

Compliance, Deterrence and Beyond

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Compliance, Deterrence and Beyond
Neil Gunningham

Abstract

This chapter examines the roles of compliance and deterrence strategies of environmental enforcement, arguing that neither is likely to be successful except in particular circumstances. It goes on to suggest that better results will be achieved by developing more sophisticated strategies which employ a judicious blend of persuasion and coercion, with the mix being adjusted to the particular circumstances and motivations of the entity they are dealing with. This is the enterprise of Responsive Regulation upon which a further strategy, Smart Regulation, builds. The latter argues that public agencies may harness institutions and resources residing *outside* the public sector (in conjunction with a broader range of complementary policy instruments) to further policy objectives. It concluded that while there are no “magic bullets” and no single approach that will function effectively and efficiently in relation to all types of enterprises and all circumstances, some approaches are considerably better than others and there is much to be learnt from each of the regulatory models described above.

Keywords: Enforcement, Compliance, Deterrence, Regulation, Responsive Regulation, Smart Regulation.

Introduction

Effective enforcement is vital to the successful implementation of social legislation, and legislation that is not enforced, rarely fulfils its social objectives. This chapter examines the question of how the enforcement task might best be conducted to achieve policy outcomes that are effective (in terms of reducing the incidence of social harm) and efficient (in doing so at least cost to both duty holders and regulators), while also maintaining community confidence.

It begins by examining the two strategies that historically dominated the debate about enforcement strategy. First, the question of “regulatory style”; and second, whether it is more appropriate for regulators to “punish or persuade”. Recognising the deficiencies of the dichotomy between the two, the chapter goes on to explore more recent approaches that have proved increasingly influential on the policy debate. These approaches include Ayres and Braithwaite’s arguments in favour of “Responsive Regulation”, which are taken further by “Smart Regulation”. The latter recognises the benefits of an escalating response up an enforcement pyramid but also argues that government should harness second and third parties (both commercial and non-commercial) as surrogate regulators and that regulation and enforcement should be designed using a number of different instruments implemented by a number of parties, and not necessarily by government alone.

To Punish or Persuade?

Regulatory agencies have considerable administrative discretion with the enforcement task. In broad terms, they can choose between (or mix) two very different enforcement styles: deterrence, and “advise and persuade” (sometimes referred to as a “compliance” strategy).

The deterrence strategy emphasises a confrontational style of enforcement and the sanctioning of rule-breaking behaviour. It assumes that those regulated are rational actors capable of responding to incentives, and that if offenders are detected with sufficient frequency and punished with sufficient severity, then they, and other potential violators, will be deterred from violations in the future. The deterrence strategy is accusatory and adversarial. Energy is devoted to detecting violations, establishing guilt and penalising violators for past wrongdoing.

In contrast, an “advise and persuade” or “compliance” strategy emphasises cooperation rather than confrontation, and conciliation rather than coercion (Hutter 1993). As described by Hawkins (1984, 4):

Compliance, Deterrence, and Beyond

A compliance strategy seeks to prevent harm rather than punish an evil. Its conception of enforcement centres upon the attainment of the broad aims of legislation, rather than sanctioning its breach. Recourse to the legal process here is rare, a matter of last resort, since compliance strategy is concerned with repair and results, not retribution.

Bargaining and negotiation characterise a compliance strategy. The threat of enforcement remains in the background, only to be invoked where all else fails.

These two enforcement strategies are two polar extremes, hypothetical constructs unlikely to be found in their pure form. Which of these enforcement strategies will achieve best results (or, if both fall substantially short, what alternative strategy should be preferred), can only be answered through an evidence based analysis of the international literature.

Assessing Deterrence

Proponents of deterrence assume that regulated business corporations are "amoral calculators" (Kagan & Scholz 1984) that will take costly measures to meet public policy goals only when (1) specifically required to do so by law, and (2) they believe that legal non-compliance is likely to be detected and harshly penalised (Becker 1968; Stigler 1971). On this view, the certainty and severity of penalties must be such that it is not economically rational to defy the law. A distinction is made between general deterrence (premised on the notion that punishment of one enterprise will discourage others from engaging in similar proscribed conduct) and specific deterrence (premised on the notion that an enterprise that has experienced previous legal sanctions will be more inclined to make efforts to avoid future penalties). Both forms of deterrence are assumed to substantially reduce the social harms proscribed by regulation (Simpson 2002). But does the evidence support the "common sense" view about the need for deterrence and if so, in what circumstances?

