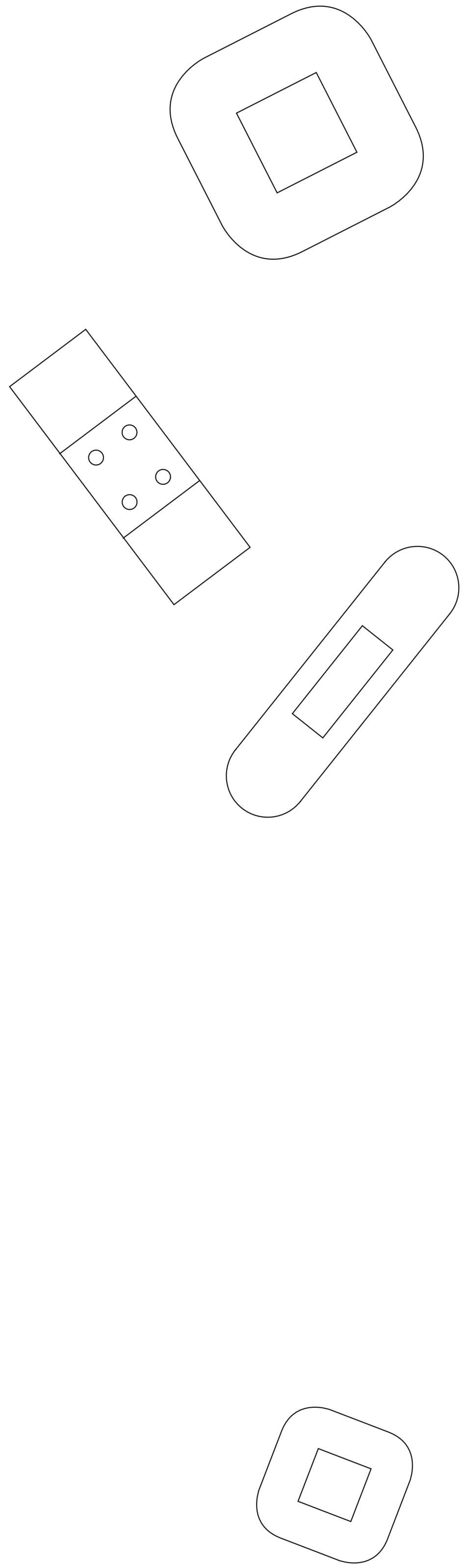
In 2008, however, Republicans gained control of the House of Representatives and the backlash against the idea of a compliance framework increased gradually. Originally, a compliance framework seemed politically feasible. Between 2003 and 2007 the Republican Senator John McCain and the Democrat Senator Joseph Lieberman made three attempts to pass a Climate Stewardship Act in support of such a framework. The three bills were defeated, but the second and third attempts were possible because the matter enjoyed sufficient bipartisan support as to consider trying again. However, a subsequent attempt to pass a climate bill known the Lieberman-Warner Climate Security Act that was introduced in 2007 and voted on in 2008, failed more clearly. This bill was still bipartisan, but McCain distanced himself from it due to the cost to his Presidential bid, which evidenced that commitment by Republicans had waned. By the end, even the support from Republicans who had initially been in favour of carbon trading was nullified by their constituencies. Failure to pass the bills meant that the CCX lost one core component of its justification, the possibility of vindicating its flexibility on being a pre-compliance experiment.

The CCX's exit was no less controversial than its existence. The organization sold to a European company called the Intercontinental Exchange for £395 ($622) million (Grant and Weitzman, 2010) at a profit for investors. Intercontinental Exchange was interested in the CCX's trading infrastructure to use it in the context of the EU's Emissions Trading System, so it subsequently weaned down the US operations. It is debatable whether Intercontinental Exchange could have done anything else, though. A recovery was unlikely to happen given that the CCX had by then lost approval from audiences across civil society (exemplified here with the boycott),and the general public (as with the Oscars). Accordingly, there was no demand for CCX offsets.

Emergencies, risk, and uncertainty

The CCX's history can be summarized as follows. The CCX willingly incurred actions that catalyzed legitimacy-losing events. Its management of these events came down to framing flexibility as a necessary pre-compliance step. Neither of these strategies indicates that the CCX considered initial legitimacy-losing events as emergencies deserving urgent action. In a way, this line of thinking was correct as, initially, the CCX managed to achieve scale, which was its primary goal. However, without the demand for CCX offsets that would have derived from a compliance market, the initiative would have needed demand from elsewhere. This was next to impossible for the CCX, which had enraged most, if not all, environmentalist audiences in the country.

For the CCX, thus, the difference between correctly and incorrectly judging an event as an emergency, and responding to it with appropriate urgency came down to a future contingency. The situation can be explained in the terms of risk; the CCX traded present scale for future risk. So, it is fair to say that it is critical for regulatory experiments like the CCX to correctly judge the cumulative effects of single legitimacy-losing events. Yet, when the future is unknown, it is hard to move from acknowledging the need for correctly judging single events to actually judging them correctly. It follows that in conditions of uncertainty about future events, all legitimacy-losing events are not necessarily emergencies. It would be hard to overstate the need for further research into this paradox.



REFERENCES

CCX (2011) CCX offset project public registry. Chicago: Chicago Climate Exchange. https://web.archive.org/web/20111212161219/https://registry.chicagoclimatex.com/public/projectsReport.js (Accessed 14 April 2018).

Grant, J. and Weitzman, H. (2010) 'ICE snaps up Climate Exchange for £395m', Financial Times, 1 May https://www.ft.com/content/b15e15d0-542f-11df-b75d-00144feab49a (Accessed 15 April 2018).

Meckling, J. (2011) Carbon coalitions: Business, climate politics, and the rise of emissions trading. Cambridge MA: MIT Press.

Scharpf, F.W. (1999) Governing in Europe: Effective and democratic? Oxford: Oxford University Press.

Suchman, M.C. (1995) 'Managing legitimacy: strategic and institutional approaches', Academy of management Review 20 (3): 571–610.

AUTHOR

Jose Bolanos is a **carr**/ FSA Research Officer. He was appointed by **carr** and the Food Standards Agency (FSA) in October 2018.