

DYNAMICS OF RECIPROCAL REGULATION

*A thesis submitted for the degree of Doctor of Philosophy of
The Australian National University*

By

Seung-Hun Hong

School of Regulation and Global Governance (RegNet)

Canberra, ACT

October 2016

© Copyright by Seung-Hun Hong 2016
All Rights Reserved

Declaration

Unless otherwise indicated, this thesis is my own original work.

Seung-Hun Hong

24 October 2016

[90,978 words]

Acknowledgements

PhD supervision may be one of the most intensive forms of regulation. The supervisor is the main regulator, who has numerous iterated encounters with the candidate in order to achieve the regulatory objective: production of a quality PhD thesis. Other members of the academic supervisory committee work as networked collaborators who help achieve the objective. And the school, and broadly the university, offers a community where students and faculties work for the common goal of academic excellence, sometimes competing and more often collaborating one another. In this networked regulatory space, the PhD candidate learns how to meet the objective of writing a fine thesis and develops her knowledge and capability to be an independent scholar. In this sense, I was more than lucky to pursue my PhD research in Regulatory Institutions Network (RegNet) at the Australian National University. My thesis is not just a product of my PhD research conducted in RegNet. It is a product of what I have felt and learned from everyday intellectual life in RegNet.

John Braithwaite has been such a great mentor and effective supervisor one can ever imagine. Through numerous face-to-face discussions, he tirelessly engaged in every big and tiny progress I have made, posed challenges, and inspired me to find a way to address them. He pushed me to do a high dive with high difficulties. It was indeed after I experienced a series of iterated face-to-face encounters with him that I realized how closely regulation permeates every corner of our daily life and how effectively regulation can be designed to elicit compliance with its objectives. If this thesis could not meet the high standard of excellence, the entire responsibility should reside in me. My other academic committee members provided excellent advice throughout many stages of my PhD research, individually and collectively as a team. Peter Drahos gave me inspirational feedbacks that helped me bolster the weaknesses of my arguments. Jeroen van der Heijden and Jong-sung You read many drafts of every chapter and sharpened my understanding of previous literature and research methodology.

The intellectual soil for this research was cultivated during my MA and PhD studies at Korea University. I owe great intellectual debt to my mentors, Professors Nae-Young Lee, Byung-Kon Kim, and Jun-Hyeok Kwak. I would like to thank Valerie Braithwaite, Neil Gunningham, and Jennifer Llewellyn for reading earlier drafts of my thesis and

giving me excellent feedbacks. My PhD research has benefited enormously from participants at the 2014 Law and Society Association Annual Meeting, the 27th Society for the Advancement of Socio-Economics Annual Meeting, the 9th Biennial Conference of the Korean Studies Association of Australasia, ANU Korea Institute Graduate workshops, Drafts R US seminars and milestone seminars in RegNet. I would like to thank all the participants who listened to my presentations and gave me helpful comments, including Cynthia Banham, Michelle Burgis-Kasthala, Ksenia Chizhova, Fiona Haines, Elliot Posner, and Natasha Tusikov.

This thesis could not be possible without the participation of my informants. I would like to thank all the participants in Australia and South Korea for their contribution. I am grateful to the Australian Prudential Regulation Authority for arranging interviews with its frontline supervisors at Sydney and Melbourne offices. Generous grants from the Commonwealth Government of Australia, RegNet, ANU Korea Institute, and ANU College of Asia and the Pacific have made it possible for me to complete this thesis. I could especially take the benefit of a luxurious student life thanks to the prestigious Kapyong Commemorative Postgraduate Scholarship of the Australian Government. I would like to thank the Australian Government, RegNet, ANU College of Asia and the Pacific Alumni, and Professor Hyaeweol Choi for the generous support. I also thank my superb case managers at the Scope Global, Nicholas Perera and Rachel Tyne, for their excellent assistance.

I am especially grateful for friendship and intellectual companionship my colleagues and friends provided to me. Suzanne Akila, Shane Chalmers, Gye-won Jo, and Christoph Sperfeldt read part of my thesis and became continuing partners for discussion. Kamallesh Adhikari, Mamoun Alazab, Kate Macfarlane, Christopher Kim, Lino J. Kim, Kyusik Kim, and Wonkeun Chang all made the last four years of my life in Canberra a rich one. Jibaek Lee helped me tremendously when I conducted fieldwork in South Korea.

My most important and extensive debt is to my family. My parents, Jong-Lim Hong and Choon-Ji Hyun, have always been unchanged and enthusiastic supporters for my study. My wife, Eunjeong, has created a wonderful life for us in Canberra and has made innumerable sacrifices to give me time to work on this thesis. Our son, Keunhoo, and daughter, Janice, are endless sources of enjoyment and pride that have supported the long journey of my PhD research.

I hope this thesis becomes a humble contribution to our society I make in return for love and support I have received.

Seung-Hun Hong

Acton ACT, Australia

Abstract

Reciprocity pervades regulation more than meets the eye. This thesis examined how regulators' forbearance gives regulatees a chance to reciprocate with reforms or compliance. Compliance with laws or regulations is a reciprocal response to legitimate regulation. Compliance can also be a response to the observed compliance of fellow citizens. This is one aspect of indirect reciprocity, a concept that was developed theoretically as a key to successful regulation in this thesis. Reciprocity is also indirectly exercised when stakeholders in a wide regulatory space impose costly sanctions on irresponsible corporations after observing their histories of defiance.

How reciprocity emerges in regulation remains largely unexamined in the literature. Past analyses of the limits of reciprocity in regulation and responsive regulation have been flawed as they failed to consider a broad range of types of reciprocity. This thesis explored ways in which diverse types of reciprocity are harnessed in regulatory space and the effects they have on regulatory outcomes. As a theory-building project, this thesis sought to answer: How diverse are the types of reciprocity observed across a broad regulatory landscape? What are the dynamics by which reciprocity renders regulators as well as corporate and individual agents responsible? What systematic tools can redress the drawbacks immanent in some reciprocal relationships?

Theoretically, I explored ancient as well as contemporary thinking on the value of reciprocity in promoting responsible behavior. Classical republicans such as Aristotle and Cicero understood reciprocity as a measure of good governance. They valued the claim that reciprocity sustains solidarity among citizens and bonds between the ruler and the ruled. Contemporary scholars have suggested that diverse types of reciprocity exist. Reciprocity sometimes conveys substantive principles or involves a strong intention to trigger costly sanctions. Reciprocity also takes place in dispersed populations or in an indirect fashion. This means that we can arrange regulation to promote responsiveness and responsibility not only from regulatory agencies but also from regulated agents and social stakeholders.

Based on this theoretical underpinning, I elaborated on six reciprocal strategies that can be intentionally harnessed by agents involved in regulation to achieve their goals. Empirical case studies of Australian and South Korean prudential regulation illustrated how those strategies are deployed. Data were acquired primarily through interviews with

frontline supervisors of Australian and Korean prudential regulators. Regulators actively harnessed different types of reciprocity in encounters with regulated agents. Regulators indirectly signaled responsiveness to regulated agents they had never encountered before; they passed on information regarding compliance attitudes to other colleagues highlighting their responsibility for their regulatory tasks. At their best, institutions maintained transparent inter-organizational structures so as to minimize arbitrariness at the regulatory frontline. Non-intrusive ways of nudging regulatee's performance became a possibility. Two reciprocal strategies that were not fully supported in the data were projected in a discussion of recent Korean childcare regulatory reforms. The thesis mapped dynamics of reciprocal regulation in which agents directly and indirectly engaged with one another to engender the possibility of responsible regulatory governance.

Overall, this thesis revealed that in the Internet age of networked governance, responsible and responsive regulation is more possible than critics believed when they worried about scarce state resources for face-to-face regulatory inspection. On the other hand, reciprocal regulation has the power to be a cause of domination as well as a remedy for it. Resources for a principled responsible and responsive regulation were found in Philip Selznick's and Philip Pettit's work.

Table of Contents

1	RECIPROCITY ACROSS NETWORKED REGULATORY SPACE	1
1.1	Responsiveness: Regulatory and Democratic	4
2	METHODS AND SCOPE.....	11
PART I THEORY OF RECIPROCAL REGULATION		21
3	RECONSIDERING RESPONSIVENESS IN REGULATION	22
3.1	Selznick’s Institutional Responsiveness.....	24
3.2	Responsiveness: A Communitarian Virtue?	34
3.3	Conclusion.....	43
4	RECIPROCAL REGULATION.....	46
4.1	Classical Accounts of Reciprocity in Governing	48
4.2	Two Types of Direct Reciprocity in Regulation	55
4.3	Making Sense of Indirect Reciprocity in Regulation	70
4.4	Conclusion.....	81
5	STRATEGIES OF INDIRECT RECIPROCITY IN REGULATION	84
5.1	Overcoming Regulatory Resource Deficits.....	87
5.2	Rectifying Arbitrariness: Anti-corruption and Anti-capture.....	98
5.3	Nudge for Better Compliance	103
5.4	Conclusion.....	106
PART II PRACTICE OF RECIPROCAL REGULATION		109
6	RISK-BASED FINANCIAL REGULATION IN SOUTH KOREA.....	110
6.1	Supervisory System of FSS	112
6.2	On-site Supervisors Program	124
6.3	A Glimpse of Indirect Reciprocity.....	141
6.4	Conclusion.....	145
7	RECIPROCAL PRUDENTIAL REGULATION IN AUSTRALIA	149
7.1	Responsible Supervisors and Responsible Business	151
7.2	Nudge for Stimulating Reputational Competition.....	162
7.3	Indirect Reciprocity among Rotating Supervisors.....	164
7.4	Emergent Virtues of Internal Transparency	168
7.5	Conclusion.....	176

8 THE PROMISE OF INDIRECT RECIPROCAL REGULATION.....	179
8.1 Childcare regulation in South Korea: A Poorly Resourced Regulator	180
8.2 Interagency Cooperation across Regulatory Domains	184
8.3 Relational Regulation Utilizing Bottom-Up Contestation.....	189
8.4 Conclusion.....	193
9 CULTIVATING RESPONSIBLE REGULATION IN THE ERA OF NETWORKED GOVERNANCE	196
9.1 How Regulatory Communities Hold Agents Responsible	196
9.2 The Promise of Reciprocal Regulation	207
APPENDIX.....	215
REFERENCES	217

List of Figures

4.1 Direct vs. indirect reciprocity	73
4.2 Variants of indirect reciprocity based on reputation	74
5.1 Indirect signaling as a responsive regulator	90
5.2 Interagency cooperation for strategic targeting	94
5.3 Passing on compliance history between rotating inspectors	97
5.4 Overlapping networked rectification of arbitrariness	100
5.5 Indirect reciprocity mechanism underlying internal transparency	102
5.6 Nudge for stimulating healthy reputational competition	105
6.1 Frequency and duration of on-site supervision, 2001-2014	126
7.1 Indirect reciprocity mechanism underlying internal transparency	172
8.1 Indirect reciprocity strategy utilizing regulatee's compliance history	186
8.2 Indirect reciprocity exercised by societal actors	190
9.1 A web of responsibility underlying Australian prudential regulation	198

List of Tables

2.1 Overview of interviewees and their backgrounds	19
6.1 Summary of Korean financial regulators' Timely Corrective Measures imposed on financial firms	117
6.2 The number of financial institutions having on-site supervision by year	128

List of Abbreviations

AFC	The Asian Financial Crisis
APRA	The Australian Prudential Regulation Authority
ASIC	The Australian Securities and Investment Commission
ATO	The Australian Taxation Office
BAI	The Board of Audit and Inspection of Korea
BIS ratio	Bank of International Settlement capital adequacy ratio
CSR	Corporate Social Responsibility
DID	Diversified Institutions Division
EFSC Act	Act on the Establishment, etc. of Financial Services Commission
EFSO Act	Act on the Establishment, etc. of Financial Supervisory Organizations
FSA	The Financial Services Authority (UK)
FSC	The Financial Services Commission
FSS	The Financial Supervisory Service
GFC	the Global Financial Crisis
IMF	the International Monetary Fund
KRW	Korean Won
M&A	Merge and Acquisition
MHW	The Ministry of Health and Welfare
MOU	Memorandum of Understanding
MSB	Mutual Savings Bank
NCR ratio	Net Operating Capital ratio
NE	Nicomachean Ethics
NGO	Non-Governmental Organization
NO _x	Nitrogen Oxide
OCC	The Office of the Comptrollers of Currency
OSP	On-site Supervisors Program
P&A	Purchase and Acquisition
PAIRS	Probability and Impact Rating System
RBC ratio	Risk Based Capital solvency margin ratio
SID	Specialized Institutions Division
SIFI Act	Act on the Structural Improvement of the Financial Industry

SNS	Social Network Services
SOARS	Supervisory Oversight and Response System
TCM	Timely Corrective Measures
UK	The United Kingdom
US	The United States of America
USSR	The Union of Soviet Socialist Republic

Reciprocity across Networked Regulatory Space

Regulation is a craft (Sparrow 2000). Regulators, whether public or private, do not just apply rules and guidelines as though making spaghetti by following a cookbook or churning out smartphones as directed in a blueprint. Regulation is a craft that addresses many challenges contemporary governance faces: eliciting compliance in a less intrusive yet more effective way; finding cost-effective ways to cope with limited resources and overlapping regulations; identifying human and non-human risks and implementing remedies in the right places; and exploring unknown risks caused by changes in social as well as environmental circumstances and enhancing the social capacity to deal with them. In the sense that it tunes up various voices, desires, and human and non-human circumstances, often conflicting rather than converging, regulation is an art of steering the flow of events (Parker and Braithwaite 2003).

Thus conceived, responsiveness is an essential trait of regulation. Regulation should be crafted to respond to the demands of regulatees for fair enforcement, against unreasonableness in governance structures, industrial and surrounding contexts and changes in them, and voices of social stakeholders who may suffer arbitrary business and regulatory conduct. Regulation may be distinct from other functions of governance such as providing, allocating and re-distributing public goods (Braithwaite 2008). Regulation takes the key steering role in securing the resilience of governance. In this sense, regulation is an important steering subset of governance.

Considering the diverse challenges, accomplishment of regulatory responsiveness may be an overwhelmingly demanding task for regulators. This engenders the uneasiness felt by many students of regulation and governance, who criticize that the scope of responsive regulation, as Ayres and Braithwaite (1992) suggested, is too myopic to

address such challenges (Black and Baldwin 2010; Coslovsky 2011; Ford 2013; Grabosky 2013; Heimer 2011; Scott 2004). This thesis explores ways in which regulatory craft and responsiveness can be achieved in the era of networked governance. Pursuit of a regulatory craft is, however, by no means new in the study of regulation and governance; it is a rather common theme among Bardach and Kagan (1982), Ayres and Braithwaite (1992), Sparrow (2000), and many other studies. In reviewing these previous analyses of flexible regulation, I discerns that the analysis of the essence of regulatory responsiveness is conducted through the lens of reciprocity. If we look through this analytical lens, the uneasiness of regulatory scholars toward responsive regulation rests on its adoption of direct, tit-for-tat reciprocity¹ in envisioning regulatory responsiveness. Their analysis rarely considered extending the scope of responsiveness.

In his explanation of generalized reciprocity, Robert Putnam provides us with an example of a T-shirt slogan a fire department in Oregon used to draw public attention to its fundraiser: “Come to our breakfast, we’ll come to your fire” (Putnam 2000, 21). Reciprocity is normally envisioned in a dyadic relation whereby I will scratch your back if you scratch mine. But a return of some gift can be made without receiving goodwill previously, as Putnam alluded. Indeed details and ways in which a return is made vary. Reciprocity may convey substantive principles (Gutmann and Thompson 1996) or involve a strong intention to trigger costly sanctions toward non-cooperators (Bowles and Gintis 2004; Fehr et al. 2002; Gintis 2000; Kahan 2003). It can also be made in a dispersed population (Keohane 1986) or in an indirect fashion in multi-player environments (Berger 2011; Leimar and Hammerstein 2001; Nowak and Sigmund 1998; Putnam 2000; Sigmund 2012; Wedekind and Milinski 2000). In a nutshell, analyses of limits of reciprocity and responsive regulation require us to consider a broad range of types of reciprocity.

Reciprocity pervades regulation more than meets the eye. We often observe that regulators’ forbearance gives regulatees a chance to reciprocate with reform or compliance (Braithwaite and Hong 2015). Compliance with law or regulation is a reciprocal response to legitimate regulation as well as fellow citizens’ conformity. Reciprocity is also indirectly exercised by stakeholders across a wide regulatory space²

¹ Tit-for-tat is a strategy that an actor cooperates first and follows the opponent’s behavior in the previous round (Axelrod 1984).

² The metaphor of the regulatory state is used to point out that resources holding regulatory power and capacities are not restricted to formal state authority but include such informal authorities and capacities

who trigger costly sanctions toward an irresponsible corporate enterprise after observing its history of defiance. The essence of regulatory responsiveness consists in finding a balance among different sorts of reciprocal relationships. For example, perils of iterated regulator-regulatee encounters whereby the industry captures regulators can be offset by other indirect reciprocity mechanisms such as internal transparency (Chapter 7) and overlapping networked checks (Chapter 8). Inspectors strive to signal responsiveness both directly and indirectly to elicit compliance by making crucial encounters with regulatees more iterated and salient (Chapter 6). Cooperation among regulators sharing a regulatory space can be assigned to enhance not only direct reciprocity among regulatory agencies but also indirect reciprocity in a broader landscape (Chapter 8). What is at stake is to discover and utilize the operation of indirect reciprocity, which in many cases flows underneath direct reciprocal relationships. Then reformers will realize that the regulatory resources they can mobilize are far greater than what they have taken for granted.

Studies in regulation and governance have offered evidence that state regulatory institutions have been weakened or withdrawn from major roles in steering the flow of events (Braithwaite 2004; Crawford 2006; Gunningham and Grabosky 1998; Jordan et al. 2005; Parker 2007; Rhodes 1997; Scott 2004; Slaughter 2004). Many developing countries are unequipped with the regulatory capacity necessary for effective governance. For some countries rowing rather than steering may still be imperative to enhance their economic conditions. It has often been observed that developing countries face difficulties in utilizing limited resources to take a more active role in economic development while securing just regulation of exploitative ventures in society. Relying entirely on private regulators is seldom a remedy. Rather, this may result in the alienation of regulation from the common good due to the absence of mechanisms for holding them responsible and accountable.

Reciprocal regulation is about how to craft intelligently diverse reciprocal relationships that pervade a regulatory community. A reciprocal regulatory design can help cope with the challenges of regulatory responsiveness. This thesis explores the dynamics of regulation through reciprocity. Specifically, it examines ways in which various types of reciprocity are harnessed to enhance responsibility of different actors in

as industry codes of conduct, reputation, or information (Scott 2001; See also Parker and Braithwaite 2003). Throughout this thesis, I use this term to depict a sphere where multiple agents interact with each other both in a vertical manner including regulator-regulatee and principal-agent relationships and in a horizontal manner such as private agent relationships.

regulatory spaces. How diverse are the types of reciprocity observed in a broad regulatory landscape? What are the dynamics by which reciprocity renders regulators as well as corporate and individual agents responsible? What systematic tools can redress the drawbacks immanent in some reciprocal relationships? In the course of addressing these questions, I sought to refine how indirect reciprocity takes place into a set of strategies that can guide and direct regulatory reform.

1.1 Responsiveness: Regulatory and Democratic

Responsiveness has been one of the central themes in the study of regulation and governance since Ian Ayres and John Braithwaite's elaboration of it (1992) in seeking a third concept in the dichotomous regulation-deregulation debate ignited by the pro-business, anti-regulation turn in the 1980s. Since then, a number of regulatory agencies have adapted responsive regulation, in countries including Australia, Britain, Canada, Indonesia, New Zealand and the Netherlands (Braithwaite 2003b; Ivec and Braithwaite 2015; Murphy 2004; Wood et al. 2010). Responsive regulation proposes that the evolution of regulatory cooperation can take place if the regulator rewards the regulatee's successful compliance while sanctioning its failure to comply (Ayres and Braithwaite 1992). Being responsive, thus understood, is taken to be adopting a reciprocal, tit-for-tat approach to regulatory enforcement.³

The quest for regulatory responsiveness is one way of approaching responsive governance. Democratic theorists have also claimed the importance of responsiveness in representative democracy. Responsiveness is a crucial democratic credential that urges political office holders to continuously act in the interests of the people, not for their own (Dahl 1956; Erikson et al. 2002; Jacobs and Shapiro 2000; Page 1994; Pitkin 1967; Przeworski et al. 1999). Periodic elections do not guarantee that the conduct of elected officials serves the interests of the people. Once elected, representatives obtain delegation

³ Regulatory scholars usually conceive of Ayres and Braithwaite's responsive regulation (1992) as tit-for-tat enforcement in a dyadic regulator-regulatee relationship, notwithstanding its emphasis on third parties ('tripartism'). For example, see Black and Baldwin (2010), Ford (2013), Gunningham and Grabosky (1998), Gunningham and Johnstone (1999), Nielsen and Parker (2009), and Scott (2004). For a notable exception, see Heimer (2011). This is discussed in detail in Chapter 4.

to pursue policies at their discretion, which can affect millions of people's lives. Their performance can be evaluated and sanctioned by retrospective voting at the next election, but this *ex post* means cannot secure the operation of democracy between elections. Retrospective voting cannot ensure that elected governments do not interfere with people's lives on an arbitrary basis. Immediate checks on the elected officials' undertakings between elections become key for substantial democracy. Scholars have thus argued for acquiring responsive policymaking procedures (Baum 2011; Bignami 1999; Rose-Ackerman 2005) or policy responsiveness (Jacobs and Shapiro 1994; Hong 2007; O'Donnell 1994) which enable citizens to have a say over democratic government's implementation of particular policies. Being democratically responsive is a virtue not only required of those elected but also of unelected regulators or regulatory decision makers operating in democratic governments. This means that pursuit of regulatory responsiveness is likely to be more meaningfully responsive when advanced concurrently with democratic responsiveness.

This thesis is an attempt to reconcile these two distinctive and developing strains of scholarship. It is a journey of raising and addressing normative as well as practical questions on regulatory responsiveness: What does being responsive mean? Why should regulators be responsive? What should they be responsive to? How is this responsiveness implemented in regulatory practice? What are responsive regulatory arrangements like? And what are the regulatory strategies that can overcome the practical difficulties in its implementation? If we comprehend regulation as part of the governing of a society, then making regulation responsive in a democratic society is a way of achieving democratic responsiveness. The democratic ideal is that government should respond to the interests of the people not only when making decisions but also in implementing and enforcing decisions. An aim of this thesis was to put more conceptual flesh on these bare bones of the ideal of democratic responsiveness.

1.2 Reciprocal Regulation for the Evolution of Cooperation

Envisioning regulatory responsiveness in terms of reciprocity originates from the tradition of responsive regulation: the stream of research suggesting tit-for-tat as an effective regulatory strategy (Ayres and Braithwaite 1992; Burby and Paterson 1993; Harrison

1995; Nielsen and Parker 2009; Scholz 1984, 1991). This ‘responsive’ scholarship was largely inspired by developments in evolutionary game theory that took tit-for-tat as key to the evolution of cooperation (Axelrod and Hamilton 1981; Axelrod 1984). The indirect reciprocity literature has attempted to explicate the evolution of cooperation among multiple agents who have never met (Alexander 1987; Berger 2011; Leimar and Hammerstein 2001; Nowak and Sigmund 1998; Ohtsuki and Iwasa 2004, 2006; Sigmund 2012; Tullberg 2004; Wedekind and Milinski 2000). So does reciprocal regulation: strategies of indirect reciprocity are also designed to explain the evolution of regulatory cooperation. Indeed behaviors in reciprocal relationships are often assessed in a binary fashion of either cooperation or non-cooperation. Some may feel uneasy analyzing complex social phenomena in such simple terms. We need to discuss, before taking up a reciprocal approach to regulation, the meaning of cooperation or non-cooperation and whether these terms are appropriate or not.

When applying Robert Axelrod’s evolution of cooperation to regulation, John Scholz defined regulatory cooperation in a general, prisoners’ dilemma sense that “helps both individuals and enforcers to achieve higher utility in the long-run by abstaining from temptations to maximize short-term gains” (Scholz 1984, 181). This definition is consequentialist in a sense that the attribute of cooperation is determined by whether it contributes to achieving a long-term higher utility, and utilitarian in the sense that the actor’s interest is defined in terms of utility. However, this utilitarian consequentialism is not helpful for assessing actions and reactions in a reciprocal relation. One shortcoming is that it hardly helps us distinguish whether an act is cooperative or not. What is important in a reciprocal relation is that an actor’s behavior is perceived as cooperative or not by whoever responds to it. Even if the actor intends to cooperate, it is always possible that others do not perceive so: the actor’s intention may be miscommunicated or even undelivered due to external obstacles. Its long-term results and whether an action is deemed cooperative are rather matters for separate assessment. It is possible that a selfish act of a corporation turns out to serve both the short-term interests of the firm and the long-run communal interests. Similarly, an altruistic act can bring about a communally devastating result in the long-run. Then it is more plausible to argue that the definition of cooperation relies on the actor’s intention, more precisely other-regarding intention, rather than its long-term benefits in utility, suggested by Scholz. Some economists use “altruistic act” instead which invests some costs in the actor when explaining the evolution of prosocial behaviors (Bowles and Gintis 2004; Gintis 2000; Fehr et al. 2002).

As explained in Chapter 4, however, the gist of reciprocity is making “proportionate return.” This means that the point of analysis is not whether an action or reaction is cooperative or not, but whether a return is deemed proportionate to what has been received. Then what should be deemed proportionate return?

We can think of several attributes of proportionate return. First, whether a return is proportionate or not may differ from community to community. In a Melanesian community a pig can be given as compensation for offences such as murder and wife stealing (Luke 1962). An outsider would think that there is no equivalence between a pig and impunity for such severe wrongdoing. But for Melanesian people, the value of a pig is high, and counts as proportionate compensation. A regulatee’s reform, performance enhancement, or rectification of wrongdoing also denotes different proportionalities in reciprocating a regulator’s forbearance. Payment of a certain amount of fine for discharging effluent that causes environmental contamination may be perceived as proportionate in one jurisdiction, while not in another.

Second, proportionate return is sometimes calibrated in emotional reparation or symbolic reparation, not just rational calculation, as many restorative justice studies have found from interviewing victims. For example, a perpetrator proffers moral engagement with the community as a return for the forgiveness of wrongdoing (Ahmed and Braithwaite 2006). Researchers have suggested that emotional involvement in shaming (Ahmed et al. 2001; Braithwaite 1989; Harris 2006), praise (Makkai and Braithwaite 1993), or expressions of gratitude (Grant and Gino 2010) can facilitate regulatory compliance or prosocial behaviors. Expressing an apology for what was perpetrated or gratitude for what has been received is sometimes deemed a proportionate return, even without making physical repayment. Melissa Nobles’s work (2008) on the politics of official apologies is an important contribution to the emotional account of reciprocity. It suggested that the official apology for wrongdoing perpetrated by a past generation, more than monuments or proclamations, is essential in healing the victims’ agony and historical reconciliation.

1.3 Outline of the Thesis

Chapter 2 of this thesis clarifies methodological issues: the design, methods for data

collection, and methods for data analysis. The rest of thesis is divided into two parts. Part I advances a theoretical underpinning of reciprocal regulation while Part II explores empirical evidence of how reciprocal regulation functions (or fails to). More specifically, Chapter 3 discusses the idea of responsiveness endorsed in socio-legal studies, critically reviewing the works of Philip Selznick (Nonet and Selznick 1978; Selznick 1987, 1992). Many scholars of responsive regulation have noticed a link between their works and Selznick's idea of institutional responsiveness (Baldwin and Black 2008; Braithwaite 2006a; Heimer 2011; Parker 2008; Vincent-Jones 2002), though not all concur in his advocacy for the evolutionary stages of repressive, autonomous and responsive law (Braithwaite 2013). Selznick's conception of responsiveness is deeply involved in his proposal for the moral community. Thus it should be comprehended in conjunction with moral development for sustaining institutional integrity. Chapter 3 interprets his idea of institutional responsiveness as comprising three distinctive yet closely intertwined elements: being relational, comprehensive, and proactive. I point out, on the one hand, how much potential his idea has to encompass democratic self-government, and on the other hand, how closely it is involved with communitarian notions of the implicated self, in which personhood is deeply embedded in a given culture. I criticize this communitarian stance and instead suggest a neo-republican understanding of contingent selfhood for the epistemological foundation of reciprocal regulation.

Chapter 4 offers a theoretical framework for various ways of reciprocation observed in regulatory space, in which the idea of responsiveness is articulated in two dimensions of reciprocal regulation. Unlike most contemporary accounts of reciprocity that posit social exchange between equivalent agents, reciprocity in regulatory space features a distinct exchange between a legal or public authority and non-authorities operating under its jurisdiction (Axelrod 1984; Diekmann 2004; Fehr and Gächter 2000; Gutmann and Thompson 1996; Keohane 1986; Ostrom 1998; contra Becker 1986, especially ch.8). Considering this peculiarity, Chapter 4 starts with exploring philosophical accounts connecting reciprocity and political authority. Two ancient writers in the civic republican tradition, Aristotle and Cicero, are introduced as major proponents of reciprocity in achieving harmony and justice in a political community. Then two dimensions of reciprocal regulation are discussed: calculative versus empathic reciprocity and direct versus indirect reciprocity. Unlike calculative, tit-for-tat reciprocity that rests on the presumption of egoistic motivation, empathic reciprocity presumes self-interested, yet other-regarding, agents who care about their emotions and morality in relation to others.

The discussion of indirect reciprocity broadens our vision to take into account indirect reciprocal interactions among numerous actors in the regulatory space.

After diverse dimensions of reciprocity in regulation are articulated, then practical questions may arise: What are the regulatory strategies we can draw from the insights of reciprocal regulation? What are the advantages in using those strategies? To what extent can those insights make a difference to real world regulation? Chapter 5 seeks to provide an answer. It aims at identifying regulatory strategies leaning on indirect reciprocity so that actors involved in regulation can intentionally deploy them against one another to achieve their goals. Six strategies of indirect reciprocity are suggested: indirect signaling of responsiveness (Strategy 1); interagency cooperation for strategic targeting (Strategy 2); intra-agency cooperation between rotating inspectors (Strategy 3); overlapping networked rectification of arbitrariness (Strategy 4); internal transparency (Strategy 5); and stimulating reputational competition (Strategy 6). After all, this chapter bridges theoretical underpinnings of different types of reciprocity discussed in Part I with empirical research that is explored in Part II, by proposing models of reciprocal regulation that can be transformed into concrete regulatory policies and practices.

Chapters in Part II are devoted to exploring empirical evidence for the strategies of reciprocal regulation. Chapter 6 examines frontline supervision of the Financial Supervisory Service of Korea (FSS), with a focus on FSS's risk-based contingency program assigning supervisors to stay at a high-risk firm permanently: the On-site Supervisors Program (OSP). One reason for exploring this residential inspector program is that, as I argue, this program is a touchstone of the changing features of risk-based supervision in Korean financial regulation. Chapter 6 explores evidence showing that the Korean rules-based regime allows room for regulatory discretion to develop a more collaborative, principles-based supervisory practice in financial regulation. After providing a brief overview of the roots of the risk supervisory system of FSS and how this is confined to the rules-based legal regime, this chapter analyzes FSS's OSP through the lens of reciprocal regulation. On-site supervisors interact closely with people in financial enterprises, not just liaising across regulatory relationships but also actively preventing moral hazards and financial accidents committed by insiders, and even seeking ways of rehabilitating those entities. I examine the dynamics of reciprocal relationships, direct and indirect, in which on-site supervisors interact with diverse groups of people in regulated enterprises. In doing so, we can discover how those supervisors cope with the challenge of scarce regulatory resources in face-to-face iterated encounters (Strategy 1).

Chapter 7 examines the Australian Prudential Regulation Authority (APRA)'s principles-based approach to risk-based regulation, focusing on ways in which reciprocal interactions take place intra- as well as inter-organizationally at the regulatory frontline. When exploring APRA's frontline supervision in this chapter, we will discover that three strategies of indirect reciprocity suggested in Chapter 5 are harnessed in regulatory space to either nudge reputational competition among regulated entities (Strategy 6) or make up for the drawbacks of intimate dyadic regulator-regulatee relationships. This chapter suggests the way in which formal and informal intra-organizational structures and dynamics of APRA are arranged to address challenges involving the close regulatory relationship between frontline supervisors and regulated entities. And surprisingly, indirect reciprocity underlies two key functions of avoiding capture. The first function is involved in regular rotation of personnel (Strategy 3), which in many cases compromises productive regulatory cooperation at the cost of avoiding capture and corruption. The interview data suggest a way in which APRA's frontline supervisors rest on indirect reciprocity mechanisms when rotation of the designated supervisors takes place. The second APRA function to avoid capture is its internal transparency mechanisms (Strategy 5). APRA's intra-organizational structure and dynamics are transparently arranged internally so as to prevent discretionary powers vested with its frontline supervisors from frequently degenerating into regulatory capture. Indirect reciprocity is the underlying logic of internal transparency in which individual supervisors hold one another responsible in a proactive manner.

Chapter 8 discusses the possibility of the so far unexplored two strategies: interagency cooperation (Strategy 2) and overlapping networked rectification of arbitrariness (Strategy 4), with a focus on ways in which indirect reciprocity presents alternative arrangements that a poorly resourced regulator can adopt. Childcare regulation in South Korea is explored as a potential site in which strategies of indirect reciprocity can offer such alternatives. Recent reforms implemented by central and local regulators to cope with arbitrariness that is rampant in childcare regulation feature networked collaboration between state regulators and societal actors. Alternative institutional attempts have been proposed on the basis of indirect reciprocity which optimize regulatory resources for supervision and enable relational regulation of childcare service providers. Reflecting on these attempts for regulatory reconfiguration, I articulate regulatory strategies of indirect reciprocity that might enhance regulatory efficiency and redress injustice.

Methods and Scope

2.1 A Theory Building Project

This thesis is built around two research questions: What are the diverse types of reciprocity harnessed by actors in the regulatory space? And what are the different ways those actors use reciprocity in the space? An observation has led me to raise these questions. Surprisingly, the scope of reciprocity discussed in regulatory studies is too myopic to comprehend reciprocal relationships between different actors in the society, and in regulatory space, compared to developments in psychology, political science, economics, and evolutionary biology. This does not mean that regulatory scholars disregard the importance of reciprocity. Indeed they have empirically explored different ways reciprocal sanctions take place in regulation. And they have also found evidence of the effectiveness of those strategies. But no one focused to date on comprehending them under a coherent theory of reciprocity. The fragmented exploration of reciprocal relationships in regulation restrains the potentiality that harnessing various reciprocal strategies can contribute to coping with challenges contemporary governance encounters. This thesis purports to provide a holistic theoretical framework of reciprocity and subsequent strategies for researchers, policymakers, regulators, and stakeholders of regulation who wish to find a way to have regulation respond to their discontents. In this sense, this research is a theory building, rather than a theory testing, project of what I call reciprocal regulation.

This research is qualitative in nature. It explores the two main research questions in three stages. The first task is to identify types of reciprocity significant in regulation. The clue for the sort of reciprocity beyond tit-for-tat in a dyadic regulator-regulatee relationship can be drawn from the literature of responsive regulation. This is so because

the type of reciprocity that is central in its game-theoretic account is different from the one at the heart of the restorative justice account.¹ A hypothesis was set up to identify the attributes of this latter sort of direct reciprocity.

H₁: An inspector harnesses different types of reciprocity when confronting regulated entities with different levels of receptiveness.

A set of questions were asked in search of clues for traits of reciprocity beyond calculative, tit-for-tat reciprocity, the dominant way of envisioning reciprocity in regulatory studies. This is an inductive, not a deductive, process of exploring types of reciprocity in regulation. A form of forgiving reciprocity derived from the restorative justice account of responsive regulation could guide one direction. But no previous research enabled me to expect that the use of the same sort of reciprocity could be discoverable especially among Korean supervisors. This is so because they were old-timer inspectors familiar with command and control regulation² in the rules-based prescriptive legal regime in Korea.

Once different forms of direct reciprocity are identified, the next question is to explore what drives them to switch from one to another form of reciprocity in regulatory enforcement. The task in this stage is to examine on which occasions inspectors use this versus that type of reciprocity. A subsequent hypothesis is:

H₂: An inspector harnesses calculative reciprocity against defiant regulatees while pulling out a more substantive form of reciprocity against cooperative regulatees.

I could not fully explore this hypothesis out of two reasons. First, exploration of this

¹ Differences between these two accounts are the focal point of discussion in Chapter 4.

² Command and control regulation is defined as “legislatures have proscribed certain behavior and set up a regulatory agency to monitor and police compliance with the legal standards” (Gunningham and Grabosky 1998, 5). Normally command and control involves controlling industry behavior through the threat of negative sanctions (Sinclair 1997). Throughout this thesis, I use the term “command and control” interchangeably with traditional regulation or unilateral deterrence to indicate regulator-driven “inflexible and unilateral adoption of deterrence options” when enforcing law and regulation, considering that law is coercive in nature (Short 2012).

sort of hypothesis requires at least analyses of frequency or pattern of frontline inspectors with large-N data. But the number of interviewees in Korea fell far short of what was expected. Recruiting was the greatest challenge to the research on Korean prudential regulation. In Australia, it turned out that APRA ran separate enforcement teams that were likely to harness calculative reciprocity. Only a few APRA frontline supervisors I interviewed were involved in dealing with high-risk entities, for which Mandated Improvement or Restructure was in play. So this hypothesis could be explored only in a very limited way.

The two stages so far discussed are exploring reciprocity in a regulator-regulatee relationship. But this research does not restrain the scope of reciprocity in a dyadic relation. The next stage is focused on identifying the role of an indirect form of reciprocity in regulation. This stage involves two hypotheses. The first hypothesis was drawn from previous studies indicating the operation of indirect reciprocity in networked regulation: naming and shaming, social license, public reporting and so on.

H₃: Inspectors use reputation of regulated entities indirectly to elicit better regulatory outcomes.

It was anticipated that questions involved in this hypothesis could not reveal much the way indirect reciprocity took place. This was so because prudential regulators seldom publicize investigation or review results in order not to produce information affecting the stability of financial markets. Evidence of indirect reciprocity in prudential regulation was discovered unexpectedly in inspectors' answers to other questions about how regulators' discretion is controlled and how regulators cope with the challenges of limited regulatory resources. A supplementary hypothesis, thus, was set up after the data collection task was carried out.

H₄: Indirect reciprocity takes place to redress the shortcomings of direct reciprocal relationships.

Those four hypotheses were explored in a qualitative way in this thesis. And I refined ways in which indirect reciprocity takes place into six strategies that can guide directions for regulatory reform. These strategies are modeled in Chapter 5. Chapters in Part II seek to explore those hypotheses empirically. Before moving on to explaining the methods of

data collection and analysis, I briefly discuss why I selected the regulatory fields of prudential regulation and childcare regulation, and also South Korea and Australia as regulatory sites.

2.2 Case Selection

The empirical research was conducted in two fields: prudential regulation in South Korea and Australia and childcare regulation in Korea. Some may raise a doubt why I chose these two seemingly unrelated regulatory fields and jurisdictions. One thing that should be made clear is that the applicability of reciprocal regulation I develop theoretically in this thesis, though it draws on them, need not be limited to the field of prudential regulation and childcare regulation. The issues that arose in South Korea and Australia are also, according to the literature, factors in many different jurisdictions.

Cases were not randomly selected. The selection was deliberately targeted. Prudential regulation is a regulatory space where powerful regulators can interact with almost all regulatees. Large financial firms are so powerful that they may have sway over regulatory actions toward them. However the regulation of capitalist ventures in the financial sector is widely accepted. Now many see it as a norm, especially after the Global Financial Crisis (GFC). It is also true that there are a number of financial institutions for regulators to interact with. But it is fewer than in other fields, and more importantly, their head offices are geographically concentrated in finance quarters of inner cities. So direct iterated encounters are a common practice in prudential regulation (Kingsford-Smith 2011). Moreover prudential regulation represents a regulatory space where state intervention is a frequent and dominant method of regulation. Oversight information in an early stage of regulation is justified to keep in confidence between the regulator and regulated entities mainly because the provision of unrefined information may result in misperceptions and embarrassment in the financial market.

Compared to financial regulation in which strong regulators face strong and large financial institutions, the conditions of childcare regulation, especially in South Korea, feature a stark contrast: poorly resourced regulators with a number of small sized facilities to be regulated. Even those facilities are thinly diffused in a wider geographical terrain. Regulators find it hard to visit on-site to verify information from facilities and investigate on user complaints. So the challenges of regulatory resource deficits become even tougher.

This reveals how “variegated” regulatory capitalism even in one country can be (see Peck and Theodore 2007). The development of regulatory rules and mechanisms may be uneven by industries especially in rapidly industrialized countries like South Korea (see Zhang and Peck 2016). The major portion of fieldwork was conducted in prudential regulation, while childcare regulation in Korea was explored in a preliminary way to see how strategies of indirect reciprocity can be deployed to address challenges poorly resourced regulators in variegated capitalism encountered.

Prudential regulators in Korea and Australia also have more differences than similarities. The first difference is at the agency level. The Financial Supervisory Service of Korea (FSS) is an integrated regulator that oversees both financial conduct and prudential regulation, while the Australian Prudential Regulation Authority (APRA) is only responsible for prudential regulation of Australian financial markets. In Australia’s twin peak system, financial conduct regulation is the job of the Australian Securities and Investment Commission (ASIC). Second, a huge gap exists at the level of the legal system: APRA is vested with legislative functions whilst FSS is not. Consequently FSS’s power and authority are externally restrained by higher acts and rules enacted by the National Assembly or the administration. APRA, in contrast, enjoys more freedom and discretion. This difference may result in the divergence whereby FSS takes up a rules-based approach to risk-based regulation while APRA upholds a principles-based approach. The third difference is at the level of the capitalist state. In Korea, the government takes a significant role in economic planning and financial industry restructuring, as revealed in the recent reshuffling of the mutual savings bank (MSB) industry. This means that South Korea exemplifies “state capitalism” where state apparatus is still relatively stronger vis-à-vis business interests (Hutchcroft 1998, 20)³, or undergoing a transition from the developmental state to the regulatory state (Lee et al. 2002). Unlike South Korea, Australia is in the stage of the post-developmental state or the post-regulatory state where state regulatory institutions are withdrawn from the major role of steering the flow of events so they can be replaced by markets (Scott 2004). Those differences between the two jurisdictions denote the possibility for a comparative case study adopting “most different systems design” (Przeworski and Teune 1970, 34-9), though comparative case

³ Hutchcroft’s classification of capitalism rests on a Weberian presumption that the development of modern rational capitalism is largely dependent on the extent to which the bureaucracy can take apparatus vis-à-vis patrimonial forces.

study is not the main purpose of this research. The primary purpose is inductive theory development from diverse cases.

2.3 Data Collection and Analysis

The data were obtained using a series of in-depth interviews with frontline inspectors in FSS and APRA. And another series of interviews was also carried out with professionals in regulated entities, including labor union members, and policymakers in order to triangulate diverse views on the regulatory style of frontline inspectors. The validity of interview data is supplemented by a number of institutional-level data, including official documents that are accessible on the regulators' websites, external audits' and committees' reports and reviews, media reports, and unofficial internal documents I obtained through the process of government information release and with the cooperation of my informants. Interviews were based on an open-ended, semi-structured questionnaire (Flick 2002). English was used for the interviews conducted in Australia, Korean for interviews in South Korea. Considering subtle differences between Korean and Australian prudential supervisory systems, questions were adjusted to reflect the context.

At the beginning of each interview, I briefly explained the purpose of this research, whilst providing the interviewee with the information sheet and oral consent form. It clearly communicated upfront what I wanted to ask the interviewee, though details may differ from case to case. What was common included:

The theme of this research is to find out ways in which frontline supervisors (or on-site supervisors) have day-to-day interactions with people in the regulated entities. It is to look at various ways regulators harness reciprocity in their interaction with the regulatees. I guess regulators and regulatees are in different positions. Normally a regulator is given much stronger authority and power to enforce rules and principles and make some timely sanctions. In this asymmetrical power relationship, regulators sometimes bear the burdens of persuasion and education even though this cooperative move is not returned with immediate cooperation from the regulatee. My research explores different features of reciprocity regulators harness and the consequences on regulatory system and compliance. So please relax and seat back.

(To supervisors) I am here to listen to your stories, your experiences. Not an official answer.

(To industry people) I have been interviewing APRA (or FSS) supervisors. But it is also very important for me to hear the voices of the industry to get a balanced view. As you know there might be different interpretations even on the same fact.

Having this kind of conversation at the beginning of an interview was important for communicating what the researcher expected to get from the interviewee. The terms, such as responsiveness or reciprocity, were academic terms which my interviewees, not just professionals in regulated entities but also supervisors in regulatory agencies, may find unfamiliar. Most of my interviewees were unsure what I wanted to get from them when I said the title of my research, but once they understood what I was after, by listening to the first paragraph above, they started to nod and talked about their experience.

Interviews were normally conducted in informants' office hours in a meeting room or an open space, such as public café or park. No other person was present. Making interviewees as comfortable as possible was critical in getting candid stories, especially because the questionnaire was designed to draw out what the interviewees had individually experienced in their everyday business when encountering or conducting frontline supervision. The key was never giving them pressure as if they were getting interviewed: putting them in a more relaxed, engaging conversation. They already came with some pressures in their mind either because they might think of the scandals in which on-site supervisors had been involved or because their interviews were arranged in a top-down fashion through an executive office. So it was of my prime concerns to make them feel like they were having a chat with somebody who wished to learn from them. One method was to make them feel that the researcher was sharing the interviewee's sentiments about the importance of their work so that the interviewee was willing to tell his or her stories.

The following is the original questionnaire used in interviews. Some questions were excluded, as an answer to those questions became no longer necessary. Sometimes I followed a different sequence of questions from that which set out here, because interviews were carried out in a responsive way, following the flow of conversation.

Category 1. Regulation in General

1. Could you explain the regulatory strategy of your institution and your role in it?
2. How do you select a target for regulatory encounter?
3. What is the regulatory process after a target is selected?

Category 2. Regulatory Styles

4. Could you please tell me about your regulatory style?
 - 4.1 What did you do if the regulatee turned out to have willingness to comply?
 - 4.2 What did you do if the regulatee turned out to be a laggard rather than a leader?
5. Is there a safeguard to prevent discretionary power from capture or corruption?

Category 3. Reciprocity & Trust

6. What is your method of building trust with the regulatee? Could you give me an example?
7. Are there enough human resources in your institution to cover the whole range of regulatory affairs?
 - 7.1 If so, could you explain how they work?
 - 7.2 If not, what are your institutions methods to make up for it?
8. Given then range of discretion, what is your institution's method of preventing capture?
9. How do you share your regulatory experience with your colleagues?
10. Do you intend to let other firms (or businesses) be aware of the supervisory results?

Category 4. Difficulties of Regulation

11. What are the most difficult things when you do the regulation?
 - 11.1 How do you attempt to cope with these problems?

As displayed in Table 2.1, the number of interviews for prudential regulation reached sixty. This breaks into twenty-three interviews in South Korea, including nine interviews with FSS's frontline supervisors, and thirty-seven interviews in Australia that include thirty-one interviews with APRA's frontline supervisors. Five individual interviews were conducted for the case study of childcare regulation in South Korea, two with policymakers of the Ministry of Health & Welfare and three with frontline inspectors of the Seoul Metropolitan Government.

In South Korea, the individual level data were acquired via snowball sampling (Goodman 1961; Salganik and Heckathorn 2004). Before carrying out field research, I collected institutional level data to get information on the operation of the On-site Supervisor Program (OSP). Secondary documents collected include: internal guidelines,

TABLE 2.1 Overview of interviewees and their backgrounds

	Prudential regulation		Childcare regulation	Total
	South Korea	Australia	South Korea	
Frontline supervisors (on-site supervisors)	9 (4)	31	3	43
Policymakers	5	1	2	8
Professionals in regulated entities	9	5	0	14
Total	23	37	5	65

casebooks, newspaper articles, official institutional reports publicly released by FSS, and judicial judgments on the cases of on-site supervisors' capture.

The field research primarily involved interviews with FSS frontline supervisors in the (Non-) Life Insurance Investigation Department and Mutual Savings Bank Investigation Department. The interviews were carried out in 2012 and 2013 in an informal way while having a coffee or tea, in order to grant the interviewees a comfortable environment to chat freely. Recruitment of participants constituted the biggest challenge to the Korean field research. Since 2009 the real estate market has been in a slump, and as a result, developers had to default on loans for construction projects, which caused shutting down sixteen MSBs only in 2011. These shutdowns sparked nationwide probes into the management of MSBs and the role of on-site supervisors, leading to the indictment of more than one hundred people. At the center of this scandal was a malfunction of FSSs supervisory system.⁴ Partly due to stress associated with this scandal, some present and former supervisors did not agree to my interview requests. As revealed in Table 2.1, only four on-site supervisors were interviewed. Thus I chose as an alternative to interview other FSS frontline supervisors (five people), officials in regulated entities who have experience of dealing with on-site supervisors (nine people), and also policymakers who are familiar with the operation of OSP (five people).

The field research in Australia ran much more smoothly. I interviewed thirty-one APRA frontline supervisors, one policymaker and five senior professionals in Australian private financial corporations. Interviewees in APRA were carried out with frontline supervisors of diverse rank—from graduate analysts to general managers. Participants

⁴ Details of this scandal are illustrated in Subsection 6.2.1 in a lengthy way.

were selected by APRA and financial institutions according to availability, as a response to my requests to conduct interviews with APRA's frontline supervisors and officers who had worked with them.⁵ The primary concern when conducting an interview was to make the interviewees as comfortable as possible. This was crucial in eliciting their candid opinions and stories because an executive office scheduled interviews, at APRA's Sydney and Melbourne offices. Interviews with senior executives in Australian financial firms, up to the level of the CEO of one of the largest banks in the world, were completed to permit triangulation on certain questions from the other side of the regulatory encounter, rather than relying only on what APRA people said. External review reports and media reports were also garnered to get the balance.

I analyzed the data using an iterated adjustment method (Parker 1999, 2002). This involved both open and axial coding (Strauss 1987; Strauss and Corbin 1990). First of all, I disaggregated core themes and concepts to be addressed in the research into a set of related codes, with reference to previous literature. The next step was to divide interview data into small pieces and compare one another to classify them in different categories. It was a process of iterated adjustment because I conducted this task of open coding until all materials were taken into account. Those categories drawn from the data were then compared to key theoretical concepts and codes I drew from existing published research on regulation and reciprocity, being subject to further adjustment. Through this iterative process, the analysis of conceptual categories developed from interviewees' description of their work practices was put together with key concepts in interaction with previous regulatory literatures. NVivo software was used throughout this process of qualitative data analysis.

⁵ I must note that recruiting in Australia was successful thanks to my supervisor Professor John Braithwaite. He was tremendously helpful in bridging the participant recruiting channel through the APRA executive office.

PART I

THEORY OF
RECIPROCAL REGULATION

Reconsidering Responsiveness in Regulation

As many regulatory scholars draw on responsive regulation, the concept of institutional responsiveness is placed at the heart of their scholarly concerns. Commentators of responsive regulation have expressed that the notion of responsiveness draws upon Philip Selznick's idea of institutional responsiveness (Baldwin and Black 2008; Braithwaite 2006a; Heimer 2011; Parker 2008; Vincent-Jones 2002). However its communitarian character, in which an institutional self is deeply implicated in the social context and thus held responsible for its surroundings, has been much neglected or poorly explained in the regulatory literature on Selznick.

Understanding the communitarian feature of Selznick's conception of responsiveness becomes especially important when we focus on his proposal for responsiveness as a way of being responsible. This is so because the communitarian idea of the implicated self bridges these two notions (Selznick 1987, 1992). Selznick's understanding of selfhood explains why responsiveness is deeply involved in responsibility. For Selznick, it is natural that a person or an institution bears responsibility for the community it belongs to. Just as a parent is responsible for the wellbeing of the family and a citizen is asked to contribute to the prosperity of the country, an institution holds responsibility for the community it sits in. Based on this premise, Selznick argues that institutional responsiveness is an essential element of institutional responsibility. Therefore making an argument resting on Selznick's idea of institutional responsiveness is taking up this communitarian justification that an institution should be responsive because it is destined to fulfill the responsibility in the social context.

This chapter shows that responsiveness holds a key to reciprocal regulation and reciprocity to responsiveness. It argues that while Selznick builds a rich edifice for

understanding responsiveness, his communitarian responsiveness cannot adequately ground regulatory reciprocity. To achieve that, this chapter proposes that one productive move is to the methodological individualism of Philip Pettit's neo-Republican theory. The chapter creates a hybrid of Selznick's responsiveness and responsibility and Pettit's republican non-domination that can ground principled reciprocity. In doing so, this chapter reconsiders the concept of institutional responsiveness, articulating it as a virtue an agent may contingently choose, rather than a destined duty it has to fulfill in the social context. The first section explains the way Selznick proposes institutional responsiveness in the course of making a case for institutional integrity and responsibility. It sheds light on three elements that constitute Selznick's conception of responsiveness—being relational, comprehensive, and proactive. The second section discusses communitarian liberalism that underlies Selznick's proposals and their limits. I introduce a distinctive epistemological stance of methodological individualism proposed by Philip Pettit as an alternative ground on which to link responsiveness with responsibility. A central question is: Does this open up a more fertile path to a theory of reciprocity?

This chapter is an important cornerstone for the entire thesis. The thesis argues that institutional responsiveness contributes to responsibility of not only the institution but also stakeholders. The rest of this thesis, thus, is committed to providing ways in which responsiveness materializes to enhance responsibility of stakeholders involved in regulation. Direct and indirect reciprocal interactions taking place at the regulatory frontline will be found to be paths to responsiveness and responsibility. As revealed in this chapter, the theoretical premise of Selznick's case for responsiveness is strikingly occupied by a macro-level institutional approach. Ways in which individual members of an institution struggle to achieve responsiveness of that institution are not in focus at this macro level. Considering that responsive practices of individual actors in the institution constitute the possibility of institutional responsiveness, we need an approach to responsive institutions that drops the level of analysis down to the practice of individual members in order to comprehend macro level institutional responsiveness. In this vein, this chapter provides an alternative conceptual framework that is more individualistic, yet still vindicates important virtues Selznick proposes: responsiveness and responsibility. The methodological individualism of Pettit can provide a theoretical ground on which reciprocal interactions between various individual actors at the regulatory frontline constitute the character of responsive regulation. Through this individualist turn we are able to show that the effects of institutional responsiveness are broadened to enhance not

only the responsibility of responsive institutions, but also that of various stakeholders who participate in the given regulation in the era of networked governance.

3.1 Selznick's Institutional Responsiveness

Selznick did not provide a lucid definition of institutional responsiveness in one sentence. Therefore understanding what he meant by institutional responsiveness requires us to draw on related concepts in his writings. He found unsatisfactory the instrumentalist drive in studies of law and society. For Selznick, researchers' concerns lay in institutional efficiency and effectiveness rather than its aims, leaving some important questions unanswered: such as, "are the postulated ends worth pursuing?" or "are the institution's values worthy of realization" (Selznick 1992, 321)? These questions are critical in understanding the social obligations a person or institution bears in its relationships with other members of the community. And the major virtue testing this moral character is integrity, said Selznick.

There are two pillars sustaining institutional integrity in Selznick's institutional theory. The first pillar is internal moral development. An institution, whether it is public or private, makes a principled decision "if it is guided by a coherent conception of institutional morality, that is, of appropriate ends and means" (Selznick 1992, 323). This implies that the institution with integrity is capable of setting up appropriate ends and also finding means to achieve them. Thus striving for institutional integrity is a continuous process of self-defining the principles: the institution needs to keep addressing what its direction is, what its principles are to go forward in that direction, and whether this process "squares with the claims of morality" (Selznick 1992, 322).

Given that the task of defining principles and means to achieve them lies primarily in the hands of the institution itself, institutional autonomy becomes a prerequisite for internal moral development. Yet what Selznick argues for is institutional semi-autonomy, rather than sheer institutional autonomy. This is so because a threat to the institution's internal moral development may be posed internally as well as externally. On the one hand, institutional integrity needs room to develop an internal morality insulated from external pressures: an institution needs some distance from external society not to be swayed by factional interests. Selznick worried about external influences that jeopardize

institutional integrity.¹ Instead he suggested checks and balances as a way of guarding against domination of factional interests, like the American Founding Fathers put forward in *The Federalist Papers*.² As “ambition must be made to counteract ambition” (Hamilton et al. 2000, 337), Selznick could argue that “[a]utonomy in the service of countervailing power is essential wherever freedom is at stake – in the structure of society as well as of government ... Autonomy is necessary, not only for freedom, but for the protection of other fragile or vulnerable values; and often for efficiency and effectiveness as well” (1992, 335).³

We can easily observe real-world cases in which external pressure promotes institutional integrity and also cases that show its flip side. One example of the negative role of external forces was Asian Financial Crisis in the late 1990s. Crony capitalism or governmental involvement in the financial sector led by blatant patronage between the political regime and major industries was one of the main factors that brought about serious damage to the financial integrity of many Asian economies (Haggard 2000; Kang 2002; Pempel 1999). In authoritarian societies where political manipulation hampered autonomy of the judiciary, judicial independence or insulation from external pressures would have enabled the legal process not to be swung by caprices of dictator or dominant groups.⁴

A counterbalancing example of successful management of institutional autonomy may be found in 21st century Australian prudential regulation. The Australian Prudential

¹ As is clearer in the following discussion, for Selznick, outreach is also a source of vitality for the institution. This means that he recognized the positive side of external influences. Therefore it may be more precise to demonstrate that external influences are a hazard to institutional autonomy for Selznick, rather than institutional integrity. But want of institutional autonomy eventually jeopardizes institutional integrity. Selznick was particularly insistent on vigilance against an institution being captured by factional interests.

² What is distinctive in Selznick’s use of checks and balances is that the device is proposed as a means to sustain institutional autonomy and competence rather than working as an external counterbalancing force to the arbitrary operation of an institution. See Selznick (1992, 334-6)

³ Note that Selznick mentions the separation of powers instead of checks and balances when quoting no. 51 of *The Federalist*. But what the original author, presumably James Madison, proposes in this part is not just that the power should be separated and distributed to different parts. Rather, he stresses, after dividing several offices, the importance of arranging them “in such a manner as that each may be a check on the other.” See Hamilton *et al.* (2000) no. 51.

⁴ Judicial independence is widely regarded as a minimal, though not sufficient, requirement of impartial rule of law. See Helmke and Rosenbluth (2009), O’donnell (2004), and Waldron (2008).

Regulation Authority (APRA) is endowed with broad discretionary power for conduct that is necessary for performing its functions, as APRA Act denotes: “APRA has power to do anything that is necessary or convenient to be done for or in connection with the performance of its functions.”⁵ Unambiguously this is rather untrammelled institutional autonomy without sufficient checks and balances from other institutions. This allows APRA broad discretion to use its resources as it sees fit without being subject to external political pressures or influences. Thus APRA could set up prudential standards and guidance that it considers necessary to protect the interests of financial beneficiaries, promote the stability of financial system, and develop its professionalism to enhance institutional integrity (see also Black 2006).

Nevertheless, insulation from external pressure is insufficient to the promotion of institutional integrity. As much as an institution needs autonomy from external pressure, it is required to cope with internal failure for developing an internal morality. Indeed the proposition for institutional autonomy stands as long as an institution successfully develops integrity. We often observe that autonomous institutions are incapable of cultivating or even sustaining internal morality. They may fail to set up the proper ends or means or keep up institutional competence on their own, degenerating into irresponsibility. The failures might be ascribed to the lack of professionalism in the case of APRA dealing with the collapse of HIH insurance group⁶ or moral hazards in a series of scandals of Korean financial regulators responsible for prudential oversight over MSBs. These internal failures call for other means to secure the resilience of institutional integrity, notwithstanding the ongoing internal effort to improve it: institutional outreach.⁷ Selznick argued that “if [institutions] fail to understand the true part they play in the life of the community, ... the claim to autonomy has a hollow ring” (1992, 336). In order for an institution not to lose touch with reality, it is required to take into account “new problems, new forces in the environment, new demands, and expectations” (1992, 336). This claim is articulated into the second pillar of institutional integrity: responsiveness.

These two pillars seem to be in conflict with each other since internal moral development requires insulation from external influence according to Selznick while

⁵ See APRA Act 1998 Section 11 (1).

⁶ According to the Palmer report, “[The team assigned to HIH] was under-qualified to supervise a major general insurance group, particularly one as complex, financially weak and poorly managed as HIH was ultimately revealed to be” (Palmer 2002, 83).

⁷ Ways of securing the resilience of institutional integrity is more discussed in Section 3.2.

responsiveness encompasses external outreach. Selznick's answer to this dilemma is implied in his distinctive understanding of the idea of responsiveness. The process of seeking the institution's ends and means is not just an internal task. It is an iterative, reflexive process of setting up ends that square with the claims of changing morality of the society and finding out the best practice of realizing them. The task of getting the best practice may be sought internally, but that of setting what its direction is and whether this direction meets its obligations to the community requires external reflection. In this way institutional responsiveness becomes an essential element of institutional responsibility. In what follows, I explore three features of institutional responsiveness of Selznick and how these are related to institutional responsibility: first, being relational to stakeholders and the community an institution is involved in; second, being comprehensive as it seeks reflexive modification of the established institutional standards; and third, being proactive to take up unexpressed or muted interests.

3.1.1 Responsiveness as being relational

For Selznick, implementing the three features of institutional responsiveness is the way an institution fulfills its purpose in the society and thus becomes responsible. What makes this idea most distinctive is his unique understanding of responsiveness as a relational, destined duty, which is based on his understanding of selfhood. Therefore relatedness is the first key attribute of institutional responsiveness that leads an institution to be responsible.

Selznick pointed out that “responsibility runs to an institutional self or identity; to those upon whom the institution depends; and to the community whose well-being it affects” (1992, 338).⁸ In other words, responsibility is not confined to oneself; it reaches beyond the boundaries of selfhood and extends to what surrounds it. This implies that an agent or institution is not an atomic self that exists independently of the society. Rather, a self is deeply implicated in a particular context.

If we ask for what and to whom we are responsible, the answer must depend to a large

⁸ It should be clear here that the distinction between individual and collective responsibility blurs in Selznick. For Selznick, not only a person but also an institution is a socially implicated self, therefore an agent who bears social responsibility. This will be further discussed in Subsection 3.2.2.

extent on a personal history and on a recognition of how we directly affect the lives and situations of others. These effects flow from our presence and from our actions, but not necessarily from explicit choices. Responsibility presumes choice, but not unconditioned choice. We choose from among limited options and *what* we have chosen is not truly known until the consequences appear. Parents are responsible for the children they have, not for those they might have liked to have or only for those they chose to have. A morality of the implicated self builds on the understanding that our deepest and most important obligations flow from identity and relatedness, rather than from consent (Selznick 1987, 451; emphasis original).

