# The Political Economy of Transparency: What Makes Disclosure Policies Sustainable?

by

Archon Fung
Mary Graham
David Weil

OPS-02-03

# The Political Economy of Transparency: What Makes Disclosure Policies Sustainable?

Archon Fung
Mary Graham
David Weil

Archon Fung, Mary Graham and David Weil are co-Directors of the Transparency Policy Project at the A. Alfred Taubman Center for State and Local Government, John F. Kennedy School of Government. Archon Fung is Assistant Professor of Public Policy at Harvard University's John F. Kennedy School of Government. Mary Graham is Fellow at the John F. Kennedy School of Government and a Visiting Fellow at the Brookings Institution in Washington, D.C.. David Weil is Associate Professor of Economics at Boston University and a Research Fellow at the Taubman Center for State and Local Government.

This is the eleventh paper in a series dedicated to understanding innovation in public public sector. The Ford Foundation launched the Innovations in American Government Program in 1985 and funded all of its elements through 2000. In 2001, the Foundation established an endowment at Harvard University to continue the Program in perpetuity and to locate it in a new Institute for Government Innovation. Each year, the Program selects the winners of the Innovations Award from approximately 1500 applications and supports research and casewriting based on the applicants. The Innovations in American Government Program also works in partnership with the Council for Excellence in Government.

**Winter 2002**

## ACKNOWLEDGEMENTS

The Institute for Government Innovation, the A. Alfred Taubman Center for State and Local Government, the Environment and Natural Resources Program, and the Dean's Research Fund of the John F. Kennedy School of Government provided generous support for this research.

We are grateful to Elena Fagotto and Khalisha Banks for their superb research assistance on this project.

# The Political Economy of Transparency: What Makes Disclosure Policies Sustainable?

By Archon Fung, Mary Graham, and David Weil

## INTRODUCTION

Transparency is becoming an important regulatory frontier. In the United States, the European Union, and developing countries, governments have designed disclosure systems to reduce health and safety risks, minimize corruption, protect civil rights, and improve public services. Traditionally legislators used their authority to compel the collection of information as an underpinning for rules and enforcement actions. Gradually, many countries also established the idea that the public has a "right to know" about information acquired or developed by government agencies. Now transparency has become a mainstream instrument of regulation as well. In scores of recent policies, lawmakers have required that corporations, public agencies, and other organizations disclose information about their activities in order to further public priorities.

Consider the central role of transparency in responses to recent crises in the United States. When accounting scandals brought down companies like Enron and WorldCom in 2001 and 2002, Congress required that corporate finances be made more transparent for investors and analysts. In 2000, when investigators found that the combination of tire failure and top-heavy design in popular sport utility vehicles triggered rollover accidents that killed hundreds of motorists, Congress required that the public be informed of the likelihood that each model would roll over. In 1999, when an expert panel reported that medical mistakes killed at least 44,000 patients a year, recommendations for reforms focused on new transparency systems. Legislators in the United States have created scores of other transparency systems aimed at promoting public priorities: annual factory-by-factory reporting to reduce toxic pollution; nutritional labeling to reduce heart disease and cancer; disclosure of bank lending patterns to reduce race and gender discrimination; school report cards to improve performance; and disclosure of sources of campaign contributions to reduce corruption. Transparency has gained prominence as policy makers have seen the shortcomings of more conventional regulation, searched for approaches to problems that do not lend

themselves to standardized rules, and recognized the potential of information technology to make complex data accessible to broad audiences.

**"Transparency has gained prominence as policy makers have seen the shortcomings of more conventional regulation"**

In the last decade, international organizations, industrialized nations, and developing countries have also employed transparency to create incentives for businesses to minimize hidden financial risks to investors and reduce health risks to communities. In 1996, the International Monetary Fund established financial disclosure requirements for countries seeking access to international capital markets. In 1998, the Basle Committee on Banking Supervision established transparency principles for international banking. Some developing countries have adopted corporate accounting standards put forth by the International Accounting Standards Committee. The World Bank adopted disclosure standards for its own projects and environmental assessments in 1993 in response to demands for greater accountability. Other countries have followed the United States by using disclosure to reduce toxic pollution. In 1992, when U.S. environmental officials announced that toxic emissions plummeted after a new transparency system was instituted, the United Nations called for international guidance to help other countries develop such systems. Mexico, Canada, Indonesia, the Philippines were among those that responded to the new laws. The European Union, too, is working on a disclosure system for major emissions by source, to be published every three years.[1]

The Institute for Government Innovation, based at the John F. Kennedy School of Government, has highlighted the importance of transparency's newly prominent regulatory role by calling attention to government efforts in the United States aimed at reducing health and safety risks. The U.S. Department of Labor was recognized in 1996 for its information strategies to improve working conditions in the apparel industry; the federal Environmental Protection Agency in 1997 and the state of Massachusetts in 1999 for new disclosure systems aimed at reducing toxic pollution; the federal Department of Agriculture in 2000 for creating an innovative system of organic food labeling;

and the Veterans Administration in 2000 for creating a unique reporting system to identify and reduce medical errors.

In 2001, the Institute sponsored an analysis of issues related to the design of transparency systems. The paper, *Information as Risk Regulation: Lessons from Experience*, examined new systems aimed at improving health and safety in the United States.[2] It argued that disclosure systems that were created to address very different kinds of policy problems constituted a cohesive policy innovation and that such systems shared characteristics that distinguished them from traditional public release of information by governments. It identified five shared characteristics:

- Mandatory disclosure
- Standardized information
- Identification of companies
- Reporting at regular intervals
- A primary purpose of reducing risks

But it also suggested that primitive metrics, mismatches between the scope of requirements and the dimensions of problems, and failure of systems to adapt to changes in markets, science and technology, or public priorities often distorted incentives and produced unintended consequences. The paper concluded that policymakers could learn how to avoid such pitfalls by heeding lessons from early experience with such systems.

This paper explores the dynamics of transparency. It asks why some government-created systems improve over time while others stagnate or degenerate into costly paperwork exercises. As products of the political process, transparency policies inevitably begin as unlikely compromises. Though transparency is universally admired in principle, its particular applications frequently conflict with other societal values or powerful political interests. Disclosing information can clash with efforts to protect

public safety and proprietary information, to guard personal privacy, or to limit regulatory burdens. It can also clash with the central economic and political objectives of target organizations that may view such disclosure as a threat to reputation, markets or political influence. At the same time, the benefits of disclosure are often diffuse. Beneficiaries may be consumers, investors, employees, and community residents. Such users are rarely organized to support and oversee transparency systems.

**"As products of the political process, transparency policies inevitably begin as unlikely compromises."**

Given this pattern of concentrated costs and diffuse benefits, it may seem remarkable that systems of legislated transparency ever get off the ground, much less improve over time. Improvement is necessary because systems that do not keep pace with changing markets, technologies, public priorities, or disclosers' discoveries of loopholes can become irrelevant or counterproductive. Improvement is also necessary, though not sufficient, for effectiveness in changing disclosers' practices to further a regulatory objective. Yet many transparency systems do improve. Their scope often broadens to more closely approach the dimensions of the problem they are intended to address. The information they generate becomes more accurate and widely used. In short, they become sustainable as policy instruments.

This paper investigates the puzzling phenomenon of sustainable transparency by examining six cases from the United States: financial disclosure to reduce investment risks to the public; banks' reporting of home-lending practices to minimize racial and gender discrimination; nutritional labeling to reduce risks of chronic disease; disclosure of toxic releases to minimize pollution; financial reporting by labor unions to minimize corruption; and efforts to create a transparency system for tracking medical mistakes in hospitals.

We examine the relationship between costs and benefits to disclosers and users in these cases to develop a more general model of the dynamics of transparency policies. We find that this relationship determines whether disclosers and users have incentives to press for improvements in transparency policies.

These incentives, in turn, help explain why some systems broaden in scope, accuracy, and use while others do not.

We conclude with several tentative recommendations for policymakers. We suggest that transparency policies should not be viewed as a general remedy when progress in promoting public priorities is impaired by the lack of reliable information. Careful analysis of the character of the information problem as well as user and discloser costs and benefits is needed to determine whether transparency is a promising regulatory approach. Substantial benefits to users, the presence of third party organizations to press for system improvement, and economic or political dynamics that lead some disclosers to promote improved transparency are all factors that influence sustainability. Through careful design, policymakers can also create conditions that foster the improvement of such systems. They can select architectural elements that foster user support and feedback, help assure that transparency operates synergistically with related regulations, and design systems that incorporate information into ongoing economic and political processes.

## Financial Disclosure in the United States: An Example of Sustainable Transparency

The complex transparency policy created by Congress to minimize hidden financial risks to investors illustrates how relative costs and benefits to users and disclosers influence efforts to improve systems of transparency. As the recent scandals at Enron, Tyco, WorldCom, and other large corporations have shown, the long-respected system of financial disclosure in the United States remains far from perfect. Yet no one would dispute that it has improved markedly in scope, accuracy, and use during the seven decades since its adoption after the Great Depression. Such improvement has not followed a smooth and continuous path, however. Instead, it has resulted from the push and pull of conflicting investor, accounting, and corporate interests. Crises

such as the collapse of conglomerates in the 1960s, the revelation of bribes and illegal campaign contributions by executives in the 1970s, and, more recently, the corporate accounting scandals in 2001 and 2002 have spurred episodic reforms. These dynamics suggest how the relative costs and benefits of transparency to users and disclosers and their ability to act collectively influence the sustainability of transparency.

**"the nation's system of financial disclosure was cobbled together as a pragmatic compromise."**

Created as a response to crisis, the nation's system of financial disclosure was cobbled together in 1933 and 1934 as a pragmatic compromise. Millions of Americans were left holding worthless securities when the stock market crashed in October 1929. By 1932, the value of stocks listed on the New York Stock Exchange had fallen by 83 percent. Congressional hearings revealed a pattern of inflated earnings, insider trading, and secret deals by J.P. Morgan, National City, and other banks that contributed to the collapse of public confidence in securities markets. Echoing Louis D. Brandeis' declaration that "sunlight is ... the best disinfectant," Franklin D. Roosevelt, the nation's newly elected president, championed legislation to expose financial practices to public scrutiny.[3] The Securities and Exchange Acts required that publicly traded companies present information about their finances in standardized form, updated in quarterly and annual reports. Congress also authorized the newly created Securities and Exchange Commission (SEC) to issue uniform accounting standards. But the scope of transparency was limited by political compromise. Opposition by business interests and investment banks excluded many securities from the laws' reach, including railroad stocks, intrastate issues, and all stock already issued. Accuracy of information was also impaired by broad corporate discretion in how to present the required data, and its use by investors remained uncertain. Felix Frankfurter, Roosevelt's senior advisor on the legislation, called the Securities Act a "modest first installment of legislative controls."[4]

As prosperity returned after World War II, one might have expected executives of the powerful corporations, who had a strong interest in opposing this raid on proprietary information, to

press successfully to dismantle financial disclosure. Instead, the system remained in place, continuing to improve episodically. Many improvements followed a common scenario. Changes in markets produced new business practices, accompanied by creative accounting methods that obscured risks to investors. Sudden revelations or market reversals directed public attention to these practices, producing a crisis of confidence in the system of transparency. To restore public trust, government agencies, institutional investors, and members of Congress demanded more accurate and complete information, and reformers seized the moment to make permanent changes in the system. As a result, the scope of transparency broadened. Information became more accurate. Users increased. In 2001 and 2002, this familiar cycle repeated itself. Accounting scandals once again shook investor confidence and focused public attention on reform, creating an opportunity for further improvement.[5]

