

**RECONFIGURING REGULATORY
INSTITUTIONS:
LEARNING FROM DIPLOMACY AND
INDIRECT RECIPROCITY**

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Abstract: Regulation is conceived as suffering reciprocity deficits that compromise its efficacy. Diplomacy is used as a model for reconfiguring regulatory institutions in response. Ambassadors for Regulatory Affairs who would be agents for all state regulatory agencies could be based in most large firms and SMEs that pose unusual regulatory risks. Rural police would be trained to be Ambassadors for Regulatory Affairs to rural towns. Just as a US Secretary of State can launch a “diplomatic surge” in Afghanistan-Pakistan-India and with Burma from 2009, so regulatory surges are possible to respond to reciprocity deficits in market sectors of high risk or high opportunity. One reason reciprocity that is only episodic in these strategic ways can promote more general responsiveness is that, as a more general theoretical proposition, strategies of indirect reciprocity can work. Diplomatic cultures rely heavily on indirect reciprocity. Indirect reciprocity is reciprocity that we do not personally experience, but learn from the experience of a culture. This means that so long as we sustain regulation as a relational, as opposed to a purely technocratic process, indirect reciprocity might civilize regulatory compliance in an historical process informed by the theories of Norbert Elias and Robert Putnam.

Key words: Responsive regulation, Diplomacy, indirect reciprocity.

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Reciprocity as a Scarce Resource in Regulation

Regulators face many difficulties: information challenges (discovering where bodies are buried); political challenges (working to political masters who like to be popular with business backers); and many more. The analysis in this essay is limited to just one of these other large challenges; reciprocity as a scarce resource. It has often been advanced as a criticism of responsive regulation (Ayres & Braithwaite 1992) that it depends on repeated encounters between regulator and regulatee (Gunningham & Grabosky 1998, p. 404; Gunningham & Johnstone 1999; Scott 2004; Nielsen & Parker 2009; Ford 2011). This is because one important way that responsive regulation works is by escalating up a hierarchy of strategies, as regulated actors fail to respond to strategies at a lower level of the hierarchy. How can a regulator escalate up an enforcement pyramid in response to failure to respond to an earlier signal without repeated encounters? It is an approach that gives forbearance a chance to be reciprocated by reform or compliance, and redemption a chance at reciprocation by de-escalation down the pyramid. This reciprocity seems impossible without iterated encounters. Nor does tit-for-tat seem possible, as in a game theoretic model of the evolution of cooperation (Axelrod 1984; Scholz 1984). Ayres and Braithwaite (1992) advanced such an iterated evolution of cooperation as one possible explanation for why a regulatory pyramid might work.

While the critics are justified in focusing concern over reciprocity deficits upon the difficulties of making responsive regulation work in practice, the concern applies to some degree to all forms of regulation. One cannot replace command and control regulation of carbon emissions with a carbon tax without repeat encounters between the new tax inspectors and regulated industries. A pure education and persuasion model, like any kind of education, is hard to deliver in a single encounter between teacher and student, or no encounters in the case of education by electronic means, especially with students who reject the idea of being educated. A police enforcement model based on prosecution at first evidence of breach of the law requires repeated

encounters between the investigating police officer and the suspect (and others who might testify). Usually it also involves more reciprocity than meets the eye. The suspect might hope that by granting the police officer access to a space without a search warrant, by voluntarily accompanying the officer to the police station without an arrest warrant, they might be less likely to be targeted by escalated investigation compared to other suspects who are more combative.

One hypothesis derived from responsive regulatory theory is that when pyramidal approaches work well, they drive such a high proportion of regulation down to the cooperative base of the regulatory pyramid that regulatory inspection can secure compliance on the basis of *fewer* iterated encounters than a police investigation model. This is implicit in the claims of responsive regulation that it can achieve more regulatory coverage than a criminal enforcement model that ties law enforcers down in lengthy criminal investigations of a few cases. This aspect of responsive regulation has not been empirically tested.

The important point is that it is certainly hard to make responsive regulation work, and possibly any regulatory strategy work, without iterated encounters. The standard response of responsive regulators is to say that an implication of the theory is that we need to make the most crucial encounters more iterated to secure an evolution toward cooperative reform. So the responsive regulator wants to see prudential regulators spending less time in their offices poring over quantitative risk models, more time visiting banks “kicking the tyres” (Braithwaite 2009). The responsive regulator wants to see tax officials spending a higher proportion of their scarce resources visiting with strategically chosen taxpayers, compared with time re-examining tax returns (Braithwaite 2005; Braithwaite *et al.* 2007b).

The purpose of this article is to respond with a prescription that puts more flesh on these bones. This is to transform regulatory practice and institutions to render them structurally more focused on iterated encounters with human beings out in the field, less focused on processing pieces of paper. Since the 1990s, the ways responsive regulatory implementation has been rolled out in tax administration, and to a lesser extent in other domains such as securities regulation (Kingsford-Smith 2011), gives a clue to our final destination. Some tax offices and securities regulators on the one

hand have for many years now located Key Client Managers permanently in the offices of many firms (Braithwaite 2005, pp. 74-80). And on the other hand, they “blitz” iterated short visits upon market segments or individual firms feared to be low in compliance. Rather than make too much of these incipient late twentieth century manifestations of the policy solution we seek to consider, we might learn more from a long-entrenched policy exemplar, diplomacy.

Our plan is first to discuss how diplomatic surges work, then we compare this with regulatory surges in contexts where reciprocity is a scarce resource. The next section considers how Ambassadors for Regulatory Affairs would work, followed by a consideration of our proposed reconfiguration of rural policing. Finally, we locate the potential for the diplomacy model in the more general potential for indirect reciprocity in a world where direct reciprocity is a scarce resource.

