
Trade Practices, Advertising, and Self-Regulation

Pilot Study on Societal Instruments of Regulation

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Summary

Trade Practices, Advertising, and Self-Regulation: Pilot Study on Societal Instruments of Regulation

Motives, subject matter, and research questions

Whenever policymakers have to decide on which instrument to use in order to attain policy goals, the instrument of legislation is the straightforward choice. There may, however, be viable alternatives such as what are termed societal instruments of regulation: namely, non-legislative forms of regulation in society initiated by private actors without any special legislative authority. For policymakers to choose between alternative instruments, it is crucial that they have a firm understanding of the respective benefits and drawbacks of the array of instruments at their disposal. What then are the advantages and disadvantages of these societal instruments of regulation? Under what conditions can instruments such as self-regulatory codes of good practice serve as an alternative instrument of government policy? To answer these questions, we need to establish, on the one hand, the standards against which legislation is evaluated and, on the other, under what conditions society (or at least part of it) is able and willing to subject itself voluntarily to regulatory goals.

This pilot study aims at providing an insight into the various ways in which non-legislative instruments of regulation work, how they are instituted, how they are enforced and complied with, and to what extent they can serve as an alternative to the legislative instruments commonly used by policymakers. To be more precise, this study focuses on one specific form: *self-regulation through codes of conduct in Dutch business with regard to consumer trade practices and advertising*. By thus focusing on a type of self-regulation, this unadorned study sets forth a basic surveillance of the field of regulation and self-regulation of B2C marketing, trade practices, and advertising of goods and services. This field is worth surveying for at least two reasons. Firstly, the Dutch approach in this field is one of broadly accepted self-designed codes of conduct, enforced by means of adjudications by the Dutch Advertising Standards Authority. Secondly, this field seems to have become increasingly dynamic, both with regard to substantive rulemaking and to enforcement. In some instances, the state legislator has superseded the initiative of private parties and replaced codes with legislation. We addressed three specific areas where this dynamic state can currently be witnessed: namely, in the area of codes of conduct with regard to advertising for alcoholic beverages, telemarketing, and consumer credit.

Research setup

We began our study with a general research question: ‘How do societal instruments of regulation work in practice and to what extent can they form a viable alternative to legislation?’ We identified four practicable benchmarks for the purpose of answering this question:

- 1) Does the instrument attain the goals set by the policymaker and if so to what extent?
 - 2) How does the instrument perform in terms of legitimacy, representativeness, and accountability?
 - 3) To what extent are the individuals and organisations involved bound by the instrument?
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4) To what extent is compliance monitored and warranted?

Obviously, these four benchmarks are relevant for policymakers but fail to take into account the motives and motivations of the private actors involved. Hence, we identified an additional number of factors that could be tested:

Factor	<i>In what direction does this factor point?</i>
Societal demands	If there is substantial public demand for regulation, this may increase the chance of private stakeholders spontaneously imposing self-designed restraints on practices, advertising, and so on.
Density rate of organisation	The more densely organised a specific branch of trade, service, or industry is, the more likely it will engage in self-regulatory initiatives.
Support	The more support there is within a specific branch for taking a certain substantive course, the more likely the institution of and compliance with self-regulation will be reached.
Clear sanctioning	If a piece of self-regulation encompasses clear sanctions, this may signal that the industry involved is committed to enforcement of the self-imposed rules.
Evaluation of self-regulation	If the industry actively evaluates the piece of self-regulation, this contributes to legitimacy and signals commitment.
Practicable	The more easily that standing business practice and design are reconciled with the product of self-regulation, the more likely self-regulation is to succeed.
Extent and size of branch	The more sizable a certain branch is, the more difficult it will be to coordinate action and to reach agreement on self-regulation.
Divergence of interest	The more extensively the interests of the various stakeholders within the branch diverge, the less likely will self-regulation be agreed upon and/or complied with.
Tradition of self-regulation	If a certain branch has a longstanding tradition of self-regulation, this will add to the chances of continued support for self-regulation by stakeholders.
Stable problem field	If the field in which businesses operate is stable both in terms of policy objectives and the numbers, size, and identity of competitors, this will stimulate stakeholders to participate in self-regulation and thus signal commitment and autonomy from

	government intervention.
Private interests	If the stated goals of a piece of self-regulation converge with the private interests of stakeholders concerned (e.g. signalling quality), the chances of these stakeholders agreeing with self-regulatory restraints increase as compared to instances in which only the public interests of the state are served.
State support	If policymakers subscribe to the course set by a self-regulatory initiative and continue to support this course, the private stakeholders will be more willing to invest in further self-regulation.