In the 1960s, for example, the scope of disclosure was broadened when an unprecedented wave of conglomerate mergers followed by a sudden collapse of their stock prices created pressures for better information. Between 1962 and 1969, 22 percent of Fortune 500 companies were acquired in mergers, and the value of combined companies was often inflated by creative accounting methods. Conglomerates like Gulf and Western and Ling-Temco-Vought produced instant increases in earnings by choosing accounting techniques that did not reflect the full cost of mergers. In addition, the profitability of specific product lines, previously visible in the accounts of separate companies, became hidden after mergers. By the end of the decade, government agencies, members of Congress, increasingly powerful institutional investors, leading authorities on accounting, and the media were all calling for broadened disclosure. The Federal Trade Commission (FTC), charged with enforcing antitrust laws, called conglomerate accounting a tool of deception and urged the SEC to outlaw it. Newsweeklies decried "profits without honor."[6] As pressure from investor groups increased and the public became concerned about the stability of some of the nation's largest

companies, Congress responded in 1968 with the Williams Act, which required disclosure of cash tender offers that would change ownership of more than 10 percent of company stock. The act was strengthened two years later by lowering the threshold for reporting to five percent. In addition, the SEC required companies to disclose product-line data. In a crisis atmosphere, support from the FTC and other regulators, institutional investors, and financial analysts proved stronger than opposition by some large accounting firms and conglomerate interests.[7]

**"The accuracy of disclosed information also improved, though at a remarkably slow pace."**

The accuracy of disclosed information also improved, though at a remarkably slow pace. Congress gave the SEC authority to establish uniform accounting standards in 1934, but it took 40 years to establish an authoritative mechanism to move toward that objective. In the first four decades after financial disclosure became law, companies continued to exercise broad discretion in the way they reported assets and liabilities to the public, and the SEC deferred to accounting professionals to set their own standards. Until 1963, companies were not even required to disclose what accounting policies they employed. Homer Kripke, a New York University law professor and prominent authority on accounting, concluded: "Accounting was Congress' most important charge to the [SEC] and represented the Commission's greatest opportunity to be of use to the investor….and it is the one problem which the SEC chose to turn over to the technicians while it sat on its own hands for 40 years."[8] In 1969 and 1970, however, when the speculative fever of the "go-go years" gave way to rapid decline in the values of many stocks and the Dow Jones average fell 35 percent, investors began to turn away from the market. To restore public trust in the legitimacy of the transparency system, the Accounting Principles Board, an outdated instrument of accounting industry self-government, was replaced with the current Financial Accounting Standards Board (FASB). The new board set authoritative accounting standards. It had broader representation and funding, a larger professional staff, and a better system of accountability.[9] New crises incited further improvements. In the late 1970s, congressional investigations

raised new questions about the FASB's domination by big business. In response the FASB opened meetings, allowed public comment on proposals, provided weekly publication of schedules and decisions on technical issues, framed industry-specific accounting standards, analyzed economic consequences of proposed actions, and eliminated a requirement that a majority of its members be chosen from the accounting profession. Again, the interests of the securities industry and increasingly powerful groups of investors proved stronger than the interests of companies in presenting their balance sheets in whatever form placed their activities in the most favorable light.[10]

Over the years, other crises broadened the scope of disclosure and improved the accuracy and use of information. In 1970, for example, Congress required new disclosures from broker-dealers concerning their management and financial stability after 160 brokerages failed.[11] In 1977, Congress broadened transparency in response to publicity about bribes and illegal campaign contributions by corporate executives.[12] Lapses in management in some of the nation's largest corporations led the SEC to issue rules in 1978 and 1979 that required new disclosures concerning the independence of board members, the oversight of company operations by the board committee, and the failure of directors to attend meetings.[13] In the 1990s, increases in individual investing and the rise of online investing led to SEC adoption of "plain English" disclosure rules, which required prospectuses filed with the agency to be written in short, clear sentences using non-technical vocabulary and featuring graphic aids. Commission chairman Arthur Levitt emphasized the importance of constant vigilance to produce clear and accurate information. Without continual oversight, "the competitive juices of corporate America are such that they will stay close to the line, and some of them will go over the line."[14]

In 2001, the sudden bankruptcy of Enron, the nation's largest energy trader, once again created a crisis-response scenario that generated pressures to improve transparency. In October 2001, Enron posted a 26 percent increase in recurring earnings; the

company had a market value of $77 billion; and its stock price hovered around $90 a share. Two months later, investigations showed huge losses from off-balance-sheet partnerships and attempts at a merger with Dynergy Corporation failed. As a result, Enron's stock price fell to 87 cents, the company's value plummeted below $500 million; and its executives declared bankruptcy. Shareholders lost their savings and employees lost their retirement funds. But the ripple effect did not stop there. As investigators began to examine the causes of collapse, inflated earnings in other large companies, evidence of collaboration by accounting firms that also earned huge consulting fees, stock-boosting by analysts, inadequate oversight by company boards, and a declining stock market once again called into question the integrity of the nation's financial disclosure system. In the heady investing environment of the 1990s, the big five accounting firms scored large financial gains by helping companies beat the system, and analysts earned high salaries that reflected their expanding role in competing for companies' initial public offerings. By the end of the decade, the system was riddled with new conflicts of interest.[15] As revelations multiplied, Arthur Anderson, Enron's accountants, declared bankruptcy as did the telecommunications giant WorldCom. The stock market had dropped 23 percent by September 2002, wiping out $6.5 trillion in value, and individuals withdrew billions of dollars from mutual funds. In response, Congress approved legislation that provided new government oversight of accounting standards and limited consulting by auditors; some large corporations voluntarily began listing stock options as expenses; Standard and Poor's unilaterally changed its assessments of operating earnings to reflect the cost of stock option expenses; and the New York Stock Exchange adopted new rules. The longterm effects of these measures, however, remained uncertain.[16]

**"the competitive juices of corporate America are such that they will stay close to the line, and some of them will go over the line."**

As an example of sustainable transparency, there are a number of striking features about the history of financial disclosure. Government requirements impose large costs on individual firms, which have much to gain from concealing or

misrepresenting various aspects of their revenues, expenses, and net income. At the same time, the benefits to investors and other users of such information, while potentially very high, are diffused across a large number of individuals and institutions. One would predict in such instances of concentrated costs and diffuse benefits that mandated disclosure requirements would be weak and would erode over time, especially when disclosers possess significant political power.

Despite this pattern, the history of financial disclosure since the passage of the Securities and Exchange Acts of 1933 and 1934 is one of episodic improvement, imperfect as the system remains. The scope of information has broadened, now embracing a wider variety of financial practices and covering an expanded set of institutions; the accuracy of information has improved as accounting standards have become more uniform; and the use of information has expanded as institutional investors, individuals, analysts, and companies themselves have come to rely on it. What explains such improvement?

**"Institutional investors have both intense interests and powerful organizations to support the expansion of transparency policy."**

First, periodic crises have played a central role in expanding the scope and accuracy of disclosure. Improvements have usually occurred in response to specific incidents such as the collapse of conglomerates in the 1960s, the discovery of widespread bribery of public officials in the 1970s, the collapse of savings and loan institutions in the 1980s, and the corporate accounting scandals of 2001 and 2002. These events have temporarily weakened the political power of corporate interests, concentrated the attention of diverse users, and provided members of Congress with support for reform. Second, some disclosers have supported transparency's improvement. During the accounting scandals of 2000 and 2001, for example, General Electric, Coca Cola, and other large companies voluntarily began reporting stock options as earnings even though such reporting weakened their stated earnings. Such companies may perceive a competitive advantage in revealing their relatively strong financial position, or they may seek to build a reputation for openness to influence customers, employees, and regulators as well as

investors.[17] Third, even in the absence of crisis, established organizations representing aspects of user interests have promoted improvement, overcoming obstacles to collective action. Institutional investors have both intense interests and powerful organizations to support the expansion of transparency policy. Stock analysts need accurate information. Stock exchanges must guard against erosion of investor confidence. Accountants have their own professional reputations to protect. The mix of incentives in favor of openness or secrecy varies from situation to situation for each of these groups. But when they have seen net benefits from greater openness their influence in fostering improvement has been substantial.

## The Political and Economic Costs and Benefits of Disclosure [18]

The history of financial disclosure illustrates more general dynamics of transparency policies. Despite its fitful progress, disclosure has improved over time on three important dimensions:

1. Increase in the use of disclosed information by consumers, investors, employees, political activists, voters, residents, or government officials;

2. Increase in the accuracy and quality of information;

3. Increase in the scope of information relative to the scope of the problem addressed.

While policies that improve along these dimensions may still fail to achieve regulatory objectives for a range of other reasons, policies that do not improve in these ways are very unlikely to be effective over time. Sustained improvement is, therefore, a necessary but not sufficient condition for the success of transparency policies.

One would not expect movement along all of these dimensions simultaneously in order to conclude that a system was improving. For systems aimed at a relatively narrow set of users, one would be most concerned that the accuracy and scope of information provided by disclosers improved over time. When relevant metrics are inherently narrow, increases in the number and frequency of users and in the accuracy of narrow measures denote progress.

**Table 1** provides an overview of 12 major transparency systems along with a brief description and a summary of the information required by each. Policies aim at widely divergent social goals and require disclosure by diverse institutions. Yet a common set of factors drives some systems to become more robust and others to become the kind of ineffectual paperwork exercises derided by critics on the political left and right.

*Political Context of Disclosure Policies*

From a political perspective, sustained improvement of transparency policies is improbable for two reasons. First, such policies are often the product of the convergence of unusual and short-lived circumstances. They are created in moments of crisis and public scandal that open the arenas of narrow group politics and private deal-making to broader public scrutiny. Such crises reveal flaws in existing regulatory arrangements. Political entrepreneurs can sometimes gain sufficient support for their remedies to translate them into laws and regulations. But the dependence of disclosure requirements upon momentary public attention also makes them vulnerable. As crises fade, so does political support. Second, the distribution of disclosure costs and benefits often makes it possible for reluctant disclosers to prevent improvement. As noted earlier, improvement is essential to keep such systems from becoming counterproductive as markets, technology, and public priorities change.

As previously noted, transparency typically imposes costs upon a small group of disclosers in the hope of generating benefits

for dispersed users. Nutritional labeling forces food producers to reveal product information to millions of food consumers, for example, and disclosure of toxic releases compels industrial firms to report discharges to hundreds of millions of residents, employees, and investors who might have an interest in their actions. Union officials must reveal financial information to union membership and the public at large. In *The Politics of Regulation*, James Q. Wilson has suggested that concentrated costs and dispersed benefits create conditions in which targeted parties can capture regulatory systems and turn them to their advantage. When these costs are imposed upon industries, previously existing industrial associations and organizations make collective political action easier still. As a general matter, then, those who suffer the costs of mandatory disclosure policies enjoy a substantial political advantage over those who benefit from them. Of policies with this cost-benefit structure, Wilson writes that: "Since the incentive to organize is strong for opponents of the policy but weak for the beneficiaries, and since the political system provides many points at which opposition can be registered, it may seem astonishing that regulation of this sort is ever passed."[19] These cases suggest that this predictable political imbalance can be altered in several ways that encourage sustainability, strengthening groups that represent users and producing groups of disclosers that expect transparency to further their interests.

**"transparency typically imposes costs upon a small group of disclosers in the hope of generating benefits for dispersed users."**

The cases examined below suggest that policies that evolve in ways that transform the underlying structure of concentrated costs and diffuse benefits can become sustainable. Crises usually weaken but do not destroy the political power of disclosers to influence the system's initial architecture. However, there are several reasons that may over time lead some disclosers to conclude that improvement in transparency serves their interests, raising perceived benefits. Among them:

- *Competitive factors* in economic markets may convince some disclosers that they will gain advantages from improved transparency.

- Disclosure may improve a *regulatory environment* that confers relative benefits to some parties at the expense of others.

- *Political and social factors* may produce unusual benefits for some disclosers, including reputational gains.

Likewise, several factors may cause users to coalesce and press for greater disclosure:

- New *crises* may temporarily concentrate user interests in a national debate and force re-examination and improvement of disclosure.

- User support for *broader agendas* may create organizations that exert continuing pressure for improvement to gain perceived economic or political benefits.