General Deterrence

In terms of general deterrence, the evidence shows that firms' *perceptions* of legal risk (primarily of prosecution) play a far more important role in shaping firm behavior than the objective likelihood of legal sanctions (Simpson 2002, Ch 2). Even when perceptions of legal risk are high, this is not necessarily an important motivator of behaviour (Braithwaite and Makkai, 1991: 35 but cf Baldwin, 2004:373). Haines (1997), in another important study, suggests that deterrence, while important in influencing the behaviour of small and medium sized enterprises, may have a much smaller impact on large ones. The size of the penalty

may also be an important consideration: mega-penalties tend to penetrate corporate consciousness in a way that other penalties do not (Gunningham, Kagan & Thornton 2005).

Gunningham, Thornton and Kagan (2005) found that in mature, heavily regulated industries such as mining, although deterrence becomes less important as a *direct* motivator of compliance, it nevertheless plays other important roles. In particular, for most respondents, hearing about sanctions against other firms had both a "reminder" and a "reassurance" function — reminding them to review their own compliance status and reassuring them that if they invested in compliance efforts, their competitors who cheated would probably not get away with it (Gunningham, Thornton & Kagan 2005). Thus general deterrence, albeit entangled with normative and other motivations, continued to play a significant role.

Specific Deterrence

Turning to specific deterrence, the evidence of a link between past penalty and improved future performance is stronger, and suggests that a legal penalty against a company in the past influences their future level of compliance (Simpson 2002). Administrative notices (such as improvement or prohibition notices) or administrative penalties, can also achieve "a re-shuffling of managerial priorities" (Baggs et al 2003, 491) even when those penalties are insufficient as to justify action in pure cost-benefit terms (Gray & Scholz 1993). Such action seems to refocus employer attention on environmental and social problems they may previously have ignored or overlooked. In contrast, routine inspections without any form of enforcement apparently have no beneficial impact (Shapiro & Rabinowitz 1997, 713).

Against the positive contribution that deterrence can make in *some* circumstances, must be weighed the counter-productive consequences of its over-use or indiscriminate use. For "if the government punishes companies in circumstances where managers believe that there has been good faith compliance, corporate officers may react by being less cooperative with regulatory agencies" (Shapiro & Rabinowitz 1997, 718). Indeed, there is evidence that managers may refuse to do anything more than minimally comply with existing regulations (rather than seeking to go beyond compliance) and frequently resist agency enforcement efforts. In some cases, Bardach and Kagan (1982) demonstrate that the result is a "culture of regulatory resistance" amongst employers.

A key conclusion may be that those who are differently motivated are likely to respond very differently to deterrence strategies. Indeed, unless deterrence is used wisely and well, it may have negative consequences

Compliance, Deterrence, and Beyond

as well as positive ones. How to steer a middle path that harnesses the positive impact of deterrence, while minimizing its adverse side effects, are issues which are explored further later in this chapter.

Assessing “Advise and Persuade” (Compliance Strategy)

Although the above section has cautioned against over-reliance on deterrence, there are also dangers in adopting a pure “advise and persuade” or compliance oriented strategy of enforcement, which can easily degenerate into intolerable laxity and fail to deter those who have no interest in complying voluntarily (Gunningham 1987). More broadly, there is considerable evidence that cooperative approaches may actually *discourage* improved regulatory performance amongst better actors if agencies permit lawbreakers to go unpunished. Those who are predisposed to be “good apples” may feel at a competitive disadvantage if they invest money in compliance when others are seen to be “getting away with it” (Shapiro & Rabinowitz 1997). Again, the broader point is that a compliance strategy will have a different impact on differently motivated organizations. It may be entirely appropriate for corporate leaders but it will manifestly not be effective in engaging with reluctant compliers or the recalcitrant, and only effective for the incompetent if it is coupled with education and advice. Regulators who are unable to determine the sort of organization they are dealing with (particularly those who make infrequent inspections of individual facilities) will be operating largely in the dark, and unable to use this strategy in the most constructive fashion.

Responsive Regulation

Given the limitations of both compliance and deterrence as “stand alone” strategies, most contemporary regulatory specialists now argue that a judicious *mix* of the two strategies is likely to be the optimal regulatory strategy (Ayres & Braithwaite 1992; Kagan 1994; Wright et al 2004). This leads to the questions: how might such a mix best be achieved? What would an ideal combination of compliance and punishment look like?