Findings

Generally speaking, the interviews we conducted confirmed that the various Dutch Advertising Codes can count on strong support from most stakeholders in the well-organised branches of the advertising industry. A substantial number of key players adhere to the rules, notwithstanding the weak legal framework for enforced compliance. It seems that the substantial reputational effects of defiance pull businesses involved towards compliance, which makes these codes flexible and cost-effective non-legislative instruments of regulation. Legally speaking, enforcement is the weak link in the design of the codes: businesses that refuse to subscribe to the standards laid down in the codes will not abide by the adjudications set forth by the Dutch Advertising Standards Authority, and there is no firm instrument available to force them to do so.

The voluntary character of self-regulation may thus actually turn into an Achilles' heel if public demands result in mounting political pressure to chastise a relatively unimportant number of 'rogue traders' that do not conform to self-regulatory business standards. In the three areas we investigated, this is exactly what seemed to have happened in recent years. Our research indicates that if for whatever reason politicians vow to guarantee full compliance with self-regulatory standards, this may pose a serious risk of failure of the self-regulatory scheme itself. Self-regulatory codes are usually not construed for enforced compliance purposes. Rather, they more or less depend on increasing compliance through persuasion, peer pressure, and naming and shaming. As a result, those that are not easily shamed will not be persuaded to comply. If this is or becomes unacceptable for policymakers or politicians, then a self-fulfilling failure is at hand, no matter how unrealistic the policy goals of full compliance may be.

We applied the factors identified in the evaluation grid above to the three areas (advertising for alcoholic beverages, telemarketing, and consumer credit). We found that the factor approach can produce valuable results in the sense that the factors we identified indeed provide guidance. In other words: most of the factors are helpful in explaining the success and failure of self-regulatory codes. In short, we found the following:

Factor	<i>In what direction does this factor point?</i>
Societal demands	Substantial public demand for regulation may increase the chances of self-regulation but it is not a sufficient condition for self-regulation. Such a demand may also cause the legislator to intervene with legislation.
Density rate of organisation	The more densely organised a specific branch of trade, service or industry is, the more likely the possibility it will engage in self-regulatory initiatives. Whether this cooperative attitude satisfies the legislator depends on the policy goals it formulates along the way.
Support	The more support there is within a specific branch for taking a certain substantive course, the more likely self-regulation will be instituted and complied with. If free riders are dominant, self-regulation will not be achieved. Moreover, <i>full</i> compliance is never guaranteed.
Clear sanctioning	If a piece of self-regulation encompasses clear sanctions, this may signal that the industry involved is committed to enforcement of the self-imposed rules. Such a signal does not impress policymakers, especially if the sanctions are never applied and cannot be imposed on those parties that did not subscribe voluntarily to the self-regulatory framework.
Evaluation of self-regulation	We were unable to verify whether active evaluation of self-regulation by the industry contributes to legitimacy and whether this does signal commitment.
Practicable	The more easily that standing business practice and design are reconciled with the product of self-regulation, the more likely self-regulation is to succeed. If the stakeholders involved do not have a private interest in the policy goals and expect compliance with self-regulation to influence business results negatively, chances of successful self-regulation are slim.
Extent and size of branch	We were unable to verify whether the more sizable a certain branch is, the more difficult it will be to coordinate action and to reach agreement on self-regulation.
Divergence of interest	The more extensively the interests of the various stakeholders within the branch diverge, the less likely will self-regulation be agreed upon and/or complied with.

Tradition of self-regulation	If a certain branch has a longstanding tradition of self-regulation, this will add to the chances of continued support for self-regulation by stakeholders.
Stable problem field	Our initial proposition was ‘If the field in which businesses operate is stable both in terms of policy objectives and the numbers, size, and identity of competitors, this will stimulate stakeholders to participate in self-regulation and thus signal commitment and autonomy from government intervention’. We found evidence of the opposite proposition: namely, ‘If the problem field changes and the number, size, and identity of competitors is unstable, this will decrease the chance of successful self-regulation’.
Private interests	If the stated goals of a piece of self regulation converge with the private interests of stakeholders concerned (e.g. signalling quality), the chances of these stakeholders agreeing with self-regulatory restraints increase as compared to instances in which only public interests of the state are served
State support	We found evidence underpinning the proposition ‘If policymakers subscribe to the course set by self regulatory initiative and continue to support this course, the private stakeholders will be more willing to invest in further self-regulation’.

