Is Transparency the Best Disinfectant?*

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"Sunlight is . . . the best of disinfectants."

– Supreme Court Justice Louis Brandeis

TRANSPARENCY is a highly regarded value, a precept used for ideological purposes, and a subject of academic study. The following critical analysis attempts to show that transparency is overvalued. Moreover, its ideological usages cannot be justified, because a social science analysis shows that transparency *cannot* fulfill the functions its advocates assign to it, although it can play a limited role in their service. We shall see that in assessing transparency, one must take into account a continuum composed of the order of disutility and the level of information costs. The higher the score on both variables, the less useful transparency is. Moreover, these scores need not be particularly high to greatly limit the extent to which the public can rely on transparency for most purposes.

I. TRANSPARENCY, WEAK AND STRONG, AND OTHER GOODS

Transparency is generally defined as the principle of enabling the public to gain information about the operations and structures of a given entity.[1] Transparency is often considered synonymous with openness and disclosure, although one can find some subtle differences among these terms.[2]

In public discourse, transparency is widely considered a "good" on the face of it, similar to privacy and free speech. Transparency is viewed as a self-evident good in Western society to the point that "we might almost say that 'more-transparent-than-thou' has become the secular equivalent of 'holier-than-thou' in modern debates over matters of organization and governance."[3] Transparency International, an organization that promotes transparency in many nations, both developing and industrialized, was founded in 1993 and has won much acclaim.

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[1]David Heald, "Varieties of transparency," *Transparency: The Key to Better Governance?* ed. Christopher Hood and David Heald (Oxford: Oxford University Press, 2006), pp. 23–45 at p. 26; Bernard I. Finel and Kristin M. Lord, "The surprising logic of transparency," *International Studies Quarterly*, 43 (1999), 315–39 at p. 316.

[2]"Openness might therefore be thought of as a characteristic of the organization, where transparency also requires external receptors capable of processing information made available" (Heald, "Varieties of transparency," p. 26).

[3]Christopher Hood, "Transparency in historical perspective," *Transparency: The Key to Better Governance?*, pp. 3–23 at p. 9.

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Several progressive groups in many democratic countries have been promoting the introduction of "sunshine" into legislation.[4] Reports indicate that transparency has been gaining ground "not only in state decision-making bodies but also in states' central banks, the international regimes to which they belong, and even in private companies within their borders."[5] Professor of Government Christopher Hood further documented this trend in a book entitled *Transparency: The Key to Better Governance*.[6] Transparency has gained additional popularity in recent years, since the lack of transparency in financial instruments has been deemed one of the major factors in causing the 2008–2009 near-global economic crisis. Also, President Obama made increasing transparency one of the major themes of his 2008 election campaign. Since his election, there has been a great deal of discussion about the need for more regulation, especially of the financial markets, but so far little new regulation has been enacted, and various draft bills have encountered a great deal of opposition. In contrast, several transparency measures have been introduced. For instance, the website *Data.gov*, which was launched in May 2009, makes public statistical information collected by over 50 federal agencies. And Obama introduced "sunlight before signing" which entails posting new legislation on the web for five days before the president signs the bills into law to allow for public comments.

In addition, transparency has an ideological application. This application makes a much stronger claim than the position that transparency is merely one feature of good government; ideological advocates of transparency maintain that it can obviate the need for most—if not all—government controls. That is, transparency becomes a tool to fight off the regulations opposed by various business groups[7] and politicians from conservative parties.[8]

The editorial page of the *Wall Street Journal*, which is openly ideological, runs articles with titles such as "Transparency is More Powerful than Regulations"[9] and lines like "transparency is better than draconian regulation."[10] The importance of the latter article is not where it was published, but who wrote it: Professor Cass Sunstein, a highly regarded scholar who has been appointed by President Obama as the head of the White House Office of Information and Regulatory Affairs (which is in charge of regulations), and Richard Thaler, one of the most respected and influential economists in the United States.

[4]Transparency International, the National Democratic Institute, and Openthegovernment.org are examples of organizations promoting more transparency in government.

[5]Finel and Lord, "The surprising logic of transparency," p. 315.

[6]Hood, "Transparency in historical perspective," p. 15.

[7]Steven Thomma and Kevin G. Hall McClatchy, "President Rolls Out Financial Regulation Proposal," *The Spokesman-Review*, June 18, 2009.

[8]Gene Healy, "Obama's statist ambitions," *DC Examiner*, June 30, 2009; Mark A. Calabria, "Cato scholar comments on the Obama Administration's financial regulation reforms," <http://www.cato.org/pressroom.php?display=ncomments&id=242>, posted June 17, 2009.

[9]L. Gordon Crovitz, "Transparency is more powerful than regulation," *Wall Street Journal*, March 30, 2009.

[10]Richard H. Thaler and Cass R. Sunstein, "Disclosure is the best kind of credit regulation," *Wall Street Journal*, August 13, 2008.