Diplomatic Surges Where Reciprocity is a Scarce Resource

The President or Secretary of State of even the best funded diplomatic endeavor, the United States government, does not have the capacity to interact with all the world’s foreign ministers. Yet they can and do put on diplomatic surges with focused groups of nations when there is a priority diplomatic opportunity or risk. That is one responsiveness remedy in diplomacy to the dilemmas of reciprocity as a scarce resource. The other principal remedy is for states, even the poorest among them, to post permanent Ambassadors to the capitals of all of the states that are diplomatically critical to them and to New York, Geneva and Brussels. Top-down diplomatic surges supply episodic focused reciprocity; Ambassadors provide continuous middle-out reciprocity, though only in key capitals. While an instructive model, in an era where so many civil wars start in rural areas (Autesserre 2010), diplomacy repeatedly runs up against the limits of diplomats cloistered in the embassies of national capitals. As with regulatory inspectors, diplomats need to get out where they “get their boots wet” (an expression from Hawkins’s (1984) environmental inspectors). This is just to say that while diplomats cannot be everywhere, diplomatic surges need to go right down to rural hot-spots in central Africa, as opposed to cocktail parties in Geneva, when those are the rural spaces that are igniting wars.

The history of a diplomacy that combines targeted surges with permanent missions starts with the diplomacy of 15th century Renaissance Italy (see Mattingly 1955; Beverley 1999; contra Fubini 2000). Throughout Medieval history, a primary concern for Italian city-states was to preserve the incumbent government from being overthrown. Continuous confrontations between the papacy and secular crowns engendered a political vacuum in the medieval system of the peninsular, and thus rulers, whether tyrants, oligarchs, or dominant factions of citizenry, had to be sensitive to external as well as internal threats. They also needed to maneuver among incessant altercations, because warfare was one of the most effective ways to expand one's sway over neighbors in the absence of dominant power. No one city-state was strong enough to subjugate all others, nor was any city strong enough to be secure. Contemporary regulatory capitalism is like this in that no economy has the regulatory power to restore order to the financial system, while many small economies have the power to unravel order. In this context, resident ambassadors were a means to deal with the unstable power equilibrium in the peninsular, by "providing incessant alertness and countering the dangers of constant war" (Mattingly 1955, pp. 58-59).

A resident ambassador was not a temporary envoy dispatched to settle something specific and then return. It was rather a fixed-term appointment strategically dispatched with diplomatic credentials until recalled, taking care of matters set out in their instructions for representing their home government (Fubini 2000, p. 27). By the mid-15th century, resident ambassadors became a standard means to maintain unremitting vigilance and intergovernmental communication in Italian city-states. Venice, which most actively used resident ambassadors, dispatched them to major Italian cities, including Florence, Milan, Rome and Naples, and to emerging non-Italian capitals in Hungary, France, Turkey and even England. Normally resident embassies were reciprocally exchanged between allies and continuously established and withdrawn in accordance with alliance shifts. For example, Venice, when it was joined by Naples and Siena against the Milanese league in 1452, immediately sent resident ambassadors to King Alfonso at Naples and to Siena (Mattingly 1955, p. 86).

Their role was primarily to gather information on other countries. That is why resident ambassadors were strategically sent from influential families. One of the reasons Venetian ambassadors in Rome outnumbered those in other destinations was that

Rome was a listening post, like contemporary Geneva or New York, where Italian and non-Italian ambassadors gathered to collect and exchange information (Beverley 1999, p. 59). Their role was, however, not restricted to this. They also acted as a channel of intergovernmental communication, enabling coordinated actions and mutual support in potential crises caused by common enemies. Resident ambassadors were asked to participate in ceremonies, rituals and conferences in the host country and through them improved relationships and mutual understanding. By building up iterated relationships with not only policy makers but other ambassadors, resident ambassadors could detect diplomatic surges and power shifts at an early stage and mediate inter-governmental relations by alerting their home government to each shift, even facilitating coalition realignment to restore a previous power balance (Mattingly 1955).

Regulatory Surges Where Reciprocity is a Scarce Resource

The diplomacy model for managing reciprocity has some (admittedly faint) resonances in regulatory practice. We have mentioned the Key Client Managers scheme which has existed at the Australian Taxation Office since the 1990s. This program is oriented to the largest or highest risk companies that over periods of many years have an ATO auditor with a desk inside the corporate headquarters, but also visiting with internal auditors on their travels around key operating sites. As with diplomatic deployment, one rationale for the policy is improving relationships and communication, and a second is improving intelligence by being close to the spaces, people and transactions where bodies are buried.

At the individual level, the High Wealth Individuals Task Force was established in 1996, an Australian innovation that at least a dozen other national tax administrations have emulated since 2000 (OECD 2009, p. 56; for cases to 2009) after Australian success in increasing revenue from the wealthy individuals targeted. The targeting here was of 142 individuals (expanded to 700 by 2004). The initial intent was to target individuals who had \$30 million in assets but paid less than \$20,000 in tax. Most had much greater wealth than this and in at least one case had paid no tax at all since 1987 (Braithwaite 2005, p. 84)! Iterated relationships were established, not so much with

them personally, as they were busy running the country, but with their accountants. Another responsive program of this sort by the Australian Taxation Office was the Promoters Task Force that worked with promoters of tax shelters to negotiate and monitor compliance plans. Because a number of these promoters were enforcement targets for non-tax regulatory agencies, whole-of-government plans were developed to curtail their aggressive gaming of the law across a number of arenas.