This paragraph represents his discontent about the liberal's preoccupation with rights and individual choice.⁹ Selznick attempted to make a case for the obligation an agent bears in broad relationships as a social being. For Selznick, what is important in one's identity is relatedness, not individual autonomy. It is not constituted by something she has chosen in her life, because her identity cannot be entirely defined by a series of choices she has made so far: sometimes and more fundamentally it is affected by circumstances not chosen, such as membership in her family and community. Thus personal choice is not the sole factor incurring responsibility for Selznick. Moreover responsibility is sometimes not confined by the fact that one has been given options to choose. Whether your possession or enjoyment is a result of your explicit choice or not does not affect your responsibility for it.¹⁰ As Selznick explained in the above paragraph, what is more important in determining responsibility for your possession is the consequence that you *have* something, regardless of whether you have been given options to opt for one or another. And there are various social factors that have affected that consequence. This is apparent in Selznick's argument for inheriting responsibility, when he said, "people who are nourished by a community, and 'accept' what they never dreamed of choosing, have no standing to deny at least some responsibility for what the community is and what it has done" (Selznick 1987, 453). It is justified that the current generation is responsible for wrongdoings its past generations have committed even though choices—explicit or

⁹ Selznick explicitly claimed that rights are only "derivative and secondary" (1987, 454). He was discontented with the liberal doctrine of individual choice in that respect. For Selznick, diversity that prioritizes individual choice may be easily transited to subjectivism in which every individual's value deserves respect or values are posited to be relative according to times and places.

¹⁰ This is discussed further in Subsection 3.2.1.

implicit—are not given to the current generation.¹¹ This implies that what incurs responsibility is not individual choice or consent, but the consequence as it is historically constructed. Therefore, if we accept that our identity is the result of historical construction in relation to others and the well-being we have enjoyed is largely dependent upon unchosen factors, then our responsibility runs not only to our own self, but to wider communities.

Having said that, a way of being responsible is openness and outreach: being responsive. By reaching out to others, a person or an institution can revise established structures, rules, methods, and policies in accordance with the changing values of the society. This is the process of reconstructing the self, as Selznick implied in describing the history of US universities responding to social demands for more diversity in higher education (1992). A public education provider, whether public or private, is responsible for developing established ends and means and also responding to the common good of the society. In doing so, the established values are subject to continuous revision as they respond to changing moralities of the society. Thus Selznick’s idea of institutional responsiveness is dynamic. An institutional actor would lose the vitality of responsiveness if it were content with its present position. Institutional autonomy is only justified as long as institutional actors incessantly strive to be responsive. Being responsive is not just a way of being responsible: it is an essential element of responsibility.

3.1.2 Responsiveness as Being Comprehensive

Once it is upheld that an institution *should* be responsive to the broader community to be responsible, the next question is *to whom* it should be responsive. One bottom line Selznick suggested is being responsive “to those upon whom the institution depends; and to the community whose well-being it affects” (1992, 338).¹² However, this claim is prone to encounter a practical problem of defining the extent to which agents are mutually dependent upon one another. How far should we track factors to determine if they affect someone’s current wellbeing?

¹¹ For similar arguments from a communitarian perspective, see Miller (2007) and Butt (2009).

¹² This is commensurable to the question that *to what* an institution should be responsive. For example, environmental regulators need to be responsive to rising temperature of the planet, prudential regulators to a plunge in liquidity.

Selznick distinguished responsiveness from opportunistic adaptation and capitulation to pressure. He regarded opportunism as the most pervasive cause of institutional debasement (Selznick 1992, 249). This implies that a responsive institution is not only responsive to comprehensive social interests but also the subject of the responsive practice. Selznick's research (1949) on the Tennessee Valley Authority (TVA) pointed out the perils of selective responsiveness. The TVA was established in the era of the Great Depression as a public enterprise that built multipurpose dams on the Tennessee river to improve navigation and flood control, produce cheap electric power, bring jobs to the people of adjacent states, and eventually develop the natural resources of the river "for the general social and economic welfare of the Nation" (Selznick 1992, 339). Notwithstanding its expected local contributions, the TVA was an autonomous federal agency that would not be accountable at the local level. One strategy for the TVA in its early period was taking the posture of grass roots democracy to defend its managerial autonomy. However, the TVA could only take into account the interests of powerful groups that were relatively prosperous in the local community and take advantage of using them as guardians against political pressures. This, Selznick argues, facilitated the technocratic turn of TVA officials: they failed to respond to "nontechnocratic criticisms, which brings to bear values, interests, and perspectives beyond those of engineering and economic analysis; and it sacrifices the integrity of the institution by constraining its mission and narrowing its responsibilities" (1992, 340).

TVA is a typical case in which an autonomous institution deteriorated into an irresponsible one as it took up partial interests opportunistically. Capitulation to pressure from narrow interests is endemic in modern representative government. In the era of political marketing and mass media, everyday performance of democratic government becomes transparent and directly available to the electorate. As a result, the risk of pushing forward public policies for the sake of political elites' own interests has significantly increased. This feature of audience democracy sometimes attracts representatives to make populist, rather than principled, decisions favored by public opinion, or at least to be seen to, in order to increase the possibility of re-election or reappointment (Arditi 2005; Manin 1997). Similarly sentencing policy may be largely affected by pandering politicians who strive to make noise about socially repugnant crimes to bandwagon public passion and garner support in the media (Pettit 2004).

One common feature of these metamorphoses of responsive institutions is that they are embroiled in factional conflicts or short-term demands of political officeholders. They

make a case for the second feature of responsiveness: being comprehensive. Selznick did not mention this term often, but it becomes obvious in his statements on responsive law. He claimed that “[t]he capacity of law to deliver justice depends on the range of interests it acknowledges” (1992, 465), and “the instrumentalism of responsive law ... is governed by the comprehensive interests of the community” (1992, 472). For institutions involved in high politics, it is to be responsive to a wide range of bottom-up demands, because the vitality of social order is not imposed by governing institutions, but “comes from below, that is, from the necessity of cooperation in everyday life” (Selznick 1992, 465). This feature of comprehensiveness particularly posits Selznick’s conception of responsiveness as a democratic ideal (Braithwaite 2006a; Braithwaite 2008). The democratic credential of responsiveness envisions a strong belief in the capacity of ordinary citizens: they are valued as bearers of public reason, political principals agents should act for, and subjects of political deliberation. Selznick stated that responsiveness calls for “respect for ordinary people and their legitimate expectations” (1992, 470). Responsiveness requires inclusion of diverse interests of the society, not just the interests of the majority, when running the institution.

Notwithstanding the vindication of public reason, Selznick appears to share with the American Founding Fathers the fear of majoritarian domination to a certain extent.¹³ Responsiveness only to the majority, or even to general interests, is not genuine responsiveness; it is no less than unprincipled capitulation to external pressure. That is why both responsiveness and moral development are vital pillars for institutional integrity, being closely intertwined in Selznick’s institutional theory. He proposed to articulate all those requirements into a corporate charter, in which operating principles, definition of the mission, decision-making processes, interests of stakeholders, and methods of consultation with broader communities are identified and enumerated (Selznick 1992). This normative framework would enable the institution to make its own decisions about the operation. This rule of law arrangement should be deemed democratic because even the charter itself is open to inquiries from comprehensive interests. Responsiveness urges a reflexive process of defining the ends of the institution and finding appropriate means to

¹³ For this fear of majority, see Hamilton *et al.* (2000, no. 10). The answer sought in *The Federalist* was judicial supremacy: to grant the judiciary power to overrule decisions made by the lawmakers. Bickel (1962) criticized this concern, describing its counter-majoritarian difficulty, in that judicial review is illegitimate as long as it allows unelected judges to overrule the democratic decisions of elected representatives.

the ends, where both means and ends are open to public inquiry. The established ends are subject to continuous revision with a view to all relevant values, as Selznick claimed that “what [the institutions’] needs are and how they should be met is always an open question” (1992, 472). But this conception of responsiveness to comprehensive interests of the society overlooks domination of the minority: the possibility that an autonomous institution gives rise to a source of arbitrary power. This issue is one of the main themes to be addressed in the next section.

3.1.3 Responsiveness as Being Proactive

The last element that is distinctive, yet intimately involved with the first two features, in Selznick’s conception of responsiveness is being proactive. This is missing in democratic ideas of responsiveness. In conventional theories of policy responsiveness, political office holders habitually respond to public opinion when making major policy decisions, because the fact that they are subject to regular election gives them the fear of removal in the next competition. This motivates them to act responsively to the public’s preferences (Abramowitz 1988; Erickson 1971; Johannes and Mcadams 1981; Serra and Moon 1994; Stimson et al. 1995). The criterion of policy responsiveness measurement is whether representatives follow preferences of the majority. In this tradition, policy responsiveness would suffice if representatives passively follow people’s desires. It requires neither *ex ante* configuration of people’s preferences nor empowerment of their capacity for political participation.¹⁴ The attempts of politicians to influence public opinion, not just respond to it, are regarded as leadership rather than responsiveness (Jacobs and Shapiro 1994).

Selznick did not endorse *ex ante* configurations of what the best interests of the people are.¹⁵ Nor does his idea of responsiveness confine the role of an institution to

¹⁴ Empirical researches defying passive conceptions of responsiveness include Jacobs and Shapiro (2000) and Hogan (2008). In observing the loss of responsiveness in American politics, Jacobs and Shapiro argued that as the influence of political activists in the election campaign increases, so representatives are more inclined to embrace policies that can meet the needs of factional political activists rather than appealing to majority of the electorate. For them, politicians do not pander to public opinion; they rather strive to shape public opinion to conform more closely their policy initiatives.

¹⁵ This position places Selznick’s idea of responsiveness somewhere in between a neutral and perfectionist view of institutions. A responsive institution is expected to be more than a neutral one, just as “more than a passive recipient of claims, more also than a friendly, nonintrusive facilitator of private

being a passive recipient of social demands. Rather Selznick's idea of responsiveness has an attribute of proactiveness in responding to comprehensive interests of the society. As presented in Chapter 8, the responsibility the Korean childcare system bears to the society was not fulfilled because it only took into account expressed demands of the stakeholders, such as those of facility directors. Compared to voices and political power that associations of childcare facility directors could mobilize, those of infant carers and parents were relatively feeble, unorganized, and inaudible. And childcare regulation was implemented in a way that reflected this social disparity of power. This resulted in partial regulatory failure to redress malfunctions of childcare facilities.

Empowerment is an indispensable element of Selznick's conception of institutional responsiveness. It is especially so in the light of relationships between an institution's competence to achieve its ends and the degree of comprehensiveness in responding to public interests. Selznick pointed out "[a]ll must have effective (as well as formal) access to the legal system, and the law must be open to claims of right" (1992, 465). This implies that a responsive institution should be able to gather voices as diverse as possible from the society to achieve its mission. And in order for all relevant parties to have effective access to the institution, it is required to seek actively to respond not only to expressed but also unexpressed demands. Therefore it is part of the institution's responsibility that the institution encourages the underprivileged to be equipped with capacity to participate in political life and make their voices heard. Failure to do so would lead the institution to respond only to expressed interests and rights, being selectively responsive.

transactions and associations" (Selznick 1992, 472). The claim for liberal neutral institutionalization insists that the political community not predetermine what the good life is and instead let people choose the way of life they wish to enjoy. The role of community or state is at most to offer a framework and forum for public discussion in which diverse views can compete with each other. Selznick denounced this liberal idea of neutrality as the major obstacle to the continuities of the individual and the collective and to the reconciliation of liberal and communitarian perspectives. Diverse interests of the society deserve respect yet not all interests do so. He claimed that political pluralism "must reject the idea of one right way, one right perspective" (Selznick 1989, 511). Yet at the same time pluralism does not say that any way is right. Alternative lifestyles are required to meet some threshold standards such as democracy, equality, civility, and rule of law. Therefore a responsive institution is an effective instrument for dealing with changing social needs that are drawn from those abstract, universal values.

3.2 Responsiveness: A Communitarian Virtue?

It now becomes apparent that for Selznick responsiveness is a virtue an institution is required to develop in conjunction with internal morality to sustain its integrity. More specifically institutional responsiveness is constituted by three distinctive yet closely related elements: being deeply related to stakeholders and the community it is involved in; taking up comprehensive interests of the society in such a way that the established institutional standards are reflexively modified by participation and deliberation among the stakeholders; and being proactive in answering to unexpressed or muted interests. By being responsive in these three ways, an institution can fulfill its purpose and responsibility in the society. The way Selznick connects institutional responsiveness with responsibility relies heavily on a premise that derives the justification of institutional responsibility from the society, which is good in itself. One problem of this premise is that the moral character of an institution's responsibility is determined by the common sense widely shared in that particular society. A danger of this is that, in a society where women's rights are relatively neglected, an institution that is responsive to this common sense could be regarded as responsible by Selznick's lights, despite its dominating effects on women. In other words, Selznick's justification of institutional responsiveness reveals a hazard that underplays the issue of domination. Proactively seeking out the preferences of women is only a partial answer to this problem. Selznick saw great evil in being swung or buffeted by arbitrary power. His concern was about the negative effects of external pressure on institutional autonomy and integrity. But he neglected the possibility that the autonomous institution gives rise to another source of domination. He tried to take into account the problem of majoritarian domination, but fell into a trap that concern for responding to the interests of the majority often trumps concern for domination of the minority. For Selznick, factional interests are a source of capitulation, rather than of domination. This section critically explores this aspect of Selznick's proposition for communitarian liberalism, with a focus on how this stance weakens his ideas of responsiveness and responsibility. It starts with his communitarian idea of the implicated self.

3.2.1 Communitarian liberalism

In democratic theory, responsiveness is not just a virtue but an essential credential for a political system to be called democratic by definition. Etymologically democracy originated from the Greek words “demos” (people) and “kratos” (rule), as distinctive from the rule of one or of a few.¹⁶ This means that public office is not the preserve of a few excellent citizens or professional politicians: people are ruling and being ruled in turn and everybody can be chosen to occupy a political office. In modern representative democracy this ideal of polyarchy is realized through regular elections.¹⁷ Some argue that establishing regular elections by which elected officials are subject to the verdict of the electorate suffices the requirements of democracy (Schumpeter 1950). But representation is not only apparent in elections but also in the nature of government actions between elections, and policy responsiveness is a central credential in making it work.

The way Selznick justified the need for institutional responsiveness is quite different from the democratic ideal of responsiveness. This is so because what Selznick conceived of as an institution is not necessarily involved with political representation. It normally refers to a group or a social practice, but an organization can be an institution as long as it is infused with social values “beyond the technical requirements of the task at hand” (Selznick 1992, 233). Thus for Selznick, institution includes government agencies, schools, museums, hospitals, NGOs, mass media, labor unions, and many governmental and non-governmental organizations. It is likely that his primary interests lay in political institutions and the legal system, but the ideal of a moral commonwealth, as Selznick conceived of it, cannot be realized only by making these public institutions responsible. Even private businesses are asked to be responsive actors in the society, considering their social engagements (see also Braithwaite 1997).¹⁸ This quest for an institution’s social

¹⁶ This distinction is well explained in Aristotle’s *Politics* (1984) Book III.

¹⁷ Election was not the original form of choosing representatives in democratic regimes. Athenian democracy used lotteries and lots in choosing assembly members and magistrates. See Finley (1973) and Hansen (1991) for the history of Athenian democracy, and Manin (1997) for how election has been taken up as the main method of choosing representatives in democracy.

¹⁸ Selznick denounced a claim for property rights as non-contextual thinking, which has been a damaging feature of modern legal history ignorant of its context. In this approach, corporate shareholders are treated as self-interested owners “with little or no regard for the enterprise as an institution or for the interests of other stakeholders” (Selznick 2003, 183).

involvement is deeply grounded in Selznick's epistemological stance of the implicated self, which presumes an agent is a social entity that depends on other agents for its psychological sustenance. For Selznick, not only a person but also an institution is deeply implicated in its social context.

The self is a social product, but that product is a unique person. That person may be, from the standpoint of others, independent and even perverse. In the idiom of George Herbert Mead, the "I," which he contrasted with the socially determined "me," is the agency of reflective morality. As such, the "I" is not a sport or freak; neither is it the gift of abstract reason. It is a viable but precarious outcome of social interaction – which may enhance or distort communication, enlarge or cramp perspectives. Moral competence therefore depends on *the nature and quality of social participation* (Selznick 1987, 447-8; emphasis added).

Although he acknowledged independence of the "I", this is not in the sense liberals conceive of the individual. Reasons and rights are not universally pre-given but socially constructed. The "I" is an organic agent, quoting Mead, that "develops in the given individual as a result of his relations to that process [of social experience and activity] as a whole and to other individuals within that process" (Mead 1934, 135). Nor is an agent's moral competence presumed universally.¹⁹ Like reasons and rights, it is rather constructed causally as the agent is involved in diverse interactions with other agents in the society. In other words, "moral persons and institutions are 'implicated selves' whose virtues depend on special forms of communal participation" (Selznick 1992, xiv). This clarification of the implicated self deserves illumination in regard to his proposition for communitarian liberalism in two respects: its view on choice and participation.

Selznick was more or less sympathetic to the left or welfare liberalism of John Rawls and Ronald Dworkin. But he also found liberal premises ahistorical and too individualistic, "insufficiently sensitive to the social sources of selfhood and obligation" (Selznick 1992, xi). He criticized the atomistic view of individuality predominant in early

¹⁹ For a clarification of this universal moral competence from the liberal point of view, see Nussbaum (1992). Based on a neo-Aristotelian interpretation of a human being, Nussbaum strives to make a case for evaluative essentialism, distinctive from metaphysical essentialism, in which what is essential in being human is not predetermined but dependent on elements that are critical in constituting human life across culture or religion. These elements are articulated into her famous capabilities list. For criticisms of this perspective, see Antony (2000); and for Nussbaum's response to Antony, see Nussbaum (2000).

modern thinkers, for instance Hobbes (1996 [1651]), with the alternative that “society is not made up of preformed, wholly competent individuals endowed by nature with reason and self-consciousness” and instead emphasized social interdependence between humans (Selznick 1987, 447). Communitarian liberalism, as Selznick called it, is an attempt to found its epistemological stance in this sociological understanding while upholding core liberal values. As one commentator puts it, “communitarian liberalism, then, is to be achieved without sacrifice of core liberal values, indeed would be incomplete and pernicious without them. The aim is to amend liberalism, not to reject it” (Krygier 2012, 251). It is true that Selznick did not denigrate such liberal values as freedom, separation of powers, checks, balances, and rights. However Selznick’s case of communitarian liberalism needs scrutiny on the perils of domination.

Selznick posited a person as a locus of choice, yet not the final arbiter of choice. Liberalism is a broad church with little consensus among proponents regarding its core values (Ryan 1993). Yet they would agree that what they have in common, as distinct from their communitarian counterparts, is the doctrine of individual autonomy in which an individual is regarded as an independent agent capable of having a final say in what they choose. Selznick denied that a person can be the final arbiter of her choice. He emphasized indeterminacy of personal choice, mentioning, “*what* we have chosen is not truly known until the consequences appear” (Selznick 1987, 451; emphasis original). For him, a person is a locus of choice, but a person cannot do it definitively or independently. Reason and moral competence are not pre-given. Rather, they are cultivated as one internalizes the generalized self in a given culture into her own identity in the process of social experience. People learn norms and civility in their interactions with other people, either directly through their own experiences or indirectly through observation of, for example, how escalation of conflicts could befall others (see also Elias 2000). Considering this social relatedness, that a person chooses one option over another does not mean that the choice is a result of independent preference; rather it reflects the particular time and space in which the decision takes place and draws on experiences the person has constructed in relation to others.

In this perspective, liberty is defined positively to entail internal self-realization; rights become contextual, cultural, and constructive rather than abstract and absolute. For Selznick, what Isaiah Berlin called negative liberty, which defines liberty as a state in which one is not externally interfered with in his action (Berlin 1969), excludes psychological and economic dependency and overlooks autonomous individuals’ free will

for overcoming internalized customs. Obstacles to one's freedom can be internal as well as external. One may fail to be free if subject to habits of subordination and some internal conditions such as self-awareness, discipline, or self-control is not realized. To effectively secure social protection for people vulnerable to this kind of social domination, liberty should rather be involved with association, discipline, and duty (Selznick 1987, 455). A person is free to the extent to which she realizes the true part she plays in the society, participating in communal life. The transition from a notion of freedom as doing what one wants to what one really wants is the first step of the path from the negative to the positive conceptions of freedom (Taylor 1985b). This process of realizing what one really wants deserves respect from other members and institutions of the society and inclusion as they strive to be responsive in their pursuit of institutional responsibility.

Thus communal participation is a heuristic process of socialization for Selznick. It is neither a matter of personal choice nor an instrument to achieve an end; it is the purpose of one's social life. It is the way a person or an institution becomes a responsible citizen in the society. What is important in determining the quality of participation is the quality of community. Selznick showed his inclination to this kind of argument when he agreed with what Irving Kristol said, "people only respect a society which makes demands on them, which insists that they become better than they are. Without such a moral conception of the self, without a vivid idea as to the kind of person a citizen is supposed to become, there can be no self-government" (Selznick 1987, 456). This represents communitarianism's typical comprehension of community.²⁰ People are not free when they do what they want. Rather they are free when, with recourse to the society, they do what they really want and obey their genuine will, as Charles Taylor expressed it.²¹ Taylor claimed, "we cannot do what we really want, or follow our real will, outside of a society of a certain canonical form, incorporating true self-government" (1985b, 217). For Selznick, the purpose of human association is not living or survival: rather it is living well. Therefore the quality of communal participation is only comprehended in the context of a community, of its purpose of living well. Social protest against miserable work conditions of low income earners is justified because it squares with the claim for living well, which

²⁰ The need of a society for human self-realization is neatly captured as Taylor, who claimed, "it is irrelevant whether an organism born from a human womb would go on living in the wilderness; what is important is that this organism could not realize its specifically human potential" (Taylor 1985a, 191).

²¹ A typical example presuming people cannot be really free outside of a community of true self-government is Rousseau's view of the general will (Rousseau 1978[1762]).

is “the promise of community” (Selznick 1987, 457).

Selznick’s communitarian liberalism should be carefully discerned from liberalism even though it takes into account such core liberal values as liberty, rights, and individual choice. This is so because these values are proposed, without universal grounding, as more or less embedded in the society and cannot be understood without considering a particular social context. Selznick’s case for communitarian liberalism seems to be subject to value relativism though he argued in one of his late writings, “a contextual approach is not an invitation to abandon principles. On the contrary, it tells us how to realize relevant ideals in the context at hand” (Selznick 2003). Even in that writing he failed to provide sufficient ground on which fidelity to context is reconciled with the quest for universal values. His journey to avoid and replace the liberal, atomistic view of individuality eventually may descend into a hazard of collectivism.

Having said that, Selznick’s communitarian understanding of selfhood as deeply implicated in a social context results in an assiduous assertion of autonomous institution building which underplays the possibility that this may bring about domination. His claim for a comprehensive response does take into account the fear of majoritarian domination, but fails to address the risk that an autonomous institution might give rise to a source of social domination. This is somewhat inevitable because Selznick’s idea of responsibility is causally ascribed to a notion of society that is good in itself. His lack of concern for domination weakens his proposition for responsiveness as proactive, by ignoring the source of unexpressed or muted voices in the society. In many cases the reason some voices of the society are unexpressed is that they are interfered with more or less on an arbitrary basis. They may be either explicitly halted by some forces or implicitly muted by non-interfering masters. Without considering those underlying reasons, a claim for proactive responsiveness has a hollow ring, to borrow Selznick’s own expression.

Considering these shortcomings, we need an alternative ground of justification for connecting institutional responsiveness with responsibility. Selznick’s idea of responsiveness may pave a way for institutional responsibility. But it fails to make a case for responsibility of individual stakeholders involved in the practice of the institution. In this regard, Philip Pettit’s version of methodological individualism is useful to comprehend individuality and commonality at the same time. The next section introduces Pettit’s neo-republican understanding of selfhood and how this can offer a theoretical ground for what I call reciprocal regulation.

3.2.2 Holistic individualism in Neo-republicanism

In making a case for responsive regulation, Ian Ayres and John Braithwaite have pointed out that human beings have multiple selves (Ayres and Braithwaite 1992; Braithwaite 2002a). What they tried to argue is not just that the same individual or institution has plural motivations for compliance and non-compliance. Braithwaite also argued that often the will to be a responsible citizen overpowers economic, calculative selfishness. This means that an individual, though self-interested, does consider others when pursuing her own interests.²² An individual would be keen to care about duties and responsibilities in social relationships, others' appraisals of her own behaviors, and furthermore, recognition of her own identity from other members of the society. While taking into account these concerns, an individual strives to pursue what she truly wants. The philosophical ground of this contingency of selfhood has been well advocated by Philip Pettit, who showed that the emphasis on commonality can stand without reference to collectivism. Unlike a communitarian account that posits an agent as a bearer of desire to achieve particular purposes, this standpoint regards it as an intentional, thinking agent who has internal seeds that enable it to become a social being considering its social responsibility or shared good (Brennan and Pettit 2004; Pettit 1993, 2007a). Then, responsibility becomes a virtue an agent gets to bear in its social interaction with other agents, not a destined duty it has to fulfill in a society.

Pettit's holistic individualism is distinct from both collectivistic and atomistic approaches, because an individual is neither implicated in the social context nor separated. Rather it is an agent who bears capacity to think what she intends to achieve in relation to other agents.

Now the distinction between the thinking and non-thinking subject, as I understand it, is determined by the range of things that the subject is capable of doing intentionally. The subject will be a thinking subject if and only if, among the things that it can do *intentionally*, it can do things that are designed to promote the prospect of its meeting various constraints of rationality: to promote the prospect of its having beliefs that are indeed true, for example, or the prospect of its performing actions that are indeed desirable. The thinking subject can cogitate and ratiocinate, deliberating in the light of

²² This aspect is of particular concern and much discussed in Chapter 4.

this or that consideration as to what it is right to believe or best to do (Pettit 1993, 6: emphasis added).

We can use a sentence such as “I do X” or “A life is saved” or “Joan is happy,” not just to report that result but to exemplify the *possibility* it expresses and then to hold up that *possibility* as an object of attention and to ask about its properties. This is something that lies beyond the reach of nonhuman animals and artifacts. ... We attend to abstract propositions or *possibilities*, not just concrete objects, and we ask questions as to whether a given way that things may be – a way we may make them to be – is good or right or better than other alternatives (Pettit 2007b, 186: emphasis added).

For Pettit, a thinking agent bears a desire to be rational. What is distinct in human exchanges of desires to be rational is that agents do care about intentions and possibilities behind an expression and make an ethical judgment on them. Thus we act upon our beliefs and desires, which are not externally driven but internally motivated to fulfill our own concerns. In order to do that, we try to understand the social conditions that may constrain our striving for such fulfillment. This capacity to think can develop as we share life with other agents in the society. Nevertheless, the way human beings depend on social relations is not causal, as communitarians claim. Rather human interdependency is contingent upon social relations. In this standpoint, a person can be both selfish and altruistic, “superveniently on the attitudes of others in the society” (Pettit 1993, 171). What Pettit calls supervenient dependency may be neatly distinguished from a communitarian stance when we juxtapose his argument with that of Charles Taylor, who argues that “living in society is a necessary condition of the development of rationality, in some sense of this property, or of becoming a moral agent in the full sense of the term, or of becoming a fully responsible, autonomous being” (Taylor 1985a, 191). For Pettit, an agent’s rationality is rather ascribed to her own capacity to think and desire to be a rational being.

Therefore Pettit’s standpoint is individualistic in the sense that an agent can be free to the extent to which she enjoys a status of being not subject to arbitrary interference of others, in which she can choose what she really wants without recourse to external authority. It is also holistic, not atomistic, in the sense that the way individuals become interdependent to each other is contingent upon social relations, depending on how they

respond to each other's attitude and to structural constraints.²³ Then, what are the advantages of Pettit's holistic individualism in the context of regulation? How does this standpoint help us get over the shortcomings of Selznick's ideas of institutional responsiveness and responsibility?

There are at least two advantages in taking up Pettit's holistic individualism in the context of the research questions for this thesis. First, this standpoint can mitigate the macro view of Selznick when we consider institutional responsiveness and responsibility. We can adopt both institutional and individual approaches. As will be clear in the rest of this thesis, a claim for responsive regulation is at many critical moments materialized by activities of individual members. It is indeed individual agents who strive to enhance regulatory outcomes by holding one another responsible in the course of interactions: that is, between frontline inspectors and their counterparts in regulated institutions, between members of regulatory agencies, and between these agents and other stakeholders. However, this does not mean that I attempt to explain institutional responsiveness and responsibility exclusively at the individual level. When holding members of a regulated firm responsible, inspectors would ask members to be responsible for particular businesses of their firm. This is so because they are agents representing those functions, and thus holding responsibility for the firm's operation. We can easily observe that a group forms a judgment or attitude toward certain propositions by, for example, "a vote in the committee of the whole, a vote in an authorized subgroup, or the determination of an appointed official" (Pettit 2007b, 186-7). Individual voices count when making a decision on corporate policies and standard operating procedures. Pettit's holistic individualism assumes that as much as individual members shape institutional norms and structures, so are their behaviors shaped and constrained by institutional factors.

Second, Pettit's holistic individualism allows us to take into account unequal power distribution and human vulnerability, leaving room for empathy and emotions. As we have reviewed, Selznick's liberal communitarian stance underplays the risk of an autonomous institution's emergence as an arbitrary or even dominating agency. On the contrary, holistic individualism sees power disparity of a society as a source that may put a constraint on an individual's pursuit of desires and beliefs. It allows a scenario in which even the most public-spirited agent cannot dodge the possibility to make an arbitrary

²³ For nuanced differences in methodological individualism and the position of Pettit's holistic individualism in that mapping, see Udehn (2002).

decision and thus exercise arbitrary influences. Nevertheless the world Pettit's holistic individualism envisions is not so gloomy because it also posits a scenario in which the most powerful agent is vulnerable in other respects. Individual pursuit of being not subject to arbitrary interference of a powerful agent can get other people's cooperation and assistance. This is so because they may be lucky enough not to fall in the same fate but acknowledge the fact that they are also vulnerable and may be subject to similar or other sources of domination. Or it can be a simple gift of help in the struggle against another's domination. An agent may be too weak to contest the domination she is subject to. But returning an evil inflicted upon her can be exercised by many others who observe her status and feel empathy toward her.²⁴ The coalition or solidarity may be formed against a powerful yet arbitrary regulator or a transnational conglomerate standing above the reach of regulatory intervention. This represents the case in which indirect reciprocity is harnessed to complement a shortcoming of direct reciprocity: to regulate dominating forces in a society. Through the process of regulation that considers direct and indirect reciprocity, we can offer a ground on which an agent can enjoy freedom resiliently on the one hand, and on the other, we can resiliently hold institutions responsible. Freedom, thus conceived, requires us to transform contingency of domination that may befall a person into security against the powerful. Reciprocity is more than just the communal glue that makes this possible; it manufactures the individual to individual, institution to institution building blocks that make freedom possible as an accomplishment of regulated domination.

3.3 Conclusion

Although Selznick's argument for institutional responsiveness eventually descends to a hazard of collectivism, his contributions to the idea of responsible institutions and responsiveness should not be underestimated. His conceptions of responsibility and responsiveness enrich the shallow normative soil of democratic responsiveness. The three features of responsiveness—being relational, comprehensive, and proactive—make a compelling case for a substantive idea of democracy that is more fertile than the idea of policy responsiveness passively responding to preferences of the electorate. Selznick's

²⁴ This aspect of empathy in reciprocity is one of the main concerns of Subsections 4.2.2 and 4.2.3.

idea provides normative justification to answer questions like why elected government is responsible for its people, not only accountable to them; why it seeks to actively empower them; and why it is open to inquiries from comprehensive interests. Although the participatory form of democracy Selznick endorsed is “*formed* by institutions of deliberation, inquiry, and responsible choice” (Selznick 1992, 524-5; emphasis original), what is equally important in his argument is the quest for people’s social involvement.

Another contribution of Selznick is to regulation. His idea of institutional responsiveness is involved in his claim for responsive law: official state law should be responsive to claims of morality in the society and also plurality of laws and rules that embrace those diverse claims. Likewise, regulation has similar features. For Selznick, regulation has fidelity to context in the sense that it is involved with activities and community values. Those activities are mainly either protecting diverse social interests and common good or disciplining socially deviant actions. He mentioned responsive regulation of business in one of his writings:

Responsive regulation is more problem-centered than rule-centered, more persuasive than coercive. ... the “good inspector” tries to limit pollution or enhance occupational safety by techniques of dialogue, diagnosis, and institutional design. Instead of “going by the book,” with its emphasis on fixed rules, violations, and fines, responsive regulators take specific circumstances into account. They participate with business and other institutions in a cooperative effort to make law effective. This may involve forbearance to mitigate unreasonableness, or technical consultation to show how improvements may be made without undue cost, perhaps by bringing to bear the experience of other firms. The ideal is to attain the maximum feasible *self*-regulation (Selznick 1992, 470).

Some important features can be extracted from this excerpt to indicate what he conceived of responsive regulation of business. First, he appreciated the possibility of cooperation between regulator and regulatee through informal dialogue. It is more likely that regulatory trust is established when the regulator focuses more on problem solving than enforcing rules. In this outcome-based approach, the regulatory agency is open and reaching out: the agency is expected to listen to what the problem is and why it has happened, persuade industry people, and attempt collectively to find a solution. Punitive sanctions are not always the best strategy in this approach, because regulatees are

regarded as partners the regulator is expected to work with. Second, it is context specific. It does not only take into account problems coming to the surface, because those problems are deeply involved in the firm's context. If the unreasonableness the firm displays is ascribed to its weak compliance power, it may be effective to give it a chance of self-reformation or technical consultation to empower its compliance capacity. In this sense, the context that is specific to an individual firm is taken into account when the regulation is proactively implemented. Last but not least, it aims at self-regulation. Perhaps the ideal form of regulation is realized if every singly regulatee becomes a responsible, self-regulating agent. Since this ideal is unrealistic and unapproachable even in a well-ordered society, a regulatory system is so required that it encourage motivation of compliers and nurtures compliance capacity of non-compliers. On a similar basis, proactiveness of a responsive regulator is justified to encourage a regulatee's capacity for self-regulation. Conceived in this way, responsive regulation is not just an enforcement strategy a regulatory agency adopts, it is rather a system with a purpose of inculcating a sense of responsibility in the regulatory agency and the virtue of self-regulation in the regulatees.

In this chapter, I disaggregated Selznick's idea of responsiveness into three attributes and criticized perils of collectivism that it may befall. Without recourse to a communitarian justification, we can offer a solid philosophical ground on which the "necessity of cooperation in everyday life" can be fostered to enhance responsibility of various agents (Selznick 1992, 465). The necessity comes from an agent's contingent response to the attitudes of others. I will elaborate this necessity into a theoretical framework of reciprocal regulation in the next chapter. But readers are asked to bear in mind that, despite the perils of collectivism inherent in Selznick's idea of institutional responsiveness, his conception provides a unique understanding of regulation that emphasizes the importance of integrity and responsibility in the context of responsiveness. Strategies of reciprocal regulation, utilizing both direct and indirect reciprocity, will be also articulated as a way of enhancing responsibility of actors involved in regulation.

Reciprocal Regulation

An expectation for proportionate return is widespread in human societies. And in many instances people meet this expectation. If proportionate return for what has been received is made between people, we call the relationship reciprocal. Readers of this chapter might jump to glance at Figures 4.1 and 4.2 on pages 73 and 74 to preview the destination of this chapter in conceptualizing different forms of reciprocity that have different implications for regulatory design. These are distinctions between calculative and empathic reciprocity, direct and indirect reciprocity, between pass-it-on (downstream) indirect reciprocity and reputation-based (upstream) indirect reciprocity. In a nutshell, this chapter puts forward the argument that past analyses of the limits of reciprocity in regulation in general, and with responsive regulation in particular, have been often flawed, because they do not consider the broader range of types of reciprocity in Figures 4.1 and 4.2.

Lawrence Becker claimed that “rituals of gift giving, unspoken understandings between lovers, patterns of family life, expectations among friends, duties of fair play, obligations of citizenship, contracts” are all understood as reciprocal (1986, 73). In many societies returning good for good received and evil for evil received are regarded as social norms, though the details and ways in which return is made differs from society to society and are normally overlaid with norms of generosity—return more good for less—and forgiveness—less evil for more. Immediate return is expected, for example, between nuclear powers that have agreed on a disarmament treaty. But neither immediate return nor return to the original provider is expected when you have received a scholarship or blood donation: norms of reciprocity exist, but the expected actions differ. Failures to meet expectations of reciprocity cause reactions, not only from the agent to whom the return is owed. The nuclear power that fails to reduce strategic nuclear weapons could face retaliation from other parties of the treaty, yet may well encounter severe sanctions

from wider international society. An indolent grant recipient who does not deliver on academic expectations would soon suffer loss of reputation among colleagues. Some failures may produce more immediate, severe, and collective reactions than others in a social punishment system.

Reciprocity also pervades regulation, as regulation is full of social exchange between various actors. Citizens' obedience to the law or regulation is a commitment to commonly binding rules; it is reciprocating fellow citizens' obedience to authority and also reciprocating legitimate regulation that governs us equally and fairly, at least when it works justly. Reciprocity is more distinctively harnessed as regulators seek to adopt more efficient and effective methods than a unilateral command and control approach. Regulators have found it more effective to adopt strategies discriminating compliers from non-compliers, for example, in implementing regulatory enforcement and adopting historically informed target selection (Ayres and Braithwaite 1992; Black and Baldwin 2012a; Braithwaite, Murphy, et al. 2007; Braithwaite 2009b; Gunningham and Sinclair 2009; Kagan and Scholz 1984; May 2004). The extent of regulatory compliance is not only observed and recalled by the regulator but also by wider publics who may use that record of law observance as a reference in the next encounter. As there are many direct and indirect forms of reciprocity in ordinary social exchange, so do diverse ways of reciprocity abound in regulatory exchange.

This chapter aims to offer a theoretical framework for various paths of reciprocation observed in the regulatory space. In this framework, the idea of responsiveness is articulated into two dimensions of reciprocal regulation. Unlike most contemporary accounts of reciprocity that posit social exchange between equivalent agents, a distinctiveness of reciprocity in the regulatory space is that it includes exchange between a legal or public authority and non-authorities operating under its jurisdiction (Axelrod 1984; Diekmann 2004; Fehr and Gächter 2000; Gutmann and Thompson 1996; Keohane 1986; Ostrom 1998; contra Becker 1986, especially ch.8). Considering the centrality of this distinction, this chapter starts with exploring philosophical accounts for connecting reciprocity and political authority. Two ancient writers in the civic republican tradition, Aristotle and Cicero, are introduced as major proponents of reciprocity in achieving harmony and justice in a political community. Aristotle saw that a certain type of reciprocity—that is not motivated by selfishness but by self-love—is essential in maintaining a political community. Cicero inherited this line of thoughts and developed it by emphasizing the importance of reciprocal relationship between the ruler and the ruled.

Informed by these classical thoughts, section 2 broadens the scope of reciprocity in regulation by adding another type that is distinct to tit-for-tat: empathic reciprocity. Unlike calculative reciprocity that is based on agents' self-interest and features immediate tit-for-tat reciprocation, empathic reciprocity represents a reason-giving process in which related parties participate in seeking fair terms of regulatory cooperation. Section 3 offers an account of indirect reciprocity. Discussions on reciprocity in regulation only focus on a direct form of reciprocity that exists in dyadic regulator-regulatee relationships. This chapter shows that regulation also embraces indirect reciprocity as the number of actors in a regulatory arena becomes large and diverse.

4.1 Classical Accounts of Reciprocity in Governing

Many thinkers have touted reciprocity as crucial glue that fosters human cooperation. Some have claimed that it is an inalienable human condition, which we are biologically wired to interact for mutual support, while others put it forward as a duty that is intrinsic in human relationships. It has also been a normative principle that constitutes and justifies political regimes.

Classical republicans conceived of reciprocity as a way of justifying legitimate rule. It binds ruling and being ruled together so that the former governs a political community for the advantage of the latter. In part this is clarified in their understanding of freedom. They comprehend that the social condition not to be dominated by others is at the heart of one's freedom (Honohan 2002; Pettit 1997; Pocock 1975). In order to be a free citizen, a person should not be interfered with by others in an arbitrary way. In this negative understanding of freedom, a quintessential condition for freedom is that a person is equipped with capability to resist and rectify evil inflicted by others, rather than that the person positively exercises it for self-realization. For this capability offers a condition under which the person can resiliently enjoy freedom of choice even though his or her choice is in danger of restriction or inhibition by many external forces. To put it in republican jargon, this capability is called contestability or contestatory power that enables citizens to enjoy freedom as resiliently as their fellow citizens (Pettit 1997). Given the unequal distribution of power in a society, it may be impossible to eliminate any attempt to interfere with others' freedom. Then what is at stake in guaranteeing freedom,

in a republican account, is to prevent this power disparity from becoming abusive or from serving any illegitimate purpose (Shapiro 2012). A person, no matter how weak and vulnerable she is, should be able to resist and rectify harm or evil inflicted by others. The next section is devoted to how classical republicans, especially Aristotle and Cicero, made a case for reciprocity to achieve justice in a society.

4.1.1 Political friendship and self-love in Aristotle

Many contemporary civic republican writers tend to exclude Aristotle from their philosophical predecessors. This trend is explicitly observed when some commentators name their tradition as neo-Roman (Pettit 1997; Skinner 1998). Considering that the thought of Aristotle has long been endorsed by civic humanists who place political participation at the core of the ideal of self-realization, this distinction is critical to civic republicans who conceive of it as nothing more than an instrument to freedom. To discuss this standardized wisdom by arguing that Aristotle should be included as a forerunner of classical republicanism, and indeed a continuing resource to enrich contemporary republican thought, lies beyond the scope of this thesis.¹ Rather, I intend to find ancient evidence highlighting the importance of reciprocity, including in Aristotle, that can provide philosophical nutrients for articulating reciprocal regulation.

Aristotle clarified some important characteristics of reciprocity and provided ways in which reciprocity can be connected to justice of political communities and just rule in *Nicomachean Ethics (NE)*. For him, reciprocity is a way of holding political communities together, without recourse to the rule of a good man. Three central features of reciprocal regulation may be drawn from Aristotle's thought on reciprocity.

First, Aristotle emphasized capabilities to reciprocate as an important condition for a human being to be an equal, political agent who shares political life.

In communities for exchange, however, this way of being just reciprocity that is proportionate rather than equal holds people together; for a city is maintained by proportionate reciprocity. For people seek to return either evil for evil, since otherwise [their condition] seems to be slavery, or good for good, since otherwise there is no exchange; and they are maintained [in a community] by exchange (*NE* 1132b-3a).

¹ Including Aristotle in the classical republican tradition is to follow Rahe (1992) and Gibson (2000).

In this paragraph, Aristotle endorsed the virtue of reciprocity that holds people together in a political community. What is reciprocated does not have to be equal to what was originally given. It is rather supposed to be proportionate, considering different personal and social circumstances. The poor may not be able to return what they have received equally to the original giver, but they can do it proportionally. No matter how different personal circumstances are, however, capabilities to make proportionate return for evil inflicted by others became an important condition for free and equal citizens. It does not matter whether the person actually performs retaliation. Nor is it implied that the person should.² The mere fact that the person has those capabilities represents that she is a free and equal citizen, because a slave cannot look the master in the eye. For Aristotle, a free citizen is a person who can resist and contest absurdity and evil inflicted upon her.

The citizen-slave distinction of Aristotle offers a way of understanding reciprocity as a requisite for equality: to have capabilities to trigger negative reciprocity—to return evil for evil—is essential in resiliently enjoying a status in which people stand on a par with others. Its message to regulation is twofold. First, regulatees should be empowered in order for their appeals against illegitimate enforcement to be heard. Otherwise, those people would share little with others who have capabilities for resistance and rectification. This is not to mention Aristotle's account that slaves cannot share what constitutes citizenship: sharing in decision and office.³ Second, reciprocity can be a means to enable a person to enjoy freedom resiliently. It may not prevent that person from undergoing some hardship or injustice caused by others. But the fact that the person can reciprocate means that she has a power to rectify the injustice afterwards.

The negative aspect of reciprocity constitutes a necessary, yet insufficient condition for people's wellbeing. This is so because, for Aristotle, one's wellbeing is intertwined with justice of the political community. The positive aspect of reciprocity—returning good for good—is essential in making the political community just. Aristotle called this aspect friendship, as friendship is established as people reciprocate goodwill they have

² Aristotle did not mention actual consequences of returning evil for evil. Nor did he clarify this negative reciprocity as a necessary rule by which one punishes norm infractors. He implied that reciprocity is a crucial principle constituting the idea of justice. But the way he defined the relationship between reciprocity and justice is not clear. For related debates on interpretation of chapter 5 of *Nicomachean Ethics*, see Danzig (2000).

³ For Aristotle's accounts for distinction between citizens and non-citizens, see *Politics* 1275a.

received over time. If goodwill received from others is not reciprocated, then there will be no friendship. Aristotle believed that friendship is intimately associated with justice, as he said, “if people are friends, they have no need of justice, but if they are just they need friendship in addition; and the justice that is most just seems to belong to friendship” (*NE* 1155a25-30). Goods are distributed in a society by exchange between people. Reciprocity contributes to justice of the community as it ensures that “relatively disempowered individuals are receiving an important good in return for a smaller share in political rule” (Yack 1993, 138).

Then, an important question we need to ask is whether justice of a community is maintained by any kind of friendship. Reciprocating goodwill may result in the development of a culture of private compensation that has nothing to do with the promotion of the common good. The second implication we can draw from Aristotle’s understanding of reciprocity is his typology of different kinds of friendship whereby he discerned various motivations for human reciprocation. Aristotle identified three species of friendship according to its objectives: friendship for advantage, for pleasure, and for virtue. The nature of first two sorts is coincidental because goodwill one shows to others does not stem from what others are but from some good or pleasure they provide. Friendship for virtue is of the complete sort in that friends wish good to others for their own sake. This enables exchanges based on altruistic devotion. However, altruistic devotion is not the sort of friendship that, Aristotle believed, can bond a city together, because altruistic friendship can only be a minority of all relationships in a city. Rather, Aristotle seemed to posit friendship for advantage as political friendship that contributes to justice of a political community, though it is a friendship “to a lesser extent, and less enduring” (*NE* 1158b5).

For Aristotle, a political community would come together and endure for the sake of mutual advantage (*NE* 1160a11).⁴ People gather together in a city not because they regard sharing life with others as a pleasure or virtue, but because they can take some advantages from this common life. Aristotle reckoned that participants in friendship for advantage seek mutual advantage from their friendship. This means that they establish community in pursuit of their mutual advantage, and also “share in an attempt to promote an end that

⁴ Those who interpret Aristotle’s political friendship as a shared advantage friendship include Cooper (2005) and Yack (1993). For another perspective that regards friendship for virtue as political friendship, see Arendt (1958), Hutter (1978), and Irwin (1988).

will be to their mutual advantage” (Yack 1993, 116). What makes this possible in Aristotle’s thought is self-love. According to Aristotle, all the features of friendship extend from oneself to others:

The defining features of friendship that are found in friendships to one’s neighbors would seem to be derived from features of friendship toward oneself. For a friend is taken to be someone who wishes and does goods or apparent goods to his friend for the friend’s own sake; or one who wishes the friend to be and to live for the friend’s own sake. ... The decent person, then, has each of these features in relation to himself, and is related to his friend as he is to himself, since the friend is another himself. Hence friendship seems to be one of these features, and people with these features seem to be friends (*NE* 1166a2-34).

Concord, then, is apparently political friendship, as indeed it is said to be; for it is concerned with advantage and with what affects life [as a whole]. This sort of concord is found in decent people. ... They wish for what is just and advantageous, and also seek it in common (*NE* 1167b3-9).

These excerpts point out an important idea of Aristotle that friendship toward others originates from friendship toward oneself, where self-love diverges from egoism and altruism. Since we are not alone capable of pursuing a sufficient life, we need other people to live with. The reason friendship exists between people is that a person feels that others are peers with whom the person has to live together, rather than adversaries against whom he or she fights for survival. For Aristotle, decent people value what is advantageous to others, and at the same time, want others to respect what they believe advantageous to them. As much as my wellbeing is an important goal for me, so is wellbeing of others a precious value that I should care about. Reciprocity enables people motivated by self-love to exchange their goodwill and establish friendship. Not all people have a natural predisposition to embrace such reciprocity based on self-love. Base people are not disposed to do that. But these people can be decent when they withstand their will to pursue egoistic interests and feel empathy toward their peers. For Aristotle, self-love involves neither selfless altruistic obligation nor egoistic calculation; it is an empathetically self-centered feeling toward human beings.⁵

⁵ For the justification of Aristotelian essentialism based on emotions toward human beings, see Nussbaum

The third important contribution we can draw from Aristotle is his belief that reciprocity is a way of justifying legitimate rule. Political friendship, which is maintained through reciprocation of goodwill, is a crucial social value legislators should be concerned about if they aim to expel civil conflict and further concord in a political community. Aristotle discerns just rules from their unjust forms according to the extent to which advantages are shared by both the rulers and the ruled (*NE* 1160a31-061a9). Tyranny is, for example, an unjust form of kingship. Unlike kingship, tyranny features no shared advantages between the ruler and ruled, so that the tyrant rules for the sake of his own advantage, which has little to do with that of citizens. In Aristotle's account, a powerful sense of mutual concern derived from self-love is inculcated and reinforced as people *share* in political activities, for example, by taking turns to rule and be ruled.⁶ This is so because a ruler who has not previously been ruled would be less likely to comprehend the needs and interests of the ruled. This is one reason that polity, an ideal form of political rule for Aristotle, takes a form of democracy. Oligarchy, in which political office and the city's goods are distributed to a few people with wealth, does not foster common good shared with the ruled. This aspect is more fully developed by the Roman Republicans as we explore in the next subsection.

4.1.2 Tyrannicide as civil disobedience in Cicero

Justification of political rule is a perennial concern of political rulers and theorists alike. Among various endeavors to accomplish this, republican theorists seemed to have favored positing reciprocity between the ruler and ruled as a central value justifying legitimate rule. Rulers are obliged to govern for the advantage of the people, rather than their own, and the ruled are also supposed to fulfill their civil obligations. These two sets of duties are reciprocally implemented so that defection from them would endow legitimacy to

(1992). Nussbaum (2001) later articulated this into her notion of compassion. For the subtle difference between compassion and empathy, see Subsection 4.2.2. For detailed interpretations of the Aristotelian notion of self-love, see Dziob (1993) and McKerlie (1991).

⁶ Aristotle endorsed circulation of political office among citizens, except for certain positions requiring professional knowledge. So a citizen can be a part of the governing body and then will be back to a normal citizen who is being ruled after his term is over. For circulation of political office, see *Politics*, especially Book III.

reciprocal sanctions. Aristotle endorsed this kind of reciprocal obligation, but it was Cicero who made a compelling case for defending the legitimacy of reciprocal sanctions against those who jeopardize duties of reciprocity in a community, though by extreme means. Inheriting Aristotle's emphasis on friendship for mutual advantage based on self-love, Cicero strove to develop a strong sense of reciprocity into a cosmopolitan ethos in *De Officiis*.

For Cicero, reciprocity is not just a natural disposition; it is also an indispensable human duty that we should uphold as we care to preserve our society. While Aristotle claimed the importance of exchanging goodwill between people, Cicero put more emphasis on reciprocating goodwill received. He argued that to give out a kind service is a matter of personal choice, but "a good man is not permitted to fail to return one" (*De Officiis*, 1.48). He even went so far as to emphasize the vice of this failure, describing behaviors increasing one's own advantage without caring for others' advantages as "more contrary to nature than death, than poverty, than pain and than anything else that may happen to his body or external possessions" (*De Officiis*, 3.21).

His disdain for failure to reciprocate goodwill is based on his belief that those behaviors are against the law of nature, destroying the common good:

In the first place, [to take something from another and to increase his own advantage at the cost of another's disadvantage] destroys the common life and fellowship of men: for if we are so minded that any one man will use theft or violence against another for his own profit, then necessarily the thing that is most of all in accordance with nature will be shattered, that is the fellowship of the human race (*De Officiis*, 3.21).

For Cicero, a person who lives in accordance with nature cannot harm others for his or her own advantage. Even worse is to harm others by defecting from returning any goodwill received. Having said that, tyranny is a serious violation of this indispensable human duty. In the Roman Republic, citizenship was another word for liberty, defined as being not subject to the arbitrary will of others. Slavery, on the contrary, described a status in which a person was subject to the domination of somebody else (Skinner 2002). Given this understanding, tyranny is a regime that places free citizens in a condition of slavery, terminating any commonality shared by the ruler and ruled. For Cicero, no friendship exists between the tyrant and his subjects, because ruling activities of the tyrant neither benefit his subjects nor encourage virtue and wellbeing among them. Under this

circumstance of estrangement, a tyrant may hold political power, but cannot have political authority.⁷ For Cicero, this represents a case in which citizens' obedience to the law or the ruler is completely abused.

Cicero does not permit harming others unless harm is done to others who failed to reciprocate goodwill. Harm to others to punish neglect of reciprocal obligations is virtuous because it is not an act for one's own benefit, but one that "could bring great benefit to the political community and to human fellowship" (*De Officiis*, 3.30). By the same token, tyrannicide—an extreme form of resistance to illegitimate political power by executing the ruler—becomes an honorable deed, Cicero argues, as it serves the shared common good of the society. He even condemns tyranny as the work of a "whole pestilential and irreverent class" and "wildness and monstrousness of a beast" that should be "expelled from the community of mankind" (*De Officiis*, 3.32). This implies not only that reciprocity between the ruler and the ruled is essential in the latter's obedience to political authority, but also that reciprocal sanction maintains the social punishment mechanism with a view to promoting a socially cooperative political order.

4.2 Two Types of Direct Reciprocity in Regulation

Based on the implications I draw from Aristotle and Cicero, the next two sections are devoted to a theoretical framework for what I call reciprocal regulation, which utilizes two dimensions of reciprocation. The first dimension deploys Aristotle's distinctions among motivations that drive reciprocal exchange. Why do people reciprocate? A straightforward answer widely presumed in contemporary reciprocity writing is that people are *Homo economicus*, who reciprocate if the expected return—no matter what the return is made by the receiver or not⁸—is greater than the cost of reciprocation. A heavy chemical industry plant may secretly dispose of waste oil into a river even in the presence of a proscriptive law if the expected gain from this non-compliance is greater than the

⁷ This distinction between power and authority is famously developed by Max Weber (1947).

⁸ Considering the possibility of indirect reciprocation that can be expected from a reputation as a reciprocator established through a series of reciprocations, it would be rational and profit-maximizing for an agent to reciprocate even though another reciprocation is not expected from the counterpart. This long term expected gain from agents other than the counterpart of direct reciprocity is discussed in the next section.

expected cost.

As we have seen, however, Aristotle's distinction of different kinds of reciprocity indicates that there are other motivations than a sheer cost-benefit calculation that drives people to reciprocate or fail to reciprocate. Dan Kahan's demonstration of the logic of reciprocity points out that modern thinkers also acknowledge the presence of a more nuanced, emotional sort of reciprocity:

In collective-action settings, individuals adopt not a materially calculating posture but rather a richer, more emotionally nuanced *reciprocal* one. When they perceive that others are behaving cooperatively, individuals are moved by honor, altruism, and like dispositions to contribute to public goods even without the inducement of material incentives. When, in contrast, they perceive that others are shirking or otherwise taking advantage of them, individuals are moved by resentment and pride to withhold their own cooperation and even to engage in personally costly forms of retaliation (Kahan 2003, 71, *emphasis original*)

Before elucidating these two different sorts of reciprocity in regulation, I should stress that reciprocal regulation strives to flesh out strategies that harness reciprocity in, most of all, regulatory enforcement. Based on the observation that reciprocity abounds in regulation, I articulate reciprocal regulation as a set of strategies in which not only regulators but also regulatees and social stakeholders utilize reciprocity to achieve regulatory outcomes. In many cases, this may be described as strategies for regulators, because it is regulators who normally take the initiative in regulatory enforcement. If this is the case, as in prudential regulation for example, regulatory approaches and styles of the regulator become a focus of empirical analysis. This regulator-centric perspective may be less compelling if the regulatee overpowers the regulator and holds sway over the regulatory relationship or as the number of stakeholders counted in the operation of reciprocity increases. As clarified in the next section, strategies of indirect reciprocity do not necessarily impose any constraint on who takes the initiative.

4.2.1 Calculative reciprocity

The first kind of reciprocity is calculative reciprocity of which the main driving force is egoistic calculation. According to Elvin Gouldner, this tendency is Benthamite

utilitarianism in which “egoism can motivate one party to satisfy the expectations of the other, since by doing so he induces the latter to reciprocate and to satisfy his own” (1960, 173). This presupposes profit-maximizing agents. Dan Kahan described these agents as “weak reciprocators” because their behavior is conditioned on multiple circumstances that should be recognizable: they reciprocate if they enter into “repeat transactions with another identifiable agent over a sufficiently long period of time under circumstances where both can observe and keep track of one another’s actions” (2003, 73). One can expect conditional cooperation from others and one would also conditionally cooperate as a response to others’ moves (Gouldner 1960; Ostrom 1998). Conceiving reciprocity as driven by profit-maximizing rational calculation has been widespread in contemporary writings in positivist political science (Axelrod and Hamilton 1981; Axelrod 1984; Ostrom 1998; Ahn et al. 2009), evolutionary biology (Boyd and Richerson 1988; Nowak and Sigmund 1992), international law (White 2014), and behavioral economics (Berg et al. 1995; Bolton and Ockenfels 2000; Fehr and Gächter 2000).

Tit-for-tat is probably the best-known reciprocity of this sort: cooperate first and replicate subsequently the opponent’s previous action.⁹ By making an immediate return in proportion to what is received, agents adopting tit-for-tat may maintain the power equilibrium and guide the evolution of cooperation in some instances, but in other cases they may bring about escalation of conflicts and subjugation of one party to another. Though motivated by rational calculation of potential gain or loss, calculative reciprocity does involve emotions: mainly fear. Reciprocation of goodwill or cooperation comes out of fear of retaliation. Tit-for-tat consists basically in retrospective response: your action is conditioned on your opponent’s previous action toward you. So people can predict that

⁹ Tit-for-tat was the winner of the computer tournaments Robert Axelrod hosted to figure out the best strategy for iterated Prisoner’s Dilemma. Game theorists were invited to take part in two computer tournaments with a program that sets up a decision rule to select the cooperative or noncooperative choice on each move. Each program was paired with each other program to play iterated Prisoner’s Dilemma game. Players were assumed to recognize another player and remember the history of previous games. If both players opted for mutual cooperation then both got 3 points while they got 1 point each if both defected. If one defected while another cooperated, then the defecting player got 5 points and the cooperating one got 0 points (Axelrod 1984). Examples of other strategies that did not foster as effective an evolution of cooperation as tit-for-tat (and variants of tit-for-tat) included downing (understand the opponent and opt for the best long-term score), friedman (never the first to defect, yet defect permanently if the opponent defects once), and tranquilizer (cooperate normally and defect if exploitation occurs too often).

failure to return goodwill received will result in withholding further cooperation and sometimes even harsher retaliation. Therefore fear of retaliation drives a person to return goodwill received, with a rational calculation of the cost of potential push back. Similarly, reciprocation of evil received is associated with fear of domination and control. Inspired by developments in evolutionary game theory (Axelrod and Hamilton 1981; Axelrod 1984), tit-for-tat has been suggested as an effective regulatory strategy, mixing cooperation and deterrence (Burby and Paterson 1993; Harrison 1995; Nielsen and Parker 2009; Scholz 1984, 1991). Ayres and Braithwaite (1992) also advanced tit-for-tat as one way of explicating the enforcement pyramid in responsive regulation.

An important presumption of tit-for-tat in regulation is that the best first step for the regulator is to cooperate by mobilizing a least dominant form of sanction or remedy no matter how deceitful the regulatee is (Ayres and Braithwaite 1992; Braithwaite 2002a, 2011). In so doing, the regulator encourages and supports the regulatee to enhance its compliance performance. The responsive regulator escalates up to more punitive sanctions when the regulatee turns out to be shunning or exploiting its cooperation. However, the way Ayres and Braithwaite drew upon tit-for-tat to explicate how responsive regulation can induce regulatory compliance features significant differences to tit-for-tat reciprocity. One could say they drew on Axelrod's (1984) evolution of cooperation insight about the benefits of mixing punishment and persuasion reciprocally while actually deviating in significant ways from the tit-for-tat model. Their model is actually a pyramid of reluctant escalation and last-resort escalation to the peak of the pyramid and they use Axelrod (1984) and Scholz (1984) as an evolution of cooperation justification for why this might be effective.

One Ayres and Braithwaite (1992) deviation from the tit-for-tat model is their reluctance to take up a more punitive sanction even after failure of a cooperative move to induce any desirable outcome. Another is their proposition to employ the same "cooperate-first" strategy again after escalating up the enforcement pyramid, and even to experiment with de-escalation.¹⁰ For example, this happens at lower levels of pyramids

¹⁰ This logic is similar to Graduated Reciprocation in Tension Reduction (GRIT) (Osgood 1962; Parks 2010). GRIT was devised as an alternative strategy that strived to resolve US-USSR confrontation in the Cold War. It is a unilateral strategy in which one party initiates concession with an expectation that the opponent reciprocates its goodwill. If the opponent does reciprocate it, then the party makes a larger concession. The party keeps taking up this strategy until both parties reach a stable common ground. The party may tolerate sporadic exploitations, yet exploitation is not tolerated if it becomes chronic. The

where regulators try another restorative justice conference with a wider circle of stakeholders after the first restorative justice conference fails to elicit cooperation. This insists that the responsive regulator initiate a kind of tit-for-tat reciprocity in every encounter, rather than play an iterated prisoners' dilemma game up to a certain level.

Tit-for-tat also seems to be an insufficient account for responsive regulation, for two further reasons. First, unequal power distribution between the regulator and the regulatee may limit its availability as a mutually adoptable strategy. Scholz (1984), for example, proposes tit-for-tat as a strategy both enforcers and businesses can effectively use to induce their counterpart to cooperate in iterated prisoners' dilemma games. Contrary to the presumed equal capacity in this game, however, regulation normally features asymmetrical power distributions between the public enforcer and individual.¹¹ In some contexts the regulated business leader will be a crony or campaign contributor to political leaders who can ask that regulators be fired if they take their regulatory responsibilities too seriously and such dismissal will not and cannot be appealed to the courts. More commonly, the regulator can utilize reciprocity in ways the regulatee cannot. No matter what kinds of moves the regulatee makes, non-cooperation can be responded to by punitive deterrence while cooperation is reciprocated by cooperative action. In this way the regulator can induce regulatory compliance from its counterpart. However, this is usually not the case for the regulatee. Of course the regulator's cooperation can be reciprocated by the regulatee's compliance and punitive sanction may be responded to by non-cooperation. But when the conflict is escalated by both parties adopting non-cooperative options, the regulatee may find itself vulnerable to the regulator's punitive sanctions because in many cases it can hardly *replicate* the equivalent of the public authority's sanctions such as termination of their business license. In these cases, the regulatee is deprived of the capability to make the interaction sufficiently iterated. Tit-for-tat is vulnerable to exploitation as long as retaliation is not a viable option for one party. This violates one of two key requisites for cooperation via tit-for-tat to thrive that Axelrod points out: cooperation is based on reciprocity, but "the shadow of the future" is not

virtue of this strategy is that a relationship between two parties can be improved unless exploitation occurs constantly from the first round.