Regulated enterprises have a variety of motivations and capabilities. This suggests that regulators must invoke enforcement strategies which simultaneously deter egregious offenders, encourage virtuous employers to comply voluntarily, and reward those who are going “beyond compliance”. Thus good regulation means adopting different responsive enforcement strategies depending upon whether one is dealing with leaders,

reluctant compliers, the recalcitrant or the incompetent. However, the dilemma for regulators is that it is rarely possible to be confident in advance as to the motivation of a regulated firm.

The most widely applied mechanism for resolving the challenge of variegated compliance is that proposed by Ayres and Braithwaite. They suggest regulators apply an "enforcement pyramid" which employs advisory and persuasive measures at the bottom, mild administrative sanctions in the middle, and punitive sanctions at the top. On their view, regulators should start at the bottom of the pyramid assuming virtue — that business is willing to comply voluntarily. However, where this assumption is shown to be ill-founded regulators should escalate up the enforcement pyramid to increasingly deterrence-orientated strategies (see Ayres & Braithwaite 1992). In this manner they find out, through repeat interaction, whether they are dealing with leaders, reluctant compliers, the recalcitrant or the incompetent, and respond accordingly.

Central to this model are the need for (i) gradual escalation up the face of the pyramid and (ii) the existence of a credible peak or tip which, if activated, will be sufficiently powerful to deter even the most egregious offender. The former (rather than any abrupt shift from low to high interventionism) is desirable because it facilitates the "tit-for-tat" response on the part of regulators which forms the basis for responsive regulation (ie if the duty holder responds as a "good citizen" they will continue to be treated by the inspectorate as a good citizen — Ayres & Braithwaite 1992). The latter is important not only because of its deterrent value, but also because it ensures a level playing field in that the virtuous are not disadvantaged.

This approach also has significant limitations (Regulation and Governance Special Issue 2013, Haines 1997, 219–20, Parker 1999, 223, Baldwin and Black 2008, 45). Some of these have been addressed by Braithwaite in his more recent iterations of responsive regulation. For example, these now take account of the possibility that different motivational postures might lend themselves to different strategies (J Braithwaite 2002, 36-40; see also V Braithwaite 2007). Perhaps the most important limitation of responsive regulation is that in many circumstances there are insufficient opportunities for repeat interactions between regulator and regulated as to facilitate a "tit for tat" approach. (Gunningham & Johnstone 1999, 123–129; Johnstone 2003, 18. In short, the less intense and the less frequent the level of inspection is, and the less knowledge the regulator is able to glean regarding the circumstances and motivations of regulated firms, the less practicable it becomes to apply a pyramidal enforcement strategy. However, even where regulators find it impractical to use the pyramid in its entirety, it may nevertheless be useful in determining which regulatory tool to employ in a given

instance (that is, at what point in the pyramid would it be appropriate to intervene, given the characteristics of the regulated entity, the degree of risk, and type of breach (Gunningham & Johnstone 1999, 124–5)).

Of course, regulation sometimes plays out differently in different national or socio-economic settings. For example, regulation in the United States is strongly shaped by a cultural mistrust of government and business, and a concern to avoid regulatory capture. The result, as Robert Kagan (2003) has so eloquently shown, is a process of “adversarial legalism” by which policy making and implementation, are dominated by lawyers and litigation and regulators are predisposed to imposed legal penalties on wrongdoers. In comparison, regulation in other economically advanced countries tends to be much more conciliatory, with penalties often being invoked only as a last resort. Responsive regulation however, would claim to be equally comfortable in addressing either of these approaches to regulation. castigating the first for going directly to the top of the pyramid without taking advantage of the opportunities for better outcomes at lower levels, and the latter for its an unwillingness to escalate up the pyramid when advice and persuasion fail to work.

Smart Regulation

Gunningham and Grabosky (1998) advocate the concept of “Smart Regulation”, a term they use to refer to an emerging form of regulatory pluralism that embraces flexible, imaginative and innovative forms of social control which seek to harness not just governments but also, businesses and third parties in the process. For example, it is concerned with self-regulation and co-regulation, with using both commercial interests and Non Government Organisations, and with finding surrogates for direct government regulation, as well as with improving the effectiveness and efficiency of more conventional forms of direct government regulation.