An example from a different domain is the On-site Supervisor Scheme of the Financial Supervisory Service (FSS) of South Korea. FSS has led intensive restructuring of a financial sector recovering from the Asian financial crisis of 1997-8. It is responsible for micro-prudential supervision of financial firms. Since 2001, the On-site Supervisor Scheme has been oriented to banks and insurance companies showing negative signs in their management. On-site Supervisors are dispatched to a firm with a broad brief to monitor corruption and illegality, inspect regulatory systems, improve relationships with other auditors, investigate the firm's risk level and prevent escalation of potential financial crises. On-site Supervisors escalate (and de-escalate) up an enforcement pyramid from recommendations, to requests, to orders for management improvement, to suspension or revocation of license.

A fourth type of tax program that many national administrations have adopted involves the targeting of firms with high international trading within the firm for Advanced Pricing Agreements (APAs), called Advanced Pricing Arrangements in some countries, as an agreed approach to keep profit shifting in check. In Australia, a responsive regulatory approach was put in place where APAs were just one level of a range of escalated interventions that were signaled to counter illegal profit shifting. This responsive regulatory pyramid was estimated to return an extra billion dollars in tax revenue for each million spent on the program (Braithwaite 2005, pp. 93-97).

Finally, in prudential regulation as with tax, there is more mundanely cyclical targeting of a wide range of taxpayer types. The idea is to communicate the possibility that the tax office may get around to focused targeting on any and all vocations eventually. In practice, targeting a vocation like academia may happen when there is some policy change that needs to be consolidated into compliance, say a change in the way academics' professional libraries are depreciated. The year when

such a change comes in may be the time when academics are chosen for their summer of interated reciprocity with tax auditors.

In summary, we might say that targeted surges to complement permanent missions (Key Client Managers) in tax administration have tended to take the form of blitzes. This philosophy has been influenced by Malcolm Sparrow's (2000) *The Regulatory Craft*. Sparrow's advice is against regulators spreading themselves thinly across a wide terrain of problems, collecting reams of information across that terrain that is rarely used. Rather his advice is to "pick important problems and fix them," rather in the fashion of a busy US Secretary of State.

Tax administration is of course an unusual case for drawing these lessons, both because of the large number of actors it must regulate – all the companies, partnerships, trusts, individuals in a country – and because tax administrations usually have very large numbers of regulatory personnel. It is harder for small agencies to locate permanent missions anywhere and to mount any surges. Even so, there is a long history of innovative approaches to doing so.

From the nineteenth century, a tiny regulator, the Coal Mines Inspectorate in the state of Queensland, Australia, supervised many mines that were taking large numbers of miners' lives, as in China today, but with few staff to supervise them. They legislated for elected worker "check inspectors" to undertake tests for methane gas levels before every shift entered a mine and for various other powers that the state delegated to them. Later the state took over paying the salaries of these workers (Braithwaite & Grabosky 1985, p. 43).

With nursing home inspection in the US, state government aged care inspectorates were so overwhelmed with getting the basics of nursing home inspection done that "picking important problems and fixing them" was something they rarely managed to do. In 1987, one of the interesting elements of a legislative reform package accomplished by the National Citizens' Coalition for Nursing Home Reform required staff of all nursing homes to meet with their resident representatives to reach agreement on one quality of care problem that they would target as a priority of their choice (Braithwaite *et al.* 2007a). That law did not specify anything about what the problem they pick to fix should be. It just required that it be chosen and a plan of

action to fix it recorded along with a methodology for measuring its accomplishment. Similar approaches were adopted in subsequent continuous improvement and continuous learning enforced self-regulation approaches to Australian nursing home regulation (Braithwaite *et al.* 2007a, pp. 198-214). Another response in both the United States and Australia has been government funding for Community Visitor and Ombudsman programs staffed mainly by volunteers who are concerned about aged care standards (often based on experiences with their own family members) but with limited numbers of state-funded professionals to back up volunteers in the worst circumstances.

As encouraging as such innovations are in showing that responses are available to the problem of reciprocity as a scarce regulatory resource, the problems remain so endemic, especially for small agencies, that more radical reconfiguration of regulatory institutions might be considered as a remedy. To this we turn in the next section.

Reconfiguring Regulatory Institutions – Ambassadors

One feature of Ambassadors in foreign capitals is that they represent every agency of their home state. Wealthier states have specialists from some of their most powerful agencies – the trade ministry, defense, the intelligence service – but most state agencies of most states are represented by generalist diplomats in most foreign capitals. So let us consider adapting this move to the reciprocity dilemmas of the regulatory state. All of the most important firms might have permanent state Ambassadors for Regulatory Affairs located within their offices. In the US context, this would include the entire Fortune 500 and many more. It would include all significant firms in highly sensitive industries, such as defense contracting, mining, pharmaceuticals, nuclear power, banks. These Ambassadors would operate in the fashion of Key Client Managers of the Australian Taxation Office or the Australian Securities and Investment Commission, but across all regulatory functions. Ambassadors may have a staff which is a mixture of specialists and generalists, as in any diplomatic embassy.

They would be a liaison not only to the tax authority or only to the securities regulator, but to both, and also to environmental, occupational health and safety, prudential regulators if they are a bank or insurance company, indeed to all state regulators. Their key interlocutors would be board audit committees and ethics committees, controllers, chief financial officers, corporate compliance groups and specialist compliance groups such as safety committees. Just as the latter private actors are bridge builders who assist with enabling private power to be more permeable to public power (Parker 2002, pp. 38-43), so would Ambassadors for Regulatory Affairs supply public bridging capital.