- *Entrepreneurial politicians* also may represent user interests in supporting improvement when they see political gains from doing so.

**"policies that evolve in ways that transform the underlying structure of concentrated costs and diffuse benefits can become sustainable."**

When organizations champion user interests in transparency regulation without allies among discloser beneficiaries, the politics of disclosure policies become interest group contests that defy reliable prediction. The stringency of transparency policies in such political environments depends upon contingent balances of power and advantage. We can expect transparency regulation to become more demanding when a particular issue is prominent on the public agenda or when political or administrative elites independently back the proposal.

Transparency systems to reduce redlining by banks and improve the healthfulness of processed foods provide examples of perceived benefits to disclosers. Under the Home Mortgage Disclosure Act (HMDA), some urban banks have become quite adept at serving "high-risk" borrowers and are recognized as leaders in the fair-lending arena by regulators and the general public. These banks not only see HMDA as an inevitable part of their regulatory environment but have also joined on occasion in support of the policy.[20] Similarly, some food manufacturers have

come to support federal nutritional labeling legislation both to avoid the possibility of having to operate under incongruous state standards and because uniform labels open new marketing channels for healthier foods. These motivations have created common ground between some food producers and public health and consumer advocates regarding the desirability of nutritional labeling.

At the other extreme, transparency systems that lack support from organized users or subsets of disclosers face poor prospects for improvement after their creation. These policies remain trapped in Wilson's entrepreneurial policy configuration of dispersed benefits and concentrated costs. Though they may be created by political entrepreneurs, political obstacles make it difficult for these systems to improve over time. Absent changes on either the user or discloser side, they will be under-utilized, implemented weakly, and subject to gradual erosion.

*Benefits and Costs of Disclosure over Time*

The scope, accuracy, and use of information may also change as a result of the relationship between the costs and benefits to users and disclosers. It is important to note that changes in benefits and costs can occur even without adjustments in the rules of mandated disclosure. Evolution in market structures, the growing strength of third party organizations, advances in information technology, and other fundamental shifts may alter costs and benefits in significant ways. Whatever their source, changes in the incentives for disclosure may alter information released and used under a given system. Finally, substantial changes in either user or discloser benefits and costs can affect the larger political environment. This, in turn, can lead to political changes in the disclosure system, changes in benefits and costs, and a new set of information outcomes.

Costs and benefits to disclosers and users evolve differently for each disclosure system, as the following cases illustrate. In general, however, central elements in the dynamics of

changing costs and benefits from the perspective of disclosers include:

- Disclosers' costs increase with the amount, scope, and/or level of detail of information provided to users.
- Disclosers' benefits decline as amounts of information disclosed increase.

The amount of information that disclosers will be willing to provide reflects these relative benefits and costs—that is, disclosers will balance the benefits from providing information to users (arising from such factors as the averted costs of not complying with mandated disclosure and the benefits that disclosers may achieve from releasing certain types of information to users) against the costs of revealing that information. Factors that change these relative costs or benefits over time, such as actions taken by other competitors or increased enforcement by government, change the amount, quality, or scope of information that disclosers will provide.

Information users will also face benefits and costs from the information provided by disclosers over time. In general terms, key aspects of those benefits and costs include:

- User benefits rise with the provision of additional information, although there may be threshold levels of information beyond which users receive little additional benefit from being provided more information.
- User costs may rise, fall, or stay the same with the provision of additional information.
- Because of the public good aspects of information (i.e. the benefits of information flow to more than just the direct consumers of it), users may under-consume disclosed data unless third party intermediaries act as agents for groups of users in collecting, interpreting, and disseminating information.

Users, like disclosers, will balance their perceived benefits and costs from information provided them. If either the benefits of information rise over time (e.g. consumers become more aware of risks) or the costs of acquiring the information fall (e.g. because of access via the Internet), the use of information along all three dimensions is likely to increase.

Over time, then, the relationship between discloser and user costs and benefits will determine how much improvement one can expect in the information provided by a system. If users' demand for information is much greater than the amount of information that disclosers willingly provide given their benefits and costs, the system will be driven to improve.[21] On the other hand, if users do not have an interest in employing even the amount of information currently provided by disclosers under a system, there is little reason to expect further improvement.

## Transparency to Minimize Discrimination, Reduce Risks, and Prevent Corruption: Five Cases

The political and economic factors that affect whether transparency policies improve or stagnate over time can be applied to a review of the origins, dynamics, and development of five transparency systems. These cases have been chosen both for their common elements and for their diversity. All aim to create incentives to further important public priorities by employing public information to influence markets or collective action. In that sense, each is a regulatory system. All feature government-mandated disclosure of factual information in standardized formats and require that information be presented company by company or product by product to provide accountability. At the same time, these systems aim to further diverse policy objectives, employ a variety of mechanisms for disclosure, and produce a range of sustainable outcomes. In order of higher to lower levels of sustained improvement over time, they are: banks' disclosure of lending practices to reduce race and gender discrimination in

approving applicants; manufacturers' disclosure of toxic releases to reduce pollution; food manufacturers' disclosure of nutritional information through labeling to reduce risks of chronic disease; unions' disclosure of financial information to reduce corruption; and hospitals' disclosure of medical errors to reduce deaths or serious injuries.

*Disclosing Lending Practices to Reduce Discrimination*

The Home Mortgage Disclosure Act (HMDA), initially enacted in 1975, compels banks, savings and loans, and other lending institutions annually to reveal the amounts and geographical distribution of their loan applications, origins, and purchases disaggregated by race, gender, annual income, and other characteristics. The law represented one response to activists' calls for greater economic equality in the later stages of the civil rights movement of the 1960s and 1970s. It followed Congressional action in 1968 to bar racial discrimination in housing sales or rentals; a settlement negotiated by the Department of Justice to end racial discrimination in the appraisal profession; and approval of the federal Equal Credit Opportunity Act in 1974, which outlawed racial and ethnic discrimination in lending. The disclosure requirement was supported by grassroots advocacy organizations and framed by entrepreneurial legislators. One key actor was Gale Cincotta, a Chicago-based leader of the fair housing and community reinvestment movement, who founded National People's Action and the National Training and Information Center—two local organizations that documented the retreat of banks from inner city neighborhoods in the 1960s and 1970s and pressed for more equitable lending. In states such as Illinois, California, and Massachusetts, advocacy groups secured reporting requirements for lending and deposit data that foreshadowed HMDA.

In the 1970s, leading members of Congress championed a national transparency policy despite opposition from the banking industry. In 1975, Senate Banking Committee Chair William Proxmire (D-WI) sponsored a bill requiring disclosure of lending

practices.[22] The banking industry opposed disclosure both before and after the law was approved. The U.S. League of Savings and Loans, for example, argued that disclosure served no useful purpose, imposed an unfair burden on its members, and would potentially reveal marketing information to competitors. Ultimately, the requirement was approved by a narrow margin in both the Senate (47-45) and the House (177-147).

**"Advocacy groups used HMDA data to document constraints on credit in their communities "**

Transparency improved in scope and accuracy over two decades. Initially, the law had two substantial limitations. First, banks were not required to provide specific information about the race, gender, and income level of borrowers or about loan applications that were denied. They simply reported the number and dollar amount of loans by census tract. Second, there was no central clearinghouse to provide access to data. Banks were simply required to make information available at their offices upon request. Three further legislative actions, supported by a wide array of community groups and framed by entrepreneurial politicians, improved the architecture of disclosure. In 1977, Congress approved the Community Reinvestment Act (CRA), which required lending institutions to meet the credit needs of the communities in which they operated and provided an incentive for banks to comply since their lending records would be analyzed by regulators who approved merger applications. In 1980, Congress approved the Housing and Community Development Act, which directed the Federal Financial Institutions Examination Council — an interagency body including the Federal Reserve System, the Federal Deposit Insurance Corporation, and others — to serve as a central clearinghouse for HMDA data. Finally, in response to the savings and loan crisis of the 1980s, Congress approved the Federal Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in 1989.[23] The law's major purpose was to stabilize and provide new oversight for the savings and loan industry. However, community reinvestment groups also used its momentum to press successfully for improvements in disclosure including: reporting of applications as well as loans; reporting of the race, sex, and income of borrowers and applicants; and

reporting by a broader range of mortgage lenders.[24] These improvements took place despite the continued opposition of banking interests, which still contended that redlining was rare and that many inner-city requests for lending were simply too risky.

With its scope and accuracy improved by Congress, the transparency system gained wider use. Advocacy groups used HMDA data to document constraints on credit in their communities and to negotiate new mechanisms for low-income lending with individual banks. Broad-based community reinvestment task forces in Washington state, Rhode Island, New Jersey, and Michigan forged partnerships between community organizations, lending institutions, and state and local governments to address access problems. Intermediaries such as investigative reporters and financial analysts used the information to document pervasive patterns of discriminatory lending and the exodus of banks from low-income neighborhoods. In 1988, for example, two reporters for the *Atlanta Journal-Constitution* reported on widespread redlining in that city. They published their findings in "The Color of Money", a series of articles that received extensive national attention. In 1992, the Boston Federal Reserve conducted a rigorous study that concluded that race had a strong influence in lending decisions. The study received broad media coverage and confronted banks with discrimination allegations from a particularly authoritative source. As they responded to a wave of requests for bank mergers in the late 1980s and 1990s, regulators also employed the data in deciding whether to approve mergers. The banking industry was shaken in 1989 when the Federal Reserve Bank first exercised this power by denying a merger request by Continental Illinois National Bank and Trust Company of Chicago on the ground that the bank had not met its community reinvestment requirements. Advocacy groups that tracked the performance of particular banks often petitioned regulators to turn down merger requests if a bank's performance indicated unfair lending practices. This shift in the competitive environment, combined with the requirements of CRA and HMDA and the proliferation of community organizations with the

expertise to understand bank lending patterns and negotiate with financial institutions, led many more banks to agree to improve fair lending practices in the 1990s. From 1977 to 1991, banks committed $8.8 billion in CRA agreements involving lending, investments, and other services to communities. From 1992 to 2000, banks committed more than $1.09 trillion.[25] A 2000 Federal Reserve Board study found that the vast majority of banks operated profitably in CRA-related loans.[26] Many banks developed products, divisions, and methods to compete in low-income markets and acknowledged that disclosure and community reinvestment requirements have proven less burdensome than expected. In the1990s, the accuracy and scope of data continued to improve, providing more timely disclosure, increasing data quality, expanding the financial institutions required to disclose, and introducing electronic data collection and distribution.

**"one of the nation's most effective environmental regulations"**

*Disclosing Toxic Releases to Reduce Pollution*

The Toxics Release Inventory (TRI), one of the most celebrated transparency policies in the United States, is often credited with reducing toxic releases by nearly half in little more than a decade. Originally enacted in 1986 as a small community "right-to-know" provision in a larger law aimed at improving emergency responses to chemical accidents, it came to be known as one of the nation's most effective environmental regulations. As a transparency measure, it proved sustainable in the 1990s, partly because the Clinton administration made expansion of its scope an administrative priority. Yet it remained seriously flawed in ways that call into question its contribution to public health.[27]

Congress required manufacturers to report annually to the public the quantities of toxic chemicals released into the environment. This legislation in part responded to a tragic accident at a pesticide plant in Bhopal, India in 1984, in which deadly gas killed more than 2,000 people and injured more than 100,000. The requirement also drew strength from a decade of work by labor and community groups to establish the idea that the public had a right-to-know about hazards in their neighborhoods or workplaces.

When Congress constructed an emergency response system for chemical accidents in the United States, it added a requirement that manufacturers in SIC codes 20-39 that produced or used large quantities of a selected list of toxic chemicals report their release into the air, water, or onto land chemical by chemical and factory by factory. The disclosure requirement initially received little attention. It was supported by key Senators—Robert Stafford (R-VT), Frank Lautenberg (D-NJ), and Lloyd Bentsen (D-TX)—by right-to-know groups, and by some environmental organizations. But the federal Environmental Protection Agency saw it as a burdensome paperwork requirement, and manufacturers sought successfully to narrow its scope by: limiting chemicals to be reported and manufacturers required to report, excluding reporting of chemical use, and allowing companies to estimate releases using a variety of techniques that could be changed without notice. Finally, the law required reporting only of total pounds of releases, which varied widely in human exposure and toxicity; it did not require manufacturers to assess risks.