On the basis of our findings, we were able to refine the list of relevant factors.

Conclusions

What can we learn from this pilot study with regard to the four benchmarks identified earlier? As far as goal attainment is concerned, we found that private stakeholders experience the pursuit of policy goals through self-regulation as a token of autonomy granted by the legislator by means of a contract-like understanding. It is therefore essential that the legislator clearly define the policy goals that are to be attained with self-regulation. As a rule of thumb we suggest the following:

- If the policy goals are not clearly defined in the policymaking process, the instruments chosen for reaching these goals run the risk of not properly addressing the problem;
- Policymakers who consider self-regulation should not only have a clear idea on the policy goals but also on the private interests that would persuade stakeholders to help reach these goals;
- If the policy goals are complex or the problem field is complex rather than simple, self-regulation may not be the appropriate tool;
- It is necessary to determine whether political dynamics and political rationality are consistent with a choice for self regulation;

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- If applicable, point out to stakeholders that the policy area is dynamic rather than static and that policy goals could well be adjusted in the near future;
 - If two or more policy goals are addressed simultaneously, political rationality may demand that instead of separating the issues suitable for self-regulation, all issues be forged into one joint legislative effort.

With regard to the benchmarks involving to what extent individuals and organisations involved are bound by the instrument and to what extent compliance is monitored and warranted, we found that expectations of self-regulation may sometimes be overstretched, making failure almost unavoidable. Self-regulation is strong on persuasion but weak on repression. Occasionally this strategy works, but not always. A policymaker should ask him/herself seriously whether full compliance is of the essence. If so, then:

- He/she should point out to stakeholders that if a certain level of compliance is not reached, legislative intervention will surely follow;
- He/she should consider setting up or using an existing regulatory framework within which self-regulation can function under the control of a supervisory agency that is authorised to compel free riders to some level of compliance;
- He/she should bear in mind that if self-regulation is dismissed because it cannot warrant full compliance with the stated policy goals, the marginal costs of attaining compliance through state intervention may well exceed the marginal benefits.

This study produced no specific results involving the benchmark of legitimacy, representativeness, and accountability.

As well as those pertaining to three of the benchmarks, we arrived at a number of more general conclusions:

- This study confirms that self-regulation does not exist in a vacuum but is increasingly part of a regulatory mix of legislative intervention, market supervision by special agencies, and self-regulatory initiatives;
 - Dutch legislative standards (7) (stating that before the policymaker decides on using legislation as a tool, he/she should assure him/herself that the policy goals cannot be reached by self-regulatory forces in the relevant branch and that state intervention is necessary) reflect an outdated dichotomy between self-regulation and legislation;
 - A consequence of the existence of a grey zone between regulation through legislation and self-regulation is that the latter is sometimes generated by the former or by the threat of policymakers to introduce the former;
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- In the areas we investigated, failure of self-regulation seems to be caused predominantly by shifting political goals and the fact that free riders among stakeholders incite policymakers to declare self-regulation a failure;
 - This study confirms that political rationality may sometimes be a predominant decisive factor against the choice for self-regulation.

Further research

This study identifies four lines of enquiry that may be worth pursuing.

1. In choosing the appropriate instrument for reaching a policy goal, lip service is sometimes paid to the fundamental concept of weighing cost and benefits. Further research into the nature and extent of ex ante cost/benefit analysis in the legislative process could help ameliorate the decision-making process in legislative drafting;
 2. In the areas we investigated, there did not seem to be room for a strict choice between legislation and self-regulation. Rather, a mix of different instruments seemed to be more apt. Given the up-surge of supervisory market authorities, it seems more appropriate to enquire after the optimal mix of regulatory and self-regulatory instruments in any given field. It seems justified to devote further study to the feasibility of an evaluation grid that would better enable policymakers to construct such an optimal mix;
 3. In our research, we merely touched upon the implications of an intensified competition policy for self-regulation. The latter is sometimes associated with restrictive practices by stakeholders. Hence, actively pursuing the use of self-regulation in certain markets raises the question of whether this is contrary to competition policy itself;
 4. Finally, we suggest that the benchmark with regard to legitimacy, representativeness, and accountability be explored in a separate legal study.
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