¹¹ It has been shown that the influence of deterrent power may change the equilibrium in a Prisoner's dilemma (Brams 1994; Schelling 1966). In this asymmetrical situation, a tit-for-tat regulatory enforcement may give rise to a form of domination, making subsequent compliance the only available option for the regulatee.

enough to make this reciprocity stable (Axelrod 1984, 173).

It is not always the case that regulators take the powerful position in the unequal power distribution between the regulator and the regulatee. Sometimes the power disparity can be ruled out or rectified, in such cases where a transnational manufacturer holds countervailing negotiation power against a local or national government which seeks to attract investors for growing its economy (Barnet and Cavanagh 1994; Barnet and Mèuller 1974). We cannot rule out the possibility in which regulatees can terminate the ‘license’ of a regulator by persuading the regulator’s political master that he or it is unreasonable. Or failing that, they may pay a bribe to reverse the decision. Failing that, they might bankroll a change of government. Less legitimately, government officials, prosecutors, or judges are sometimes murdered if, for example, they threaten the business of a powerful crony or gang. Power disparity can run either way. The balance is sometimes restored or even reversed, and if so, results in conflict escalation in a tit-for-tat way.

Another reason tit-for-tat cannot sufficiently explain the way responsive regulation works involves the public character of regulation. Tit-for-tat does not take into account intentions and motivations behind non-compliance: regulators harnessing tit-for-tat reciprocity only respond to behaviors of regulatees.¹² One justification for regulators to take up a cooperative strategy is the concern for regulatees’ willingness to obey legitimate legal rules. But this is hardly considered in a strict tit-for-tat application of legal enforcement. However, it is always possible that the regulatee is incapable of complying with the regulation. This is especially so in developing countries in which regulatees are relatively impoverished with immature capability to comply. It is also frequently observed that each party’s intention is not delivered due to noise (Bendor 1993; Bendor et al. 1991; Van Lange et al. 2002). A strict application of tit-for-tat reciprocity that does not take into account agents’ intention, willingness and capability to comply may end up with unfair, arbitrary and ineffective exercise of regulatory power, exploiting regulatees’ goodwill to be a good citizen. Tit-for-tat is basically a reactive strategy. It insists that an agent not change behavior unless the opponent changes her behavior first.

Indeed many commentators maintain a perception that conceives tit-for-tat as the

¹² Though Ayres and Braithwaite’s responsive regulation (1992) responds to various other things such as the business environment, opportunities to educate the business community with a strategic case, and more. This is another reason why it is a distortion to call responsive regulation a tit-for-tat model.

essence of responsive regulation (Baldwin and Black 2008; Gunningham 2011; Gunningham and Johnstone 1999). However, ways in which responsive regulation is implemented in practice never presume pure tit-for-tat reciprocity and often imply a deeply distorted tit-for-tat rationale. Empirical research on regulators' comprehension of responsiveness (Nielsen 2006) and regulatees' perception of responsive regulatory enforcement (Nielsen and Parker 2009) confirms that responsive regulatory enforcement is rarely practiced in a tit-for-tat way. It is apparent that Ayres and Braithwaite acknowledged the flip side of strict implementation of tit-for-tat reciprocity when they introduced republican empowerment to prevent this risk. Braithwaite has continually developed this into a more integrated restorative justice version in which he adopted a more substantive form of empathic reciprocity. He put more restrictions on the employment of calculative reciprocity in regulation, by insisting regulators take a more punitive sanction "only reluctantly and only when dialogue fails, and then escalate to even more punitive approaches only when the more modest forms of punishment fail" (Braithwaite 2002a, 30). Conversely, he also defines circumstances where regulators would override the presumption of starting at the base of the pyramid—for example, where a suicide bomber is about to detonate. His commitment to the republican idea of non-domination drives him to put forward the least dominating form of regulatory enforcement by encouraging agents to seek networked cooperation for rectification of non-compliance at the lowest level of the pyramid possible (Braithwaite 2006a; Braithwaite 2013, 2014a).

One apparent instance is the outside-in proposition in designing a responsive regulatory regime (Braithwaite 2005). Unlike imposing the authority's regulatory rules on the regulatory regime, this suggests inclusion of stakeholders in the society, not only the regulatees, in regulatory regime building. They are encouraged to participate in deliberation on how to construct a responsive regulatory pyramid, for example. In this deliberative forum, they can identify shared regulatory goals and the legitimacy of legal enforcement in achieving them, discuss when to punish and when to persuade considering their diverse capabilities and contexts, and input their interests and different conceptions of good. Through this self-governing process, stakeholders collectively justify the regulatory pyramid and make their reciprocal commitment to the outcome of deliberation, by which they are commonly bound. Here a more substantive form of reciprocity serves as a foundation for self-government.

4.2.2 Empathic reciprocity

The second type of reciprocity is empathic reciprocity. While calculative reciprocity posits profit-maximizing agents, or maximizers of some other value like fame, who care only about their own utility, empathic reciprocity rests on a premise that regulatees are other-regarding agents. Their motivation may be self-interested, but it encompasses desire to justify their claims to those with whom they must cooperate (Gutmann and Thompson 1996; contra Brennan and Pettit 2004), and indeed to their own ethical self. When reciprocating, therefore, they not only care about their own emotions and morality but also for the emotions and morality of others. Martin Hoffman points out the importance of coupling reciprocity with empathy.

Reciprocity underlies most justice principles: Good deeds should be rewarded, bad acts punished; punishments should fit crimes. I suggest reciprocity is not inherently prosocial, as it encompasses “eye-for-an-eye” as well as “hard-work-should-be-rewarded” thinking. But *it can become prosocial when it is associated with empathy*, as when reciprocity is violated by someone’s being treated unfairly. When that happens, reciprocity can intensify the observer’s empathic distress and transform it into an empathic feeling of injustice (Hoffman 2000, 16; *emphasis added*).

The ability to consider other people’s experience is a key to the faculty of empathy. Empathy is defined as cognitive awareness or imaginative reconstruction of another person’s experience (Ickes 1997; Deigh 2011; Nussbaum 2001). Therefore empathy constitutes a basis for consideration for others. Then it is important to note that this other-regarding motivation should be discerned from such similar motivations as selfless altruism or compassion. Psychological studies on prosocial behaviors suggest that empathy is associated not only with altruistic concerns for someone but also with self-centered personal motivations (See Batson 1987; contra Cialdini et al. 1987). It is not a purely egoistic motivation because it cares for other people’s emotions. Nor is it a selfless motivation as its fulfillment involves self-satisfaction or pleasure.

Empathy suggests that people identify with others’ happiness or misfortune mainly because they care about the probability of the same thing happening to themselves. In this sense, empathy seems to be a prospective emotional faculty. But it is also envisioned in a counterfactual way. Let us assume that you are dying and in your last days show cognitive

awareness or imaginative reconstruction of your lifetime foe's experience and situation, and as a result, you forgive that person to put the long hatred to an end. A reason this happens may be that your imagined self convinces you that you would have done the same if you were placed in his situation, though you cannot expect anything from a future you no longer have (let us put aside any personal belief in resurrection).¹³ If you forgive that person without undergoing such a process—say, you are converted and decide to follow a religious creed of forgiving—then this motivation should be called selfless altruism.¹⁴ You may feel empathy to a character in a movie or a novel, simply because you imagine what you would have done if you were the character. Or you find yourself non-empathic if you fail to identify with that character's behaviors or thoughts. This clearly has nothing to do with the prospect that the same thing *will* happen to you in the future: empathy is imaginative, and sometimes counterfactual, motivation that drives you to behave in a certain way. So construed, empathy is not a selfless motivation but is defined as a relational, partly self-centered motivation toward others, as Aristotle stresses in his argument for political friendship.

As much as empathy is discerned from selfless altruism, so is it distinguished from such similar emotions as compassion or sympathy. They are similar to each other in that both involve identification of others' plights¹⁵ and constitute affective responses to them. Nussbaum (2001) discerned empathy from compassion in at least three interrelated ways

¹³ Please note that even though I hereby discern a self from an imagined self, I do not endorse that empathy comes with the awareness that an agent can be the sufferer. Here I follow Nussbaum's argument that no matter how much an agent can psychologically identify with the sufferer, the imagined self stands separately from the sufferer (Nussbaum 2001, 327-8).

¹⁴ This motivation to follow what is deemed proper is neatly discussed in March and Olsen's work on a logic of appropriateness (1996). In this view, political action is driven by "a logic of appropriateness that is associated with roles, routines, rights, obligations, standard operating procedures and practices" (March and Olsen 1996, 249). Similarly, selfless altruism can be exercised as a habitual response. A person may be disposed to cooperate with or help other people habitually regardless of their behaviors (Ouellette and Wood 1998). This may be involved in the stage whereby a norm of reciprocity is internalized and self-perpetuating: "The motivation for reciprocity stems not only from the sheer gratification which Alter receives from Ego but also from Alter's internalization of a specific norm of reciprocity which morally obliges him to give benefits to those from whom he has received them. In this respect, the norm of reciprocity is a concrete and special mechanism involved in the maintenance of any stable social system." (Gouldner 1960, 173-4).

¹⁵ People may become compassionate without imaginative reconstruction of others' experience.

in her influential book on human emotions.¹⁶

First, compassion or sympathy is connected with another person's plight or misfortune, while empathy stands for utter reconstruction of another person's experience no matter whether that experience is positive or negative (see also Wispé 1987). Compassion is directed to others' misfortune such as distress, sadness, or absurdity, not their good fortune. On the contrary, you can be empathic to someone's happy or joyful experiences, as much as you feel empathy to that person's misfortune. Second, compassion always involves moral assessment that suffering is bad while empathy does not: Empathy can be malevolent. Nussbaum stressed that a malevolent person may imaginatively reconstruct another person's plight as a torturer can be cognitively aware of the victim's pain, taking pleasure in it. Empathy does not necessarily denote a degree of altruism, though it is an other-regarding motivation. Rather it is a neutral faculty that can be associated with positive or negative emotions. Third, compassion is associated with more intensive emotions than empathy. Nussbaum pointed out that one of the cognitive requirements of compassion is size of distress, in her words, "a serious bad event has befallen someone" (2001, 321). As empathy can be morally neutral, it does not necessarily involve someone's serious distress.¹⁷

Although Nussbaum recognized the existence of malevolent empathy, she admitted that the benefit empathy brings about is much bigger than this flip side: realization of humanity. Empathy is the utter faculty to imagine fellow human beings' situations, acknowledging the probability that a similar, though not the same, fate can befall anyone.¹⁸ It bridges people in a different social and economic status to share humanity by

¹⁶ Please note that the following is my reconstruction based on Nussbaum's argument. She does not specifically distinguish three ways in which empathy is different from compassion.

¹⁷ If we follow this line of argument, this difference can be neatly comprehended in the following example. The recent photos of Aylan Kurdi, a 3-year-old Syrian refugee who was found dead on a Turkish shore in September 2015 on his tragic escape from fierce fighting between Islamic State insurgents and Kurdish forces, may be too tragic for observers to bring up empathic identification. So people shocked by those photos may have compassion rather than empathy for the boy. But if it drives arousal of people's attention to the calamity of refugees in general, then people may be able to feel empathy to those who flee the brutal war, imagining how painful that would be. This is also understood as a case in which compassion ignited by the observation of a shocking incident triggers people's general empathic identification with other people (refugees in this case), which would not be aroused otherwise. Empathy, though it is discerned from compassion, is closely related to it.

¹⁸ It may be argued that empathic emotions can be directed to non-humans. Someone who pampers a

making them give back and forth a sense of solidarity. Empathy enables you to understand another person's situation and forgive his faults on the basis of the prospect that you would appreciate a second chance as well. This empathic forgiveness binds that person to a norm of reciprocity, imposing a duty to return your forgiveness with a better practice, though not immediately. Sometimes it is deemed reciprocal if the person returns that forgiveness to a third person rather than to you, the original benevolent heart.¹⁹ In this way, empathy has a strong connection with reciprocity, unlike compassion. Compassion is involved in other people's severe distress, so the relationship between the observer and the sufferer is emotionally asymmetrical. This asymmetrical relationship makes it difficult to expect the sufferer—who, by definition, is experiencing a severe plight—to return a compassionate assistance. Compassion may result in unilateral or unconditional cooperation or assistance, similar to selfless altruism.²⁰ But empathy becomes a moral ground on which people can expect one another to treat and be treated in the same fashion: as much as I regard your situation I can also expect you to consider my situation in return, though the size of consideration may vary.

In his influential book on the contribution of empathy to people's prosocial moral action, Hoffman (2000) argued that empathy involves not just a psychological identification but also "an affective response more appropriate to another's situation than one's own (4)." Empathy, so construed, motivates people to respond to other people's situations and the cause of them, triggering emotional assistance or sanction on a basis of their appraisal of others' situations.²¹ As Hoffman continues to stress, empathic distress toward another person's plight may develop into empathic anger toward those who have put that person in a plight, or be transformed to empathic feeling of injustice toward those

companion animal may feel stronger empathy toward it than any other human being. Despite this possibility, I suggest empathy as an important anthropocentric emotional faculty.

¹⁹ This aspect of pass-it-on reciprocity is one clear example of indirect reciprocity, which will be briefly discussed in the next section.

²⁰ The subtle difference between compassion and selfless altruism lies in that the latter is not necessarily associated with the sufferer's plight. Realization of other's plight is not a condition for selfless altruism.

²¹ In this sense, empathy seems to be similar to emotional intelligence, defined as "the ability to perceive emotions, to access and generate emotions so as to assist thought, to understand emotions and emotional knowledge, and to reflectively regulate emotions so as to promote emotional and intellectual growth" (Mayer and Salovey 1997, 5). But calculative reciprocity also involves emotions such as fear or control as we discussed in section 4.1.1. To my point of view, an act of harnessing different reciprocal strategies at times and places to elicit intended outcomes is an emotionally intelligent behavior.

who fail to return goodwill or violate reciprocity by treating people unfairly.²² Empathic distress may drive people to assist the person they identify with, and empathic feeling of injustice may trigger a rectificatory sanction against the source of injustice in lieu of the person suffering injustice. In other words, empathy encourages people to pursue outcomes that are mutually advantageous, justifiable and acceptable, triggered indirectly as well as directly. As a result, people show a strong tendency to make their own contribution even without recourse to material incentives.

They may be “strong reciprocators” or *Homo reciprocans* who are disposed to reciprocate though it is costly (Bowles and Gintis 2002, 2004; Fehr and Gächter 1998; Fehr et al. 2002; Gintis 2000; Kahan 2003). Strong reciprocators refer to those who are inclined to pay back kindness and trigger costly sanctions against non-cooperators, albeit at a sacrifice to their resources. In this regard, researchers argue that the existence of *Homo reciprocans* is important in the evolution of cooperation though chances of repeated encounter are limited. Immediate and clear retaliation for defection can be a virtuous deed if it contributes to maintaining the common good, for example, a social punishment system. In this sense, strong reciprocity has a clear resonance with the way Cicero justified tyrannicide. Egoism is not the driving force of strong reciprocity. Rather strong reciprocators would be willing to trigger a costly retaliation mainly because they believe it is a civic duty that brings about common advantage. This motivation should be discerned from altruism, which features non-conditional cooperation.

It is true that empathic reciprocity has a feature of strong reciprocity in the sense that agents have at least willingness to cooperate voluntarily and adhere to a social norm. We comply with a social norm with an expectation that our fellow citizens also comply with it. As Fehr et al. (2002) indicated, a sense of fairness is premised in the proposition of strong reciprocity. Therefore non-compliance to the social norm that binds us equally—thus treats us fairly—is to betray this expectation and the reciprocal bond among fellow citizens. A subtle difference may arise between strong reciprocity and empathic reciprocity when it comes to regulatory enforcement, for example. It lies in the behavioral tendency of agents to punish non-cooperators. Strong reciprocity justifies immediate and clear retaliation for defection. On the contrary, empathic reciprocity does not always

²² This argument is in line with what Gouldner suggested: “[The norm of reciprocity] motivates and regulates reciprocity as an exchange pattern, serving to inhibit the emergence of exploitative relations which would undermine the social system and the very power arrangements which had made exploitation possible” (Gouldner 1960, 173-4).

prioritize immediate retaliation. Granting a second chance for reciprocation is allowed with a view to enhancing cooperative outcomes. As Putnam emphasized, “if we don’t have to balance every exchange instantly, we can get a lot more accomplished” (Putnam 2000, 21). Forgiveness of wrongdoing is embraced in the notion of empathic reciprocity, as this forgiveness or generosity is also nurtured as reciprocation with a view to better cooperation.

There are four attributes of empathic reciprocity that can be found in the republican interpretation of responsive regulation: a) to improve mutual understanding of each others’ context within which motivations are formed and reformed; b) to adopt cooperative strategies such as persuasion and moral suasion in order to enhance the regulatory outcome rather than mere compliance; c) to escalate up to a more punitive strategy only if it is a last resort to enhance the regulatory outcome; and d) to include as many stakeholders as possible in the regulatory rule-making that binds them equally and fairly.

The first characteristic of contextualization is important in establishing a sense of fairness (Ahmed and Braithwaite 2007; Braithwaite, Murphy, et al. 2007; Feld and Frey 2007; Tyler 1990). We discussed possibilities that a tit-for-tat application of legal enforcement overlooks people’s willingness and capability of compliance. Likewise, mere application of strong reciprocity without a consideration of these contextual differences between individuals may endanger their freedom not to be subject to the arbitrary will of others. This may generate a greater evil because strong reciprocity relies on a stronger social justification, deviance from which would face greater social punishments. In regulation, direct reciprocity requires related parties to have, or at least have prospects for, iterated face-to-face encounters over a sufficient period. In doing so, they get to understand each other’s intention and context, minimizing the possibility of misunderstanding and miscommunication: i.e. negative noise.

The second attribute denotes the purpose of regulatory enforcement. In many regulatory domains, a better regulatory outcome sometimes goes beyond mere compliance with legal rules. This is especially so as the development of legal rules does not catch up with that of industrial technology and business innovation. In prudential regulation, for example, broadly defined principles-based regulation may be more effective in achieving the soundness of financial institutions than a stringent rules-based regulatory approach (as discussed in Chapters 6 and 7). What is at stake at the regulatory frontline is that supervisors comprehend the entity’s risk appetites and monitor how successfully the company’s risk governance and risk management strategies deal with

them. In doing so, a lot of reciprocity is generated as those frontline supervisors interact with people in the financial firm, in a face-to-face way more closely with some than others. Of course there are rules and guidelines companies must abide by, but prudential regulation is not just aimed at achieving regulatees' compliance with those rules, which are in many cases defined in a negative fashion. Rather it aims at more proactive outcomes: such as financial institutions' responsible risk management.

The third feature of punishment as a last resort can be motivated by restorative justice as an important component of responsive regulation (Braithwaite 2002a, 2006b, 2009a). It is the reluctance to escalate up the enforcement pyramid that leads responsive regulation to diverge from tit-for-tat reciprocity. As mentioned above, this is related to the republican commitment to minimizing domination that can be created by the use of public power: regulators should seek by all means cooperative ways to rectify wrongdoing before taking up more punitive sanctions, including networking with partners horizontally (Braithwaite 2008, 2014a). This consideration responds to the attractions of retributivist options rather than preferring a domination-minimizing one, as Braithwaite warned:

A problem is that if we leave ourselves with access to escalation to violence, we are likely to do so more often than best serves minimization of domination. We are especially at risk of that if we are part of a Great Power system. Give even a good president access to a button he can push to exterminate an enemy from a drone, and he is likely to push that button more often than can be justified by the objective of tyranny reduction. All pyramids need special barriers, checks, and balances against escalation to violence (Braithwaite 2014a, 449).

Two republican implications can be drawn from this paragraph. First is that the punishment of wrongdoing should be guided by "consideration of how best to promote some more fundamental goal" (Braithwaite and Pettit 1990, 156).²³ People are easily tempted to use a punitive sanction to thwart any threat to their freedom, but this may be neither an effective nor a proportionate option. The lesson here is that reciprocal regulation should consider the objective of regulation and a best possible means to achieve it, considering the possibility of domination caused by the use of public as well as private power. The second implication is the need for institutionalizing barriers to check

²³ This has a clear resonance with Gutmann and Thompson's notion of substantive reciprocity (1996, 2002).

inclinations or social sentiments to take punitive sanctions before sufficiently considering alternative options. This is in line with the republican critique of Selznick's idea of institutional responsiveness as proposed in Chapter 3: any attempt at institutionalization must take into account the possibility that the most public spirited agent can become an arbitrary power. Upon passing this test of checking, the use of reciprocity and reciprocal sanction can be institutionalized into a norm that commonly, and fairly, binds the participants.

The last characteristic of empathic reciprocity may critically reinforce Selznick's idea of responsiveness, articulated in Chapter 3. One important feature of responsiveness is to take up comprehensive interests of the society in such a way that the established institutional standards are reflexively modified by deliberation among participants. If we move our lens down to the individual level of striving for comprehensiveness, we can observe that empathic reciprocity is well exercised in this process of deliberation. This is a process in which the participants mutually give their words and avowals back and forth to build up and modify a commonly binding institutional standard. This is also a bottom-up process of legitimizing the institution by collective participation.

It is now clear that a responsive regulator is encouraged to take up empathic reciprocity rather than calculative reciprocity when required to opt for one over another reciprocal strategy after making the first cooperative move. Given that responsive regulation does not exclude the regulator's use of calculative reciprocity even by triggering the maximum legal power, a crucial question is: when to switch to a more strict strategy? Although answering this question needs empirical examination, a line of social psychological research on the role of empathy in human cooperation may give general guidelines to regulators who seek to discern when to take up calculative over empathic reciprocity. Researchers have supported the effectiveness of empathy in reducing non-cooperative behavior and eliciting cooperative behavior (Batson and Ahmad 2001; Klapwijk and Van Lange 2009; Rumble et al. 2010; Van Lange et al. 2002). Considering noisy situations in which an actor's intentions become uncertain or miscommunicated, they found that empathy-motivated cooperation helps people overcome unintended incidents of non-cooperation, whereas it is inclined to be less effective in getting over intentional non-cooperation over the long term (Rumble et al. 2010).²⁴ According to these

²⁴ It has also been explored that defection in dyadic regulator-regulatee relationships may be constrained by external factors or accidentally committed, rather than intentionally conducted.

researchers, a generous, forgiving strategy motivated by empathy toward others' situation can effectively elicit cooperation from an unintentionally non-cooperating agent while this effect of empathic reciprocity is likely to diminish in the face of an intentional defector. This gives us a lesson to discern intentions of the opponent when opting for one reciprocal strategy over another. This issue is much discussed in Chapter 6, with an analysis of on-site supervisors who interact with employees of regulated firms in different prudential situations.

The idea of empathic reciprocity is in strong consonance with a substantive account of reciprocity that people are inclined to offer reasons (or public reasons) that other people can accept no matter how much they share one another's values. Gutmann and Thompson's work on deliberative democracy (1996, 2002) illuminated the importance of reciprocity of this kind in politics. According to them, substantive reciprocity "asks us to appeal to reasons that are shared or could come to be shared by our fellow citizens" (1996, 14). This is a perspective in which one acknowledges other people as partners in social life. People share, in the process of reciprocation, not only reasons that can be accepted by other people but also respect for one another's values. It is substantive in the sense that it contains a set of normative principles or virtues that can be justified in this reciprocal process. Reciprocity holds that "citizens owe one another justifications for the mutually binding law and public policies they collectively enact" (Gutmann and Thompson 2002, 156). Here the primary job of reciprocity is to regulate public reason, in which citizens justify to one another their claims regarding all other goods. Unlike calculative reciprocity in which agents' interests rarely change and the process of reciprocation is more likely to be bargaining than deliberation, empathic reciprocity paves a way that attitudes and behaviors of regulators, regulatees, and other stakeholders of regulation play an important role in shaping and reshaping the perceptions of one another.

4.3 Making Sense of Indirect Reciprocity in Regulation

Complementing calculative versus empathic reciprocity, the second dimension of reciprocal regulation is direct versus indirect reciprocity. As emphasized in the previous sections, reciprocity is not only present in dyadic relations. Indirect reciprocity may also operate in multi-player circumstances.

Classic studies of twentieth century social science recognized that reciprocity, defined as making a proportionate return to the original giver (Becker 1986; Gouldner 1960; Malinowski 1926; Mauss 1954), becomes an impetus to the evolution of cooperation (Axelrod 1984; Ostrom 1998). Human cooperation, however, emerges not only between two people but also in a multilateral environment, even among people who do not know each other in person. People may be more inclined to help someone who helped others in the past. Even among those helpers, they may be willing to help a person with a constant history of reciprocation rather than those who have exploited another's help occasionally. In making donations for children in poverty, for example, an individual donor would want her money to be steered by an institution with a good reputation rather than one notorious for corruption or misuse of funds. Here, reciprocity may well be playing a key role. Studies in human society have focused on why and how cooperation can evolve indirectly among people who have no previous encounters.

4.3.1 Models of indirect reciprocity

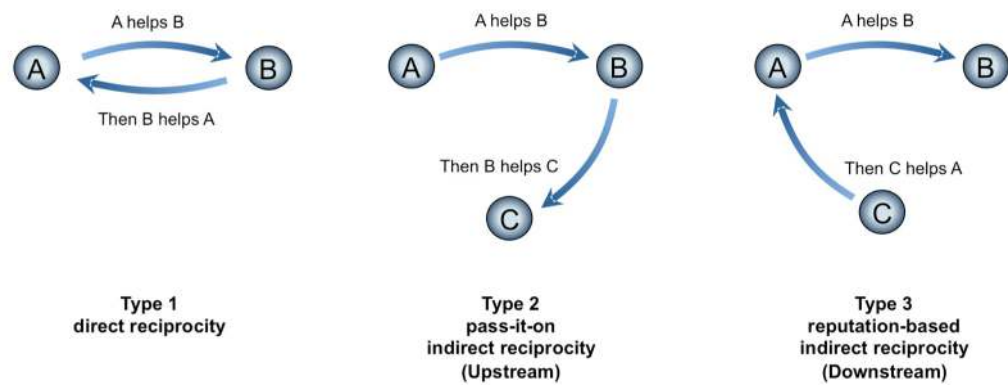
The term indirect reciprocity originates from Richard Alexander's influential work (1987) on a biological approach to the foundation of human ethics. In this book, he claimed that philosophers and social scientists failed to provide sufficient accounts for the development of human ethics because they did not consider the quintessential aspects of human evolution. According to Alexander, the life goal of any organism is reproduction. What is distinctive about humans is that only humans are enemies to one another when they may cause failure to survive and reproduce. In struggling for reproduction, humans are aware that interests sometimes conflict or converge. They realize that they can further their interests by cooperating with others. People's self-interest seeking becomes socially mediated, and the mediated efforts are returned by others directly as well as indirectly. In other words, people's reproductive efforts are socially mediated due to the possibility of mutually beneficial, reciprocal interactions. Alexander's claim is that humans are evolutionarily aware of confluences of interests. They are able to translate this general awareness into rules that govern human competition. For Alexander, the mechanisms of those rules are direct and indirect reciprocity: "humans are unusual among organisms in that all of their life effort that is *social* in nature is permeated with *reciprocity*" (Alexander 1987, 81; emphasis original). In indirect reciprocity, claims Alexander, "the

return is expected from someone other than the recipient of the beneficence” (1987, 85). Indirect reciprocity involves reputation and status, which is being assessed and reassessed by numerous others with whom a person has iterated encounters in a social group.

Simple, abstract diagrams may help understand ways in which indirect reciprocity works. Figure 4.1 shows different ways of reciprocation we can observe in social exchange.

Type 1 on the left stands for direct reciprocity between two agents. This represents a common-sense understanding of reciprocity whereby a return is made to the original giver: if A helps B then B helps A in return. Type 2 and 3 represent cases in which reciprocation is made indirectly. Type 2 depicts a situation in which A helps B then B helps C, rather than the original giver A. This means that agent B returns the help it has received from A to somebody else. Such pass-it-on based on past experience may seem at odds with what we mean by reciprocity. But many researchers have articulated this sort of reciprocity involving one-way flows of benefits as “generalized reciprocity” (Hamilton and Taborsky 2005; Pfeiffer et al. 2005; Sahlin 1965; Yamagishi and Cook 1993). Robert Putnam’s influential work (2000) on social capital also emphasized the importance of generalized reciprocity in building social capital: “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, 20-1). The underlying logic of what Putnam means by “a norm of generalized reciprocity” seems to be a virtuous circle of beneficence: if A helps B, then B helps C and C helps A. The logic of why B, after receiving help, becomes a helper is difficult to prove.²⁵ But the presence of generalized reciprocity is observed in many social interactions. Scholarship provision or blood donation might be good examples of this relay of help or charity. University scholarship schemes subsidize students to pursue higher education and research, but the recipients are not expected to return the help back to the scholarship provider. They are rather expected to make good quality academic or practical contributions. It seems obvious that the recipients of scholarships do reciprocate what they have received. The only difference lies in the direction of reciprocity: it is not made back to the original provider, but to somebody else. The popular “pass it on movements” in civil society actively seek to promote this sort of indirect reciprocity as a

²⁵ See Boyd and Richerson (1989) for the instability and error-prone character of this sort of indirect reciprocity.



[Source] Nowak and Sigmund (2005, 1292)

FIGURE 4.1 Direct vs. indirect reciprocity

virtue by encouraging people to exercise an act of kindness they have received to help somebody else.²⁶ Not only goodwill or kindness is reciprocated in this way. Reciprocation of an absurdity or injustice afflicted on oneself in a social relationship can also be directed to someone other than the original—and maybe powerful—inflictor, as a form of hate crime.²⁷

Type 3 describes the way indirect reciprocity operates on a basis of reputation. If A helps B then C helps A. The underlying logic is that people are inclined to help people who helped others in the past, perhaps based on Selznick’s community-building virtues or on a psycho-logic of just rewards for those who help others. It would be clearer if we assume C observes reciprocation between A and B, as described in Figure 4.2.

Figure 4.2 illustrates variants of reputation-based indirect reciprocity. Type 3a represents a situation in which A helps B but B does not help A in return. A reciprocal response available here is that C will help A while punishing B. The probability that C punishes B will increase if C is a strong reciprocator, because B’s defection would jeopardize the social norm of reciprocity.²⁸ Type 3b describes a hard case in which A

²⁶ For details of this campaign, see <https://www.wecannetwork.org/compassion-is-contagious-pass-it-on-campaign/> (last accessed on 20 Mar 2015).

²⁷ This kind of negative pass-it-on indirect reciprocity is widely observed in hierarchical institutional settings such as boarding school culture or defense culture, where distress inflicted by a senior student or officer is directed someone who is junior than oneself.

²⁸ Note that a strong reciprocator C would punish B even without considering B’s reputation. As discussed in Subsection 4.2.2, strong reciprocity does not refer to actor’s reputation. Alexander also indicates that C would punish B’s exploitation because otherwise C would encounter exploitation or evil from another actors in the society at no cost to them (Alexander 1987).

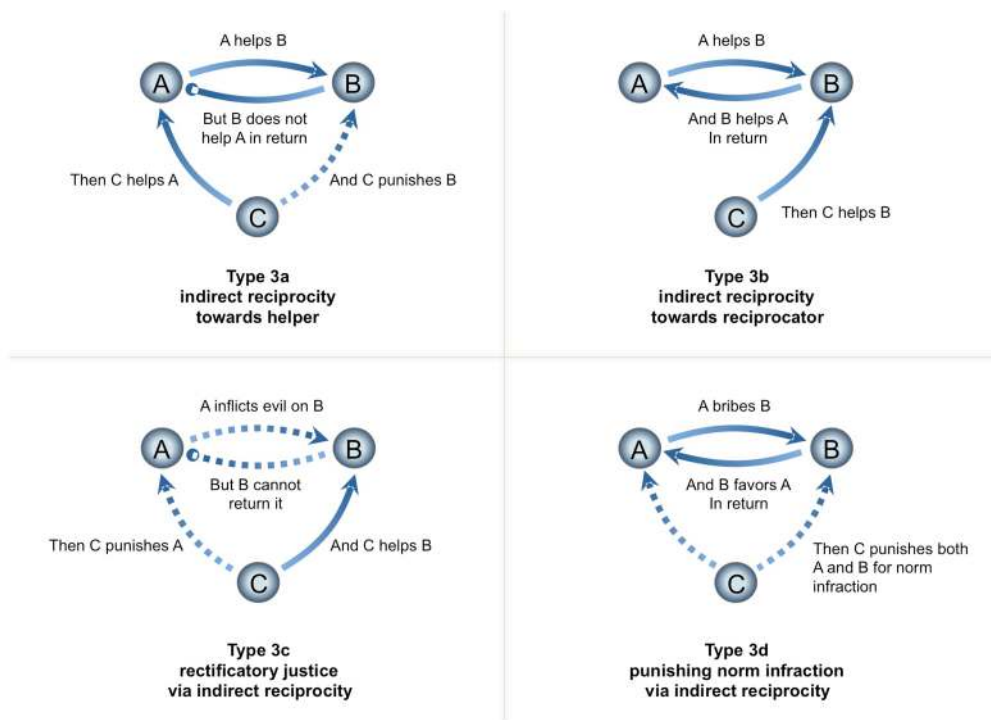


FIGURE 4.2 Variants of indirect reciprocity based on reputation

helps B and B makes a proportionate return to A. Upon observing this reciprocation between two actors, what would C do? One account is that C is more inclined to help B than A, because C can expect that helping B would be more likely reciprocated by B, who reciprocated before (Tullberg 2004). A is also a helper, but it is not clear whether A does reciprocate from this one-off observation. However it is very difficult to say that C will make a decision on this one-off observation. In an actual situation, C would be willing to see A and B’s history of reciprocation. Therefore reputation that has been accrued over time is quintessential in understanding this sort of indirect reciprocity.

This is a theoretically important issue in regulatory theory. Critics of responsive regulation say it can only work—as tit-for-tat can only work—with iterated encounters between this regulator and that regulatee (Ford 2011; Gunningham and Grabosky 1998; Gunningham and Johnstone 1999; Nielsen and Parker 2009; Scott 2004). Indirect reciprocity explains how in place of repeat personal encounters a regulatory inspector can observe the history of reciprocation of a firm with other actors. From that the inspector can decide whether to punish or cooperate after observing the first serious violation of the law. In the empirical chapters that follow, evidence is found in regulatory practice of such observation of histories of reciprocation with actors other than oneself. This reveals yet another sense beyond those discussed in Sections 4.2 that responsive regulation in

practice is at its best when it transcends simple tit-for-tat—by also taking account of indirect reciprocity.

Type 3c depicts a situation where B is unfairly treated by A, but cannot return the evil received. Upon observing this unfair transaction, C would be willing to assist B while punishing A in lieu of B. C's behavior in this case is to rectify the wrongdoing committed in a society. It is also B's strategy to publicize this absurdity to mobilize public sentiments against injustice or arbitrariness. The last case Type 3d represents the development of direct reciprocity as norm infraction. Here cooperation between A and B are in a corrupt form from C's point of view. Then C will trigger punishment toward both A and B. This type also carries a significant implication especially in regulatory studies, because the very conditions nurturing the evolution of cooperation also become the conditions for the evolution of regulatory capture and corruption (Ayres and Braithwaite 1991). C's role as a power contesting this unethical practice of reciprocity is crucial in preventing capture.

A number of scholars have striven to develop different accounts in which cooperation through indirect reciprocity based on reputation is evolutionarily stable (Berger 2011; Leimar and Hammerstein 2001; Nowak and Sigmund 1998; Ohtsuki and Iwasa 2004, 2006; Sigmund 2012; Wedekind and Milinski 2000). They argue that this stability occurs because the observer helps helper while punishing exploiter. The observer expects this behavior to increase her own reputation and elicit future help from other actors in the society. I also focus primarily on indirect reciprocity of this kind, because it has more significance in regulatory contexts. Nevertheless, this does not overlook the moral importance of indirect reciprocity based on past experience, as "my return must be something my benefactors will perceive *as* a return, and *as* a good" (Becker 1986, 110).

4.3.2 Reputation, learning, and indirect reciprocity

Human cooperation is an important theme for evolutionary biologists because they posit that cooperation evolves among individuals who are presumably competitors in the struggle for survival and reproduction. Indeed cooperation is, for evolutionary biologists, antithesis of natural selection. Therefore Alexander's attempt to comprehend human cooperation as an evolutionary process involving direct and indirect reciprocity induced many theorists to delve into the mechanisms of indirect reciprocity. Since Alexander, a lot of evolutionary theorists have striven to test the hypothesis that cooperation via indirect

reciprocity among unacquainted people is evolutionary stable. Their works are diverse in using different research methods such as computer simulation²⁹ or lab experiments,³⁰ assuming non-human population or human population,³¹ or testing in a large population or a limited small population.³² One major point of scholarly dispute that is of grave significance in the empirical application of the idea of indirect reciprocity is how to measure reputation.

Nowak and Sigmund's work (1998) is the pioneer in testing the stability of indirect reciprocity. They attempted to explain the evolution of cooperation via downstream indirect reciprocity based on reputation (see Figure 4.1, Type 3). Their question was how cooperation can evolve under the circumstance in which neither kinship nor personal acquaintanceship exists. It is assumed players can either cooperate or defect. This is observed by all community members. Players gain an image score of 1 for cooperation or -1 for defection. Using computer simulation,³³ they found that almost all populations

²⁹ For indirect reciprocity research based on computer simulation, see Leimar and Hammerstein (2001), Nowak and Sigmund (1998), and Ohtsuki et al. (2009). They designed computer simulation in the following ways: Researchers discretionarily take into account factors constituting the context, define characteristics of players and also define options players can opt for which are vested with values. Then researchers run simulation in which players have rounds of interactions with other players in the population.

³⁰ Wubben et al. (2011) uses experiments to show that emotion takes a critical role in the evolution of cooperation through indirect reciprocity. Their method is involved in the participation of undergraduate students in experimental settings.

³¹ Evidence of indirect reciprocity is scarce for non-human organisms, whereas it is widely accepted as relevant for human cooperation. For studies based on human populations, see Leimar and Hammerstein (2001), Masuda (2012), Watanabe (2014), Wedekind and Braithwaite (2002), and Wedekind and Milinski (2000).

³² In early works on indirect reciprocity testing its stability, populations typically consist of limited numbers of individuals who are assumed not to meet again either as a donor or a recipient. See for example, Nowak and Sigmund (1998) and footnote 33 in this chapter. For studies assuming a fairly large size or even infinite population, see Leimar and Hammerstein (2001), Masuda (2012), and Ohtsuki and Iwasa (2004).

³³ On the nature of the data in such computer simulations, see Footnote 9 of this chapter. Here is the story in Nowak and Sigmund (1998). There are one hundred players in a generation and each player is initially given an image score zero. Throughout their entire life, the same individuals do not meet again, either as a donor or a recipient. In each encounter, players can either cooperate or defect. If the player cooperates then her image score increases by one unit; if she decides not to then she loses one unit. The range of image scores is limited from -5 to +5. The image score will be inherited to the next generation at the end

discriminate cooperators from non-cooperators after a sufficient number of interactions, which means that players cooperate with those who cooperate, defect for those who defect. Based on this finding, they argued that the evolution of cooperation via indirect reciprocity is stable. Of course, once indirect reciprocity has evolved in this way, indirect reciprocity can be reinforced as a normative expectation within a culture that the young model from elders they admire. Then it can become a habit, rather like polite greetings that people enact automatically without thinking, until someone gives them reason to reflect on the option of being rude rather than polite.

Nowak and Sigmund's image score strategy indicates that the donor will get beneficial results by founding her donation on the recipient's image score: she donates if the recipient's image score is high; she does not if it is low—below zero (see footnote 33). However, this strategy does not always guarantee a beneficial result to the donor and also to the community. It commands the donor to defect if the recipient has defected, which would subsequently decrease her own image score and chances of getting future cooperation. This makes individual punishment of a defecting player costly. It might be a more plausible scenario of image score strategy that the donor minds her *own* image score irrespective of that of the potential recipient, considering it would increase her chances of getting future cooperation via indirect reciprocity (see also Milinski et al. 2001). The donor is likely to end up choosing a non-discriminating strategy of cooperation in this scenario.

Alternatively, “good standing” may be a more solid assessment and action rule for indirect reciprocity than image score (Leimar and Hammerstein 2001; Panchanathan and Boyd 2003; Sugden 1986). The standing strategy works in such a way that an individual would lose her good standing by failing to help others in good standing while she could improve it by helping others. Good people lose their good standing if they fail to help other good people, while they do not if those people are in bad standing. Consequently, this makes punishment of a non-cooperator less costly: the player would need to

of each generation. In this context, a strategy k means the player helps another player if and only if the recipient's image score is at least k . Thus, that a player uses a strategy 0 means she cooperates if and only if the recipient's score is the same or greater than 0: she discriminates a cooperator from a non-cooperator. Strategy -5 means the player uses non-discriminating cooperation: she always cooperates regardless of the recipient's score. By contrast, strategy 5 means the player uses non-discriminating defection. Nowak and Sigmund found that players' strategy k converges on zero after a sufficient number of generations. Note that this computer simulation presumes non-human population.

discriminate cooperators from non-cooperators in order to increase her chances of getting future benefit. Standing becomes a rule of assessing the recipient's reputation, and at the same time, a rule of acting in accordance with her interests of increasing her own reputation. The difference between image score and standing strategies becomes clear. Unlike image scores that do not take the recipient's moral standing into account, standing strategies claim that the donor's reputation depends on the moral standing of the recipient and her subsequent action.

In regard to this issue, Panchanathan and Boyd (2003) provided a lucid clarification of the difference between these two strategies. They insist the image score strategy reflects action while the standing strategy considers intention behind action. In image scoring strategies, reputation is determined by the *act* of helping or not helping. Thus defection from help always decreases the donor's image score while helping always increases it. This is not true in standing strategies. Here what is more important is underlying *intention*. Defection from helping an individual in bad standing can be justified because it constitutes punishment. Likewise, helping an individual in bad standing is unjustified because it encourages defective actions and ruins the punishment system. Because an image scoring strategy ignores this difference, they claimed, it overlooks the possibility that all defecting actions are treated negatively (Panchanathan and Boyd 2003). Researchers establish that discriminating people according to their good or bad standing leads to the establishment of good reputation (Ohtsuki and Iwasa 2004, 2006; Ohtsuki et al. 2009).

Upon considering the contextual differences between assumptions of theoretical works in evolutionary theory and the reality of regulatory practice, it is a challenging task to make sense of indirect reciprocity in regulation. Nevertheless, many regulatory studies (eg, Carpenter 2010; Fisse and Braithwaite 1983), including this thesis, present revealing clues showing that reputation matters and that indirect reciprocity actually works, though not explicitly, in many regulatory arrangements. But I need to address one potential criticism of the application of indirect reciprocity in regulation: perfect information.

The assumption of perfect information is probably the most notable hypothetical set-up in evolutionary theory that cannot be realized. In image scoring literature, a player's image score is obtained by all other members of the community. Image scoring strategies require a player to be able to track the image score of everybody else. This implies that indirect reciprocity may work at best in a group of small or medium size in which each player can observe and remember all other members' encounters. Nowak and Sigmund

acknowledged this problem and showed that a cooperative strategy becomes not dominant as group size increases under imperfect information (1998).

Making a real-world case for standing strategies seems more challenging. Milinski et al. (2001) claimed that a standing strategy is too demanding to be realized because it attributes too much memory capacity for tracking all the standings of recipients in the previous rounds to the helper, making it prone to error. Even compared with strategies of image score, this requires greater cognitive capacity.³⁴ For it demands a potential donor to track the standings of its counterpart's recipients in all previous rounds in order to know her intent, shrinking the applicable group size (Panchanathan and Boyd 2003). Therefore what is essentially required in the successful operation of indirect reciprocity, under whichever strategy, is to offer sufficient information to more community members.

The limits of imperfect information can be mediated in reality by third party that regulates information flow. Evolutionary theories do not normally assume the presence of third party. Thus information acquisition is solely attributed to individual capacity. People should be able to get sufficient information on others' behaviors to make a right decision, because unjustified defection or cooperation will leave a stain on their own reputation. Sometimes they are required to track down the recipients' history of cooperation. These limitations can be, though only partly, overcome in a real-world situation if the information diffusion is mediated and facilitated by other means, such as public announcements, mass media, word of mouth, online media such as SNS, or standardized measures that are accessible to wider populations.

Some institutional settings may dramatically facilitate the reputational information flow. Airbnb and Uber are good examples that place two-way reputational assessment by both users and service providers at the heart of its operation. Airbnb offers online services connecting accommodation seekers and providers, while Uber connects individual cap service providers with customers who need a ride. Both Airbnb and Uber enable customers to choose services based on the providers' information as well as previous customers' reviews on the quality of service. What is distinct in these two services is that they offer information not only on the providers. They also provide information on customers. Airbnb provides information on the accommodation seekers, such as profiles,

³⁴ If it comes to regulation, however, this capacity may not be cognitive. For regulators, it is a digital record of the past compliance responsiveness of regulatees. For larger regulatees, it is comparable records of past encounters in the files of regulatory affairs departments.

social relationships, and most importantly the reviews from previous hosts who have provided accommodation to them. Customers who do not want to expose such private information online can choose not to do that. Then accommodation providers would opt for not receiving such customers. Uber offers diverse channels through which information on customer reputation can be shared and used by drivers. It provides a consumer reputational score based on all the transactions that customer has completed. The driver can just look at the rating when accepting a ride. Only if it is unusually low will he look at qualitative data on the Uber database about the customer before accepting the ride. The qualitative data may allow the driver to move from a simple image scoring assessment to a standing assessment if the consumer has been rated as overly assertive by one driver several times—when, for example, that driver is known by others to be rude.³⁵

An Airbnb user confesses that because the provider can assess her stay she spends some time to clean the room, not throwing towels on the floor for example, whenever she gets accommodation through Airbnb; in contrast, she used to be relaxed about leaving towels on the floor when staying in hotels. By making reputation of both service providers and customers accessible to one another as well as many other people in the network, Airbnb and Uber encourage users to harness the experience of others, rather than their own experience (Nowak 2012).

The same point applies to the more descriptive information available with corporate financial and Corporate Social Responsibility (CSR) ratings or “Dirty Dozen” lists put out by environmental NGOs or the media. In the regulatory arena, information on the reputation of a firm or a regulator can also be distributed by mass media, or by each party’s efforts to publicize the performance. The condition of perfect information cannot be met in any existing world of regulatory practice. Rather the theory of indirect reciprocity implies that the more reputational information becomes salient, the more prevalent evolution of social cooperation would be. And the more relevant indirect experience from indirect reciprocity would be in new governance compared to personal experience of direct regulatory interactions.

³⁵ Indirect reciprocity would become more relevant to regulation in the Internet age as these services gain popularity. Low-scored providers will naturally drop out of the competition with other providers. Airbnb and Uber are keen to monitor consumer complaints more closely to enhance its service quality, because consumer complaints may seriously damage their reputation and jeopardize eventually their success in the market. A consumer affairs regulator might look at Uber’s reputational data with a complaint against an Uber driver who refuses a refund required by consumer protection law.

4.4 Conclusion

This chapter has proposed two dimensions of reciprocity—calculative vs. empathic reciprocity and direct vs. indirect reciprocity—as a conceptual framework for reciprocal regulation. This framework provides a useful tool for answering such questions as: *Who* harnesses a certain sort of reciprocity? *When* and *why* do they opt for one over another sort of reciprocity in a wide regulatory landscape? Addressing all these questions is beyond the reach of this thesis because it requires a series of comprehensive research projects mapping human and institutional behaviors in diverse regulatory domains. Rather, this thesis narrows its focus, in particular, on ways in which participants in the regulatory process take up some sort of reciprocity in order to hold one another responsible for enhancing regulatory outcomes. It maps direct and indirect reciprocity possibilities that exist in regulatory spaces without counting their frequency or testing one versus another causal theory of their emergence. Chapter 5 discusses a series of detailed regulatory strategies adoptable by agents involved in regulation. Chapters 6 and 7 demonstrate evidence showing that those strategies are implemented in the domain of prudential regulation in South Korea and Australia. Before moving on, we need to clarify the significance of this conceptual framework in regulatory scholarship. Theoretical contributions of reciprocal regulation vis-à-vis the current regulatory literature will be much discussed in the concluding chapter. Suffice it to say for now that reciprocal regulation is discerned from responsive regulation as it has come to be theorized and implemented in practice, as opposed to misleading constructions of responsive regulation as a direct tit-for-tat model.

Most features of empathic reciprocity are drawn from the republican aspects of responsive regulatory theory. Empathic reciprocity implores us to amend some important perspectives of responsive regulation, however, reconsidering the idea of responsiveness. This takes us back to Selznick as an important resource. Regulatory researchers turned their attention to reciprocity with an aspiration to comprehend the evolution of regulatory cooperation by relying on the development of game theory in the 1980s. Therefore it is no wonder that regulatory researchers focused on only one version—direct tit-for-tat—when envisioning reciprocity. This constituted their idea of institutional responsiveness: the

regulator responds to the regulatee's behavior or attitude in the previous encounter. Reciprocal regulation broadens our view to a wider regulatory landscape that considers diverse sorts of reciprocal relationships among participants, by showing that not a single but multiple kinds of reciprocity are used to engage agents to hold one another responsible.

The reciprocal regulation perspective makes at least two contributions. First, the distinction based on motivations of reciprocity suggests a way of discerning when to adopt different direct reciprocal strategies—calculative or empathic—in order to elicit a cooperative move more effectively. An agent taking up a certain sort of reciprocity over another in regulatory interactions manifests an intentional response to the regulatee's behavior or attitude, considering the context of their underlying capacity and intention. In the course of responding to a regulatee's capacity and intention, reciprocal regulation hypothesizes that it is likely to be effective to use calculative reciprocity against an intentionally defiant regulatee, whereas empathetically reciprocal strategies are more likely to be effective against most other types of regulatees. A reciprocally responsive regulator might therefore consider using a strict tit-for-tat approach against a “dismissive” or “game-playing” business firm (Braithwaite 2009b). Punishing non-compliance may give the firm a signal that it needs to rectify its dismissiveness or game-playing. In other cases of non-compliance, triggered by incompetence, forgetfulness or principled dissent from a mandated regulatory practice, for example, a strategy based on empathic reciprocity may be sought before legal enforcement. As will be concluded in Chapter 6, a frontline inspector is inclined to draw on empathic reciprocity even toward a firm with a high-risk profile unless the firm is intentionally defiant. This chapter has also discerned a republican justification for the use of different kinds of direct reciprocity.

A much more important contribution reciprocal regulation makes to responsive regulation is incorporation of indirect reciprocity into the idea of responsiveness. In turn, networked responsiveness gives normative and dynamically strategic content to reciprocal regulation. This enables us to refine regulatory theory and address some serious critiques of responsive regulation. One is on reciprocity deficits and another is involved in the networked feature of contemporary regulatory arrangements. The reciprocity deficit critique points out that repeated interactions between regulator and regulatee may be too infrequent to make the pyramidal approach viable in certain industries (Baldwin and Black 2008; Gunningham and Johnstone 1999; Haines 1997; Kingsford-Smith 2011; Mendeloff 1993; Nielsen and Parker 2009). According to these authors, regulators

normally have insufficient regulatory resources to iterate face-to-face encounters with all regulatees. The networked governance critique is that responsive regulation is too state-centric (Grabosky 2013; Scott 2004; Shearing and Wood 2003), dyadic (Coslovsky 2011; Heimer 2011), or spatially narrow (Ford 2013) to scale up in response to changing regulatory environments in the era of networked governance and wicked problems like climate change and global derivatives markets. They argue that responsive regulation, especially the enforcement pyramid, focuses on face-to-face interactions in dyadic regulator-regulatee encounters, despite the original authors' endorsement of tripartism. Critics persist in the refrain that responsive regulation inevitably ends up with a narrow understanding of a regulatory landscape that does not take into account regulatory arrangements involving multiple actors. I argue that reciprocal regulation is the micro-foundation for a responsive institutionalism that can address both kinds of criticisms. Combining direct with indirect, calculative with empathic reciprocity structurally reconceptualizes institutional responsiveness to encompass reputational indirect reciprocation in a regulatory web. Moreover, it provides explanations for ways in which relational regulation involving non-public actors operates in a wider regulatory landscape. In this way, reciprocal regulation supplies missing links between the micro responsive mechanisms in Ayres and Braithwaite (1992) and the webs of dialogue and webs of coercion in Braithwaite and Drahos's scaling up to *Global Business Regulation* (2000) that transforms global *Regulatory Capitalism* (Braithwaite 2008; Levi-Faur 2005, 2006a; Jordana and Levi-Faur 2004). This is also accomplished via a republican normative theory (Pettit 1997) that assists in bridging the micro of methodological individualism to the macro of Selznick's institutional responsiveness.

Strategies of Indirect Reciprocity in Regulation

We have been through a long journey of theoretical underpinning for the idea of responsiveness to address the challenges to the conventional vertical understanding of regulators being responsive to regulatees. As we explored in Chapter 4, reciprocal regulation urges us to envision a range of specific types of reciprocity when seeking to render regulation responsive. Indeed, regulatory and social exchanges among different actors are continuously observed and assessed by numerous actors, more purposefully by some than others. What then are the regulatory strategies we can draw from the insights of reciprocal regulation? What are the advantages in adopting those strategies? To what extent can reciprocity insights make a difference to practical regulatory design?

This chapter aims to identify regulatory strategies leaning on indirect reciprocity. Indirect reciprocity can be harnessed to overcome the insufficiency of regulatory encounters that is inherent in any regulation or to elicit better regulatory compliance without resorting to the intrusive overreach of regulation as domination. It may also inform anti-corruption and anti-capture strategies that humble arbitrary power of regulators or regulatees unchecked against the common good. This chapter bridges theoretical underpinnings of different types of reciprocity discussed so far in Part I with empirical research that will be explored in Part II, by proposing models of reciprocal regulation that can be applied to concrete regulatory policies and practices.

The main theme of this chapter, and of reciprocal regulation, is reputation or image. Reputation is a crucial asset not only for regulators, but also for regulatees and other social stakeholders. An informant from a large Australian bank confessed that the company would never introduce a financial product that might compromise the organization's reputational capital no matter how much profit it was expected to produce. This means that reputation may have been a restraining factor conditioning profit-seeking activities at least for that executive. Reputational capital is indeed one reason private

companies opt to be socially responsible firms (Hahn 2015; Garriga and Melé 2004; Matten and Crane 2005; McWilliams and Siegel 2000; McWilliams et al. 2006). Regulatory agencies should be concerned about their own reputation because a positive reputation becomes a great booster for effective regulation while a negative reputation among regulatees breeds resistance to regulatory enforcement, induces more political incursions into their autonomy, and sometimes results in organizational restructuring (Carpenter 2010). Social stakeholders such as NGOs, international organizations, and professional associations realize that their legitimacy largely rests on their reputation, as assessed and shared across a wide range of social relationships (Cole 2012; Hafner-Burton 2008; Mitchell 2015).

As much as reputation is important capital that actors can cash out, so is it one reason making the powerful vulnerable to one another's influence. An abused employee may inform regulators to mount investigations on labor conditions or workplace health and safety that are costly to the firm (Fisse and Braithwaite 1983). In the Internet age, publicizing unfair treatments by powerful people or groups on social network services (SNS) makes it much easier for the weak to help organize political or consumer activism demanding justice (Choi and Park 2014; Harlow 2012; Micó and Casero-Ripollés 2014). Reputational capital is hard to build yet easy to smirch. Indirect reciprocity is a mechanism that can empower the socially weak to mobilize like-minded companions to contest and sanction the strong. Likewise, it can also bring about reputational sanctions lethal enough to socially destroy the weak for misdemeanors alleged against them by the public relations machines of state and corporate power.¹

If actors involved in regulation realize that indirect reciprocity flows through networks, they can intelligently harness strategies that may not involve actual interaction to pursue their goals. This means that indirect reciprocity can be also deployed as strategies regulatees adopt to contest regulators and even capture them. But I must make clear that this sort of use stands beyond the purpose of this thesis. Strategies considered in this chapter are intended to inform thinking about effective regulation. They are not strategies only relevant to state regulators. Private regulators, international organizations, public interest groups, or even individual citizens that wish to render regulation

¹ The proportionality of reputational sanctions via indirect reciprocity is an important issue in the application of indirect reciprocity. The republican ideal of minimizing domination is a guideline here. It will be discussed in a lengthy fashion in the concluding chapter.

responsive to their demands in daily life might all consider these strategies. I look into intra-organizational structure and dynamics so that individual as well as organizational actors utilize indirect reciprocity against one another. It can be a strategy that a member of a regulatory agency can deploy against other members of the same organization, or a strategy an inspector can use toward a certain group of people in a regulated entity. The fact that their conduct is exposed to one another's gaze within a regulatory landscape could motivate actors to behave in a cooperative and responsible way.

Having said that, strategies presented in this chapter represent only part of the entire range of reciprocal strategies that might be employed by many different actors. They are a list to illustrate the potential and fertility of the idea of reciprocal regulation without pretending to be exhaustive. They propose some basic ideas that actors can apply to their specific circumstances. Some of them will be illustrated as I unfold my empirical research in Chapters 6, 7, and 8. In this chapter, I suggest six indirect reciprocity strategies that can be categorized into three groups with a view to achieving regulatory goals:

- Overcoming regulatory resource deficits
 - Strategy 1. Indirect signaling of responsiveness
 - Strategy 2. Interagency cooperation for strategic targeting
 - Strategy 3. Intra-agency cooperation between rotating inspectors

- Rectifying arbitrariness: anti-corruption and anti-capture strategies
 - Strategy 4. Overlapping networked rectification of arbitrariness
 - Strategy 5. Internal transparency

- Nudge for better compliance
 - Strategy 6. Stimulating healthy reputational competition

These three categories are identified being mindful of the difficulties many regulators encounter in their regulatory practice. The details of each category and subsequent strategies will be considered in the next three sections.

5.1 Overcoming Regulatory Resource Deficits

One of the main criticisms of responsive regulation is that many regulators do not have the capacity for encounters with all regulatees let alone iterated encounters so that tit-for-tat could work. This is not a concern pertinent only to responsive regulation. It is applicable to all forms of regulation to some degree. It is certainly impossible to punish a firm without interacting repeatedly with it to gather evidence and ascertain their side of the story. Many regulatory agencies emphasize in-office review of paperwork they receive from regulatees; most of them find it difficult to spend a high proportion of their scarce human resources visiting a wide range of regulatees to “kick the tires” (Braithwaite 2009a, 440).² Regulatory resource deficits especially become a serious challenge to state regulators that face neo-liberal imperatives for smaller yet more efficient government.

The important point is that it is hard to make any regulatory strategy work without direct, iterated encounters (Braithwaite and Hong 2015). Schell-Busey et al.’s (2016) meta-analysis of regulatory deterrence found little evidence consistent with the power of deterrence but a lot of evidence for the power of inspection in increasing compliance and evidence of the mix of regulatory strategies that is integral to responsive regulation, smart regulation, and kindred approaches. May and Wood’s (2003) work on frontline inspectors’ enforcement style also indicates the importance of iterated, consistent contacts with inspectors: “Relative to homebuilders without direct contact with inspectors, those with direct contact rated inspectors as more facilitative on average, were more likely to agree that inspectors were useful as a form of quality control, and were more likely to consider their reputation with building inspectors as an important influence on compliance with code provisions” (129). Indeed regulation involves more interactions than meet the eye.

5.1.1 Strategy 1: Indirect signaling of responsiveness

Regulatory strategies in the first category appeal to regulators who suffer regulatory resource deficits. The first strategy is to signal responsiveness indirectly to regulatees who have not had direct encounters with the regulator. Regulators are encouraged to build a cooperative as well as a firm image by making most critical encounters more iterated.

² This is a big challenge particularly to regulators who oversee small and medium sized enterprises. See Gunningham and Johnstone (1999).

This is to give regulatees a chance to learn from others' experience rather than their own costly experience.

A key requirement for a successful responsive regulator is to signal that it is a responsive regulator, who is willing to privilege a cooperative over a deterrent enforcement strategy. So the series of regulatory contacts between a regulator and a regulatee amount to a mutual learning process in which the regulator becomes aware of the appetite of the regulatee and the regulatee learns the law's as well as the regulator's expectations from its own experience. Braithwaite (2011) stressed the importance of signaling responsiveness to regulatees in two ways: "signal that you prefer to achieve outcomes by support and education to build capacity," and "signal, but not threaten, a range of sanctions to which you can escalate; signal that the ultimate sanctions are formidable and are used when necessary, though only as a last resort" (503-7). This means that regulators need to signal in a principled way that they are by all means cooperative, but only as long as regulatees are also cooperative in return: regulators are cooperative yet firm.³ Regulatory scholars have emphasized the importance of consistent signaling in regulator-regulatee relationships in which regulator-regulatee encounters risk ambiguity and inconsistency (Etienne 2013; Hawkins 1984; Lindenberg 2000; May and Wood 2003).⁴

Braithwaite and Hong (2015) suggested broadening the recipients of responsiveness signals from regulatees in a direct encounter to those who have not encountered the regulator. They stressed the importance of indirect signaling in which a regulator signals to non-encountered regulatees that a responsive regulator is willing to cooperate first, yet is ready to wield its legal and regulatory power when necessary. Their message to regulators is "making the most crucial encounters more iterated" in a principled way (as

³ Signaling intention is also important in the evolution of cooperation via direct reciprocity because the original theory proposed by Axelrod (1984), assumes perfect information. Researchers have indicated the effects of noise—external factors by which intention of cooperation or deterrence is not clearly communicated—that impair the effectiveness of tit-for-tat (Bendor et al. 1991; Mueller 1987).

⁴ May and Wood's work (2003) posed doubts on the consistency of signals in responsive regulation. They claim that the flexible application of cooperative and deterrent strategies gives inconsistent signals to regulatees and thus "undermines regulatees' understanding of rules and the development of shared expectations concerning compliance" (135). But responsive regulation's conditional cooperative strategy—regulators are cooperative, but only as long as the regulatees are also cooperative as well—is a principled signaling, though not consistent in the sense of May and Wood—adopting either a "get along" or "get tough" approach.

in direct signaling) so that they “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” (25). The first strategy of indirect reciprocity develops this line of indirect image signaling. Regulators who suffer resource deficits may cope with this difficulty, though only partly, by actively seeking to build reputation as a committed on-site visitor.