The central argument is that, in the majority of circumstances, the use of multiple rather than single policy instruments, and a broader range of regulatory actors, will produce better regulation. Further, that this will allow the implementation of complementary combinations of instruments and participants tailored to meet the imperatives of specific environmental issues. It is however, as Scott (2004) points out, an approach that privileges state law rather than treating the state as simply one of a number of governance institutions.

To put Smart Regulation in context, it is important to remember that traditionally, regulation was thought of as a bi-partite process involving government and business, with the former acting in the role of regulator and the latter as regulatee. However, a substantial body of empirical research reveals that there is a

plurality of regulatory forms and that numerous actors influence the behaviour of regulated groups in a variety of complex and subtle ways (Rees 1988, 7). Mechanisms of informal social control often prove more important than formal ones. Accordingly, the Smart Regulation perspective suggests that we should focus our attention on such broader regulatory influences as: international standards organisations; trading partners and the supply chain; commercial institutions and financial markets; peer pressure and self-regulation through industry associations; internal environmental management systems and culture; and civil society in a myriad of different forms.

In terms of enforcement, Smart Regulation builds on Braithwaite's "enforcement pyramid", and argues that it is possible to reconceptualise and extend the enforcement pyramid in two important ways:

First, beyond the enforcement roles of the state, it is possible for both second and third parties to act as quasi-regulators. In this expanded model, escalation would be possible up any face of the pyramid: not just the first face (government regulation), but also the second face (through self-regulation), or the third face (through a variety of actions by commercial or non-commercial third parties or both. To give a concrete example of escalation up the third face, the developing Forest Stewardship Council (FSC) is a global environmental standards setting system for forest products. The FSC both establishes 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 institutionalising green consumer demand. While government involvement, for example through formal endorsement or through government procurement policies would support the FSC, the scheme is a free standing one: from base to peak (consumer sanctions and boycotts) the scheme is entirely third party based. In this way, a "new institutional system for global environmental standard setting" will come about, entirely independent of government (Cashore et al, 2007, McDermott et al 2010).

Second, Braithwaite's pyramid utilises a single instrument category, specifically, state regulation, rather than a range of instruments *and parties*. In contrast, the Smart Regulation pyramid conceives of the possibility of regulation using a number of different instruments implemented by a number of parties. It also conceives of escalation to higher levels of coerciveness not only within a single instrument category but also across several different instruments and across different faces of the pyramid. A graphic illustration of exactly how this can occur is provided by Rees' analysis of the highly sophisticated self-regulatory program of the

Compliance, Deterrence, and Beyond

Institute of Nuclear Power Operators (INPO) (Rees 1994). INPO is an unusually effective self-regulatory initiative but even so, it is incapable of working effectively in isolation. There are, inevitably, industry laggards, who do not respond to education, persuasion, shaming, or other instruments at INPO's disposal. INPO's ultimate response, after five years of frustration, was to turn to the government regulator, the Nuclear Regulatory Commission (NRC). That is, the effective functioning of the lower levels of the pyramid may depend upon invoking the peak, which in this case, only government could do. As Rees puts it: "INPO's climb to power has been accomplished on the shoulders of the NRC".

A combination of government mandated information (a modestly interventionist strategy) in conjunction with third party pressure (at the higher levels of the pyramid) might also be a viable option. For example, government might require business to disclose various information about its levels of emissions under a Toxic Release Inventory, but leaving it to financial markets and insurers (commercial third parties) and environmental groups (non-commercial third parties), to use that information in a variety of ways to bring pressure on poor environmental performers (Hamilton 1995). However, controlled escalation is only possible where the instruments in question lend themselves to a graduated, responsive and interactive enforcement strategy. In summary, the preferred role for government under Smart Regulation is to create the necessary preconditions for second or third parties to assume a greater share of the regulatory burden rather than engaging in direct intervention. This will also reduce the drain on scarce regulatory resources and provide greater ownership of regulatory issues by industry and the wider community. In this way, government acts principally as a catalyst or facilitator. In particular, it can play a crucial role in enabling a coordinated and gradual escalation up an instrument pyramid, filling any gaps that may exist in that pyramid and facilitating links between its different layers.

