This chapter seeks to encapsulate the considerable Australian experience of codes of practice\(^1\) rather than to rehearse the various potential benefits and pitfalls of codes in the abstract. It does so in three parts. First, it describes a variety of Australian government initiatives intended to nurture this approach, including the development of a Guide to Codes of Conduct and principles about their use. Second, it focusses on one code which contains many of the best features of this approach, and in relation to which there is considerable empirical evidence: the *Australian Code of Practice for Computerised Checkout Systems in Supermarkets*.\(^2\) Third, it draws broader lessons about the factors necessary for codes of practice to function effectively and in the public interest, and about their potential role as an alternative or complement to government regulation.

### When are Codes of Practice Appropriate?

#### The Australian Government Experience

A 1988 Trades Practices Commission (TPC) report on self-regulation provided the impetus for a reassessment of the role of codes of conduct in Australian industry. Australia first considered developing a manual on the appropriate uses, design and implementation of codes of conduct in 1989. From this original concept, the *Guide to Codes of Conduct* gradually evolved in the early 1990s. Draft guidelines were developed and distributed to industry informally. The Commission then consulted business and consumer representative bodies for comment and input. At this stage, further reflection went into the design of the Guide, which was then formally released in October 1996.\(^3\)

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1. In keeping with this book’s definition of voluntary codes, in this chapter codes of practice will be taken to encompass non-legislatively required commitments by industry designed to change or influence firm behaviour, and which ensure that industry practices comply with basic principles of consumer protection. Later in the chapter I will explore why it is important not to describe them as necessarily “pure” self-regulation. Nevertheless, the term *self-regulation* is often used by government and others to describe codes of practice; see, e.g., the work of the Australian Taskforce on Industry Self-Regulation, *Industry Self-Regulation in Consumer Markets* (Canberra: Department of the Treasury, August 2000), available at <www.selfregulation.gov.au/publications/TaskForceOnIndustrySelf-Regulation/FinalReport/download/final_report.pdf>.


Kernaghan Webb, Editor, *Voluntary Codes: Private Governance, the Public Interest and Innovation*. This chapter ©2004 Neil Gunningham, pages 317–334. Published by the Carleton Research Unit for Innovation, Science and Environment, Carleton University, Ottawa, Canada.
In subsequent years, the Commonwealth government has continued to study the value of codes of conduct and self-regulation generally. In March 1998, the Minister of Customs and Consumer Affairs released *Codes of Conduct Policy Framework*. This document shares common themes with the Guide, but places codes of conduct in the context of the government’s policy objectives, describing “the Government’s likely response to problems that arise in the marketplace and, in particular, when a code of conduct might be the appropriate response to answer that problem.” More recently, there have been other significant developments. In 1999, the Minister for Financial Services and Regulation established a Task Force on Industry Self-Regulation, which produced its final report in August 2000. Also, the Commonwealth Treasury commissioned a consultancy group to produce a report on the efficacy of self-regulation. Released in 2000, this report identifies “the characteristics of markets where various forms of self-regulation are likely to operate effectively and the circumstances where self-regulation is likely to be inappropriate.” Finally, the Australian Government announced its intention to develop another guide to self-regulation for industry.

The stated purpose of the current Guide is to serve as a “useful reference tool,” promoting codes as a “means of improving the economic and social well-being of Australia.” The other documents produced over the past few years expand upon this purpose. The Task Force, for its part, associates the use of self-regulatory schemes with cost-efficiency. According to the Task Force, “Self-regulatory schemes tend to promote good practice and target specific problems within industries, impose lower compliance costs on business, and offer quick, low cost dispute resolution procedures. Effective self-regulation can also avoid the often overly prescriptive nature of regulation.” The consultancy group similarly recognized the argument that self-regulation tends to lead to efficiencies, but notes that the extent to which market failures can be redressed by self-regulation depends entirely on a set of contextual circumstances. For instance, among its key findings, the group notes that self-regulation is more likely to reach its stated

5. Ibid., p. 7.
8. On December 13, 2000, the Minister for Financial Services and Regulation announced that the government would publish a guideline for businesses, consumers and government advisers. This guideline is intended to provide practical advice on self-regulation and to be a gateway to other resources on self-regulation. This initiative responded to a suggestion made by the Minister’s Task Force on Industry Self-Regulation. The guideline is currently being drafted and the government promises that it will appear at <www.selfregulation.gov.au/ind_self_reg.asp>.

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goals in a market that is competitive and when the products in question are homogeneous; it is less likely to do so in an uncompetitive market and when the products are “complex and heterogeneous in the eyes of consumers.”

The overall problem to which the Guide, and the codes themselves, are addressed, is that of protecting consumers from the abuses sometimes generated by completely unregulated competition. For example, in a deregulated marketplace, consumers commonly confront problems relating to the supply of inferior-quality or unsafe goods, costs of access to redress when there are problems with a product, inadequate service standards, and lack of information about product use and after-sales service.