Business sites visited by responsive inspectors can be chemical plants and car factories for an environmental regulator, infant care facilities for a childcare regulator, banks and insurance companies’ regional offices for a prudential or financial conduct regulator, passenger and cargo ships for a maritime safety regulator, restaurants and food factories for a food and health regulator, or taxpayers’ accountants’ offices for tax officials. The purpose is not just to get necessary information on whether they abide by the regulatory rules and guidelines. Visits often involve conversations over mutual expectations, difficulties in meeting expectations, and education and discussion about how to meet expectations so that the regulator and regulatee constitute a regulatory relationship (Black 1998). The first strategy suggests that regulators show their commitment to on-site visits and make it convey to other regulatees information on those encounters, including reasons for visits, attitudes to deal with the target regulatee, methods of handling non-compliance, and their motivations.

Regulators strategically select a target for reasons such as possibility of corruption, weak risk governance, accrued consumer complaints and so on (Black and Baldwin 2012a). They sometimes trigger regular visits with a targeted list of review items. On-site visits may bring about specific deterrence effects, because the targeted entity would learn from its own experience with the regulator. But regulators may also anticipate general deterrence effects from on-site visits. If regulators are seen to visit business sites in a targeted way as far as they can despite scarce resources, regulatees may also realize the pressure from the law and regulation that they can be targeted in the next visits.⁵ General deterrence normally points out that people who have not been subject to legal punishment but have observed or heard about legal sanctions against others are deterred from violating rules. Criminological studies on general deterrence suggest certainty of detection is a useful predictor of compliance with the law (Blumstein 2011; Friesen 2012; Nagin

⁵ The indirect pressure from the law is also captured in what researchers call law’s expressive function. See McAdams (2000).

2013; Robinson 2011), much more so than severity of punishment.⁶

However targeted on-site visits do not always elicit a cooperative response either from the regulated entities in direct encounters or from other unencountered regulatees. The regulator may face resistance or defiance from the regulatee, depending on its approach or the firm's predisposition (Braithwaite 2003b, 2009b). Then other regulatees who observe those regulatory conflicts may also opt for noncompliance. Using a responsive approach, therefore, is important in anticipating the positive effects of indirect reciprocity. It justifies the regulator's reasons in switching to punitive sanctions in iterated encounters: the regulatee's failure to return the favor received. The indirect reciprocity function underlying responsive regulatory visits is described in Figure 5.1.

Figure 5.1 depicts a situation where Regulator (R) treats Business 1 (B₁) in a responsive way, and this is returned with cooperation not only from B₁ but also from other regulatees (B₂ B₃ ... B₇) who observe those encounters. General deterrence would argue that being a tough visitor to B₁ might enable R to anticipate compliance from other regulatees. But indirect reciprocity tells us that what is more important in anticipating

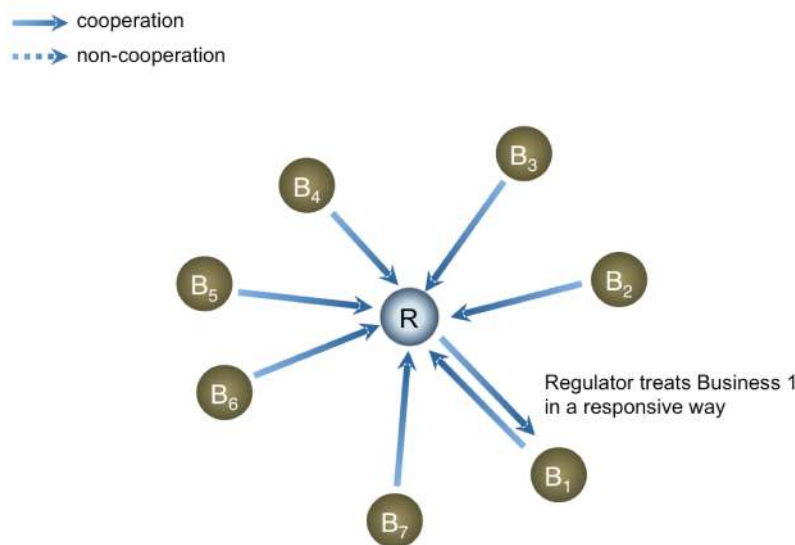


FIGURE 5.1 Indirect signaling as a responsive regulator

⁶ One reason that certainty of detection is a more useful predictor of legal compliance is involved in fear of shame. Fear of shame communicated by the public, rather than by legal authorities, is sometimes so powerful and humiliating for some people as to degrade their identities and shatter their fragile ego. There is disagreement among scholars on the extent to which shame engendered by general deterrence is or is not constructive. For a review of research that has attempted to distinguish healthy from unhealthy shame and argued for reintegrative shaming and healthy shame management, see Ahmed et al. (2001); Braithwaite (1989); and Harris (2006).

others' compliance is how those others recognize the encounters. If R's sanction in those encounters is seen illegitimate or excessive—for example, B₁ has attempted to meet R's expectation or R's attitude is arbitrary and imperious without considering B₁'s specific circumstances—the sanction is likely to be recognized as exploitation of goodwill. The sanction may be seen differently compared to the same degree of sanction against a gaming or dismissive regulatee who has committed the same degree of contravention. This is why responsive regulators who harness empathic reciprocity in iterated regulatory encounters are likely to anticipate cooperation from other regulatees whom they have not encountered.

One important condition for the first strategy is to signal to other regulatees that the regulator is committed to adopting a responsive approach. This signal should point out a principled approach to regulatory enforcement: that the regulator cooperates first, when and why it switches to a more punitive method, and when and why it switches to a less punitive method. Then this signaling transmits the pressure B₁ has received from R to a wide range of regulatees (B₂ B₃ ... B₇) so that they also realize that they can be targeted next time, but in a non-arbitrary way. Expecting regulatees to share B₁'s experience, through for example word of mouth or social media, is a plausible option. The regulator would be inclined to act on more active information delivery. Setting out the regulator's general enforcement approaches on its own website⁷ or sending out letters of expectations to regulated enterprises may be an effective option. Regulators can convey information on the iterated encounters they have had by publicizing cases of regulatory escalation and lists of administrative undertakings.⁸ They can also publicly release the results of visits

⁷ For example, the Australian Taxation Office (ATO) clearly communicates its responsive approach with taxpayers who use an online tax return program. On the first page of E-tax 2012, ATO says “Be assured that if you do your best to fill in your tax return correctly, you will not be subject to any penalties if you get these things wrong ... If you follow our information in *e-tax 2012* and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith, we will not charge you interest,” E-tax 2012 (last accessed on 21 June 2014). The first sentence of this citation is erased in E-tax 2015. <https://www.ato.gov.au/Individuals/Lodging-your-tax-return/Lodge-online/> (last access on 30 October 2015).

⁸ Many financial regulators keep the list of administrative orders updated on their website. For example, two Australian financial regulators, APRA and ASIC, both publicize the enforceable undertakings register online. This is a clear sign to other financial institutions and personnel indicating what they should refrain from conducting.

that tout the business as an exemplar, thus boosting its reputation. What is important is to inform regulatees that they are entangled in a social and regulatory web of indirect reciprocity. Through these endeavors, a poorly resourced regulator has a better chance of deterring calculative firms acting on a cost-benefit calculation and also invigorates the willingness of regulatees to be responsible citizens.

5.1.2 Strategy 2: Interagency cooperation for strategic targeting

The second strategy seeks cooperation among regulatory agencies in such a way that they share the accumulated compliance history of regulatees that lie across different regulatory domains. Not only regulators with rudimentary capacity but also regulators who have to oversee unprecedented transnational business activities would adopt this strategy to overcome the regulatory resource deficits.

Regulators encounter many coordination challenges. There are growing scholarly concerns on the ineffectiveness of overlapping regulation in which different regulators inspect the same regulatees operating in “shared regulatory space” (Freeman and Rossi 2012; Nou 2014; see also Sharkey 2013).⁹ This shared regulatory space may feature diverse state regulators from the national and local levels, but sometimes see the co-existence of public and private regulators and even domestic and international regulators. While some of these delegations and arrangements produce inefficiency and duplication, the problem of shared regulatory space is “to minimize inconsistency, maximize joint gains, plug gaps, and prevent systemic failures” (Freeman and Rossi 2012, 1149). Apart from the existence of redundancy in shared regulatory space, the need for interagency cooperation arises from transnational business activities. Many regulators face transnational business activities beyond the boundary of conventional regulatory jurisdiction so that one regulator can hardly regulate businesses of transnational firms

⁹ Freeman and Rossi’s work (2012) on shared regulatory space echoes President Obama’s call for interagency coordination: “We live and do business in the Information Age, but the last major reorganization of the government happened in the age of black-and-white TV. There are 12 different agencies that deal with exports. There are at least five different agencies that deal with housing policy. Then there’s my favorite example: The Interior Department is in charge of salmon while they’re in fresh water, but the Commerce Department handles them when they’re in saltwater (Laughter). I hear it gets even more complicated once they’re smoked (Laughter and applause),” remarks by the President in State of Union Address, delivered on 25 January 2011. <https://www.whitehouse.gov/the-press-office/2011/01/25/remarks-president-state-union-address> (last accessed on 30 October 2015).

(Coen and Thatcher 2008; Eberlein and Newman 2008; Eberlein et al. 2014; Posner 2009). Thus understood, the coordination challenges comprise dual pressures: one from the demands for domestic regulatory arrangements and another from the demands for transnational regulatory arrangements. Both denote a common challenge to regulators: how to arrange effective interagency coordination?

The second strategy of indirect reciprocity addresses one of the coordination challenges: strategic targeting for regulators. Strategic targeting is in most cases inevitable for regulators because even the most powerful regulator cannot monitor and oversee all activities of all potential regulatees. A well-known way of dealing with the target-selection issue is to sort regulatees according to their motivations and performance in regulatory compliance and then adjust targeting strategies to individual regulatees referring to their compliance history (Ayres and Braithwaite 1992; Black and Baldwin 2012a; Braithwaite, Murphy, et al. 2007; Gunningham and Sinclair 2009; Kagan and Scholz 1984). However, this is a strategy only available to regulators with a fairly long history of regulation that have accumulated information on the regulated over time. Most rudimentary regulators in the developing world or experienced regulators even in developed countries may encounter this challenge in regulatory practice to a different degree.

The second indirect reciprocity strategy proposes interagency cooperation among regulators in different levels and domains as a remedy. Figure 5.2 describes the logic of indirect reciprocity that may underlie a shared regulatory space.

Denote Regulator 1 (R_1) as a rudimentary regulator that falls short of information on facilities' compliance history, whereas Regulators 2 and 3 (R_2 and R_3) are experienced agencies with accrued information on business firms' compliance history. This is a situation in which R_1 undergoes difficulties in mobilizing its limited human resources to select the target strategically because it falls short of information about which business firms are or are not compliant. Indirect reciprocity suggests that if there is interagency cooperation in which those three regulators share compliance histories of regulatees,¹⁰ R_1

¹⁰ One major obstacle to this interagency information sharing is legal prohibitions based on privacy laws. But the degree of sharing that is permitted under privacy laws may differ among countries. For example, the Privacy Act of Australia hinders the use of collected personal information for purposes other than the original purpose. South Korea's Personal Information Protection Act also sets out that the use of personal information collected is also limited only to the purpose for which the information was obtained. However, use may be permitted "where it is inevitable for a public institution to perform its affairs

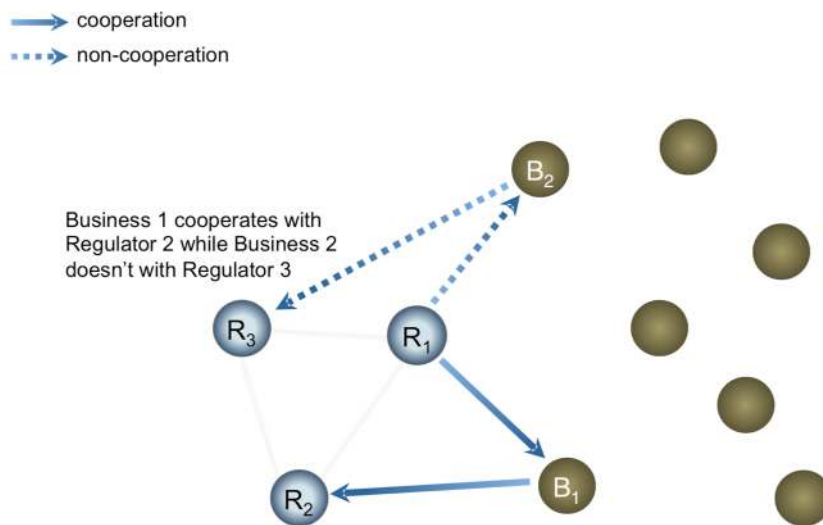


FIGURE 5.2 Interagency cooperation for strategic targeting

can access the information and be aware that B₁ has cooperated with R₂ while B₂ has not cooperated with R₃. In this way, a regulator can obtain information on regulatees' compliance history, without spending significant resources on its own database. If such a system is in place, information R₁ acquires in its regulatory conduct can give an alert to R₂ and R₃ who may have not obtained the same information that is necessary to them. In some sense, this interagency cooperation embraces direct and indirect reciprocity among them.

This strategy gives a regulatory agency that suffers information deficits a chance to utilize other regulators' experience through interagency cooperation. In a shared regulatory space, regulatees are subject to regulation of several agencies. As explored in Chapter 8, for example, a childcare facility in South Korea may be visited not only by the childcare regulator for its entire operation, but also by the labor inspectorate or workplace health and safety regulator who oversees infant carers' working conditions. The environmental regulator may also have reason to visit the facility to supervise indoor air pollution issues and the tax inspector may also look at tax compliance. Regulators in different countries are delegated different degrees and ranges of authority for supervision in a certain field. And in many cases they overlap.¹¹

provided for in any Act and subordinate statute, etc." (PIPA 2013, § 15-1-3).

¹¹ One reason for this redundancy is to prevent an agency's regulatory failure from being transmitted to totalizing failure in regulating that particular industry (Freeman and Rossi 2012). For example, many

There are due process concerns that regulators should consider when applying this strategy of indirect reciprocity to their practice. A regulated actor could reasonably object to its information being shared among regulators without its consent or to any regulatory decisions being made based on information obtained by another regulator without giving it an opportunity to respond to that information. As a matter of law, the cross-regulator sharing of information may amount to a violation of privacy law that makes a regulator difficult to justify a decision made based on information that it has not created itself. What I am proposing in the second indirect reciprocity strategy is that a poorly resourced regulator should not entirely rely on information obtained by other regulators in making a regulatory decision.

The second strategy asks the regulator to share information on regulated entities in a limited way: for example, referring to information obtained by other regulators when making decisions on which entities to visit and target its limited regulatory resources rather than using that information as a clue for enforcement. The shared information is only used to narrow down numerous targets the regulator needs to check on-site. Thus regulated entities are given opportunities to respond to the regulator's visit based on information from other regulators. The indirectly sourced visit makes the regulator's visit a chance to create and verify its own evidence for enforcement. The amount and nature of information shared should differ from regulator to regulator, as permitted by particular legal contexts. As discussed in Chapter 8, in some jurisdictions like South Korea, where the use of personal information is permitted in view of performing the legal delegates, regulators may by law share private information as long as the sharing is deemed inevitable for them to fulfil their objectives. In jurisdictions where sharing sensitive private, organizational information is a violation of privacy act, regulators should carefully consider the scope and contents of the information sharing. Sometimes organizational information protection stands out of the scope of privacy laws in several jurisdictions, such as Australia and South Korea.

Financial regulators in Australia have maintained close inter-organizational cooperation through a series of memorandum of understandings (MOUs) that enumerate the scope and contents of sharing of information and intelligence. As of October 2016,

countries employ a twin-peak financial regulatory system so that two professional regulators—one specializing in risk supervision and another for investigating dubious financial conduct—are responsible for the nation's financial integrity.

APRA has seventeen MOUs with its domestic partners and thirty MOUs with its international partners.¹² Most of MOUs APRA signed with domestic agencies are about intra-agency regulatory coordination and cooperation. For example, the MOU between the APRA and the Australian Crime Commission sets out “The Parties acknowledge that the timely sharing of information and intelligence, and other cooperative arrangements, will contribute to the production of key intelligence products to support law enforcement and other investigatory processes.”¹³ The MOU between APRA and ASIC sets out that APRA collects data from Australian financial service providers on behalf of ASIC. It also emphasizes the importance of information sharing between the two agencies and even of sharing of confidential information, given that both agencies acknowledge “the confidentiality and secrecy requirements of the legislation under which each agency operates.”¹⁴

5.1.3 Strategy 3: Intra-agency cooperation between rotating inspectors

While the first strategy encourages regulators to care for their own reputation and the second asks them to utilize intelligently the reputation of regulatees, the third strategy uses reputation of both regulators and regulatees. Inspectors at the frontline consider their own reputation as well as that of regulatees when taking over inspection as part of organizational rotation. This is a strategy that can be most of all harnessed by inspectors at the regulatory frontline. Many regulatory agencies adopt regular rotation policies for its personnel. For some agencies this is a preventive measure for regulatory capture. For others it is seen as a way of developing performance, capacity and breadth of experience for employees. One common, critical challenge is that a rotation policy unavoidably

¹² The entire list and contents of MOUs of APRA can be read and downloaded: <http://www.apra.gov.au/AboutAPRA/Pages/ArrangementsandMoUs.aspx> (last accessed on 15 October 2016).

¹³ See Memorandum of Understanding for Cooperation and Information Sharing between the Australian Prudential Regulation Authority and the Australian Crime Commission, p. 4. <http://www.apra.gov.au/AboutAPRA/Documents/MoU-APRA-ACC.pdf> (last accessed on 15 October 2016).

¹⁴ See Memorandum of Understanding between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission, p. 3. <http://www.apra.gov.au/AboutAPRA/Documents/ASIC-MoU.pdf> (last accessed on 15 October 2016).

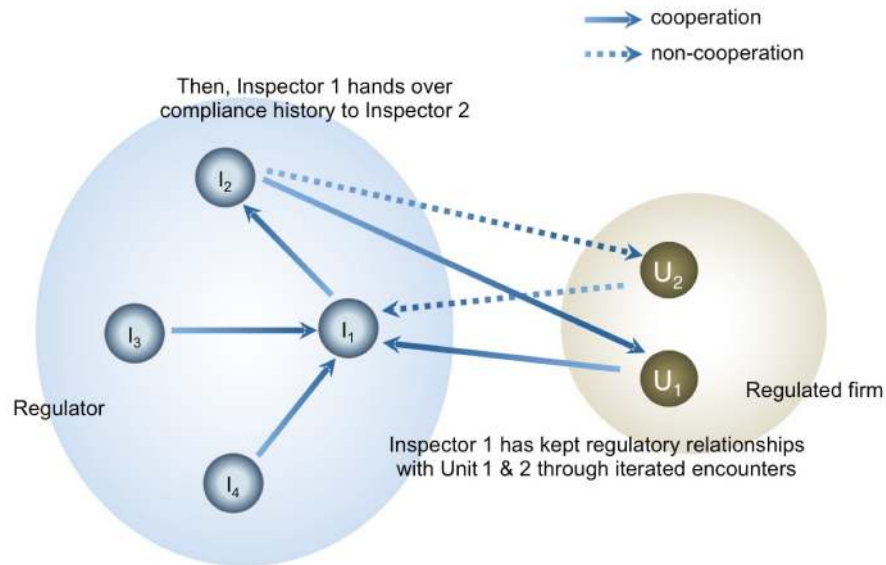


FIGURE 5.3 Passing on compliance history between rotating inspectors

brings about a trade-off between the needs for rotation and the level of local, contextual knowledge. Especially regulatory agencies that have successfully maintained the quality of frontline supervision may wish to keep the side effects of rotation to a minimum. The third strategy of indirect reciprocity is that inspectors hand over their first-hand knowledge on regulatees' compliance attitudes to successor inspectors so that they can more quickly establish their regulatory relationships. The underlying logic can be described in a generic way in Figure 5.3.

Say a regulatory agency runs designated inspectors at the regulatory frontline who are responsible for supervision of certain entities. The relationship an inspector has maintained may be adversarial or friendly depending on various factors, but it is commonly observed that the designated inspectors keep the level of first-hand knowledge on the business units and personnel in the regulated entities that is accrued over years of iterated contacts. So it is reasonable to assume that Inspector 1 (I_1) in Figure 5.3 is aware of different units' and personnel's attitudes at least toward her—for example, Business unit 1 (U_1) has been telling I_1 in a timely and honest manner while Business unit 2 (U_2) has not. This information can be passed on in a cooperative way as rotation is made at the frontline, in such a way that I_1 informs I_2 , the next designated inspector, of each business unit's compliance history.

Then, two dynamics of indirect reciprocity take place. One is of course between I_2 and U_1 and U_2 in the regulated entity. It is predictable that I_2 will refer to the information conveyed from I_1 when initiating a new regulatory relationship so that she can grab the

picture immediately, though being not entirely dependent on it.¹⁵ Another indirect reciprocity dynamic takes place among frontline inspectors. It may not be always the case that I_1 hands over her first-hand knowledge to I_2 . In many cases this kind of handover occurs in an informal way between individual inspectors. If the information pass-on is made in a good faith, one underlying reason is that I_1 is concerned about her own reputation among her peers in the agency. Her non-cooperation with I_2 will be observed, shared, and returned in a non-favorable way by I_3 or I_4 in the future, though it is unpredictable by whom the return will be made.

The second dynamic of indirect reciprocity might suggest an interesting point of intra-organizational reform for regulatory agencies when their internal culture is competitive and callous rather than cooperative and amicable. In such a culture, passing on their first-hand knowledge and expertise to their potential competitors may seem naïve. Then indirect reciprocity that flows through intra-organizational networks may operate toward consolidating informal factions in which inspectors only cooperate among like-minded, in-group members. And this can subsequently engender a barrier to effective information sharing in staff rotation. The third strategy of intra-organizational cooperation suggests that such regulatory agencies come up with remedies that intelligently harness the effects of indirect reciprocity, for example, formalizing the informal culture of handover.

5.2 Rectifying Arbitrariness: Anti-corruption and Anti-capture

Strategies in the first category suggest ways in which regulators can overcome various regulatory resource deficits. Strategies of indirect signaling, interagency cooperation, and intra-agency cooperation commonly give regulators tips that they can mobilize dexterously their limited resources to implement regulation in an effective and efficient way. Strategies in the second category are suggested to cope with another sort of challenge: contesting arbitrary actions of regulators as well as regulatees. Two strategies are deployed in this section. Strategy 4 is an anti-corruption strategy while strategy 5

¹⁵ Entirely depending on the passed on information when triggering a new regulatory relationship should be discouraged. In fact, this indirect reciprocity strategy would hand over a biased view toward regulatees, so the taking-over inspectors are required to adopt any subsequent strategies in a conscious way.

proposes an anti-capture strategy.

5.2.1 Strategy 4. Overlapping networked rectification of arbitrariness

Acting on consumer complaints or whistleblowers' insider information a regulator can identify and rectify malfunctions or corruption of regulatees. It is a bigger regulatory failure if the regulator is not acting on such information, due to for example, corruption of regulators by bribes from regulatees. Figure 5.4 below shows the application of the Type 3c indirect reciprocity function of rectificatory justice.

Say, Business 1 (B_1) is corrupt, and as a result, punishes Whistleblower (W) while W is powerless to return that punishment. W does not have to be the victim of B_1 's arbitrary behavior. W may be an abused employee or a group of local residents whose living environment is contaminated by B_1 's illegal discharge of effluent. Or W may be shareholders of B_1 's business and thus may be eventually harmed by that corruption, or simply a passer-by who by accident detects the wrongdoing.

One possible indirect reciprocity is that W notifies Regulator (R) of B_1 's wrongdoing. Then R can trigger a costly investigation of B_1 and rectify it. But it may be the case that R, even after receiving the information, does not act on it. R may consider there is insufficient evidence to trigger investigation, or may be captured by B_1 . Or R may naively pass on the information to B_1 for self-rectification as will be illustrated in Chapter 8. This strategy suggests that if R does not act on W's information disclosure, then W can disseminate the information on both B_1 and R's non-cooperation to other social stakeholders, such as NGOs, Unions, relevant government bodies (Govn't), and Media to mobilize contestation. In a nutshell, actors encompassed in this figure are intertwined with one another in chains of indirect reciprocity that might be deployed to rectify corruption and injustice. The fourth strategy of indirect reciprocity is to institutionalize those channels through which information on the reputation of regulators and regulated businesses flows so that they are urged to act in a cooperative way concerning for their own reputational capital.

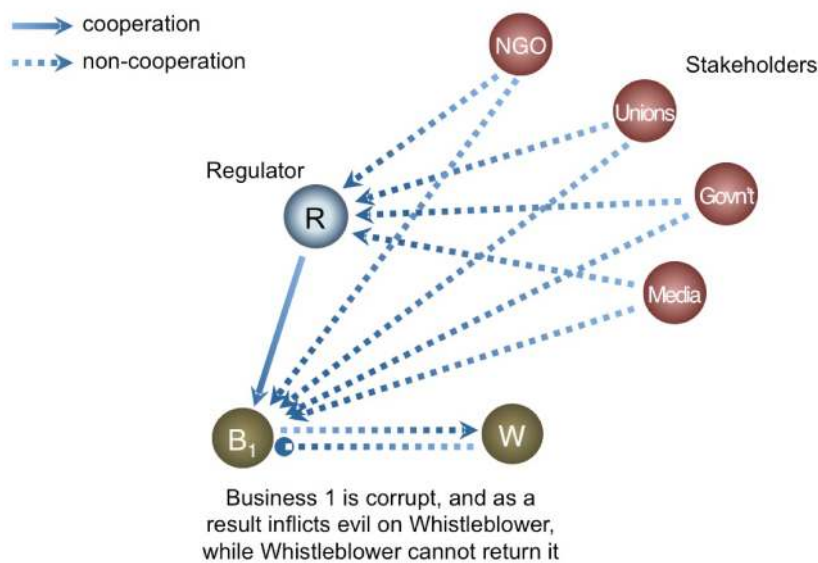


FIGURE 5.4 Overlapping networked rectification of arbitrariness

What is implied in this strategy is the classical problem of who guards the guardians. This strategy suggests that a remedy for this issue cannot be hierarchical. Nor is horizontal balance of power sufficient to check arbitrary use of public as well as private power. Rather it acts in the way that John Dryzek argued deliberation works (Dryzek 2013). For Dryzek, deliberative accountability is realized as those affected by a collective decision participate in making that decision. One similar yet slightly different way of realizing republican contestability in regulation is affected people's participation in the regulation of arbitrary use of power. Republican checks help those subject to arbitrary intervention with contestatory power to check power to ensure resilient enjoyment of freedom as non-domination. This line of thought leads us to insist that regulation of a deadly acid leak in a chemical plant, which threatens the lives of workers as well as local community members, encompasses at least the voice of the affected workers and community members. Similarly regulation of child abuse in childcare facilities should include the voice of children (largely represented by their parents). The type of reciprocity involved in this sort of indirect reciprocity strategy may be calculative reciprocity if actors only consider future benefits and loss. It may also involve empathic reciprocity if those actors trigger sanctions in terms of empathic distress toward victims of wrongdoing, as discussed in Subsection 4.2.2. This strategy contributes to broadening the concept of regulatory responsiveness: being responsive not only to the attitude or motivation of the regulated enterprises, or intention or context behind their action, but also to stakeholders' desire to resiliently enjoy freedom as non-domination.

5.2.2 Strategy 5. Internal transparency

The fifth strategy of indirect reciprocity responds to the risk of regulatory capture caused by close regulatory relationships. As discussed in Chapter 4, regulatory researchers have suggested tit-for-tat—that is to mix up cooperation and deterrence—as an effective enforcement strategy that brings up the evolution of regulatory cooperation (Ayres and Braithwaite 1992; Burby and Paterson 1993; Harrison 1995; Nielsen and Parker 2009; Scholz 1984, 1991). But the very conditions nurturing the evolution of regulatory cooperation also become the conditions for the evolution of regulatory capture and corruption (Ayres and Braithwaite 1991; 1992 Chapter 3) Regulatory capture that features in direct collusive relationships may be associated not just with direct bribes, but also with revolving door dynamics: the flow of personnel between regulatory agencies and regulated industry.¹⁶ It has been argued that a revolving door dynamic does not in itself generate regulatory capture and corruption (Carpenter and Moss 2014; Cohen 1986; Gormley 1979). Some argue that revolving doors can improve the performance of regulated entities because expected future gains from cooperation can outweigh short-term gains from opportunism (Salant and Woroch 1992; Salant 1995). Yet the risk is unavoidable that personnel of a regulatory agency may tend to be more supportive of the industry that formerly employed them or that regulators are seduced by prospects of more lucrative employment in industries they were regulating (Makkai and Braithwaite 1992). What is at stake in preventing regulatory capture of this sort is how to detect and check capture.

The fifth indirect reciprocity strategy to cope with this challenge is internal transparency. Transparency is part of the democratic ideal of organizational openness and accountability (Bovens 2007; Stasavage 2003). It is defined as making an organization's activities and performance visible to external publics (Heald 2006; Kolstad and Wiig 2009; Kostadinova 2015; Lindstedt and Naurin 2010; Settembri 2005; Sibert 2009). *External* transparency of an organization is the idea here. The visibility of organizations from outside is not the only transparency ideal, however. Transparency can be *internal*, meaning individual or group gazes at the activities and performance of their own

¹⁶ Besides, regulatory capture can also take an indirect and more implicit form of political campaign, cultural capture (Kwak 2014a) or researchers' capture (Zingales 2014).

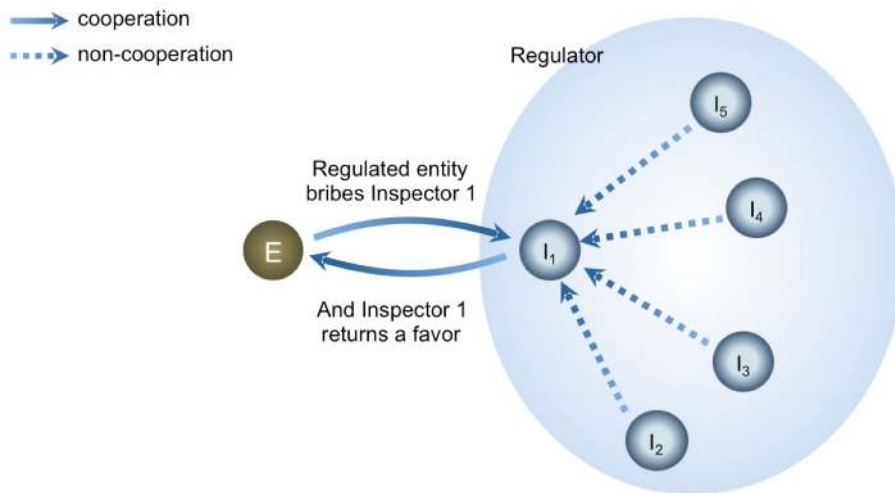


FIGURE 5.5 Indirect reciprocity mechanism underlying internal transparency

organization or a sub-unit within it.

Figure 5.5 describes a generic situation that applies Type 3d reciprocity, punishing norm infraction via indirect reciprocity, as discussed in Chapter 4. It depicts an indirect reciprocity mechanism that underlies internal transparency.

Imagine that Regulated Entity (E) corrupts Inspector 1 (I_1) and I_1 favors E in return. Figure 5.5 could be easily adapted to represent capture rather than corruption: for example, I_1 being captured in a close relationship in which he or she makes business judgments based on private intimacy. Internal transparency asks the regulatory agency to make I_1 's regulatory activities and enforcement against E as visible as possible to other inspectors (I_2 , I_3 , I_4 , and I_5). Then there are two possible scenarios. First, I_1 may be oblivious of the fact that he or she is captured or corrupted. If I_1 's regulatory conduct is accountable to the scrutiny of many different groups inside the agency—through for example an intranet system by which all members of the regulatory agency can view the work of all others, peer reviews, or benchmarking processes, as illustrated in Chapter 7—capture can be detected and notified to I_1 for correction. Second, I_1 may be aware that reciprocating E's bribe or regulating E in a favorable way is a norm infraction—violating professional ethics or the agency's codes of conduct. If the regulatory agency is internally transparent, then I_1 will not respond to that request because he realizes that his peers could condemn his conduct, damaging his reputation, and triggering formal punishment. Internal transparency means that an organization is equipped with a system in which ethical

breaches are so easily detected that even an egoistically motivated member acts in accordance with the communal norm.

5.3 Nudge for Better Compliance

Indirect reciprocity suggests actors involved in regulation can utilize, to different degrees, people's concerns about their own reputational capital and desire to be recognized as good citizens. Then those actors can steer the flow of information about others so that people who get to access the information might respond as consumers, suppliers, or employees for example. In this sense, regulators may be gatekeepers or "choice architects" as nudge theorists put it: who intentionally strive to alter people's choices without "forbidding any options or significantly changing their economic incentives" (Thaler and Sunstein 2008, 6).¹⁷ This section introduces one indirect reciprocity strategy in which the regulator can be a choice architect: nudging for stimulating reputational competition.

5.3.1 Strategy 6. *Stimulating reputational competition*

If we follow Thaler and Sunstein's definition of a choice architect, anyone who self-consciously delivers and disseminates information that may have sway over others' reputation can be a choice architect. This is so because the delivery would neither forbid any options for people's choice nor significantly alter their economic incentives. Of course it affects people's choice by providing new information that they might not have known and thus stimulates them to opt for a certain option they would otherwise have not chosen. But it potentially can do so in a non-intrusive way, even a non-dominating way according to republican theory (Pettit 1997). Considering that a regulatory landscape consists of networks and communities in which members continuously and intentionally strive to influence one another's activities, we can easily observe cases in which someone

¹⁷ This approach is what those authors call libertarian paternalism. It is at once libertarian in that it gives people's freedom of choice the utmost importance, and paternalistic in the sense that it moves people to opt for options that serve their best interest, as judged on the basis of their own verdict. So people would not choose the option implied by a choice architect if they deem it not serving their best interest. This argument encourages regulators to use non-interventionist methods by which they stimulate regulatees to comply with rules and guidelines without enforcing it.

becomes a choice architect in an information flow.

Regulators often hold information on regulatees' business, at least on their regulatory compliance. Information on a firm's regulatory compliance is a crucial asset especially if the firm takes seriously its reputation as a responsible actor. If regulators are aware of the firm's reputational appetite, they may find it an easily accessible, and sometimes very effective, option to tarnish the firm's reputation or to enhance it for taking compliance up through new ceilings. Many regulatory scholars have suggested reputational sanctions as an effective deterrence option (Fisse and Braithwaite 1983; Van Erp 2011, 2013) and inspection report praise as an effective reward (Braithwaite, Makkai, et al. 2007; Lee 2010).

While naming and shaming can counterproductively foster defiance (Ahmed et al. 2001), it is a well-known regulatory approach in which regulators use reputational sanctions as a means for social control. It usually takes a form of negative sanctions against lawbreakers, harnessed by both the regulator and other social stakeholders.¹⁸ As governmental regulators keep a public register of personal convictions, institutional penalties or mandated outcomes like CO2 reductions (Liebman and Milhaupt 2008; Van Erp 2008), so can non-governmental organizations or mass media publicize firms' or even states' violations (Hafner-Burton 2008).¹⁹ Naming and shaming is also proposed as a regulatory strategy in which the powerless can sometimes be empowered to hold contestatory power against the powerful (Braithwaite and Drahos 2002; Braithwaite 2006a).

¹⁸ International relations scholars also argue that reputational sanction enhances cooperation among players in international relations (Keohane 1984; Park and Hirose 2013; Simmons 2000; Tomz 2007).

¹⁹ The exercise of social pressure on private industries' business activities is well captured by the social license literature (Gunningham et al. 2004). A business firm or public organization is so much concerned about its own social reputation that it strives to meet the expectations of the society and avoid activities that are deemed socially unacceptable or blamable. In environmental regulation, for example, many civil watchdogs keep a close eye on a nuclear plant or chemical refinery and are ready to raise issues and mobilize collective actions concerning any environmental pollution or contamination. In a field in which social license is strongly in place, it may be an effective strategy for a regulator to empower various institutions of civil society.

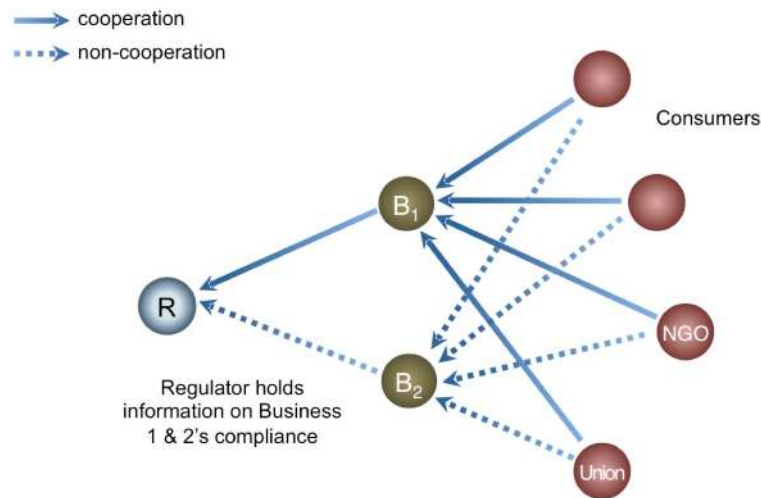


FIGURE 5.6 Nudge for stimulating healthy reputational competition

Public reporting of private industries' performance is a similar approach in which a regulator can utilize information on regulatees. For example, the Nursing Home Quality Initiative was introduced by the U.S. Department of Health and Human Services in 2001 in order to provide consumers with sufficient information on the quality of nursing homes' performance (Harris and Clauser 2002; Marshall et al. 2003; Stevenson 2006). Behind this initiative lies the logic of indirect reciprocity, because information on performance shapes organizational reputation. So people are expected to choose a nursing home with good performance over those with bad performance. Publicizing quality information would enable consumers to make informed decisions and eventually improve nursing homes' performance quality.²⁰

It is common in those two regulatory approaches that regulators take the role of choice architects who consciously disclose information that may affect regulatee reputation for good or ill. The underlying logic of indirect reciprocity in this case can be captured in Figure 5.6.

In Figure 5.6, Regulator (R) is aware of the compliance behavior of Business 1 (B₁) and Business 2 (B₂), who are presumed to compete with each other in the market, that B₁ has been compliant whilst B₂ has not. Both naming and shaming and public reporting commonly adopt information disclosure to make this information accessible to social stakeholders, such as NGOs, Unions, and Consumers. What these two methods suggest is

²⁰ For a critical treatment of the limits of this analysis, see Braithwaite, Makkai and Braithwaite (2007).

that if the information is successfully delivered, then those stakeholders may be more cooperative with B_1 than B_2 . Another subsequent anticipation is that B_1 , B_2 and other firms will be willing to comply with R , as they expect this to happen or have learnt of this risk from their own or others' experience.

What has not been suggested in the current literature is that R , by the same token, can stimulate reputational competition between B_1 and B_2 without actually disclosing the information to the public. Sometimes it may suffice to inform each regulated entity that its performance in a certain field of regulatory compliance is behind its competitor. If B_2 is aware that its performance in the field of consumer service or risk governance falls significantly behind B_1 and other companies, its senior management or board will be concerned and attempt to improve performance. This sort of nudging for reputational competition can be conceived as an indirect reciprocity strategy that I will explore in Chapter 7 to be actively harnessed by prudential regulators in both Korea and Australia. Supervisors in both organizations say that this nudge is effective in their real world of regulation.

5.4 Conclusion

Readers may find strategies introduced in this chapter generic and abstract at this stage of their development. Actual regulatory spaces are always more complex than the models in the Figures of this chapter. What this thesis will establish is that the potential policy applications of regulatory reciprocity are diverse, rich and mostly still waiting to be tapped. Yet the thesis will also establish that it is undeniable that many regulators in fact harness to differing degrees at least the six indirect reciprocity strategies discussed in this chapter. It is also indisputable that many previous regulatory studies have already embraced important points of indirect reciprocity, even if they have conceived them within some other theoretical framework such as nudge. Thus conceived, strategies of indirect reciprocity do not claim to introduce a new paradigm of regulation. They claim to develop the full and sadly neglected implications of a paradigm as old as Aristotle.

Chapters in Part I have suggested a holistic theoretical framework that enables us to see regulation through a widened reciprocity lens. Part II will lead us to explore empirical experience of reciprocal regulation in action. Indirect as well as direct reciprocity

strategies will be illustrated as I unfold my empirical research on Korean and Australian prudential regulation in Chapters 6 and 7. But there are other strategies the data I have acquired do not fully enclose. Some of those prospective strategies based on indirect reciprocity will be embodied as I explore Korean childcare regulation in Chapter 8. More specifically, Chapter 6 addresses strategy 1, Chapter 7 gives a clue for strategies 3, 5, and 6, and Chapter 8 explores strategies 2 and 4.

It is important to mention that actors are intentionally responding to each other's demands in an indirect way. In fact, information on reputation does not flow in itself. To arrange regulation in accordance with indirect reciprocity, therefore, is to respond intentionally to various social demands delivered through channels of indirect reciprocity. Indeed activities involving indirect reciprocity – delivering information, mounting sanctions and cooperation as a response, issuing critical press releases, and more – are intentional. This chapter has suggested strategies to expose stakeholders as well as regulators and regulatees to one another's gaze so as to hold them responsible for their conduct. According to the intention of gatekeepers or "choice architects," indirect reciprocity mechanisms can take place in less intrusive or harsher ways. Chapters in Part II will illustrate ways in which regulators deploy reciprocal strategies in prudential and childcare regulation. One humble hope is to provide regulatory practitioners, civil society activists, policy makers and researchers with ideas for indirect reciprocity by which they can cope with various challenges. Upon acknowledging that all are entangled in webs of reputational networks in which all are more or less vulnerable to one another, plural kinds of actors in regulatory communities (Meidinger 1987) can realize that the power they exercise in this web may be far greater than they previously believed.

PART II

PRACTICE OF
RECIPROCAL REGULATION

6

Risk-Based Financial Regulation in South Korea

Part I discussed the theoretical aspects of reciprocal regulation. Part II is devoted to exploring empirically whether and how strategies of reciprocal regulation are applied in practice. What are the ways in which stakeholders in regulatory landscapes harness different types of reciprocity? Why do they adopt certain reciprocal strategies over others? What are the purposes of their practice? The focus is primarily but not exclusively on supervisory work at the frontline of Korean and Australian prudential regulation. This chapter explores frontline supervision of the Financial Supervisory Service of Korea (FSS), with a focus on FSS's risk-based contingency program assigning supervisors to stay at a high-risk firm permanently: the On-site Supervisors Program (OSP). One reason for exploring this residential inspector program is that, as I argue, this program is a touchstone of the changing features of the risk-based supervisory regime in the Korean financial regulation.

Regulatory agencies have attempted to adopt a coherent enforcement approach throughout the organization in order to achieve their mission. Since its establishment in 1999, FSS has acknowledged the global trend towards risk-based supervision and sought benchmark standards for risk governance as a response to the changing environment of financial markets (FSC 1998). However the implementation of this risk-based approach is structurally confined to the nation's stringent rules-based regulatory regime. This chapter explores FSS's responses to regulated entities' motivations and intentions as they appear in on-site supervisors' supervisory styles. What sort of reciprocity can be found in the interplay between on-site supervisors and regulated entities? And what are the influences this has on the outcomes of prudential regulation? Can indirect reciprocity be observed in FSS's frontline supervision? If so, in what way is it harnessed?

Previous literature on Korean financial regulation has largely focused on macro-level analysis of the supervisory system (Chang et al. 1998; Choi 2002; Evans 1998; Jung 2009; Kim 2002b; Kim and Lee 2006). Research on regulatory styles of supervisors at the regulatory frontline is largely missing in the current literature. Yet there is a good reason to explore regulatory styles.¹ Focusing on the styles and strategies of individual supervisors who conduct inspection and supervisory activities enables us to track changes in the institutional supervisory approach.² As many researchers have observed, formal regulatory approaches in a central office may diverge from the regulatory styles and strategies “street level bureaucrats” harness in the field (Lipsky 2010; see also Braithwaite et al. 1994; Day and Klein 1987; Gofen 2014; May and Winter 2009). This is so because individual street level bureaucrats have different interpretations of the reasons for non-compliance and intentions behind compliance behaviors. It is often the case that their interpretation and the consequent enforcement activities become experiments in testing and updating the institutional approach. Therefore individual level analysis of FSS supervisors in this chapter provides an assessment of the role of those street-level bureaucrats in Korean financial regulation and also of its changing features that previous macro-level research could hardly trace. One practical issue in this regulatory development is whether street-level bureaucrats are allowed to choose more or less independently regulatory styles to elicit future regulatory compliance.

In South Korea, discretion of regulatory agencies—and of course those of individual inspectors—is systematically prohibited in theory and to a surprising degree in practice. Because government interference with private affairs must be grounded on laws enacted by the National Assembly, FSS is given little room for flexibly choosing tools as a response to regulatees’ motivations and receptiveness. As a result, this imposes serious constraints on the regulator’s supervisory capability and effectiveness to conduct risk-based regulation. Enhancing rule compliance and eliciting better risk management outcomes are two separate regulatory goals that are not always in accord, and the former takes priority over the latter in Korea’s rules-based risk management regime. Under this

¹ Note that in this thesis I use ‘regulation’ and ‘supervision’ interchangeably, though there is a subtle difference in their meaning. I use ‘regulator’ in referring to an institutional regulatory agency, while using ‘supervisor’ to indicate an individual inspector (personnel).

² A regulatory approach is an institutional matter while regulatory style refers to individual inspectors’ methods of enforcement. On the importance of distinguishing regulatory approach from regulatory style, see May and Winter (2011).

circumstance, the regulator has predominantly taken a command and control enforcement approach that seeks to deter illegal behaviors. This chapter complicates this general picture by showing how the OSP creates limited opportunities to break away from a command and control approach.

The chapter explores evidence that even a rules-based regime can allow room for developing a more collaborative, principles-based supervisory practice in financial regulation. A theoretical key to this analysis is reciprocity, as I discern ways in which supervisors harness different variants of reciprocity as a response to the regulatee's intention and motivation. This chapter is organized as follows: Section 6.1 provides a brief overview of the roots of the risk supervisory system of FSS and how this is confined to the rules-based legal regime. Section 6.2 analyses FSS's OSP through the lens of reciprocal regulation. FSS assigns one or two supervisors to stay at a high-risk bank or insurance company for a certain period of time, with a view towards minimizing the risk of prudential failure. The regulatory styles of on-site supervisors tend to harness different reciprocal strategies when confronting entities with different motivations and intentions. Section 6.3 discusses the way in which on-site supervisors harness indirect reciprocity in order to overcome limited face-to-face iterated encounters.

6.1 Supervisory System of FSS

6.1.1 Roots of a risk-based supervisory system

In the aftermath of the Asian Financial Crisis of 1997-8, the South Korean Government launched integrated financial supervisory bodies, the Financial Supervisory Commission (FSC) and FSS, in April 1998 and January 1999 respectively, in order to lead intensive restructuring of the financial sector recovering from the Crisis.³ FSC is a government

³ Before the establishment of FSS, financial supervisory authority was distributed to four individual regulators: the Bank Supervisory Board, Insurance Supervisory Board, Securities Supervisory Board, and Korea Credit Management Fund. The legal grounds for establishing FSC and FSS was the Act on the Establishment, Etc. of Financial Supervisory Organizations (EFSO Act), first promulgated in December 1997, after the onset of the Asian Financial Crisis. This act was later replaced by the Act on the Establishment, Etc. of Financial Services Commission (EFSC Act) in February 2008 as the government

body that “perform(s) duties concerning financial policy, prudential supervision of the soundness of foreign exchange business management institutions, and financial supervision.”⁴ While FSC is an administrative oversight body making major policy decisions over financial regulation, FSS is an administrative arm conducting “the inspection and supervision on financial institutions under the guidance and supervision of the Financial Services Commission.”⁵ This chapter focuses on FSS, because it is responsible for micro prudential regulation of individual financial institutions, conducting daily off-site and on-site supervision of approximately 1,300 financial institutions ranging from large banks, securities companies, and insurance companies to small credit unions, community mutual savings banks, and local branches of foreign banks. Rules and guidelines on FSS’s regulatory practice are directly rooted in higher legislation enacted by FSC. But it retains authority to conduct its supervision independently of other government bodies involving financial affairs, such as FSC and the Bank of Korea.

It is now claimed that South Korea has a highly developed financial services sector including the 3rd largest banking market in Asia and the 8th largest insurance industry in the world (IMF 2014). However, these figures are radically at odds with its gloomy financial outlook two decades ago, when the Korean economy suffered a liquidity crisis and relied on bailout from the International Monetary Fund (IMF). From the 1960s through 1980s, the South Korean economy recorded double-digit growth every year. The development of Korean financial institutions was propelled by the national policy drive prioritizing economic growth with an emphasis on export-oriented heavy-chemical industries. The success of Korea’s leading manufacturers in electronics, construction, chemicals, shipbuilding, and automobiles, among others, required continuous heavy capital injection not only in their early stage of market entry but also in their later development. In the 1970s and 1980s investment was supported through government involvement in the financial sector that distributed international financial aid primarily to those industries through government-led commercial banks. Deposit-taking retail banks and insurance companies were also encouraged to take part in this national drive. As a

decided to integrate the Financial Supervisory Commission with the Financial Policy Bureau of the Ministry of Finance and Economy to create the Financial Services Commission.

⁴ See Article 3 “Establishment and Status of Financial Services Commission” of EFSC Act. Before this institutional aim was articulated in February 2008, it had been regarded as an institution that simply performed duties concerning financial supervision, not dealing with financial policy.

⁵ See Article 24 “Establishment of Financial Supervisory Service” of EFSC Act.

result, those manufacturers with strategic priority could easily get large loans from banks, repayment of which was guaranteed by the government. Under this favorable developmental state environment of protectionism, Korea's financial institutions could pursue stable yet paradoxically feeble development. This so-called crony capitalism was not as extreme as Sukarno's and Suharto's Indonesia or Marcos's Philippines. Yet there was blatant patronage between the political regime and large conglomerates, known as *chaebols*. This created aggressive business operations in several Korean firms with a high debt-equity ratio that made the Korean financial system vulnerable to external shocks.⁶ Imprudent clientelism was one of the main factors that caused serious damage to the nation's financial integrity in the late 1990s (Haggard 2000; Kang 2002; Kim 2002a; Pempel 1999).

One lesson the South Korean government learned from the liquidity crisis was the importance of risk governance. Poor risk management systems of *chaebols* were unable to control unreasonable business diversification. Reckless capital loans could not be steered under strong Korean clientelism. A number of *chaebols* were in bankruptcy in 1998, which spilled over into a sharp increase in nonperforming loans of 32 trillion Korean won, which amounted to 7% of GDP (Lee and Lim 1997). Therefore the first task for FSC upon its creation was to conduct major surgery on poorly managed *chaebols* and the financial sector. FSC weeded out several insolvent companies and carried out a large-scale restructuring of financial markets, including introduction of financial supervisory policies strengthening the nation's prudential regime.⁷ A report published by FSC in early 1998 demonstrates this push:

Advanced supervisory agencies, such as OCC of the US or FSA of the UK, transformed their supervisory system to risk-focused supervision, that is to mobilize its resources to supervision of financial institutions' risk management. Many other countries have taken up this system as well. International organizations such as BIS, IOSCO, and IAIS set up international standards involving financial institutions' prudential risk management. ... Meanwhile, the soundness of Korean financial institutions has been exacerbated as the once favorable environment was in transition to a more competitive market. They

⁶ For clientelism between the political regime and industry, see Cho and Kim (1997).

⁷ Upon its establishment, FSC launched a special task force team on reformation of financial supervisory rules, to improve the national supervisory approach up to international standards of risk-focused supervision (FSC 1998).

strived to adjust themselves to this market shift, but their overall risk management system is still premature. Therefore there is a strong need to strengthen risk-focused prudential supervision (FSC 1998).

Following up on this drive for international benchmarking, FSC embarked on two supervisory measures in order to meet the need for effective risk supervision: the Timely Corrective Measures (TCM) and the self-regulatory capital ratio. TCM is a phased supervisory system in which the regulator may impose different degrees of corrective actions according to the target entity's capital soundness. The Act on the Structural Improvement of the Financial Industry (SIFI Act), enacted in 1997, sets out that the regulator may ask a financial entity to undertake specific actions, under TCM comprising three phases: Recommendation, Request, and Order for Management Improvement.⁸ FSC also adopted simplified standardized criteria for self-regulatory capital ratios for determination of sound prudential status.⁹ This included the BIS capital adequacy ratio (BIS ratio) for banks and complex financial institutions,¹⁰ the net operating capital ratio (NCR) for securities companies, and the risk based capital solvency margin ratio (RBC) for general and life insurance companies.¹¹ According to these measures, if an insurance company's RBC rate is higher than 100%, for example, it is judged to have sufficient capital to absorb any risk that may unexpectedly arise.

⁸ Article 10 of SIFI Act stated "Where any financial institution's financial status falls short of the standards referred to in paragraph (2), such as its equity ratio failing to meet the specified standards, or it is deemed evident that a financial institution's financial status falls short of the standards referred to in paragraph (2) due to the occurrence of any major financial scandal or accrual of non-performing loans, the Financial Services Commission shall recommend, request or order the financial institution concerned or the executives of such financial institutions to take the following measures or order it to furnish its implementation plan in order to prevent insolvency, and promote the sound management of such financial institution" http://elaw.klri.re.kr/kor_service/lawView.do?hseq=28795&lang=ENG (last accessed on 2 September 2014).

⁹ One main reason FSC adopted the BIS ratio was to follow the international standard requested by the IMF.

¹⁰ The BIS (Bank for International Settlements) ratio refers to the guideline of the Basel Committee on Banking Supervision initially enacted in 1988. This evolved into Basel II in 2004 and Basel III after the Global Financial Crisis. The BIS ratio FSC enforces also reflects this development.

¹¹ The latter two ratios refer to the ratio of equity capital to risk-weighted assets.

6.1.2 Command and control enforcement approach

TCM and the self-regulatory capital ratio constitute an overarching risk-based supervisory framework under which FSS operates. One interesting feature is that TCM is designed to make the regulator operate responsively to the regulated entity's performance in risk management. FSS runs constant off-site surveillance and occasional on-site examination for all financial institutions' risk management in normal circumstances. Off-site surveillance aims at early detection of potentially troubled entities and their weaknesses. It includes a broad range of supervisory methods such as interviewing people in senior management and business units, conducting on-site evaluations, analyzing the entity's business situations, reviewing reports related to the entity's financial conditions, quantitative and qualitative evaluation of its management status, and collecting and analyzing other information. FSS triggers on-site examination based on the results of off-site surveillance, regularly or on an issue basis. A financial entity is subject to TCM if its capital adequacy ratio drops to a certain level, as described in Table 6.1.¹² If the institution is subject to the first phase, Management Improvement Recommendation, the financial entity is required to turn in a management improvement plan including necessary corrective actions to be implemented within a specific time frame. The entity will be released from this measure if it successfully implements the requirements in the time frame and its capital adequacy is ameliorated.

Each phase of TCM sets out a list of corrective actions FSS may impose.¹³ The first phase features a minimum degree of intervention and austerity. Corrective actions in this phase aim to enhance the firm's risk management capacity and normalize its risk status. They seek to improve organizational efficiency, pursue more conservative business operations, and most critically, improve its capital adequacy ratio by acquiring more capital through disposal of nonperforming assets or inducing external capital injection.

¹² The decision to escalate is not made solely on the basis of the entity's capital adequacy ratio. FSS conducts management status evaluations on financial entities with checklists to evaluate quantitatively and qualitatively their prudential management, reflected in the decision on TCM.

¹³ The title of each measure does not necessarily represent the attribute of respective corrective actions. Those actions in the phase of Management Improvement Recommendation, for example, are not just recommended for implementation: institutions are obliged to undertake those actions. The title rather represents the degree of intervention in the firm's business.

TABLE 6.1 Summary of Korean financial regulators' Timely Corrective Measures imposed on financial firms

Measure	Condition for FSS decisions			Corrective actions required by FSS and FSC
	Banks	Securities firms	Insurance firms	
Recommendation for Management Improvement	BIS ratio below 8%	NCR ratio below 8%	RBS ratio below 100%	Management improvement of human resources and organization; Reduction of costs and expenses; Improvement of efficiency in the operation of local offices; Restriction on investment in fixed assets, entering into a new business field, or new investment; Sale of non-performing assets; Increase or decrease of capital; Restriction on the distribution of earnings; Creation of allowance for irrevocable debts, etc.
Request for Management Improvement	BIS ratio below 6%	NCR ratio below 6%	RBS ratio below 50%	Closedown or amalgamation of business offices or restraints on new establishment of business offices; Downsizing of organizations; Restraint on holding high-risk assets and disposal of assets; Restraint on the level of interest in raising the funds by receiving deposits; Sale of subsidiaries; Demand replacement of executives; Partial suspension of business operations; Establishment of a plan for a merger, acquisition by a third party, or transfer of business in whole or in part
Order for Management Improvement	BIS ratio below 2%	NCR ratio below 2%	RBS ratio below 0%	Retirement of stocks in whole or in part; Suspension of senior management executives from performing their duties and appointment of a superintendent; A merger or incorporation as a subsidiary into a financial holding company; Transfer of business in whole or in part; Acquisition by a third party; Suspension of business operation

Sources: Regulations on Supervision of Insurance Business; Regulations on Supervision of Banking Business; Regulations on Supervision of Financial Investment Business

The level of intervention gets more severe in the latter two phases. Therefore the phase of Management Improvement Order is for maximum government intervention in the private business. Entities in this status are considered unable to resuscitate the business on their own. Senior management executives are suspended from duty and replaced by superintendents FSS sends out to take steps toward liquidation. The bottom line in this phase is to minimize the influence that the entity's risk management failure has on financial beneficiaries and stakeholders.

Risk-based or risk-focused regulation entails a set of strategies in which the regulator seeks to allocate resources at sites and activities that present threats to its ability to achieve the regulatory objectives (Black 2005; Black and Baldwin 2010, 2012b; Hutter 2005). If we accept this definition, then there are at least three tasks that constitute risk-based regulation. The first task is identification of risks. A risk-based regulator is required to identify diverse risks according to their priority, which can be defined in two dimensions: probability and impact (Black and Baldwin 2012b).¹⁴ The second task is allocation of resources. The regulator needs to allocate its limited resources to manage risks identified by the first task. Two considerations are of grave importance to a risk-based regulator, also according to probability and impact: whether to put more resources simply in high-risk rather than low-risk areas or whether to invest more on entities with bigger impact when failure occurs or on entities with smaller impact. The third task is to adopt effective enforcement strategies to achieve the objectives of risk-based regulation. This task involves institutionalizing the operational middle ground between the risk analysis and formal enforcement action (Black and Baldwin 2012a).

The Korean financial supervisory system has developed the first two tasks of risk-based regulation. TCM is set to manage risks as a response to the financial institution's performance in risk management. The Korean financial regulators have accepted international standards such as Basel I, II, and III, and arranged its risk-based frameworks such as the Risk Assessment and Application System (RAAS) to identify and manage risks. Compared to those two tasks, however, the Korean financial regulators have been less concerned about the third task of implementing effective enforcement strategies. Without contemplating what would be effective strategies to elicit compliance from financial entities, they have resorted to unilateral deterrence approaches, seeking to punish

¹⁴ APRA's PAIRS is one such measure where a prudential regulator classifies regulated entities according to probability and impact of risk failure. For a detailed discussion, see Chapter 7.

illegal activities rather than coaxing and caressing better regulatory outcomes.

This does not mean that unilateral deterrence or command and control regulation is intrinsically inferior or less effective to other forms of regulation. Neither does this admit a necessary disconnect between risk-based and command and control regulation. Over a decade since FSC acknowledged the need for introducing risk-based regulation to Korean financial regulation, FSS has been conducting risk-based regulation by harnessing command and control enforcement. There was no significant failure in financial regulation other than that in the MSBs regulation in 2009, and we cannot blame command and control enforcement as the root cause of the failure. As Short (2011) persuasively points out, command and control regulatory enforcement might be one aspect of state coercion. However, a report on perceptions of the quality of Korean financial supervision in 2006 revealed that financial entities' main discontent with FSS was largely ascribed to the authoritarian enforcement style of FSS supervisors (Park and Kim 2006).¹⁵ According to the stakeholder survey on which the report is based, the majority of respondents (72.21%) concurred that FSS supervisors' command and control style was a reason for their dissatisfaction with FSS.¹⁶ FSS supervisors were inclined to command and order rather than communicate and persuade. Furthermore, many regulatees found it hard to communicate with FSS supervisors because of their imperious and authoritarian attitude. Some employees of foreign financial institutions participated in the focus group interviews described:

[The Korean financial supervisors] are not keen on problem solving through dialogues and discussions with financial institutions. Their attitude when we raise some questions

¹⁵ This report is based on a stakeholder survey and focus group interviews that were conducted by researchers at the Korean Development Institute. The survey used non-random sampling. The research team deliberately selected 367 financial institutions in seven financial industries and asked each industry association to distribute one to four questionnaires to each institution according to size. Employees of each financial institution were expected to answer. For the descriptive profile of respondents, see Park and Kim (2006, 36-42). The research team attempted to maintain the anonymity of respondents because the study was commissioned by FSC. The response rate was 68% (439 out of 650 questionnaires). For the survey design, see Park and Kim (2006, 34-6).

¹⁶ The original question was: How much do you agree with the following statement? You feel discontent toward the regulatory approach using command and order rather than conversation and persuasion. Respondents were given five options from strongly agree, agree, neutral, disagree, and strongly disagree. See Park and Kim (2006, 159).

is pretty passive, repeatedly saying “I don’t know” and giving us no additional explanations (Park and Kim 2006, 27).

This reveals that FSS had significant problems in maintaining the level of professionalism at the regulatory frontline. One reason for evading answers for hard questions was to evade responsibilities associated with those answers and decisions. This might lead to the perils of arbitrary decision-making where supervisors applied rules and guidelines in an unnecessarily passive and draconian way without giving specific reasons. Many respondents in regulated entities had experiences in which a supervisor had reached a negative conclusion on their propositions without endowing them with opportunities for making a case. The report concluded that the culture and practice of the Korean financial regulator did not allow room for amelioration by taking into account external points of view:

Foreign financial institutions, which used to be resistant to unreasonable regulation, now realize that there is no reason for them to actively engage with regulators in order to rationalize unreasonable regulatory practice. They have learnt that it is more beneficial for them to be seen as compliant with the given regulation (Park and Kim 2006, 29).