**"information triggered responses from manufacturers that far exceeded the expectations of the system's designers"**

Despite these limitations, placing standardized information about toxic releases from specific facilities in the public domain triggered responses from manufacturers that far exceeded the expectations of the system's designers and initial supporters. Large firms such as Monsanto and 3M announced that they would dramatically reduce their toxic releases.[28] Journalists and community organizations called attention to facilities with high levels of releases and ranked companies by total pounds of chemicals released. Regulators planned new initiatives and enforcement efforts.[29] According to EPA reports, facilities reduced their total releases of listed chemicals by 45.5 percent, from 3.2 billion to 1.5 billion pounds, between 1988 and 1999.

The system has also displayed surprising sustainability. It has been costly to manufacturers, calling into question their reputations as good citizens. Yet the requirement has expanded in scope, accuracy, and use. The number of chemicals reported has more than doubled, thresholds for reporting of particularly hazardous chemicals have been lowered, significant new sectors

(power plants and mining, for example) have been required to report, estimating techniques have improved, and use has increased.

Three factors have been responsible for these improvements. First, the Clinton administration played an entrepreneurial role in expanding disclosure administratively as one of its top environmental priorities. (Congress added one significant expansion, requiring reporting of total toxic waste and recycling in 1990.) Second, the disclosure system benefited from the strength of environmental organizations. Annual reporting raised public awareness of toxic pollution, making it a valuable tool to national groups. Third, information technology, particularly rapid growth in use of the World Wide Web, allowed users to customize data by factory, industry, chemical, and neighborhood. Intermediaries such as the Right-to-Know Network (rtknet.org) and Scorecard (scorecard.org), a Web-based disclosure system launched by Environmental Defense, have supplemented and expanded government systems (envirofacts.gov) to make the complex data more accessible. Manufacturers and trade associations also customize data and make it available on web sites to demonstrate improved performance.

Weaknesses persist, however. Lack of reliable information about chemical toxicity and exposure limit efforts to translate total pounds of releases into useful information about risks. The accuracy of disclosed data remains problematic since it is based on company estimates, arrived at using changeable techniques, with little or no outside monitoring. In addition, the scope of disclosure captures only a portion of toxic pollution. It does not track pollution from cars and trucks or from neighborhood sources such as gas stations and dry cleaners.

The politics of toxic chemical disclosure has matured into a struggle between contending environmental and business interest groups. Increasing use of the data as information technology advances combined with pressure from environmental and right-to-know groups may continue to prevent erosion of the scope and

accuracy of the information, despite high industry costs. These and other intermediaries will likely continue to develop their own expertise to improve risk assessments and public risk communication. However, future improvements in the scope and accuracy of toxic disclosure are likely to be intermittent, dependent upon political mandates created by infrequent crises or upon the priorities of entrepreneurial politicians.

*Disclosing Food Information to Reduce Disease*[30]

The Nutrition Labeling and Education Act of 1990 (NLEA) requires food processors to label products with amounts of key nutrients as a public health measure. Chronic diseases such as heart ailments, cancer, and diabetes are the largest causes of preventable deaths in the United States, killing more than 1.5 million people each year. Medical research has determined that the most important single factor in preventing and minimizing the effects of such diseases is improved diet. Before Congress acted, however, consumers had no way to assess the healthfulness of most products. Supporters of the law hoped that it would encourage Americans to eat healthier foods and put pressure on manufacturers to produce healthier products.

**"The law was appropriately heralded as the most important change in national food policy in 50 years."**

The new law forced food processors to list in standardized formats amounts of total fat, saturated fat, cholesterol, sodium, total carbohydrates, complex carbohydrates, sugars, dietary fiber, and total protein in each serving, in the context of amounts recommended for consumption as part of a daily diet. Companies also had to list total calories and calories from fat in each serving, and serving sizes were standardized to conform to amounts customarily consumed. Products that were not labeled accurately and completely could be deemed misbranded by the federal Food and Drug Administration and removed from the market. In 1994, when the law took effect, interested shoppers could compare nutrients in virtually every can, bottle, or package of processed food for the first time. The law was appropriately heralded as the most important change in national food policy in 50 years.[31]

Nutritional labeling was supported by unusual alliances. Consumer groups combined with organizations such as the American Cancer Society and the American Heart Association to promote nutritional labeling as a public health measure rather than simply a "right-to-know" cause. Entrepreneurial members of Congress, led by Representative Henry Waxman (D-CA) and Senator Howard Metzenbaum (D-OH), supported the campaign for a new labeling law. In the end, food processors themselves joined in supporting national action as preferable to the proliferation of conflicting state requirements. Some processors may also have judged that federal labeling would give them a competitive advantage.

**"Nutritional labeling improved in fits and starts, with several substantial setbacks."**

However, political compromise produced a disclosure system that left out many unhealthy foods, proved too complex for many shoppers to understand, and failed to inform the public about supplements with complex risks and benefits. Responding to industry pressure, Congress provided that fast food outlets, restaurants, grocery delicatessens, and small retailers did not have to label products they packaged, even though convenience foods are often particularly high in fat.[32] Pressured by influential groups such as the American Beef Cattlemen's Association, Congress also made labeling voluntary for fresh meats, poultry, and seafood, even though red meats were some of the most significant sources of cholesterol and fats linked to heart disease and cancer. Congress and the FDA also opted for a system of quantitative labeling that did not include color-coding, graphics, or other simple messages to alert shoppers whether foods were high in fat, sodium, or other nutrients that were linked to chronic diseases. And after an extraordinary lobbying effort by health food stores and the supplement industry, Congress placed herbal remedies and other dietary supplements on a separate—and ultimately less restrictive—track, even though little was known about their benefits and risks.

Nutritional labeling improved in fits and starts, with several substantial setbacks. After the law was passed, federal regulators translated its terms into a uniform label that became

respected, used by some shoppers, and accepted by the food industry. But improvement remained problematic and the scope of nutritional labeling contracted and expanded only at the margin. Congress narrowed the scope of disclosure with regard to dietary supplements just as the market for them was increasing rapidly, and manufacturers began to add them to conventional foods. New legislation in 1994 shielded supplements from the usual safety and disclosure rules for food and drugs.[33] On the other hand, the FDA broadened the scope of disclosure with regard to allergens when a two-year investigation by the agency revealed that a quarter of food plants visited failed to list all allergens on labels and that only half of manufacturers checked products for accurate labeling of ingredients.[34]

Trends in label use remained uncertain. Research suggested that complex labels were less useful to consumers over 60, recent immigrants, and others who lacked complete literacy than they were to more educated consumers. Most consumers did not understand the meaning of percent daily value, could be misled by "fat-free" or "cholesterol-free" claims, and remained unaware of the degree to which the government regulated label claims. In 2001, FDA economists concluded that "government regulation of label claims was an aspect of the new food label that was poorly communicated to American consumers."[35] Incomplete evidence suggested that the impact of labels on product choices may have declined somewhat over time. A third of shoppers in 1995 and 1996 said they had stopped buying a product within the last month or six months because of information on food labels, about the same portion as before government labeling rules were adopted (when only foods with added nutrients were required to be labeled, some manufacturers labeled products voluntarily, and ingredients were listed), according to surveys by the industry's Food Marketing Institute. In 1997 that portion decreased to 28 percent.[36]

By the end of the decade, sales of low-fat foods appeared to be leveling off or declining. Surveys showed a 12 percent decline from 1999 to 2000 in how often customers consumed fat-

free products. Sales declined 33 percent for fat-free potato chips, 22 percent for fat-free ice cream, and 12 percent for fat-free cookies and margarine in one year. Surveyors found consumers of fat-free foods disappointed with their taste and discouraged about their contribution to weight loss.[37] From 1996 to 1999, the portion of consumers who said they sought out low-fat, low-cholesterol, or low-salt foods declined substantially.[38] People had more information from increasing sources about diet and disease but were often frustrated about how to use it.

*Disclosing Union Finances to Minimize Corruption*

**"Its goal was to use transparency to reduce the likelihood of corruption in union activities."**

The Labor Management Reporting and Disclosure Act (LMRDA), enacted in 1959 in response to revelations of widespread union corruption, requires unions to reveal to their members' information regarding financial practices (revenues, expenditures, financial health) and governance procedures (constitution, changes to core governance documents) on an annual basis. Its goal was to use transparency to reduce the likelihood of corruption in union activities. Its framers envisioned that members would employ disclosed information to discover the use of dues for excessive salaries, improper expenses, or union activities not favored by the majority of members and then use federally protected union procedures to stop or change such activities. In the 1950s, more than a quarter of the workforce was unionized (as compared to 13 percent in 2001), and unions represented the majority of workers in steel and auto manufacturing, trucking, construction, food processing, and other industries central to the economy. Union leaders such as John L. Lewis, Walter Reuther, George Meany, and Jimmy Hoffa were prominent national figures. Unions held considerable political power, which provoked growing opposition, reflected in the Taft Harley Act's provisions to limit union practices and increase employer rights.[39]

In 1957, high-profile hearings chaired by Senator John L. McClellan (D-ARK) revealed racketeering in the labor movement. Union officials undertook voluntary reforms, but national attention created a demand for government intervention to reassure the

public of the honesty in union governance. In this crisis atmosphere, Congress approved the Landrum-Griffin Act, which placed limits on uses of union funds and established members' rights to run for office and voice their views on policies and candidates for union office. The disclosure provision of the law required unions to reveal information about constitutional provisions, financial activities, names and salaries of officers, and financial relations that could potentially cause a conflict of interest.

Compromise produced a disclosure requirement that was relatively narrow in scope and placed significant barriers in the way of use of the information by rank and file union members.[40] Disclosure focused on each union's balance sheet, loan activity, officer salary, and line item disbursements (e.g. for employee salary and benefits, administrative expenses, and rent and operating expenses) rather than on programmatic expenditures at the national and local union level.[41] From the start, disclosure imposed significant costs on union officers with few corresponding benefits, creating incentives to provide the minimal amount of information required,[42] although enforcement provisions were relatively strong.[43] Accessing this information was difficult in practice. To obtain the financial information, union members either had to go to a reading room at the Labor Department in Washington D.C., or to a regional office, or make a request by mail, paying a per-page charge.[44] Information remained fragmented. Regional offices carried only records relating to union affiliates in that geographical area.[45] In addition, most union members remained unaware that the information existed and, even for those who learned about it, reporting forms proved technical and difficult to interpret.[46] These high costs to individual users create a potential role for third parties. However, it is uncommon to find formal groups within unions acting independently of incumbent officers and capable of playing this third party role. Finally, the decline of union strength beginning in the early 1980s also made many in the labor movement reluctant to "air dirty laundry" in public for fear of providing ammunition to anti-union

employers and lowering public opinion of the labor movement. Even employers rarely used the information to discredit unions; they had more effective tools at hand.[47]

With high costs to disclosers and users, and few intermediaries available to lower user costs, it is not surprising that the scope, accuracy, and use of this disclosure system have not improved much in 40 years. The only significant expansion in scope has been to include reporting by financial institutions that make loans to unions. Accuracy of the information has improved little.[48] The financial categories and definitions have not been appreciably refined. Information is no more timely than it was in the past; reports are available months after year-end. And despite enforcement provisions, the Government Accounting Office in 2000 estimated an annual delinquency rate of 25 percent of unions. The likelihood of a record-keeping inspection was small, and most penalties were directed towards unions that have intentionally failed to file or falsified reports.[49] Overall use of information by rank and file union members has been minimal and relatively unchanging over time. Contrary to the aims of the requirement's framers, most users over the past three decades have been academics or business groups.[50] In 1997, a typical year, the Labor Department responded to only 8,000 disclosure requests from all sources (out of 13 million union members who were covered by the Act in that year). It is possible, however, that information technology will increase use in the future. By April, 2002, unions were able to obtain electronic forms via the Web, and records from 2000 and 2001 could be downloaded directly, lowering user costs substantially.[51]

**"the scope, accuracy, and use of this disclosure system have not improved much in 40 years."**

Even with Internet-based reporting, it seems unlikely that disclosure will improve in the future. The costs to disclosers remain substantially unchanged, and users may not perceive strong enough benefits to make it worthwhile to seek out information, even if access is easier. The decline in union strength over the past 40 years may also undermine disclosure as a tool to increase governance accountability. Thus, there is little prospect that disclosure will fulfill its architects' ambitious objectives.