As the consultancy group indicated, there are a number of ways in which market failures can be addressed, of which codes of conduct are only one, and one which is not appropriate to every market imperfection. It is important, therefore to first ask whether intervention is really required. It might be, for example, appropriate (if the problem is trivial) to take no action at all, or if action is justified, codes may not be the most effective and cost-efficient option. While the consultancy group drew up its own elaborate list, the Task Force highlighted a checklist developed by the Commonwealth Office of Regulation Review. The checklist calls for self-regulation when:

- there is no strong public interest concern, in particular, no major public health and safety concern;
- the problem is a low risk event, of low impact/significance, in other words, the consequences of self-regulation failing to resolve a specific problem are small; and
- the problem can be fixed by the market itself, in other words there is an incentive for individuals and groups to develop and comply with self-regulatory arrangements (e.g. for industry survival or to gain a market advantage).

Even in circumstances when a code does seem a viable approach, the creation of such a code does not necessarily imply that government should completely vacate the field. On the contrary, it may still have a continuing role in enforcing the general consumer protection legislation when code participants breach that legislation, and it must be prepared to escalate up a regulatory pyramid by introducing legislation if the code proves to be ineffective. By keeping such sticks in the closet, an industry has more incentive to regulate itself effectively. Consistent with the above, the Codes of Conduct

12. Ibid.
13. Noting that different contexts create very different circumstances, the group states that “the development of effective regulation involves a careful analysis and comparison of the relative merits of alternative forms of self-regulation, government regulation, and legislation, and mixes of those regulations.” (Wallace, Ironfield and Orr [footnote 7], p. ix.)
14. Alternatives to the use of codes of practice include no action, fostering improved market responses such as improved information, guidance by the regulator, establishing a complaint handling mechanism, either at the firm or industry association level, co-regulation, direct regulation, and taxes and charges to ensure that the costs of externalities are borne by producers and users. See Trade Practices Commission (Australia), Final Report by the Trades Practices Commission on the Self-Regulation of Promotion and Advertising of Therapeutic Goods, Canberra: Trade Practices Commission, July 1992, p. 8.
15. See footnote 11.
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Policy Framework, released by the Minister of Customs and Consumer Affairs in 1998, suggests implementing the following four principles:

• The general presumption is that competitive market forces deliver greater choice and benefits to consumers.
• The government will consider intervention when there is market failure or demonstrated need to achieve a particular social objective.
• Effective voluntary codes of conduct are the preferred method of intervention.
• When a code of conduct is not effective, the government may assist industry to regulate effectively.¹⁷

Necessary Elements of a Code

Assuming that, in the circumstances, a code is an appropriate response to market failure — because it will potentially produce a more efficient market outcome than other solutions — the crucial question then becomes how to design and structure codes so as to best achieve their public interest goals. It is here that the Guide makes its most important contribution in identifying some basic criteria and suggesting some options for use within those criteria. That is, drawing upon the experience of existing codes that agencies believe have been successful in delivering fair trading outcomes, the Guide provides a reference for any party interested in developing a new code.

The Guide only very briefly addresses the process of code development, emphasizing the importance of participation by industry members, consumer affairs agencies and consumer public interest groups.¹⁸ It deals far more extensively with substantive matters, proposing seven sections that a “code should contain,” while recognizing that “there will be variations between industries in the content and extent of detail in each of these sections.”¹⁹ The sections are:

• scope (who it applies to and who is bound by the code);
• objectives (the expected outcomes);
• core rules (technical standards and performance benchmarks to be delivered by members of the industry);
• complaints, dispute procedures and sanctions;
• administration of the codes;
• publicity and reporting; and
• monitoring, review and amendments.²⁰

¹⁷. Minister of Customs and Consumer Affairs (footnote 4), p. 3.
¹⁹. Ibid., p. 5.
²⁰. Ibid.

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The Guide itself is somewhat terse in its requirements. It is, therefore, worth noting a more detailed list of requirements, proposed by the TPC in 1992:

- a clear statement of the objects of the code principles that address common complaints about industry practices and/or that set performance standards for industry;
- a mechanism to provide for administration of the code that contains some form of outside representation (such a body would have direct responsibility to supervise the ongoing administration of the code, ensuring that it was adequately resourced, publicized and modified to meet prevailing market conditions);
- membership covering a substantial proportion of the relevant industry;
- provision for an independent complaints-handling body that can deal with complaints from the public and industry members when there are breaches of the codes principles (such a body to be easily accessible and to provide quick and inexpensive remedies for complainants);
- provision for commercially significant sanctions for breaches of the code of practice;
- ensuring knowledge of the existence of the code and its complaints handling provisions amongst relevant groups through widespread publicity and other methods;
- training, so that association members and their employees are conversant with the provisions of the code;
- data collection, so that the association members or the association itself have a good profile of what practices or which members are giving cause for concern, and to give some indication of how practices may have changed over time;
- ongoing monitoring for compliance with standards of practice;
- transparency provisions, such as the production of annual reports on the operation of the code to allow for a period assessment of the scheme’s effectiveness by industry members, its customers and the public at large; and
- regular review to ensure that the standard is meeting current community expectations.21

However, the gap between theory and practice may be considerable, and further insights can be gained as to the value of the principles articulated above, by examining the application of a particular industry code in concrete circumstances.