The dominant, and sometimes unreasonable, use of a command and control approach is deeply rooted in the rules-based regulatory regime of South Korea. The Korean legal system does not recognize comprehensive delegated legislation. Article 75 of the Korean Constitution¹⁷ has been interpreted that constraint on individual rights should not be delegated comprehensively to presidential decrees and inferior legal rules without setting out the scope specifically in acts.¹⁸ All acts, including financial laws such as the Banking Act, the Insurance Business Act, the Financial Investment Services and Capital Markets Act, the Mutual Savings Banks Act, and so on, have a separate chapter on penal provisions setting out sanctions associated with violation of the legal provisions. This

¹⁷ The President may issue presidential decrees concerning matters delegated to him by an Act with the scope specifically defined and also matters necessary to enforce Acts.

¹⁸ See the Constitutional Court Decisions 94Hun-Ma125 (1995); 91Hun-Ba1 (1995); 94Hun-Ba40 (1995); 93Hun-Ba14 (1996); 96Hun-Ba52 (1998); 97Hun-Ba31 (1998); 97Hun-Ka8 (1999); 97Hun-Ba16 (1999); and 99Hun-Ka2 (1999).

means that financial regulators should execute the penal action as enumerated in financial acts upon detecting any violation. They are not given legal authority to discretionarily choose sanctions as a response to the regulated entities' performance or compliance history.¹⁹ FSS and FSC may hold a legal right to introduce new regulations deemed timely and necessary to catch up with the changing environment of financial markets, within the scope of higher acts. If it comes to enforcement of sanctions, however, the regulators have to abide by the laws: discretionary adoption of sanctions that may better serve regulatory objectives, as the regulators see it, may be violations of acts.²⁰

It is not surprising that FSS's supervisory practice became detection-oriented in this strict rules-based regime. On-site examination, which is one of FSS's major supervisory actions, was focused on detecting breaches of regulatory rules and guidelines. It was even reported that FSS examiners often conducted on-site examinations with a pre-set number of detections they aimed to accomplish (Park and Kim 2006, 26). This means that on-site examination was focused on meeting examiners' targets by finding faults with regulatees' business activities, without considering whether it is a better way to achieve the objective of risk-based regulation. If FSS's enforcement is focused on detecting and deterring illegal activities, then it is reasonable for the foreign financial institutions mentioned in the above quote to display a compliant posture as they are free to carry out business activities unless these activities violate financial rules. An interview that I conducted in 2013 with an officer of the Board of Audit and Inspection of Korea (BAI), who was responsible for conducting national audits and examinations on FSS confirmed this tendency of FSS supervisors:

¹⁹ This aspect is echoed in IMF's 2003 Financial System Stability Report on Korea: "[Korean] prudential regulators lack the unfettered right to issue new regulations when they perceive a need to do so" (IMF 2003, 24).

²⁰ The limit of the prohibition of comprehensive delegated legislation becomes more apparent when compared to the APRA Act of Australia, which sets out "APRA has power to do anything that is necessary or convenient to be done for or in connection with the performance of its functions." See Australian Prudential Regulation Authority Act 1998, <http://www.comlaw.gov.au/Details/C2014C00500> (last accessed on 1 Sep 2014). Similarly, UK financial regulators—the Financial Conduct Authority and the Prudential Regulation Authority—retain rule-making power when it appears necessary or expedient for the purpose of meeting their regulatory objectives. See Financial Services and Markets Act 2000, <http://www.legislation.gov.uk/ukpga/2000/8/contents> (last accessed on 4 June 2015).

Our main focus in conducting audits on FSS is to see whether they are doing their job. Before the Global Financial Crisis took place, our expectation for FSS was that they detected and sanctioned any breach of rules and guidelines committed by financial institutions. Financial regulation was not expected to be prospective. FSS should rather focus on conducting effective retrospective examination to ensure financial institutions complied with rules and guidelines (from an interview with KOR12 conducted on 26 July 2013).

This implies that FSS supervisors were expected to take up a command and control style focusing on the detection of illegality. An inspector would be charged with dereliction of duty if a BAI audit result pointed out, for example, he or she had used discretion to give certain financial entities a second chance for improving compliance, not strictly imposing the penalty as written in laws and regulations. But as no necessary disconnect exists between risk-based regulation and command and control regulation, there is no intrinsic disconnect between risk-based regulation and a rules-based regime. Rather, the practice of command and control, though rooted in the rules-based regime, might be a matter of administrative culture. The informant in BAI continued by mentioning that there was a shift in BAI's audit practice after the Global Financial Crisis (GFC):

There was a paradigmatic shift in our audit approach after the Global Financial Crisis in 2008. We observed the breakdown of the US financial supervisory system and changed our audit approach to focus more on risks. We carried out a series of comprehensive audits on FSS and other public financial institutions, with a focus on system risks (from an interview with KOR12 conducted on 26 July 2013).

This means that the surrounding environment after the GFC allowed FSS supervisors more flexibility to opt for enforcement strategies that may better serve the objectives of risk-based regulation. FSS also announced that they would introduce principles-based regulation and attempt to apply it “harmoniously” with the existing practice (FSS 2007). Despite these, FSS's obstinate adherence to the traditional enforcement approach continued to exist even after the GFC. IMF's 2014 Financial System Stability Report on Korea indicated the rigidity of regulatory enforcement. According to this report, the Korean financial regulators adopted “predominantly prosecution-centric” approaches while less actively harnessing administrative pecuniary sanctions than other jurisdictions

(IMF 2014, 23). This does not mean that prosecution is the only option for FSS and FSC.²¹ They can opt for a wide range of different sanctions when detecting illegal activities. Against institutions, they may take necessary measures such as fines, penalty surcharges, institutional warnings, suspension of license, and cancellation of license. The regulators can also request that financial entities take disciplinary actions, such as suspension, salary reduction, and reprimand, on their employees who are involved in illegal activities.²² Considering this diversity, the 2014 IMF report can be interpreted that FSS, and FSC as well, still resorts to prosecutorial legal actions upon detecting a broad range of offences or breach of financial rules, rather than utilizing the diverse options in consideration of eliciting compliance effectively from regulated entities. An interview I conducted in 2014 with a senior examiner in FSS indicated that detection-oriented command and control enforcement is still prevalent: legality dominates FSS's enforcement practice as well as inspectors' mindsets.

It may be the case that we detect some breaches of supervisory rules when conducting a management assessment. If this is the case, then we have to take legal actions as set out in the rules. Entities contrive to find loopholes in the legal system while we try hard to chase and reveal their breaches. Sanctions should be strictly applied to every breach, because otherwise this would give rise to equity issues (from an interview with KOR16 conducted on 8 May 2014).

Recently, FSS and FSC announced that they will introduce a two-track examination system to allow more flexible enforcement approaches, by separating examination for prudential status and for legal compliance (FSS and FSC 2015).²³ As part of this, they attempt to increase the use of pecuniary sanctions and financial entities' internal compliance controls, which are actively harnessed by other prudential regulators such as APRA. It may be too early to assess success or failure of these new regulatory reforms. Instead, I explore the OSP of FSS. This program allows on-site supervisors to act

²¹ The authority to take enforcement action is largely delegated to FSS, while FSC retains decision-making authority for measures of grave significance such as TCM or suspension and revocation of license.

²² The range of sanctions FSS and FSC can impose on institutions and individuals is set out in Chapters 3 and 4 of Regulations on Examination and Sanctions against Financial Institutions. Most of those sanctions were added either in 2005 or 2006.

²³ This reflects the fact that FSS is an integrated regulator conducting both prudential and financial conduct regulation.

responsively to the attitude and performance of the regulated entity. In practice, on-site supervisors are given room to opt for cooperative strategies to improve the entity's risk stance in a more flexible and responsive way. In the next section, I will show ways in which on-site supervisors cope with many challenges they encounter by utilizing different types of reciprocity.

6.2 On-site Supervisors Program

OSP represents FSS's risk-based contingency response to high-risk financial entities. Its purpose is to address pre-emptively forthcoming potential risks. It aims at minimizing the risk of prudential failure by assigning frontline supervisors to stay at an institution for a certain period. FSS maintains off-site surveillance on the basis of information financial institutions submit monthly through the direct financial reporting network called the Financial Information Exchange System (FINES). Before OSP was introduced, an institution would be subject to FSS's more intensive surveillance and targeted on-site examinations if considered suspicious for corruption or unlawful deeds. However both methods revealed the limits of an *ex post* passive response. Supervisors could hardly stay on top of the institution's fragile risk management, because surveillance was only maintained through interim self-reports from the industry. Nor could desk auditing respond proactively to the potential risks caused by weak credit or illegal loans due to the punitive nature of on-site examination. Considering this, OSP was part of a supervisory reformation in which supervisors were set to reside in a financial institution pre-emptively to monitor corruption and illegality, improve relationships with other auditors, investigate the firm's risk level, and prevent escalation of potential financial crises.

FSS initially introduced this risk-based supervisory scheme in 2001 to become part of routine monitoring of financial institutions in a similar way that the Office of the Comptrollers of Currency (OCC) of the United States has resident inspectors in large banks permanently throughout the year (OCC 2007). However, the way FSS harnessed OSP has been more targeted. FSS's routine surveillance system predominantly relies on monthly management reports of each financial institution's affairs. In reviewing this, FSS makes a decision as to whether inspectors need to start residing on-site or whether surveillance may follow up at a distance. The use of this intimate surveillance is limited to

institutions showing negative signs in their prudential status. Its main purpose is to protect financial beneficiaries by preventing additional poor management or corruption. Therefore FSS sets out to install on-site supervisors as early as possible before the situation becomes irretrievable.

6.2.1 Regulatory conversations over signing the MOU

To date, FSS has placed on-site supervisors in 112 financial institutions²⁴ including 82 mutual savings banks, 12 banks, 13 insurance companies, and 5 securities companies.²⁵ Figure 6.1 below shows the frequency and duration of on-site supervisor deployments. While each line in this graph represents an individual case of a financial institution receiving on-site supervision, its length represents the duration of on-site supervision at a financial institution. The average duration of on-site supervision was 6.8 months: 6.4 months for mutual savings banks, 9.8 months for banks, 6.4 months for insurance companies, and 9.5 months for securities companies. This figure helps us descriptively grasp the operation of the program. Data for this figure was collected through a series of requests for Public Release of Information I made to FSS in 2013.²⁶

Figure 6.1 shows that OSP mainly operated in the bank and insurance industries when it was first introduced in 2001. This reflects the industry-wide restructuring in banking and insurance businesses undertaken as a response to the Asian Financial Crisis in 1997. The first phase of restructuring of the bank industry began in early 1998 targeting the nation's 12 major banks with BIS capital adequacy ratios below 8%. They were requested to submit management improvement plans, which were subsequently evaluated and used to justify liquidation of five banks, with their assets to be taken over by the five soundest banks. Another seven banks were requested to pursue either more capital acquisition or mutual merging in order to strengthen their prudential standing. As a result

²⁴ This is based on data as of December 2013.

²⁵ Under the Financial Investment Services and Capital Markets Act, which came into effect in 2011, previously securities, futures, financial asset managing, and trust businesses were classified as financial investment business. For general readers, however, I use "security companies" rather than "financial investment companies" throughout this thesis.

²⁶ It should be noted that the list of financial institutions where on-site supervisors have resided came anonymously, as a response to a series of official requests for Public Release of Information.

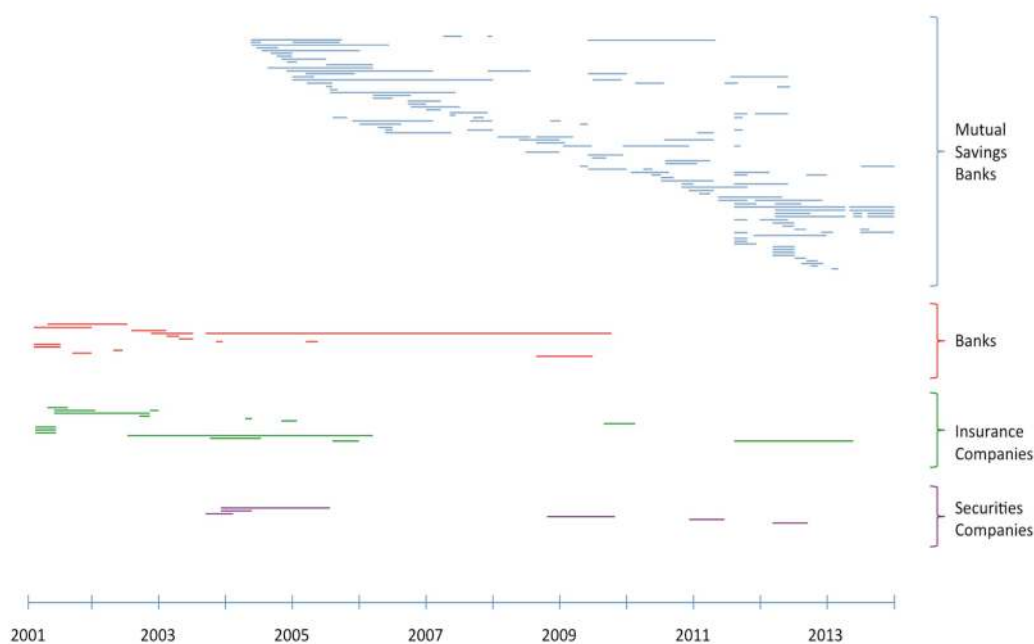


FIGURE 6.1. Frequency and duration of on-site supervision, 2001-2013
 Key: Data from Mutual Savings Banks are valid through September 2013 while all others are as of December 2013.

of this first phase of bank restructuring, two major banks (Cheil and Seoul Banks) were sold to Newbridge, an overseas investor, five regional banks (Dongwha, Dongnam, Daedong, Kyungki, Choongchung Banks) were put into liquidation, nine banks were mutually merged into four large banks, and seven relatively sound banks were normalized either through public funds injection or implementation of self-rescue measures.

FSS started to use OSP actively in the second phase of restructuring from the end of 2000. Seven banks went through major restructuring under TCM due to their poor capital adequacy levels. After requiring them to settle troubled assets, the South Korean Government injected public funds of around 7.1 trillion Korean won to revive those banks. The insurance industry was not free from the repercussions of the Asian Financial Crisis and was also expected to undertake major restructuring. Owners of general insurers, Daehan, Hanil and Daeshin, and non-life insurers, Kukje and Regent, were ordered to pursue further capital acquisition by disposing of assets and stakes in the firm. Then those insurers underwent intensive governmental intervention in their major business operations. FSS actively harnessed OSP in this process to closely monitor any further poor management, improve communications between FSS and the institution, and communicate any veto rights to the institution board's decision-making if necessary. On-site supervisors were targeted at banks and insurance companies to see if they

successfully implemented management improvement.

Despite this early development, on-site supervisors have been most frequently used against mutual savings banks (MSBs). Table 6.2 shows that OSP was used in this industry continuously after 2004, reaching its peak in 2011 (25 MSBs). This reflects poor risk management prevalent across the MSB industry. MSBs are deposit-taking institutions specifically designed for middle to low income consumers and small- and medium-sized enterprises, providing higher deposit interest rates than normal banks. In the 1980s, MSBs' annual growth was over 30% and the industry's total assets grew fourteen times in that decade.²⁷ They used to aggressively invest in high-risk high-return products, such as stocks and project financing, in order to keep interest rates high. This success could not persist as the nation's economy took a sharp downturn. The Asian Financial Crisis in 1997 and household credit crisis in 2004 had a great influence on the business of MSBs with unstable financial portfolios. The GFC in 2008 destroyed the Korean stock market and caused a long slump in the real estate market, in which MSBs had aggressively invested. Risky real estate bets gone bad wiped out the savings of many average Koreans. The number of MSBs, 249 in 1983, reduced to 93 by 2012, most of them closed by the regulator. The industry is still undergoing a FSS-led restructuring process. The far-reaching, purposive nature of this restructuring affirms the Korean economic emergence as a developmental state or "statist capitalism," led by a strong rational-legal state (Hutchcroft 1998, 20).²⁸

²⁷ According to the Korean Federation of Savings Banks, the total assets of the industry that was once 799 billion KRW in 1981 became 11.5 trillion KRW in 1990.

²⁸ Some researchers have argued that since the AFC, South Korea has undergone a transition to a regulatory state while retaining the legacy of a developmental state (Lee et al. 2002). To them, historical trajectory of the Korean developmental state differs from that of the Western countries where the welfare state gave way to the regulatory state. I agree that Korea has taken steps different from those of the Western countries. But I disagree that South Korea underwent a transition to the regulatory state under the two Korean administrations after the AFC. State regulation is still prevalent while non-state regulation is feeble. For the debate on the regulatory state and regulatory capitalism, see Braithwaite (2000, 2006c, 2008), Levi-Faur (2005, 2006b), Parker and Nielsen (2009), and Yasuda and Ansell (2015).

TABLE 6.2 The number of financial institutions having on-site supervision by year

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total
MSBs	0	0	0	11	12	9	9	6	12	13	25	19	10	126
Banks	5	3	4	0	1	0	0	1	0	0	0	0	0	14
Insurances	7	6	1	2	1	0	0	0	1	1	0	1	0	20
Securities	0	0	3	0	0	0	0	1	0	1	0	1	0	6
Total	12	9	8	13	14	9	9	8	13	15	25	21	10	166

The primary reason that OSP has been taken up only intermittently is its insecure legal status. This program does not have a formal, statutory status. Rather regulatory instruments open a possibility for assigning examiners to stay at an institution for a certain period of time if considered necessary²⁹ and also for entering into a memorandum of understanding (MOU) in order to rectify serious managerial weaknesses that have been detected.³⁰ Thus it is not mandatory for a financial institution to accept on-site supervisors. Most on-site supervisors I interviewed acknowledged this as one of the biggest challenges to the operation of this program. One interviewee confessed, “since this scheme is not set out in an act, unlike on-site superintendents, its legal ground is pretty weak and we have to convince the financial institution, rather than unconditionally compelling obedience.”³¹ This limitation ironically paved a way for positioning OSP by FSS as a flexible risk management tool. FSS can enter into a MOU with the institution to utilize on-site supervisors as a means to reinforce its internal controls and risk management. And this MOU becomes a source of mutually binding regulatory authority.

Although the contents of a MOU may differ from case to case, it normally includes

²⁹ On-site supervisors hold legal authority that is different from on-site superintendents who are by law authorized to control all management activities of the firm. See Article 6-2 of the Detailed Regulations on Examination and Sanctions against Financial Institutions, stating “the Governor [of the FSS] may, if he/she considers it necessary to reinforce internal control and risk management of a financial institution, assign an examiner to stay at the institution for a specified period to carry out routine surveillance (newly inserted on November 13 2001).”

³⁰ See Article 20-2 of the Regulations on Examination and Sanctions against Financial Institutions, indicating “The Governor may enter into the MOU with a financial institution for the establishment and implementation of improvement measures against serious managerial weakness found as a result of supervision, off-site surveillance or examination of such financial institution (newly inserted on March 5 2004).”

³¹ This is based on an interview with KOR09 I conducted on 16 July 2013.

three major clauses apart from setting aside agreements on the duration of residence and confidentiality. First, it sets out the institution's management improvement plan, articulating further means for capital acquisition. Submission of the plan is not particularly required by the MOU because the institution should submit it anyway as required at an early stage of TCM. Capital acquisition is considered to be a major goal of management improvement because the TCM decision is normally made in accordance with the institution's capital adequacy level. Secondly, it is agreed that on-site supervisors will keep in-house surveillance over the institution's implementation of this management improvement plan. This becomes a mutually binding ground on which supervisors can reside on-site. This is followed by more detailed guidelines, enumerating what should be approved *ex ante* or *ex post* by the on-site supervisors. Lastly, it sets out the institution's duty to cooperate and provide physical and human resources necessary for the operation of OSP. These clauses together act as a set of broadly defined principles both parties abide by.

One important feature of the process of signing a MOU is that it is empathically reciprocal. An on-site supervisor said,

Normally the Supervisory Department rings an early alarm if it is discovered in the routine monitoring that a certain institution's financial soundness drops to a certain level, upon which they decide to call forth in-depth control or not. If so, headquarters signs a Memorandum of Understanding with the institution and sends supervisor(s) to stay on-site. People at the institution of course would not welcome it, because they would find it an officious, nitpicking government intervention. Therefore it is important to *persuade* them to accept it, by saying for example, "we're not coming to make a verdict of life and death [of the company]. We're coming to help you, to prevent a bigger crisis that may otherwise be brought about. It's just another part of close surveillance activity." *By all means* we try to get them to sign this MOU (from an interview with KOR09 conducted on 16 July 2013).

This quote implies that the Supervisory Department acts responsively to the regulatee's attitude or motivational posture in this process of signing a MOU (Braithwaite, Murphy, et al. 2007; Braithwaite 2009b). Then how responsively do they act? The Department is given two options when the time comes to convince the institution to sign a MOU: either persuade or threaten the target institution. The absence of a formal legal mandate for OSP excludes unilateral enforcement from the list of plausible options. It is

an expensive option to bring about confrontation or even a legal dispute, which might cause serious damage to FSS's authority and legitimacy. Nor would the Department bring its deterrence power up front, even though threat was deemed a credible option.

Threatening may not be a favored option in general, though it hardly is unadoptable. If the firm's motivational posture is positive, showing commitment or capitulation (Braithwaite 2009b), then FSS has no reason to adopt an expensive deterrence strategy. Deterrence is only expressively harnessed toward resistant or gaming institutions, as supervisors threaten for example, "if you don't accept this MOU, then we cannot help but evaluate your risk management governance badly, and this would make your situation even worse."³² Given financial institutions' acknowledgement of the practice of FSS supervisors, it is obvious that they also realize that opting for a defiant posture would result in conflict escalation.

The important point that should be noted is that FSS intentionally attempts dialogue first. There is a reason for this. Regardless of the motivational posture of the firm, FSS always begins with opening up a dialogue with the institution by pointing out that having supervisors on-site is beneficial to the institution. Signing a MOU dialogue means that both parties enter into a mutually binding agreement in which they ask each other to identify common goals and appeal to reasons for sorting out any opinion gaps or sources of conflict. By taking a dialogue-first strategy, FSS sets up a normative ground that constitutes mutual reliance. Specifically, FSS can claim that on-site supervisors are supposed to help sort out an ongoing crisis that might otherwise be exacerbated. In the transition from the crony capitalist state to the rational developmental state, the developmental state turns out to be a reciprocal regulator.

What is presupposed in the process of signing a MOU is a shared understanding that the institution is in crisis. Ford and Hess (2011) notice the importance of initial rapport between the regulator and the entity for a corporate monitor as an independent personnel to oversee the entity's compliance. They claim that a corporate monitor would have "a productive working relationship with the company because the government and the company felt that the process was fair and that they benefited from it" (Ford and Hess 2011, 521). Having supervisors on-site is considered a severe intervention in management prerogatives. The institution's autonomy is compromised to the extent that on-site supervisors step into the process of, for example, introducing a new insurance product,

³² This was based on an interview with KOR09 conducted on 16 July 2013.

authorizing daily cash flow, or attracting external sources of capital injection. On-site supervisors are mandated to authorize the institution's internal risk management, though only partially. This reflects the regulator's recognition that the institution's risk management system has not been trustworthy, and thus can be more intensively reshaped by FSS to rebuild organizational integrity and protect consumers.³³ Therefore it is a prerequisite of signing a MOU for on-site supervision that both parties share an understanding that the institution faces a crisis severe enough to require this intensive surveillance. That is why FSS strives to use common indicators to convince its counterpart of having on-site supervisors: such as the institution's RBC rate in insurance supervision, or TCM in the supervision of a MSB.³⁴

6.2.2 Direct reciprocity in on-site supervisors' regulatory style

a. Discretion over regulatory style

This chapter focuses on how on-site supervisors interact with financial institutions at the regulatory coalface. As mentioned above, no ground rules exist for their operation. Nor is there any guideline for the regulatory style each supervisor is asked to adopt. The MOU sets out the broad range of conduct on-site supervisors may implement and the principles and goals of that conduct. However, it is not a legally binding document offering a ground for imposing punishment or penalty if non-compliance occurs. Therefore the conduct of on-site supervisors is ambivalent: they are weak on legal authority for enforcement while as agents of a developmental state that has recently radically restructured the entire financial sector they rely on the "infrastructural power" of a developmental state (Mann 2008).³⁵ The following supervisor's comment reveals an aspect of this ambiguity in the

³³ It may be argued that the regulator is not the sole alternative to take up this kind of guardianship. Third party policing might be an option as long as the third party does not involve any conflict of interest.

³⁴ The operation of the OSP in MSB Supervision Department has changed since it was introduced in 2001. Before 2004, it was harnessed against all institutions in which contravention or breach of financial rules was detected in the on-site examination and also against institutions that were subject to suspension of license. Then it was expanded to include institutions whose ownership is in transition, because those firms are more inclined to have weak governance. Since 2010, however, it is only limitedly harnessed against those institutions undertaking TCM. See FSS (2011).

³⁵ Infrastructural power is a methodologically holistic conception of power that the state infiltrates in the infrastructure of society to have an influence on diverse decision-making. For a methodologically

way on-site supervisors understand their role:

To make an analogy, the on-site supervisor is like a *sentinel*. We don't conduct investigation or examination. What we do is to figure out whether further action is necessary. In my personal view, the role of on-site supervisors is to be a *messenger* between headquarters and the financial institution. It is important for us to absorb the voices in the field as a sponge does and deliver to headquarters and vice versa. What is required here is not to firmly grab, but to grasp the mainstream events in order to lessen the level of stress of both sides (from an interview with KOR03 conducted on 4 June 2013).

This supervisor's description of the role of on-site supervisors as a sentinel represents the FSS perspective of fire-alarm oversight, akin to placing "fire-alarm boxes on street corners ... and sometimes dispatches its own hook-and-ladder in response to an alarm" (McCubbins and Schwartz 1984, 166). An on-site supervisor is a direct channel through which FSS can obtain day-to-day information on the firm's business. This enables the regulator to maintain a maximally intimate level of surveillance. It also partly implies that the regulator no longer considers information and data the firm generates as trustworthy or sufficient. The trust relationship between the supervisor and the firm is rather realistic as opposed to what Black means by "regulatory utopia" (Black 2008). Therefore the role as a sentinel is an attempt to be on top of everything involving the firm's business operation decision-making.

At the same time, his description of a messenger stands in sharp contrast with this role. The regulatory relationship implied with the on-site supervisor as a messenger is no longer adversarial. In the role as a sentinel, on-site supervisors only act for the interests of the regulator: maintaining oversight and getting intimate information on the institution's business. The financial institution in question is an object that is to be surveilled and checked, not the subject or partner for problem solving. In the role as a messenger, on the contrary, on-site supervisors are expected to represent and convey the voices of both parties. This extends the role of a sentinel to a bilateral, two-way channel of information

individualist conception of power, see Robert Dahl's definition of power that "A has power over B to the extent that he can get B to do something that B would not otherwise do" (1957, 202-3) or Lukes's clarification that "A exercises power over B when A affects B in a manner contrary to B's interests" (1986, 30).

exchange: not only acquiring and delivering information and opinions from the institution, but also conveying regulatory signals exactly and securely to the institution. The sentinel and messenger models can be intertwined in a two-way practice of reciprocity, as when the sentinel picks up an alarm signal that reverses direction; the bank says this regulatory requirement risks causing a crash and that message is passed by the supervisor from the bank back to the state. In other words, on-site supervisors can offer a locus in which regulatory conversation can take place. The role as a messenger is important in enhancing the firm's understanding of the given regulation. This facilitates informal regulatory dialogue between on-site supervisors and the firm, in which the firm can catch the regulator's intention or information that is concealed, for example, in the formal letter of notice. It may eventually contribute to deepening the level of mutual regulatory understanding between regulator and regulatee.

Those two roles do not fundamentally require on-site supervisors to actively utilize their professional discretion. The ambiguity occurs when their role reaches "not to firmly grab, but to grasp the mainstream of the events," as the interviewed supervisor stated. This means that information sifting or gatekeeping is also a role that is required of on-site supervisors. It might be the case that this supervisor is an outlier who recognizes that a frank delivery of every single bit of information he has acquired from one side to another would not help undertake his mission. What is implied here is that on-site supervisors are given room to use their discretion regarding a variety of issues.

A shared understanding exists among the on-site supervisors I have interviewed in that they are expected to consult with headquarters when facing crucial decision-making. But some perceived themselves to be equipped with authority to make independent decisions on most other issues. There is variation in the extent of on-site supervisors' independent decision-making in using discretion, as revealed in the following two interview excerpts with on-site supervisors.

Supervisor A:

In no way can on-site supervisors be on top of the institution's business without active cooperation from the firm's employees. This is so because what we can do in our everyday work relies heavily on the premise that the institution opens all its information and data to us. Therefore there is nothing we can do about it if the institution deliberately conceals information or makes important decisions without consulting with us. It may be the case that these misbehaviors, if *ex post* detected, will be punished as

specified in the MOU or corrected by scrutinized examinations of FSS. But conducting examinations is not on-site supervisors' business. On-site supervisors do not have *ex ante* means to detect and redress those misconducts, until it is revealed by *ex post* examination (from an interview with KOR01 conducted on 16 May 2013).

Supervisor B:

On-site supervisors do not hold any authority to impose sanctions. If I become aware of any unlawful deed or breach of the MOU after hand, then I immediately call on the examination team. Before relying on this method, however, I attempt myself to prevent it as far as possible. One method is to double check whether I receive the necessary data and information as I expect. The MOU sets out the institution's duty of cooperation, including detailed items to get the supervisor's approval in advance. So we get the reports from the business units. Apart from this, I attempt to seize control of the business approval lines. For example, approval of business operation involving a certain amount of expenditure should go through the internal audit office. Signing up a new contract should also be authorized by the compliance officer. What I do is to make sure that those offices get my approval before authorization. This enables me to compare information from both lines, and to see if both lines are acting in a *bona fide* way (from an interview with KOR09 conducted on 16 July 2013).

Supervisor A in the first excerpt represents a defensive on-site supervisor while Supervisor B in the second represents an assertive supervisor. Most interviewees who have experienced, observed, or worked with on-site supervisors admit that the defensive supervisor is more frequently observed. This is in some sense rational because on-site supervisors have an interest in a peaceful work life. Even assertive supervisors said that they have neither incentive nor responsibility to work harder for ameliorating the firm's risk status. An interview with a leader of the Finance and Service Workers' Union who has observed a number of on-site supervisors illustrates this tendency:

Most on-site supervisors I observed have tried to dodge responsibility. Those supervisors manage things so long as no liability is incurred in a worst case. Their point of view is to get the firm to take a smooth step to liquidation, without having corruptions and other financial incidents. Therefore, from the firm's point of view, I would say, it is lucky enough to meet an on-site supervisor with goodwill to resuscitate the firm as far as possible, not the one who bears malice toward it (from an interview with KOR19 conducted on 16 May 2014).

Variation in the regulatory style of on-site supervisors arises from the free-floating or liminal nature of this program. Some supervisors simply follow the routine rules-based approach of FSS, ticking boxes in the checklist to see if listed items are being met, while others take on the developmental state project of mooring a secure financial system by attempting to intervene in the institution's business more actively. It is difficult to reach a definitive verdict on the influence of this variance on regulatory outcomes. Notwithstanding the limited number of data points, we can identify a couple of factors that are involved in the variance of on-site supervisors' assertiveness. Of course each individual supervisor's disposition is one factor. As implied in the above quotes, it is obvious that some supervisors' inclination is more assertive than others. But supervisors' disposition is quite restrained by context. On-site supervisors placed in a firm in an early stage of TCM are given more room to be assertive agents of the developmental state. However, the role of on-site supervisors placed in an institution under an Order for Management Improvement, for example, is limited both by that Order and the fact that the institution's situation is devastated, with little hope for rehabilitation. Their role is defined very defensively: to prevent corruption and further financial damage committed by insiders. As a supervisor stated, "if you are placed in a firm with Recommendation or Request for Management Improvement, then you can feel at least the vigor among the employees to get the firm back to normal. If this is the case, then the supervisor's role is to invigorate them and infuse some hope that the firm can be normalized."³⁶ This implies that the earlier on-site supervisors are deployed, the more effectively can they be used as a tool for risk-based regulation.

b. Motivational postures and direct reciprocity

Considering Korea's bureaucratic tradition, it is likely that those on-site supervisors who were experienced old-timer examiners or investigators clung to their familiarity with a conventional command and control style. This seems true in some sense. The major source of conflict between on-site supervisors and the senior management of financial institutions arises over the method of management improvement. Normally on-site supervisors adopt a conservative, risk-averse way of problem solving, while the firm in a crisis is inclined to prefer aggressive high-risk, high-return methods. Confrontation often

³⁶ This is excerpted from an interview with KOR03 conducted on 4 June 2013.

arises when the owner tries to make a risk-taking decision while on-site supervisors say the owner should not. Although on-site supervisors do not hold legal rights to interfere with the firm's business, they can effectively enforce their perspectives, either through threatening to call the scrutinized investigation team or to reflect the firm's non-compliance in the management assessment that is important in deciding TCM over the firm. However, the way on-site supervisors adopt different types of reciprocal strategies shows a similar pattern to the case of signing a MOU. Let us consider the following interview with a manager of a financial institution who worked closely with on-site supervisors:

On-site supervisors ask us to maintain a risk-averse investment strategy, while the company likes to pursue a risk-taking business operation to get back to normal. This makes up the major conflict between on-site supervisors and the institution. ... If the firm had enough capital strength then this kind of confrontation would not have occurred. The reality is that we had to sign the MOU and on-site supervisors are here to get us to implement the conditions set out in it. There was no right answer at that time as I recall. The firm might have improved its prudential status through aggressive business operations or not. If a confrontation occurs, both parties try to logically convince each other. If there is any escalation of confrontation, however, the party who should accept is always us (from an interview with KOR04 conducted on 5 June 2013).

Apart from cases of conflict escalation, the major method of interaction is conversation. On-site supervisors stated they try dialogue first. Most on-site supervisors agree that a 'dialogue-first-strategy' is critical not only to get authentic information inside the firm but also to encourage people to speak candidly about their problems and discontents. The manager continued by saying:

Unlike examiners conducting on-site examination, on-site supervisors I have come across do not prioritize punishment. In my personal experience, they tried dialogue first. Since, as you know, we're all in the same industry, both parties are quite aware of each other's circumstances. Therefore there is a degree of reciprocation. If the case is an absolute "no," then they resolutely say to us "no." But nobody would say "no" on every occasion. In most cases both parties try to discuss and reach mutual concession by yielding a little bit of their own opinions. Nevertheless, from the perspective of the

company, we cannot pursue something they say no to. Too much burden (from an interview with KOR04 conducted on 5 June 2013).

It is inferred in the above two statements that the supervisory style of on-site supervisors denotes some sort of reciprocity regardless of the firm's receptiveness. However, the content of reciprocity varies according to the institution's motivational posture in a troubled situation. Valerie Braithwaite identified five motivational postures of regulatees in response to the authority's regulatory attitude: commitment, capitulation, resistance, disengagement, and gaming (Braithwaite 2009b, 2014b; Braithwaite, Murphy, et al. 2007). Motivational postures are a series of signals regulatees send to regulatory authorities to express their willingness or unwillingness to respect the way the authority governs. These signals not only change in response to the actions of an authority, but are also restrained by the firm's circumstances (Braithwaite 2014b).

In this sense, the dialogue-first-strategy reflects the trust function between on-site supervisors and the institution. Initially the relationship cannot but be adversarial with no or less trust, as represented in the role as a sentinel. One on-site supervisor put it this way:

On-site supervisors would think, "this firm has so many problems and people working in the firm would not welcome my residence" while the employees would speculate, "why are they here? Aha, they are here to nitpick at what we're doing wrong. What should I say to them? What if what I'm saying goes wrong?" (from an interview with KOR03 conducted on 4 June 2013).

It is reasonable that on-site supervisors come to the institution with a negative view on the firm's employees and especially the owner or top management. The employees of the firm reasonably look suspiciously at the supervisor's intentions and are concerned about possible individual liability for infractions uncovered by supervisor 'nitpicking.' Because both parties are very aware of the common practice of FSS to impose sanctions on individuals for any breach of supervisory rules, it becomes important for on-site supervisors to clarify upfront that they come with amicable intentions.

What is important is not to punish them, but rather to convince them to accept that they committed a wrongful deed. By nature the relationship between FSS and a firm is coercive, though in part. But it is ineffective to unilaterally punish them if they don't accept. For eventually this is not to catch thieves, but to protect customers. If I mention

this, they understand and accept it (from an interview with KOR09 conducted on 16 July 2013).

Empathy is important in opening up their mind. The point is that I open up my mind first. So I tried to listen to their difficulties and sometimes take their side in criticizing FSS. It is hard for me because I'm actually a part of it, but opening their mind is impossible unless I do mine first. However treating them nicely, FSS's enforcement is still something which the regulatee feels is difficult and wants to dodge, somebody that is too far to be close. It is important to get them to come to my office and talk about what they otherwise wouldn't. If I keep reacting positively to their stories, then they start to trust me and speak candidly about their difficulties (from an interview with KOR03 conducted on 4 June 2013).

What is implied in the above two excerpts is that on-site supervisors strive to approach the institution with a cooperative move, as they intentionally implement a dialogue-first-strategy in signing a MOU. The approach described here is consequentialist in that it aims at enhancing the outcomes: that is, the protection of financial customers and maintenance of a sound financial system, not at proportionality in enforcing supervisory rules or guidelines. This does not mean that on-site supervisors are not concerned with catching thieves. They do catch thieves, yet for the sake of preventing potential damage to financial customers and markets. What is more important than catching thieves is to prevent people from becoming a thief and to convince them that they can overcome their crisis and become a responsible member of the financial market. The initial adversarial relationship between on-site supervisors and target institutions can be ameliorated as on-site supervisors take up a cooperative stance.

Specifically, the regulatory style implied in the first excerpt reveals the possibility that on-site supervisors utilize their opportunities to harness alternative enforcement methods with a view to achieving the regulatory objectives. People in regulated entities are aware of the FSS's punitive enforcement approach in off-site surveillance and on-site examination. There is less room for conversation or negotiation in the case of on-site examination due to the rules-based characteristics. On the contrary, the success of on-site supervisors more or less depends on their capability to build rapport with their counterpart. Thus it is partly true that on-site supervisors are given more discretion than other examiners conducting occasional on-site examination in a short period of time. They are given more time to listen to the voices from the firms, utilize their interpersonal skills to

get the counterpart to work cooperatively with them, and eventually build up trust between the regulator and regulatee. Put another way, the institution of on-site supervision is structurally conducive to reciprocal regulation and responsive regulation. This is a theme the thesis returns to. On-site supervisors, if not all, acknowledge the importance of discretionary decision-making and strive to exercise it in limited circumstances in order to elicit better regulatory outcomes.

Ways in which on-site supervisors harness indirect reciprocity in this flexible environment constitute the main point of analysis of the next section. Before moving on, it is important to point out that empathy, according to informants, is important in building rapport between on-site supervisors and people in the regulated firm and eventually in transferring the realistic relationship to a more amicable “regulatory utopia” (Black 2008). Empathy is a more radical term than having common understandings. As discussed earlier, placement of on-site supervisors is made on the basis of a mutually shared understanding that the firm is in a crisis. The trust function between on-site supervisors and the entity shows that having a common understanding does not always guarantee that parties with conflicting interests mutually cooperate. Although both parties have a common perception of the institution’s crisis, it may be that their methods of dealing with the crisis include stark confrontation. Therefore on-site supervisors need time to ascertain that people in the firm are cooperative and equipped with professional ethics. Likewise, people in the firm would like to see that on-site supervisors have goodwill, not malice toward the firm or at least toward them. Empathy is a key to establishing this mutual process of understanding and eliciting a ‘commitment’ posture from regulatees, encouraging them to go beyond compliance and do more than supervisors expect (Braithwaite 2014b), reciprocated by a commitment posture from the developmental state. Empathy is also critical to the transition of supervisors’ role from a sentinel to a messenger. Trust may arise when both parties or at least a weaker one have a real sense that despite the difference in position, both are working together to sort out the problem they commonly face. This becomes the basis on which both parties can reciprocally work together to prevent risks, withstand any short-term loss to achieve long-term goals, and eventually find workable solutions for all parties. An interviewee at a financial institution stated:

It takes more or less a month to establish an initial rapport. When they first came to reside in our firm there was no trust. We needed some period of knowing and

understanding each other's style. Then we could adjust the different ways of problem solving (from an interview with KOR04 conducted on 5 June 2013).

The cooperation-first-strategy that is taken up initially is replaced by calculative tit-for-tat reciprocity if the regulatee turns out to be less receptive. Sometimes a more stringent strategy is adopted from the beginning when the Supervisory Department recognizes the firm's attitude is defiant or game playing. This normally occurs as a result of the owner's disposition. An on-site supervisor confessed:

I will tell you about an episode of an owner. This guy told me that he was going to wander about to look for additional sources of capital. But it seemed to me that he was using a stalling tactic. He told me that he had found external sources who wished to invest capital in the firm, but never said who they were and just wanted me to trust him. I started to think that if he didn't tell me then he was not capable of capital acquisition. I couldn't trust him, so asked the CEO's office to report to me whenever the CEO used his car. But I still didn't get reports. Guess what I did? I parked my car in front of the CEO's to make sure I got reports when the CEO drove the car out. Then guess what happened? The CEO bought a new car! (from an interview with KOR09 conducted on 17 July 2013).

This episode may be typical of only a small number of cases where the CEO is defiant and gaming the regulator. But it shows the sort of pyramidal, tit-for-tat reciprocity an on-site supervisor can employ against a game playing institution or owner.³⁷ The methods of deterrence differ sharply from supervisor to supervisor. Some supervisors simply report the reality of resistance to headquarters as it is, while others enthusiastically strive to achieve the maximum outcome possible by utilizing threats. Sometimes the difference in enforcement style mirrors the anticipation FSS imposes on the specific supervisor. Nevertheless we can observe the changing nature of relationships among stakeholders involved in on-site supervisors' operation in the firm. And this reveals some interesting features of direct reciprocity.

³⁷ This is reflected in the selection criteria for on-site supervisors. Apart from professional experience and good communication skills, they need to have strong personality to hold command over the firm's business if necessary.

6.3 A Glimpse of Indirect Reciprocity

So far this chapter has overwhelmingly discussed direct reciprocity. The interviews revealed that empathic reciprocity evolves in the process of convincing a target institution to receive on-site supervisors, and also in those supervisors' regulatory dialogue with the institution. Reciprocity thus harnessed is a direct form as long as supervisory activity against a financial institution is conducted primarily between the regulator and the regulated. However, this does not mean that there is no room for indirect reciprocity to emerge in the unpacking of this dyadic institution-to-institution relationship. Indeed indirect reciprocity can be seen in the data. This section explores a case in which indirect reciprocity is harnessed in the FSS's prudential regulation, though in a limited way.

6.3.1 Bifurcated reputation building

OSP works as a regulatory surge FSS puts on with an institution of high prudential risk.³⁸ Although on-site supervisors may become a continuous source of direct reciprocity, their limited resources constrain the extent to which they can maintain direct, repeated encounters. A common discontent of on-site supervisors I interviewed is the problem of scarce human resources. On-site supervisors are required to build up as early as possible a system in which they are located in the middle of information flows. Since only one or two supervisors are placed in an institution except for exceptional circumstances, it is challenging for them to build up rapport across an institution's entire business activities in a short span of time. On-site supervisors' strategy to cope with an antagonistic environment with scarce human resources is reputation building. This is an application of indirect signaling of responsiveness (Strategy 1) discussed in Chapter 5.

According to my data, on-site supervisors strive to build two kinds of reputation:

³⁸ Surges of face-to-face encounters concentrated in high-risk spaces, times, and people are how police forces cope with their incapacity to have iterated encounters with all citizens. They do have iterated encounters with gang leaders, mafiosi, rapists, serial killers and serial domestic violence offenders. It works. The police science literature is clear that random police patrols are not very effective at preventing crime, but face-to-face policing concentrated at hot spots that addresses where most crime is reported is very effective (Sherman et al. 1989; Weisburd and Green 1995; Weisburd et al. 2006).

communicative and firm. Supervisors seek to establish a communicative reputation when they are engaged in regulatory conversations. In the previous section supervisors said that it is essential to spend their time making iterated encounters in order to steer the flow of stories:

Empathy is important in opening up their mind. The point is that I open up my mind first. So I tried to listen to their difficulties and sometimes take their side in criticizing FSS. It is hard for me because I'm actually a part of it, but opening their mind is impossible unless I do mine first ... If I keep reacting positively to their stories, then they start to trust me and speak candidly about their difficulties (from an interview with KOR03 conducted on 4 June 2013).

What underlies this supervisor's direct reciprocity building efforts is that these efforts are accumulated in the supervisor's communicative reputation. This reputation is shared, for example, by word of mouth and recognized by other people who also want to speak about their grievances and complaints. This reputation works if she keeps sending out signals to other employees that they are also welcome to come and chat. It might have been difficult for the supervisor to build up initial rapport. But once the rapport is established, her reputation becomes social capital that makes it cheap for her to get others' cooperation. In other words, the word on the financial street, or rather in the financial corridor inside the building, becomes that this on-site supervisor has a reputation as a listener who helps people fix problems. The reputation of tirelessness in the face of the impossibility of iterated encounters with everyone diffuses. It becomes a widespread understanding inside the firm that even though this on-site supervisor faces an impossible pile of problems in trying to save the firm and a mountain of employees whose problems she cannot all solve, at least she listens and helps fix problems where she can.

An on-site supervisor confessed that he could get information on a CEO's dubious activities from members of a labor union.³⁹ For him, this was one outcome he could get from his previous efforts to maintain good rapport with unions, incessantly trying to signal that he was a cooperator. Furthermore, unions in other firms may observe the way that their fellow unionists in insolvent firms can save their employees' jobs via cooperation with on-site supervisors. Such learning is a clear example of indirect rather than direct reciprocity for unions in solvent firms that have never had an interaction with

³⁹ This was based on an interview with KOR09 conducted on 16 July 2013.

an on-site supervisor. Supervisors' goodwill and cooperative moves may not be returned immediately. But reciprocation may come at a critical moment, maybe from someone supervisors have never come across.

The supervisor KOR03 also indicated that cooperative reputation, if it is the only reputation she holds, is not effective. She continued by mentioning:

We cannot review all paperwork to make sure it is done right. And it is pretty obvious that they also know that we can't. What is important here is that I do sometimes review it and show that I can stay firm (from an interview with KOR03 conducted on 4 June 2013).

From the excerpt above, a communicative reputation needs to be buttressed by a firm reputation: she will not tolerate any exploitation of her goodwill. On-site supervisors' permanent desk in a financial entity may work as a continuous regulatory surge galvanizing alarms people in the entity ring for themselves (Braithwaite and Hong 2015). But having a permanent desk does not necessarily result in a virtuous cycle of regulatory cooperation via indirect reciprocity. On-site supervisors invest some time to visit business sites to see if the reporting system works well rather than spending time at their desk, waiting for reports to come, and getting them analyzed. Through this iterated process of "kicking the tires" on-site supervisors establish a firm image that maintains attention not only among people they interact with, but also among those they do not (Braithwaite 2009a, 440).

As implied in the excerpt above, no driver would do a self-check to make sure he or she is not speeding and everyone in the car buckles up if he or she already knew that patrol officers would not be concerned about detecting such violations. Nor will any lesson be learned if it is apparent that regulators will never target anybody else in the future. On-site supervisors establish a firm image to promise future penalization or at least detection. They tend to target their visit or review to core departments—mainly the treasury department—rather than thinly diffuse it throughout the organization, because they expect those departments to learn from their previous encounters and enhance compliance. This firm image constructed through a series of iterated encounters at the firm's core may work as a solid ground of indirect reciprocity that can prevent noncompliance among people without regulatory encounters.

6.3.2 Indirect reciprocity in Korean prudential regulation

The two reputation-building processes—communicative and firm—come together to work as a principled responsive approach. Supervisors expressed their commitment to on-site visits, attitudes to deal with regulated people in an amicable way, and methods of handling non-compliance. This shows one way the first strategy of reciprocal regulation—indirect signaling of responsiveness—is applied in practice. Through these methods, FSS on-site supervisors could effectively steer the flow of information, prevent corrupt behaviors in advance, and invigorate employees' willingness to cooperate.

One caveat: this does not confirm the effectiveness of the strategy in normalizing the firm's risk status. Among the four on-site supervisors I interviewed, two of them were committed to indirect signaling of responsiveness. The two companies returned to a normal risk status by successfully attracting new investors. Additionally both on-site supervisors and employees of those firms highly evaluated the role of on-site supervisors in overcoming crises. Nevertheless, the lack of data significantly limits our assessment of the role of on-site supervisors in improving the quality of Korean prudential regulation.

Some may wonder why so many MSBs were liquidated in South Korea after the GFC despite the fact that on-site supervisors were actively deployed in those firms. South Korean prosecutors indicted more than 100 people including the former Governor of FSS over alleged illegal lending and corruption involving suspended MSBs in 2011.⁴⁰ Among them, some executive officers of MSBs were indicted for dereliction of duty, as they leaked information about the suspension of the bank's business in advance to large depositors. This motivated the large depositors to withdraw and secure their deposits. At the early stages of investigation some on-site supervisors were subject to suspicion of involvement in this process. But the investigation concluded that the MSBs' decisions that caused a bank run had taken place behind on-site supervisors' backs and those supervisors attempted to thwart it as soon as they were aware of it.

This ironically suggests that what on-site supervisors can do is limited. And this perspective is in consonance with the defensive style supervisor's argument that "there is nothing we can do about it if the institution deliberately conceals information or makes

⁴⁰ The Governor of FSS Kim Jong-Chang was denied a chance to get involved in the lobby from Busan MSBs to withdraw the suspension of business operation. Instead he was accused of violating the Public Service Ethics Act. In 2014, the Supreme Court acquitted him.

important decisions without consulting us.”⁴¹ This limitation can be, though in part, overcome if on-site supervisors opt for a more assertive style as illustrated so far in this chapter. Defensive style supervisors were not concerned about utilizing various types of reciprocity in regulating those entities. What this chapter suggests is that, as shown in the case of assertive supervisors, supervisors may be able to seek more effective regulation by broadening their sights to intelligently use different types of direct and indirect reciprocity. Harnessing empathic reciprocity and indirect reciprocity may enable them to stay on top of the firm’s business operation, build social capital of indirect reciprocity networks, and eventually, become an effective problem solver.

A systematic analysis on the effects of on-site supervisors could have been carried out if access was allowed to richer data including, for example, when on-site supervisors were deployed to each MSB and how they conducted daily supervision. Given the limited access to data, we can only take into account circumstantial evidence. On-site supervisors’ role at MSBs was systematically limited because the macro prudential policy on MSBs allowed them to maintain risky investments. FSS’s supervisory policy was to retain “tight prudential regulation, lax conduct regulation” in the MSB industry (Kim 2011).⁴² The minimum requirement for the first phase of TCM for MSBs was below the BIS ratio of 5%, compared to 10% for banks. This means that by the time on-site supervisors were deployed in MSBs, the risk status of those firms was already irrevocable. As mentioned above, what we can conclude is that the earlier on-site supervision is installed the larger the possibility is to improve the firm’s prudential status. This hypothesis can be explored in the future.

6.4 Conclusion

This chapter explored the changing features of Korean prudential regulation, with a focus on different kinds of reciprocity on-site supervisors harness against regulated financial institutions. I examined ways in which FSS has harnessed OSP as a risk-based

⁴¹ This is based on an interview with KOR01 conducted on 16 May 2013.

⁴² Kim pointed out that FSS’s failure to retain tight prudential regulation caused MSBs to invest in high-risk high-return financial products in stock and project financing markets. As I stated earlier in this chapter, the GFC had a great influence on those two markets.

contingency program grounded on a mutually binding non-statutory agreement. On-site supervisors were given room to use strategies discretionarily as a response to regulated actors' motivational postures. I revealed that supervisors realized the benefit of opting for more nuanced, empathic reciprocity unless they faced defiant regulatees. Against gaming actors, supervisors preferred strategies based on strict tit-for-tat, bringing FSS's enforcement power to the front. It was also discovered that supervisors resorted to indirect reciprocity, thought in a limited way, in order to elicit cooperation from people in the regulated firms in the absence of direct encounters.

Some may criticize the argument proposed in this chapter in three ways. The first criticism might point out the researcher's bias toward only the bright side of the effects of discretion given to on-site supervisors. Considering the possibility that discretion gives rise to arbitrariness, on-site supervisors' discretion should not be allowed, in this view. I do agree that unchecked discretion is easily corrupted. It is unclear how FSS has sorted out challenges of on-site supervisors' discretion, such as excessive and sometimes unreasonable business intervention. This certainly is a critical challenge that needs to be addressed if FSS is to more actively harness OSP as its risk contingency tool. But I would not extend my consent to any dichotomous claim that on-site supervisors' discretion should therefore be reduced. What should be contained is an arbitrary use of discretion, not discretion itself. On-site supervisors' supervisory methods and activities thus need to be subjected to checks and balances. One way of realizing checks and balances is to expose supervisors' activities to the gaze of their peers, as suggested in Chapter 5. I will explore ways in which APRA deploys this strategy of internal transparency in the next chapter.

Second, some can also argue that the story of on-site supervisors harnessing empathic reciprocity exaggerates their role. It is true that in practice it is very rare to find such a supervisor. And in many cases on site supervisors' role was very limited as they set to reside in a firm at a late stage for facilitating the firm's liquidation. My data cannot revoke this line of criticism. My intention is not to argue that many supervisors are virtuous or that the nature of supervisors is changing. As I admitted, defensive style supervisors are more frequently observed. Most of the time, they do not even trigger tit-for-tat reciprocity by cooperating first. This means they are not interested in developing regulatory cooperation. It may be that they are willing to be cooperative yet realize that it is too late for them to spend time and energy in such relationship building or that they are simply disposed to be defensive. What I suggest is rather that supervisors may opt for a

cooperative style when they are given room for using discretion. They would do so because they notice that this is a way of responding to the regulatees' discontents with the normal command and control enforcement approach of FSS.

Last but not least, my findings have come to a conclusion that seems quite different from research on "corporate monitorships": a financial firm hires an independent monitor to watch over undertakings the firm enters into in exchange for leniency for alleged violation of financial laws or rules (Ford and Hess 2008; 2011). Ford and Hess have reached a more pessimistic view about corporate monitors' effectiveness. Apart from being an extended body of a government regulator, on-site supervisors seem to share many similarities with corporate monitors, such as requiring a level of mutual trust and providing experienced human judgement. Ford and Hess, based on their analysis of US firms, argue that corporate monitors failed to meet their objectives, mainly due to lack of experience and incentives to perform beyond their mandate. It may be too early to conclude its comparative advantages, but OSP, as government monitorships, certainly have features corporate monitorships do not, in terms of experience and motivation of such monitors. On-site supervisors are experienced inspectors who have especially overseen the target entity over a period of time. The on-site supervisors I interviewed and my interviewees observed were quite aware of the culture and different voices of regulated entities. So they could act responsively to the supervisees' motivational posture: being tough on game-playing executives while maintaining amicable relationships with cooperative labor unions. The on-site supervisors I interviewed were also motivated to get the firm back to a normal stance, though their role was constrained by the prudential conditions of the firm. These two features of OSP are distinct from independent corporate monitorships as on-site supervisors are non-independent, government inspectors.

It strays beyond the scope of this chapter to examine effectiveness of OSP or conditions of its success or failure. This task requires more on-site supervisor cases to analyze and preferably random sampling of them. Nevertheless, the conclusions of this chapter, though tentative because of the limitations of the data, are clear enough on one inference: it is possible for principles-based regulation to take place in a strict rules-based regime. Black et al. (2007, 191) define principles-based regulation as "moving away from reliance on detailed, prescriptive rules and relying more on high-level, broadly stated rules or Principles to set the standards by which regulated firms must conduct business." Although FSS and FSC recognized the need for principles-based approaches in financial supervision as early as in 2007, they have since then retained the perspective that an

application of principles-based regulation to enforcement practice must be limited because the Korean legal regime is rules-based (FSS and FSC 2015). OSP makes a case for overturning this argument. OSP is FSS's responsive regulatory approach of only limited scope used toward firms with a high-risk profile. It is also a principles-based approach, setting up a set of principles in a form of mutually binding MOUs by which on-site supervisors and the regulated firm must conduct supervision and business. For a rules-based regulatory agency like FSS, weak spots in the law can induce critical domains of institutional responsiveness and flexibility. By avoiding the routine constraints on institutional discretion, OSP paves a way for FSS's transition from top-down unilateral deterrence to a more responsive and principles-based regulation based on regulator-regulatee partnership.

Reciprocal Prudential Regulation in Australia

Unlike South Korea's integrated financial regulators, its Australian counterpart consists of a so called twin-peak system, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). While ASIC is responsible for the supervision of financial conduct and consumer protection in Australia's financial market, APRA looks after prudential regulation of the Australian financial sector. APRA has long been a proponent of principles-based regulation with a solid practice to improve the risk-based supervisory regime, even while many other countries struggled with the GFC. APRA claims that its risk-based supervisory approach was a main factor that the Australian financial industry could withstand GFC without major failure (Lewis 2013). This chapter examines APRA's principles-based approach to risk-based regulation,¹ focusing on diverse ways in which reciprocal interactions take place intra- as well as inter-organizationally at the regulatory frontline.

The development of principles-based regulation of the financial services industry has been a prominent feature of the UK financial Services Authority (FSA). Black et al. (2007, 191-3) draw out three features of principles-based regulation from the practice of FSA: preference of general principles over detailed, prescriptive rules; outcome-based regulation; and inculcating senior management responsibility. In other words, principles-based regulation is to focus on improving regulatory outcomes rather than mere compliance by regulating not through detailed rules set out by the regulator but through broadly defined principles that allow regulated entities to meet the ends of those principles using their own means. Increasing the entities' integrity as responsible actors in the financial market is an essential outcome that principles-based regulation aims at. Thus

¹ For an overview of APRA's principles-based regulation, see Black (2006). For principles-based securities regulation in Canada, see Ford (2008).

conceived, principles-based regulation is closely linked to performance-based regulation (Coglianese et al. 2003; May 2003) or outside-in design (Braithwaite 2005) which allows regulatees to adopt their system as long as it meets the standard or principles set out by the regulator. This chapter examines micromanagement strategies of a principles-based regulator, APRA, to achieve its objectives.

When exploring APRA's frontline supervision in this chapter, we will discover that three strategies of indirect reciprocity suggested in Chapter 5 are harnessed in the regulatory space to either nudge reputational competition among regulated entities or make up for the drawbacks of intimate dyadic regulator-regulatee relationships. The latter aspect of indirect reciprocity becomes especially important in the context of reciprocal regulation. Chapter 4 discussed criticisms of responsive regulation that point to its reciprocity claim: direct reciprocity between regulator and regulatee for the evolution of cooperation. But the dyadic reciprocity is also deeply involved in another notorious issue of arbitrariness: regulatory capture. The very conditions nurturing the evolution of cooperation have also become the condition for the evolution of corrosive regulatory capture (Ayres and Braithwaite 1991, 1992). Chapter 6 alluded that unchecked discretionary power vested with prudential regulators may result in regulatory capture in which the discretion becomes arbitrary and the reciprocal relationship degenerates into reciprocal private compensation.

This chapter explores the way in which the formal and informal intra-organizational structure and dynamics of APRA are arranged to address challenges involving the close regulatory relationships between frontline supervisors and regulated entities. Surprisingly, indirect reciprocity underlies two paths for avoiding capture. The first path is regular staff rotation, a classic solution to the risks of capture and corruption (Ayres and Braithwaite 1991; Carpenter and Moss 2014; Grabosky and Braithwaite 1986; Kaufman 1960). The rotation policy inevitably compromises productive regulatory cooperation in pursuit of the benefit of avoiding capture and corruption. The interview data suggest ways in which APRA's frontline supervisors informally use indirect reciprocity mechanisms when rotation of the designated supervisors takes place. The second APRA path for avoiding capture is its internal transparency mechanisms. APRA's intra-organizational structure and dynamics are transparently arranged internally so as to prevent discretionary power vested with its frontline supervisors from degenerating to regulatory capture. Indirect reciprocity is the underlying logic of internal transparency in which individual supervisors hold one another responsible in a proactive manner.

This chapter consists of four main sections. The first section explores APRA's strategy for making financial entities responsible, with an emphasis on reciprocal relationships fostered by frontline supervisors. Like its South Korean counterpart, APRA's frontline supervisors also adopt different sorts of direct reciprocity as a response to the financial institution's receptiveness and subsequent risk profile. The way the principles-based approach is implemented in practice embraces a lot of empathic reciprocity. The subsequent three sections consider three indirect reciprocity strategies. Section 2 explores ways in which APRA frontline supervisors nudge regulated entities to enhance their performance in certain areas of risk management. Section 3 analyzes compliance history pass-on between designated supervisors in regular staff rotations. Section 4 examines APRA's intra-organizational structure and dynamics to prevent reciprocal regulator-regulatee relationships from capture. The logic of indirect reciprocity underlies ways in which members of APRA share their supervisory activities internally and supplement risks of interpersonal direct reciprocity. This suggests an alternative idea of internal transparency may contribute to responsibility of an institution in which external transparency is limited.

7.1 Responsible Supervisors and Responsible Business

APRA's frontline is organized around so-called responsible supervisors, who are designated to be in charge of prudential oversight over a set of financial entities. This results in a radical difference in APRA's organizational structure from that of FSS. FSS's frontline is aligned so that a division oversees a specific industry. Even its supervisory workload is divided into supervisory and examination departments in one industry so that the supervisory department is in charge of the overall management of regulatory activities while the examination department conducts off-site surveillance and on-site examinations.² In contrast to the separation of supervisory duties in FSS, APRA simply divides its frontline into two major divisions according to the significance of its supervisees in the financial industry.³ The Diversified Institutions Division (DID) deals

² This functional divide is valid as of January 2015. FSS's organizational structure is reshuffled quite often.

³ For the general development of APRA structure in its early stages, see Black (2006).

with complex and large entities or those with a high impact on the market while the Specialized Institutions Division (SID) oversees smaller and less complex institutions. This reflects APRA's risk assessment tool, the Probability and Impact Rating System (PAIRS), in which it identifies regulated entities with probability and impact of failure. This allows APRA to allocate its limited resources according to how significant financial institutions are in the nation's financial industry. For the supervision of a large conglomerate, for example, DID assigns a team of multiple analysts and a manager. SID may designate one analyst to oversee a handful of small superannuation funds and credit unions, although risk management of smaller entities is inclined to be poor.

APRA's commitment to responsibility is most of all showcased in the appellation it puts on frontline supervisors, "responsible." Not all frontline supervisors use the title of responsible supervisor. Only managers or senior managers who are in charge of frontline supervisory teams are called responsible supervisors. Yet other members of the team are still called responsible analysts, as they are the first point of contact for financial institutions. As apparent in these titles, APRA's designated frontline teams are responsible both for on-site and off-site supervision of financial institutions. They become APRA's supervisory window that maintains interpersonal relationships with various units and individuals in the regulated entity.

APRA's expectation for financial entities' responsibility is clearly set out in APRA's service charter:

We expect your board and senior management to be primarily responsible for your financial soundness and be aware of the legislative and prudential requirements you need to meet. We also expect you to be honest, professional and courteous in your dealings with us and our staff. We expect you to provide us with timely and accurate information. Ultimately, our role is to protect the interests of beneficiaries of your products and services and, if necessary, we will be firm in using our powers to do this (APRA 2011, 3).