One hope for Ambassadors for Regulatory Affairs is that they might leverage systemic improvement in compliance systems, audit, complaints handling and learning from critical incidents at their firm that would be a benefit across all domains of regulatory compliance. Specialist regulators find it hard to justify systemic improvement diagnostics with one firm when there are manifest risks to move on to at a long list of other firms. They also fall down on sifting single firm intelligence for the same reason. They fail to pick up learnings from critical incidents at a single firm that might drive what Parker (2002, p. 277) calls triple loop learning across a whole regulatory system in how to treat risks or seize opportunities for improvement.

While Ambassadors would be less expert in all substantive areas of regulation, they would become more expert at business diplomacy and at triple loop learning. So Ambassadors involve a trade-off between solving the reciprocity problem and the technical competence problem. As with international diplomats, part of the craft of the diplomat is being good at knowing what expertise one lacks, knowing what part of one's state or civil society has the expertise, and knowing how to build a bridge across which that expertise can travel when it is most desperately needed. Sometimes the Ambassador-generalist solution will be radically suboptimal. This happens when bridges are no substitute for having the expertise of a specialist regulator in place. Diplomacy has accumulated wisdom in how to make particularistic judgments about contexts where a generalist diplomat should be replaced by a specialist. For example, many great trading cities of the world that are not national capitals are dotted with Consulates staffed by a trade specialist from the home state, with no generalist

diplomat to be found in the Consulate. A military attaché may be found unaccompanied by generalist diplomats in rural war zones far from capitals.

Likewise, regulatory diplomats and their specialist staff need to spend much of their time “getting their boots wet” at the site level where so many problems arise. Many sites are significant enough to need their own ambassador supported by specialist staff, such as a nuclear power plant, a large environmentally and safety-sensitive mine (many of which already have resident inspectors in many countries), or an abattoir where there are constant tensions among consumer health, animal welfare, environmental, and occupational safety concerns, about the frequency and methods for washing blood from wet floors and managing large animals who are not killed cleanly, for example. Perhaps more importantly, Ambassadors would need to make their intelligence function work to direct specialists from specialist regulators to targets from a large number of possible sites at which blitzes might be directed. This includes SME sites upstream and downstream from large firms that can be revealed as non-compliant from large firm intelligence sources. Obversely, SME blitzes by specialist regulators would need to be harnessed to provide intelligence to Regulatory Ambassadors at large firms upstream and downstream from SMEs. As with international diplomats, regulatory diplomats would be at risk of “going native,” becoming “captured,” and so would require the same remedy of optimized rotation. This is a different kind of trade-off. Rotations that are too long risk excessive capture by the powerful political actors of the local site; overly short rotations cut off reciprocity and acquisition of specialized local knowledge before these are sufficiently matured.

A secondary function of a ministry of regulatory affairs that deployed generalist regulatory ambassadors would be nurturing coordination among state regulatory agencies. Strategic coordination among different state regulators has tended to be weak, so this might be a significant benefit. A cadre of regulatory generalist diplomats built up through ambassadorial experiences might help lay bare some of the gaps between regulators, contradictions and missed opportunities in the rule of regulatory law and policy.

Reconfiguring Regulatory Institutions – Returning Police to Their Roots

1829 was a watershed year for the regulatory state. It saw the creation of the London Metropolitan Police. Much was decisive about this watershed; a distinctive path dependency of the regulatory state flowed from it globally. One shift was the rapid globalization in the course of the 19th century of police as paramilitary organizations specializing in one principal form of regulation – criminal law enforcement. This globalization was of a different conception of police from the dominant conception in Europe and North America in previous centuries. From late medieval times, police had meant village and town constables who were regulatory generalists. Police had the same Greek etymology as politics and policy. In addition to regulating theft and violence, constables would regulate alcohol licensing, pollution into streams, weights and measures and other consumer protection, usury, the monopolies of guilds, forestry and hunting, community safety from sources that ranged across unsafe food, unsafe roads, unsafe machinery, unsafe mines, unsafe animals, the whole gamut of regulatory functions.

After police became crime control specialists, from the mid-nineteenth century, new specialist regulatory agencies such as the Alkali Inspectorate, factories inspectorates, mines inspectorates, weights and measures and health inspectorates began to spring up to pick up functions the new Peelian police had sloughed off. This new late modern specialization in regulation worked well in many ways. But only in cities. Inspectors almost never got out to factories, shops, sources of pollution or unsafe food located in rural areas at long distances from their city offices.

Police continued to have a presence in rural towns and villages, but police who no longer saw themselves as responsible for non-criminal regulation. Rural people, especially in countries like Australia where rural spaces are vast, missed out on the benefits of the regulatory state. The worst rural pathologies of regulatory states are in the least developed economies. Illegal logging of the tropical forests of the Solomon Islands by foreign firms has contributed to war, top-down corruption of a kleptocratic state, trafficking of arms on logging ships under the protection of that corruption, and the trafficking of children for sexual exploitation (Braithwaite *et al.* 2010). John

Braithwaite and Sinclair Dinnen's fieldwork revealed that when chiefs complained to local police that multinational loggers were destroying their village livelihoods and environments, they were told this is not a police matter. They should complain to the Forestry Inspectorate far away in the capital city. Because there were few forestry inspectors in the capital and the costs of travel to the remote forests targeted for destruction is prohibitive, no one comes, no one is even called.

So Braithwaite (2008, p. 30) proposed that rural police officers could be agents for all regulatory agencies. If a consumer has a complaint about a butcher's scales selling them short, the rural police officer could investigate this on behalf of the consumer protection agency. If another complains of the two gas stations in the town moving their prices in liaison as a duopoly, the police officer, on behalf of the competition regulator, could drop around to remind them of their legal obligations. Rural police in contemporary conditions are in repeated contact with most local businesses in their town on all manner of service call-outs. In a world where they became not only the local ambassador of the criminal law, but also an ambassador for all regulatory law, reciprocity would become even more iterated. Obviously, each rural police officer would need to cover a smaller patch than they do today in order to cope with these extra responsibilities. Like the sheriff of old, they would be a peer to the mayor in the power and responsibility they wield, and so would need to be paid much more than contemporary rural police.