Testing by Results: the Australian Code of Practice for Computerised Checkout Systems in Supermarkets

Origins and Administration

During the late 1980s, major supermarket chains in Australia began to implement new bar code scanning technology for the sale of goods to consumers. Under this new system, prices are no longer visible on the product. Instead, a price appears on the shelf, and a bar code is present on the product itself, which in turn correlates to a

centralized price register kept on the store’s computer database. As each individual product passes through a checkout scanner, a price appears on the checkout’s display unit. This system provides a number of efficiencies for supermarkets, particularly for those with a larger turnover of stock.

At the time of its introduction, however, concerns were raised about the accuracy of prices and potential scope for abuse. Such concerns arose because of a potential gap in information between the consumer and the retailer. In particular, consumers have to remember the shelf price if they want to be sure they are charged the correct price when they reach the checkout. Since this may not be easy, particularly when a person is buying large numbers of items, discrepancies between the shelf price and the price charged at the checkout may go unnoticed by the consumer. There is a risk that supermarkets could exploit this possibility to systematically overcharge shoppers.

In order to address such fears, a supermarket industry association introduced the Australian Code of Practice for Computerised Checkout Systems in Supermarkets (the “Scanning Code” or “Code”) in 1989, with the support of the then Trade Practices Commission (TPC). The aims of the Scanning Code are to minimize discrepancies between the shelf price and the price charged, ensure shelf labels and receipts are informative and readable, provide a remedy for customers when overcharges or other problems arise, and inform customers and store staff about these safeguards and remedies. The TPC gave permission for its name and logo to appear on signs and leaflets promoting the Code, and the ACCC’s name and logo continue to appear on the current (2001) version of the Code. According to a 1992 review of the Code, at least 83 percent of scanning supermarkets in Australia subscribed to the Code. A number of incentives are built into the Code to discourage abuse. With regard to overcharging for a single item, for example, the customer receives the item free of charge. In the case of multiple items with the same bar code being charged at more than the shelf price, then the first item is free of charge, with the remainder being charged at the lower price.

However, these provisions are only effective to the extent that consumers are able to bring price discrepancies to the attention of supermarket staff and obtain redress. To this end, the Code sets out the course of action consumers must follow in terms of complaint handling and dispute resolution procedures. First, consumers must speak to the store manager or supervisor. In turn, retailers are required to ensure that all such complaints are taken seriously and treated courteously. Second, and failing a successful resolution in the first instance, the store manager or supervisor is required to inform the customer of the formal complaints procedures available: completion of a complaints form

22. The original supermarket association was replaced by the Australian Supermarket Institute, which is now a division of the Australian Retailers Association (ARA). ARA administers the Scanning Code for its member supermarkets. See Scanning Code (footnote 2), s. 1.

23. Since then, the TPC was replaced by the current Australian Competition and Consumer Commission (ACCC). See Scanning Code, ibid.

24. While not explicitly stated in the text of the Scanning Code itself, these aims are noted in Wallace, Ironfield and Orr (footnote 7), pp. 95–96.

25. This information is taken from TPC, Checkout the Price: Review of Supermarket Scanning Code Report (Canberra: TPC, July 1992). Exact percentages for today are not available, though the consultancy report indicates that supermarkets subject to the Code now number approximately 5000. (Wallace, Ironfield and Orr, footnote 7, p. 96.)
made available by the supermarket (along with a reply-paid envelope) or by a telephone call to the relevant industry association. Complaints are then heard by a state-based administrative committee made up of industry, government and consumer representatives, and a decision is made within 28 days. Third, if a decision cannot be reached by the committee, or if a decision is unacceptable to either party, then an independent arbitrator is appointed.

The overall administration of the Code is conducted by a National Administrative Committee (NAC) chaired by the ASI Executive Director and made up of executive directors from each of the state/territory industry associations. In addition, a consumers’ representative must be present, and a representative of the Commonwealth government may attend as an observer. The NAC is responsible for continually reviewing the Code, and, when it is deemed appropriate, initiating modifications (following a call for submissions from interested parties). While the Code itself does not have force of law, all supermarkets (whether or they use scanners or not) are subject to an enforceable regulatory background, in particular the provisions of both state and Commonwealth legislation which make it illegal to mislead a customer about the selling price or description of any item.