Others advance the argument that "better transparency is the surest way to make markets more efficient and less volatile. Market wisdom results when more people access better information."[11] Some argue that disclosure will allow consumers to become "citizen-regulators" and do the job better than the government.[12]

The following analysis deals mainly with this kind of transparency—its strong form—rather than with its weak, supplementary form. What is at issue is whether transparency can be the mainstay of delivering the sought-after goods, rather than whether it can make a contribution to their promotion. To put it differently, *the critical question is whether transparency constitutes a reliable mechanism of promoting good governance and sound markets under most circumstances—or whether it is a rather weak means that itself relies on other forms of guidance and can supplement regulation but not serve a main form of guidance*.[13] I find that even the soft version—as just an element of regulation—cannot carry much weight.

I need to make two comments in order to properly focus the following discussion. The transparency I deal with here is public and not social. Communitarianism has long established that informal social controls can be very powerful. People have a profound need for approval from others, especially people to whom they are related by bonds of affection—often members of their family, social group, or community.[14] For such controls to work, these others must know how an ego is behaving. When people conceal their addictions or abuses from others, social control is often held in abeyance, while disclosure activates it. The mechanisms at work in this situation are radically different from the kind of strong transparency studied in this article; social controls are informal and voluntary. The focus here is on transparency mandated by the government, including annual audited statements by corporations and voluntary associations; campaign contribution disclosure; nutrition and ingredient labels for food; warning labels on hazardous materials; disclosure of terms of contracts and privacy policies; and numerous other transparency mechanisms. This kind of transparency is held to provide a substitution for government regulations, not for informal social controls.

Second, even advocates of strong transparency do not claim that it is an absolute value. Clearly there are situations in which transparency must be squared with other values, including security, private property (e.g. trade secrets

[11]L. Gordon Crovitz, "Transparency is more powerful than regulation," *Wall Street Journal*, March 30, 2009.

[12]Daniel Roth, "Road map for financial recovery: radical transparency now!" *WIRED Magazine*, 17, February 23, 2009.

[13]I use the term guidance rather than control because it captures the observation that as a rule regulations merely point to preferred choices and are rarely fully coercive in their adaptation. For more discussion see Amitai Etzioni, *The Active Society* (New York: Free Press, 1968).

[14]Dennis Wrong, *The Problem of Order: What Unites and Divides Society* (Cambridge, MA: Harvard University Press, 1995).

and copyright protections), and privacy.[15] The best example of the limits of transparency is the rationale for a secret ballot. However, when one is concerned with economic activities, laissez-faire conservatives, libertarians, some kinds of liberals, and many others hold that (a) the market can regulate itself and (b) if it does need regulation, transparency can provide it.

II. THE THEORY OF TRANSPARENCY

Both popular and academic texts lay out the ways in which transparency is expected to function. Although they are well known, I review these here to lay out the elements and mechanisms on which transparency is believed to rely—which, we shall see, in effect are not available.

A. In the Economic Realm

According to the popular—and hence very well-known—version of transparency, consumers control the direction of the economy by using their purchasing power to "vote" on which businesses will succeed and which will fail.[16] For this consumer "sovereignty" to work, consumers must be able to know the attributes of the goods they are about to purchase. This explains the introduction of labels that disclose the attributes of various food items, such as their caloric value, types and levels of vitamins and so on, as well as labels on cigarette boxes and posters in liquor stores. The transparency theory presumes that such disclosure will enable consumers to make informed choices, reward the businesses that provide the preferred products, and discourage—even put out of business—those that disregard the informed consumers' preferences.[17]

Furthermore, transparency has a strong normative underpinning. As Chapman University law professor Susanna Kim Ripken notes, "Respect for individual autonomy, responsibility, and decision-making is deeply entrenched in our culture and law. We believe that people can order their own economic affairs and, given sufficient information, can make their own personal assessments of the risks and benefits of transactions."[18]

[15]Patrick Birkinshaw, "Transparency as a human right," *Transparency: The Key to Better Governance?* pp. 47–57 at p. 50; Finel and Lord, "The surprising logic of transparency," p. 320; Mark Landler, "Experts say full disclosure may not always be best tactic in diplomacy," *New York Times*, June 17, 2009; Kristin M. Lord, *The Perils and Promise of Global Transparency* (Albany: State University of New York Press, 2006); Warren Bennis, "The new transparency," *Transparency* (San Francisco: Jossey-Bass, 2008), pp. 93–122 at p. 11. For further discussion see also: Albert Breton, Gianluigi Galeotti, Pierre Salmon, and Ronald Wintrobe, *The Economics of Transparency in Politics* (Burlington, VT: Ashgate, 2007), p. 1.

[16]M. Joseph Sirgy and Chenting Su, "The ethics of consumer sovereignty in an age of high tech," *Journal of Business Ethics*, 28 (2002), 1–14 at p. 2.

[17]Ibid., p. 1.

[18]Susanna Kim Ripken, "The dangers and drawbacks of the disclosure antidote: toward a more substantive approach to securities regulation," *Baylor Law Review*, 58 (2006), 139–204 at p. 195. See also: Jerry Brito and Jerry Ellig, "An accountability agenda," *Regulation*, 31 (2008), 4–7 at p. 5.