This statement sets out the purpose of prudential supervision (to protect the interests of beneficiaries of your products and services), APRA's enforcement philosophy (if necessary, we will be firm in using our powers to do this), and APRA's expectations of financial institutions (primarily responsible for your financial soundness and aware of the legislative and prudential requirements you need to meet). APRA's regulatory approach is

therefore summarized as seeking responsibility from the overall financial sector. The purpose of responsible prudential regulation can be, believes APRA, achieved by making both the regulator (APRA) and regulatees (financial entities) responsible for their business. The former task is the main concern of Sections 3 and 4. This section explores ways in which APRA's frontline supervisors implement the latter task, focusing on three aspects of the principles-based approach to risk-based regulation.

First, frequency of contact represents APRA's understanding of risk-based regulation. A frontline supervisor's comment highlights the need to maintain frequent direct contacts with regulated firms:

When we get financial data it is always looking backwards. So by the time you get the financial data, financial firms have a month or six weeks to prepare for submission. The data come to us through a system called D2A. Then it takes our statistical teams a month or six weeks to look through it and make sure all are validated at a high level. And they produce a template and give it to the frontline. So there is often two to three months delay before you can see the data in a usable form. This means that if you are just relying on data, you are looking backwards and you are not picking things up in a timely manner (from an interview with AU04 conducted in February 2014).

APRA frontline supervisors realize that maintaining regular contact with financial entities is important in getting APRA on top of management of entities' risk. Frequency of official contact is set up in baseline supervision according to the entity's PAIRS rating.⁴ If an entity's PAIRS rating is high, for example, then frontline supervisors need to conduct a risk review quarterly and a prudential consultation every two years. Entities with higher impact ratings get more frequent visits. APRA's risk-based regulation conceives of large entities as complex to understand and also their failures are seen to incur bigger impacts. A senior supervisor of APRA confesses that they sometimes make more than fifty contacts with big entities over a year:

So a common question we face is "should we devote most people to the largest entity or to the most problematic entity?" The current structure we have is not structured in the latter way. I guess part of that rationale is that very large entities are so complex that we can't do a single review in a week in order to understand the whole organization. For

⁴ For APRA's baseline supervision, see Lewis (2013).

larger banks we will look at very small parts, for example, when doing a credit review. It might be just for one particular product rather than saying, “we look at your entire portfolio.” As a result, we do have more frequent and additional meetings with larger entities. So we would go on-site and have meetings or other activities probably once a week, with a larger entity: some times between fifty to eighty engagements over twelve months (from an interview with AU13 conducted in February 2014).

The level of frontline supervisors’ engagement also depends on entities’ risk level. The Supervisory Oversight and Response System (SOARS) refers to a risk-based supervisory framework of APRA, comprising four stances: Normal, Oversight, Mandate Improvement, and Restructure (APRA 2012). Entities with a higher SOARS stance will get more intervention, the amount of which is not set up in advance being subject to the discretion of APRA supervisors.⁵ Depending on these two factors—PAIRS rating and SOARS stance—frontline supervisors discretionarily contact people in the regulated entities, more frequently with some than others. Therefore APRA’s approach can be seen as interventionist, starting to engage from the very early stage of risk management.

Second, APRA’s principles-based regulation is an outcome-based approach. The following note describes APRA’s principles-based approach in comparison with other regulators. While the view expressed by the supervisor in this excerpt undoubtedly understates how risk-based US regulators and ASIC are, they are nevertheless revealing of how APRA regulatory staff think.

It is interesting to compare the United States and Australia. The US approach is more prescriptive: checking compliance line by line, tick, tick, and cross tick, like an audit. They would go into the office [in the firm] for three months, for example, and check everything. We don’t use that approach (from an interview with AU14 conducted in February 2014).

This excerpt points out how one important aspect of APRA’s principles-based approach is different from a rules-based approach. A rules-based regulator would check compliance line by line to make sure entities abide by what is enumerated in rules and

⁵ Many APRA supervisors perceived that they were not given discretion in deciding how many contacts they have with regulated entities, because their decision was restrained in many different ways. Ways in which APRA supervisors’ discretion is contested will be discussed in detail in Section 7.3.

guidelines. As mentioned in Chapter 6, FSS conducts management status evaluations on financial entities with checklists to evaluate their prudential management. This approach gives regulated entities a sophisticated designed set of tasks the regulator expects them to carry out. Although it may be too burdensome for the entities to meet all listed items, checklists deliver an unequivocal sign that if entities meet listed items they are free to pursue their business.⁶ But a discussion about the unreasonableness and inappropriateness of listed items or alternative means to achieve the objectives of risk-based regulation is of less concern in this approach. In principles-based regulation, on the contrary, these constitute the major concern. As Ford (2010, 261) points out, what is fundamental to principles-based regulation is the development of an effective interpretive community that regulators, regulated businesses, and other stakeholders sustain through “ongoing communication around the content of regulatory principles.” A supervisor indicated the difference between rules-based and principles-based regulation in the following way:

APRA prudential standards are written in a very principled style. They do not read like a prescriptive legal statement. They read more in terms of regulatory objectives: objectives about liquidity, capital adequacy, or something like that. And it gives a number of features about achievements those objectives would involve. So those are the sort of guidelines and standards we try to enforce. But “enforce” is an interesting word. [What we do] is not in a legal sense; we try to ensure compliance with the objectives (from an interview with AU05 conducted on 13 February 2014).

As this supervisor described, one essential difference between rules-based and principles-based regulation rests on the objective of compliance. Rules-based regulation aims at securing regulatee compliance with legal rules. The supervisors’ job is to make sure regulated entities comply with the rules, because the rules are the only recognized means to achieve the objectives of risk-based regulation. They are not required to see if, for example, entities’ own risk management systems can better serve the objectives.⁷ On

⁶ For the debate on whether principles give regulatees a more constant sign than rules, see Braithwaite (2002b).

⁷ This might have been a major reason for the discontent of foreign financial institutions with the Korean financial regulation, discussed in Chapter 6. If those institutions were familiar with principles-based regulation, then it was reasonable for them to ask questions as to whether their way of meeting the objectives of FSS risk-based regulation was permissible. According to Park and Kim (2006), foreign institutions reported that FSS supervisors repeatedly said “I don’t know,” and gave them no additional

the contrary, principles-based regulators strive to elicit compliance with the objectives of risk-based regulation. Put another way, principles-based regulation aims at complying with the spirit of the law as opposed to the letter of the law. What underlies this approach is a criticism of rules-based regulation that compliance with legal rules does not always guarantee the achievement of the regulatory objectives. A supervisor illustrated this point:

I think [APRA's principles-based approach] gives entities a better outcome than just putting rules together, saying that "you abide by the rules, so I will tick excellent," and putting it away. We're trying to avoid that. We don't want them to tick in boxes, and saying yes, done and forget about it. We actually want them to do this day-to-day (from an interview with AU04 conducted on 12 February 2014).

What is implied in this excerpt is that often rules-based regulation is carried out in such a way of checking compliance for the sake of checking compliance, not for the sake of achieving regulatory objectives. If risk management is implemented to meet checklists of the regulator then one plausible result would be similar to what a FSS examiner described, "Entities contrive to find loopholes in the legal system while supervisors try hard to chase and reveal their breaches."⁸ This is so because entities are aware that they would be subject to no more regulatory intervention if they perform well in those occasional interventions. APRA sets out prudential standards in each industry with an expectation that entities find their own way to enhance risk management and meet the APRA requirements. This approach is to let the regulated entities choose the methods of improving their risk management.

APRA supervisors call this a consultative approach. It may be one reason that APRA's interventionist approach does not get much push back from regulatees, compared to other financial regulators in Australia (Murray et al. 2014). Describing that APRA's principles-based regulation is consultative in nature does not mean that APRA supervisors act like consultants. APRA frontline supervisors do not consult on what to do to improve risk management. Their focus is rather on encouraging entities to figure out what they need to do to meet APRA expectations, and eventually, to act as a responsible actor in the Australian financial market. Some supervisors described this aspect:

explanations when encountering hard questions (27).

⁸ This is based on an interview with KOR16 conducted on 8 May 2014.

In risk management, we can give entities hints about what they could do. But the difference [between our approach and rules-based one] is that we want to make sure that they think of what they want, rather than us telling them what they should be doing, because they are in the business they're responsible for (from an interview with AU14 conducted in February 2014).

What we're about achieving is a risk-based outcome. So that might, for example, involve talking to institutions that, "well we think you need to do more in ... be better in that way" or "you need a better provisioning policy." So we could give them a series of things we want to see them change in their provisioning policy. They may well come back and say, "we don't want to do it that way. But how about doing it this way? That would achieve your objectives." Then we may well say, "yes, that's fine." Or we may not. But there is a constructive dialogue that can take place. This becomes sometimes a serious dialogue. But the dialogue nonetheless is an objective (from an interview with AU05 conducted in February 2014).

Frontline supervisors I interviewed admitted that a consultative approach such as persuasion or moral suasion is their common practice, unless the entity is intentionally defiant. The dialogue described in the second interview means that it is a process of deliberation rather than negotiation. Both parties come to the conversation table knowing that their preferences can change as the deliberation takes place. APRA supervisors may prefer one method to others, but they should accept entities' method so long as it can meet the objectives set out in the prudential standards. The entity also comes with the understanding that they will not adhere to its preferred method if they fail to convince the supervisors. Both parties' interests would not change as a result of deliberation, but their preferences may change. This is one reason that APRA, as indicated in the second quote above, perceives that having a dialogue with entities is an objective of APRA's principles-based approach. Through the dialogic relationship frontline supervisors build up, both parties can get much intimate and up-to-date information, understand each other's intentions more clearly, and deepen a sense of cooperative problem-solving.

The outcome-based, consultative aspect of APRA principles-based approach is closely intertwined with the other two aspects. This approach inevitably involves frequent regulator-regulatee encounters. Ford (2010, 278) mentions diverse channels through which regulators communicate with regulated businesses, including "official administrative guidance, speeches, 'no action' or 'Dear CEO' letters, compliance audits,

comments on industry standards, or specific enforcement actions.” APRA frontline supervisors’ method of building an interpretive community is more direct than Ford envisions: through repeated interpersonal regulatory interactions. APRA needs to ensure that entities’ risk management practice meets its expectations. And this cannot be fulfilled by resorting only to entity self-reports: supervisors need to contact regulated entities frequently—sometimes in a face-to-face fashion rather than remotely over the phone or email—to ensure they are complying with the objectives of risk-based regulation. This approach also contains a lot of empathic reciprocity.

The third aspect of APRA’s principles-based regulation is that what underlies the consultative approach is empathic reciprocity. Let us consider the above interview on deliberation and the next interview together:

We are trying to make sure that entities understand what we’re trying to achieve and that it is all a benefit to them. I think most of them in the end sort of see the value in that (from an interview with AU04 conducted on 12 February 2014).

This note highlights that APRA frontline supervisors perceive building up a common ground with the entity and persuading people to be effective. The common ground is established around the objectives of risk-based regulation. APRA attempts to convince regulated entities that it does not seek its own interests unilaterally in iterated regulator-regulatee encounters. Rather APRA emphasizes that the process is mutually advantageous. This is so because the process eventually benefits the stakeholders of Australian financial supervision. APRA’s prudential supervision engenders stakeholders’ trust in the soundness of financial institutions. Given that all financial institutions in Australia compete with each other under the scrutiny of APRA, institutions would find it less reasonable to show defiance towards APRA. Australian financial industries’ solid performance in the face of the GFC compared with other countries may bolster financial institutions’ belief that the supervisory process is mutually advantageous.

Based on this common ground, APRA takes entities as a partner in achieving the objectives of risk-based regulation. This is one reason that the process of dialogue often takes the form of deliberation rather than negotiation. Negotiation may also take place when both parties reach a settlement in which, for example, APRA would not bring the

case to court if the firm replaces its senior management.⁹ But in most cases the regulated entities are regarded as partners in the deliberation for problem solving. The following interview indicates that empathy is critical in this partnership with regulated entities:

You're being as honest as possible with an entity. If you say what you're going to do and actually do it so that you're making sure that they have trust in you, then that reciprocation sort of happens from there. So if you don't stand as a right example, then you never get them to do the right thing. Because obviously they would think, "this guy does that then why should we bend over backward for him?" (from an interview with AU04 conducted in February 2014).

What is implied in this quote is similar to the FSS on-site supervisor who attempted to steer the flow of stories in the regulated firm (see the interview with KOR03 on p.135 in Chapter 6). It is based on an empathic consideration that if my trust in my opponent is conditioned on her treating me in a trustworthy way, then she will think in the same way. By the same token the supervisor tries to be as honest as possible in order to get honest responses from the entity. Empathic reciprocity also flows underneath supervisors' practice to give entities a second chance to fix problems on their own. And this is closely involved in the way APRA holds regulated entities responsible for their business.

If we find a contravention of the standards in our on-site review, we will issue a requirement to the entity. We issue, for example, a requirement saying "you must rectify this issue by this date" to the entity. One effective way of ensuring they do that is to report it to senior management and the board, because they are responsible for their own business. And they have to provide us with "we confirm we've rectified it. Here are documents that prove it." We will expect their internal audit to go through them. We will expect their board and senior management to be aware of it and sign it off (from an interview with AU23 conducted in February 2014).

In response to my question of how supervisors would respond if they detected a contravention or breach of the prudential standards, all the supervisors answered that they

⁹ One such example is enforceable undertaking. Enforceable undertakings are most actively harnessed by ASIC. But APRA has so far had 27 enforceable undertakings with individuals and institutions. For the complete list, see <http://www.apra.gov.au/CrossIndustry/Pages/EnforceableUndertakings.aspx> (last access on 1 March 2016).

would not impose sanctions. As illustrated in the above interview, instead, their common practice is to offer a second chance to fix the problems. In doing so, APRA's emphasis is not just on the rectification itself. It is rather that the firm recognizes the problems and fixes them in order to act as a responsible corporate actor in society. A rules-based regulator can also take up a similar method. As described in Chapter 6, FSS may opt for requesting financial entities to take disciplinary actions on their employees. They may look similar in that regulators give a second chance to regulated entities without mobilizing direct intervention. Again, the difference is that in Korea entities are requested to impose sanctions on behalf of FSS while APRA's method focuses on fixing problems to improve risk management. In this sense, APRA's principles-based regulation is a form of meta regulation: APRA conducts regulation of corporate self-regulation (Braithwaite 2003a; Grabosky 1995; Parker 2002).

The use of empathic reciprocity becomes more apparent if we take into account the ways in which APRA supervisors respond to the regulated entities' compliance performance. APRA monitors and reviews financial entities' risk management to ensure their self-regulatory function works properly. If not working properly, APRA gets the entity to fix it first. If the problem still occurs, then APRA will do the job on behalf of the entity. This is the phase that APRA calls "Mandated Improvement." APRA's level of engagement may also increase if the entity is intentionally taking risky options, even though it is not placed in Mandated Improvement. An interview with an experienced supervisor described APRA's general approach to defiant financial firms as follows:

We accept that there is a different range of risk appetite. You know, without naming it, there are banks out there that are known to take deliberately high-risk products and get a high return for them. Investment banks tend to be in that end of the market. We don't say that's wrong. We say, "well, we will look at you a lot more closely. We're going to set a higher standard. We will make you need a whole lot more capital, and we'll come and visit you more often. As long as you have enough safeguards, we will allow you to do that. But we'll apply a higher level of scrutiny to you and we'll expect more from your risk management systems than if you're doing just a plain level of business" (from an interview with AU05 conducted in February 2014).

This statement reflects well APRA's supervisory philosophy to invest more regulatory resources, but more importantly greater self-regulatory resources, to higher risk

entities. More scrutinized surveillance is normally conducted at the stage of “Oversight.” Supervisors will visit entities more often and ask them to prove that they have enough safeguards to observe risks they carry. Accordingly, supervisors’ responses become more strict and immediate. If entities are not being responsible for their own business, then they will decide to escalate the entities’ risk stance to “Mandated Improvement.” This stage is when APRA ceases to steer the flow of events and steps in to row and execute necessary actions to rectify issues.

This kind of flexible regulation seems less plausible in FSS’s rules-based regulatory approach. One major reason is attributed to the nature of the regulator’s risk-based regulatory framework. FSS’s TCM may look similar to APRA’s SOARS as long as both are phased responsive frameworks. However, the condition for each phase in TCM is strictly set out in higher acts and FSS does not hold a right to flexibly put some entities at a higher stance, just because they have run their business in an aggressive and risky way. It is not a flexible tool the way APRA harnesses SOARS. The decision-making authority in TCM is not given to FSS but to FSC making it more difficult for FSS to use this tool flexibly.

So far we have examined that empathic rather than calculative reciprocity underlies APRA’s consultative principles-based approach. Empathic reciprocity is important in creating common ground between regulator and regulatee and establishing a partnership to improve firms’ risk management. APRA frontline supervisors incessantly harness this reciprocity in frequent face-to-face meetings, sometimes giving entities chances to redress weaknesses in their risk management. As the last quote implies, supervisors’ style can change in the face of intentionally defiant regulatees. They would rather immediately respond to the entities’ behaviors in a tit-for-tat way. In sum, APRA prudential supervision intelligently harnesses empathic and calculative reciprocity when holding regulated entities responsible for their business. The mixed use of direct reciprocity, however, does not secure responsibility of APRA supervisors. Principles-based regulation endows frontline supervisors with discretion as they are asked to make frequent and intimate encounters with the regulated entities. Given that APRA supervisors are susceptible to capture and corruption, the question is how APRA maintains integrity in its frontline. If APRA frontline supervisors are called “responsible” supervisors, what are the mechanisms to maintain responsibility of those supervisors? Surprisingly we will find that indirect reciprocity undergirds APRA’s internal dynamics and mechanisms to maintain integrity in its frontline. Before moving on to APRA’s internal mechanisms, I will explore

another way in which APRA and FSS supervisors harness indirect reciprocity in their everyday supervision.

7.2 Nudge for Stimulating Reputational Competition

One advantage corporate firms can draw from amicable rapport with regulators is the acquisition of information about other regulated entities. It is especially appreciated because information is kept in confidence rather than shared across competing firms, especially in prudential regulation. As far as the regulator can be a channel through which regulated entities can obtain necessary information on their competitors, they have good reason to maintain the relationship. Sometimes it becomes a source of regulatory capture as entities strive to acquire such information on business strategies or new products by providing regulators with bribes, lucrative future employment or consultancies when they retire. But if information flow is carefully steered, regulators can use it toward facilitating entities' competition to have better, or at least not worse, compliance performance than their competitors. Prudential regulators are intrusive when using state power to regulate registration, operation, and exit of financial corporations and garner risk management information. As long as financial entity's success in the market is closely involved in the extent to which a financial firm maintains a high level of stability and carries strong risk management capacity, however, prudential regulators can also become non-intrusive choice architects (Thaler and Sunstein 2008).

Supervisors in both FSS and APRA confess that they acknowledge the importance of stimulating reputational competition among regulated entities. This provides evidence of the last indirect reciprocity strategy described in Chapter 5: stimulating reputational competition. The following two interview excerpts describe the way in which frontline supervisors in both prudential regulators harness this strategy of indirect reciprocity:

Especially, we bring up a lot of comparative examples when conducting non-quantitative assessment of insurance companies. This is so because there are no absolute guidelines in this qualitative assessment. "This is industry average, which has this much gap with your company's performance." "Your company's performance is the worst in your industry." "You may want to bring your attention to this." Then they

become very susceptible. And they strive to address it. At the end of the day, it is subject to the decision of the CEO. It is normally the case that entities are not aware of the performance of their competitors and industry average. If FSS alerts them, CEOs normally respond, “Thanks, we need to make up for it.” We’re helping them improve performance, rather than commanding them to rectify what they’re doing wrong. CEOs appreciate chatting with us because we inform about such information that might not be gathered internally and reach the CEOs (from an interview with supervisor KOR16 conducted on 8 May 2014).

Surprisingly enough, if you tell the company “you’re below your PAIRS,” they take that seriously. They don’t want to be below their competitors in dealing with the regulator. This is not publicized. These are all confidential. Nothing gets out (from an interview with supervisor AU19 conducted in February 2014).

As illustrated in the above excerpts, supervisors in both agencies neither direct regulated entities to work on certain areas nor express their expectations for the entities to enhance performance when handing over information. They just deliver information which may be enough to stimulate the entities’ interests not to get behind their competitors. An interesting phenomenon is that entities respond sensitively to this information delivery, even though information about the entities’ risk governance or performance is kept in confidence. FSS publically releases summaries of on-site examination results on its website, yet does not post detailed risk assessments for each financial institution. Details of RAAS rating of FSS¹⁰ and PAIRS rating of APRA are confidential and only provided to the respective entity. So entities are not aware of their detailed status in the financial market, nor are any other actors in society likely to obtain the information. Then why do regulated entities become susceptible to their relational status in the market and strive to spend resources to improve their weak spots?

Even though consumers are unlikely to get the information, it is difficult to keep such information in confidence in the world of networked governance. It may be the case that other regulators sharing such information use it for future targeting or that rumors spread by word of mouth in peer meetings of the financial industry people or in shareholder

¹⁰ FSS’s RAAS, introduced in 2007 in the supervision of insurance companies, evaluates insurance companies’ risks in seven aspects: management governance, insurance, interest rate, investment, liquidity, solvency margin, and profitability risks. Supervisors conduct both quantitative and qualitative assessments on each risk area and yield an overall rating for each insurance company.

meetings. Regulated entities may realize the possibility that their own individual and institutional reputation can be damaged if the weak spots are not ameliorated and as a result they are put into a more intensive supervisory stage. Sharing information that a financial firm's internal governance control is particularly weak with external actors, for example, may tarnish individual as well as the institutional reputation. This makes it important to give positive reputational boosts to firms with serious risk problems that implement remedies that are clever or innovative or effective or unusually intensive self-regulation in response. Board and senior management of financial entities are aware that they can be more competitive by improving weaknesses in some aspects of risk assessment. In other words, a web of indirect reciprocity, as depicted in Figure 9.1, underlies financial firms' concerns about their relational risk management status in the market. They are indeed entangled in a web of indirect reciprocity in such a way that if their weak areas of risk management are known to other actors in the regulatory space, such as other regulators and social stakeholders such as consumers, NGOs, and credit rating agencies, they may receive sanctions or non-cooperation from those actors. The reverse is true about strong areas of their corporate risk management and corporate responsibility becoming known: the more regulators indirectly learn about this, the more indirect reciprocity will drive benefits for their company. Supervisors in both FSS and APRA use information asymmetry to stimulate entities' reputational competition. This non-intrusive stimulation strategy remains effective even without actually disclosing the information to the public.

7.3 Indirect Reciprocity among Rotating Supervisors

Regular rotation policy is a common practice of many regulatory agencies. Most of my interviewees in APRA, including those in senior management positions, concurred that rotation is a systematic tool to avoid regulatory capture. However it is neither the only nor the primary reason for rotation. When asked about APRA policies to cope with regulatory capture, an executive officer of APRA answered as follows:

One balancing policy is that we do not rotate them too quickly. Avoiding capture is one reason, yet not the prior reason. The bottom line is that our frontline supervisors are not

locked into one situation. ... They need time to learn a new business. So rotation is not only about managing capture. It is also about career development by learning about new business (from an interview with AU01 conducted in November 2013).

Rotation is one solution for professional training in APRA, while it is one source of amateurism for FSS. According to a report, regulated financial firms in South Korea indicated occasional rotation of inspectors as the biggest reason for the lack of professionalism of FSS (Park and Kim 2006). They said that they had to start over with a new set of conversations if their counterpart at FSS was replaced due to occasional staff rotation.

According to my informants in APRA, APRA's staff rotation takes place every two to three years in the main office in Sydney. The rotation may take longer in regional offices, which are normally short in frontline supervisors for occasional rotations, as APRA sees it. APRA maintains a good level of oversight at the regulatory frontline through its designated frontline teams. Thus it attempts to keep the side effects of rotation on everyday supervisory work to a minimum so that the designated frontline teams stay on top of managing the regulated entities' risks. The rotation policy inevitably compromises productive regulatory cooperation at the cost of avoiding capture and improving career development. APRA seems to have two official measures to keep up the level of supervision.

One explicit, systematic resolution is partial rotation: only a small part of a frontline team—one or two supervisors—is subject to rotation at a time. Colleagues on a team have intimate knowledge about the supervision of entities their team members have been responsible for. This is especially so because APRA's frontline comprises a set of designated teams within which the manager is responsible for the supervision of the team's entire portfolio. Frontline teams internally share and discuss their assessments and plans. Rotation takes place to sustain as far as possible the integrity of frontline teams' supervisory task. In this way partial rotation may contribute to minimization of the possible supervisory gap caused by rotation. Another official measure is training programs. APRA expects its frontline supervisors to continually deepen their knowledge on the regulated business. This knowledge can be nurtured through official training programs. Many frontline supervisors say that they have received weeks of training about the industry and this is important to their technical competence.

Beyond these two official processes, according to my informants, another informal

process of knowledge pass-on takes place between new frontline supervisors and their predecessors. The information that is handed over includes compliance history, attitudes, methods of dealing with diverse individuals of the regulated entity, and so on. A frontline supervisor confessed:

That a company has a history of informing supervisors in an upfront manner becomes generally an indicator that it will also do so in the future. And there is some level of trust. If there is a history of the company trying to keep things from you, then there is no trust. Supervisors are normally with a company for two to three years. And [they] keep track of the history of compliance in internal files. And they have that history in mind. And when it is handed over, a supervisor will inform the next one, “Ok, this is how we deal with the entity, and these are the issues. They tell us things in a timely manner” or “They try to keep things from us.” All those kinds of things are communicated between supervisors. ... There is no formal system to track the compliance history. *It's informal and almost like the generations passing down.* When I am taking on an entity, one of first questions I ask is how they have dealt with us. I will be told of “this person deals with us this way, that person deals with us that way.” And you will get this picture immediately. When you speak to them after you have supervised the entity for a few years, you will pick it up quickly about how to deal with them. And you will pick up very quickly “Ok I need to deal with them in this way, because I need to get them to hear.” So that sort of judgment comes from us (from an interview with AU21 conducted in February 2014).

Partial rotation and training may enable newly arriving supervisors to get necessary information such as industry characteristics, risk updates, risk stance of regulated entities and even their risk appetite. But acquiring information from the existing team members may pose another challenge to them. Information pass-on between rotating supervisors can be an informal measure to make up for the drawbacks of the regular rotation policy. What is interesting is that, as long as this measure is informal, the predecessors are not obliged to pass on such intimate information to new supervisors. It may be a communal norm of APRA that supervisors pass on such informal information, but there is the risk of not passing on insights if the organizational culture is competitive and callous rather than cooperative and amicable. FSS in Korea is an example of an agency in which supervisors are very reluctant to share their activities with other supervisors.¹¹ Even within the most

¹¹ This aspect will be discussed in Section 7.4.

collaborative regulatory culture it is hard to persuade employees who resign because they are passed over for promotion to pass their wisdom on to their successor.

Considering that supervisors may or may not hand over intimate information to new supervisors at takeover, a relevant question is why would they hand over such information? What is the motivation behind this seemingly altruistic behavior? The deficiency of data renders a full-fledged exploration of this question implausible in this thesis. However, the above interview excerpt may offer a direction for two hypotheses involving indirect reciprocity. First, as the interviewee implicated, it is “*like the generations passing down.*” This means that I hand over the information to you because I have also benefited from my predecessor’s information pass-on. This is one example of pass-it-on reciprocity where A helps B then B helps C, not A in return, as described in Figure 4.1 (see page 73). This intergenerational pass-it-on is reinforced as part of APRA corporate culture as seen from my data. Leaders in the corporate history of the helpful bottom-up practice saw an informal pass-it-on indirect reciprocity that was then reinforced by those leaders as a top-down expectation for what the good frontline supervisor would do. From the interviews, the practice of passing on such information has been established as an informal organizational norm, and supervisors are complying with that norm.

The second hypothesis asks the reason for why such information pass-on could be established as a norm in APRA.¹² This is based on a presumption that the information pass-on is a result of a reputation-based indirect reciprocity mechanism. As suggested in section 5.1.3 as the third strategy of indirect reciprocity, a reason that supervisors make information pass-on in good faith may be that they are concerned about their own reputation among their peers in APRA. In an organization where information about members’ cooperation or non-cooperation with one another is observed and shared by other members, a member is likely to cooperate, considering his or her own reputation. The norm of information pass-on may be a product of this indirect reciprocity mechanism.

¹² Or, one can ask a question like, why are supervisors complying with such an informal norm? This will lead us to the same hypothesis that supervisors pass on information because not doing so will result in their reputational loss.

7.4 Emergent Virtues of Internal Transparency

Regulatory capture is an enemy of healthy and sound regulation. The risk of capture becomes significant if a wide discretionary power is given to the regulator, as in the case of APRA. The perils of unchecked discretionary power given to FSS examiners were empirically revealed in South Korean financial regulatory capture in the supervision of MSBs.¹³ This resulted in the transformation of reciprocal regulator-regulatee relationships to corrosive industry compensation of regulators. This section explores APRA's internal structure and dynamics designed to address the issue of capture. Interestingly, internal transparency based on indirect reciprocity is critical in their proper operation.

In APRA, supervisors' supervisory activities are viewed and shared across the entire agency as well as in the team through the intranet system. Although anyone in APRA can observe supervisory practices and plans of other frontline supervisors on the intranet, colleagues of the team tend to have more intimate knowledge on the designated entities as well as on their fellow team members' supervision. This basic transparency is facilitated by other structural mechanisms so that the discretionary power is responsibly controlled.

The first measure is the peer review system. Various levels of supervisory meetings are held for a particular industry segment across regions. According to a supervisor I interviewed, two teams in SID doing superannuation regulation have fortnightly meetings. A regional meeting is held every quarter with supervisors in superannuation regulation from all regional offices: Brisbane, Melbourne, Sydney, Perth, and Adelaide. Every industry has a peak group where representatives from every region and division meet every six weeks and discuss selected issues related to the superannuation industry. There are also cross sectional working groups and committees across DID and SID where supervisory issues based on specific risk areas are shared and discussed. A senior manager mentioned that:

We actually have a meeting today with large bank supervisors about the key issues we have for each of the entities, what the supervisory approach is we're planning to do. We have a discussion and say, "oh, that's an interesting approach." Then I might come and

¹³ In 2011, Korean prosecutors indicted seven FSS senior examiners over taking bribes from some MSBs and conniving at their poor risk management in return. <http://ko.pokr.kr/bill/1813068/text> (last accessed on 1 March 2016).

have a talk and I will follow the same approach. So it's more from a collaboration viewpoint (from an interview with AU07 conducted in February 2014).

As this supervisor pointed out, these horizontal meetings provide a forum in which supervisors share difficulties and best practices with their peers. Some supervisors might have difficulties communicating with senior management of regulated entities. Others may have confronted issues analyzing risk of a particular financial product that is newly introduced on the market. Unknown risks in the current risk rating system may have been discovered in the supervision of a certain entity. Supervisors who are innovators with new approaches are also rewarded and get a good reputation in peer review meetings because word spreads about the interesting approach they have come up with or that their large bank has come up with. Frequent peer meetings may impose some additional workload on frontline supervisors, but the benefits frontline supervisors and also APRA get from these meetings often are greater than the cost.

Secondly, a benchmarking process functions as a quality control process. This benchmarking process is conducted by the Supervisory Framework Team, which oversees the supervisory methods and risk assessments of frontline supervisors. This team selects a range of regulated entities and compares those supervisors' risk assessments, supervisory plans, and approaches. It may be the case that a frontline supervisory team is seeing a credit risk problem while others are not. Then it is either that the team has found something that others have not seen or that it is just being too cautious, conservative, and overrating the issue. A member of this team stated:

It is a challenge process. We look at the risk profiles first, and the other part of the day, we look at the actions they have taken. We ask supervisors, "If you were seeing this risk, what would you do about it?" And we see if those actions are proportionate and consistent (from an interview with AU05 conducted in February 2014).

As she mentioned, this benchmarking process is meant to challenge frontline supervisors whether their assessments are reliable and ask them to justify their own assessment and action plans. This is a process where supervisors' discretion is significantly controlled. Supervisors are exposed to discussion with experienced supervisors who can provide feedback and constructive criticism to their risk analysis and supervisory actions. They tell the stories explaining why they have, for example, had

more frequent face-to-face contacts with this entity than that entity. This is also a forum where they can get advice regarding their difficulties. It makes the APRA frontline supervision a process to garner collective wisdom. It is also an experimentalist process in which best practices of the APRA frontline are shared, compared and applied to different contexts to enhance integrity of both supervisors and regulated entities (see Dorf and Sabel 1998; Sabel and Simon 2004).

The last device that is necessary to facilitate information flow and review through internal transparency is a culture of early engagement. As implicated in the above excerpt, the way APRA holds its frontline supervisors responsible is neither punitive nor retrospective. It is APRA's philosophy to intervene as early as possible before risks materialize. This may be costly because it will result in a lot of discussions to convince the other party before concrete evidence of a real problem has appeared. Preparing a report to convince APRA in an early stage may cost a couple of million dollars, according to one top management person at a large bank.¹⁴ But one benefit of early engagement, regardless of whether it minimizes or increases the cost of risk management, is that it becomes easier to hold someone responsible in a proactive way. If APRA does not start engaging with a regulated entity from an early stage, it may be too late for its supervisors to tackle the entity's weaknesses in a preventive way. Then the process of holding the entity responsible is likely to take the form of holding it liable for the misconduct in a retrospective way. APRA applies this early engagement policy into its internal mechanisms as well. The above supervisor continued by saying that:

The Supervisory Framework Team does not ask supervisors, "Why did you rate risk in this way?" or "This is wrong." Rather the team says, "Have you thought about this? What about that?" So that is how the benchmarking works (from an interview with AU05 conducted in February 2014).

Such constructive consultation is possible partly because this benchmarking process takes place in an early stage, long before a particular risk is realized. It is an ongoing process concomitantly undertaken along with frontline teams' risk assessment. Once a practice is set up in a way of holding one another responsible not for what you have done but for what you can do better, it becomes easier for people to speak up and challenge

¹⁴ This is based on an interview with AU35 conducted in February 2014.

each other. Two senior supervisors' statements are pertinent here:

A forward-looking attitude is the best way to attack the problem. Culturally we are trying to challenge our supervisors, because everyone has their own views on things. I do too. I've been doing this for a long time. We try to challenge people's perceptions by exposing them to different views. That is what we do culturally (from an interview with AU13 conducted in February 2014).

Of course there is hierarchy in a team consisting of junior and senior people. It is part of our values. We try to encourage people to always be prepared to speak up when you need to. And we are quite good in tolerating different points of view. I am more worried about the passive side of that: an analyst at the bottom just sits there and relies on whatever the boss says ... There are more than ten people working for me. You want these people to expose when you are wrong. Because otherwise, you are going to step on a landmine, no one is going to tell you. You want them to tell you when you are wrong. You want them to tell you, "Here's something we should look at. So let's talk about it." The best way to learn is to have different points of view coming in (from an interview with AU05 conducted in February 2014).

The way internal transparency works in APRA's intra-organizational dynamics mentioned so far implies some important developments in the theory of indirect reciprocity. Figure 7.1 is a real world application of indirect reciprocity mechanism underlying internal transparency in Figure 5.5 (see page 100). Imagine that FS_1 , denoting a frontline supervisor in APRA, is corrupted by the regulated entity (R'ted). Internal transparency asks the regulatory agency to make FS_1 's risk assessment and supervisory activities against this entity as visible as possible to other frontline supervisors (FS_2 , FS_3 , FS_4 , and FS_5). Then there are two possible scenarios. First, FS_1 may be oblivious of the fact that he is captured and that this capture actually amounts to corruption. Through the intranet system, and also peer review and benchmarking processes, this inappropriate favor to the firm can be detected. APRA's early engagement policy helps with earlier detection. Second, FS_1 may be aware that reciprocating the entity's bribery or promise for future lucrative employment is a norm infraction—violating professional ethics, not to mention APRA's codes of conduct and the criminal law. If the regulatory agency is internally transparent, then FS_1 will not respond to that request because he realizes that his peers can observe his behavior. Detection of FS_1 's involvement in bribery or future

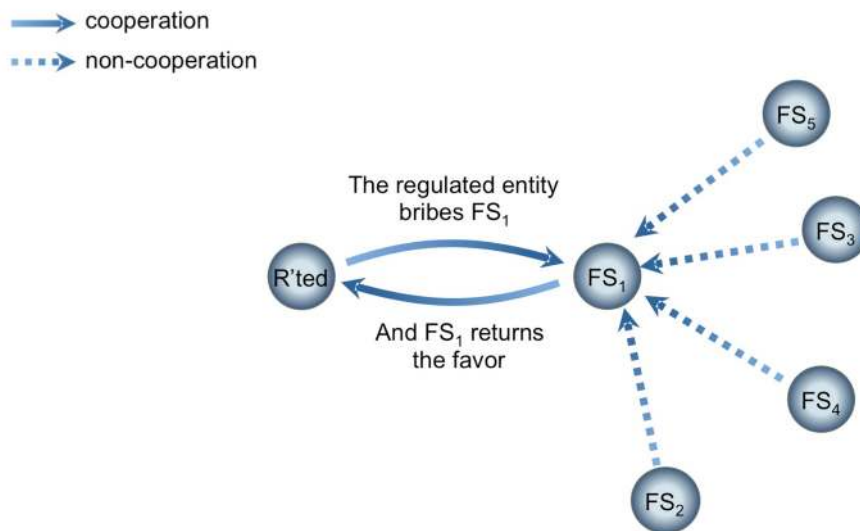


FIGURE 7.1 Indirect reciprocity mechanism underlying internal transparency

lucrative employment may not be plausible. If FS_1 's regulatory activities are transparently shared and challenged in diverse ways, however, it may be at least impossible for FS_1 to reciprocate any attempt to capture it. Internal transparency insists that an organization be equipped with an environment in which direct reciprocation involving communally unethical behaviors is easily detected, that even an egoistically motivated member acts in accordance with the communal norm.

APRA's intra-organizational structure and dynamics make at least four important contributions to the development of indirect reciprocity. First, this APRA case suggests that indirect reciprocity can offer a theoretical ground for internal transparency. What is at stake in the success of the aforementioned indirect reciprocity mechanism is to make a frontline supervisor's reciprocation observable to other members of the same organization. Observing an entity's attempt to capture a frontline supervisor may also be important, yet only a clue to catching a supervisor involved in a corrupt transaction. Thus the idea of internal transparency suggests that frontline supervisors' risk assessment and supervisory activities against entities should be shared by and transparent to other members of APRA. As they are involved in such horizontal and vertical processes of sharing and assessing supervisory activities, APRA's frontline supervisors are eventually exposed to one another's gaze, and checks and balances, though not to external gaze.

This intra-organizational structure of APRA is observed in this research to be in stark contrast to that of FSS. FSS's frontline supervisors, no matter whether they are on-site supervisors or frontline examiners, do not share their risk assessments and supervisory

activities with other supervisory teams. Their risk assessment and supervisory plans are also documented and reported through the intranet system, but it is not horizontally shared in FSS. Attempting to know, or spying on other teams' work is culturally prohibited. A senior supervisor of FSS confessed that:

We do not have a forum in which we discuss risk assessment issues or challenges we may face. Managers do not even try to be aware of what other managers do in the field. If it is something we need to share, then we certainly do, but we do not have to do that. As for sharing best practices, we would be more inclined to in private meetings, not in official meetings. If we do this in sort of official meetings in which to share best practices, then we will be easily overloaded ... Best practices are not shared across different supervisory departments. We do not have an inter-department forum in which to discover best practices and discuss their applicability to other supervisory fields. They often say, for example, "it may not be the case that the best practice in one supervision is applicable to the supervision of another industry" (from an interview with KOR16 conducted on 8 May 2014).

This excerpt represents FSS's intra-organizational structure that rarely embraces internal transparency. FSS may be more externally transparent than APRA in that the result of on-site examination is publicly released on its website. But it cannot be an ongoing process of exposing individual supervisors' risk assessment and supervisory actions to one another's gaze. The internally opaque organizational dynamics of FSS may be prone to regulatory capture. It may consequently act as an obstacle to the introduction of a principles-based approach to FSS risk-based regulation. Discretionary power without checks and balances can hardly address the issue of "who guards the guardians" in regulation. We can learn from the comparison of these two regulators that what is more required for a prudential regulator to be secured from capture may be internal transparency, as much or even more than external transparency.

The second contribution is that the value of reciprocal exchange between two actors may be subject to the viewers' assessment. Researchers have focused on strong reciprocity or indirect reciprocity mainly in order to understand the evolution of cooperation in multiple circumstances. Their primary concern is on ways in which altruistic behavior evolves among self-interested actors, not so much on the possibility that reciprocation can be a communally corrupt form from observers' viewpoint. If not considering the context, the initial transaction depicted in Figure 7.1 can be understood as

a reciprocation of goodwill. The APRA case of internal transparency suggests that it is important to address the extent to which the reciprocator's behavior is comprehended and recognized by his or her peers. It can be the case that an organization is so corrupt or short on internal control that members of that organization have no compunction to take bribes and seek personal compensation for favorable supervision. Then those practices become communally normal rather than communally unethical. Internal transparency may then facilitate the proliferation of communally endorsed corrupt reciprocation, though this reciprocation may still be socially unethical or corrupt from the viewpoint of outsiders. This means that internal transparency only works in the public interest when norms of responsibility in Selznick's sense exist, by which insiders make ethical evaluations of norm infraction.

Third, this indirect reciprocity mechanism of internal transparency counts the receiver's intention. The mere fact that the receiver responds to the entity's bribes and makes an equivalent return does not constitute the observers' response. I have discerned two possible scenarios when it came to the operation of internal transparency in Figure 7.1. One possibility is that the frontline supervisor is captured without recognizing the capture as capture. This is apparently the case when the supervisor is captured, but in an unintentional manner. It is a virtue of the internal transparency mechanisms of APRA to detect those unintended behaviors at an early stage, by overlapping horizontal as well as vertical reviews on frontline supervisors' risk assessments and supervisory activities. A series of socio-psychological studies suggested that a generous, forgiving strategy motivated by empathy toward another's situation can effectively elicit cooperation from an unintentionally non-cooperating agent (Batson and Ahmad 2001; Klapwijk and Van Lange 2009; Rumble et al. 2010; Van Lange et al. 2002). As clarified in those studies, the observers' motivation that triggers indirect reciprocation in this case is empathy toward the frontline supervisor's situation.

The last contribution of this APRA case is that indirect reciprocity works in a way that allows actors involved in indirect reciprocation to harness it as a means to holding one another responsible. Here responsibility means both retrospective and proactive responsibility. As discussed in Section 7.1, APRA's frontline supervisors predominantly harness empathic reciprocity against regulated entities. In doing so, they actively hold financial actors operating in Australia responsible for their own business. This is not just done by asking entities to comply with written rules of the prudential standards. Checking whether entities satisfy this or that provision is not the purpose of regulation. Rather

APRA's frontline supervisors ask entities to foster their own capacity to meet the regulator's expectation by all means. Running a business in a responsible way is the job of an entity itself, but what APRA can do in this process is give the entity some tips, for example, giving them feedback on how their competitors meet the regulator's expectations, as illustrated in Section 7.2. APRA's internal transparency mechanisms based on indirect reciprocity supplement this direct reciprocity process of holding entities responsible, by reducing the size of the room in which individual supervisors' discretion takes place. What is important is that all APRA frontline supervisors are entangled in this network of internal indirect reciprocity. Exposing themselves to this network of peer review and mutual challenge, APRA's frontline supervisors can ensure that their approach and assessment are in line with APRA's risk-based regulation.

In sum, APRA's broad discretionary power is regulated through a variety of devices facilitating internal transparency. Such mechanisms as peer review meetings and benchmarking processes, along with vertical delegation, give APRA's frontline supervisors a chance to maintain some level of consistency in their everyday practice. One main idea of principles-based regulation is that regulation can be flexible, in many things though not all. Street-level bureaucrats such as APRA's frontline supervisors are inclined to adapt supervision to the regulated entity's context when encountering those with different business conditions. It is difficult to expect a small credit union to attain the same risk management structure a large conglomerate can easily reach. It may also be the case that risk assessment reflects supervisors' personal dispositions or the relationship a supervisor has with a certain entity. APRA's response to these risks is to make individual supervisors' work as internally transparent as possible and overlap different devices to avoid arbitrary practice. In this way, APRA pursues transparency *in* organization as a means of promoting its responsibility, under a circumstance in which transparency *of* organization is limited. Once your behavior becomes observable and challenged by someone you need to live with, your responsible self might overwhelm the selfish self in your behavior. As Davis argued, "[t]he proper goal is to eliminate unnecessary discretionary power, not to eliminate all discretionary power" (1969, 217). APRA's internal transparency mechanisms, combined with its rotation of staff, comprise a structure that keeps a check on its discretionary power.

7.5 Conclusion

Acquiring responsibility in financial institutions becomes a key challenge prudential regulators encounter in the post-GFC era. Many researchers have examined macro-prudential policies, structures of supervisory governance and even global frameworks to ensure that domestic and international supervisory arrangements work pertinently to gauge systemic as well as individual risks to overall financial stability (Baker 2013; Goodhart 2015; Moshirian 2011). Compared to the volume of work conducting macro-level analysis of regulatory frameworks and policies, we know little about the intra-organizational structure and dynamics that mediate regulators' efforts to promote the financial sector's responsibility. This chapter sought to fill that gap by deepening our understanding of how financial regulators arrange their internal structure to respond to the demands of responsibility.

This chapter explored two paths of reciprocation by which the Australian Prudential Regulation Authority keeps repeated face-to-face interactions with financial institutions, and at the same time, maintains institutional effectiveness and responsibility internally. It has drawn some important attributes of empathic reciprocity from supervisory attitudes of APRA's frontline supervisors. First, supervisors harness empathic reciprocity in order to elicit compliance with the objectives of regulation. A better regulatory outcome sometimes goes beyond mere compliance with legal rules. This is especially so as the development of legal rules does not catch up with business innovation and technological change. In a principles-based approach to risk-based regulation, diverse ways of meeting the requirements of risk management are allowed. What is at stake at the regulatory frontline is that supervisors comprehend the entity's risk appetites and monitor how successfully the company's risk governance and risk management strategies deal with them. A lot of reciprocity is generated as those frontline supervisors interact with people in the financial firm in a face-to-face fashion, more closely with some than others. Of course there are rules and guidelines financial entities must abide by, but prudential regulation is not just aimed at achieving regulatees' compliance with those rules, which are in many cases defined in a negative manner. Rather it aims at more proactive outcomes: such as financial entities' responsible risk management. Another feature is generosity of frontline supervisors. Supervisors are easily tempted to use punitive sanctions, especially if they perceive that they are powerful enough to deter any non-

compliance of regulatees. It is obvious that APRA has this power and this is also perceived to be the case by financial entities operating in Australia. But as the interview data revealed, APRA supervisors use it rather sporadically and strive to bind regulated entities with a norm of reciprocity triggered by granting a second chance.

This chapter argues that this direct reciprocal relationship between regulator and regulatee needs to be buttressed by indirect reciprocity mechanisms. Internal transparency is one mechanism of this kind. Internal networking processes of APRA provide fora for the delivery of both indirect and direct reciprocity. Indirect reciprocity is transmitted through APRA's internal networks because supervisors' risk assessments and supervisory action plans are being observed and discussed with other supervisors who have not experienced encounters with those entities. A supervisor is less likely to collude with a regulated entity if it becomes observable to his or her peers. This chapter argues that indirect reciprocity undergirds direct communication by bolstering it. Room for arbitrary decisions substantially decreases as supervisors share and review their experiences for best practice regulation. Supervisors are encouraged to participate in deliberation of how to find the most suitable practice for their portfolio. In this deliberative forum, they can (re-)identify shared regulatory goals and the legitimacy of supervisory actions in achieving them, and input their experiences and different interpretations in revising the prudential framework.

This chapter does not suggest limiting the applicability of the idea of internal transparency only to regulatory agencies. It is indeed applicable to any sort of organization. Reformers who struggle to minimize the possibility that discretion vested by any organization in some members is transformed to arbitrariness may want to consider internal transparency mechanisms as a remedy. But they should bear in mind that the way internal transparency works is not to, for example, install surveillance cameras in every corner of the office to monitor the activities of the members. Nor does it mean that private activities, such as who goes to the bathroom or has a coffee break more often, should be discussed and shared internally. Rather it refers to diverse horizontal and vertical fora that reduce arbitrariness through member deliberation over their tasks, practices, and experiences.

It also follows from this that an interesting path to improving the global regulatory architecture would be to encourage visiting supervisors from other regulators in other countries to sit in on these fora. As visiting peer reviewers, they could offer suggestions on alternative regulatory responses that have proved effective in their country. They could

learn from local responses what could be innovative for application in their own country. Indirect reciprocity could then do global regulatory work. It could enhance the reputation of innovators across the entire regulatory community around the world system. Indirect reciprocity through peer reviewers visiting internal transparency fora could make identifying the countries who were likely incubators of risky banks that might trigger the next financial crisis more transparent across the regulatory community of supervisory insiders. Internal transparency is therefore not merely a micro strategy. Potentially it could scale up the global regulatory architecture.

One justification for external transparency is that it encourages those who have access to information to form their opinions on matters of public concern (Manin 1997). The purpose of internal transparency is also to invigorate members to discuss their business conduct, form their opinions on it, seek better practices, and eventually establish a culture of self-regulation in which participants collectively and reciprocally commit to deliberation about responsibility.

The Promise of Indirect Reciprocal Regulation

It is now apparent that not only a lot of indirect reciprocity operates in regulatory arenas but also the application of the idea of indirect reciprocity is plausible. Among six strategies of indirect reciprocity suggested in Chapter 5, I have explored evidence for the application of four strategies in prudential regulation of South Korea and Australia: indirect signaling of responsiveness; intra-agency cooperation between rotating inspectors; overlapping networked rectification of arbitrariness; and stimulating reputational competition. This chapter discusses the possibility of the so far unexplored two strategies: interagency cooperation (strategy 2) and overlapping networked rectification of arbitrariness (strategy 4). It especially attempts to show ways in which indirect reciprocity presents alternative arrangements that a poorly resourced regulator can adopt, focusing on childcare regulation in South Korea.

A series of recent reports on malpractices of private childcare facilities in South Korea reveals the perils of regulatory arbitrariness after a rapid increase of public funding for infant care provision. Fragmented childcare regulators are too poorly resourced to enforce legal rules and monitor illegality of regulated entities. The regulators have sought networked cooperation with the private sector to cope with their resource deficits, but the effectiveness of this collaboration is still unclear. This chapter aims to offer ways in which the poorly resourced Korean childcare regulators can craft networked regulation of a large number of facilities. I argue that strategies of indirect reciprocity discussed in Chapter 5 can guide a direction for regulatory reform.

This chapter consists of three sections. Section 8.1 offers a brief summary of the context of Korean childcare regulation and addresses why it did not meet the needs for fair and effective regulation. Section 8.2 introduces recent reforms put forward by central

and local regulators to cope with arbitrariness of regulators as well as regulated facilities. Alternative institutional attempts have been proposed on the basis of indirect reciprocity that optimize regulatory resources for supervision and enable relational regulation of childcare service providers. Reflecting on these attempts for regulatory reconfiguration, I articulate regulatory strategies of indirect reciprocity so as to enhance regulatory efficiency and redress injustice that is prevalent in the Korean childcare industry in Section 8.3. I also argue that this exploration represents a case in which indirect reciprocity offers a plausible resolution to reciprocity deficits responsive regulation has been criticized for neglecting.

8.1 Childcare regulation in South Korea: A Poorly Resourced Regulator

In South Korea, infant care policy is implemented in such a way that the private sector takes up the major role in the operation of childcare facilities while the government subsidizes it and assists parents of zero- to five-year-old infants with childcare benefits. The number of private childcare facilities has explosively increased for the last two decades, from 1,500 in 1990 to 37,375 in 2012 (MHW 2012). As of 2013, only 11% of 1.4 million Korean infants are attending government-running or public facilities while 75% of entire childcare arrangements are made with private or family childcare service providers.¹ In early 2013, the government decided to extend free childcare services to all households regardless of income,² making private childcare facilities rely entirely on government subsidies. As an inspector describes, they “became a public facility with an end of profit maximization”.³

Compared to the exponential increase of private childcare facilities in recent decades, the development of regulatory systems has been unable to catch up with this rapid change. The Infant Care Act sets out how to guide and supervise nursery facilities in its chapter 7, but it only states sanctions in accordance with malpractices committed in the field. The

¹ The other 14% of infants do not use any childcare service.

² The universal free childcare service has been gradually extended from low income to all households, as recent administrations claimed to provide public childcare service. It was partly introduced first in 2006 and became universally free in 2013.

³ This is based on an interview with KC04 conducted on 16 May 2014.

statutory authority to oversee nursery facilities is not given to a single agency but thinly diffused to a central government ministry (the Minister of Health and Welfare), and municipalities (the Mayor/*Do* governor and the head of *Si/Gun/Gu*) (ICA, § 41). Regulatory oversight is in most cases exerted by local counties (*Si/Gun/Gu*) as the central ministry focuses more on policy decisions and delegates its authority down to municipalities. Accordingly welfare officers in local counties have to hold responsibility for childcare regulation while experiencing serious deficits in their capacities and resources. The regulatory space in Korean childcare regulation displays a stark difference from that in financial regulation, where a strong regulator (FSS) holds authority to enforce financial rules over relatively less number of regulatees. This reveals the “variegated” feature of the Korean regulatory capitalism (Brenner et al. 2010; Peck and Theodore 2007; Zhang and Peck 2016)

While operation of private childcare centers remained opaque to the public, the actual conditions of childcare services have been disclosed by virtue of a series of media reports. The most common malpractice is embezzlement of government subsidies. For example, facilities falsely register ghost infants or carers at the facilities, and sometimes appropriate the subsidy for meal provision or fees for extra organic food illegally collected from the parents.⁴ The number of childcare facilities making false claims for government subsidies has sharply increased (from 319 cases in 2010, 608 in 2011, to 885 in 2012). It is almost impossible to track accounts without police investigation if the facility made a false financial statement and concealed such illegal activities as rebates, price-fixing, or wage embezzlement.⁵

A less frequent yet more serious problem is child abuse. The number of reported child abuse cases in childcare facilities has been constantly increasing from 61 cases in 2008 to 135 in 2012 (MHW 2011). Media coverage of serious child abuse including physical abuse, mental abuse and even sexual harassment brings about social calls for putting the regulatory system under scrutiny and introducing more punitive policies.

The major difficulty in regulating childcare facilities is the lack of human resources. The number of social welfare officers, who are in charge of the implementation of all welfare affairs including childcare, falls short for the number of childcare facilities. In the

⁴ http://www.hani.co.kr/arti/society/society_general/589696.html (last accessed on 10 August 2013).

⁵ http://news.khan.co.kr/kh_news/khan_art_view.html?artid=201307012208165&code=940702 (last accessed on 10 August 2013).

last six years, the number of welfare beneficiaries increased by 159% (482 to 1,249 million) while social policy officers only increased by 11%, so that the number of welfare beneficiaries per social welfare officer more than doubled during this period (211.8:1 in 2007 to 492.1:1 in 2012) (BAI 2013). In local counties, only one or two street-level welfare officers are overseeing four to five hundred childcare facilities, sometimes even more, and it is only a part of their daily work.⁶

This human resource deficit gives rise to another difficulty: information deficits. Regulators need information on regulatees to strategically choose targets. Powerful regulatory authorities usually accumulate compliance history of the regulated and use this as a reference for future encounters. The Ministry of Health and Welfare (MHW) introduced the Evaluation Certification System to improve the quality of childcare services in 2006. Each facility self-evaluates seven benchmark categories of nursery environment, management, curricula, carer-infant interactions, nutrition and health, safety, and cooperation with parents and local community, which are to be reviewed and double-checked on-site by welfare officers. The certificate is subject to periodic renewal every three years, but is not suspended or revoked unless serious malpractice has occurred. Therefore it can be hardly used as a regulatory resource, and welfare officers do not have information on where the bodies are buried.

This subsequently results in a reciprocity deficit. Street-level regulators can only sporadically visit the facilities. Most information is acquired through the facilities' own reports, which may be double-checked on-site by welfare officers only occasionally. They rather spend most of their time sitting in the office and reviewing reports. This overburdened welfare officer position is regarded something to avoid among public servants.⁷ One reason that the Evaluation Certification System seldom functions as a regulatory tool is that the assessment is largely made by paper reviews rather than on-site investigation or verification of reports. Ironically it rather weakens the quality of childcare services, demanding carers to spend time preparing a number of documents and daily logs of care and communication with parents.

The presence of powerful interest groups also obstructs attempts to redress regulatory

⁶ As of 2013, 197 out of 292 welfare services are implemented by these street-level welfare officers in local counties (BAI 2013). Their poor working conditions started to receive public concerns after some local welfare officers were driven to commit suicide in early 2013.

⁷ This is based on an interview with KC01 I conducted in the Seoul Metropolitan Government on 14 May 2014. The average tenure of welfare officer position in local counties is less than a year.

failure. Whistleblowing is a way to divulge the reality behind the scene. But whistleblowers—normally carers—are exposed to the occupational hazard of blacklisting and circulation of their name among directors of private childcare facilities. Several reports reveal that whistleblowers are not protected yet easily discoverable, because local welfare officers may bring evidence of child abuse or insanitary facility conditions to the director for correction, which is hardly attainable by non-facility members. Moreover interest group lobbies to national congress members can thwart a new bill proposal for rectifying the current regulatory arrangement. In early 2013, Korean Private Nursery Educare Association, an organization of directors of childcare facilities, allegedly took collective action for withdrawing the bill proposal for endowing welfare officers with special jurisdiction, blackmailing members of the National Assembly that they will run campaigns against proponents of the bill. The proposal was withdrawn in three days as one of the lawmakers revoked his participation in the proposal.⁸

The challenges the Korean childcare regulators face are a mixture of regulatory efficiency and non-arbitrariness. The Korean government acknowledges that the most urgent solution is admittedly to increase human resources to the extent that is sufficient to visit and check the facilities (BAI 2013). Some efforts, though limited, are made to address this challenge. For example, the Seoul Metropolitan Government expanded its on-site inspection team in 2013 and has visited facilities every day.⁹ And MHW has encouraged multiple on-site reviews to be operated by different levels of government, infant care specialists and voluntary parents.¹⁰ Getting more human resources is a necessary move, but it is hardly sufficient. Rather a systematic effort to make the regulatory arrangements more efficient and just should be in order. In what follows, I argue that two strategies of reciprocal regulation suggested in Chapter 5 may suggest a

⁸ http://news.khan.co.kr/kh_news/khan_art_view.html?artid=201305060000005 (last accessed on 10 August 2013).

⁹ An On-site Inspection team was first established in 2012 with only two inspectors. This was expanded to two teams consisting ten inspectors devoted solely to inspection of childcare facilities. In 2013, these teams could visit 374 out of around 6,800 facilities enrolled in Seoul. However this kind of human resource expansion is unlikely to be implemented by other municipalities due to fiscal constraints. This is based on an interview KC02 I conducted in the Seoul Metropolitan Government on 14 May 2014.

¹⁰ MHW and local counties conduct main on-site inspection. Korea Childcare Promotion Institute, an infant care specialist group, is authorized to undertake on-site observation before and after the evaluation certification. Parents of infants can also voluntarily participate in monitoring groups that occasionally visit facilities. See MHW (2014).

direction for regulatory re-arrangement to cope with the two issues Korean childcare regulators face. In doing so, I point out that the recent reforms are partly leaning on the idea of indirect reciprocity. The two regulatory strategies are proposed to give practical implications to policy makers and regulators that the idea of indirect reciprocity may contribute to the amelioration of those reforms by seeking actively to apply the idea of indirect reciprocity.

8.2 Interagency Cooperation across Regulatory Domains

One indirect reciprocity response to the issue of inefficient regulation is Strategy 2 interagency cooperation across regulators in different levels and domains. Regulators choose their targets strategically. This is in most cases inevitable because even the most powerful regulator cannot monitor and oversee all activities of all potential regulatees. One way of dealing with this target-selection issue is to sort regulatees according to their motivations in regulatory compliance, and adjust regulatory strategies to each actor, referring to the actor's compliance history (Ayres and Braithwaite 1992; Black and Baldwin 2012a; Braithwaite, Murphy, et al. 2007; Gunningham and Sinclair 2009; Kagan and Scholz 1984). However, this is only available to a regulator with a fairly long history of regulation that has accumulated information on the regulated over time. This is one aspect where the rudimentary Korean childcare regulators fall short. An indirect reciprocity idea is to overcome this deficit by using other regulators' experience rather than one's own.

In South Korea, childcare regulators, including MHW, and municipal governments, are the main regulator overseeing the overall operation of childcare facilities. But those facilities are not only subject to the regulation of these childcare regulators. Their business is also subject to the regulation of the labor inspectorate and environmental regulator as long as the former oversees employment conditions of the carers¹¹ and the latter investigates on the quality of facility environment such as indoor air quality.¹² In many

¹¹ Labor inspectors launched a regulatory blitz on childcare facilities to inspect the working and employment conditions of the employees. One report revealed that 80 violations of Labor Standard Act were detected in 23 childcare facilities in Daegu (LaborToday 2013).

¹² Environmental inspectors take regular investigations on indoor air quality of public use facilities,

cases, childcare regulators fall short of human resources enough to visit facilities for inspection. Due to this human resource deficit, regulators are unable to target on-site visits because they lack the information on “where bodies are buried” (Braithwaite and Hong 2015). One indirect reciprocity strategy those childcare regulators may harness to overcome this difficulty is to use other regulators’ experience, as the second strategy of interagency cooperation suggests.

Figure 8.1 describes a situation we can easily observe in the regulation of childcare facilities in South Korea. Here, Facility 1 has history of complying with the environmental inspectorate, whereas Facility 2 has not complied with the labor inspectorate.¹³ Upon accessing this information, it is reasonable for the childcare regulator to suspect that Facility 2 rather than Facility 1 is more likely to commit contravention of regulatory rules and principles. This is so because a facility that exploits its employees, for example, is more inclined to embezzle government subsidies than a facility that provides fair working conditions to carers. Also it is also perhaps reasonable to assume that a facility taking good care of cleaning and sanitation issues would be more concerned about infant health and nutrition. Once the information on compliance history of facilities in other regulatory domains has been acquired, the childcare regulators can utilize it to launch strategic regulatory surges to verify the information. Occasional joint or overlapping inspections where two different kinds of inspectors of child care centers organized for one to visit in the morning, the other in the afternoon, with inspectors from the two regulators meeting in between over lunch could be an informal path to indirect reciprocity. Functionally, this would be similar to the pass-on indirect reciprocity of handovers discussed in the last chapter inside a single agency.

including childcare facilities, and publish reports every year. According to 2012 Report on the Investigation of Indoor Air Quality Control in Public Use Facilities (ME 2013), infant care facilities recorded the highest rate of violation (13%) among all facility categories.