Evaluating the Code

Has the Code been effective in minimizing discrepancies between the shelf price and the price charged; ensuring shelf labels and receipts are informative and readable; providing a remedy for customers when overcharges or other problems arise; and informing customers and store staff about these safeguards and remedies?

Based on a series of reviews, the then TPC concluded that price discrepancies had been within reasonable limits and shelf labels and receipts were, on the whole, informative and readable.26 However, whether this was due to the Code was hard to gauge, “but it seemed likely that the current code and its predecessors, which date back to 1989, played a role in achieving this.”27 The following were particularly significant: in both scanning and non-scanning supermarkets, undercharges usually outweigh overcharges, so that customers have a good chance of coming out ahead over time in monetary terms; customers fare no worse on average in scanning stores than in non-scanning stores, in terms of overcharging; and this was the situation as early as 1987–1988, pre-dating the formal launching of the Code in 1989.28

Another important performance indicator is the number of formal complaints, which has been trending downwards. While by 1999 some 299 phone calls and 52 letters had been received by the ASI, the majority of these were not actually complaints.29 Rather, they were a range of suggestions for store improvements or other non-Code-related matters. When consumers did have a complaint about pricing, all of these were resolved without further customer complaint.

26. TPC, ibid., p. 8.
27. Ibid.
28. Ibid., p. 9.
From the evidence it had gathered, the TPC (and its successor, the ACCC) concluded that there was no justification for making the Code mandatory. Not only had the Code performed acceptably well, but it covered more than 83 percent of the supermarket scanning industry, and was already underpinned by the general legislative provisions concerning misleading selling. However, the TPC did identify several areas of possible improvement of the Code. In particular, it noted that past monitoring had been deficient in a number of areas, that complaints data had not been uniformly recorded, that some data that might have been useful had not been recorded at all, and that no analysis of national performance had been attempted by the industry body. This led the TPC to suggest a number of modifications to the Code. Prominent among these were the following:

- making the complaints system more accessible to consumers;
- reducing the size of in-store signs, but making them more eye-catching and informative;
- enhancing consumer representation on the Code committees;
- providing the public with annual reports of the Code’s operation; and
- setting out the scope of the item-free policy in the Code.30

The TPC concluded that it would be impractical to extend the Code to cover non-supermarket retail scanning in all retail sectors, given the variety of store circumstances and the possibility of very expensive consumer items being obtained free of charge. Instead, it was determined that the TPC would write to the industry associations of each of the major retail sectors recommending that the Code be used as a guide for developing their own codes.

The question, however, of how much of the supermarkets’ performance (in terms of the rate of overcharging) can be attributed directly to the Code, remains difficult to answer. For example, the extent to which customers have received free items when overcharged is only an estimate because the Code does not require stores to actually record this. Numbers of consumer complaints may be more an indicator of the public awareness of the complaints system than a measure of overall consumer satisfaction. On the issue of customer awareness of the Code, for example, the TPC review suggested there was room for improvement, and further, that checkout staff’s awareness of the item-free policy and ability to provide consumers with a copy of the explanatory leaflet on the Code was patchy.31

To provide a more definitive answer to the question of Code performance, the ASI has commissioned a series of surveys to determine consumer awareness. These have revealed a relatively high consumer recognition rate, in the order of 70 percent. Additional ASI-commissioned surveys have confirmed the TPC review’s conclusion that there has been no widespread overcharging of consumers. Overall, it is hard to disagree with their view that the Code, “while far from perfect, has probably played a role, along

31. Ibid., p. 8.

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with improvements over time in scanning management systems and technology, together with competition, in helping stores make a relatively smooth transition to scanning and in helping allay consumer concerns about scanning.”

Accepting that the Code has been successful in achieving its stated objectives (that is, allaying consumer concerns) in improving the ability of consumers to verify the accuracy of displayed prices, providing cost efficient dispute resolution procedures, and providing compensation via the “item free policy,” then what are the reasons for its success? Crucially, there is evidence to suggest that there is a substantial coincidence of interest between that of consumers in not paying misleading prices and that of large supermarket chains in protecting their reputation.33 We explore in more detail below how to harness this coincidence of interest and, more important, how best to face the challenges to regulatory design in circumstances when public and private interest substantially diverge.

Ensuring that Codes of Practice Function Effectively

Co-Regulation: the Role of Government and Third Parties

Drawing from the experience of the Australian Scanning Code, from impressionistic evidence of a broader range of codes gathered during the course of our research, and from the experience of other self-regulatory initiatives, such as Responsible Care, this section identifies the wider lessons that can be learned about the prerequisites for successful codes and for the design of such codes. In particular, it examines the extent to which an underpinning of State control is necessary for the successful functioning in the public interest of the large majority of codes of practice.