In addition, she says, "Disclosure promotes fairness and empowers the investor with information to make smart investment choices."[19]

B. In the Public Realm

The same basic argument is a very familiar part of the popular theory of democracy. "Greater openness and wider information-sharing enable the public to make informed political decisions . . ." write World Bank economist Tara Vishwanath and the Brookings Institute's Daniel Kaufmann.[20] Specifically, according to political philosopher Onora O'Neill, transparency "is supposed to discipline institutions and their office-holders by making information about their performance more public. Publicity is taken to deter corruption and poor performance, and to secure a basis for ensuring better and more trustworthy performance."[21] In short, ". . . the more strictly we are watched, the better we behave," as Jeremy Bentham put it.[22]

In the 1970s, the U.S. legislature introduced new requirements that mandated the disclosure of campaign contributions. The Federal Election Commission (FEC) was founded in 1975. The FEC requires that campaign contributions over $200 to those running for federal office be reported in a timely manner. The McCain-Feingold Act of 2002 requires public disclosure of large donations to political campaigns and was upheld by the Supreme Court in 2003 on the grounds that disclosure of funding is vital for the American citizen to effectively assert his or her right to choose representatives.[23]

Transparency of medical organizations is critical for improving healthcare, according to Sen. Ron Wyden (D-OR).[24] In 1975, *U.S. World and News Report* began issuing rankings on mortality in various hospitals to allow consumers to select those that perform better and to deny patients to poor performers, assuming that such disclosure would either force them to improve their service or close down.[25] The same argument was made in reference to disclosing data about the relative performance of various public schools.[26]

[19]Ripken, "The dangers and drawbacks of the disclosure antidote," pp. 153–4.

[20]Tara Vishwanath and Daniel Kaufmann, "Toward transparency: new approaches and their application to financial markets," *The World Bank Research Observer*, 16 (2001), 41–57 at p. 41.

[21]Onora O'Neill, "Transparency and the ethics of communication," *Transparency: The Key to Better Governance?* pp. 75–90 at p. 13.

[22]Jeremy Bentham, "Farming defended," *Writings on the Poor Laws*, vol. 1, ed. Michael Quinn (Oxford: Oxford University Press, 2001), pp. 276–90 at p. 277.

[23]*McConnell v. Federal Election Commission* (02-1674), 540 U.S. 93 (2003).

[24]Ron Wyden, "Transparency: a prescription against malpractice," *Public Health Reports*, 110 (1995), 380–1; Clay Christiensen, "What Obama's health care team can learn from Massachusetts," *Harvard Business Review*, January 22, 2009.

[25]Michael B. Rothberg, Elizabeth Morsi, Evan M. Benjamin, Penelope S. Pekow and Peter K. Lindenauer, "Choosing the best hospital: the limitations of public quality reporting," *Health Affairs*, 27 (2008), 1680–7.

[26]Jay Mathews, "FAQ: best high schools," *Newsweek*, May 17, 2008, <http://www.newsweek.com/id/137415/page/1>; Andrew J. Rotherman, "In politics of school reform, transparency doesn't

C. In Academic Discussions

There are a fair number of academic treatments of transparency that parallel, and hence at least indirectly support, the popular theory of transparency. These works are, as a rule, much more qualified and nuanced than the ideological texts, although some works, such as those by Milton Friedman, have a considerable ideological content. For instance, academic works by economists provide a major modification to the theory of transparency with the introduction of transaction costs—including the cost of collecting and processing information. This element allows one to recognize that consumers and voters may not find it efficient to absorb and process all the disclosed information. That is, that sub-optimal processing of revealed information may actually serve to make optimal choices. (This applies to all the cases in which the costs of additional collecting and processing of information, of additional "search," exceed the expected gains.)

Another major addition to the popular theory of transparency is the thesis that the public can utilize intermediaries, experts, technologies, heuristics, and choice architecture to help process the information.[27] As Jason Zweig points out, a 47-page mortgage can lull people into a false sense of security, as they mistakenly believe that more details means more honesty. However, as he sees it, if the industry were required to offer a standard mortgage with easy-to-understand terms, consumers might receive less direct information but would gain information they would be able to digest and use.[28]

These two brief examples may suffice to illustrate my point that even when some of the academic work on transparency might be said to support the strong transparency thesis, it does so in a much more qualified way than as seen in transparency's ideological usages.[29]

III. EMPIRICAL STUDIES OF TRANSPARENCY

Given the high value put on transparency, its ideological currency, and scholarly interest, it is surprising to find that there are few empirical studies of the effects of transparency, especially of the strong kind under discussion here. Moreover, there seem to be no comparative studies of the use of transparency versus other means of regulation, to determine which is more effective. I am hardly the first or

equal accountability," *U.S. News and World Report*, May 14, 2009, <http://www.usnews.com/articles/opinion/2009/05/14/in-politics-of-school-reform-transparency-doesnt-equal-accountability.html>.

[27]Richard H. Thaler and Cass R. Sunstein, *Nudge* (New Haven, CT: Yale University Press, 2008).

[28]Jason Zweig, "About time: regulation based on human nature," *The Wall Street Journal*, June 20–21, 2009.