¹³ Note that cooperation or non-cooperation could be coded differently for the regulator and the regulated. Compliance to the regulation is deemed to be cooperation for the regulated while persuasion or not opting for punishment can be considered cooperation for the regulator. This operational definition is allowed as far as they can be regarded something equivalent to each other.

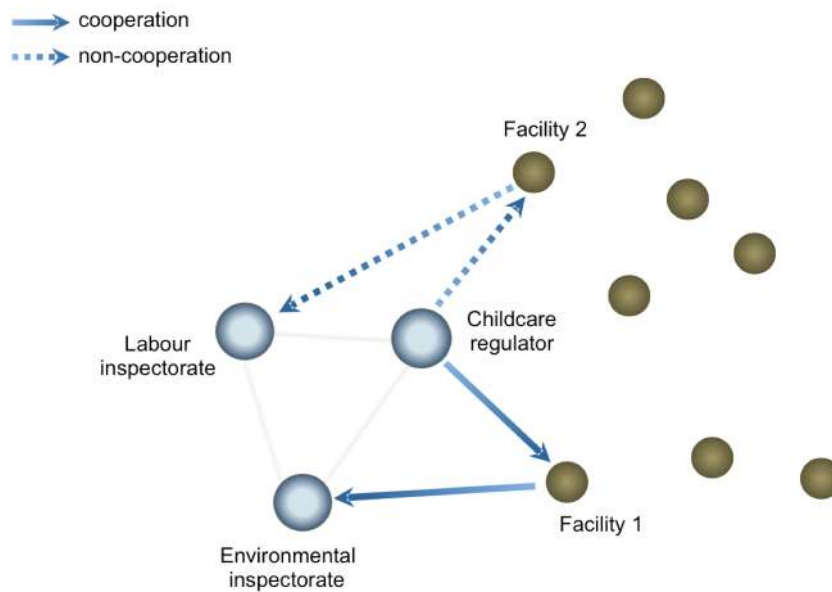


FIGURE 8.1 Indirect reciprocity strategy utilizing regulatee’s compliance history

This, nevertheless, does not suggest that regulators have to gaze a suspicious eye on regulatees that are notorious for non-compliance. Having this sort of prejudice even before conducting on-site inspections may result in unfair treatment or even discouragement of any efforts for improvement. It may raise due process concerns as discussed in Chapter 5. It is always possible that once a non-cooperative facility has so successfully redeemed its mistakes and malfunctions that it operates in a good manner. Therefore if those regulatory agencies keep a good level of information sharing, new information the childcare regulator obtains can be also shared with the labor and environmental inspectorates to update their records in return. In some sense, interagency cooperation needs a good level of direct and indirect reciprocity even among those cooperating regulators.

Reflecting on this line of thought, there are two regulatory arrangements that can address inefficiency of Korean childcare regulators. First is to facilitate information sharing or build up integrated information systems across different regulatory domains and levels,¹⁴ which relevant regulators can access, recording their own regulatory

¹⁴ State and local fusion centers in the US represent cross-regulator information sharing systems. These are joint forces operations in which terrorism-related information is shared between state, local and federal officials in the US. See US Senate (2012).

experiences with the regulated, and retrieve other regulators' experiences.¹⁵ Each regulator has their own records and database of the regulatory performance and attitude of the regulated. By sharing these records with others, the childcare regulator can get benefits from the database the labor and environmental regulators have built up in their own domain, and vice versa. Building up an integrated database across regulatory domains would decrease the cost and labor of establishing individual databases significantly and contribute to a valuable national regulatory asset. Once the integrated database is established, a newly authorized regulator could also access it and find a way to effectively supplement their rudimentary regulatory intelligence.

Institutional cooperation across domains is partly implemented by MHW.¹⁶ As of 2010 MHW started to share infants' history of entry and exit with the Korea Immigration Service. If an infant getting childcare subsidy leaves the country, then it is automatically notified to MHW and stops the payment. An integrated inspection system has operated since January 2014 for registering the record of on-site inspection. But this system only allows regulators to keep the record of facilities they have visited, so as to preclude overlapping inspection by central and local regulators. These are rudimentary steps to employ the idea of indirect reciprocity. However they can serve as an infrastructure for the development of full-scale strategies of indirect reciprocity. Different regulatory agencies may exchange information on the regulatees' compliance history, build up an integrated regulatory information system, and authorize street-level investigators to access and use it in regulating childcare facilities.¹⁷

Another path of regulatory cooperation is to integrate human resources. This calls for

¹⁵ The cross-regulator sharing of information on compliance history may be implausible in a country like Australia where the Privacy Act hinders the use of collected personal information for purposes other than the original one (Privacy Act of Australia). According to the Personal Information Protection Act of South Korea (PIPA) (2013), the use of personal information collected is also limited for the purpose other than one for which the information was obtained. However, the use may be permitted "where it is inevitable for a public institution to perform its affairs provided for in any Act and subordinate statute, etc." (PIPA 2013, § 15-1-3). Therefore, information sharing will be lawful if it is enumerated in any subordinate statutes to Infant Care Act. Organizational information protection is not enumerated in this Act.

¹⁶ This is based on an interview with KC04 I conducted on 16 May 2014.

¹⁷ MHW recently announced the implementation of the Integrated Information System on Social Welfare Services, by which welfare officers can access and share information on personal information for welfare purposes.

a radical arrangement a step further than sharing or integrating regulatory information. At the same time, it is reminiscent of the role of town constables of previous centuries as regulatory generalists who regulated not only theft and violence but also “alcohol licensing, vagrancy, 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” (Braithwaite and Hong 2015, 21). The practice of Korean childcare regulation involves considerable overlap among different regulatory authorities, which is deemed inefficient. The main authority to supervise overall operation of childcare facilities including approval and revocation of the license is in the hands of MHW as enumerated in the Infant Care Act. Meanwhile employment conditions enunciated in the Labor Standard Act are overseen by the Ministry of Employment and Labor, and air pollution in public facilities are supervised by the Ministry of Environment as described in the Indoor Air Quality Control in Public Use Facilities Act. Thus childcare facilities have to undergo sporadic regulatory visits individually by three inspectors, which are all suffering a certain degree of human resource deficit.¹⁸

A loose form of integration is to exchange MOUs between regulatory agencies, share their expertise and take coordinated action according to the terms. As mentioned in Chapter 5, Australian financial regulators have signed multiple MOUs with partner agencies to enhance regulatory efficiency and effectiveness through sharing necessary information that is permitted under relevant laws. Based on MOUs, APRA and ASIC used to undertake joint investigations on issues that lie in overlapping supervisory areas.¹⁹ More tightened forms can be the establishment of an integrated regulatory agency or regulatory ambassador that takes care of childcare regulation, or even more broadly all regulatory issues (Braithwaite and Hong 2015). While signing up a MOU is a cheaper, non-statutory solution, the regulatory ambassador reform would require a bold and systematic reconfiguration involving statutory re-arrangements.

Two effects are subsequently expected. On the one hand, those strategies would

¹⁸ Local counties normally carry out state regulation in Korea, unless a ministry has its own regional or affiliated organization taking up the regulation. Therefore the authority of overseeing air pollution is given to the Mayor/*Do* governor and the head of *Si/Gun/Gu*, just as the childcare regulation, while specialist labor inspectorate in the regional office undertakes labor inspection.

¹⁹ This is based on an interview with AU28 conducted in February 2014.

facilitate potential regulatees' motivation to comply should it be known. Regulatees would be willing to cooperate with regulators because they are aware that their non-compliance or gaming of regulation is recorded, shared across regulatory agencies, and maybe returned as regulatory surges by other regulators. Upon recognizing that regulatees learn from others' experience that it is not only the regulator in contact but also other regulators who can reciprocate its compliance, regulators could become keener on launch an on-site regulatory blitz (Braithwaite and Hong 2015; O'donnell 2004). On the other hand, it would enhance transparency and accountability of the regulator, at least horizontally. The success of indirect reciprocity is most of all dependent upon whether the performance is well observed or recognized by other members of the society. Therefore regulators have a strong incentive to encourage information on the regulated to be delivered to and recognized by other regulators. Since this information not only carries the performance and attitude of the regulated but also those of the regulator, the regulator should be conscious about its own regulatory performance and methods and ready to account for them.

8.3 Relational Regulation Utilizing Bottom-Up Contestation

The second proposition suggests a way of redressing arbitrariness caused in regulation as well as addressing the call for efficient regulation. It is an application of the fifth indirect reciprocity strategy suggested in Chapter 5: overlapping networked rectification of arbitrariness. It utilizes indirect reciprocity exercised by stakeholders in the regulatory space, especially those affected by the arbitrary practices of childcare facilities. This not only features third party involvement in regulating childcare facilities. As mentioned above, selected infant care specialists or some voluntary parents are organized to visit the facilities and check their performance through on-site observation or monitoring groups. This only grants contestatory power to a selected number of parents who volunteer to spend their own time and resources. However, a childcare facility's performance can be observed and appraised by families of infants attending that facility, potential parents who should depend on the service sooner or later, carers, and eventually all tax payers bearing the financial burden. Media can become one of these stakeholders, mediating the flow of information. This indirect reciprocity strategy implies that different iterated encounters

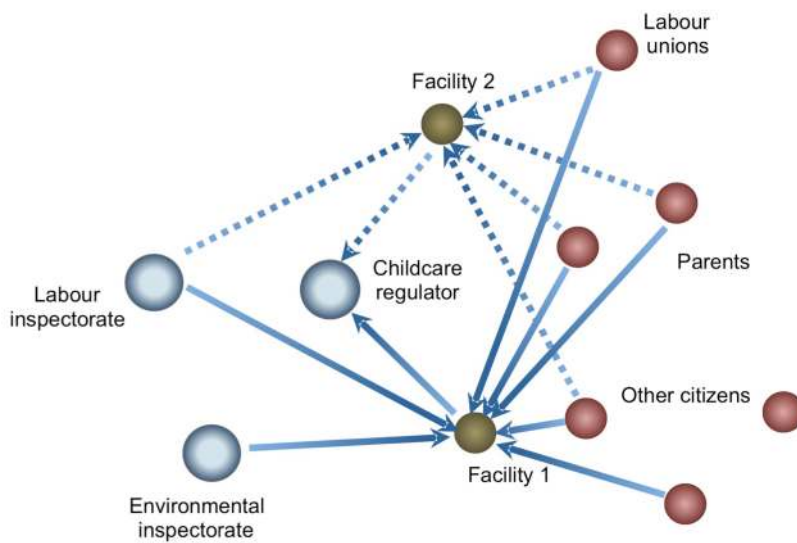


FIGURE 8.2 Indirect reciprocity exercised by societal actors

those social stakeholders have with the childcare facility can be harnessed in a regulatory system to endow all those affected with contestatory power against them. This situation is projected in Figure 8.2. Note that the list of stakeholders in this figure is not exhaustive.

Figure 8.2 is an extension of the state of affairs Facility 1 and 2 runs into in Figure 8.1 by encompassing other stakeholders in the society, such as labor unions, parents, and other citizens. Just as in Figure 8.1, indirect reciprocity takes place when actors who observe Facility 2's non-compliance reciprocate Facility 2 non-compliance with the actors' non-cooperation with Facility 2. The reason this indirect sanction occurs is that it is a justified action to punish Facility 2's irresponsibility, and that evidence of irresponsibility may be the only information the observers have about Facility 2.²⁰ Upon realizing that stakeholders in the society could observe its regulatory performance and this in turn could affect its business, Facility 2 may find it reasonable to take active steps to comply. It is almost universal that when any kind of business gets into trouble with a regulator they do whatever they can to discourage journalists and prevent the issue from becoming a scandal in the media. Figure 8.2 is a plausible account of why childcare centers and other business actors should behave that way—to prevent all social stakeholders in Figure 8.2 becoming indirectly aware of their wrongdoing and as a result withdrawing some kind of

²⁰ In order for other actors to consider that defecting against Facility 2 is a just punishment, it should be assumed that the given regulation is fair and just. If it is unjust, at least to the other actors' point of view, then Facility 2's non-compliance can be viewed and justified as resistance against injustice, followed by other actors' cooperation.

valuable cooperation with the business in bad standing.

This projection also captures the way the “social license” works in practice (Gunningham et al. 2004). But indirect reciprocity may allow us to adopt a wider range of alternatives. The social license is deemed to be distinctive, another form of license from the formal regulatory license. I suggest the idea of indirect reciprocity be crystalized into a more direct form of regulatory arrangement embracing stakeholders’ contestation against arbitrariness they have to bear. It is especially required in a society like South Korea where powerful persons or groups, particularly business elites, mobilize their resources to exploit others and interfere with others’ freedom on an arbitrary basis. Regulators should take into account the vulnerability of infants who have to live with violence and harassment or who are exposed to insanitary facility conditions or poor quality of food. Regulators should also hear the discontents of whistleblowing carers who have to bear the perils of job insecurity and occupational branding. This is essential in preventing their vulnerability from transforming to a status of domination. If regulators are not disposed to do this job, then they need to be forced in wider regulatory space to rectify arbitrariness of regulated businesses.

South Korea is a society where those discontents are frequently shared and discussed online. Parents very actively share particular information in regional online cafés on several portal sites.²¹ An intelligent way of addressing the challenges of regulatory efficiency and non-arbitrariness can be to offer diverse channels through which to organize stakeholders’ voice delivered to the regulators.

This second proposition values a regulatory system that encompasses the voice of those affected by arbitrary practices of childcare facilities. The injustice the affected stakeholders have to endure can be redressed by their direct participation in regulating those facilities. One idea is to utilize parent involvement. Infants’ parents, among outsiders, are the most frequent visitors, the most interested stakeholders, and at the same time, the richest information bearers. Every day they can observe carefully whether the facility is well maintained when bringing and picking up their child. It is also common

²¹ Numerous moms’ online cafés have become a major forum where moms share their experiences and ask about the reputation of certain childcare facilities. For example, “Mom’s holic baby” café on Naver.com, the biggest Korean portal service, features 2.4 million members and 19 million postings as of January 2016. Not all postings are involved in the information on childcare facilities, and such information is more actively exchanged in regional fora. A number of regional moms’ cafés with more than 20,000 members and around 1 million postings are actively run on various portal services.

that parents ask their kids about what has happened in the facility. Then the regulatory system can be arranged, for example, to allow the parents to log into an online childcare assessment form on a regular basis, on which they can record what they have observed or experienced. And the pile of parent grievances accumulated in that way can give a guideline to the regulators what to target next. If individual observations are accumulated on each childcare facility and regulators prioritize on-site visits based on this record of parent grievances, the online participation becomes a regulatory process by which the most affected people can equally exercise contestability against the arbitrary use of private power (Pettit 1997). One way of implementing this is to arrange the Evaluation Certification System to encompass parents' evaluations, probably qualitatively rather than quantitatively. That is when inspectors notice a pattern of parent concerns about a particular issue, they can pick up the phone to a few of the complaining parent and then ask the facility to give their side of the story on these complaints.

The fourth strategy of indirect reciprocity to overlap networked rectification gives a direction for checking arbitrariness of the regulators in the chain of indirect reciprocity. If parent assessments are recorded on an online system, it is not difficult to make it accessible to the regulators' political principals and external auditors, such as BAI and the National Assembly. MHW can be a central regulator supervising local inspectors' regulatory activities. It means that the childcare regulators' inactivity or unfair regulatory activities can be viewed and sanctioned through this online system. This strategy aims to institutionalize a chain of checking based on indirect reciprocity: a facility is subject to self-assessment, assessment of parents, assessment of the regulators, and assessment of the meta regulators.

Online assessment participation by parents is only one way of granting contestability to those affected. There can be several other ways to realize this indirect reciprocity strategy. The interests of carers working in childcare facilities may also be taken into account in the regulation of the facilities in order that their vulnerability is not converted to a form of domination. So may the interest of other taxpayers and potential parents. What this strategy suggests to reformers is to institutionalize diverse channels through which affected people's contestation can influence regulation. Then those people, based on information they have obtained, can offer the necessary information that regulators need in making strategic targeting.

One way people can resiliently enjoy freedom is that those subject to arbitrary intervention have contestability to check it (Braithwaite 2006b; Maynor 2003; Pettit 1997,

1999; contra Young 1999). Just as deliberative accountability can be realized in a way that the people affected by a collective decision to participate in making that decision (Dryzek 2013; Habermas 1996; Nino 1996), so is democratic contestability in regulation realized if the affected people participate in the regulation of arbitrary use of that power (Pettit 2006). This form of regulation calls for reconsidering responsiveness in responsive regulation. It is responsive not only to the attitude or motivation of the regulatee (Ayres and Braithwaite 1992), or the industrial context or environment in which regulation takes place (Baldwin and Black 2008; Black and Baldwin 2010). It is also to stakeholder's interests not to be dominated by arbitrary use of public as well as private power, and eventually, to resiliently enjoy freedom. Indirect reciprocity offers a way of realizing democratic regulatory responsiveness.

8.4 Conclusion

Selznick's conception of responsiveness offers a useful framework to analyse the responsibility the Korean childcare regulator bears in the society. The Korean childcare regulator has not developed an internal morality and competence of the kind Selznick values. Establishing internal reflexive ends-means processes stand beyond the regulator's current capacity. Without having room for internal moral development, institutional outreach became only selective in its responsiveness, in taking expressed demands of its stakeholders into account. Compared to voices and political power that associations of childcare facility directors could mobilize, the voice of infant carers and parents were relatively unorganized, inaudible, and underrepresented in the regulatory process. And childcare regulation was implemented in a way that reflected this social disparity of power, which resulted in partial regulatory failure to redress arbitrariness that pervades childcare regulation.

In this chapter, I developed the current regulatory reforms into more articulated strategies of indirect reciprocity of two kinds. One strategy is to utilize the experience of other regulators, rather than resorting solely to one's own rudimentary regulatory resources. It is an application of indirect reciprocity Strategy 2: interagency cooperation for strategic targeting. Another strategy is to harness indirect reciprocity exercised by other societal actors, especially those affected by malpractice of the regulatees, and thus

institutionalize their contestability against arbitrariness they have to bear.

Indirect reciprocity may look like an exogenous idea that has been developed under unrealistic assumptions. But it is widely harnessed, unconsciously rather than consciously, by many actors across the multilateral regulatory landscape. The idea of indirect reciprocity embodies relational responsive regulation. In a regulatory landscape where diverse forms of reciprocity pervade, the resources regulators can harness and mobilize are far more than they habitually imagine. This chapter suggests two possible ways in which the poorly resourced Korean childcare regulators can secure necessary resources, though they might not be sufficient to implement an effective regulatory craft. One important benefit is that it suggests a way in which affected people's interests are not overly swayed by the private power holder and can be incorporated into the regulatory system.

This chapter points out that prevalent indirect reciprocity in regulatory networks urges actors to broaden their sights beyond the given regulatory encounter. Not only does it provide an attractive regulatory option for developing countries with weak regulatory capacity, it also offers a general theoretical ground on which effective and fair regulation can secure people's resilient enjoyment of freedom. What the theory would inspire in regulatory scholars is a promise that regulatory cooperation will evolve if certain conditions are met.

Some action rules are required to make indirect reciprocity work. Even though the point of indirect regulatory reciprocity is to make responsiveness effective in conditions on non-repeated encounters, stakeholders are encouraged to make crucial encounters more repeated. It is essential that iterated encounters occur somewhere in the regulatory landscape so that they are available to others' observation. In these encounters, an actor could get opportunities to enhance their reputation and increase the chances of obtaining benefits in future encounters as a recipient. The two strategies of indirect reciprocity suggest harnessing repeated encounters of other regulators and stakeholders, rather than one's own. In so doing, the regulator could acquire enough resources for responsive regulation. By making this given crucial encounter more repeated, in turn, the regulator can give a lesson to other potential regulatees that they are lucky to avoid regulatory investigation at this moment but still subject to future ones. Though it is impossible even for the most capable regulator to have repeated encounters with all regulatees in the society, making single strategic encounters iterated is not unattainable even for the most poorly resourced regulator. Not even the poorest child care regulator would fail to have

iterated engagement with a child care centre subject to repeated complaints of inappropriately sexualized fondling of children followed later by the murder of one of those allegedly abused infants. In that circumstance, what is going on in that center would not escape the gaze of every parent with a child in the centre in the present or the past. The strategy of indirect reciprocity gives regulatees a sense that they always need to build up civil society reputation and regulatory reputation that will help them cope with future encounters with different stakeholders. No business, no organization, can afford to dismiss the possibility that one day it might err in making a bad appointment onto its staff who drags the organization into a major scandal. This future possible reputational risk is why every organization must attend to its social license.

Moreover, regulators are encouraged to make regulatory encounters so conspicuous that they are observable to potential regulatees and other stakeholders. What indirect reciprocity can promise is that, as indicated previously, the more information becomes public and accessible to broader stakeholders, the more indirect reciprocity will come into play in the social regulatory network and facilitate relational regulation. A simple path to indirect reciprocity that inspectorates often lay is to put up a sign at the entrance to the facility that says “An inspector from X regulatory agency is visiting this facility today. Please feel welcome to talk to the inspector about any concerns you have about this facility.” This is obviously a cheaper option to the regulator. This implies that the regulator should continuously attempt to make sure that necessary information is distributed in the regulatory network and delivered to different stakeholders. Likewise, the regulatory system should be designed to make the voice of stakeholders heard. Democratic responsiveness of regulation is a contribution the idea of indirect reciprocity can make to the development of responsive regulation.

Cultivating Responsible Regulation in the Era of Networked Governance

9.1 How Regulatory Communities Hold Agents Responsible

Business scandals grab great media attention. Returns from financial fraud and other business crimes are high. The chances for detection and the penalties are low in comparison to those rewards. Big financial institutions can and do bribe supervisors and capture political leaders when their offences are detected. So people often find it hard to understand why regulatory compliance is common.

The answer to this question is the people themselves, according to this thesis. One reason for compliance being common is that a regulatory space is a community in which agents are entangled, shaping and reshaping attitudes and actions toward one another (Meidinger 1987). It is not a space where agents retain their pre-existing preferences as they confront, contest and bargain. Profit-maximization, for example, is not a singular steadfast motivation that drives a private business to pursue interests. Confrontation or bargaining may occur as a consequence of how agents in this space interact with each other, but it is not a defining characteristic of the regulatory space. The regulatory space is rather a community, sometimes a fractured one, that is connected and bound by a set of norms and anticipations constructed through agents' acts of networking. And these norms and anticipations also do not exist prior to regulatory interaction. They are products of more or less intentional social interactions among different agents over periods of time. Depending on ways in which networking is arranged, a profit-maximizing self can be trumped by a responsible self and egoistic calculators can learn from their own and others' experiences that fulfilling expectations of responsible citizenship can, in the long-run, be more beneficial for their wellbeing.

Reciprocal regulation is about how we can arrange regulation in such a way that

elicits agents' willingness to opt for prosocial behavior. I have argued that human beings are reciprocating animals; business organizations are reciprocating denizens of markets because markets are reciprocating human institutions in which delivery of goods or services is reciprocated with cash. Indeed all organizational life, Selznick's and Gouldner's sociology reveals, is an accomplishment of reciprocity.

Reciprocal regulation asserts that there are diverse channels through which we can promote effectiveness and efficiency of regulation: regulators seek to overcome various resource deficits through indirect signaling and inter- and intra-agency cooperation; social stakeholders hold both regulators and regulatees responsible for their conduct; members of an organization can form a culture of internal transparency that prevents regulatory capture; and victims of unfair regulation or unjust business activities can raise voices of discontent. All these possibilities can be reflected in regulatory design, enforcement, and reform. Strategies of reciprocal regulation eventually aim at institutionalizing a regulatory arrangement in which agents, whether organizations or individuals, realize that they are entangled in a regulatory, and more broadly, social web of indirect reciprocity. It is a web in which agents can become autonomous, self-regulatory agents. Figure 9.1 below describes a web of responsibility that may underlie a considerable proportion of current Australian prudential regulation.

This figure shows how pluralistic the efforts to hold different agents in Australian prudential regulation responsible are. It may look a bit complex, but the bottom line is threefold: First, APRA is accountable to diverse organizations of the Commonwealth Government of Australia, such as Parliament, Treasury, and the National Audit Office. These organizations are either principals to APRA in a representative, vertical principal-agent chain or constitutional agencies that exercise institutional checks on the power and functions of APRA. In the sense that there are official, direct channels through which those agencies can hold APRA accountable to them, they hold APRA responsible via direct reciprocity.

Second, the power and functions granted to APRA to oversee Australian financial markets are exercised, though not entirely, by its frontline inspectors in iterated encounters with regulated financial entities. An individual or a team of individual supervisors maintains direct reciprocal relationships with various units of an entity, from senior management to business units.

Third, besides these two direct reciprocal mechanisms there are at least two sets of indirect reciprocity mechanisms in operation. One takes place inside APRA, at the

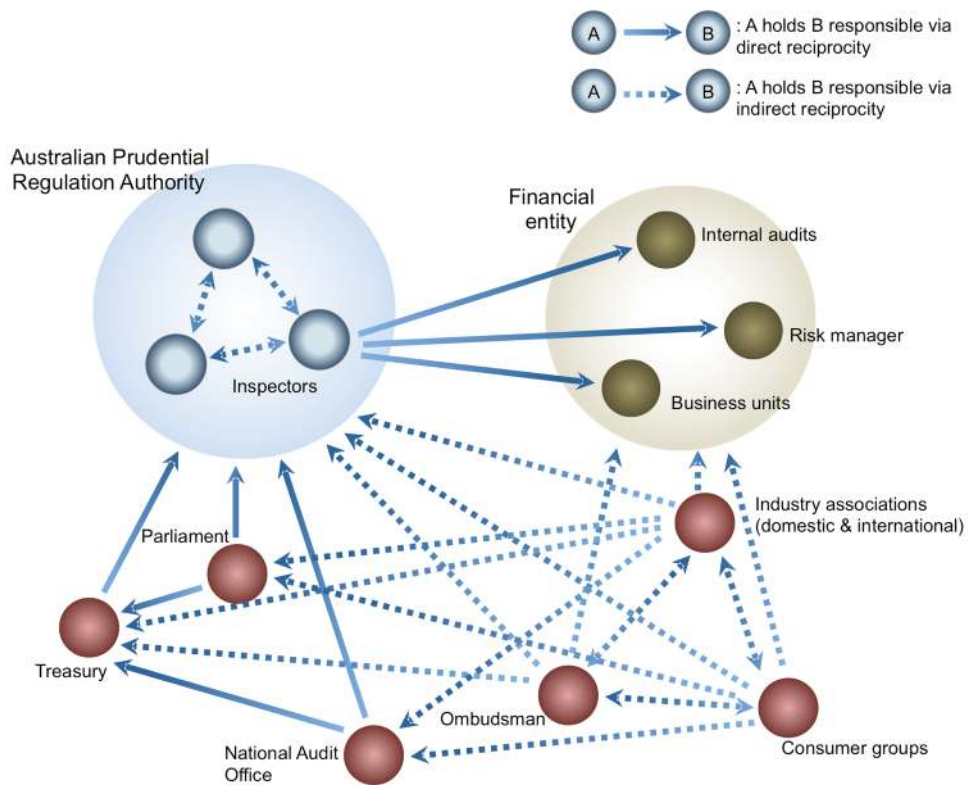


FIGURE 9.1 A web of responsibility underlying Australian prudential regulation

individual level, and in the form of internal transparency. It is a mechanism that exposes individual frontline supervisors’ regulatory activities and risk assessments internally to one another’s gaze. As I discussed in Chapter 7, this enables APRA to maintain and promote resiliently institutional integrity and responsibility, preventing close direct regulatory relationships from degenerating into regulatory capture. Another mechanism takes place as both APRA and the regulated entity’s behaviors are exposed in a broader social network to stakeholders such as industry associations (Australian Bankers Association, Insurance Council of Australia, Association of Superannuation Funds of Australia, and so on), the Financial Ombudsman Service, the Credit and Investments Ombudsman, various consumer groups, and international agencies such as IMF, the Basel Committee on Banking Supervision, the Financial Stability Board, and so on. Other regulators, such as ASIC and the Australian Taxation Office (ATO), may also observe and get information on the entity’s compliance attitudes and issues involving risk management, not to mention diverse levels of interagency cooperation. These agents may or may not have direct encounters with APRA and regulated entities. But they are able and sometimes ready to trigger non-cooperation or social sanctions against APRA if its regulatory enforcement is considered unfair or excessive, and against regulated entities if,

for example, some risk management officers are known to be taking excessive risks despite APRA's prudential efforts. Some of them may blame other governmental organizations such as Treasury, Parliament, or the National Audit Office, holding them responsible for meta regulation of prudential regulation in Australia. There are multiple regulatory modes those informal authorities can adopt as a regulator by other means, and some of them are found to be more influential than state-centered regulation (Grabosky 2013; Gunningham et al. 2004; Parker 2008). One influential channel through which information from social stakeholders affects regulatory reform of powerful national regulators is periodical financial system inquiries.¹

Figure 9.1 could be made more complex by adding individual citizens into the model who join consumer groups, read audit reports in newspapers, shift their investments from bank financial advisors to industry pension funds or to other banks they regard as more reputable, and vote against politicians who fail to strengthen the regulation of banks. In a financial crisis that is bad enough they can participate in a run on the banks and even occupy the streets of the financial district demanding the heads of bankers. Their role in indirect reciprocity is critical to my story and while it is not represented in Figure 9.1 it is in a simple way in Figure 8.2.

Figure 9.1 could also be elaborated and enriched were Australia to adopt some of the lessons from the OSP in Korean financial regulation (Chapter 6). Figure 9.1 is to a considerable degree about how the limited resources available for iterated direct encounters can be buttressed by a plurality of indirect reciprocations. Yet Chapter 6 shows that another direct reciprocity path is a resident inspector who lives inside the firms exposing the biggest systemic risks to a financial system. While I found that Korean financial regulation is not as sophisticated as Australian regulation in its responsiveness, responsibility, or mobilization of indirect reciprocity, the direct reciprocity of the Korean developmental state rose to a much bigger challenge than the 21st century Australian regulation has ever met: the Asian Financial Crisis. Korean regulation performed decisively well in liquidating, merging, and restructuring many banks. Chapter 6 shows that the command and control regulatory enforcement and deterrence of a potent

¹ There have been three financial system inquiries in the recent history of Australian financial regulation. The final reports are the Campbell report (1981), Wallis report (1997), and Murray report (2014), respectively. Besides these periodical inquiries, a special commission was organized to investigate the collapse of the HIH insurance group in 2001 and produced the Palmer report (2001). These reports triggered major changes in Australia's financial system and were important sources of data for this thesis.

developmental state was softened and nuanced by MOUs that allowed on-site supervisors to be principled direct reciprocators. Sadly there were also some moments when Korean financial regulators were as corrupt as the criminal banks they were regulating. Korea therefore teaches us the strengths of concentrating direct reciprocity through resident inspectors and regulatory blitzes at times and sites of crisis. Chapter 6 also reveals the importance of indirect reciprocity as a check on such corrupted or captured direct reciprocity.

Upon realizing that they are entangled in the web of direct and indirect reciprocity in Figure 9.1, APRA (and its frontline supervisors), the regulated business, and other stakeholders strive to act in a responsible way: they mostly make good faith attempts to fulfill their professional duties, cooperating with cooperators while punishing non-cooperators. APRA is intertwined in external as well as internal mechanisms that enable it to promote its organizational integrity and vibrancy despite discretion at the regulatory frontline. The regulated business finds it advantageous to acquire a reputation as a responsible agent in its social networks, considering increasing calls for corporate social responsibility (Garriga and Melé 2004; Hahn 2015; Matten and Crane 2005; McKenna 2016; McWilliams and Siegel 2000; McWilliams et al. 2006). Social stakeholders are also required to consider their reputations and carefully assess others' reputation before imposing any sanctions, because they are also exposed to the others' gaze in this web of responsibility. In sum, this functions as a web for enforced self-regulation and self-government.

9.1.1 Empathy and the norm of reciprocity

One presumption of reciprocal regulation is that norms and anticipations governing the regulatory space are constructed by agents' intentional acts of making direct and indirect reciprocity flow through networks. These include acts of triggering cooperation or costly sanctions, and also acts of gatekeepers or "choice architects," as Thaler and Sunstein (2008) called them, who self-consciously deliver and disseminate information that may have sway over others' reputations.

Thus agents' intentions to respond or not to a particular set of pressures upon them become the critical force that constructs norms and generates expectations. This means that the way agents are entangled in a broad social web of reciprocity become self-

regulating and self-governing autonomous agents is not natural. If they opt for prosocial behaviors, they would do so not because they desire to achieve particular purposes derived from a particular society, as presumed in Selznick's understanding of institutional responsiveness. Rather, their act of becoming a self-regulating agent is contingent on ways in which they interact with each other, as Pettit would insist. It is contingent on their intention to be a responsible agent and the attitudes of others in society, because they can opt for diverse options as responses to the attitudes of others. They are agents who care about intentions and possibilities behind an expression and make an ethical judgment about them (Pettit 1993). Thus conceived, reciprocal regulation broadens Selznick's idea of institutional responsibility by encompassing efforts to hold agents involved in regulation responsible. At the same time, the idea of institutional responsiveness understood in dyadic regulator-regulatee relationships includes diverse accountability and checking mechanisms essential in contestatory democracy (Braithwaite 2007; Pettit 1997).

Empathy plays a key role in constructing the norm of reciprocity, eventually cultivating a culture of reciprocity in the regulatory community. As emphasized in Chapter 4, empathy is an important emotional faculty that helps people fulfill their humanity. It is the faculty to imagine fellow human beings' situations, acknowledging the probability that a similar, though not the same, fate could befall anyone. Empathy enables people to understand another's situation and forgive their faults on the basis of the prospect that actors would appreciate a second chance themselves. As much as empathy constitutes a common ground on which people can feel humanity, it becomes a strong force that binds people to the norm of reciprocity. Empathic forgiveness or cooperation imposes a duty to return forbearance and generosity with better practice. Sometimes the original benevolent agent may regard generosity as reciprocated if the return is made to a third person, as pass-it-on indirect reciprocity illustrates. Pass-it-on seems implausible in regulation, but we have found empirically that it takes place in staff rotation by new inspectors at the moment of handover who receive informal information on regulated entities' postures, compliance track record, and even stories of kindness by regulatees. Their inspection predecessors also pass on knowhow to their successors to deal with financial institutions, as explained in Chapter 7. It can also occur as a meta regulator wants its empathically reciprocal approach to be adopted by sub-regulators. The meta regulator can consider its forgiveness reciprocated if sub-regulators have taken up a similar approach in, for example, industry self-regulation.

The norm of reciprocity constituted by empathy mixed with calculation constitutes a

sense of justice or a sense of non-arbitrariness in many people's minds (Braithwaite 2013). So harnessing empathic reciprocity renders regulatory enforcement more just and legitimate, binding regulatees to the norm of reciprocity. And this norm of reciprocity is extended across wider regulatory networks through the operation of indirect reciprocity. Therefore the duty imposed here encompasses far more than the duty to comply with the law. The compliance burden of regulatees arises not only from the existence of the law itself. It also comes from the attitudes and approaches of regulatory agencies implementing and enforcing the law,² and even from diverse modes of social pressure and control as illustrated by the post-regulatory state literature (Black 2001; Crawford 2006; Scott 2004). The duty of compliance imposed by the norm of reciprocity may bring about the burdens generated by regulators' postures and social pressure. But these two sources keep the compliance burden to a minimum because it is non-arbitrary interference that does not reduce people's freedom as non-domination. Pettit made a case that a just law does not restrict people's freedom, rather it secures and extends it by checking arbitrary abuse of power (1997).

Malinowski's classical work (1926) paid attention to this aspect of reciprocity in which individuals mutually exchange equivalent services in a group (see also Becker 1986). The duty of conformity with the norm of reciprocity is something that people in the three regulatory communities I have studied feel they owe to each other. Therefore failure to fulfill this duty is breaking the norm of reciprocity that regulatees share and owe to each other. If a regulatee does not meet the regulator's expectation even after a second chance was given, this intentional exploitation provides a reason for sanctions not only from the regulator but also from other regulatees, stakeholders, and even other regulators who wish to maintain the norm of reciprocity in the regulatory space. One path to reciprocal regulation is therefore to encourage regulators to harness empathic reciprocity, and at the same time, arrange diverse channels through which information on reputation can diffuse. In this sense, this thesis has made a contribution to the literature on responsive regulation by making a case that conceiving of responsive regulation as a tit-for-tat theory is misleading. Ayres and Braithwaite (1992) saw tit-for-tat as offering an explanation for why the enforcement pyramid works. The central plank of responsive regulation is rather that the pyramid dynamics will work better than pure deterrence or

² This explains why regulation cannot be reduced to a set of rules: both regulation and compliance are ongoing processes (Braithwaite forthcoming; Meidinger 1987).

pure persuasion. Ways in which deterrence and persuasion can mix vary. Both Ayres and Braithwaite and their critics erred in paying so much attention to tit-for-tat. The thesis has also shown that taking into account indirect reciprocity broadens the scope of responsive regulation to responsive democratic regulation.

9.1.2 Intention and discretion

If we accept the claim that empathic reciprocity harnessed by a regulator binds regulatees to the norm of reciprocity, imposing a duty of compliance that is shared in a broad regulatory community, then a question may arise: would calculative reciprocity also generate the norm of reciprocity? It may be argued that tit-for-tat also enables a regulator to anticipate a similar effect, considering that the way it works is to cooperate first and replicate the opponent's behavior in the previous round. The fact that tit-for-tat begins with cooperation may provide a ground for justification as well. If an empathically motivated regulator can impose a duty to comply with regulated entities, then a regulator harnessing calculative reciprocity may be able to bind regulatees to a norm of reciprocity by the same token.

This seems like a plausible argument, but my answer is no because tit-for-tat reciprocity does not take into account intentions and motivations behind non-compliance, as discussed in Chapter 4. It only allows regulators to respond to the behavior of regulatees. It is plausible to argue that if a regulator's first move is cooperation this would look more legitimate than taking up unilateral command and control enforcement or kicking off with a non-cooperative option. However, harnessing tit-for-tat contributes to the norm of reciprocity only if it is targeted at defiant regulatees who intentionally evade or game the regulator. This is so because the regulator's strict application of tit-for-tat in this case is reciprocating antisocial behaviors threatening the norm of reciprocity in the regulatory community. Responding to behaviors without considering underlying intentions and motivations may make it difficult for regulators to gauge the possibility of regulatory miscommunication, unintended incidents of non-cooperation, and willingness to be or become a responsible citizen. And this would discourage observers' willingness to comply as well. It imposes on them a burden to comply only with the law itself and the ruthless enforcement of regulators.

Reciprocal regulation thus indispensably advances to advocating discretion for

principled regulators. A deep affinity with principles-based, rather than rules-based regulation is also an implication of this analysis. In a strict rules-based regime such as Korean financial regulation where every operation of regulators is governed by legal rules, regulators' activities to identify reasons of non-compliance, uncover sources of unknown risks, and cope with those reasons and sources in a timely and pertinent manner are limited. Regulators become almost automatons responding to the behaviors of regulatees in a narrow space allowed by specific legal rules. Their enforcement is inclined to take up command and control or at most tit-for-tat reciprocity. "Going by the book," as Bardach and Kagan (1982) argued, is purported to prevent arbitrary judgment of government inspectors and investigators who enforce rules of law. This sort of argument is deeply rooted in the idea of equality before the law as legal formalists suggest in their claim of "treating like cases alike" (Dworkin 1986).³ The presumption of this line of argument is that indeterminacy inherent in discretionary judgment of government agencies and regulators brings about arbitrariness.

Arbitrariness of regulatory agencies and government inspectors is an enemy of good governance that few would disaffirm. Yet a huge gap exists between the resolutions suggested: some insist that specific legal rules govern regulators' activities to minimize discretion, while others argue that regulators' discretionary activities can be guided by broadly defined principles and by deliberative accountability (Baldwin and Hawkins 1984), as opposed to specific legal rules. Indeed, on empirical grounds, some defenders of principles that trump rules find that this approach increases regulatory consistency (Braithwaite 2002b, 2005, 2013). Still others suggest external controlling mechanisms to check and contest the arbitrariness of regulatory agencies (Pettit 1997). This third opinion may be suggested in combination with either the first or second proposition. The resolution reciprocal regulation proposes is close to the third, Pettit's option, insofar as it

³ Dworkin's conception of rights becomes the foundation for his commitment to the idea of liberal neutrality. For him, the basic rights are universal and pre-politically given. Thus a political process or authority cannot violate people's basic rights. The way in which a government can guarantee basic rights is treating people equally in political and judicial processes so that they, without any arbitrary governmental intervention, exercise their rights to choose the way of life they believe to be good. Therefore governmental power should be limited by the rule of law to prevent its arbitrary and tyrannical use (Dworkin 1986, 1995). But this argument interprets the rule of law in a narrow, formalist way. For critiques of legal formalism, see Braithwaite (2013) and Hong and Kwak (2011).

favors institutional settings that systematically check on arbitrariness. But it argues more than that, at least in two senses.

First, reciprocal regulation suggests that institutional settings should be devised in an internal as well as external way. As I suggested as a strategy for regulatory reform in Korean childcare regulation in Chapter 8, an external mechanism of rectifying arbitrariness of both regulatees and regulators needs to be institutionalized. What is distinct in reciprocal regulation is that the endeavor of institutionalization also reaches inter-organizational structure and mechanisms. The internal transparency mechanisms of APRA illustrated in Chapter 7 suggest a direction for organizational reform. APRA has multiple layers of devices to minimize the possibility that its discretionary power is transformed to arbitrariness against regulated businesses and also financial beneficiaries at the regulatory frontline. This is to institutionalize Type 3d indirect reciprocity of punishing norm infraction, as discussed in Chapter 4. It is a matter of future empirical testing whether external or internal mechanisms are more effective ways of reducing arbitrariness of regulators. What reciprocal regulation implies at this stage is that reformers are encouraged to consider internal transparency as a viable option for institutional reform.

Second, reciprocal regulation does not argue that institutionalization alone—whether external, internal, or both—can cope with the hazard of arbitrariness. Rather it requires reformers to acknowledge the importance of organizational norms and culture. Chapter 7 emphasized the importance of sound organizational norms, such as a common sense of professional ethics or disciplinary codes of conduct, according to which members can make ethical evaluations on norm infraction. If a regulatory agency is so corrupt or falls so short of internal controls that members of that organization have no compunction to take bribes or seek personal compensation for favorable supervision, then these practices are no longer communally ethical. Internal transparency at its worst contributes to a proliferation of reciprocated corruption of capitalism, even though this corruption or capture is regarded as unethical by outsiders. In the GFC we saw this pathology where an unaccountable bonus culture continued to be reciprocated by Wall Street insiders while it disgusted outsiders on “Main Street.” Such pathologies of an unethical Wall Street of the 2000s or an unethical Korean banking system of the 1990s called for organizational restructuring from those who wished to sustain norms of principled reciprocity. This implies that any endeavor of institutionalization should be propelled alongside the consideration of internally guiding principles inside firms, inside regulators, and inside

Wall Street.

This point reinforces the first remedy of institutionalization. Reciprocal regulation is about rendering regulation transparent. Internal transparency suggests *a* direction for organizational reform, but it should not be taken as *the* sole option, excluding the possibility for external transparency. Considering the possibility that power corrupts and absolute power corrupts absolutely, reciprocal regulation encourages reformers to expose organizational customs and practices to various external gazes for contestation. Thus, institutionalizing both internal and external transparency mechanisms is in order. I suggested these two mechanisms in Chapter 5 (as Strategies 4 and 5) as if they were separate strategies. But they should be aligned together in the way Figure 9.1 describes so that arbitrariness of both regulators and regulatees are resiliently checked and contested by different actors through diverse channels of indirect reciprocity.

One cultural mode reciprocal regulation suggests is a culture of face-to-face deliberation. The intranet system of APRA through which frontline supervisors' activities and risk assessments are viewed and shared across the entire agency constitutes one model infrastructure. Other facilitative devices can build on this infrastructure, such as peer review meetings (including interagency peer reviews that scale up globally), benchmarking processes, and early regulatory engagement policies. What is common in the latter facilitative devices is that they are all made in a face-to-face fashion. External transparency encourages those who have access to information to form their opinions on public matters (Manin 1997). The purpose of internal transparency is also to invigorate internal deliberation and form members' opinions on common matters. Supervisors are encouraged to participate in deliberation of how to find the most suitable practice for their portfolio. In those deliberative fora, they can (re-)identify shared regulatory goals and the legitimacy of supervisory actions in achieving them, and input their experiences and interpretations in revising the prudential framework. This would become a culture of self-regulation in which participants collectively and reciprocally commit to deliberation.

9.2 The Promise of Reciprocal Regulation

9.2.1 The virtue of face-to-face dialogue

Putnam (2000) recognized the role of indirect reciprocity in transforming people's engagement in communal life to trust and social capital, though he used a slightly different term, generalized reciprocity (see also Braithwaite and Hong 2015).⁴ He stated that the norm of generalized reciprocity is "the touchstone of social capital" because it enables people to anticipate that honesty and goodwill will be returned by someone else in the community, though not by the recipient (2000, 134). If this anticipation settles as a communal norm, then it gives a sense that others follow the same principle and reinforces citizen reproduction of prosocial behaviors.

One important presumption of this belief is that people have face-to-face dialogue with one another. Without face-to-face dialogue, the norm of generalized reciprocity Putnam proposed—and of course the norm of reciprocity reciprocal regulation suggests—cannot be established. It should take a number of direct encounters among different agents in society in which defection is sanctioned while cooperation is rewarded before this norm is established. And reputation is an outcome of a series of direct encounters individuals or organizations accrue over a certain period of time with other agents. Face-to-face dialogue also constitutes a crucial aspect of political life. It is the way people engage with each other: arguing their opinion, persuading others, and also staying open to others' persuasion in return, rather than deafly asserting self-interest (Bilakovics 2012).

Having said that, face-to-face encounters, putting aside the aspect of dialogue, are something that may not take place at every regulatory frontline. This is so especially in many regulatory landscapes with numerous individuals or small and medium sized enterprises. The police force is the best resourced regulatory agency in many societies; yet most citizens go for years without any significant interaction with a police officer. It is also suggested that face-to-face relationships cannot guarantee effective regulatory enforcement against large corporate conglomerates whose business takes place in a transnational way (Ford 2013). And these perspectives comprise the pessimistic view on

⁴ What Putnam meant by generalized reciprocity, as distinct from specific reciprocity in a dyadic relation, is pass-it-on indirect 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, 20-1).

responsive regulation that its direct reciprocal approach is either too demanding for many regulators to harness against numerous regulatees or too narrow to deal with complex transnational regulatory affairs.

Nevertheless, face-to-face relationships are essential and will remain essential in regulatory enforcement, no matter how complex business activities become. In December 2014, the Australian Treasurer announced that ATO had been embedded in the offices of ten transnational companies, presumably including Google, to scrutinize closely whether those companies were paying their fair share of tax.⁵ Harnessing these resident inspectors follows the ATO's experience of the Key Client Mangers scheme, which assigned ATO auditors to reside permanently at a desk inside the highest-risk companies (Braithwaite 2005; Braithwaite and Hong 2015). In business regulation face-to-face encounters take place when various small business associations negotiate with the regulator and then each persuades their members to abide by the regulatory agreement. A tax authority may meet with the major accounting firms and ask them to bring to their business clients' attention any changes in taxation policy. The empirical case studies in this thesis also revealed that face-to-face relationships have been actively carried out in dealing with complex regulatory affairs in many fields and have proven effective.⁶

As illustrated in Chapters 6 and 7, prudential regulators of Korea and Australia actively concentrate on financial hot spots for direct regulatory encounters, even striving to have their frontline inspectors reside permanently in the highest-risk regulated entities. Interpersonal regulatory contacts may occur between financial entities and non-state regulators such as banking associations and ombudsman, or within a financial firm between business units and risk managers or internal auditors. International standards suppliers such as the Basel Committee, the International Bank of Settlements, the Financial Stability Board or IMF have often had direct contacts with national prudential regulators and major bankers, especially during crises. Face-to-face encounters are also required to sort out difficulties of immature Korean childcare regulators, who are responsible for overseeing numerous small childcare facilities, as examined in Chapter 8.

This thesis argues that, despite the physical limitations on iterated contacts between regulator and regulatee, face-to-face encounters in a regulatory space do enhance

⁵ <http://www.theguardian.com/business/2014/dec/09/joe-hockey-profit-shifting-tax-audit-multinationals-australia> (last accessed on 5 January 2015).

⁶ For the effectiveness of face-to-face encounters such as regulatory surge, see footnote 39 in Chapter 6.

intelligence and mutual understanding, decrease the possible cost of miscommunication, and eventually cultivate the norm and the culture of reciprocity.

9.2.2 Two-faced Janus of imperfect information

Unlike the lab experiments and computer simulations that previous studies of indirect reciprocity have relied on,⁷ my data suggest a reality where the regulatory space is rife with imperfect information. And indirect reciprocity cannot take place if others do not acquire the information on agents' behaviors and underlying intentions. Considering the possibility of noisy situations, in which information delivery is hindered or skewed by many intervening factors, the acquisition of accurate information is a challenging task. Indeed the success of strategies of indirect reciprocity depends largely on the degree of information that flows through networks. But it should be noted that the issue of imperfect information is not an obstacle only pertinent to the operation of indirect reciprocity. Noise in any domain of regulation can communicate false impressions of the intentions of regulatory players.

Having said that, one promising aspect is that the traditional obstacles to information diffusion have been to a significant degree eradicated where it matters most due to rapid development of information technology that enables real-time information delivery and connection of geographically distant people. The activities of governments, business corporations, NGOs, and even individuals are exposed and shared through numerous channels such as SNS and online review or sharing sites. Additionally, a lot of private as well as public organizations realize the benefits of publicizing organizational information to render them more transparent and responsive to the demands of other members of society. I have discussed examples such as Airbnb and Uber in Chapter 4. Regulators can also take up the role of facilitating information delivery, especially on regulatees' compliance, as I suggested in Chapters 5 and 7. Regulators increasingly require posting of compliance auditing reports—external and internal—on the internet in domains like aged care regulation (Braithwaite, Makkai, et al. 2007). That real world conditions feature imperfect information implies that there is always room for improvement of information delivery.

Regulatory strategies leaning on indirect reciprocity suggest that agents involved in

⁷ For how computer simulations have been carried out, see footnotes 9 and 33 in Chapter 4.

regulation can steer the flow of information on others to move people to respond in an anticipated way. Even though regulation is designed to embrace some indirect reciprocity strategies with diverse channels of information flow, we can observe many cases in which the anticipated results of indirect sanction do not occur. Moreover we can hardly guarantee that the operation of indirect reciprocity always brings about positive results. Addressing these issues may require rigorous hypothesis testing. What then are some of the potential factors that need to be taken into account in future research?

First, motivations driven by indirect reciprocity may not be as strong as other factors. One such countervailing factor can be material incentives. Another factor can be the lack of robust in-group norms. Those who wield indirect sanctions may not be either disposed to have a strong moral sense or drawn to put forward their responsible self. Sanctioning non-cooperators and rewarding cooperators are both costly. If all are strong reciprocators who opt for costly sanctions regardless of cost, then no such issue arises. Where this is not the case—and this is more plausible—then it can always happen that someone opts for exploiting reciprocity to loot material gains.

One example is consumer responses to the recent Volkswagen's emission-cheating scandal. Notably in terms of Figure 9.1, it was a shocking abuse detected not by a regulator but by an environmental NGO working with university researchers on a \$50,000 research grant. After it was revealed that the German car manufacturer had intentionally cheated on nitrogen oxide (NO_x) emission controls of its cars in September 2015, the company's new car sales in November 2015 compared with the previous month fell 15.3% in the US market.⁸ But it displayed a record-breaking increase by 377% in the South Korean market for the same period.⁹ This figure in Korea means a 66% increase of sales from the same month in 2014. In contrast, the German manufacturer's sales for the same period dropped by 25%, 20%, and 32% in the US, the UK, and Japan respectively, and even had a 2% decline in the German market.¹⁰ One difference might be the Korean retailer's aggressive sales marketing, providing up to 30% discounts to consumers while

⁸ The car sales volume of the Volkswagen Group in the US market was 52,278 in October 2015 and was 45,220 in November 2015. <http://www.autonews.com/section/datalist> (last accessed on 5 December 2015).

⁹ The sales volume was 947 in October 2015 and 4517 in November 2015. <http://www.kaida.co.kr/ko/statistics/StatisticsCenter.do> (last access on 5 December 2015).

¹⁰ <http://www.bbc.com/news/business-35005158> (last accessed on 5 December 2015); http://biz.chosun.com/site/data/html_dir/2015/12/14/2015121403729.html (last accessed on 15 December 2015).

the sales were halted in some other markets.¹¹ What is implied in these contrasting figures is that people's responses to the same non-compliance issue may show remarkable differences and that there may be different reasons, such as material incentives, degree of social connectedness, or presence of communal norms stronger than the norm of reciprocity, that governs people's reciprocal behaviors.¹² None of this is to deny the possibility that it may have been the Korean market that offered consumers the best deal, that a 30% discount may have been good compensation for the real drop in the value of new Volkswagens.

Another example in which the norm of reciprocity may not work can be found in Korean prudential regulation. An executive officer of a financial institution that is about to be liquidated may have a strong temptation to get involved in fraudulent activities by utilizing his or her superior intelligence. Then it would be reasonable for him or her to calculate the cost of potential legal penalties and the probability of getting caught. It would also be reasonable for him or her to consider the reputational cost and shame imposed by the general public as well as his or her private peer and professional communities if those activities were detected and penalized. Many executive officers of insolvent MSBs in Korea who were indicted should have considered such diverse possibilities. But they opted for committing corporate crime. It is unclear why, despite the foreseeable consequences, they ended up choosing to do so. It may be that there was a stronger incentive for them to take the path of a criminal, or that they took the potential reputational loss not as seriously.

The second issue is involved in the influence of reputational capital. As briefly mentioned in Chapter 5, indirect reciprocity can provide a victim of a private or public agent's arbitrariness with a means to resist it, by damaging the arbitrary power's reputation or mobilizing like-minded people to humble that power. I have discussed the bright side of indirect reciprocity which encourages regulatory compliance, activities that are more than compliance with legal rules, cooperation among regulators, and democratic contestation of social stakeholders. However, the idea of indirect reciprocity is not

¹¹ <http://news1.kr/articles/?2506911> (last accessed on 5 December 2015).

¹² According to a newspaper article, a Volkswagen Korean representative said, "If we include those buyers who signed a contract in November but haven't registered their cars yet, the sales figures would rise further. Many people think it is a good time to own a foreign car at a bargain" <http://www.wsj.com/articles/volkswagen-sales-in-south-korea-make-sharp-upturn-1449203756> (Last accessed on 15 December 2015).

inherently designed to promote social justice and rectify arbitrariness. Cooperation can also evolve amid socially unethical activities and indirect reciprocity may be used to maintain and even reinforce current power disparities. The blacklist of whistleblowing carers circulated among directors of childcare facilities in South Korea is an example of this flip side of indirect reciprocity. The whistle is blown as a non-cooperative activity to the malpractice of a childcare facility. Meanwhile the blacklist works as an information shortcut through which carers' non-cooperation with childcare facilities are recorded and shared among employers to end their career.

On the negative side, indirect reciprocity can also invoke reputational sanctions lethal enough to socially ostracize the weak for some misdemeanors they have committed. Put another way there are challenges of proportionality and domination (Citron 2009; Gerson and Rappaport 2011; Poole 2013). In most societies powerful groups control mass media through media cartels. This empowers controlling elites to abuse indirect reciprocity to eliminate rivals or critics. Elites have also learned how to mobilize their superior resources to marry their domination of mass media to new forms of domination of social media. For example, Braithwaite and D'Costa (2016: Chapter 4) found that the Indian state moved from a strategy of countering social media critics of state human rights abuses by blocking critical social media and attacking critics in state-controlled mass media to a new strategy of orchestrating counterattacks against the reputation of Facebook critics. So a Kashmiri who says something critical about the Indian police would find 40 other citizens destroying their reputation in ways that intelligence services know how to do through Facebook posts. In regulation, this means that indirect reciprocity can be used by powerful regulated entities to take down a reformist head of a regulatory agency that has been tough on investigations or reforms.

In a society in which sound norms of reciprocity govern and diverse channels of indirect reciprocity are established, reciprocity tools are at hand to help thwart such abuses. While many will regard them as abuses and act on that abuse, it is also true that concentrated interests have stronger motivations than diffuse interests (Edelman 1964) and the most concentrated resources. As mentioned above, diverse factors may interfere with the operation of indirect reciprocity. Although the remedies to cope with arbitrariness can apply here—institutionalizing internal and external mechanisms of indirect reciprocity and initiating norms and cultures of reciprocity—they do not always work. They may fail to secure the modes of indirect social sanctions and controls that prevent domination.

Indirect sanctions such as naming and shaming are normally unregulated and exempt from accountability claims. If so, indirectly exercised shaming against some individuals who are responsible for regulatory failure or involved in capture and corruption may be in excess or too humiliating thus failing to deliver reintegrative shaming (Ahmed et al. 2001; Braithwaite 1989; Makkai and Braithwaite 1994; Zhang and Zhang 2004). It sometimes gives rise to a form of stigmatization (Kwak 2014b; Nussbaum 2004). One difficulty I faced in recruiting on-site supervisors for interviews was related to this issue. When I asked for introductions to some retired on-site supervisors for interviews, most of the informants at FSS refused and reluctantly confessed that they would not want to be interviewed. In fact, said informants, they attempted to conceal the fact that they were involved in the supervision of MSBs. They were aware of the effects of social sanctions on irresponsible supervisors who had been involved in capture. And they were concerned with the possibility that they could be socially branded as captured regulators, whether or not they were actually involved in the scandal and regulatory capture.

The proportionality of reputational sanctions via indirect reciprocity is an important issue in the application of indirect reciprocity. Indeed difficult judgments about threats to freedom are now before us. How does regulatory capitalism respond, for example, to the vindictive Uber consumer, or the competitor from another taxi company, who repeatedly posts false allegations against an Uber driver to destroy her livelihood? Do we respond to the temptation to install surveillance cameras in child care centers to protect our children from abuse by linking the cameras to artificial intelligence software that posts to a regulator an image of a large human striking a small one?¹³ This software already exists in carparks that informs private security companies in real time of any incidents of purse snatching or key snatching. These are important topics for future research motivated by the republican ideal of striking regulatory balances that maximize freedom as non-domination.

Reciprocal strategies proposed in this thesis do not encompass all kinds of regulatory innovations we can imagine on the basis of indirect reciprocity, nor does reciprocal regulation suggest a new frontier of regulation that has never been explored. Its humble purpose is to provide a holistic and integrative perspective on the role of reciprocity in regulation based on insights that can be observed being applied in regulatory practice. Yet

¹³ It is surprising that the installation of surveillance cameras in childcare facilities became mandatory in South Korea, as an amendment to the Infant Care Act passed the National Assembly in April 2015.

it carries a clear renewal message for regulatory reformers. In the regulatory community, agents are entangled in a web of reputational networks where all are more or less vulnerable to one another. If agents of freedom realize that the power they can exercise through this reciprocal web of regulation is far greater than they previously believed, the necessity of cooperation in everyday life will be reinforced as they invite and encourage one another to engage with responsibility in achieving common goals.

Appendix

No.	Serial No.	Classification	Date	Method
1	KOR01	On-site Supervisor	16/5/2013	Face-to-Face
2	KOR02	Frontline Supervisor	27/5/2013	Phone
3	KOR03	On-site Supervisor	4/6/2013	Face-to-Face
4	KOR04	Industry Person	5/6/2013	Face-to-Face
5	KOR05	On-site Supervisor	10/7/2013	Face-to-Face
6	KOR06	Frontline Supervisor	10/7/2013	Face-to-Face
7	KOR07	Policymaker	12/7/2013	Face-to-Face
8	KOR08	Frontline Supervisor	15/7/2013	Face-to-Face
9	KOR09	On-site Supervisor	16/7/2013	Face-to-Face
10	KOR10	Industry Person	16/7/2013	Face-to-Face
11	KOR11	Industry Person	19/7/2013	Face-to-Face
12	KOR12	Policymaker	26/7/2013	Face-to-Face
13	KOR13	Policymaker	31/7/2013	Face-to-Face
14	KOR14	Policymaker	13/12/2013	Face-to-Face
15	KOR15	Frontline Supervisor	13/2/2014	Face-to-Face
16	KOR16	Frontline Supervisor	8/5/2014	Face-to-Face
17	KOR17	Policymaker	1/5/2014	Face-to-Face
18	KOR18	Industry Person	15/5/2014	Face-to-Face
19	KOR19	Industry Person	16/5/2014	Face-to-Face
20	KOR20	Industry Person	16/5/2014	Face-to-Face
21	KOR21	Industry Person	22/5/2014	Face-to-Face
22	KOR22	Industry Person	22/5/2014	Face-to-Face
23	KOR23	Industry Person	23/5/2014	Face-to-Face
24	AU01	Policymaker	6/11/2013	Face-to-Face
25	AU02	Industry Person	6/11/2013	Face-to-Face
26	AU03	Frontline Supervisor	2/2014	Face-to-Face
27	AU04	Frontline Supervisor	2/2014	Face-to-Face
28	AU05	Frontline Supervisor	2/2014	Face-to-Face
29	AU06	Frontline Supervisor	2/2014	Face-to-Face
30	AU07	Frontline Supervisor	2/2014	Face-to-Face

31	AU08	Frontline Supervisor	2/2014	Face-to-Face
32	AU09	Frontline Supervisor	2/2014	Face-to-Face
33	AU10	Frontline Supervisor	2/2014	Face-to-Face
34	AU11	Frontline Supervisor	2/2014	Face-to-Face
35	AU12	Frontline Supervisor	2/2014	Face-to-Face
36	AU13	Frontline Supervisor	2/2014	Face-to-Face
37	AU14	Frontline Supervisor	2/2014	Face-to-Face
38	AU15	Frontline Supervisor	2/2014	Face-to-Face
39	AU16	Frontline Supervisor	2/2014	Face-to-Face
40	AU17	Frontline Supervisor	2/2014	Face-to-Face
41	AU18	Frontline Supervisor	2/2014	Face-to-Face
42	AU19	Frontline Supervisor	2/2014	Face-to-Face
43	AU20	Frontline Supervisor	2/2014	Face-to-Face
44	AU21	Frontline Supervisor	2/2014	Face-to-Face
45	AU22	Frontline Supervisor	2/2014	Face-to-Face
46	AU23	Frontline Supervisor	2/2014	Face-to-Face
47	AU24	Frontline Supervisor	2/2014	Face-to-Face
48	AU25	Frontline Supervisor	2/2014	Face-to-Face
49	AU26	Frontline Supervisor	2/2014	Face-to-Face
50	AU27	Frontline Supervisor	2/2014	Face-to-Face
51	AU28	Frontline Supervisor	2/2014	Face-to-Face
52	AU29	Frontline Supervisor	2/2014	Face-to-Face
53	AU30	Frontline Supervisor	2/2014	Face-to-Face
54	AU31	Frontline Supervisor	2/2014	Face-to-Face
55	AU32	Frontline Supervisor	2/2014	Face-to-Face
56	AU33	Frontline Supervisor	2/2014	Face-to-Face
57	AU34	Frontline Supervisor	2/2014	Face-to-Face
58	AU35	Industry Person	2/2014	Face-to-Face
59	AU36	Industry Person	2/2014	Face-to-Face
60	AU37	Industry Person	2/2014	Face-to-Face
61	KC01	Frontline Supervisor	14/5/2014	Face-to-Face
62	KC02	Frontline Supervisor	14/5/2014	Face-to-Face
63	KC03	Frontline Supervisor	14/5/2014	Face-to-Face
64	KC04	Policymaker	16/5/2014	Face-to-Face
65	KC05	Policymaker	30/5/2014	Face-to-Face

References

- Abramowitz, Alan I. 1988. Explaining Senate Election Outcomes. *American Political Science Review* 82(2): 385-403.
- Ahmed, Eliza, and Valerie Braithwaite. 2006. Forgiveness, Reconciliation, and Shame: Three Key Variables in Reducing School Bullying. *Journal of Social Issues* 62(2): 347-70.
- _____. 2007. Higher Education Loans and Tax Evasion: A Response to Perceived Unfairness. *Law & Policy* 29(1) :121-36.
- Ahmed, Eliza, Nathan Harris, John Braithwaite, and Valerie Braithwaite. 2001. *Shame Management through Reintegration*. Cambridge: Cambridge University Press.
- Ahn, T. K., Justin Esarey, and John T. Scholz. 2009. Reputation and Cooperation in Voluntary Exchanges: Comparing Local and Central Institutions. *Journal of Politics* 71(2): 398-413.
- Alexander, Richard D. 1987. *The Biology of Moral Systems*. New Jersey: Transaction Publishers.
- Antony, Louise M. 2000. Natures and Norms. *Ethics* 111(1): 8-36.
- APRA. 2011. APRA Service Charter. Sydney: Australian Prudential Regulation Authority.
- _____. 2012. Supervisory Oversight and Response System. Sydney: Australian Prudential Regulation Authority.
- Arditi, Benjamin. 2005. "Populism as an Internal Periphery of Democratic Politics." In *Populism and the Mirror of Democracy*, edited by Francisco Panizza, 72-98. London: Verso.
- Arendt, Hannah. 1958. *The Human Condition*. Chicago: University of Chicago Press.
- Aristotle. 1984. *The Politics*. Translated by Carnes Lord. Chicago: University of Chicago Press.
- _____. 1999. *Nicomachean Ethics*. Indianapolis, IN: Hackett Publishing.