Rural police, under our model for reconfiguring the regulatory state, would attend some of the same training courses at the Ministry for Regulatory Affairs that would equip regulatory ambassadors to large corporations. They would be provided with some of the same intranet resources of the Ministry for Regulatory Affairs on how to conduct a preliminary investigation, how to report to the competition authority on their findings in a price fixing allegation, for example.

So our proposal for reconfiguring regulatory institutions is now fleshed out not only as scattering Ambassadors for Regulatory Affairs across the big firms listed on the world's major stock exchanges, across many high-risk sites of those firms, and across high-risk SMEs, but also across the smallest of towns, where prospects for iterated regulatory encounters with city-based inspectorates are most remote. In between, in

city firms that are not large or priority targets of regulatory scrutiny, repeated encounters with regulators only happen when regulatory surges target specific issues for their industry sector, or when specific allegations are laid against their firm of a very serious nature. This means still a huge reciprocity deficit, yet a greatly reduced one in comparison to current configurations of regulatory states.

Reconfiguring Regulatory Capitalism

An agency like a tax authority that regulates tens of millions of entities of course does very little of its iterated regulatory work with taxpayers themselves. It does it with tax preparers, many of whom have hundreds or thousands of taxpayers clients. Mostly, when someone taps a taxpayer on the shoulder and warns them that their conduct may be a breach of the law, it is their tax preparer rather than a tax inspector who does it. When a company is alerted that an aspect of a prospectus they intend to issue is illegal, it is more likely that warning will come from a law firm retained to assist in the preparation or checking of the prospectus than from the securities regulator. This is an observation from the regulatory capitalism tradition (Levi-Faur 2005) that while state regulators are important, in contemporary conditions most regulation is undertaken in a private market for regulatory services. In that world, smart regulators harness those private providers of regulatory services to their compliance projects. They write to all the registered tax advisors to request that they please warn all their clients of an intention to implement certain enforcement surges in the coming year. They urge accountants to please use the year to ensure all their clients are maintaining the records necessary to document their compliance with these provisions. It is not then the state enforcement on these things during the next year that drives most of the compliance benefit; it is private enforcement in the market for regulatory services. It is a meta regulatory rather than a direct regulatory accomplishment.

It follows that while the reforms we propose are for the reconfiguration of the regulatory state, under conditions of regulatory capitalism, most of the leverage of state regulators and state Ambassadors for Regulatory Affairs would be indirect. This is relevant to considering the important limitation of our proposed reconfiguration that it trades off specialized technical competence for enhanced reciprocity. We would worry about that more in a world where most state regulation was directly supplied by

state actors rather than by leveraging the technical competence of private providers of regulation. So we envisage the monthly meeting of the local police constable wearing his hat as the Ambassador for Regulatory Affairs running through a checklist of regulatory surges likely to arrive in the coming months at a local chamber of commerce meeting:

I advise that the tax office will be conducting a blitz on employment related expenses, so please talk to your accountant about assuring your compliance in that area. There will be some spot checks that gas pumps are delivering accurate volumes, including in rural areas, so you would be wise to get your pumps checked by a certified service agent. The environment inspectorate is blitzing noise pollution around pubs and clubs. If your business is in that category, I have noise detection equipment that I can lend you to check your own compliance before you get into trouble. I recommend you do that collaboratively with your nearest residential neighbors so they get to see that you are in compliance and that you are checking compliance. Then you will get fewer illegitimate complaints from your neighbors. The occupational health and safety inspectorate has made available at this website a self-auditing tool for threshing machines and other farm machinery. Please pass word among your farm customers that if they correctly, carefully self-certify as compliant and a farm worker does happen to be injured, I will be spared the unpleasant task of arresting them for a work safety breach. Any questions that I can answer myself or pass on to get you an answer from the experts?

And we can imagine a comparable town hall meeting of the Ambassador for Regulatory Affairs to a large corporation where various constituencies within the firm, and perhaps from without as well, are put on notice about the advisability of getting a compliance audit done on this or that.

The Strategy of Indirect Reciprocity

We turn now to theoretical developments in the concept of reciprocity to consider what we call the strategy of indirect reciprocity. Our argument here will be that even though Regulatory Ambassadors to corporations and small towns combined with regulatory surges elsewhere spread reciprocity thinly (albeit more widely and strategically than current practice), if surges are discharged with sufficient frequency and publicity, they may imbue indirect reciprocity in the compliance behavior of those not targeted by surges or ambassadors. The message of invincibility that an enforcement pyramid is intended to give is not learned mainly through the personal experience of being pushed up a pyramid by a regulator. It is also learned through efforts by regulators to educate a community that a regulatory pyramid exists. It is also learned by observing misfortune of others who escalate up pyramids during surges. Most of all, good responsive regulators use outside-in regulatory design (Braithwaite 2005, p. 156). This means the regulated industry participates in designing regulatory pyramids. Participation in the design and periodic re-design of regulatory pyramids is another path whereby leaders from the regulated community learn to play the game at the base of the pyramid, reducing the frequency and costs of iterated encounters at higher levels of the pyramid.

