

Transparency Policies: Two Possible Futures

By Archon Fung, Mary Graham, David Weil, and Elena Fagotto, Transparency Policy Project

Nutritional labeling, hospital safety rankings, restaurant hygiene grades, and workplace hazards disclosure provide a few examples of an important innovation in social policy that has often germinated in state and local experiments. Long a pillar of financial policy, transparency requirements have recently taken a legitimate place beside standard-setting and financial incentives as a means of promoting other public priorities – everything from improving the safety of restaurant food and workplaces to reducing deaths from cancer and heart disease.

However, the story of transparency as public policy is often one of missed opportunity. If some of the information that the public needs remains hidden or distorted due to politics or poor planning, legislative requirements that place standardized information about risks and public service flaws in the public domain can cause more harm than good.

We are drowning in information. Yet millions of dollars of savings are lost and hundreds of thousands of needless deaths, injuries or illnesses occur each year when needed, knowable facts remain hidden from public view because of transparency policies that don't work well. Without information

needed for informed choices, people check into hospitals with bad safety records, drink tap water that is contaminated, mishandle workplace chemicals they don't realize are dangerous, eat at restaurants with substandard hygiene standards in the kitchen, and travel to places where unreported and deadly infectious diseases threaten their health.

One problem is that political dynamics can produce gerrymandered transparency such as nutritional labeling with exceptions carved out for fast-food stores and restaurants or toxic pollution reporting with exceptions carved out for requirements that exempt neighborhood businesses that release some of the most dangerous toxins. In the United States, a nation that rightly prides itself on openness, the politics of secrecy often prevail even in laws designed to provide the public with information about serious health and safety risks.

Failed transparency can also result from poor planning or execution such as drinking water quality reports that fail to provide comparable measures or lack of enforcement that leaves the accuracy of toxic pollution reports in doubt.

When transparency fails, the consequences can be serious.

The Transparency Policy Project

Archon Fung, Mary Graham, and David Weil are co-authors of *Full Disclosure: The Perils and Promise of Transparency*. Archon Fung is associate professor of public policy at the Kennedy School of Government, Mary Graham is a Taubman Center research fellow, and David Weil is professor of finance and economics at Boston University's School of Management and a Taubman Center visiting fellow. Together they direct the Taubman Center's Transparency Project. Elena Fagotto is a Taubman Center senior research associate.

A. Alfred Taubman Center for State and Local Government

The Taubman Center and its affiliated institutes and programs are the Kennedy School of Government's focal point for activities that address urban policy, state and local governance, and intergovernmental relations.

Taubman Center Policy Briefs are short overviews of new and notable research on these issues by scholars affiliated with the Center.

© 2007 by the President and Fellows of Harvard College. The contents reflect the views of the authors (who are responsible for the facts and accuracy of the material herein) and do not represent the official views or policies of the Taubman Center for State and Local Government.

A. Alfred Taubman Center for State and Local Government
John F. Kennedy School of Government,
79 JFK St., Cambridge, MA 02138

Telephone: (617) 495-2199

Email: taubman@ksg.harvard.edu
www.ksg.harvard.edu/taubmancenter

Companies, school systems, health care providers, and other organizations spend millions of dollars compiling and disseminating information that is useless, out of date, or unintelligible. Failed transparency also undermines trust in public and private institutions. City dwellers who learn to disregard government alerts may fail to heed accurate warnings about the next terrorist attack. Patients who are uncertain about the risk of medical errors may wait too long to check in to the hospital. More needless losses result.

The story of transparency as public policy is often one of missed opportunity.

But another future is possible. Transparency policies could be dramatically improved by shining light on the politics of disclosure policies, by better understanding of how users make decisions, and by leveraging advances in information technology to improve our most important public information systems. Intermediaries could help too. Private and public groups could further improve the performance of transparency systems by assisting consumers, workers, and citizens. They could act as their agents where appropriate in interpreting the data provided. They could also push for improvements in the quality of information in political arenas. In time, growing public awareness of the promise and pitfalls of such policies could create new vigilance and political dynamics that favor robust transparency.

In today's complex world, transparency policies could become a powerful tool for informing choices that in turn lead to improvements in products and practices. But this requires policy makers, information users, and disclosing companies to choose a different

path for many established and future policies. Much depends on understanding the types of policy problems that legislated transparency can and cannot address and on understanding the design features that are critical for the success of such policies.

When can transparency be effective social policy?