In considering this last question, it is important to recognize that there is no clear dichotomy between self-regulation on the one hand and government regulation on the other. Rather, there is a continuum, with pure forms of self-regulation and government regulation at opposite ends. However, those pure forms are rarely found in the real world, in which distinctions between self-regulation and government regulation are incremental rather than dichotomous.

While codes of practice are conventionally viewed very much as a form of self-regulation, there is no reason in principle why they should be located at the voluntary self-regulation extreme of the continuum. Indeed, there are considerable reasons in practice why they should not. For reasons we explore below, in the majority of circumstances, codes of practice are likely to more effective when they function in combination with some form of outside (usually government) regulation or control.

Such models are often referred to as “co-regulation,” this being defined variously as “the formulation and adoption of rules and regulations done in consultation

32. Ibid., p. 17.
33. Consistent with this, the consultancy report draws three general conclusions: First, the regularity and familiarity of consumer supermarket shopping habits mean that they are likely to be more price conscious than in other retail circumstances. Second, in a competitive environment, supermarkets place a premium on their reputation. And third, there is a shared interest between supermarkets and their consumers in ensuring true pricing. See Wallace, Ironfield and Orr (footnote 7).
with stakeholders, negotiated within prescribed boundaries and as industry-wide voluntary standards that are ratified by government and enforced by industry associations and public interest groups. Since there are numerous possible forms of co-regulation, no single definition adequately encapsulates them all. To illustrate why a variety of different forms of self- and co-regulation may be desirable, the following categorization of codes of practice and of the settings in which they may be used, is helpful:

(i) those that advance the private interests of industry members but have no detrimental effect on consumer or public interests;

(ii) those having the primary purpose of pursuing the industry’s private interests at the expense of consumer and public interests (e.g., through collusive, anti-competitive arrangements);

(iii) those intended to reduce the costs of market failure by imposing restrictions on the competitive process to achieve an overall net public benefit; and

(iv) those intended to overcome a market failure without imposing significant public detriments including restrictions on the competitive process.

As one commentator has pointed out:

Category (i) is of no direct interest to competition or public policy, while category (ii) arrangements are likely to be in breach of the Trade Practices Act and will be vigorously pursued by the Commission. Category (iii) represents the most difficult case and a mechanism is needed to ensure that net public benefits are achieved and delivered over time and to ensure that the arrangement is not “captured” by the private interests of the industry. Category (iv) cases are less

36. TPC (footnote 14), p. 7. The former Trade Practices Commission provided another useful typology as follows:

• a code designed primarily to improve the image of an industry by setting minimum standards in the area of product/service quality and information disclosure, and to provide a complaint mechanism when there is a breach of code principles;

• a code which sets down minimum quality standards as a competitive tool for members of the association within a particular industry when such an association does not have full coverage of industry members;

• a code which operates in addition to existing law, in which the government regulators “move back” and allow the industry to regulate its own members and only intervene if they consider that the code of conduct breaks down;

• a code which operates instead of government regulation following repeal of such regulation; and

• a code that comes into operation as an alternative to enacting government regulation.

In the last three circumstances above, government may choose to confer a large degree of industry ownership of regulation even when there is a significant market failure or “mischief” to be addressed, as an alternative to public enforcement. Note that if the public benefits of a code outweigh its anti-competitive effects then the Commission may authorize the Code, with the consequence that those who are bound by the Code will be immune from court action brought under the competition provisions of the federal Trade Practices Act 1974 (Cth).

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An example of category (iv) is the Electronic Funds Transfer Code of Conduct, which is intended, *inter alia*, to provide an efficient mechanism for disseminating information about the service to customers. It is there to reduce information asymmetries between providers and users and to resolve consumer disputes.\(^{38}\)

### Why “Pure” Self-Regulation is Usually Inadequate

In the following paragraphs some general reservations are expressed about the likely utility of codes of practice, at least if they are used as a stand-alone mechanism of social control, and as a form of pure self-regulation. Pure self-regulation in this context means total or voluntary self-regulation, whereby an enterprise, industry or profession establishes codes of practice or enforcement techniques that are entirely independent of government. Some important prerequisites to the success of codes of practice, over and beyond those identified in the Guide, will also be identified.

There are only a very limited range of circumstances where total or voluntary self-regulation, without any form of oversight or external intervention, can work in the public interest. The best documented such example is Rees’ study of self-regulation in the nuclear power industry, which works well precisely because there are compelling reasons of self-interest why the industry as a whole must avoid a nuclear incident (let alone an accident) and where there is a sufficiently small number of players (all of them large) to make such self-regulation viable.\(^{39}\)

Similarly, studies of occupational health and safety have found that the greatest motivation to comply with voluntary codes is in circumstances when an industry has a public image to protect, when improved safety can contribute significantly to profits (or, as in the chemical industry, when poor safety can lead to catastrophic explosions) and when, in short, companies have a self-interest in improved health and safety performance. When this is not the case, then the track record of self-regulation is a poor one.\(^{40}\) Since only in a minority of circumstances will the self-interest of the target group and the public interest coincide, voluntary self-regulation, and voluntary codes of practice, are only capable of operating successfully under very narrow conditions.