One idea here is that even when a social practice like diplomacy is transacted in one-shot interactions, those who have been socialized as diplomats learn habits of cooperation. That is, the diplomatic norm, even with enemies, is that cooperation is the normal response, with betrayal reserved as a response for exceptional circumstances where interests are seen as exceptionally profound. Diplomats mostly do not learn the norm that cooperation is normally the right response from iterated encounters in which they learn bad consequences of non-cooperation. Rather, they learn to be cooperative in their training. Secondly, because so many of the moves and counter-moves of diplomacy are publicly known, especially to insiders of the craft, diplomats learn from observing escalated iterated encounters experienced by other diplomats. They observe escalations to war even if in their personal experience they never encounter an escalation that leads to such a serious outcome.

Consider a more universal experience of learning norms of civility in reciprocity. Ken Polk's (1994) study of young men who experienced homicidal encounters with other men in Victoria, Australia, found that many of his homicides were male honor contests. One problem was that these young men had not learned basic scripts of civility that are engrained for most of us. They had not learned that if one accidentally bumps into another person, regardless of who is at fault, an appropriate script is "excuse me." Normal people do not learn these scripts from near escapes from escalated homicidal encounters. They learn them mostly from their families as habits acquired in socialization. Children frequently accidentally bump into adults, who are forgiving of the bumps (because they are children). But good parents seize upon the encounter to educate their child that they must apologize. They learn the habit of apologizing without understanding the life-preserving functions this fulfills. Later in life, they observe a male status contest in a club that starts from one young man abusing another after a bump and a spilt drink. Only then do they reflect on why their habit of automatically uttering an apologetic script is prudent. So socialization for civility is the first line of defense, observation of uncivil escalations of others is a second less important defense, and personal experience of uncivil bumps escalating to assault is the least important defense against being a victim of this kind of homicide.

Norbert Elias (2000) sees a long historical trajectory in such "civilizing" processes in the west. Diplomacy is central to that history. "Courtly" good manners arise first in the courts of kings and nobles in the Middle Ages. Before the rise of "courtesy," knights achieved their objectives through largely unregulated violence; unarmed citizens deferred to them out of fear. As state structures consolidated, however, even powerful knights learned to live in worlds surrounded by others capable of killing them. In the court, knights learned to avoid upsetting others by following courtesies of diverse kinds. These averted aggravation of others: from refraining from spitting on the floor during a meal, discarding a bone on the floor, blowing one's nose on the tablecloth. These forms of bad manners became shameful, though only if perpetrated in the gaze of other members of the aristocracy. All such things could be done in the presence of servants or the middle class. Even more shameful things such as masturbation in a bath could be done in the presence of servants until the eighteenth century (though this is a more controversial claim: see Braithwaite 1993, p. 4). But

from that point, according to Elias's documentary history of manners, shame democratized as an emotion. Shame evolved into a Victorian emotion that could be experienced by aristocrats for doing something shameful in the presence of the lower classes.

This was one of the ways that shame became a more powerful regulatory tool during the past 700 years of human history. At the end of this civilizing process, aristocrats ceased regulating members of lower classes by wearing a sword in public (Braithwaite 1993, p. 3; Shoemaker 2001, p. 205). Instead, members of the gentry learned that life was safer when both duels with other sword-wearing gentlemen were avoided and when abrasive encounters even with the lower orders of society were averted by habits of civility that became more universalized. At the end of this historical civilizing process, polite, cooperative encounters with others were favored over uncooperative, abusive ones first through habits of socialization for civility, only secondly through observation of how escalation could befall others and only thirdly through personal experiences of escalation to violence arising from one's own rudeness. Elias likened the court to a stock exchange where the *repute* of each 'courtier' was continuously being formed and assessed. Later, when the division of labor became more complex, those of high rank found themselves more dependent on the lowly, and so all of social life became an exchange where *repute* for civility was being formed and assessed. Technological change was also significant in Elias. In a 17th century world with little traffic, the aristocracy did not fear shameless rudeness to the lower orders as something that might trigger road rage. While we agree that Elias taps something sociologically fundamental about the long run democratization of shame and civility and its connection to today's low homicide rates compared to the Middle Ages, genocides remind us that there is no unidirectional inexorability or irreversibility about this.

Reciprocity is usually defined as a pattern of mutually contingent exchange between two or more players (Malinowski 1926; Gouldner 1960). This concept is fundamentally bilateral, basically a matter between two actors, even if there are more than two present. By expanding this bilateral concept to the broader context of regulation, we might advance a concrete strategy for Regulatory Ambassadors even with scarce resources, which encourages them to enhance relational iteration with

regulatees. The idea is to transform regulatory practice and institutions to render them structurally more focused on iterated encounters in the field with human beings, as opposed to say record review, partly because this facilitates relational learning and relational habits. We will argue that the image of the actively relational regulator induces cooperation from other members of the community with whom the regulator has had no encounters.

Many thinkers have hailed reciprocity as crucial glue that fosters human cooperation since Aristotle stressed its importance in building friendship and expelling civil conflict.¹ Cicero also asserted reciprocity was a duty indispensable in human relationships.² It was probably Gouldner (1960) who first, amongst modern thinkers, presented a systematic account of reciprocity. Criticizing functionalists' negligence in failing to develop a concrete definition of reciprocity despite its centrality in maintaining social equilibrium and cohesion, Gouldner suggested that reciprocity is at once a conditional (which he opposed, for example, to Christian notions of "turning the other cheek") and universal (as opposed to culturally contextual) norm, even if its specific form may vary according to time and space. A certain form of duty can be generated among people even without kinship or fellowship: a duty that people owe one another because of their prior interactions. This norm of reciprocity, once established, develops a beneficent cycle of mutual reinforcement because people involved in this cycle have internalized some general moral norm.