[29]For examples of limited transparency theory, see: "Disclosure as a legislative device," *Harvard Law Review*, 76 (1963), 1273–93 at pp. 1277–8; Jon Faust and Lars E. O. Svensson, "Transparency and credibility: monetary policy with unobservable goals," *International Economic Review*, 42 (2001), 369–97; Andrea Prat, "The wrong kind of transparency," *American Economic Review*, 95 (2005), 862–77 at p. 869; Robert Bloomfield and Mareen O'Hara, "Market transparency: who wins and who loses?" *Review of Financial Studies*, 12 (1999), 5–35.

only one who notes this fact. There continues to be a dearth of studies empirically testing the theoretical claims of transparency advocates, even as legislation and institutional support for their case accumulates exponentially.[30]

Some of the handful of available findings deal with communitarian and not public transparency, namely of the kind used by communities for their members that is voluntary in nature rather than imposed by the government. One case in point is the study of "open book" management. With "open book" management, financial information is shared with everyone in a company. Moreover, the management also lays out the meaning of the financial information and points to ways the employees can contribute to the company's success. A 2005 survey found that 40 percent of the firms among "the five hundred fastest-growing private companies employed the practice in some fashion—far more than in the business community as a whole."[31] However, this study deals with the internal process of a company, not with the public at large.

The following are typical findings of the few studies that deal with public transparency. A study of nutrition labels[32] examined changes in nutrition labeling in grocery stores in New England from 1986 to 1989. It found that such labels affected consumer purchases; however, the effect was small. For instance, the share of household income devoted to milk labeled "healthy" over unlabeled milk rose slightly in the first year. Moreover, this effect was found only "in those food categories where differences in other quality characteristics (e.g. taste) are relatively small between more and less 'healthy' products."[33] That is, consumers were only likely to switch to healthier food if the healthy and unhealthy products had similar tastes.

Other studies find that the introduction of warning labels enhances awareness of risk, but to a rather limited extent. In the first year after the introduction of alcohol warning labels in 1989, there was a slight increase in the public's perception of the risk associated with consuming alcoholic beverages. About 54 percent of the sample described alcoholic beverages as "very harmful" in 1990, compared to 50 percent of the same a year earlier. The increase was somewhat

[30]Martin N. Marshall, Paul G. Shekelle, Sheila Leatherman, and Robert H. Brook, "The public release of performance data," *Journal of the American Medical Association*, 283 (2000), 1866–74 at p. 1866.

[31]Bennis, "The new transparency," pp. 108–9.

[32]For example: Scott B. Keller, Mike Landry, Jeanne Olson, Anne M. Velliquette, Scot Burton and J. Craig Andrews, "The effects of nutrition package claims, nutrition facts panels, and motivation to process nutrition information on consumer product evaluations," *Journal of Public Policy & Marketing*, 16 (1997), 256–69; Scot Burton, Abhijit Biswas and Richard Netemeyer, "Effects of alternative nutrition label formats and nutrition reference information on consumer perceptions, comprehension, and product evaluations," *Journal of Public Policy & Marketing*, 13 (1994), 36–47; John C. Kozup, Elizabeth H. Creyer and Scot Burton, "Making healthful food choices: the influence of health claims and nutrition information on consumers' evaluations of packaged food products and restaurant menu items," *Journal of Marketing*, 67 (2003), 19–34.

[33]Mario F. Teisl and Alan S. Levy, "Does nutrition labeling lead to healthier eating," *Journal of Food Distribution Research*, 28 (1997), 19–26.

larger among "heavy" drinkers.[34] Note that this study deals with awareness and not with changes in behavior.

A study of disclosure statements in television ads in 2002 found that such disclaimers provide little clarification for consumers. The study of 258 undergraduate students over a six-week period tested disclaimers in multiple ways. At times the students were explicitly told to pay attention to the disclosure statements, which were then shown multiple times, yet the failure rate for recall remained high.[35] Another scholar concluded with regards to political financial disclosures, "There is no empirical evidence that this has resulted in a more aware electorate."[36]

The quality of 382 commercial HMOs was observed between 1997 and 2000. The study found that the quality significantly improved among those HMOs that publicly disclosed quality information, "suggesting that public release of quality information can serve as a mechanism to improve quality in healthcare."[37] However, there are very few such studies, and there is no evidence that these improvements do not wash out over time.

In short, there are few empirical studies of transparency to begin with, and several of those that are available deal with communitarian rather than government-imposed transparency or with situations in which the information is easy to collect and process and the change in behavior required to benefit is not taxing.

Most importantly, none of these studies indicate that the effects of transparency are significant enough to obviate the need for regulation, especially in those cases in which the harm done by a given activity or product is considerable (relatively high disutility) and the information is relatively complex (that is, the cost of processing the disclosed information is high for the user). Given the paucity of empirical studies, I turn next to suggest that strong transparency *cannot* work.

IV. A CRITICAL EXAMINATION OF TRANSPARENCY

A. Strong Transparency is a Form of Regulation

The transparency often discussed as an alternative to regulation is, in effect, a form of regulation because it is required by the government. For instance,

[34] Michael B. Mazis, Louis A. Morris, and John L. Swasy, "Evaluation of the alcohol warning label: initial survey results," *Journal of Public Policy and Marketing*, 10 (1991), 229–41 at pp. 239–40.

