

# ONE

## Governance by Transparency

### THE NEW POWER OF INFORMATION

On September 12, 2000, Masatoshi Ono, the chief executive of leading U.S. tire manufacturer Bridgestone/Firestone, faced a panel of senators and a battery of television cameras in a packed hearing room. The senate panel was investigating mounting deaths from a mysterious series of auto accidents in which tires blew out without warning, causing vehicles – many of them Ford Explorer SUVs – to roll over. Addressing the senators and the room full of victims’ families, auto safety advocates, and industry representatives, as well as a nationwide television audience, Ono uttered words that no CEO wants to say: “I come before you to express my deep regret and sympathy to you, the American people and especially to the families who have lost loved ones in these terrible rollover accidents.”<sup>1</sup>

The Firestone scandal remained national news during the summer and fall of 2000 because auto companies and tire makers had failed to inform the public about deadly risks. Documents from Firestone/Bridgestone and Ford indicated that both companies had been aware of a pattern of fatal accidents caused by a combination of tire tread separation and top-heavy SUVs but had done nothing to alert drivers. Bridgestone/Firestone executives knew that its plant in Decatur, Illinois, where most of the problem tires were made, had long had quality-control problems. When the count was finally complete, 271 people had been killed in accidents involving problematic SUV design and defective tires.<sup>2</sup>

The public, however, learned about these problems only by chance – and only after many of the deaths and injuries. In early February of 2000, Houston station KHOU-TV reported that lawsuits claimed that exploding Firestone tires and associated Explorer rollovers had caused thirty deaths. It took another six months for Bridgestone/Firestone executives to acknowledge

the problem and recall 6.5 million tires, the largest tire recall since the 1970s.<sup>3</sup>

More troubling, the Senate investigation revealed that the problem was larger than a limited number of defective tires. In the 1990s, many people bought SUVs because they thought they were safer than smaller cars. The Firestone/Explorer revelations showed that, to the contrary, SUVs were more likely to roll over than other cars – and some SUV models were much more prone to roll over than others. That was important because rollovers remained the most deadly auto accidents, accounting for nearly a third of auto fatalities in the United States even though they represented less than 4 percent of all accidents.<sup>4</sup> Nonetheless, information about which SUVs were prone to roll over – like the facts about the unusual Firestone tire blowouts – remained locked in company files.

As reports of deaths and injuries mounted, congressional committees debated what action to take. Regulators had authority only to mandate recalls and impose modest fines on automakers and tire companies for safety defects. States could prosecute officials for criminal negligence, of course, and injured passengers could sue for damages. But such actions would not reduce the likelihood of future deadly accidents.

Circling around contentious issues concerning how to mandate safer design, Congress instead legislated targeted transparency. The Transportation Recall Enhancement, Accountability, and Documentation (TREAD) Act, approved in November 2000, required auto companies for the first time to give car buyers the facts about each model's rollover risks so that they could make their own safety choices.<sup>5</sup>

The idea was not just that the public deserved better information. It was that the power of information would create a chain reaction of new incentives. Armed with new rollover ratings, buyers would choose safer cars. Confronted with declining sales of the most top-heavy SUVs, auto companies would improve design. Safer design would save lives and prevent injuries. The new law thus made transparency into a precise policy tool.

Information had new power because policymakers did not stop at simply placing facts about risks in the public domain – where they could easily be lost in the cacophony of new-car hype. Instead, policymakers required that information be presented in a format that was designed to be user-centered. They distilled the complex probabilities of rollovers into simple five-star ratings based on government tests of each new model (see Figure 1.1). In a few seconds, car buyers, regardless of their math or language skills, could compare risks and identify rollover-prone models. A five-star vehicle, with a 10 percent or less chance of rolling over in a single-vehicle crash, was much safer than a one-star vehicle, with a 40 percent or more chance of rolling





Save vehicles	Vehicle	Frontal Star Rating ** based on risk of head & chest injury		Side Star Rating ** based on risk of chest injury		Rollover Rating	
		Driver	Passenger	Front Seat	Rear Seat	2 wheel drive	4 wheel drive
	2006 Acura MDX 4-DR. w/ SAB (SUV)	☆☆☆☆☆	☆☆☆☆☆	☆☆☆☆☆	☆☆☆☆☆	<i>Not rated</i>	☆☆☆☆
	2006 Buick Rendezvous 4-DR. w/ SAB (SUV)	☆☆☆	☆☆☆☆	☆☆☆☆☆	☆☆☆☆☆	<i>Not rated</i>	<i>Not rated</i>
	2006 Cadillac Escalade 4-DR. w/ SAB (SUV)	☆☆☆☆	☆☆☆☆	<i>Not rated</i>	<i>Not rated</i>	☆☆☆	☆☆☆
	2006 Cadillac Escalade ESV 4-DR. w/ SAB (SUV)	☆☆☆☆	☆☆☆	<i>Not rated</i>	<i>Not rated</i>		☆☆☆