- Axelrod, Robert M. 1984. *The Evolution of Cooperation*. New York: Basic Books.
- Axelrod, Robert M., and William D. Hamilton. 1981. The Evolution of Cooperation. *Science* 211:1390-6.
- Ayres, Ian, and John Braithwaite. 1991. Tripartism: Regulatory Capture and Empowerment. *Law & Social Inquiry* 16(3): 435-96.
- _____. 1992. *Responsive Regulation: Transcending the Deregulation Debate*. New York: Oxford University Press.
- BAI. 2013. Special Audit Report on Welfare System [in Korean]. Seoul: Board of Audit and Inspection of Korea.
- Baker, Andrew. 2013. The New Political Economy of the Macprudential Ideational Shift. *New Political Economy* 18(1) :112-39.
- Baldwin, Robert, and Julia Black. 2008. Really Responsive Regulation. *Modern Law Review* 71(1): 59-94.
- Baldwin, Robert, and Keith Hawkins. 1984. Discretionary Justice: Davis Reconsidered. *Public Law*: 570-99.
- Bardach, Eugene, and Robert A. Kagan. 1982. *Going by the Book: The Problem of Regulatory Unreasonableness*. Philadelphia: Temple University Press.
- Barnet, Richard J., and John Cavanagh. 1994. *Global Dreams: Imperial Corporations and the New World Order*. New York: Simon & Schuster.
- Barnet, Richard J., and Ronald E. Mèuller. 1974. *Global Reach: The Power of the Multinational Corporations*. New York: Simon and Schuster.
- Batson, C. Daniel. 1987. Prosocial Motivation: Is It Ever Truly Altruistic? In *Advances in Experimental Social Psychology*, 65-124. New York: Academic Press.
- Batson, C. Daniel, and Nadia Ahmad. 2001. Empathy-Induced Altruism in a Prisoner's Dilemma II: What If the Target of Empathy Has Defected? *European Journal of Social Psychology* 31(1): 25-36.
- Baum, Jeeyang Rhee. 2011. *Responsive Democracy: Increasing State Accountability in East Asia*. Ann Arbor: University of Michigan Press.
- Becker, Lawrence C. 1986. *Reciprocity*. London: Routledge & Kegan Paul.
- Bendor, Jonathan. 1993. Uncertainty and the Evolution of Cooperation. *Journal of Conflict Resolution* 37(4): 709-34.
- Bendor, Jonathan, Roderick M. Kramer, and Suzanne Stout. 1991. When in Doubt ... Cooperation in a Noisy Prisoner's Dilemma. *Journal of Conflict Resolution* 35(4): 691-719.

- Berg, Joyce, John Dickhaut, and Kevin McCabe. 1995. Trust, Reciprocity, and Social History. *Games and Economic Behavior* 10(1): 122-42.
- Berger, Ulrich. 2011. Learning to Cooperate via Indirect Reciprocity. *Games and Economic Behavior* 72(1): 30-7.
- Berlin, Isaiah. 1969. Two Concepts of Liberty. In *Four Essays on Liberty*. London: Oxford University Press.
- Bickel, Alexander M. 1962. *The Least Dangerous Branch: The Supreme Court at the Bar of Politics*. Indianapolis: Bobbs-Merrill.
- Bignami, Francesca E. 1999. The Democratic Deficit in European Community Rulemaking: A Call for Notice and Comment in Comitology. *Harvard International Law Journal* 40(2): 451-515.
- Bilakovics, Steven. 2012. *Democracy Without Politics*. Cambridge, MA: Harvard University Press.
- Black, Julia. 1998. Talking about Regulation. *Public Law* 1998: 77-105.
- _____. 2001. Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post-Regulatory' World. *Current legal problems* 54(1): 103-46.
- _____. 2005. The Emergence of Risk-based Regulation and the New Public Management in the United Kingdom. *Public Law* 2005: 512-49.
- _____. 2006. Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority. *Law & Policy* 28(1): 1-30.
- _____. 2008. Forms and Paradoxes of Principles-based Regulation. *Capital Market Law Journal* 3(4): 425-457.
- Black, Julia, and Robert Baldwin. 2010. Really Responsive Risk-Based Regulation. *Law & Policy* 32(2): 181-213.
- _____. 2012a. When Risk-based Regulation Aims Low: A Strategic Framework. *Regulation & Governance* 6(2): 131-48.
- _____. 2012b. When Risk-based Regulation Aims Low: Approaches and Challenges. *Regulation & Governance* 6(1): 2-22.
- Black, Julia, Martyn Hopper, and Christa Band. 2007. Making a Success of Principles-Based Regulation. *Law and Financial Markets Review* 1(3): 191-206.
- Blumstein, Alfred. 2011. Approaches to Reducing Both Imprisonment and Crime. *Criminology & Public Policy* 10(1): 93-101.

- Bolton, Gary E., and Axel Ockenfels. 2000. ERC: A Theory of Equity, Reciprocity, and Competition. *American Economic Review* 90(1): 166-93.
- Bovens, Mark. 2007. Analysing and Assessing Accountability: A Conceptual Framework. *European Law Journal* 13(4): 447-68.
- Bowles, Samuel, and Herbert Gintis. 2002. Homo Reciprocans. *Nature* 415: 125-8.
- _____. 2004. The Evolution of Strong Reciprocity: Cooperation in Heterogeneous Populations. *Theoretical Population Biology* 65(1): 17-28.
- Boyd, Robert, and Peter J. Richerson. 1988. The Evolution of Reciprocity in Sizable Groups. *Journal of Theoretical Biology* 132(3): 337-56.
- _____. 1989. The Evolution of Indirect Reciprocity. *Social Networks* 11(3): 213-36.
- Braithwaite, John. 1989. *Crime, Shame, and Reintegration*. Cambridge: Cambridge University Press.
- _____. 1997. On Speaking Softly and Carrying Big Sticks: Neglected Dimensions of a Republication Separation of Powers. *University of Toronto Law Journal* 47(3): 305-61.
- _____. 2000. The New Regulatory State and the Transformation of Criminology. *British Journal of Criminology* 40(2): 222-38.
- _____. 2002a. *Restorative Justice and Responsive Regulation*. Oxford: Oxford University Press.
- _____. 2002b. Rules and principles: A Theory of Legal Certainty. *Australian Journal of Legal Philosophy* 27: 47-82.
- _____. 2003a. Meta Risk Management and Responsive Regulation for Tax System Integrity. *Law & Policy* 25(1): 1-16.
- _____. 2004. Methods of Power for Development: Weapons of the Weak, Weapons of the Strong. *Michigan Journal of International Law* 26: 297-330.
- _____. 2005. *Markets in Vice, Markets in Virtue*. Annandale, AU: The Federation Press.
- _____. 2006a. Responsive Regulation and Developing Economies. *World Development* 34(5): 884-98.
- _____. 2006b. Accountability and Responsibility through Restorative Justice. In *Public Accountability: Designs, Dilemmas and Experiences*, edited by M Dowdle. Cambridge: Cambridge University Press.
- _____. 2006c. The Regulatory State? In *The Oxford Handbook of Political Institutions*, edited by Rod A. W. Rhodes, Sarah A. Binder and Bert A. Rockman, 407-30. Oxford: Oxford University Press.

- _____. 2007. Contestatory Citizenship; Deliberative Denizenship. In *Common Minds: Themes from the Philosophy of Philip Pettit*, edited by Geoffrey Brennan, Robert Goodin, Frank Jackson and Michael Smith, 161-81. Oxford: Oxford University Press.
- _____. 2008. *Regulatory Capitalism: How it Works, Ideas for Making it Work Better*. Cheltenham, UK: Edward Elgar.
- _____. 2009a. Restorative Justice for Banks through Negative Licensing. *British Journal of Criminology* 49(4): 439-50.
- _____. 2011. The Essence of Responsive Regulation. *UBC Law Review* 44(3): 475-520.
- _____. 2013. Relational Republican Regulation. *Regulation & Governance* 7(1): 124-44.
- _____. 2014a. Limits on Violence: Limits on Responsive Regulatory Theory. *Law & Policy* 36(4): 432-56.
- Braithwaite, John, and Bina D'Costa. 2016. *Cascades of Violence*. Forthcoming.
- Braithwaite, John, and Peter Drahos. 2000. *Global Business Regulation*. Cambridge: Cambridge University Press.
- _____. 2002. Zero Tolerance, Naming and Shaming: Is There a Case for It with Crimes of the Powerful? *Australian and New Zealand Journal of Criminology* 35(3): 269-88.
- Braithwaite, John, and Seung-Hun Hong. 2015. The Iteration Deficit in Responsive Regulation: Are Regulatory Ambassadors an Answer? *Regulation & Governance* 9(1): 16-29.
- Braithwaite, John, Toni Makkai, and Valerie A. Braithwaite. 2007. *Regulating Aged Care: Ritualism and the New Pyramid*. Cheltenham, UK: Edward Elgar.
- Braithwaite, John, and Philip Pettit. 1990. *Not Just Deserts: A Republican Theory of Criminal Justice*. Oxford: Oxford University Press.
- Braithwaite, Valerie. 2003b. *Taxing Democracy: Understanding Tax avoidance and Evasion*. Aldershot: Ashgate.
- _____. 2009b. *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy*. Cheltenham: Edward Elgar.
- _____. 2014b. Defiance and Motivational Postures. In *Encyclopedia of criminology and criminal justice*, edited by Gerben Bruinsma and David Weisburd, 915-25. New York: Springer.
- _____. forthcoming. "Regulation: from Social Dread to Social 'Cred'."

- Braithwaite, Valerie, John Braithwaite, Diane Gibson, and Toni Makkai. 1994. Regulatory Styles, Motivational Postures and Nursing Home Compliance. *Law & Policy* 16(4): 363-94.
- Braithwaite, Valerie, Kristina Murphy, and Monika Reinhart. 2007. Taxation Threat, Motivational Postures, and Responsive Regulation. *Law & Policy* 29(1): 137-58.
- Brams, Steven J. 1994. *Theory of Moves*. New York: Cambridge University Press.
- Brennan, Geoffrey, and Philip Pettit. 2004. *The Economy of Esteem: An Essay on Civil and Political Society*. Oxford: Oxford University Press.
- Brenner, Neil, Jamie Peck, and Nik Theodore. 2010. Variegated Neoliberalization: Geographies, Modalities, Pathways. *Global Networks* 10(2): 182-222.
- Burby, Raymond J., and Robert G. Paterson. 1993. Improving Compliance with State Environmental Regulations. *Journal of Policy Analysis and Management* 12(4): 753-72.
- Butt, Daniel. 2009. *Rectifying International Injustice: Principles of Compensation and Restitution between Nations*. Oxford: Oxford University Press.
- Carpenter, Daniel P. 2010. *Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA*. Princeton, NJ: Princeton University Press.
- Carpenter, Daniel P., and David A. Moss. 2014. *Preventing Regulatory Capture: Special Interest Influence and How to Limit it*. New York: Cambridge University Press.
- Chang, Ha-Joon, Hong-Jae Park, and Chul Gyue Yoo. 1998. Interpreting the Korean Crisis: Financial Liberalisation, Industrial Policy and Corporate Governance. *Cambridge Journal of Economics* 22(6): 735-46.
- Cho, Yoon-je, and Joon-Kyung Kim. 1997. *Credit Policies and the Industrialization of Korea*. Vol. 9701, *KDI Research Monograph*. Seoul: Korea Development Institute.
- Choi, Jin-Wook. 2002. Regulatory Forbearance and Financial Crisis in South Korea. *Asian Survey* 42(2): 251-75.
- Choi, Sujin, and Han Woo Park. 2014. An Exploratory Approach to a Twitter-based Community Centered on a Political Goal in South Korea: Who Organized It, What They Shared, and How They Acted. *New Media & Society* 16(1): 129-48.
- Cialdini, Robert B., Mark Schaller, Donald Houlihan, Kevin Arps, Jim Fultz, and Arthur L. Beaman. 1987. Empathy-Based Helping: Is It Selflessly or Selfishly Motivated. *Journal of Personality and Social Psychology* 52(4): 749-58.

- Cicero, Marcus Tullius. 1991. *On Duties, Cambridge texts in the history of political thought*. Cambridge: Cambridge University Press.
- Citron, Danielle Keats. 2009. Law's Expressive Value in Combating Cyber Gender Harassment. *Michigan Law Review* 108(3): 373-415.
- Coen, David, and Mark Thatcher. 2008. Network Governance and Multi-level Delegation: European Networks of Regulatory Agencies. *Journal of Public Policy* 28(1): 49-71.
- Cogliances, Cary, Jennifer Nash, and Todd Olmstead. 2003. Performance-based Regulation: Prospects and Limitations in Health, Safety, and Environmental Protection. *Administrative Law Review* 55(4): 705-29.
- Cohen, Jeffrey E. 1986. The Dynamics of the "Revolving Door" on the FCC. *American Journal of Political Science* 30(4): 689-708.
- Cole, Wade M. 2012. Institutionalizing Shame: The Effect of Human Rights Committee Rulings on Abuse, 1981-2007. *Social Science Research* 41(3): 539-54.
- Cooper, John M. 2005. Political Animals and Civic Friendship. In *Aristotle's Politics : Critical Essays*, edited by Richard Kraut and Steven Skultety, 65-89. Lanham: Rowman & Littlefield Publishers.
- Coslovsky, Salo V. 2011. Relational Regulation in the Brazilian Ministerio Publico: The Organizational Basis of Regulatory Responsiveness. *Regulation & Governance* 5(1): 70-89.
- Crawford, Adam. 2006. Networked Governance and the Post-Regulatory State? Steering, Rowing and Anchoring the Provision of Policing and Security. *Theoretical Criminology* 10(4): 449-79.
- Dahl, Robert. 1957. The Concept of Power. *Behavioral Science* 2(3): 201-15.
- Dahl, Robert Alan. 1956. *A Preface to Democratic Theory*. Chicago: University of Chicago Press.
- Danzig, Gabriel. 2000. The Political Character of Aristotelian reciprocity. *Classical Philology* 95(4): 399-424.
- Davis, Kenneth Culp. 1969. *Discretionary Justice: A Preliminary Inquiry*. Baton Rouge: Louisiana State University Press.
- Day, Patricia, and Rudolf Klein. 1987. The Regulation of Nursing-Homes: a Comparative Perspective. *Milbank Quarterly* 65(3): 303-47.
- Deigh, John. 2011. Empathy, Justice, and Jurisprudence. *The Southern Journal of Philosophy* 49(s1): 73-90.

- Diekmann, Andreas. 2004. The Power of Reciprocity : Fairness, Reciprocity, and Stakes in Variants of the Dictator Game. *Journal of Conflict Resolution* 48(4): 487-505.
- Dorf, Michael, and Charles Sabel. A Constitution of Democratic Experimentalism. *Columbia Law Review* 98(2): 267-473.
- Dryzek, John S. 2013. The Deliberative Democrat's Idea of Justice. *European Journal of Political Theory* 12(4): 329-46.
- Dworkin, Ronald. 1986. *Law's Empire*. Cambridge, MA: Belknap Press.
- _____. 1995. Foundations of Liberal Equality. In *Equal Freedom: Selected Tanner Lectures on Human Values*, edited by Stephen Darwall, 190-306. Ann Arbor: University of Michigan Press.
- Dziob, Anne Marie. 1993. Aristotelian Friendship: Self-Love and Moral Rivalry. *Review of Metaphysics* 46(4): 781-801.
- Eberlein, Burkard, Kenneth W. Abbott, Julia Black, Errol Meidinger, and Stepan Wood. 2014. Transnational Business Governance Interactions: Conceptualization and Framework for Analysis. *Regulation & Governance* 8(1): 1-21.
- Eberlein, Burkard, and Abraham L Newman. 2008. Escaping the International Governance Dilemma? Incorporated Transgovernmental Networks in the European Union. *Governance* 21(1): 25-52.
- Edelman, Murray J. 1964. *The Symbolic Uses of Politics*. Paperback ed. Urbana: University of Illinois Press.
- Elias, Norbert. 2000. *The Civilizing Process: Sociogenetic and Psychogenetic Investigations*. Oxford: Blackwell.
- Erickson, Robert S. 1971. The Electoral Impact of Congressional Roll Call Voting. *American Political Science Review* 65(4): 1018-32.
- Erikson, Robert S., Michael MacKuen, and James A. Stimson. 2002. *The Macro Polity*. New York: Cambridge University Press.
- Etienne, Julien. 2013. Ambiguity and Relational Signals in Regulator-Regulatee Relationships. *Regulation & Governance* 7(1): 30-47.
- Evans, Peter. 1998. Transferable Lessons? Re-examining the Institutional Prerequisites of East Asian Economic Policies. *Journal of Development Studies* 34(6): 66-86.
- Fehr, Ernst, Urs Fischbacher, and Simon Gächter. 2002. Strong Reciprocity, Human Cooperation, and the Enforcement of Social Norms. *Human Nature* 13(1): 1-25.
- Fehr, Ernst, and Simon Gächter. 1998. Reciprocity and Economics: The Economic Implications of Homo Reciprocans. *European Economic Review* 42(3-5): 845-59.

- _____. 2000. Fairness and Retaliation: The Economics of Reciprocity. *Journal of Economic Perspectives* 14(3): 159-81.
- Feld, Lars P., and Bruno S. Frey. 2007. Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation. *Law & Policy* 29(1): 102-20.
- Finley, Moses I. 1973. *Democracy Ancient and Modern*. New Brunswick, NJ: Rutgers University Press.
- Fisse, Brent, and John Braithwaite. 1983. *The Impact of Publicity on Corporate Offenders*. Albany: State University of New York Press.
- Flick, Uwe. 2002. *An Introduction to Qualitative Research*. 2nd ed. London: SAGE Publications.
- Ford, Cristie. 2008. New Governance, Compliance, and Principles-Based Securities Regulation. *American Business Law Journal* 45(1): 1-60.
- _____. 2011. Macro- and Micro-Level Effects on Responsive Financial Regulation. *UBC Law Review* 44(3): 589-626.
- _____. 2013. Prospects for Scalability: Relationships and Uncertainty in Responsive Regulation. *Regulation & Governance* 7(1): 14-29.
- Ford, Cristie, and David Hess. 2008. Can Corporate Monitorships Improve Corporate Compliance? *Journal of Corporate Law* 34: 679-737.
- _____. 2011. Corporate Monitorships and New Governance Regulation: In Theory, in Practice, and in Context. *Law & Policy* 33(4): 509-541.
- Freeman, Jody, and Jim Rossi. 2012. Agency Coordination in Shared Regulatory Space. *Harvard Law Review* 125(5): 1131-211.
- Friesen, Lana. 2012. Certainty of Punishment versus Severity of Punishment: An Experimental Investigation. *Southern Economic Journal* 79(2): 399-421.
- FSC. 1998. Kūmyung kamdokjōngchaek ūi sōnjinhwa ch'ujinsanghwang (Progress Report on the Advancement of Financial Supervisory Policy). Seoul: Financial Supervisory Commission.
- FSS. 2007. Announcing a Blueprint for the Advancement of Financial Supervision. Seoul: Financial Supervisory Service.
- _____. 2011. Internal Guidelines for the Operation of On-site Supervisors and Superintendent in Mutual Savings Banks. edited by Department of Mutual Savings Banks Supervision. Seoul: Financial Supervisory Service.

- FSS, and FSC. 2015. Reform of Examination and Sanctions of Financial Institutions [in Korean]. Seoul.
- Garriga, Elisabet, and Domènec Melé. 2004. Corporate Social Responsibility Theories: Mapping the Territory. *Journal of Business Ethics* 53(1-2): 51-71.
- Gerson, Ruth, and Nancy Rappaport. 2011. Cyber Cruelty: Understanding and Preventing the New Bullying. *Adolescent Psychiatry* 1(1): 67-71.
- Gibson, Alan. 2000. Ancients, Moderns and Americans: The Republicanism-Liberalism Debate Revisited. *History of Political Thought* 21(2): 261-307.
- Gintis, Herbert. 2000. Strong Reciprocity and Human Sociality. *Journal of Theoretical Biology* 206(2): 169-79.
- Gofen, Anat. 2014. Mind the Gap: Dimensions and Influence of Street-Level Divergence. *Journal of Public Administration Research and Theory* 24(2): 473-93.
- Goodhart, Lucy M. 2015. Brave New World? Macro-Prudential Policy and the New Political Economy of the Federal Reserve. *Review of International Political Economy* 22(2): 280-310.
- Goodman, Leo A. 1961. Snowball Sampling. *Annals of Mathematical Statistics* 32(1): 148-70.
- Gormley, William T. 1979. Test of the Revolving Door Hypothesis at the FCC. *American Journal of Political Science* 23(4): 665-83.
- Gouldner, Alvin W. 1960. The Norm of Reciprocity: A Preliminary Statement. *American Sociological Review* 25(2): 161-78.
- Grabosky, Peter. 1995. Using Nongovernmental Resources to Foster Regulatory Compliance. *Governance* 8(4): 527-50.
- _____. 2013. Beyond Responsive Regulation: The Expanding Role of Non-State Actors in the Regulatory Process. *Regulation & Governance* 7(1): 114-23.
- Grabosky, Peter N., and John Braithwaite. 1986. *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies*. Melbourne Oxford University Press.
- Grant, Adam M., and Francesca Gino. 2010. A Little Thanks Goes a Long Way: Explaining Why Gratitude Expressions Motivate Prosocial Behavior. *Journal of Personality and Social Psychology* 98(6): 946-55.
- Gunningham, Neil. 2011. Strategizing Compliance and Enforcement: Responsive Regulation and Beyond. In *Explaining Compliance: Business Responses to*

- Regulation*, edited by C. Parker and V. L. Nielsen, 199-221. Cheltenham, UK: Edward Elgar.
- Gunningham, Neil, and Peter N. Grabosky. 1998. *Smart Regulation: Designing Environmental Policy*. Oxford: Clarendon Press.
- Gunningham, Neil, and Richard Johnstone. 1999. *Regulating Workplace Safety: System and Sanctions*. Oxford: Oxford University Press.
- Gunningham, Neil, Robert A. Kagan, and Dorothy Thornton. 2004. Social License and Environmental Protection: Why Businesses Go Beyond Compliance. *Law and Social Inquiry* 29(2): 307-41.
- Gunningham, Neil, and Darren Sinclair. 2009. Regulation and the Role of Trust: Reflections from the Mining Industry. *Journal of Law and Society* 36(2): 167-94.
- Gutmann, Amy, and Dennis F. Thompson. 1996. *Democracy and Disagreement*. Cambridge, MA: Belknap Press.
- _____. 2002. Deliberative Democracy beyond Process. *Journal of Political Philosophy* 10(2): 153-74.
- Habermas, Jürgen. 1996. *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy*. Cambridge, MA: MIT Press.
- Hafner-Burton, Emilie M. 2008. Sticks and Stones: Naming and Shaming the Human Rights Enforcement Problem. *International Organization* 62(4): 689-716.
- Haggard, Stephan. 2000. *The Political Economy of the Asian Financial Crisis*. Washington, DC: Institute for International Economics.
- Hahn, Tobias. 2015. Reciprocal Stakeholder Behavior: A Motive-Based Approach to the Implementation of Normative Stakeholder Demands. *Business & Society* 54(1): 9-51.
- Haines, Fiona. 1997. *Corporate Regulation: Beyond "Punish or Persuade"*. Oxford: Clarendon Press.
- Hamilton, Alexander, John Jay, James Madison, and Robert Scigliano. 2000. *The Federalist: A Commentary on the Constitution of the United States*. Modern Library ed. New York: Modern Library.
- Hamilton, Ian M., and Michael Taborsky. 2005. Contingent Movement and Cooperation Evolve under Generalized Reciprocity. *Proceedings of the Royal Society B-Biological Sciences* 272: 2259-67.
- Hansen, Mogens Herman. 1991. *The Athenian Democracy in the Age of Demosthenes: Structure, Principles, and Ideology*. Oxford: Blackwell.

- Harlow, Summer. 2012. Social Media and Social Movements: Facebook and an Online Guatemalan Justice Movement That Moved Offline. *New Media & Society* 14(2): 225-43.
- Harris, Nathan. 2006. Reintegrative Shaming, Shame, and Criminal Justice. *Journal of Social Issues* 62(2): 327-46.
- Harris, Yael, and Steven B. Clauser. 2002. Achieving Improvement through Nursing Home Quality Measurement. *Health Care Financing Review* 23(4): 5-18.
- Harrison, Kathryn. 1995. Is Cooperation the Answer? Canadian Environmental Enforcement in Comparative Context. *Journal of Policy Analysis and Management* 14(2): 221-44.
- Hawkins, Keith. 1984. *Environment and Enforcement: Regulation and the Social Definition of Pollution*. Oxford: Clarendon Press.
- Heald, David. 2006. Varieties of Transparency. In *Transparency: The Key to Better Governance?*, edited by Christopher Hood and David Heald, 25-43. Oxford: Oxford University Press.
- Heimer, Carol A. 2011. Disarticulated Responsiveness: The Theory and Practice of Responsive Regulation in Multi-layered Systems. *UBC Law Review* 44(3): 663-93.
- Helmke, Gretchen, and Frances Rosenbluth. 2009. Regimes and the Rule of Law: Judicial Independence in Comparative Perspective. *Annual Review of Political Science* 12 :345-66.
- Hobbes, Thomas. 1996 [1651]. *Leviathan*. Cambridge: Cambridge University Press.
- Hoffman, Martin L. 2000. *Empathy and Moral Development: Implications for Caring and Justice*. Cambridge: Cambridge University Press.
- Hogan, Robert. E. 2008. Policy Responsiveness and Incumbent Reelection in State Legislatures. *American Journal of Political Science* 52(4): 858-73.
- Hong, Seung-Hun. 2007. Yoron kwa Jongchaik: Minjuhwa ihu Han'guk jongpu ui jongchaik ungtapsong (Public Opinion and Policy: Policy Responsiveness of Democratic Governments in South Korea) [in Korean]. *Sahoe Yon'gu (Korean Journal of Social Issues)* 13(1): 9-43.
- Hong, Seung-Hun, and Jun-Hyeok Kwak. 2011. Liberal Neutrality and Agonistic Politics: The Judicial Review of the Korean Constitutional Court Reconsidered. *Korean Political Science Review* 44(5): 7-28.
- Honohan, Iseult. 2002. *Civic Republicanism*. London: Routledge.

- Hutchcroft, Paul D. 1998. *Booty Capitalism: The Politics of Banking in the Philippines*. Ithaca, NY: Cornell University Press.
- Hutter, Bridget M. 2005. *The Attractions of Risk-Based Regulation: Accounting for the Emergence of Risk Ideas in Regulation*. Vol. 33. London: Centre for Analysis of Risk and Regulation, London School of Economics and Political Science.
- Hutter, Horst. 1978. *Politics as Friendship: The Origins of Classical Notions of Politics in the Theory and Practice of Friendship*. Waterloo, CA: Wilfrid Laurier University Press.
- Ickes, William John. 1997. *Empathic Accuracy*: Guilford Press.
- IMF. 2003. Republic of Korea: Financial System Stability Assessment. Washington DC: International Monetary Funds.
- _____. 2014. Republic of Korea: Financial System Stability Assessment. In *Country Report No. 14/126*. Washington D.C.: International Monetary Fund.
- Irwin, Terence. 1988. *Aristotle's First Principles*. Oxford: Oxford University Press.
- Ivec, Mary, and Valerie Braithwaite. 2015. Applications of Responsive Regulatory Theory in Australia and Overseas: Update. Regulatory Institutions Network, Canberra.
- Jacobs, Lawrence R., and Robert Y. Shapiro. 1994. Studying Substantive Democracy. *Ps-Political Science & Politics* 27(1): 9-17.
- _____. 2000. *Politicians Don't Pander: Political Manipulation and the Loss of Democratic Responsiveness*. Chicago: University of Chicago Press.
- Johannes, John R., and John C. Mcadams. 1981. The Congressional Incumbency Effect: Is It Casework, Policy Compatibility, or Something Else - An Examination of the 1978 Election. *American Journal of Political Science* 25(3): 512-42.
- Jordan, Andrew, Rüdiger. K. W. Wurzel, and Anthony Zito. 2005. The Rise of 'New' Policy Instruments in Comparative Perspective: Has Governance Eclipsed Government? *Political Studies* 53(3): 477-96.
- Jordana, Jacint, and David Levi-Faur. 2004. *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance*. Cheltenham, UK: Edward Elgar.
- Jung, Heon Joo. 2009. Financial Regulatory Reform in South Korea Then and Now. *Korea Observer* 40(4): 701-34.
- Kagan, Robert A., and John T. Scholz. 1984. The "Criminology of the Corporation" and Regulatory Enforcement Strategies. In *Enforcing Regulation (Law in A Social Context)*, edited by Hawkins K and Thomas J. M., 67-96. Oxford: Kluwer-Nijhoff.

- Kahan, Dan M. 2003. The Logic of Reciprocity: Trust, Collective Action, and Law. *Michigan Law Review* 102(1): 71-103.
- Kang, David C. 2002. *Crony Capitalism: Corruption and Development in South Korea and the Philippines*, Cambridge studies in comparative politics. Cambridge: Cambridge University Press.
- Kaufman, Herbert. 1960. *The Forest Ranger: A Study in Administrative Behavior*. Special reprint ed. Baltimore: Johns Hopkins Press.
- Keohane, Robert O. 1984. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton NJ: Princeton University Press.
- _____. 1986. Reciprocity in International Relations. *International Organization* 40(1): 1-27.
- Kim, Hong-Bum, and Chung H Lee. 2006. Financial Reform, Institutional Interdependency, and Supervisory Failure in Postcrisis Korea. *Journal of East Asian Studies* 6(3): 409-31.
- Kim, Joongi. 2002a. Clientelism and Corruption in South Korea. In *Political Corruption in Transition: A Skeptic's Handbook*, edited by Stephen Kotkin and András Sajó, 167-85. Budapest: Central European University Press.
- Kim, Sang-Jo. 2002b. Financial Sector Reform in Korea: A Dilemma between 'Bank-Based' and 'Market-Based' Systems. *Korea Journal* 42(1): 42-73.
- _____. 2011. Reason, Current Status, and Resolution for Insolvent Mutual Savings Banks. The Korea Money and Finance Association 2011 Summer Conference, Seoul.
- Kingsford-Smith, Dimity. 2011. A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector. *UBC Law Review* 44(3): 695-741.
- Klapwijk, Anthon, and Paul A. M. Van Lange. 2009. Promoting Cooperation and Trust in "Noisy" Situations: The Power of Generosity. *Journal of Personality and Social Psychology* 96(1): 83-103.
- Kolstad, I., and A. Wiig. 2009. Is Transparency the Key to Reducing Corruption in Resource-Rich Countries? *World Development* 37(3): 521-32.
- Kostadinova, Petia. 2015. Improving the Transparency and Accountability of EU Institutions: The Impact of the Office of the European Ombudsman. *JCMS: Journal of Common Market Studies* 53(5): 1077-93.
- Krygier, Martin. 2012. *Philip Selznick: Ideals in the World*. Stanford: Stanford Law Books.

- Kwak, James. 2014a. Cultural Capture and the Financial Crisis. In *Preventing Regulatory Capture*, edited by Daniel P. Carpenter and David A. Moss, 71-98. Cambridge: Cambridge University Press.
- Kwak, Jun-Hyeok. 2014b. Non-Domination and 'Shame' Culture. In *Republicanism in Northeast Asia*, edited by Jun-Hyeok Kwak and Leigh Jenco, 39-53. London: Routledge.
- LaborToday. 2013. Childcare Facilities Infringing on Labor Standard Act (Korean). *Labor Today*, 20 June 2013. Accessed 10 August 2013. <http://www.labortoday.co.kr/news/articleView.html?idxno=119038>.
- Lee, Eungkyoon. 2010. Information Disclosure and Environmental Regulation: Green Lights and Gray Areas. *Regulation & Governance* 4(3): 303-28.
- Lee, Kyung-shik, and Chang-Yuel Lim. 1997. Letter of Intent of the Government of Korea to IMF. December 3, 1997.
- Lee, Yeonho, YooJin Lim, and Sukkyu Chung. 2002. The Rise of the Regulatory State and Government-Business Relations in South Korea [Korean]. *Korean Political Science Review* 36(3): 199-222.
- Leimar, Olof, and Peter Hammerstein. 2001. Evolution of Cooperation through Indirect Reciprocity. *Proceedings of the Royal Society of London Series B-Biological Sciences* 268: 745-53.
- Levi-Faur, David. 2005. The Global Diffusion of Regulatory Capitalism. *Annals of the American Academy of Political and Social Science* 598: 12-32.
- _____. 2006a. Regulatory Capitalism: The Dynamics of Change beyond Telecoms and Electricity. *Governance* 19(3): 497-525.
- _____. 2006b. Varieties of Regulatory Capitalism: Getting the Most out of the Comparative Method. *Governance* 19(3): 367-82.
- Lewis, David. 2013. Risk-based Supervision: How Can We Do Better? An Australian Supervisory Perspective. Sydney: the Australian Prudential Regulation Authority.
- Liebman, Benjamin L., and Curtis J. Milhaupt. 2008. Reputational Sanctions in China's Securities Market. *Columbia Law Review* 108(4): 929-83.
- Lindenberg, Siegwart. 2000. It Takes Both Trust and Lack of Mistrust: The Workings of Cooperation and Relational Signaling in Contractual Relationships. *Journal of Management and Governance* 4(1): 11-33.

- Lindstedt, Catharina, and Daniel Naurin. 2010. Transparency Is Not Enough: Making Transparency Effective in Reducing Corruption. *International Political Science Review* 31(3): 301-22.
- Lipsky, Michael. 2010. *Street-Level Bureaucracy: Dilemmas of the Individual in Public Services*. 30th anniversary expanded ed. New York: Russell Sage Foundation.
- Luke, Harry. 1962. *Islands of the South Pacific*. London: Harrap.
- Lukes, Steven. 1986. Introduction. In *Power*, edited by Steven Lukes. Oxford: Blackwell.
- Makkai, Toni, and John Braithwaite. 1992. In and Out of the Revolving Door: Making Sense of Regulatory Capture. *Journal of Public Policy* 12(1): 61-78.
- _____. 1993. Praise, Pride and Corporate Compliance. *International Journal of Sociology of Law* 21(1): 73-91.
- _____. 1994. Reintegrative Shaming and Compliance with Regulatory Standards. *Criminology* 32(3): 361-85.
- Malinowski, Bronislaw. 1926. *Crime and Custom in Savage Society*. London: K. Paul, Trench.
- Manin, Bernard. 1997. *The Principles of Representative Government*. Cambridge: Cambridge University Press.
- Mann, Michael. 2008. Infrastructural Power Revisited. *Studies in Comparative International Development* 43(3-4): 355-65.
- March, James G., and Johan P. Olsen. 1996. Institutional Perspectives on Political Institutions. *Governance* 9(3): 247-64.
- Marshall, Martin N., Paul G. Shekelle, Huw T. O. Davies, and Peter C. Smith. 2003. Public reporting on quality in the United States and the United Kingdom. *Health Affairs* 22(3): 134-48.
- Masuda, Naoki. 2012. Ingroup Favoritism and Intergroup Cooperation under Indirect Reciprocity Based on Group Reputation. *Journal of Theoretical Biology* 311: 8-18.
- Matten, Dirk, and Andrew Crane. 2005. Corporate Citizenship: Toward an Extended Theoretical Conceptualization. *Academy of Management Review* 30(1): 166-79.
- Mauss, Marcel. 1954. *The Gift: Forms and Functions of Exchange in Archaic Societies*. Glencoe: Free Press.
- May, Peter J. 2003. Performance-based Regulation and Regulatory Regimes: The Saga of Leaky Buildings. *Law & Policy* 25(4): 381-401.
- _____. 2004. Compliance Motivations: Affirmative and Negative Bases. *Law & Society Review* 38(1): 41-68.

- May, Peter J., and Søren C. Winter. 2009. Politicians, Managers, and Street-Level Bureaucrats: Influences on Policy Implementation. *Journal of Public Administration Research and Theory* 19(3): 453-76.
- _____. 2011. Regulatory Enforcement Styles and Compliance. In *Explaining Compliance: Business Responses to Regulation*, edited by Christine Parker and Vibeke Lehmann Nielsen, 222-44. Cheltenham: Edward Elgar.
- May, Peter J., and Robert S. Wood. 2003. At the Regulatory Front Lines: Inspectors' Enforcement Styles and Regulatory Compliance. *Journal of Public Administration Research and Theory* 13(2): 117-39.
- Mayer, John D., and Peter Salovey. 1997. What is Emotional Intelligence: Implications for Educators. In *Emotional Development and Emotional Intelligence: Educational Implications*, edited by Peter Salovey and David J. Sluyter. New York: Basic Books.
- Maynor, John W. 2003. *Republicanism in the Modern World*. Cambridge: Polity.
- McAdams, Richard H. 2000. An Attitudinal Theory of Expressive Law. *Oregon Law Review* 79: 339-90.
- McCubbins, Mathew D., and Thomas Schwartz. 1984. Congressional Oversight Overlooked: Police Patrols Versus Fire Alarms. *American Journal of Political Science* 28(1): 165-79.
- McKenna, Kylie. 2016. *Corporate Social Responsibility and Natural Resource Conflict*. New York: Routledge.
- McKerlie, Dennis. 1991. Friendship, Self-Love, and Concern for Others in Aristotle's Ethics. *Ancient Philosophy* 11(1): 85-101.
- McWilliams, Abigail, and Donald S. Siegel. 2000. Corporate Social Responsibility and Financial Performance: Correlation or Misspecification? *Strategic Management Journal* 21(5): 603-9.
- McWilliams, Abigail, Donald S. Siegel, and Patrick M. Wright. 2006. Corporate Social Responsibility: Strategic Implications. *Journal of Management Studies* 43(1): 1-18.
- ME. 2013. Report on the Investigation of Indoor Air Quality [in Korean]. Seoul: Republic of Korea.
- Mead, George Herber. 1934. *Mind, Self, and Society*. Chicago: University of Chicago Press.

- Meidinger, Errol. 1987. Regulatory Culture: A Theoretical Outline. *Law & Policy* 9(4): 355-86.
- Mendeloff, John. 1993. Overcoming Barriers to Better Regulation. *Law & Social Inquiry* 18(4): 711-29.
- MHW. 2011. National Report on Child Abuse [in Korean]. edited by National Child Protection Agency. Seoul.
- _____. 2012. Infant Care Statistics [in Korean]. edited by Division of Childcare Policy. Seoul.
- _____. 2014. Guidance to 2014 Infant Policy. Sejong.
- Micó, Josep-Lluís , and Andreu Casero-Ripollés. 2014. Political Activism Online: Organization and Media Relations in the Case of 15M in Spain. *Information Communication & Society* 17(7): 858-71.
- Milinski, Manfred, Dirk Semmann, Theo C. M. Bakker, and Hans-Jürgen Krambeck. 2001. Cooperation through Indirect Reciprocity: Image Scoring or Standing Strategy? *Proceedings of the Royal Society of London Series B-Biological Sciences* 268: 2495-501.
- Miller, David. 2007. *National Responsibility and Global Justice*. Oxford: Oxford University Press.
- Mitchell, George E. 2015. The Attributes of Effective NGOs and the Leadership Values Associated with a Reputation for Organizational Effectiveness. *Nonprofit Management & Leadership* 26(1): 39-57.
- Moshirian, Fariborz. 2011. The Global Financial Crisis and the Evolution of Markets, Institutions and Regulation. *Journal of Banking & Finance* 35(3): 502-11.
- Mueller, Ulrich. 1987. Optimal Retaliation for Optimal Cooperation. *Journal of Conflict Resolution* 31(4): 692-724.
- Murphy, Kristina. 2004. Moving Forward towards a More Effective Model of Regulatory Enforcement in the Austarlian Taxation Office. *British Tax Review* 24(6): 603-19.
- Murray, David, Kevin Davis, Craig Dunn, Carolyn Hewson, and Brian McNamee. 2014. Financial System Inquiry Final Report. Canberra: Commonwealth of Australia.
- Nagin, Daniel S. 2013. Deterrence in the Twenty-First Century. *Crime and Justice in America, 1975-2025* 42: 199-263.
- Nielsen, Vibeke Lehmann. 2006. Are Regulators Responsive? *Law & Policy* 28(3): 395-416.

- Nielsen, Vibeke Lehmann, and Christine Parker. 2009. Testing Responsive Regulation in Regulatory Enforcement. *Regulation & Governance* 3(4): 376-99.
- Nino, Carlos Santiago. 1996. *The Constitution of Deliberative Democracy*. New Haven, CN: Yale University Press.
- Nobles, Melissa. 2008. *The Politics of Official Apologies*. Cambridge: Cambridge University Press.
- Nonet, Philippe, and Philip Selznick. 1978. *Law and Society in Transition: Toward Responsive Law*. New York: Harper & Row.
- Nou, Jennifer. 2014. Agency Coordinators Outside of the Executive Branch. *Harvard Law Review Forum* 128: 64-74.
- Nowak, Martin. A. 2012. Evolving Cooperation. *Journal of Theoretical Biology* 299:1-8.
- Nowak, Martin A., and Karl Sigmund. 1992. Tit-for-Tat in Heterogeneous Populations. *Nature* 355: 250-3.
- _____. 1998. Evolution of Indirect Reciprocity by Image Scoring. *Nature* 393: 573-7.
- _____. 2005. Evolution of Indirect Reciprocity. *Nature* 437: 1291-8.
- Nussbaum, Martha C. 1992. Human Functioning and Social Justice: in Defense of Aristotelian Essentialism. *Political Theory* 20(2): 202-46.
- _____. 2000. Aristotle, Politics, and Human Capabilities: A Response to Antony, Arneson, Charlesworth, and Mulgan. *Ethics* 111(1): 102-40.
- _____. 2001. *Upheavals of Thought: The Intelligence of Emotions*. Cambridge: Cambridge University Press.
- _____. 2004. *Hiding from Humanity: Disgust, Shame, and the Law*. Princeton, N.J.: Princeton University Press.
- O'Donnell, Guillermo A. 1994. Delegative Democracy. *Journal of Democracy* 5(1): 55-69.
- O'donnell, Guillermo A. 2004. Why the Rule of Law Matters. *Journal of Democracy* 15(4): 32-46.
- OCC. 2007. Bank Supervision Process. edited by The Office of the Comptroller of the Currency.
- Ohtsuki, Hisashi, and Yoh Iwasa. 2004. How Should We Define Goodness? Reputation Dynamics in Indirect Reciprocity. *Journal of Theoretical Biology* 231(1): 107-20.
- _____. 2006. The Leading Eight: Social Norms That Can Maintain Cooperation by Indirect Reciprocity. *Journal of Theoretical Biology* 239(4): 435-44.
- Ohtsuki, Hisashi, Yoh Iwasa, and Martin A. Nowak. 2009. Indirect Reciprocity Provides Only a Narrow Margin of Efficiency for Costly Punishment. *Nature* 457: 79-82.

- Osgood, Charles Egerton. 1962. *An Alternative to War or Surrender*. Urbana: University of Illinois Press.
- Ostrom, Elinor. 1998. A Behavioral Approach to the Rational Choice Theory of Collective Action. *American Political Science Review* 92(1): 1-22.
- Ouellette, Judith A, and Wendy Wood. 1998. Habit and Intention in Everyday Life: The Multiple Processes by Which Past Behavior Predicts Future Behavior. *Psychological Bulletin* 124(1): 54-74.
- Page, Benjamin, I. 1994. Democratic Responsiveness: Untangling the Links between Public-Opinion and Policy. *Ps-Political Science & Politics* 27(1): 25-9.
- Palmer, John. 2002. Review of the Role Played by the Australian Prudential Regulation Authority and the Insurance and Superannuation Commission in the Collapse of the HIH Group of Companies.
- Panchanathan, Karthik, and Robert Boyd. 2003. A Tale of Two Defectors: The Importance of Standing for Evolution of Indirect Reciprocity. *Journal of Theoretical Biology* 224(1): 115-26.
- Park, Chang-kyun, and Hyun-wook Kim. 2006. A Report on Improving Perception of Financial Regulation for the Regulatory Advancement. Seoul: Korea Development Institute.
- Park, Jong Hee, and Kentaro Hirose. 2013. Domestic Politics, Reputational Sanctions, and International Compliance. *International Theory* 5(2): 300-20.
- Parker, Christine. 1999. *Just Lawyers: Regulation and Access to Justice*. Oxford: Oxford University Press.
- _____. 2002. *The Open Corporation: Effective Self-Regulation and Democracy*. Cambridge: Cambridge University Press.
- _____. 2008. The Pluralization of Regulation. *Theoretical Inquiries in Law* 9(2): 349-69.
- Parker, Christine, and John Braithwaite. 2003. Regulation. In *The Oxford Handbook of Legal Studies*, edited by Peter Cane and Mark Tushnet, 119-45. Oxford: Oxford University Press.
- Parker, Christine, and Vibeke Lehmann Nielsen. 2009. The Challenge of Empirical Research on Business Compliance in Regulatory Capitalism. *Annual Review of Law and Social Science* 5: 45-70.
- Parker, Rachel. 2007. Networked Governance or Just Networks? Local Governance of the Knowledge Economy in Limerick (Ireland) and Karlskrona (Sweden). *Political Studies* 55(1): 113-32.

- Parks, Craig D. 2010. Graduated Reciprocation in Tension Reduction (GRIT). In *Encyclopedia of Group Processes & Intergroup Relations*, edited by John M. Levine and Michael A. Hogg, 310-1. Thousand Oaks: Sage Publications, Inc.
- Peck, Jamie, and Nik Theodore. 2007. Variegated Capitalism. *Progress in Human Geography* 31(6): 731-72.
- Pempel, T. John. 1999. *The Politics of the Asian Economic Crisis*. Ithaca: Cornell University Press.
- Pettit, Philip. 1993. *The Common Mind: An Essay on Psychology, Society, and Politics*. New York: Oxford University Press.
- _____. 1997. *Republicanism: A Theory of Freedom and Government*. Oxford: Oxford University Press.
- _____. 1999. Republican Freedom and Contestatory Democratization. In *Democracy's Value*, edited by Ian Shapiro and Casiano Hacker-Cordón, 163-90. Cambridge: Cambridge University Press.
- _____. 2004. Depoliticizing Democracy. *Ratio Juris* 17(1): 52-65.
- _____. 2006. Democracy, National and International. *Monist* 89(2): 301-24.
- _____. 2007a. Resilience as the Explanandum of Social Theory. In *Political Contingency: Studying the Unexpected, the Accidental, and the Unforeseen*, edited by Ian Shapiro and Sonu Bedi, 79-96. New York: New York University Press.
- _____. 2007b. Responsibility Incorporated. *Ethics* 117(2): 171-201.
- Pfeiffer, Thomas, Claudia Rutte, Timothy Killingback, Michael Taborsky, and Sebastian Bonhoeffer. 2005. Evolution of Cooperation by Generalized Reciprocity. *Proceedings of the Royal Society B-Biological Sciences* 272: 1115-20.
- Pitkin, Hanna Fenichel. 1967. *The Concept of Representation*. Berkeley: University of California Press.
- Pocock, J. G. A. 1975. *The Machiavellian Moment: Florentine Political Thought and the Atlantic Republican Tradition*. Princeton, NJ: Princeton University Press.
- Poole, Emily. 2013. Hey Girls, Did You Know: Slut-Shaming on the Internet Needs to Stop. *University of San Francisco Review* 48(2): 221-60.
- Posner, Elliot. 2009. Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millennium. *International Organization* 63(4): 665-99.
- Przeworski, Adam, Susan Carol Stokes, and Bernard Manin. 1999. *Democracy, Accountability, and Representation*. Cambridge: Cambridge University Press.

- Przeworski, Adam, and Henry Teune. 1970. *The Logic of Comparative Social Inquiry*. Malabar, FL: R.E. Krieger Publishing.
- Putnam, Robert D. 2000. *Bowling Alone: The Collapse and Revival of American Community*. New York: Simon & Schuster.
- Rahe, Paul Anthony. 1992. *Republics Ancient and Modern: Classical Republicanism and the American Revolution*. Chapel Hill: University of North Carolina Press.
- Rhodes, Rod AW. 1997. *Understanding Governance: Policy Networks, Governance, Reflexivity, and Accountability*. Philadelphia: Open University Press.
- Robinson, Laurie. O. 2011. Exploring Certainty and Severity: Perspectives from a Federal Perch. *Criminology & Public Policy* 10(1): 85-92.
- Rose-Ackerman, Susan. 2005. *From Elections to Democracy: Building Accountable Government in Hungary and Poland*. Cambridge: Cambridge University Press.
- Rousseau, Jean-Jacques. 1978[1762]. *On the Social Contract with Geneva Manuscript and Political Economy*. New York: St. Martin's Press.
- Rumble, Ann. C., Paul. A. M. Van Lange, and Craig. D. Parks. 2010. The Benefits of Empathy: When Empathy May Sustain Cooperation in Social Dilemmas. *European Journal of Social Psychology* 40(5): 856-66.
- Ryan, Alan. 1993. "Liberalism." In *A Companion to Contemporary Political Philosophy*, edited by Robert E. Goodin and Philip Pettit, 360-82. Oxford: Blackwell.
- Sabel, Charles, and William Simon. 2004. Destabilization Rights: How Public Law Litigation Succeeds. *Harvard Law Review* 1015-1101.
- Sahlins, Marshall D. 1965. "On the Sociology of Primitive Exchange." In *The Relevance of Models for Social Anthropology*, edited by Michael Banton, 139-236. London: Tavistock.
- Salant, David J. 1995. Behind the Revolving Door: A New View of Public Utility Regulation. *Rand Journal of Economics* 26(3): 362-77.
- Salant, David J, and Glenn A Woroch. 1992. Trigger Price Regulation. *The RAND Journal of Economics* 23(1): 29-51.
- Salganik, Matthew J., and Douglas D. Heckathorn. 2004. Sampling and Estimation in Hidden Populations Using Respondent-Driven Sampling. *Sociological Methodology* 34(1): 193-240.
- Schell-Busey, Natalie, Sally S. Simpson, Melissa Rorie, and Mariel Alper. 2016. What Works? A Systematic Review of Corporate Crime Deterrence. *Criminology & Public Policy* Forthcoming.

- Schelling, Thomas C. 1966. *Arms and Influence*. New Haven: Yale University Press.
- Scholz, John T. 1984. Cooperation, Deterrence, and the Ecology of Regulatory Enforcement. *Law & Society Review* 18(2): 179-224.
- _____. 1991. Cooperative Regulatory Enforcement and the Politics of Administrative Effectiveness. *American Political Science Review* 85(1): 115-36.
- Schumpeter, Joseph A. 1950. *Capitalism, Socialism, and Democracy*. New York: Harper.
- Scott, Colin. 2001. Analysing Regulatory Space: Fragmented Resources and Institutional Design. *Public Law*: 329-53.
- _____. 2004. Regulation in the Age of Governance: The Rise of the Post Regulatory State. In *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance*, edited by J. Jordana and D. Levi-Faur, 145-76. Cheltenham, UK: Edward Elgar.
- Selznick, Philip. 1949. *TVA and the Grass Roots: A Study in the Sociology of Formal Organization*. Berkeley: University of California Press.
- _____. 1987. The Idea of a Communitarian Morality. *California Law Review* 75(1): 445-63.
- _____. 1989. Dworkin's Unfinished Task. *California Law Review* 77(3): 505-13.
- _____. 1992. *The Moral Commonwealth: Social Theory and the Promise of Community*. Berkeley: University of California Press.
- _____. 2003. 'Law in Context' Revisited. *Journal of Law and Society* 30(2): 177-86.
- Senate, US. 2012. Federal Support for and Involvement in State and Local Fusion Centers. Permanent Subcommittee on Investigations.
- Serra, George, and David Moon. 1994. Casework, Issue Positions, and Voting in Congressional Elections: a District Analysis. *Journal of Politics* 56(1): 200-13.
- Settembri, P. 2005. Transparency and the EU Legislator: 'Let He Who Is Without Sin Cast the First Stone'. *Jcms-Journal of Common Market Studies* 43(3): 637-54.
- Shapiro, Ian. 2012. On Non-domination. *University of Toronto Law Journal* 62(3): 293-336.
- Sharkey, Catherine M. 2013. Agency Coordination in Consumer Protection. *University of Chicago Legal Forum* 2013: 329-58.
- Shearing, Clifford, and Jennifer Wood. 2003. Nodal Governance, Democracy, and the New 'Denizens'. *Journal of Law and Society* 30(3): 400-19.

- Sherman, Lawrence W., Patrick R. Gartin, and Michael E. Buerger. 1989. Hot Spots of Predatory Crime: Routine Activities and the Criminology of Place. *Criminology* 27(1): 27-55.
- Sibert, Anne. 2009. Is Transparency About Central Bank Plans Desirable? *Journal of the European Economic Association* 7(4): 831-57.
- Sigmund, Karl. 2012. Moral Assessment in Indirect Reciprocity. *Journal of Theoretical Biology* 299: 25-30.
- Simmons, Beth A. 2000. International Law and State Behavior: Commitment and Compliance in International Monetary Affairs. *American Political Science Review* 94(4): 819-35.
- Sinclair, Darren. 1997. Self-Regulation Versus Command and Control? Beyond False Dichotomies. *Law & Policy* 19(4): 529-59.
- Skinner, Quentin. 1998. *Liberty before Liberalism*. Cambridge: Cambridge University Press.
- _____. 2002. A Third Concept of Liberty. In *Proceedings of the British Academy*, 237-68.
- Slaughter, Anne-Marie. 2004. *A New World Order*. Princeton: Princeton University Press.
- Short, Jodi. 2011. The Paranoid Style in Regulatory Reform. *Hastings Law Journal* 63: 633-694.
- Sparrow, Malcolm K. 2000. *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance*. Washington, DC.: Brookings Institution Press.
- Stasavage, David. 2003. Transparency, Democratic Accountability, and the Economic Consequences of Monetary Institutions. *American Journal of Political Science* 47(3): 389-402.
- Stevenson, David G. 2006. Is a Public Reporting Approach Appropriate for Nursing Home Care? *Journal of Health Politics Policy and Law* 31(4): 773-810.
- Stimson, James A., Michael B. Mackuen, and Robert S. Erikson. 1995. Dynamic Representation. *American Political Science Review* 89(3): 543-65.
- Strauss, Anselm L. 1987. *Qualitative Analysis for Social Scientists*. Cambridge: Cambridge University Press.
- Strauss, Anselm L., and Juliet M. Corbin. 1990. *Basics of Qualitative Research: Grounded Theory Procedures and Techniques*. Newbury Park, CA: Sage Publications.

- Sugden, Robert. 1986. *The Economics of Rights, Co-operation, and Welfare*. Oxford: Blackwell.
- Taylor, Charles. 1985a. Atomism. In *Philosophy and the Human Sciences*, 187-210. Cambridge: Cambridge University Press.
- _____. 1985b. What's Wrong with Negative Liberty. In *Philosophy and the Human Sciences*, 211-29. Cambridge: Cambridge University Press.
- Thaler, Richard H., and Cass R. Sunstein. 2008. *Nudge: Improving Decisions about Health, Wealth, and Happiness*. New Haven: Yale University Press.
- Tomz, Michael. 2007. *Reputation and International Cooperation: Sovereign Debt across Three Centuries*. Princeton: Princeton University Press.
- Tullberg, Jan. 2004. On Indirect Reciprocity: The Distinction between Reciprocity and Altruism, and a Comment on Suicide Terrorism. *American Journal of Economics and Sociology* 63(5): 1193-212.
- Tyler, Tom R. 1990. *Why People Obey the Law*. New Haven, CN: Yale University Press.
- Udehn, L. 2002. The Changing Face of Methodological Individualism. *Annual Review of Sociology* 28: 479-507.
- Van Erp, Judith. 2008. Reputational Sanctions in Private and Public Regulation. *Erasmus Law Review* 1(5): 145-61.
- _____. 2011. Naming and Shaming in Regulatory Enforcement. In *Explaining Compliance: Business Responses to Regulation*, edited by C. Parker and V. L. Nielsen. Cheltenham: Edward Elgar.
- _____. 2013. Messy Business: Media Representations of Administrative Sanctions for Corporate Offenders. *Law & Policy* 35(1-2): 109-39.
- Van Lange, Paul A. M., Jaap W. Ouwerkerk, and Mirgam J. A. Tazelaar. 2002. How to Overcome the Detrimental Effects of Noise in Social Interaction: The Benefits of Generosity. *Journal of Personality and Social Psychology* 82(5): 768-80.
- Vincent-Jones, Peter. 2002. Values and Purpose in Government: Central-local Relations in Regulatory Perspective. *Journal of Law and Society* 29(1): 27-55.
- Waldron, Jeremy. 2008. Concept and the Rule of Law. *Georgia Law Review* 43: 1-62.
- Watanabe, Takamitsu, Masanori Takezawa, Yo Nakawake, Akira Kunimatsu, Hidenori Yamasue, Mitsuhiro Nakamura, Yasushi Miyashita, and Naoki Masuda. 2014. Two Distinct Neural Mechanisms Underlying Indirect Reciprocity. *Proceedings of the National Academy of Sciences of the United States of America* 111(11): 3990-5.

- Weber, Max. 1947. *The Theory of Social and Economic Organization*. Translated by A. M. Henderson and Talcott Parsons. New York: Oxford University Press.
- Wedekind, Claus, and Victoria A Braithwaite. 2002. The Long-Term Benefits of Human Generosity in Indirect Reciprocity. *Current Biology* 12(12): 1012-5.
- Wedekind, Claus, and Manfred Milinski. 2000. Cooperation through Image Scoring in Humans. *Science* 288: 850-2.
- Weisburd, David, and Lorraine Green. 1995. Policing Drug Hot Spots: The Jersey City Drug Market Analysis Experiment. *Justice Quarterly* 12(4): 711-35.
- Weisburd, David, Laura A. Wyckoff, Justin Ready, John E. Eck, Joshua C. Hinkle, and Frank Gajewski. 2006. Does Crime Just Move around the Corner? A Controlled Study of Spatial Displacement and Diffusion of Crime Control Benefits. *Criminology* 44(3): 549-91.
- White, Nigel D. 2014. *Advanced Introduction to International Conflict and Security Law*. Cheltenham, UK: Edward Elgar.
- Wispé, Lauren. 1987. History of the Concept of Empathy. In *Empathy and Its Development*, edited by Nancy Eisenberg and Janet Strayer, 17-37. Cambridge: Cambridge University Press.
- Wood, Charlotte, Mary Ivec, Jenny Job, and Valerie Braithwaite. 2010. Applications of Responsive Regulatory Theory in Australia and Overseas. *Regulatory Institutions Network Occasional Paper*.
- Wubben, Maarten J. J., David De Cremer, and Eric van Dijk. 2011. The Communication of Anger and Disappointment Helps to Establish Cooperation through Indirect Reciprocity. *Journal of Economic Psychology* 32(3): 489-501.
- Yack, Bernard. 1993. *The Problems of a Political Animal: Community, Justice, and Conflict in Aristotelian Political Thought*. Berkeley: University of California Press.
- Yamagishi, Toshio, and Karen S. Cook. 1993. Generalized Exchange and Social Dilemmas. *Social Psychology Quarterly* 56(4): 235-48.
- Yasuda, John Kojiro, and Christopher Ansell. 2015. Regulatory Capitalism and Its Discontents: Bilateral Interdependence and the Adaptability of Regulatory Styles. *Regulation & Governance* 9(2): 178-92.
- Young, Iris Marion. 1999. State, Civil Society, and Social Justice. In *Democracy's Value*, edited by Ian Shapiro and Casiano Hacker-Cordón, 141-62. Cambridge: Cambridge University Press.

- Zhang, Jun, and Jamie Peck. 2016. Variegated Capitalism, Chinese Style: Regional Models, Multi-scalar Constructions. *Regional Studies* 50(1): 52-78.
- Zhang, Lening, and Sheldon Zhang. 2004. Reintegrative Shaming and Predatory Delinquency. *Journal of Research in Crime and Delinquency* 41(4): 433-53.
- Zingales, Luigi. 2014. Preventing Economists' Capture. In *Preventing Regulatory Capture*, edited by Daniel P. Carpenter and David A. Moss, 124-51. Cambridge: Cambridge University Press.