*Disclosing Medical Mistakes to Reduce Deaths and Injuries*

Despite an urgent call by the prestigious Institute of Medicine in 1999 for a new disclosure system to reduce medical mistakes in hospitals, opposition from hospitals and doctors blocked federal efforts to improve transparency, and state reporting requirements generally proved unsustainable. As of 2002, the nation still had no accountability system for one of the largest causes of accidental deaths.[52] In its 1999 report, the Institute, an arm of the National Academy of Sciences, concluded that between 44,000 and 98,000 patients died in the United States annually as a result of hospital errors.[53] That was more than the 43,458 people who died in 1998 in motor vehicle accidents, the 42,297 who died from breast cancer, and the 16,516 who died from AIDS. In addition, as many as 938,000 hospital patients were injured each year by such errors. High rates of error were costly not only in deaths and injuries but in loss of trust by patients in the health care system, loss of morale by health care professionals, loss of productivity by the workers who were their victims, and in many other ways. In economic terms alone, estimated national costs of preventable hospital errors resulting in injury or death totaled between $17 and 29 billion a year.[54] Such deaths and injuries were not the result of rare slips by bad doctors. They were extreme examples of patterns of care that created systematic risks. "These stunningly high rates of medical errors," William C. Richardson, the panel's chairman, argued, "are simply unacceptable in a medical system that promises first to 'do no harm.'"[55]

**"errors are simply unacceptable in a medical system that promises first to 'do no harm.'"**

Instead of new rules or stiff penalties for doctors, the Institute called on Congress and state governments to require standardized public disclosure by health care organizations of incidents where medical treatment resulted in death or serious injury. Public disclosure was needed to hold providers accountable for serious errors, create incentives to reduce them, and respond to the public's right-to-know. The report recommended that Congress also take action to encourage voluntary, confidential reporting of less serious errors and near-misses by doctors, nurses, and other

health care workers. Such internal hospital reporting would create a knowledge base that would translate the pressures created by public reporting into appropriate corrective actions by hospital managers. The report drew national media coverage for two reasons. First, it documented a serious national problem that defied conventional wisdom. Not only were medical errors a major source of deaths and injuries, but they occurred even at good hospitals. Second, it suggested that something could be done about the problem—and done quickly.[56]

Response was immediate. President Bill Clinton announced that he favored national action to reduce medical errors by 50 percent in five years, including the creation of a new national office of patient safety, as the Institute's panel had recommended. He promised that hospitals that were operated by the military, or the Veterans Administration, or that received funds from the federal Medicare program would take immediate steps to promote patient safety. Leading Democrats and Republicans introduced at least seven bills to carry out the Institute's recommendations, and Congress appropriated $50 million for fiscal 2001 for a federal office of patient safety and for new research. Fifteen state legislatures also took up proposals aimed at reducing errors. The issue received national media attention for weeks after the report was released. A poll taken by the Kaiser Family Foundation two weeks after the report found that an astonishing 51 percent of respondents were aware of the report. The private Joint Commission on Accreditation of Healthcare Organizations (JCAHO), which accredited hospitals and had been criticized for conducting only planned visits, announced that its representatives would start making random inspections in January 2000. Executives of several large companies, including General Motors and General Electric, redoubled their efforts to use better information about errors to guide employees to the safest health care providers. Donald M. Berwick, head of the Institute for Healthcare Improvement, a nonprofit organization that worked with hospitals to improve quality of care, defined the moment: "I have never before seen such a tremendous opportunity for

improvement as we now have due to public attention to the issue of patient safety. If we act promptly and with courage, millions of future patients will be saved the pain and risk of injury from errors in their care."[57] A national campaign for transparency to improve patient safety, considered long overdue by many experts, appeared to be underway.[58]

However, within months, conflicting interests created a political stalemate. The apparent consensus for national action splintered into conflicts among groups representing doctors and hospitals, public health advocates, state interests, consumer concerns, and trial lawyers. When the debate got down to specifics, the American Medical Association and the American Hospital Association opposed the kind of hospital-by-hospital disclosure of serious errors that would be meaningful to consumers. They feared liability, embarrassment, and public misunderstanding and expressed doubts that any disclosure system could adjust adequately for differences in patient populations. In at least some instances, economic incentives may also have been perverse, although no one suggested that hospital executives acquiesced for economic reasons. Serious errors often meant extended hospital stays and added procedures that could be costly to patients and their insurers but could mean added revenue for the hospitals themselves. Medical organizations clashed with the American Nurses Association and a variety of consumer groups that supported such transparency. Organizations representing health care providers also argued that information about errors should have broad protection from discovery in lawsuits. On that issue they were opposed by the American Trial Lawyers Association, which sought to narrow such confidentiality. A new federal office of patient safety and a promising public-private coalition, the National Quality Forum, attempted to encourage research and grapple with the issue administratively as did several oversight groups. Some hospitals created their own systems for identifying and acting on medical errors. But a consensus for congressional action remained elusive.[59]

**"Not only were medical errors a major source of deaths and injuries, but they occurred even at good hospitals."**

Disclosure proposals were buried because well-organized disclosers anticipated that reporting would have very high costs, and users were neither well organized nor strongly represented. Hospitals perceived that disclosure would be costly in potential liability and negative effects on reputation as well as in budget impact. While researchers failed to find links between disclosure and liability (individual patient information was never released), hospital managers believed that disclosure would increase malpractice liability. Many also feared the reputational effects of patients drawing overly broad conclusions from limited data on errors. Most hospitals in the United States were already suffering from financial difficulties, and the cost of malpractice insurance was on the rise. Several factors may have accounted for the lack of sustained public pressure by users to promote disclosure. First, errors were isolated events that usually created health risks for only one individual. Second, for most users, hospital visits were rare and unplanned events. Third, with managed care in the ascendancy, many patients may have concluded that they had little or no choice among hospitals. Fourth, patients themselves often remained unaware that errors had occurred in their treatment or the treatment of others. Few intermediaries kept up pressure for change. In addition, all interest groups recognized that successful reporting required substantial and continuing efforts by hospitals that could not simply be dictated by government authorities. Collecting and verifying such information was costly to hospitals, especially the process of distinguishing inevitable adverse events from errors. It meant encouraging health care professionals to report their own mistakes and those of others, an inherently difficult task made harder by fears of personal liability. Clearly, this was not a case of simply requiring organizations to produce information that was already on hand.

One significant intermediary group, large purchasers of health care, did initiate and sustain a major effort to reduce medical errors, but they chose to rely on market forces rather than government action to produce improvement. By 2000, 80 companies and public purchasers had joined the Leapfrog Group,

a coalition of large purchasers sponsored by the Business Roundtable and committed to improving patient safety. The human toll taken by errors on their employees was large and preventable. The Leapfrog Group looked for changes that would produce significant reductions in errors, could be introduced quickly, would be appreciated by patients, and could be easily monitored. It came up with three goals: referring patients to hospitals with the best outcomes for specific procedures; encouraging hospitals to adopt computerized entry systems for prescriptions; and assuring that intensive care units were staffed with physicians trained in critical care. Ultimately companies hoped to use these criteria to choose which hospitals to do business with. Members launched their own initiatives. Ford and General Motors mailed a consumer's guide to employees in Cleveland, Atlanta, Buffalo, and other cities that graded local hospitals on deaths, complications, and lengths of stay for common procedures. General Motors also launched a $15 million, 3-year program to buy handheld computers for 5,000 physicians that treated the company's employees to provide automated entry of prescriptions and access to the latest medical literature.[60]

**"The idea that the public needed to be informed about serious medical errors quickly receded from the national agenda."**

Some hospital managers continued or expanded efforts launched in the 1990s to identify patterns of errors and take corrective actions. The LDS Hospital in Salt Lake City used computerized medical records to monitor medical errors. By 1991, the system alerted health care workers to situations that might cause errors—sudden changes in doses, abnormalities in laboratory tests, and possible drug interactions, for example. David Classen reported in 1991 that automated detection resulted in a 60-fold increase in detection of adverse events due to medication.[61] At Brigham and Women's Hospital in Boston, introduction of computerized systems for ordering medications reduced medication errors by more than half.[62] In 1998, a year before the Institute of Medicine reported the magnitude of errors, Kenneth W. Kizer, undersecretary for health in the U.S. Department of Veterans Affairs, had called for the department's 173 medical centers to initiate voluntary, confidential reporting of

most errors. Under his leadership, the Department devoted substantial resources to patient safety, including extra training for hospital staff, computerizing and bar-coding medication ordering, and using error reports to make changes in patient care.[63] The Department of Defense, which operated hospitals and clinics for military personnel and their families, took similar steps. In addition, federal authorities required the 300 programs that provided health care for federal employees to initiate patient safety programs and disclose the elements of those programs to consumers.

However, at least in the short term, conflicting values, political interests, and resource shortages blocked efforts to place much of this new knowledge in the service of reducing risks. Information strategies proved controversial and often costly. The idea that the public needed to be informed about serious medical errors quickly receded from the national agenda. The idea that hospital managers needed confidential, voluntary reporting of less serious errors to improve practices remained entangled in a congressional debate about the appropriate scope of confidentiality. Physicians' concerns about liability countered efforts to improve reporting. State officials' concerns about federal control countered efforts to standardize information. Hospital administrators' concerns about financial stability slowed adoption of systems to uncover, analyze, and correct errors. A rare alignment of new understanding, promising approaches, and national attention created an opportunity to save lives and reduce injuries. A familiar combination of practical obstacles blocked efforts to take advantage of it. Pockets of innovation reduced errors at some hospitals but also highlighted gaps between promise and practice. For the public at large, little changed.

## Conclusion: Crafting Effective Transparency Policies

Because many transparency policies impose concentrated costs on a limited number of disclosers for the sake of dispersed

beneficiaries, the deck is stacked against them. Transparency is effective regulation only if it influences the performance of targeted organizations in the direction of a specified policy goal. Improvements in quality, scope, and use are necessary, though not sufficient, pre-conditions for effectiveness. Systems that do not keep pace with changing markets and public priorities can become counterproductive.

Despite these challenges, some disclosure programs have improved in scope, quality of information, and use, as these six cases illustrate. Others have stagnated, imposing costs on disclosers without providing real benefits to users. **Table 2** provides an assessment of these six cases as well as a preliminary assessment of several other major transparency policies.

Policies that have improved in scope, accuracy, and/or use since their inception include financial disclosure, nutritional labeling, disclosure of the distribution of bank mortgage loans to improve equity in lending, and reporting of campaign financing to minimize corruption. Other disclosure systems started as weak compromises and have largely remained weak over time because of the nature of user and discloser benefits and costs. These include disclosure of union finances and advanced notice of plant closing or large-scale terminations reporting. Finally, the sustainability of some systems remains uncertain: they have improved in some respects and stagnated in others.

*What Makes a Disclosure Policy Sustainable?*

The political economy of disclosure developed in our analytic framework provides an explanation for these diverse outcomes. Insights from the framework and detailed case studies suggest more general policy implications.

