



March 30, 2009

The Transparency Policy Project (TPP) at the Harvard Kennedy School, dedicated to understanding the dynamics, design, and effectiveness of transparency systems in law and policy, is pleased to offer these comments in response to the President’s memorandum of January 21, 2009 on “Transparency and Open Government.” Based upon our research, we offer several suggestions to expand and improve federal efforts to use transparency systems to further important public priorities.

I. Background — Targeted Transparency

President Obama has made his commitment to transparency clear in both his words and early actions. A great deal of attention so far has been directed at policies to promote public access to information regarding the ongoing working of government. This important type of transparency, required by the Freedom of Information Act and other public access laws, assures that the government discloses records related to the creation, deliberation, and execution of federal policies.

However, there is another equally important type of federal transparency requirement that aims to protect the public in specific ways that can save lives, reduce injuries, and prevent needless financial losses. Because these policies aim to achieve specific objectives rather than to satisfy a general right-to-know, we call them “targeted transparency.” These targeted transparency requirements are in urgent need of improvement and their failures are frequently in the news. Some recent examples: Mortgage disclosure requirements prove ineffective in informing consumers; medical devices continue to cause deaths years after recalls; contaminated peanut butter evades auditors. However, these requirements have so far received little attention in the president’s commitments and actions.

Targeted transparency laws call upon the president and his agency heads to provide the American people with corporate, as opposed to government, transparency in order to reduce critical public risks or improve essential services. Familiar examples abound. Financial reporting aims to encourage companies to act in the interest of shareholders. Nutritional labeling aims to encourage companies to produce healthier products. Car safety ratings aim to improve new-model design. Bank lending disclosure aims to discourage redlining in order to reduce racial

discrimination. All of these policies are based on the premise, now confirmed by a generation of research, that markets and political processes do not automatically provide ordinary citizens with the information they need to make safe and effective choices in everyday life.

Targeted transparency policies have different architecture and work differently from other regulatory tools. With conventional regulation, government acts directly on private firms or public organizations by setting standards of behavior or performance, imposing taxes, or creating markets (as with tradable pollution permits). With targeted transparency, government simply compels private firms or public organizations to disclose information about public risks they create or flaws in services they provide. That information is then used by consumers, investors, managers, journalists, and advocacy organizations. Some use such information to make decisions that better protect them against risks — in nutrition, health care, or product choices, for example. Others use such information to highlight behavior or performance that they view as undesirable — by singling out financial institutions with poor minority lending records or low foreclosure workout rates, for example. However disclosed information is used, policy makers intent is the same -- to give companies new incentives to reduce risks they create or to improve their practices by, for example, making healthier foods, improving health care quality, manufacturing less dangerous products, or increasing the racial equality in their lending portfolios.

Such transparency policies have taken a legitimate place beside rule-making and taxes, subsidies, or trading as government tools to further public priorities. They hold great promise to make government and markets work better. They can increase the quality and reach of needed regulation and create a style of regulation in which government policies operate in concert with civic and social action to advance public objectives. They can enable consumers, investors, and employees to make better choices. However, transparency policies to date have often proven ineffective. Policies are often poorly designed or fail to keep pace with changing markets; and lessons learned in one policy area generally are not applied to others.

Federal regulatory policy should seek to improve the quality of targeted transparency regulation by promoting a collective learning process across policy areas. The first step in doing so is to recognize the distinctive character of such regulation and to understand its particular sources of success and failure.

At the outset, it may be useful to note two research findings that defy conventional wisdom about the way regulation works. First, transparency policies are rarely an alternative to other forms of regulation — standards, taxes, or trading, for example. Instead transparency often works best in synergy with other regulatory approaches. Efforts to reduce discrimination in home lending, for example, benefit from home mortgage disclosure requirements working in combination with merger and acquisition requirements under the Community Reinvestment Act.

Second, transparency policies inevitably begin with imperfect data. It is the dynamics of these policies that are important. Contrary to policy approaches that refrain from disclosing data until regulators are highly confident of its accuracy and usefulness, our research has established that some of the best targeted transparency policies begin as highly imperfect constructs. If policies are well constructed, data then improves in scope and accuracy over time. Users discover what kinds of information are particularly helpful in informing their choices; disclosers develop

capacity to collect and process data more effectively. Such transparency systems would not exist at all if policy makers had insisted that data be perfect before getting started.

The following guidelines suggest a process for increasing the effectiveness of existing policies and evaluating the potential of new proposals. They are based on our detailed evaluation of a wide range of US transparency policies.¹

II. Criteria for Evaluating Transparency Policies

Transparency policies represent a relatively new regulatory approach. Like other regulatory tools, they are not well suited to all policy problems. Transparency policies are most appropriate to situations where a bridgeable information gap contributes substantially to public risks or service failures. They are most appropriate where the information gap lends itself to measurement; where a reasonable consensus exists on appropriate metrics; and where information users have the will, capacity, and cognitive tools to process and act upon information, sometimes with the help of intermediaries.