In the very large majority of circumstances, the gap between private and public interest is so large that in the absence of external controls or oversight, the former overwhelms the latter. As Martin puts it, “this approach [purely voluntary] can be

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effective where compliance efforts will largely coincide with best business practices, or where there are strong and effective non-government pressures to comply (which could be just peer group pressure)."\(^4\) In general, however, it is unlikely that "an industry regulating itself can deliver any credible outcomes either to its members or its users."\(^3\)

There are also a further range of other circumstances, beyond the public-private interest divide, which will also limit the potential for pure self-regulation. Some of these, acknowledged in a draft of the Australian Guide, include economic circumstances that force a focus on short-term profit, particularly when firms are economically marginal, the size, mobility and public profile of participating firms, whether the industry or industry sub-sector has had a positive record on the issue in the past, and whether a breach of the code would be readily transparent.\(^3\) A particularly useful checklist of such factors has been suggested by the Netherlands’ former Minister for Environment, Pieter Winsemius, as including a small number of firms in each sector, domination of each sector by large firms, and sectoral associations that are able to negotiate on behalf of their members.\(^4\)

Also important is the prevailing business culture.

Finally, even assuming that, in a particular instance, the gap between public and private interest is modest, and that the relevant industry association wants the code to work, there may still be serious weaknesses with it — weaknesses that only a broader mix of policy instruments, including direct government intervention, would be likely to compensate for. For example, even a broader range of sanctions under the code may not work against recalcitrants. Shaming cannot work against firms with no reputation to protect. Expulsion cannot work when firms can still operate effectively outside the industry association. This is a particular example of the free-rider problem examined below, a problem likely to require government intervention to overcome it.

To the extent that there is a significant gap between public and private interests, or when other circumstances identified above suggest there are limits to effective self-regulation, then from the standpoint of public policy (accepting, for reasons considered earlier, the desirability of industry involvement when this is practicable), the issue becomes how best to design co-regulatory mechanisms. The latter should be designed to take advantage of the strengths and virtues of codes of practice and industry self-regulation, while compensating for their weaknesses as stand-alone mechanisms by underpinning them with sufficient state intervention to ensure that they do operate in the public interest — that is, that they are effective in achieving their purported social and economic goals and have credibility in the eyes of the public or their intended audience. Precisely what form of state intervention will provide the most appropriate underpinning is likely to vary with the particular circumstances of the case. Unfortunately, there are no

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magic bullets or universally appropriate prescriptions. However, it is at least possible to identify some of the most commonly important variables, and to illustrate by example how co-regulation might operate to optimal effect in particular circumstances.

**The Role of the General Law**

First, it is usually crucial that the self-regulatory code operates in the shadow of rules and sanctions provided by the general law, for it is these that are the most obvious and visible (but not the only) means of giving regulatees the incentive to comply with the code. For example, the Scanning Code operates against the backdrop of the general law, which makes misleading pricing an offence. As one astute commentator has put it:

> Society cannot expect miracles from self-regulation when the substantive law is weak. Traders will be part of a self-regulatory code when it offers an alternative to legislation and/or litigation. In many ways the best thing government can do for self-regulation is to provide for effective general laws. No trader will submit her/himself to stringent standards if she or he has little liability at general law. ... All codes have to work against the background that the law itself will provide a less palatable sanction to industry than will self-regulatory codes. This is the incentive to make self-regulatory codes operate effectively.45

Certainly, there is considerable evidence from a variety of jurisdictions that it is largely fear of government regulation that drives the large majority of self-regulatory initiatives.46 Since those initiatives are more concerned with keeping government at bay that with genuinely self-regulating their industry, it seems unlikely that they will perform the latter task well, in the absence of continuing government oversight and the threat of direct intervention.

A related and important role for government is in preventing free riding. If 80 percent of the industry agrees to comply with a code, but 20 percent refuses to sign on, a failure to address the misconduct of the latter (which since they are outside of the code, is beyond the scope of the self-regulatory scheme) will almost certainly result in the failure of the code. This is because those who sign the code cannot afford to be put at a competitive disadvantage as against those who do not. For example, if traders are competing on price and quality but only those covered by the code agree to provide the quality while the others (unknown to the consumer) do not, it is unlikely that the code will be successful.47 That is, there is a considerable threat to support for code

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implementation created by outsiders who adopt lower standards while competing strongly on price, and by free-riding traders who provide lower standards while taking advantage of the higher industrial image created by codes. Here, government must intervene directly to curb the activities of non-code members.