Our research suggests that transparency policies work best when six characteristics mark the underlying problem that policy makers aim to address:

- **A bridgeable information gap contributes substantially to public risks or service failures.** Clarity about the nature of the information gap, its relationship to the problem to be addressed, and how to fill the gap helps to increase the chances that transparency policies will succeed. No amount of information could prevent an asteroid collision with the earth, at least at today's state of knowledge. But telling shoppers which muffins contain trans fats creates an opportunity to reduce deaths from heart disease and telling patients which hospitals feature large numbers of deaths and injuries from medical mistakes creates an opportunity to save lives.
- **The policy problem lends itself to measurement.** Transparency is unlikely to work if people disagree about how to measure improvement. Parents, teachers, government officials, and students do not yet agree about appropriate metrics of public school performance (test scores versus more complex measures, for example). Lack of consensus about metrics impairs the credibility of transparency.
- **Communication is practical.** Some problems are simply too complex or multi-faceted for public communication

of risks or performance problems to be practical. Toxic pollution reporting still lacks a simple metric that incorporates toxicity levels and exposure, important factors for assessing risk. By contrast, 5-star rollover ratings for new cars build in complex probabilities in a credible way.

- **Information users have the will, capacity, and cognitive tools to improve their choices.** Information that consumers or citizens do not value or misvalue is not a good candidate for transparency. Cities could publicize locations of pedestrian injuries in jaywalking accidents but lifelong jaywalkers would probably ignore the data. Governments' reports of infectious diseases or terrorist threats may produce over-reactions as individuals and organizations systematically exaggerate catastrophic risks.
- **Information disclosers can feasibly reduce risks or improve performance.** Transparency policies are unlikely to work when corporations or other disclosing organizations are unable to improve their practices. Car designers are often locked in to two to three year design cycles. Small businesses may lack the resources to reduce toxic pollution.
- **Variable results are acceptable.** Finally, transparency policies are appropriate only when it is acceptable to reduce risks or improve services for some people but not others. Congress might have required labeling of lead levels in gas, giving gas-station managers and drivers a purchase choice. Instead, legislators imposed a national ban on leaded gasoline because they concluded that leaving some communities subject to more lead exposure than others was unacceptable, since lead can cause serious neurological damage in children.

10 Principles for Crafting Effective Transparency Policies

Even in circumstances where transparency policies are feasible, policies must be carefully crafted with a clear understanding of the needs and limitations of their many audiences. Once launched, they also require enforcement and frequent tune-ups. We suggest here ten principles for the design of effective transparency policies.

1. **Provide information that is easy for citizens to use.** The most important condition for transparency effectiveness is that new information becomes embedded in the decision routines of information users. Therefore, once transparency is chosen as a promising way to address a policy problem, designers must start by understanding how diverse groups of customers, employees, voters, or other intended users make decisions. Designers can then tailor transparency systems to provide new facts at the time, in the place, and in the format that are most convenient for most people.
2. **Strengthen user groups.** Transparency systems are likely to be more sustainable when advocacy groups, analysts, entrepreneurial politicians, or other representatives of user interests have incentives to maintain and improve them. Institutional investors, stock exchanges, stock analysts, and other organizations have formal roles in maintaining the corporate integrity of the financial disclosure system, for example. Labor unions and other workplace-based organizations like health and safety committees have a role in interpreting and disseminating information on workplace risks. Transparency systems can also create watchdog roles for user groups. The Community Reinvestment Act, for example, provides incentives

for community groups to monitor and improve banks' mortgage lending disclosures.

3. Help disclosers understand users' changed choices. Transparency policies fail if companies are unable to discern customers' changed choices and the reasons for those changes from the noise. Advances in information technology are rapidly improving company executives' capacities to track customer, employer, investor, or voter responses. Requirements that chief executives certify the accuracy of reported data (included in Sarbanes-Oxley accounting reforms and toxic chemical reporting, for example) increase the likelihood that executives will track their impact.

The success of transparency depends on understanding the types of problems that can and cannot be successfully addressed through information disclosure.

4. Design for discloser benefits. When some disclosers perceive benefits from improved transparency, systems are more likely to prove sustainable. Policy makers should therefore seek to generate information that amplifies economic, political, and regulatory incentives in disclosers' environments. Companies and other disclosing organizations may seek to improve disclosure for competitive reasons (for example, to raise entry barriers for other firms), to ward off more stringent federal regulation, to avoid the headaches that come with variable state disclosure requirements, or to reduce reputational risks. Thus, food companies aimed to avoid a patchwork of state

actions and to gain profits from healthier products when they supported nutritional labeling requirements in 1990.

5. Design metrics for accuracy and comparability. Corporate accounting standards, restaurant hygiene grades, and nutritional labeling succeed in part because they feature metrics that are reasonably well matched to policy objectives and allow users to easily compare products or services. Policies for disclosure of workplace hazards and drinking water contaminants, by contrast, use confusing metrics that skew incentives for behavior change and fail to provide comparable results.

6. Design for comprehension. Policies are more effective if they match information content and formats to users' levels of attention and comprehension. If information users are likely to be rushed, simple distinctions, grades, stars, bar, or pie charts, or other relatively straightforward metrics – with back-up facts available – may work well. Web sites can provide quick answers while also allowing more interested users to delve further into the facts. Policy makers can draw on research insights concerning cognitive distortions to design transparency systems that build in probabilities, limit information search costs, and minimize the impact of other cognitive problems.