First, we identify the central elements that our analysis suggests are necessary preconditions for a sustainable transparency policy. Although public policies cannot directly affect these factors, they provide guidance regarding when

disclosure is likely to be effective and when it is not. Transparency policy has broad appeal across the political spectrum, partly because it is difficult to argue that providing information has negative consequences. Thus, such policy is embraced by those who see it as a way of achieving important social goals by engaging information users and by those who see it as a palliative that can stave off more invasive forms of regulatory intervention. Our analysis argues for a more careful approach. We suggest that disclosure policies require certain circumstances in order to flourish. In particular, transparency policies should be focused on a subset of policy arenas that have three broad characteristics.

**"crises enabled proponents of transparency to overcome inherent asymmetries of information"**

**1. Strong political intermediaries representing information users**

Disclosure policies are likely to be more sustainable where advocacy groups or entrepreneurial politicians representing user interests are able to continue to participate in the policymaking environment. In most of the cases summarized here, crises enabled proponents of transparency to overcome inherent asymmetries of information: disclosers, who bear most of the costs of transparency, are better organized politically than potential users who tend to receive more benefits from the policies. Hence, financial disclosure passed in the wake of the stock market crash and Great Depression benefited from the growth of institutional investors, stock exchanges, stock analysts, and other organizations that had interests in maintaining the integrity of the system as well as from politicians who translated the momentum of later crises into system improvements. Disclosure of mortgage lending improved as community groups and state taskforces gained strength. Disclosure of toxic chemicals benefited from the political influence of national environmental groups. User groups are often critical at the operational level as well. Community reinvestment groups make mortgage lending data accessible and negotiate with individual banks to change their practices. National environmental and right-to-know groups translated complex data concerning toxic releases into a Web-based system that made possible searches by community, chemical, company, and facility. Absent such

organized political activity and groups to interpret information and put it to use on the behalf of users, the expected political dynamic will return, and disclosure policies will stagnate or erode.[64]

**2. Comprehensible Information Content**

Transparency policies can require information to be conveyed in a manner that is readily interpretable by intermediaries and/or end users. This in turn requires that information have four major characteristics:

- Core metrics must be understood and agreed upon by interested parties.
- Core metrics must be relatively simple in format.
- Users must be able to respond to the data without significant cognitive distortions. This aspect affects both the type and quantity of information provided to potential users.
- Metrics must have some degree of comparability across different sources.

Financial disclosure, of course, benefits from the ability to translate complex corporate changes into the universal metric of dollars and from 70 years of work toward common definitions of key terms. But some social transparency systems have also developed consensus metrics that provide comparability. Despite their shortcomings, nutritional labels provide standardized information in a form that allows some consumers to quickly understand and use it. Listed percentages of daily-recommended requirements provided by products establish a benchmark for consumption. The system also allows consumers to compare nutrient levels across different products that all carry similar labels and assessments.

**3. Some Disclosers Derive Benefits from Transparency**

The more that significant groups of disclosers benefit from releasing information under a mandated disclosure policy, the more improvement one can expect in the system. As we have

seen, competitive pressures and efforts to avoid more intrusive regulatory systems sometimes produce such benefits. Disclosers that perceive benefits from improved transparency create pressures for change in two ways. They may lobby for system changes. In the wake of accounting scandals in 2001, for example, some publicly traded companies advocated expensing stock options. When scientists concluded that folic acid could help prevent birth defects, food processors urged regulators to allow them to communicate that information on labels. They may also create pressure by example. The willingness of some disclosers to provide more or better information than others or to make changes in practices in response to new informationcan in turn create a dynamic that increases the threshold for information disclosure as a whole. When forced to disclose toxic releases, for example, some companies made voluntary commitments to reduce their levels, creating reputational challenges to other manufacturers. Similarly, in the case of federal campaign disclosure, candidates have been compelled to release information beyond the minimum required under the law because their opponents voluntarily chose to do so. Thus, if there are significant divergences in the willingness among disclosers to provide information, transparency can expand over time because of the jockeying that occurs between disclosers.[65]

**"The more that disclosers benefit from releasing information the more improvement one can expect in the system."**

*What Improves the Sustainability of Disclosure Policies?*

Transparency policies that satisfy the major preconditions discussed above may still face significant barriers to improvement. New transparency policies, informed by an understanding of the political economy of disclosure, can be crafted to change aspects of the disclosure system in ways that create conditions for even more sustainable development.

**1. Strengthening User Intermediaries**

Policymakers can fashion transparency systems that encourage continuing oversight by intermediaries representing users. Design elements may include periodic re-assessments of

disclosure effectiveness, including required analyses and opportunities for public participation; designing policies in ways that lower the cost to third parties of accessing information; providing on-going roles for user groups in serving on advisory councils or providing audits; and providing adequate funding for such analysis and participation.

Policymakers can also enact companion laws that help to strengthen incentives for user groups to participate in pressing for improvements and align incentives for such groups with policy objectives. The Community Reinvestment Act, for example, provided community groups with an incentive to analyze HMDA data, because they could use them to negotiate CRA agreements with banks and to target lenders that were discriminating against certain neighborhoods. Legislative changes to the financial disclosure system should include improving the incentive alignment between accounting firms and investors as a major reform to that system. Reforms that attempt to lower user costs and improve incentives for user groups are natural steps towards improving sustainability.

**"transparency can expand over time because of the jockeying that occurs between disclosers"**

**2. Encouraging Effective Enforcement**

Transparency is not self-enforcing. Some accounts have suggested that it constitutes a substitute for methods of traditional regulation, thus eliminating the problem of ensuring compliance through enforcement tools. Although transparency works through very different mechanisms than traditional regulation, enforcement remains an essential part of each system. In economic terms, disclosers' assessments of costs and benefits include expected costs of non-compliance (that is, the costs associated with failing to report or reporting inaccurately, factoring in the likelihood of getting caught). Unreliable information also can reduce benefits for users, who will not find it worthwhile to interpret and act on flawed facts. Thus, enforcement policies are an important component of improving the sustainability because they raise the costs of non-compliance. Enforcement of campaign finance reporting, initially weak, improved as new crises revealed

flaws in reporting and led to wider use. In contrast, there is no systematic mechanism for auditing the toxic release data provided by companies, although the penalties for failing to disclose are quite high. The Department of Labor does undertake some review regarding the accuracy of previously filed reports and attaches penalties to both the failure to file reports and for filing incomplete or false information concerning union finances. However, the low probabilities of inspection and the modest size of actual penalties in practice make the expected cost of non-disclosure fairly low.

**3. Taking Advantage of Regulatory Synergies**

**"The impact of disclosure policies can be enhanced when they are reinforced by related policies"**

The impact of disclosure policies can be enhanced when they are reinforced by related policies that increase the political value of information or increase the stakes associated with good and poor performance. The force of bank lending disclosures, for example, was dramatically strengthened by the Community Reinvestment Act (CRA), which provides for remedies to communities that have experienced systematic discrimination. CRA created legal sanctions to change bank behavior, while the disclosure requirement provided the informational infrastructure that allowed third parties to identify banks whose behavior needed changing—those with discriminatory lending practices. A different regulatory dynamic has arisen between disclosure of toxic releases and the EPA's larger regulatory agenda. Performance has been used as a means of targeting enforcement efforts, in part based on changes in toxic releases over time.[66]

**4. Complementing Market Interactions**

To the extent that disclosed information becomes integrated into larger market decisions, transparency policies will be pushed to improve along the three dimensions of sustainability. In such instances, information helps to harness market forces to push towards social objectives. As markets come to value that information, the importance of disclosure itself and the incentives to improve disclosure (at least for some parties) both increase. For example, disclosure of toxic releases has been shown to have effects on capital market valuations of firms, at least initially. This

effect arises in part because government policies to increase information about discharges increased awareness of investors and the capital market to potential problems associated with toxic releases. As a result of this link between TRI information and capital market, costs increased for disclosers (because those disclosers have more to lose as a result of the information). At the same time, the capital market valuations demonstrate that toxic release activity is valued by markets and as such warrants more attention than might have been paid by corporations where there was no mechanism to value this information through a market mechanism.

Nutritional labeling represents a complicated case of disclosure and market interactions. On one hand, the use and interest in information provided by food companies on labels provided incentives for companies to adjust product offerings to include nutritional preferences in making product mix decisions. However, in certain instances as consumers became impatient with connection between "low fat" and weight loss, or became confused about the meaning of new medical studies on nutrition, consumer interest in labels—and its market kick—became more attenuated. The long-term credibility of nutritional labels to food consumers will then, in the long run, have a major impact on the opportunities for further improvement of that system.

---

We are now testing a proposition of growing importance in public life: that government can legislate transparency. For nearly 70 years, a centerpiece of American financial policy has been the idea that disclosure by publicly traded companies can reduce ordinary investment risks. After the stock market crash of 1929, millions of Americans were left holding worthless securities. Congress responded by mandating public reporting of corporate profits and balance sheets in the Securities and Exchange Acts of 1933 and 1934. Those disclosure requirements

have formed the basis for confidence in securities markets ever since.

Many of the transparency systems discussed above, including financial disclosure, rely on standardized reporting of factual information, company-by-company or product-by-product. They aim to further public priorities by creating political and economic pressures for organizations to improve their practices. Such systems must be dynamic in order to be effective. All begin as imperfect compromises. Congress initially exempted securities issued by railroads, banks, and governments from financial disclosure. Nutritional labeling left out products that account for about half of families' food budgets, including those sold in fast-food outlets, restaurants, and grocery delis. Union financial disclosure laws required reporting on only broad areas of line item expenditures.

To produce information that is accurate and useful, these systems must evolve to keep pace with changing markets, advancing science and technology, and new political priorities. As a result, there is a need for continuing vigilance to find ways to enhance the incentives for disclosure and close loopholes that distort data. Likewise, it is crucial to find new ways of communicating with increasingly diverse information recipients, including the intermediaries that play critical roles as agents for final users.

We have shown that improving transparency is no simple matter. New facts alter competitive advantage and change the benefits and costs for disclosers. They empower some interests and threaten others, rearranging the political environment surrounding the transparency system. Continued improvement depends on the growth of user constituencies that stand to benefit from public access to more accurate and complete information.

Despite recent crises in financial disclosure, the scope and accuracy of disclosure has improved markedly since the 1930s. Until the 1970s, the SEC didn't even require uniform accounting

standards. After the 1960s explosion of hostile takeovers and conglomerate mergers, regulators called for advance notice of plans to buy large blocks of stock and more detailed accounting of earnings. When illegal campaign contributions and falsification of corporate records created public alarm, additional checks encouraged management oversight. It is very likely that the constellation of factors that have brought the financial disclosure system into better balance in past crises will ultimately lead to positive changes in the use, accuracy, and scope of the system following the present one. These improvements, imperfect as they have been and will continue to be, reflect a common interest in improving the system's integrity.

The larger issue posed by the current crisis goes beyond financial disclosure to the new systems that cover reporting of environmental, safety, and health risks — everything from nutritional labeling to medical errors. The lesson of the recent financial disclosure crisis is abundantly clear. Without constant political oversight, careful attention to the benefits and costs surrounding disclosers and users, awareness of the impact of changes in the market and regulatory environments surrounding the disclosure system, and vigilant and well-funded enforcement efforts, the disinfecting power of disclosure soon fades.