Significantly, the Codes of Conduct Policy Framework does recognize that legislative backing is sometimes necessary to make a code effective. Such legislative backing may include, inter alia, enforcement of undertakings to comply with a code, prescribing a code as a regulation (though the code would only apply to those subscribing to it), and setting out standards that can be overridden by a more stringent industry code, should the industry choose to implement one. Again, the degree of legislative backing will necessarily vary from industry to industry and will depend on the broader economic circumstances.

In this context, the authorization process used by the Australian Competition and Consumer Commission is of particular significance. This specifies that if industry members agree to a code of conduct which substantially lessens competition in a particular market for goods and services, they may leave themselves open to court action under the competition provisions of the Trade Practices Act. However, it is open to the Commission to authorize a code of conduct (though never one that involves price fixing) if the code’s proponents can prove to the Commission’s satisfaction that the benefits to the public flowing from the agreement outweigh the detrimental effects the code would have on competition. Authorization in this context means that the code subscriber will have immunity from court action brought under the competition provisions of the Trade Practices Act in relation to the code.

Other Co-Regulatory Strategies

While a legislative underpinning to codes of practice is perhaps the most obvious way of giving them “bite” and credibility, it is not necessarily the only way. In some circumstances, the mere threat of imposing legislation may provide sufficient incentive to the target group to make its actual imposition unnecessary. In others, less direct forms of State oversight or control will be sufficient. For example, it may be appropriate for a State agency to endorse a particular code by permitting it to use the agency’s logo or other official seal of approval, thereby giving the public greater confidence in the code’s credibility. This in turn may help the industry sell its product or provide other commercial benefits. In these circumstances, the capacity of the agency

48. Ibid.
50. In Australia, most of the state/territory trade practices statutes provide for statutory recognition of industry codes of practice and machinery for their enforcement, making possible, through regulation, their application to entire industries.
52. There is no provision under the Trade Practices Act (Cth.) that gives the ACCC the authority to endorse a code, although the Scanning Code is one case in which this has happened.
to withdraw its endorsement may provide a significant inducement to the target group to self-regulate effectively. For example, under the Scanning Code, the regulator has allowed its logo to be used to give legitimacy to the scheme, and by doing so has leverage over the industry to maintain its standards. It remains an open question whether there is a serious danger of an agency — by promoting and becoming closely identified with a particular code — being thus captured by the regulated industry.

Another means of incorporating codes into a broader co-regulatory strategy is to harness third parties to act as surrogate regulators, policing the code as a complement or alternative to government involvement. The most obvious third parties with an interest in playing this role are consumers themselves. This contribution may be through their direct involvement in administration of the code itself (in which case it has greater credibility as a genuinely self-regulatory scheme) or in their capacity as potential victims of code malpractice, in taking direct action against firms that breach the code. For example, under the Scanning Code, consumers who are overcharged have a right to receive the item free.\(^\text{53}\) Assuming (heroically) that consumers know of this provision, then their capacity to enforce it directly, in their own self-interest, may make this aspect of the Code largely self-enforcing.

Moreover, consumers are not the only ones whose self-interest in policing a code is sufficient to make it effective. Rival traders provide another important group whose self-interest in ensuring a level playing field, and that their competitors do not abuse the code and thereby gain a competitive advantage, can be used to good effect. In Australia, the best illustration of this is the *Code of Practice and Administrative Rules for the Fruit Juice Industry*.\(^\text{54}\) There is a considerable temptation for fruit juice manufacturers to make claims as to the fruit juice contents of their products, but to then dilute the product contrary to those claims. This practice is difficult to detect once the product is in the store. However, by providing for inspection at the production stage by rival manufacturers, the code is largely self-policing.

One major consequence of codes that can be made self-enforcing — whether through harnessing the self-interest of consumers, rival traders or others — is that there is consequently far less need for direct involvement of government regulators, who may take a back seat, intervening only to the extent that the self-enforcing mechanisms break down in practice, or need external support in order to make them effective. Finally, the importance of utilizing a broader regulatory mix cannot be over-emphasized. In the past, policy makers have often assumed that various instruments should be treated as alternatives rather than as complementary mechanisms, and have tended to embrace one or more of these instruments without regard to the virtues of the others. This single-instrument approach is misguided in that all instruments have strengths and weaknesses and none are sufficiently flexible and resilient as to be able successfully to address all problems in all circumstances. Accordingly, in the large majority of circumstances a mix of instruments will achieve far more than single-instrument approaches, though the nature of the mix will necessarily vary with the nature of the problem and its particular context.

\(^{53}\) Scanning Code (footnote 2), s. 3.