[35] Fred W. Morgan and Jeffery J. Stoltman, "Television advertising disclosures: an empirical assessment," *Journal of Business and Psychology*, 16 (2002), 515–35 at p. 535.

[36] Jeffrey Kraus, "Campaign finance reform reconsidered: New York's public finance program after fifteen years," *The Forum*, 3 (2006), 20 (article 6). See also: Nathaniel Persily and Kelli Lammi, "Perceptions of corruption and campaign finance: when public opinion determines constitutional law," *University of Pennsylvania Law Review*, 153 (2004), 119–80 at pp. 119–20.

[37] Kyoungrae Jung, "The impact of information disclosure on quality of care in HMO markets," presented at iHEA 2007 6th World Congress: Explorations in Health Economics, abstract available at <http://ssrn.com/abstract=992234>.

corporations are required by law to issue annual statements about their financial activities to the Securities and Exchange Commission. Most food manufacturers are required by the Federal Food, Drug, and Cosmetic Act to place nutrition labels on their products, and so on. Politicians who are running for federal offices are required by law to post campaign contributions with the FEC. That is, transparency is coercive, a label sometimes affixed by opponents to regulation, but which also applies to transparency.[38]

Additional regulation is required if the information released in order to meet the transparency requirements is to be *understandable* to consumers and voters. Unless the government requires disclosure in forms that the public finds digestible, the information is often released in ways that provide little *de facto* transparency.[39] This is an issue with the small, legalistic, and opaque text on the back of airline tickets and when people take out mortgages, credit cards, and auto loans in the United States.[40]

Still more regulation is required to ensure the *veracity* of the released information. The U.S. Securities and Exchange Commission requires public companies to disclose their financial and operating information as defined by federal statutes, including net sales or operating revenues, income or losses from continuing operations, total assets, long-term obligations and redeemable preferred stock, every six months in the form of a portfolio snapshot at a particular point in time. This snapshot "can easily be manipulated by readjusting the composition just before and after the snapshot is taken—a well-documented practice known as *window dressing*."[41]

Another example of manipulative disclosure concerns hospital mortality rates: "The reduction in standardized mortality ratio . . . observed [after the implementation of disclosure of mortality rates] most likely reflects the changes in palliative care: fewer patients were admitted to die in hospital and more patients were discharged to die elsewhere."[42]

Political Action Committees (PACs), composed by special interest groups, regularly adopt names that very effectively conceal whom they are promoting. For instance, try to guess to which political party the following PACs are linked: "All America," "America's Foundation," "American Dream," "America Works," and "American Leadership Council." (Answers: D, R, R, D, R.) The same holds for lobbies that represent various special interests.

[38]William Walker, "Some reflections on transparency in the contemporary security environment," *Disarmament Forum*, 2 (2003), 55–9 at p. 56.

[39]Communication Research Institute, "Card Statements Blind Consumers to Debt Traps," <http://communication.org.au/modules/cri_news/item.php?itemid=16>.

[40]Sara Hansard, "Insurers, banks criticize Obama's proposed consumer watchdog agency," *Investment News*, June 24, 2009.

[41]Prat, "The wrong kind of transparency," p. 93. See also: Heald, "Transparency as an instrumental value," p. 62; Lord, *The Perils and Promise of Global Transparency*, p. 5; Bennis, "The new transparency," pp. 112–3.

[42]Kaveh G. Shojania and Alan J. Forster, "Hospital mortality: when failure is not a good measure," *Canadian Medical Association Journal*, 179 (2008), 153–7 at p. 155.

Finally, like other regulations, the requirements to be transparent must be *enforced* by government. Thus, one reason transparency regarding campaign contributions does not disclose much is that when disclosure laws are violated, the matter goes before the deadlocked, minimally staffed, and poorly funded Federal Election Commission. If the commission does manage to find a grossly misleading disclosure, it is often months too late, well after the election is over. Regulators failed to impose penalties on almost 500,000 violations by companies that dumped hazardous chemicals in places from which people draw their drinking water, in violation of the Clean Water Act.[43]

In short, to a significant extent, transparency is merely a form of regulation by other means. These observations are ignored by those who oppose regulation and argue that transparency obviates the need for regulation.

A less dichotomous proposition is more defensible. Regulations come in different shades and forms. For instance, some regulations are more coercive than others: compare those that impose minor fines (like the $20 fine on text messaging while driving in Virginia) to those that require jailing offenders. Also, some regulations outright ban certain products or activities, while others merely require that safety measures be added to dangerous products but do not ban them outright (e.g. seat belts, motorcycle helmets, and, in some jurisdictions, child locks on guns). In this context, transparency stands out as a relatively light form of regulation, in the sense that meeting its requirements is much less restrictive of producer and consumer choice than other forms of regulations. However, for it to work, consumers and voters must be able to process the released information.