A set of questions can help determine how a new policy or a policy in need of improvement should be structured in order to assure that new information is integrated into decisions by consumers or investors and, in turn, that better informed choices improve the practices of companies or public agencies.

1. Who are the intended users of the information? How do they integrate information into current decision-making activities?

To date, most disclosure policies have been crafted with only a vague notion of the needs of intended users. A rigorous analysis must begin with an assessment of the characteristics and decision-making habits of each group of intended users. For example, a disclosure system aimed at improving the quality of nursing homes would require review of the major pathways by which individuals enter into nursing homes, of their socioeconomic characteristics, and of how, when, where, and with what advice decisions are made.

It should also be recognized that users are not a monolith. In fact, users of most transparency systems vary across multiple dimensions related to their interest and capacity to use information in decisions. One particularly important dimension is socio-economic status and education level. Interest in, access to, and capacity to use information in intended ways vary significantly by socio-economic status and education in nutritional diet, health care, education, and product safety choices. If these differences are not expressly integrated into what and how information is conveyed, a transparency system can reinforce or even amplify inequities. This should be an area of particular concern where one group of relatively affluent and educated users has access to wider and deeper information that may save lives or improve health while less affluent users lack such access or fail to use existing information in intended ways.

¹ See Archon Fung, Mary Graham, and David Weil, *Full Disclosure: The Perils and Promise of Transparency*, (NY: Cambridge University Press, 2007).

2. *Do users have the capacity and the will to employ new information in making choices?*

Most disclosure systems feature multiple intended audiences that seek information at different levels of complexity and in different formats. An understanding of the interests and limitations of each audience, including cognitive shortcuts that may distort decision-making will help policy makers construct metrics and formats that serve users' needs.

3. *Do metrics track desired policy outcomes?*

Although transparency policies should reflect the information that users seek, metrics should also be directed toward the outcomes of ultimate concern. But metrics often miss the mark. For example, some users might assess nursing home facilities based on capital expenditures, but if those expenditures primarily reflect cosmetic investments (e.g. expenditures on entry areas or visitor amenities) rather than healthcare related commitments, a disclosure system might send the wrong signals.

4. *Are there intermediaries that play a role assisting users? If so, who are they and how aligned are their incentives with those of intended users?*

In many areas where transparency policies can be used, individuals make decisions in concert with others. These may be family members or close friends (for example in the case of nursing care choices); professionals or experts (physicians and other care providers in health care; financial advisors in the area of pension investments); or advocacy groups with specific interests in policy outcomes (e.g. environmental or community groups). These intermediaries may play a decisive role in steering users through information towards making choices. In some instances, they may also make critical choices themselves. If intermediaries are decisive in making choices, a transparency system should fully incorporate their role into system design. Policy assessment must also focus on alignment of interests between users and intermediaries.

5. *What are the mechanisms by which disclosers receive information about user behaviors?*

Transparency systems imply an action cycle where new information informs and presumably improves user choices which, in turn, alter incentives of information disclosers who then improve products or practices. In many cases, this assumption is reasonable. For example, providers of goods or services have a first order concern in understanding consumer choices and how those choices are altered by the provision of new information about product characteristics. But this need not always be the case: If disclosers, for example, are small or relatively unsophisticated businesses, they may lack the capacity to pick up changes in consumer behavior.

6. *Are there sufficient incentives / enforcement tools to lead disclosers to provide information?*

Transparency policies are not self-enforcing. The incentives created by policies that compel the provision of accurate information must be analyzed, just as they must be under any other regulatory system. This includes assessing incentives to encourage disclosure, accuracy, and timeliness. Penalties for non-compliance must be sufficient to lead to timely and accurate disclosure.

7. *Do disclosers have sufficient incentives to change behavior in light of user responses to new information?*

Disclosers must also have the financial / organizational incentives to change their behavior. In responding to any regulation, corporate managers assess whether it is in their interest to reduce risks to the public or improve services. The evaluative question hinges on an understanding of how targeted organizations make such choices since transparency policies often rely on an even more complicated sequence of activities than traditional regulatory interventions.

8. *How do the transparency interventions leverage other social policies in the particular area?*

Finally, transparency policies often coexist with other regulatory tools or government policies directed toward the same goal. Information can improve or reduce the effectiveness of other regulatory systems. Evaluations should assess the extent of such convergence and consider how transparency policies might leverage the effects of other policies.

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The Office of Management and Budget and agency officials could use the above guidelines as a starting point to establish best practices for transparency policies. The OMB director could also convene a working group of agency officials to share disclosure strategies and research results as part of the Open Government Directive. These guidelines should not be understood as hurdles that disclosure policies must surmount, but rather heuristics that contribute to the craft of designing effective targeted transparency.

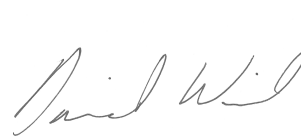
Sincerely,



Archon Fung



Mary Graham



David Weil