7. Incorporate analysis and feedback. Transparency systems can grow rigid with age, resulting in a tyranny of outdated benchmarks. Generously funded requirements for periodic analysis, feedback, and policy revision can help keep such systems supple and promote adaptation to changing circumstances. For example, in recommending a disclosure system for medical errors, the Institute of

Medicine also recommended a new and well-funded federal Center for Patient Safety to initiate and coordinate research and to continuously assess the disclosure system and adjust it accordingly.

8. **Impose sanctions.** Corporations and other organizations usually have many reasons to minimize or distort required disclosure. Organizations naturally resist revealing information about public risks they create or flaws in services they provide, or seek to place that information in the most favorable light. Information can be costly to produce and even more costly in reputational damage. As a result, substantial fines or other penalties for non-reporting and misreporting are an essential element of successful systems.
9. **Strengthen enforcement.** Sanctions are not enough, however. Legal penalties must be accompanied by rigorous enforcement to raise the costs of not disclosing or disclosing inaccurately. The fact that there is thus far no systematic mechanism for auditing toxic pollution data provided by companies means that no one knows for sure how accurate or complete that data is. Some systems include provisions for institutional watchdogs. The confessed crimes of lobbyist Jack Abramoff in 2006 led to proposals in Congress for the creation of an audit board for campaign finance disclosures, for example. And some create watchdogs to watch the watchdogs. Recent accounting reforms created a public oversight board to monitor the practices of accounting firms.
10. **Leverage other regulatory systems.** When transparency by itself is insufficient to generate effective outcomes, transparency can be designed to work in tandem with other government policies. Los Angeles County's restaurant hygiene

grading would not work without a health inspection system that provides the basis for letter grades. Mortgage lending reporting generates information that allows community organizations to identify discrimination practices by local banks, while the Community Reinvestment Act powerfully embeds that information into the strategies of users and disclosers. As noted above, this suggests that transparency should be considered a complement and not a replacement for other forms of public intervention.

Even though transparency policies use the power of private choices to achieve public objectives, they still require vigorous enforcement and real sanctions to be effective.

The Road Ahead

The future of public transparency remains uncertain. Political controversies about specific transparency policies fill the news. Some recent developments suggest that a constructive learning process is underway. But resistance to change in other critical systems suggests continuing failure.

Spirited debate continues over how to improve corporate financial disclosure in the wake of accounting scandals, including battles over the reporting of stock options, special entities, and executive pay, and their impact. The European Union has required its 25 member nations to adopt a single set of corporate financial reporting standards even as doubts persist about whether those nations have the capacity to implement the edict.

Food labeling issues remain contentious. Democrats in the U.S. Congress led a long

and ultimately successful fight to clarify labeling of allergens like peanuts and shellfish on packaged foods after reports of several consumer deaths. A 20-year struggle to include harmful trans fats on nutritional labels ended with a new disclosure rule effective in 2007.

In 2005, federal regulators concluded an acrimonious debate about how to more accurately report auto fuel economy with a new system that was expected to reduce previous ratings by as much as 20 percent.

On the other side of the ledger, a hard-to-understand color-coded terrorist threat warning system is generally ignored by the American public.

Even as national concern grew about the public health risks from obesity, Congress has buried proposals to require fast-food stores and restaurants to report on calories and nutrients.

In 2006, the Bush administration proposed back-tracking on toxic chemical disclosure by reducing the scope and frequency of reporting for some firms.

Inadequate and late reporting contributed to more than 700 deaths from the SARS epidemic and pointed to the failure of the international infectious disease surveillance system.

The system of chemical hazard reporting in the workplace continues to provide highly detailed, technical, and therefore largely incomprehensible data about health risks to the millions of workers the system is designed to protect.

As a nation, we continue to test the proposition that government can legislate transparency to reduce risks and improve public services. Effective transparency is far from assured in our public policies and institutions.

Transparency systems always begin as imperfect compromises and must improve to keep pace with changing markets, advancing science and technology, and new political priorities.

At their best, public transparency represents a promising form of information-age governance. However, the benefits of transparency are not automatic. Transparency is likely to work best when it is part of a disciplined process that sets priorities, assesses probable impacts of alternative or complementary government measures, and minimizes unintended consequences by generating feedback, analysis, and system improvement over time.

Transparency systems always begin as imperfect compromises and must be adapted to keep pace with changing markets, technology, and political priorities.

Whether the broad innovation of legislated transparency increases trust in public and private institutions or erodes that trust will depend on both greater understanding of how transparency really works and the political will to translate that understanding into action.

RELATED PUBLICATIONS

“Full Disclosure: The Promise and Perils of Transparency,”

By Archon Fung, Mary Graham, and David Weil, (Cambridge, UK: Cambridge University Press, 2007)