**Table 1**
**Information Disclosure Systems: An Overview of Major U.S. Policies**

| DISCLOSURE SYSTEM | YEAR | INFORMATION DISCLOSED | PRIMARY DISCLOSERS | PRIMARY USERS | ACTIVE 3rd PARTY: POLITICAL LEVEL | ACTIVE 3rd PARTY: OPERATIONAL LEVEL |
|---|---|---|---|---|---|---|
| Financial disclosure (SEC) | 1933 | Financial characteristics of companies | Public companies | Investors & financial inter-mediaries | Yes—Many | Yes—Many |
| Home Mortgage Disclosure Act | 1975; amend in 1989 (FIRREA) | Lending activity at the detailed community level | Banks and other lending institutions | Community groups | Yes—Many | Yes—Some |
| Toxic Release Inventory | 1986 | Amount of toxic releases | Manufacturers | Public in areas exposed to toxic releases | Yes—Some | Some |
| Nutritional Labeling | 1994 | Nutrients in most processed foods | Food companies | Consumers | Yes—Some | No |
| LMRDA | 1959 | Financial expenditures and status of the union | Labor unions | Labor union members | Few | Few |
| Medical mistakes legislation | 1998-2000 (Not passed) | Mistakes in patient treatment | Hospitals and health care providers | Patients; major health care purchasers | Yes | Some |
| Federal Election Act | 1973 | Source and amount of political contributions | Political candidates and parties | Voters | Yes | Many |
| School Report Card Reporting | 1994 (Federal); States: Various years | School level performance | Individual schools | Families with school children | Yes | Some |
| Automobile Safety Reporting | 1978 | Performance of cars in crash test | Automobile manufacturers | Consumers | Yes | No |
| Megan's Law | State by state: WA: 1990 CA: 1994 | Residency status of dangerous offenders released from prison | Police departments and convicted felons | Concerned public | Yes | Some |
| Hazard Communication Standard (OSHA) | 1983 | Presence of hazardous material and their risks | Employers | Workers | Few | Some |
| Worker Adjustment Retraining & Notification Act | 1988 | Plans of large scale termination/ facility closings | Large companies | Affected workers and communities | Few | Few |

**Table 2**
**Disclosure System Improvement: A Qualitative Assessment**

| | | IMPROVEMENT IN DISCLOSURE SYSTEM METRICS OVER TIME (SUSTAINABILITY) | | |
|---|---|---|---|---|
| **DISCLOSURE SYSTEM** | **YEAR ESTABLISHED** | **AMOUNT OF USE** | **ACCURACY OF INFORMATION** | **SCOPE OF INFORMATION** |
| Financial disclosure (SEC) | 1933 | Yes | Yes | Yes |
| Home Mortgage Disclosure Act | 1983 | Yes | Yes | Yes |
| Toxic Reduction Inventory | 1987 | Yes | No | Yes |
| Nutritional Labeling | 1994 | Increased relative to pre-legislation; some fall back in recent years | No | Fast foods—No<br>Supplements—No<br>Allergens—Yes |
| LMRDA | 1959 | No | No | Minimal |
| Medical mistakes legislation | 1998-2000<br>(Not passed) | No | No | No |
| **Other major disclosure systems[a]** | | | | |
| Federal Election Act | 1973 | Yes | Loopholes in law and implementation lower accuracy | More entities covered;<br>Some efforts to capture soft money |
| School Report Card Reporting | 1994<br>(Federal);<br>States: Various years | Increasing use by parents, educators, third parties (e.g. real estate; corporate recruiters) | No standardization across states;<br>Problems of "grade inflation";<br>Many attempts to make information more user friendly | Types of schools requiring disclosure have not changed; Measure of improvement grow in many states |
| Automobile Safety Reporting | 1978 | Yes | Yes | Yes<br>(e.g. roll overs) |
| Megan's Law | Different states:<br>WA: 1990<br>CA: 1994 | WA: State finds ways to get information out to community<br>CA: State thwarts wide access | WA: Timely provision of information a focus of ongoing efforts;<br>CA: Updates on an annual basis | WA: Scope of offenders on registry expanded<br>CA: Some evidence of expanded scope of offenders |
| Haz/Com Standard (OSHA) | 1983 | No (Workers)<br>Yes (Companies: Use for operational purposes) | Some | No |
| WARN | 1988 | No | No | No |

[a]These disclosure systems are evaluated in research currently underway by the authors.

## ENDNOTES

1 For detailed analyses of transparency policies in Europe, developing countries, and international organizations, see Florini, Ann, "The End of Secrecy," *Foreign Policy*, Summer 1998, and "Does the Invisible Hand Need a Transparent Glove? The Politics of Transparency," *Annual World Bank Conference on Development Economics 1999* (The World Bank, 2000); Chayes, Abram and Antonia Handler Chayes, *The New Sovereignty* (Harvard University Press, 1995); Nelson, Paul J. "Transparency Mechanisms at the Multilateral Development Banks," *World Development*, Vol 29. No. 11, 2001; and Reinicke, Wolfgang, *Global Public Policy: Governing Without Government?* (Brookings Press, 1998).

2 Graham, Mary, *Information as Risk Regulation: Lessons from Experience* (Institute for Government Innovation, OPS-10-01, 2001).

3 Seligman, Joel, *The Transformation of Wall Street* (Northeastern University Press, 1995) pp. 41-42.

4 Seligman, Joel, *The Transformation of Wall Street,* pp. 69-72. Quote appears at p. 71.

5 The law gave the government authority to "prescribe the methods to be followed in preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and non-recurring income, in the differentiation of investment and operating income and in the preparation of income accounts." Quoted from Previts, Gary John and Barbara Dubis Merino, *A History of Accountancy in the United States: The Cultural Significance of Accounting* (Ohio State University Press, 1998) (hereafter Previts, Gary, A History of Accountancy in the United States) p. 273.

6 Seligman, Joel, *The Transformation of Wall Street,* pp. 418-431. Quote appears at p. 431.

7 Seligman, Joel, *The Transformation of Wall Street*, pp. 431-437.

8 Kripke, Homer, "Accounting: What Does It All Mean? The Commission's Biggest Failure" in Zeff, Stephen A., *Financial Accounting Theory*, pp. 62-66 (quote appears at p. 62). See also Previts, Gary, *A History of Accountancy in the United States*, pp. 271-276.

9 The FASB was governed and financed by a new Financial Accounting Foundation, a nonprofit organization whose trustees were nominated by five leading accounting organizations (though still elected by the board of the AICPA). Task forces drawn from a spectrum of interested groups as well as a broad-based advisory council gave the FASB broader accountability. Unlike the previous Board, its seven members held full-time positions and did not have other business affiliations. Soon after the Board began operation, the SEC issued a policy statement recognizing its opinions as authoritative. Pacter, Paul A., "The FASB after 10 Years," in Zeff, Stephen A., *Financial Accounting Theory*, pp. 6-10. See also Seligman, Joel, *The Transformation of Wall Street*, pp. 452-466, 554.

10 Pacter, Paul A., "The FASB after 10 Years," in Zeff, Stephen A., *Financial Accounting Theory*, pp. 10-18; Seligman, Joel, *The Transformation of Wall Street*, pp. 555-557.

11 One response was the Securities Investor Protection Act of 1970. It produced new SEC disclosure rules that required broker-dealers to give notice when new capital was insufficient or records were not current. Seligman, Joel, *The Transformation of Wall Street*, pp. 451-465.

12 The scandal led to the 1977 Corrupt Practices Act, which required companies to maintain new accounting controls to assure that transactions were authorized by management. This additional transparency was designed to discourage illegal transfers. Seligman, Joel, *The Transformation of Wall Street,* pp. 539-549.

13 Seligman, Joel, *The Transformation of Wall Street*, pp. 549-550.

14 Levitt is quoted in Norris, Floyd, "Levitt to Leave S.E.C. Early; Bush to Pick 4," *The New York Times*, December 21, 2000, p. C1.

15 Coffee, John C., Jr., "Guarding the Gatekeepers," *The New York Times*, May 13, 2002, p. A19. See also Emshwiller, John R. and Rebecca Smith, "Behind Enron's Fall, A Culture of Operating Outside Public's View," *The Wall Street Journal*, December 5, 2001, A1; Byrnes, Nanette and David Henry, "Confused About Earnings?" *BusinessWeek*, November 26, 2001, p. 77 (cover story); Schroeder, Michael and Greg Ip, "The Enron Debacle Spotlights Huge Void in Financial Regulation," *The Wall Street Journal,* December 13, 2001, p. A1.

16 On proposals for reform, see, for example, Hill, Andrew, "Companies face new pressure on stock options," *The Financial Times*, May 13, 2002, p. 1; "Wasted Energy," *The Economist*, December 8, 2001, p. 13; Malkiel, Burton, "Watchdogs and Lapdogs," *The Wall Street Journal,* January 16, 2002, p. A; Stone, Peter H. and Shawn Zeller, "Enron's Collapse Renews Old Battles," *National Journal*, January 19, 2002, p. 182.

17 We discuss several instances of this type of competitive positioning in the wake of recent corporate disclosure scandals in the final sections of this paper.

18 A more detailed discussion of the issues in this section can be found in Fung, Archon, Mary Graham, and David Weil, "The Political Economy of Transparency: Foundations of Continuous Improvement in Information-Based Regulation" *Working Paper*, Transparency Policy Project, John F. Kennedy School of Government, September 2002.

19 Wilson, James Q., "The Politics of Regulation" in *The Politics of Regulation* (New York: Basic Books, 1980), p. 370.

20 In the late 1980s several banks were specifically focusing on affordable housing in the New York area, among them Chemical Bank, Manufacturers Hanover Trust, and Dime Savings Bank. Chemical Bank proved to be particularly progressive lender. In 1995 its president, Edward D. Miller stated that "timely disclosure of information on home mortgage lending by race and gender has shown us where we need to step up our efforts and has given us the impetus to move forward". From "Keep Credit Available to All," *The Washington Post*, August 11, 1995.

21 However, the prospects for political improvement are bounded by the factors described in the previous section.

22 Later on, Proxmire played a determinant role in the enforcement of fair lending legislation. In 1988 he held public hearings in which he urged regulatory agencies to take a more aggressive position to assure lending to low income areas, and in the late 1980s regulators started to deny banks' merger applications on the grounds of poor lending to local communities.

23 Following a wave of deregulation in the early 1980s, many Savings and Loans diversified their investments into unfamiliar areas. By 1987, hundreds of Savings and Loans had failed, the Federal Savings and Loan Insurance Corporation was insolvent, and losses amounted to more then $100 billion.

24 The argument of community organizations promoting the expansion of the regulation was that they represented neighborhoods that had not benefited from the bad loans that caused the S&L debacle, therefore they should not suffer the public costs of the bailout.

25 National Community Reinvestment Coalition. *CRA Commitments*. (Washington, D.C.: National Community Reinvestment Coalition, 2001).

26 The study analyzes the performance and profitability of CRA-related lending and reports that nearly two-thirds of responding institutions agree that CRA-related lending has opened new business opportunities and that it serves as a tool to promote a good image of banks in the community. The study shows that CRA lending is overall profitable or marginally profitable and that performance of CRA lending activities in general does not differ from other non-CRA-related mortgage activities. Board of Governors of the Federal Reserve System. *The Performance and Profitability of CRA-Related Lending.* (Submitted to Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999). July 17, 2000.

27 This account draws on several detailed analyses of the Toxics Release Inventory, including Karkkainen, Bradley C., "Information as Environmental Regulation," *Georgetown Law Journal* (January, 2001); Fung, Archon and Dara O'Rourke, "Reinventing Environmental Regulation from the Grassroots Up," *Environmental Management*, Vol. 115, No. 25 (2000); Graham, Mary, *Democracy by Disclosure* (Brookings/Governance Institute, 2002); Graham, Mary and Catherine Miller, "Disclosure of Toxic Releases in the United States," *Environment*, October, 2001, pp. 8-20; Pedersen, William F., "Regulation and Information Disclosure," *Harvard Environmental Law Review* (April, 2000); Cohen, Mark A., "Information as a Policy Instrument in Protecting the Environment: What Have We Learned?," *Environmental Law Reporter,* April 2001, p. 10425; Case, David W., "The Law and Economics of Environmental Information as Regulation," *Environmental Law Reporter*, July 2001, p. 10773.

28 Hamilton, James T., "Pollution as news: media and stock market reactions to the toxics released inventory data.," *Journal of Environmental Economics and Management* 28, no. 1 (Jan 1995): 98-113.