Finally, Smart Regulation cautions that there are two general circumstances where it is inappropriate to adopt an escalating response up the instrument or enforcement pyramid, irrespective of whether it is possible to achieve such a response. First, in situations which involve a serious risk of irreversible loss or catastrophic damage, then a graduated response is inappropriate because the risks are too high: the endangered species may have become extinct, or the nuclear plant may have exploded, before the regulator has determined how high up the pyramid it is necessary to escalate in order to change the behaviour of the target group. In these circumstances a horizontal rather than a vertical approach may be preferable: imposing a range of instruments,

including the underpinning of a regulatory safety net, simultaneously rather than sequentially (Gunningham and Young). Second, a graduated response is only appropriate where the parties have continuing interactions - it is these which makes it credible to begin with a low interventionist response and to escalate (in a tit for tat response) if this proves insufficient. In contrast, where there is only one chance to influence the behaviour in question (for example because small employers can only very rarely be inspected), then a more interventionist first response may be justified, particularly if the risk involved is a high one. Perhaps a third, borrowing from Haines, Sutton, and Platania-Phung (2008) should also be added, namely that 'smart' regulatory solutions are only likely to be adopted where they address what she terms socio-cultural and political risk, as well as actuarial risk. At the very least, it can be conceded that policy proposals, to gain traction, must not only promise effectiveness (and increasingly efficiency) but also political acceptability.

In summary, the preferred role for government under Smart Regulation is to create the necessary preconditions for second or third parties to assume a greater share of the regulatory burden rather than necessarily engaging in direct intervention. This will also reduce the drain on scarce regulatory resources and provide greater ownership of regulatory issues by industry and the wider community. In this way, government acts principally as a catalyst or facilitator. In particular, it can play a crucial role in enabling a coordinated and gradual escalation up an instrument pyramid, filling any gaps that may exist in that pyramid and facilitating links between its different layers.

Conclusion

In isolation neither compliance nor deterrence has proved an effective or efficient enforcement strategy. The evidence suggests that a compliance strategy, whilst valuable in encouraging and facilitating those willing to comply with the law to do so, may prove disastrous against "rational actors" who are not disposed to voluntary compliance. While deterrence can play an important positive role, especially in reminding firms to review their compliance efforts and in reassuring them that if they comply, others will not be allowed to "get away with it"; its impact is very uneven. Deterrence is more effective against small organisations than large ones and better at influencing rational actors than the incompetent. Unless it is carefully targeted, it can actually prove counterproductive, as when it prompts firms and individuals to develop a "culture of regulatory resistance".

Compliance, Deterrence, and Beyond

Responsive regulators have found that they gain better results by developing more sophisticated strategies which employ a judicious blend of persuasion and coercion. The mix is adjusted to the particular circumstances and motivations of the entity they are dealing with. A valuable heuristic, in thinking about how best to tailor enforcement strategy to individual circumstances, is that of the enforcement pyramid. This embraces an approach which rewards virtue while punishing vice and in which the regulator is responsive to the past action of the regulated entity as a guide to its present posture. Thus although it is not possible for the regulator to be confident at the outset, of a duty holder's motivation, or whether they are an industry leader, a reluctant complier, a recalcitrant or incompetent, this will gradually become apparent through the "tit for tat" strategy of pyramidal enforcement.

The enforcement pyramid approach is best suited to the regulation of large organisations with which the regulator has frequent interactions. However, it can also be of use in determining which enforcement tool is most suited to the particular circumstances of a smaller enterprise with which they have infrequent contact. Here, its value is in providing guidance as to which arrow to select from the quiver, rather than to how best to conduct a series of repeat interactions.

Smart Regulation attempts to expand upon some of the insights of responsive regulation and the enforcement pyramid. It suggests how public agencies may harness institutions and resources residing *outside* the public sector (in conjunction with a broader range of complementary policy instruments) to further policy objectives. In particular it argues that markets, civil society and other institutions can sometimes act as surrogate regulators and accomplish public policy goals more effectively, with greater social acceptance and at less cost to the state (Gunningham *et al* 1999). This approach resonates with the broader transition in the role of governments internationally: from "rowing the boat to steering it" (Osborne and Gaebler 1992) or choosing to "regulate at a distance" by acting as facilitators of self-and co-regulation rather than regulating directly. However, its authors caution that there are limits to the circumstances in which it will be possible for escalation up one or more of the three sides of the pyramid.

Unfortunately there are no "magic bullets" and no single approach that will function effectively and efficiently in relation to all types of enterprises and all circumstances. Nevertheless, some approaches are considerably better than others and there is much to be learnt from each of the regulatory models described

above. Their nuanced application in appropriate contexts could considerably advance regulatory compliance and enforcement.

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