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Multinational Corporations and Emissions Trading: Strategic Responses to New Institutional Constraints

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Although the Kyoto Protocol intended to implement emissions trading globally, this has so far been impossible. As a result, particularly Multinational Corporations (MNCs) currently face a wide variety of emissions trading schemes that differ in scope and enforcement, thus creating divergent levels of institutional constraints across locations. This article sheds light on the implications of these new constraints for MNCs, and also explores their responses to emissions trading schemes in terms of (perceived) opportunities to (re)shape the institution. Findings on strategic responses of Global 500 companies expose the constraints of particularly the EU emissions trading scheme, as well as the opportunities being explored or already exploited in various ways in this scheme and other emerging ones. Based on these findings the article proposes a framework that discerns four scenarios in which MNCs can find themselves: institutional conformist, institutional evader, institutional entrepreneur and institutional arbitrageur.
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Introduction

Over the past decade, climate change has made headway as a global issue, leading to the emergence of new institutions to restrain greenhouse gas (GHG) emissions. Since the adoption of the Kyoto Protocol in 1997 and the subsequent negotiations on the specificities in terms of implementation, particularly emissions trading has gained ground as a legitimate way to deal with this environmental issue. Emissions trading allows countries which fall under the Kyoto Protocol to reduce their GHG emissions by exchanging part of this obligation with another party to the Protocol (Grubb *et al.*, 1999). However, the implementation of this intergovernmental emissions trading regime on a company level has seen great diversity worldwide regarding the specific institutional forms that emerged to enable trading between companies and the progress made in implementation.

In Europe, public institutional forms have prevailed as emissions trading has been established through regulatory approaches. The European Union established an emissions trading scheme (EU-ETS) in

2005, a step already taken by Denmark and the UK in respectively 1999 and 2002. In contrast, in the US and Australia, countries that have so far refused to ratify the Kyoto Protocol, emissions trading has emerged on a smaller scale at the sub-national level, sometimes as a public initiative, but with the establishment of the Chicago Climate Exchange also as a private arrangement. Several non-European industrialised countries that fall under the Kyoto Protocol, such as Japan and Canada, have not yet really implemented trading schemes. However, companies from these countries can use the other Kyoto mechanisms – Clean Development Mechanism (CDM) and Joint Implementation (JI) – to reduce emissions via reduction projects in developing countries or economies in transition.

Thus, while climate change is still a global issue in its causes, manifestations and implications, and international policy regimes exist, the institutional forms of corporate-level emissions trading differ significantly across countries. This raises the question how multinational companies (MNCs) deal with this whole variety of institutional forms with which they are confronted. To this end, this article examines how MNCs act in response to newly created emissions trading schemes, taking a new-institutionalist perspective. This approach asserts that companies do not necessarily have to comply with institutional pressure, but can also choose to respond strategically by avoiding pressure or use their bargaining power to influence actors that enforce institutions (Child and Tsai, 2005; DiMaggio, 1988; Ingram and Silverman, 2002; Oliver, 1991).

In this article, we will first map existing and emerging emissions trading schemes, considering their main peculiarities, to identify the type of institutional constraints faced by MNCs. Subsequently, we will consider how these constraints can also lead to opportunities for MNCs to (re)shape the institutions (the so-called 'institutional agency'). These analytical insights will then guide the subsequent empirical exploration of responses of Global 500 companies. Based on that, we will discuss the implications and propose a framework that presents different scenarios for strategic responses to emissions trading schemes.

Emissions Trading and Institutional Constraints

From a new-institutionalist viewpoint, institutions are defined as a set of rules that constrains organizations (and individuals) in conducting their activities (Ingram and Clay, 2000). In this vein, an emissions trading scheme is an institution which sets boundaries on the amount of greenhouse gases that firms emit into the atmosphere. As an institution, emissions trading has initially been shaped on an international level in negotiating the Kyoto Protocol (Grubb *et al.*, 1999). However, instead of becoming a uniform global institution, emissions trading has seen a trickle-down trajectory (Djelic and Quack, 2003) and has eventually been reshaped to fit climate and energy policies on regional, national, and sub-national levels, creating a whole variety of new 'local' institutions (Maguire and Hardy, 2006). It was the start of the EU-ETS in 2005 that has given an impetus to the international dispersion of trading schemes that enable emission reduction transfers between companies. At present, even in the US the political debate to set up a federal level emissions trading scheme aimed at companies is gaining momentum (Lohr, 2006).

Nevertheless, there are currently various trading schemes in place (or under development) that differ in the constraint they put on emissions. The type of constraint of an institution typically depends on the actor that sets the rules as well as the accompanying enforcement mechanism, if any (Ingram and Clay, 2000), since this affects the scope and the stringency. States create public institutions that affect a broad range of actors who cannot avoid being affected. Non-state actors can create private institutions that have a more limited scope because they are bounded to a specific group of organisations or individuals who are often voluntarily covered (cf. Ingram and Clay, 2000; Ingram and Silverman, 2002). Due to the fact that actors cannot opt out, a public institution generally produces a stronger constraint, all the more because enforcement is in the hands of a third party (Ingram and Clay, 2000). In contrast, a private institution usually emerges more organically from unorganised interaction between actors (Fligstein, 1997a; Granovetter, 1985), and creates a weaker constraint as it is enforced (or controlled) by other members of the same group (Ingram and Clay, 2000).

Most current schemes are of a public nature, with the implication that once companies fall under a scheme they cannot opt out (Ingram and Silverman, 2002). This includes the EU-ETS, its predecessors that were set up some years earlier in the UK (suspended at the end of 2006) and Denmark (suspended at the end of 2004), the Regional Greenhouse Gas Initiative (RGGI) of the Northeastern states of the US, and Australia's New South Wales Greenhouse Gas Abatement Scheme (NSW). However, due to their different geographical coverage, not all these public institutions produce the same, strong constraint. The EU-ETS clearly stands out as it has been created on a regional European level. It regulates industrial installations located in the EU, including energy activities (combustion installations exceeding 20 megawatt, oil refineries, coke ovens), production and processing of ferrous metals, mineral industry (installations for cement, glass and ceramic products), and pulp and paper production plants (EC, 2003). As a consequence, a broad range of MNC subsidiaries from different sectors could be affected. Nonetheless, the impact of the EU-ETS is not equal for all MNCs in

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