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For example, in the case of the chemical industry’s Responsible Care program, even though the industry as a whole has a self-interest in improving its environmental performance, collective action problems and the temptation to free ride mean that self-regulation and its related codes of practice alone will be insufficient to achieve that goal. However, a tripartite approach, involving co-regulation and a range of third-party oversight mechanisms, may be a viable option. This might involve creating greater transparency (through ensuring a community’s right to know about chemical emissions), which in turn enables the community to act as a more effective countervailing force; greater accountability (through the introduction of independent third-party audits which identify whether code participants are living up to their commitments under the code); and an underpinning of government regulation which, in the case of companies that are part of the scheme, needs to kick in only to the extent that the code itself is failing or when individual companies seek to defect from their obligations under it and free ride.

One convenient means of encapsulating the potential dynamic between government, business and third parties in achieving effective co-regulation is a three-dimensional instrument pyramid (see next page), conceived of as having three faces or sides, one side each representing respectively: first parties (government), second parties (business), and third parties (commercial and non-commercial).

In this model, escalation (i.e. increasing coercion) would be possible up any face of the pyramid, and not merely in terms of government action. That is, it would also be possible up the second face (through self-regulation), or up the third face (through a variety of actions by commercial or non-commercial third parties or both).

In this model, one might regulate (in the broadest sense) using a number of different instruments across a number of dimensions (or faces of the pyramid). Escalation

55. See John Moffet, François Bregha and Mary Jane Middelkoop, “Responsible Care: A Case Study of A Voluntary Environmental Initiative,” Chapter 6, above.

56. The original enforcement pyramid, on which we build, is John Braithwaite’s (see Ayres and Braithwaite, footnote 35). Our own conception of the pyramid is broader in two main respects. First, Braithwaite’s pyramid is concerned with the behaviour of, and interaction between, only two parties: (state) regulator and (business) regulatee, whereas we are concerned with the potential regulatory role not just of the state but also of second and third parties. Second, Braithwaite’s pyramid is concerned with how best to tailor enforcement responses within a single instrument category, specifically, state regulation, rather than with how best to utilize a range of instruments. In contrast, our pyramid conceives of the possibility of regulation using a number of different instruments across a number of dimensions (or faces of the pyramid). Our conception of the three-dimensional pyramid was first mooted in Gunningham, Codes of Practice: The Australasian Experience, a paper presented to the Voluntary Codes Symposium, Office of Consumer Affairs, Industry Canada, and Regulatory Affairs Division, Treasury Board Secretariat (Canada), Ottawa, September 1996, and is further developed in N. Gunningham and D. Sinclair, “Integrative Regulation: A Principle-Based Approach to Environmental Policy,” Law & Social Inquiry 24:4 (Fall 1999), pp. 853–896.

57. To give a concrete example of the latter, the Forest Stewardship Council (FSC) is a global environmental standards-setting system for forest products. The FSC both approves standards that can be used to certify forestry products as sustainably managed and certifies the certifiers. It relies for its “clout” on changing consumer demand and upon creating strong “buyers groups” and other mechanisms for institutionalizing green consumer demand. That is, its success will depend largely on influencing consumer demand. While government involvement — for example, through formal endorsement or government procurement policies that supported the FSC — would be valuable, the scheme is essentially a freestanding one: from base to peak (consumer sanctions and boycotts), the scheme is entirely third-party based. (See Gregory T. Rhone, David Clarke and Kernaghan Webb, “Two Voluntary Approaches to Sustainable Forestry Practices,” Chapter 9, above.)

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58. In practice, such seamless escalation is not always possible. See further Gunninningham and Sinclair (footnote 56).

**Conclusions**

Judging by the Australian experience, there is no doubt that codes of practice, properly designed and administered, in appropriate circumstances, and in combination with an underpinning of government oversight or regulation, can provide important benefits to consumers, industries and governments. As the Australian Competition and Consumer Commission has put it, summarizing its experience over the last few years:

> There is considerable scope for using voluntary codes of practice to improve the operation of the marketplace by overcoming elements of market failure without imposing significant restrictions on competition. .... in such circumstances effective codes of conduct can provide benefits for business, customers and the community at large, compared
with the alternatives of open competition and direct government regulation.  

Based on the experience of the Australian codes, the Guide and the various other government-commissioned studies of recent years, one may conclude that certain features are required of codes if they are to achieve public credibility and therefore public acceptance. Notwithstanding the considerable potential of codes of practice that have the above-mentioned features, great care should be taken not to adopt codes in inappropriate circumstances, when they are likely to do far more harm than good, and may seriously devalue the concept of industry self-regulation in general.

Equally important, codes are likely to make their greatest contribution in combination with, rather than in the absence of, government regulation. It is in this context that they make their greatest contribution to “sustainable governance.” (For a more detailed discussion of sustainable governance, see Chapter 14.) In the enthusiasm to embrace voluntary mechanisms in general, and codes in particular, this crucial qualifying factor is all too often forgotten.

60. See “Necessary Elements of a Code,” above.

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