This concept of reciprocity based on previous encounters became more articulated as some economists and biologists sought to use formal modeling to explain the evolution of cooperation (Taylor 1976; Axelrod 1984; Boyd & Richerson 1988; Nowak & Sigmund 1992; Bowles & Gintis 2004). While Gouldner did not give a sufficient answer to why altruistic behavior comes out of egoistic motivations, these scholars sought to resolve that dilemma through what Gouldner called "an altruism in egoism, made possible through reciprocity" (Gouldner 1960, p. 173). For example, Axelrod argued reciprocity does not require us to assume conversation, trust or altruism between players, the presence of central authority or even their rationality, if there is an indefinite number of interactions between them (Axelrod 1984, pp. 173-174). In a Prisoner's Dilemma, people have incentives not to cooperate with each other in a single encounter because of the possibility that the other will take advantage

of this and defect. If the game is repeated indefinitely, however, then tit-for-tat, as revealed in Axelrod's famous computer tournament, tends to foster an evolution of cooperation.

While this reciprocity assumes that individuals repeatedly encounter a partner, theories of non-direct reciprocity have been proposed to accomplish the evolution of cooperation even without assuming indefinite bilateral encounters. Among them, Nowak and Sigmund's (1998) proposal of indirect reciprocity has a resonance to real world regulation especially where there is a large reciprocity deficit. In Nowak and Sigmund's influential article in *Nature*, they insist on a way of reaching cooperation without repeated encounters between two parties, using computer simulation on an N of 100 individuals. Indirect reciprocity is a newer theoretical framework based on acquaintanceship in which cooperation does not require the same two individuals ever to meet again. What matters here is an individual's image in the community as a civilized member of it. People are more inclined to cooperate with individuals who have helped others in the past, who present in encounters with habits of civility, even if they have not met them before. Consider the case of the Red Cross, which builds an image as an organization that assists victims of war from any side, unconditionally. This image protects the Red Cross from attack when they help victims from one side, even when they have not yet helped a victim from the other side. Nowak and Sigmund claim that indirect reciprocity works because cooperation "confers the image of a valuable community member to the cooperating individual" (1998, p. 573).

Two conditions may apply: first, iterated encounters must be common in a community, though not necessarily between the same individuals; second, it must be possible for a player to estimate the image score of the opponent (Nowak & Sigmund 1998, p. 576). It seems that iterated encounters are not necessary when indirect reciprocity exists in a situation where an individual is assigned to a partner for a single round and their decisions are observed by other community members (Fehr & Gächter 2002; Diekmann 2004; Ahn *et al.* 2009). Nevertheless, it is essential that iterated encounters occur somewhere in the regulatory landscape so that they are available to be observed, and thus individuals get opportunities to increase their image score and therefore "increase the chance of obtaining benefit in a future encounter as a recipient" (Nowak & Sigmund 1998, p. 576). Individuals and firms may not rely

mainly on an image score that has been built in the course of a specific regulatory encounter in the present, but in past encounters with that regulator on very different matters and with unrelated officials who may not even be regulators. Here comes our strategy of indirect reciprocity. The expectation that a regulatory surge could strike any member of a given community makes up for the absence of an iterated encounter in the present, even the absence of an actual future encounter.

A Regulatory Ambassador would strategically choose her target. By making the most crucial encounters more iterated, she can give a lesson to other potential regulatees that they are lucky to avoid regulatory investigation at this moment, but still subject to future escalation risks. This might be similar to the logic of why responsible citizens help a wife who is dominated by her husband or support a labor union fighting against an employer's domination (Pettit 1997), even though they are not subject to the domination in question. This is so because they think that some kind of domination may befall them. I may not be subject to the particular form of domination as far as I am not a wife or an employee, but I may in some other domain. This is why I take domination as an evil against which we should support one another. No human being is entirely exempt from the arbitrary interference of others in certain domains. This human vulnerability underwrites empathy that in turn underwrites civility. Cohen sees new governance scholars as envisioning an individual who "incorporates the limits of her knowledge into her comparative deliberations and decisions, to see how her choices reflect contingent and uncertain rather than stable or objective realities" (Cohen 2010, p. 370; see also Cohen 2008, pp. 527-529). Therefore, the strategy of indirect reciprocity should give a sense to others that they always need to build a civil reputation that will help them cope with the next uncertain encounter with a regulator. This is cooperation without future encounter, but with *risk of future encounter*.

The first element of indirect reciprocity (iterated encounters between others that can be observed) is closely related to a second element: to make the regulator's image so conspicuous that regulatees are persuaded to indirect reciprocation. This instructs Regulatory Ambassadors that, if regulation is to be successful, even where there is a large reciprocity deficit, they should incessantly promote an image and a practice of active relational engagement with regulatees. By building this kind of image in the community, a prudent regulator not only gives regulatees the sense that they are

subject to iterated escalation in regulatory surges at any time, but also utilizes the relationships and communication with regulatees to strengthen networks of reciprocity and social capital. This delivers the social capital benefits theorized by Robert Putnam as effects of generalized reciprocity (Putnam *et al.* 1993; Putnam 2000).