29 Fung, Archon and Dara O'Rourke. "Reinventing Environmental Regulation From The Grassroots Up: Explaining And Expanding The Success Of The Toxics Release Inventory" in *Environmental Management*. Vol. 25, No. 2 (February 2000):115-27.

30 This account is drawn from a longer case study in Graham, Mary, Democracy by Disclosure (Brookings/Governance Institute, 2002).

31 These provisions are set forth at 21 U.S.C. 343(q)(1). See also signing statement, P.L. 101-535, 26 Weekly Compilation of Presidential Documents 1795.

32 The Institute of Medicine, *Nutrition Labeling: Issues and Directions for the 1990s* (National Academy Press, 1990) pp. 90-91, 144-150.

33 Dietary Supplement Health and Education Act of 1994, 21 U.S.C. 321 et seq.

34 Winter, Greg, "F.D.A. Survey Finds Faulty Listings of Possible Food Allergens," *The New York Times,* April 3, 2001, p.C1; Winter, Greg, "Tighter Standard on Food Labeling is Set by Industry," *The New York Times,* May 31, 2001, A1.

35 Derby, Brenda M. and Alan S. Levy, "Do Food Labels Work?" in Bloom, Paul N. and Gregory T. Gundlach, eds., *Handbook of Marketing and Societ*y (Sage Publications, Inc., 2001) pp. 372-383, quote appears at page 384. See also Kristal, Alan R. et al., "Trends in Food Label Use Associated with New Nutritional Labeling Regulations," *American Journal of Public Health*, August 1998, pp. 1212-1215 (from 1993 to 1996, the portion of women surveyed who usually used labels increased from 34 to 43 percent and men from 16 to 27 percent) and Haldeman, Lauren, et al., "Development of a color-coded bilingual food label for low-literacy Latino caretakers," *Journal of Nutritional Education*, May/June, 2000, pp. 152-160 (on the challenges that labeling presents to immigrant groups).

36 Derby, Brenda M. and Alan S. Levy, "Do Food Labels Work?" in Bloom, Paul N. and Gregory T. Gundlach, eds., *Handbook of Marketing and Society* (Sage Publications, Inc., 2001) pp. 380-381.

37 Tannenbaum, Jeffrey A., "Fat-free Store Tries to Gain Weight as U.S. Gets Greasy," *The Wall Street Journal*, February 13, 2001, p. B2. Results are from surveys by ACNielsen and NPD Group Inc.

38 Shoppers who said they sought out low-fat products declined from 81 to 77 percent, those who sought out low-cholesterol products declined from 70 to 60 percent and those who sought out low-salt products declined from 61 to 53 percent. Derby, Brenda M. and Alan S. Levy, "Do Food Labels Work?" in Bloom, Paul N. and Gregory T. Gundlach, eds., *Handbook of Marketing and Society* (Sage Publications, Inc., 2001) p. 390.

39 The Taft-Hartley Act was a set of sweeping amendments to the National Labor Relations Act (created by the Wagner Act of 1935). Among other features, the Act enunciated a new set of unfair labor practices by labor unions, including prohibitions against secondary boycotts and other forms of concerted activities by unions as well as increasing the rights of employers to counter union organizing activities. Not surprisingly, the Act was passed after major battles in Congress. See Gross, James, *History of the National Labor Relations Act*, (Ithaca, NY: Cornell University Press).

40 The LMRDA requires each level of the union with governance responsibility to provide separate disclosure under the Act, providing information only regarding financial activity (revenues and expenses) at that level of the union. This makes it a complicated matter for a user examining reports of a local with information regarding related expenditures or revenues at regional and national levels.

41 Concern about the LMRDA violating union officers' Fifth Amendment rights under the Constitution is discussed in Robb, Richard A., "LMRDA Section 505: Amendment to LMRA Section 302 on Crimes of Extortion and Bribery," in Ralph Slovenko, ed. *Symposium on the Labor-Management Reporting and Disclosure Act of 1959.* (Baton Rouge, LA: Claitor's Bookstore Publishers, 1961). The need for more detailed disclosure as a curb against corrupt practices by union officers (such as kickbacks or other forms of illegal payments from unions to other parties) is discussed in Goldwater (op. cit.). A more pessimistic view from the time concerning the prospects for improving internal union democracy through government intervention can be found in Petro, Sylvester, *Power Unlimited: The Corruption of Union Leadership*. (New York: The Ronald Press Company, 1959).

42 The Office of Labor Management Services (OLMS), the division within the U.S. Department of Labor that enforces LMRDA, has an auditing staff of 5 and a total of 158 investigators. Between 1998-99, OLMS conducted 600 audits of regional and local unions. Given that there are more than 31,000 reporting entities (national, regional, and local union bodies) covered by the Act, the annual probability of receiving an inspection is about 1 in 100 (OLMS also undertook an average of 2 audits of international unions per year that increases the probability of inspections of subordinate bodies). As a result, the expected penalty facing a union or reporting entity arising from noncompliance is trivial (well below $250). The above calculations are based on figures reported in U.S. Government Accounting Office, *Department of Labor: Administering the Labor-Management Reporting and Disclosure Act*, HEHS-00-116, (Washington, DC: Government Accounting Office, 2000), pp. 8-9.

43 If unions (or other parties required to file under LMRDA) willfully fail to file a report, knowingly make false statements or withhold information, or conceal or destroy materials, they face fines of up to $100,000 and up to one year in prison. See Employment Standards Administration, Office of Labor-Management Standards, *Reports Required Under the LMRDA and the CSRA.* (Washington, DC: U.S. Department of Labor, 2001).

44 A typical Form LM-2 form (the detailed reporting document filed by unions under the LMRDA) for a national union is well over 100 pages, and may cost $15.00 or more to purchase. Because a user may desire reports from several different reporting levels of the union in order to gain a full picture of financial flows, the total direct charge could be much higher. But these out-of-pocket expenses are relatively small next to the investment of time to interpret the documents once they have been located.

45 For example, many union locals receive a great deal of representation and administrative support from staff paid for by the international office of the union. These expenditures (the salaries of these individuals as well as associated expenses) show up in the accounts of the international, rather than local union. Unions also deal with the flow of dues revenues to the various levels of the union in different ways. In many unions, dues are paid to the local union, which in turn remits some portion of them to intermediate and national levels of the organization based on "per capita" fees set out in union constitutions. In a smaller number of unions, all dues flow directly to the international that, in turn, remits a portion of them back to the local union. Although the LM-2 form required under the LMRDA allows one to analyze these flows, it requires significant sophistication and understanding of union structures and accounting terms to do so.

46 For critiques along these lines, see Masters, Marick F., *Unions at the Crossroads: Strategic Membership, Financial, and Political Perspectives,* (Westport, CT: Quorum Books, 1997); Hunter, Robert, Paul Kersey, and Shawn Miller, *The Michigan Union Accountability Act: A Step Toward Accountability and Democracy in Labor Organizations,* (Mackinac Center for Public Policy, 2001).

47 For a discussion of the role played by unions in this respect, see Weil, David, "Analyzing Regulatory Performance: Insights on the Implementation of Federal Workplace Policy." in Kaufman, Bruce E., ed. *Government Regulation of the Employment Relationship.* (Madison, WI: Industrial Relations Research Association 1997), pp.429-474.

48 Reporting requirements were reduced for small unions, in part arising from requirements of the Paperwork Reduction Act. Rather than filling out the detailed Form LM-2, union entities with total annual receipts of less than $200,000 may use a more simplified Form LM-3 to report financial activities. Unions with annual receipts of less than $10,000 of annual receipts can file an even more abbreviated Form LM-4. LM-3 forms apparently date back to the time of LMRDA passage; LM-4 forms were adopted in 1992 but were not put into effect until January 1994 (interview with Patrick Hyde, U.S. Department of Labor, Office of Labor Management Service, April 2002). .

49 U.S. General Accounting Office, *U.S. Department of Labor: Administering the Labor-Management Reporting and Disclosure Act,* HEHS—00—116, (Washington, D.C.: Government Accounting Office, 2000), p. 29. The report also cites other reasons that unions face minimal incentives for timely reporting, including that cases against union entities with receipts under $5000 are not even initiated until they have been delinquent filers for 3 consecutive years (p. 32). Further, in the cases of unions that provided deficient information to OLMS, the agency used voluntary methods to handle 9 percent of the cases, and OLMS took no action regarding the remaining cases.

50 Interviews with Hank Guzda, U.S. Department of Labor, Office of Labor / Management Services, April 1, 2002; David Geiss, Industrial Relations Specialist, U.S. Department of Labor, Office of Labor / Management Services, April 1, 2002.

51 See U.S. General Accounting Office, *Labor Management Reporting and Disclosure Act: Status of Labor's Efforts to Develop Electronic Reporting and a Publicly Accessible Database.* HEHS-99-63R. (Washington, D.C.: General Accounting Office, 1999).

52 This account is drawn from a longer case study in Graham, Mary, *Democracy by Disclosure* (Brookings/Governance Institute, 2002).

53 The Institute of Medicine defined errors as failures in the planning or execution of a medical treatment. Errors were a subset of adverse events, defined as injuries attributable to medical management rather than to a patient's underlying condition. Errors are also referred to as preventable adverse events. Institute of Medicine, *To Err is Human: Building a Safer Health System* (National Academy Press, 1999 (paperback)) pp. 23-30 (hereafter IOM, To Err Is Human).

54 IOM, *To Err is Human*, pp. 1-3.

55 IOM, *To Err is Human,* pp. 22-42. Richardson is quoted in Pear, Robert, "Group Asking U.S. For New Vigilance in Patient Safety," *The New York Times*, November 30, 1999, p. A1.

56 Ibid., pp. 3-13 (quote appears on p. 3).

57 Testimony of Donald Berwick, Hearing on Medical Errors, Senate Committee on Health, Education, Labor, and Pensions, February 16, 2000. For discussion of public response to the Institute's report, see the introductory section of this chapter.

58 Glazer, Sarah, "Medical Mistakes," *CQ Researcher* (February 25, 2000) pp. 137-160.

59 Ibid.

60 Ibid.; DeMattia, Robin F., "Getting into the game; Employers want their chance to shape and improve the quality of care," *Modern Physician,* April 1, 2001, p. 21; personal communication with Arnold Milstein, spokesman for the Leapfrog group and Medical Director, Pacific Business Group on Health; Leapfrog Group reports are posted on www.leapfroggroup.org.

61 Classen, David C., et al, "Computerized Surveillance of Adverse Drug Events in Hospital Patients," *Journal of the American Medical Association*, November 27, 1991, p. 2847.

62 See, for example, Classen, David C. et al., "Computerized Surveillance of Adverse Drug Events in Hospital Patients," p. 2847; Bates, David W., Lucian L. Leape, and Stephen Petrycki, "Incidence and Preventability of Adverse Drug Events in Hospitalized Patients," *Journal of General Internal Medicine*, June, 1993; "Putting Adverse Drug Events Into Perspective," *Journal of the American Medical Association*, January 22/29, 1997, Vol 277, No.4, pp. 341-2.

63 Phillips, Donald F., "New Look Reflects Changing Style of Patient Safety Enhancement," *The Journal of the American Medical Association,* January 20, 1999, p. 217.

64 Third parties may also distort the information provided by disclosure systems. For example environmental groups that have been key supporters of TRI at the political and operational level have an interest in distorting the degree of risk posed by releases because of the nature of their constituencies. The recent problems in financial disclosure policy arise in part because of conflicting incentives among accounting organizations who are the key information intermediaries in that system.

65 This dynamic is further reinforced when the divergence in interests plays out at the political level, with some of the parties who initially opposed transparency regulations can come to benefit from them, and so become political supporters. These allies help stabilize the policy, and may even support improvements that expand its user base, enhance the quality of information provided to the public, and expand its scope.

66 However, such synergies also raise discloser costs, thereby lowering the information that they desire to release. It will therefore depend on the particular disclosure case whether the potential synergies outweigh the incentives on disclosures to limit information release.