B. The Limits of Knowing

Transparency, unlike other forms of regulation, has a major disadvantage: it assumes that those who receive the information released by producers or public officials can properly process it and that their conclusions will lead them to reasonable action.[44] However, the well-known and often-cited findings of behavioral economics demonstrate that very often the public is unable to properly process even rather simple information because of “wired in,” congenital, systematic cognitive biases.[45]

[43]Charles Duhigg, “Clean water laws neglected, at a cost,” *New York Times*, September 13, 2009.

[44]Florini, *The Right to Know*, p. 4.

[45]D. Kahneman, J. Knetsch and R. Thaler, “Anomalies: the endowment effect, loss aversion, and status quo bias,” *Journal of Economic Perspectives*, 5 (1991), 193–206; J. Edward Russo and Paul J. H. Shoemaker, *Decision Traps* (New York: Simon and Schuster, 1989); Arthur Lefford, “The influence of emotional subject matter on logical reasoning,” *Journal of General Psychology*, 34 (1946), 127–51; Amos Tversky and Daniel Kahneman, “Judgment under uncertainty: heuristics and biases,” *Science*, 185 (1974), 1124–31; Marco Cipriani and Antonio Guarino, “Herd behavior and contagion in financial markets,” *The B.E. Journal of Theoretical Economics*, 8 (2008); Robert H. Frank, Thomas Gilovich, and Dennis T. Regan, “Does studying economics inhibit cooperation?” *Journal of Economic Perspectives*, 7 (1993), 159–71.

Counterarguments do not seem to hold. The argument that these findings apply only to experimental conditions does not take into account that the same limitations have also been demonstrated in field studies.[46] The suggestion that it is rational for people to stop processing information when the cost of additional processing exceeds the benefit assumes that people can correctly assess the cost of information they have not yet collected, but there is next to no evidence that this is the case.[47]

None of this is to suggest that providing transparency where it is lacking has none of the desired effects, but merely that often it cannot *by itself* suffice to serve the goals set for it, even when consumers and voters must deal with only modestly complex information. And it cannot carry much of the needed public protection under any circumstances. That is, even the merits of the soft position are greatly limited.

In today's "disclosure regime," "disclosure documents . . . are written by corporate lawyers in formalized language to protect the corporation from liability rather than to provide the investor with meaningful information,"[48] notes Susanna Kim Ripken. "The complexity and detail in disclosure documents can make them almost incomprehensible at times . . . Disclosure cannot fulfill its communicative purpose if investors find it impenetrable and therefore ignore it."[49] Aware that "transparency mandates *disclosure* or *dissemination*, but does not require effective communication with any audience,"[50] these advocates state that "to be effective, information should be fair, reliable, timely, complete, consistent, and presented in clear and simple terms."[51] However, such disclosure is rare, and itself requires additional regulation and enforcement. Moreover, if the released information is to serve the goals set for it, there are often limits on the extent to which it can be simplified, as it tends to contain rather complex assumptions, probabilities, and multiple correlations. Hence, we should not be surprised that it is far from demonstrated that information that is reasonably comprehensive can still be digested by most people, even those trained in statistics.[52] Indeed, behavioral economics and other studies consistently show that often people cannot process even relatively simple information.[53]

[46]Brigitte Madrian and Dennis Shea, "The power of suggestion: inertia in 401(k) participation and savings behavior," *Quarterly Journal of Economics*, 116 (2002), 1149–225; Kahneman et al., "Anomalies"; Uri Gneezy and Also Rustchini, "Incentives, punishment, and behavior," *Advances in Behavioral Economics*, ed. C. F. Camerer, G. Lowenstein, and M. Rabin (Princeton, NJ: Princeton University Press, 2004), pp. 573–89.

[47]Gordon Malkiel Burton, *A Random Walk Down Wall Street: Including a Life Cycle Guide to Personal Investing*, 7th edn (New York: Norton, 1999).

[48]Ripken, "The dangers and drawbacks of the disclosure antidote," p. 186.

[49]Ibid., p. 185.

[50]Onora O'Neal, "Transparency and the ethics of communication," p. 81.

[51]Vishwanath and Kaufmann, "Toward transparency: new approaches and their application to financial markets," p. 43. See also: Onora O'Neill, "Transparency and the Ethics of Communication," pp. 88–9; Virginia A. Sharpe, "Science, bioethics, and the public interest: on the need for transparency," *Hastings Center Report*, 32 (2002), 23–6 at p. 24.

[52]Ripken, "The dangers and drawbacks of the disclosure antidote," p. 163.

[53]See footnote 45.

In response to those who claim that not all investors are "smart," the Efficient Capital Market Hypothesis defends transparency on the grounds that "the biases, errors in judgments, and decision-making shortcomings of uninformed investors are random and will cancel each other out in the market. Even if people are subject to errors and inconsistencies in decision-making, these fallibilities will be exploited and weeded out of the market by the more sophisticated, rational agents."[54] However, this theoretical hypothesis is not supported by evidence. Consumers were not protected by "more sophisticated agents" when they were sold sub-prime mortgages they could not possibly pay for, and millions lost their homes; people who rely on brokers or financial advisers for investment advice are doing worse than those who invest in passive investment instruments such as index funds; consumers are not protected by private intermediaries from those who market foods contaminated with E. coli, melamine, or salmonella. Nor, as the record of the last years reminds us, is the whole economic system protected from major crises by such agents. True, other factors are involved, such as irresponsible acts by consumers who were seeking speculative gains in real estate, individuals who consumed more than they earned by using credit cards and so on, tendencies in turn fanned by changes in the culture and by marketing. However, people were not educated about, encouraged to deal with, or protected from these failings by "sophisticated agents."