Putnam recognizes the importance of this indirect reciprocity if it becomes a norm when he explains social capital, even though he employs a slightly different term. Instead, he uses generalized reciprocity, when he says “even more valuable, however, is a norm of *generalized* reciprocity: I’ll do this for you without expecting anything specific back from you, in the confident expectation that someone else will do something for me down the road” (Putnam 2000, pp. 20-21).³ Though he adapts the norm of generalized reciprocity as a medium by which networks of civic engagement give rise to the emergence of social trust and social capital (Putnam 1995), the effects of this reciprocity have clear implications for responsive regulation: “A society that relies on generalized reciprocity is more efficient than a distrustful society, for the same reason that money is more efficient than barter. Honesty and trust lubricate the inevitable frictions of social life” (Putnam 2000, p. 135). In the era of regulatory capitalism, whether regulators build trust relationally or distrust through betrayal of responsiveness is a rather critical variable in the constitution of Putnam’s generalized reciprocity. Regulatory Ambassadors should prefer to get into the field and communicate with people as Venetian resident ambassadors did at the Holy See or at the court of the Holy Roman Empire, because by doing so, they can enhance the communication and intelligence, and at the same time, create the networks of relational regulation which would eventually become social capital assets. It is still true that the choice to cooperate or not is the regulatee’s, and even the strategy of indirect reciprocity cannot enforce their compliance. By employing this strategy, however, Regulatory Ambassadors can at least build up “a cultural template for future collaboration” in a world where reciprocity is a scarce resource (Putnam 1995, p. 67).

Conclusion

Cristie Ford’s (2011) critique of responsive regulation is that it can work with regulatory challenges of modest scale and complexity, such as factory inspection, partly because it is possible for iterated encounters between inspectors and factory

managers. However, responsive regulation struggles to secure scalability to problems where direct reciprocity is difficult because of large scale. Ford wonders whether more technological, less relational strategies may be in order to manage these scalability challenges. Braithwaite (2011) sought to respond to that critique by arguing that technological fixes can be a poor substitute for the relational regulation needed to confront big problems like global financial crises. We do not rejoin all those arguments here. We must add to them, however, the observation that diplomacy is a game of vast scale, conducted at the commanding heights of states and the UN and encompassing the whole globe. Even at the level of the diplomats with the most sweeping power, the President of the United States, the Secretary-General of the United Nations, the game is overwhelmingly played as a relational one. Players of the game enact a culture of civility with strangers, at least until there is a strong interest in being uncivil, because of the power of indirect reciprocity in diplomacy.

World leaders who are above assiduous relationship-building with friends and enemies alike come to be viewed as failed statesmen. President Sarkozy of France is a recent deposed leader whose image was not outstanding at relational diplomacy. When leaders come to believe that the scale of a particular problem, such as global terrorism, is such that relational diplomacy is best substituted by a miracle new regulatory technology, this is when their diplomacy is most likely to explode in their face. Drones are an example. Americans may come to believe this the day a drone screams a hell-fire missile into the Oval office. John and Robert Kennedy spurned relational diplomacy with their neighbor, Fidel Castro. They banned any contact of their citizens with his people and mounted assassination attempts against him and his brother Raul. Who knows the truth, but at least one possibility is Lyndon Johnson's view that this may have backfired: "Kennedy was trying to get Castro, but Castro got to him first" (Weiner 2007, p. 235).

Reciprocity deficits, like information deficits, political commitment deficits and other large challenges of regulatory capitalism cannot be fixed by any simple reconfiguration of the regulatory state. Nor is nihilism in order. The strength of the institutional redesign proposed here is that it might enhance the quality of regulatory conversations (Black 1998) at the center and at the periphery of capitalist societies. Regulatory ambassadors would not do much for the huge urban middle of small and

medium enterprises and people who work for them. That is the realm where regulatory surges and indirect reciprocity would have to do the work. Regulators can learn something from diplomats about the value of being seen, even at a distance at cocktail parties, in building indirect reciprocity. Yet we know that the capacity to deliver many surges is limited, even if we can economize on their use by deploying Ambassadors at both the commanding heights and the periphery of capitalism. And there are limits to the reach of indirect reciprocity without backup by enforcement surges. This backup is of course at the heart of the theory of responsive regulation. More than a sword is needed to achieve the objectives of the ruling classes of regulatory capitalism. Both the regulators and the regulatees who command the economy need civility that is not dependent on iterated encounters, yet that is secured by smoke curling from a benign big gun.

Many of us have had the experience of meeting diplomats at a cocktail party in which we are staggered by their ignorance about some aspect of the country in which they ply their craft. That is an inevitable hazard of relying on generalists. At the same time, the Global Financial Crisis was a warning that regulation has not worked well in the trust of specialists. Whether Ambassadors for Regulatory Affairs located in every one of those Wall Street, Irish, Icelandic, British, Greek and Spanish banks that caused so much grief could have reduced the damage is something we could only learn from future empirical experience with such an innovation. While our proposal is for a radical reconfiguration of regulatory institutions, it is one that lends itself to randomly assigning rural towns, large corporations and SMEs to receiving and not receiving an Ambassador for Regulatory Affairs. Then it would be possible to evaluate experimentally whether outcomes improved - from greenhouse gases released, workers injured, taxes collected, to streamlined regulatory compliance costs.

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Notes

1 For Aristotle, friendship, which is reciprocated good will, is something legislators should be concerned about if they aim to expel civil conflict and further concord in cities. He considers friendship is an essential element in holding cities together. See Aristotle (1999) Book VIII and IX, especially 1155a-b.

2 See Cicero (1991) Book I. "No duty is more necessary than that of requiring gratitude ... Whether we grant one or not is up to us. A good man, however, is not permitted to fail to return one (provided, of course, that he can do so without injustice)" (pp. 20-21).

3 It should be stressed that Putnam’s usage of the term “generalized reciprocity” has evolved. He defined generalized reciprocity, in his 1993 book, as opposed to balanced reciprocity, in that it refers to bilateral relations where “a continuing relationship of exchange ... involves mutual expectations that a benefit granted now should be repaid in the future” (Putnam et al. 1993, p. 172). Some biologists have also adapted generalized reciprocity when they explain the evolution of cooperation based on prior experiences, irrespective of the identity of their partners (Pfeiffer et al. 2005). Later Putnam uses this term in a similar way to our usage of indirect reciprocity.