In short, studies of processing information strongly favor adding stronger forms of regulation than those that merely require transparency even if requirements to communicate are added.

V. INTERMEDIARIES: EVALUATION AND TRUST

A. Reliance on Intermediaries

Advocates of transparency respond to the findings of behavioral economics by suggesting that people need not process the information because they can rely on experts or leaders—the "smart" members of the masses.[55] For instance, people do not need to test appliances; they can rely on reports such as those issued by the Consumer Union or on the Good Housekeeping Seal of Approval. Instead of reading long legalistic statements about a corporation's privacy policy on its website, they can rely on the green TRUSTe icon. However, issues we face in dealing with the absorbability and veracity of what might be called first-order information we also face when dealing with intermediaries, that is, with second-order, processed (rather than directly accessed) information.

[54] Ripken, "The dangers and drawbacks of the disclosure antidote," p. 178.

[55] Helen Margetts, "Transparency and digital government," *Transparency: The Key to Better Governance?* 197–207 at p. 201; Richard H. Thaler, "Mortgages made simple," *New York Times*, July 5, 2009.

The public does not have the cognitive capacities to determine which intermediary provides information that is better processed than another. Reference here is not to deliberate manipulation, but to differences in the quality of the information processing due to differences in access to primary information, resources available to the analysts, their skills and training, and the assumptions they make. A case in point is the ranking of colleges provided by various publications such as the *US News and World Report*, the *USA TODAY*, and the *Princeton Review*, whose lists differ from one another and whose rankings have been subject to considerable controversy.[56] There is no evidence that consumers can evaluate the relative reliability of these rankings any better than they can process the raw information on which these ratings draw.

Hospital rankings have been issued by *US News and World Report* and *Healthinsight.org*, among others, based on data compiled by the Centers for Medicare and Medicaid. Drawing on such processed information, users may well wish to avoid hospitals that have high morality rates. But actually, these are likely the best hospitals because they attract patients with severe illnesses. Rankings of high schools issued by *US News and World Report* draw in part on the number of AP classes taken, which in turn correlates with admission to "elite" colleges. However, these data do not inform the users of such rankings whether the schools' success is due to the selection of students (i.e. "successful" schools draw a large number of their students from affluent neighborhoods, which tend to produce more prepared students) or due to the quality of education provided in the school. In short, the users of intermediaries (and the information processed by them) face many of the same problems individuals encounter when they deal directly with raw information.

Second, the old question of who will guard the guardians applies to intermediaries. As long as they are not regulated, the intermediaries can, and in some occasions do, manipulate their rankings. The TRUSTe label is granted practically to all who pay for it.[57] Far from indicating that a corporation that displays such an icon provides strong privacy protection, which is how many interpret it, it merely indicates that the corporation is living up to whatever policy it announces, even when the small print states that it will sell clients' information to third parties. One may say that rankings and labels provided by the federal government can be trusted and save the consumer from having to find out on his or her own what the score is. However, a report on the "USDA Organic" label finds that it often applies to products that do not meet consumer expectations of

[56]Elizabeth F. Farrell and Martin Van Der Werf, "Playing the rankings game," *Chronicle of Higher Education*, May 25, 2007; Glen Kersten, "Grading on the curve: college ratings and rankings," *Points of Reference*, January, 2000, <http://www.sls.lib.il.us/reference/por/features/99/collrank.html>; Eric Hoover, "Liberal-arts college group plans to help develop alternative to commercial rankings," *Chronicle of Higher Education*, June 20, 2007.

[57]Wired Blogs, "Report: TrustE sites twice as likely to be bad actors," September 26, 2006, <http://www.wired.com/threatlevel/2006/09/report_truste_s/>.

organic: "foods without pesticides and other chemicals, produced in a way that is gentle to the environment." Instead, many products include ingredients that are neither natural nor environmentally friendly.[58]

In short, consumers and voters cannot evaluate or rely on intermediaries much more than they can rely on the original sources of information—especially if neither is closely regulated.

B. Information versus Choice

Transparency advocates tend to assume that if given information, individuals will use it to make improved decisions. Actually, more than a generation ago, we learned that "a curious feature of the growing demand for more information is the paucity of concrete evidence that past disclosures have made significant differences in consumer or market *behavior*."[59]

Data from psychological studies shows that people "do not make rational choices when it comes to saving and investing activities . . . information is beneficial only to the extent that it can be understood and utilized by the individual to whom it is directed. . . . Evidence suggests that when people are given too much information in a limited time, the information overload can result in confusion, cognitive strain, and poorer decision-making," concludes Susanna Kim Ripken.[60]

A survey found that only 11 percent of Medicare beneficiaries have sufficient knowledge to make an informed choice between new Medicare+Choice options and the traditional fee-for-service program.[61]

Most importantly, in numerous situations, even a well-informed person may find choice restricted, and must rely on other sources of control for protection. Small investors with pension funds provided by their employers cannot affect the composition of these funds or the selection of funds among which they may choose (if any is provided). In the case of health plans, the selection is likely to be even more limited and changes in the plans even less subject to individual preferences. Theoretically, a person could choose to seek another job with the preferred kind of pension or health plan, but the costs of such a shift are often very high. Hence, a case can be made that beyond being transparent, pension and health plans should be mandated to meet at least minimal standards. Even if one disagrees on this point, there is no denying that transparency has limited consequences when the choice is nil.

[58]Kimberly Kindy and Lyndsey Layton, "Purity of federal 'organic' label is questioned," *Washington Post*, July 3, 2009. See also: Heald, "Transparency as an instrumental value," p. 70; O'Neill, "Transparency and the ethics of communication," p. 75.

[59]George S. Day, "Assessing the effects of information disclosure requirements," *Journal of Marketing*, 40 (1976), 42–52 at p. 42.

[60]Ripken, "The Dangers and Drawbacks of Disclosure," pp. 159–60.

[61]William M. Sage, "Regulating through Information," *Columbia Law Review*, 99 (1999), 1701–829 at p. 1729.

VI. THE GUIDANCE CONTINUUM

To reiterate, the question is not, as the *Wall Street Journal* put it, whether "transparency is better than regulation" (which should be "better than other forms of regulation"), but how much of the regulatory mission transparency can carry out. The preceding analysis suggests that it is fairly limited. The main factors that determine the extent to which one can rely on transparency without backing it up it with stronger regulatory means (sometimes referred to as substantive regulation[62]) are as follows: the degree of disutility if the information is not heeded; the education level (whether people are likely understand the information released); the culture of compliance (whether people trust and heed the information released); and one's values. Clearly if the harm one seeks to prevent is great when the education level is low and when there is strong tendency to ignore or mistrust information released by the government or by corporations, transparency can be relied on even less than if all these factors are reversed. Moreover, the preceding data suggest that the cutoff point on the continuum that these variables form (I call it the guidance continuum)—the point at which transparency cannot be relied upon—is fairly close to the low end of the continuum. That is, even if the disutility and distrust are not high, compliance is reasonable, and the level of education is considerable, transparency will often be insufficient for achieving a reasonable level of public protection.

Ultimately though, it is a normative issue. If one values autonomy very highly and considers it morally acceptable for people to suffer various ill effects as long as they were informed about the risks involved (or opportunities they miss), one would lean toward relying more on transparency than if one holds that protecting people who cannot protect themselves from serious disutility is morally justified.

Also, one should note that regulations have an "expressive" function—they express the community's shared values and help to set norms. Relying on transparency indicates that the community considers the matter at hand—public safety, prevention of pandemic, exploitation, manipulation, or fraud—less consequential than if the activities or products at issue are banned or their provision is required.[63]

VII. IN CONCLUSION

Transparency is a very popular concept. It reflects the idea that people are autonomous rational choosers who can govern themselves. Theoretically, transparency could be limited to voluntary disclosures. Thus, it could be promoted by consumers refusing to purchase items from sources that do not disclose their content, and investors refraining from investing in corporations

[62]Ripken, "The dangers and drawbacks of the disclosure antidote."
[63]Ibid, p. 149.

that do not provide financial details. Indeed, some measure of such voluntary, communitarian disclosure is taking place because it generates good will and is considered "good business." However, to ensure the veracity of the information that is released, to promote releases that are comprehensible to the public and comparable to information released by other sources, and to secure that such information will be regularly made available, often requires government regulation.

There are few empirical studies of the effects of transparency, and there seem to be none that compare its effects to other methods of regulation under the same conditions. However, other data—especially evidence assembled by behavioral economists—strongly indicate that people are neither as able to process information nor as likely to act on it as transparency theory presumes. Hence, in situations in which adverse outcomes have a relatively high disutility (e.g., there is a high probability that they will cause death, serious bodily damage, or loss of one's home or life's savings) or the information is complex (e.g., medical information), drawing on other sources of regulation in addition to transparency seems called for. That is, transparency cannot replace other kinds of regulation, and even its "soft" version is overrated; it cannot provide much of the necessary public protection, even when combined with other means of regulation.

Finally, one should note that from a normative viewpoint, the difference between transparency (which is relatively welcomed by laissez-faire conservatives and libertarians and by academics whose assumptions parallel these ways of thinking) and other forms of government regulations (which the same sources consider an anathema) is smaller than it at first seems. Under numerous conditions, transparency has to be mandated or it is not provided, the forms of information disclosed must be prescribed—or even the more prepared users will be unable to decipher the meaning of the released information—and its veracity must be assured. At the same time, other kinds of regulation are not necessarily highly coercive. Some merely provide incentives for good conduct. Others impose a minor fine and thus leave it to the regulated agent whether or not to comply. And for those regulations that outright ban an activity, enforcement varies a great deal. When all is said and done, there is room for increased, validated, and comprehensive transparency (and vetted intermediaries). However, it is not sufficient protection when the disutility and the information costs are high—and often even when they are not.