Figure 1.1. Rollover Star Rating Graphic. Source: <http://www.SaferCar.gov>

over. Buyers could also customize information to suit their needs. Anyone interested in more detail could delve deeper into narratives and Web site links. In 2005, Congress made the policy even more user-centered. A new law required that information be presented by September 2007 *where* car buyers most needed it, on showroom new-car stickers.<sup>6</sup>

The policy also included an interesting built-in mechanism intended to increase the chances that transparency would be sustainable. It required that ratings become more accurate over time. The initial scores would be based on simple mathematical modeling of rollover propensity combining each model's center of gravity and track width. But the law required that safety regulators also work toward a road test that would more accurately mimic real-world driving conditions, and it directed the National Academy of Sciences to study possible tests and required regulators to consider the academy's recommendations. As a result, regulators instituted a new test in 2004 that combined modeling with driving maneuvers.<sup>7</sup>

Congress added other disclosure-based incentives. The TREAD Act required tire pressure monitoring sensors by 2003;<sup>8</sup> safety regulators required automakers to disclose information on customer complaints and other early indications of safety defects;<sup>9</sup> and new labels made it easier for car owners to see if their tires had been recalled.<sup>10</sup>

This, then, was the concept: government would use the power of information to drive better choices by car buyers, which in turn would improve vehicle designs and reduce risks. But would it work?

Five years after the release of the first set of rollover ratings, the answer appeared to be yes. Initially, SUV models had widely varying rollover rates – and most performed poorly. In 2001, thirty models received only one or two stars, meaning that they had a greater than 30 percent chance of rolling over, while only one model (the Pontiac Aztek 4-DR) earned a four-star rating, meaning that it had a less than 20 percent chance of rolling over. By 2005, however, only one model (the Ford Explorer Sport Trac) received as few as two stars, while twenty-four models earned four stars.<sup>11</sup>

Transparency also created pressures that ended a generation of industry lobbying against a rollover safety standard. The national attention that rollover accidents received in 2000 and the new star ratings spurred automakers to accelerate their introduction of stability-control technology. By 2005, 20 percent of new vehicles were equipped with sensors that triggered corrective braking, compared with fewer than 5 percent in 2000. Voluntary adoption of new technology changed the political dynamic. In 2005, Congress approved the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), which directed regulators to issue minimum performance standards for auto rollovers.<sup>12</sup>

## TRANSPARENCY INFORMS CHOICE

In recent years public attention has focused mainly on struggles over broad transparency in government – President Clinton’s championing of a broader public right to know and President George W. Bush’s controversial moves to increase government secrecy, for example. Few have recognized that a second generation of targeted transparency has been rapidly gaining ground.

Instead of aiming to generally improve public deliberation and officials’ accountability, targeted transparency aims to reduce specific risks or performance problems through selective disclosure by corporations and other organizations. The ingeniousness of targeted transparency lies in its mobilization of individual choice, market forces, and participatory democracy through relatively light-handed government action.

Since the mid-1980s, scores of targeted transparency policies have percolated up through the political system in the United States – usually without any awareness by their creators that they were participating in a more general innovation in governance. After a deadly chemical accident in Bhopal, India, killed thousands of people, Congress required in 1986 that manufacturers tell the public about the toxic pollutants they released – factory by factory and chemical by chemical. After scientists confirmed that unhealthy eating habits were contributing to millions of deaths from heart disease and cancer each year, Congress required in 1990 that food companies inform the public about the levels of fat, sugar, and other nutrients in each can of soup and box of cereal. After a series of revelations about the surprising frequency of serious medical mistakes, Congress considered proposals in 2000 to require hospitals to inform the public about such mistakes, and several states required hospitals and doctors to tell the public their mortality rates for specific procedures. After the corporate accounting scandals of 2001 and 2002, Congress required that public companies improve their financial disclosure.

Targeted transparency policies have also been crafted to improve the fairness and quality of public services. In response to continuing concern about financial institutions’ discrimination against inner-city borrowers, Congress strengthened requirements in 1989 and 1992 that banks report on their mortgage loans according to the race, gender, and income level of borrowers in each geographical area they serve. In response to continuing concern about the quality of public schools, Congress required in 2001 that school performance reporting demonstrate school improvement as a condition of federal aid.

Each of these laws wrested from the files of corporations, nonprofit organizations, or public agencies some of the facts that executives would often

like to keep confidential – information about the risks they create and about flaws in the quality of goods and services they provide. Each offered sunlight in a format that poor performers would most like to avoid – in labels, reports, or Web sites that allowed consumers, investors, employees, and community residents to compare products and practices.

Though the problems they address vary widely, the idea behind all these new laws is the same. A generation of research by economists and political scientists has shown that markets and deliberative processes do not automatically produce all the information people need to make informed choices among goods and services. When hidden risks or service flaws create serious problems for the public at large, the government can help reduce those risks or improve services by stepping in to require the disclosure of missing information.

Why is government action needed? Three reasons: First, only government can compel the disclosure of information from private and public entities. Second, only government can legislate permanence in transparency. Third, only government can create transparency backed by the legitimacy of democratic processes.

The core characteristics of targeted transparency policies are also the same. It is hard to imagine that nutritional labeling, school performance ratings, and corporate financial reporting have much in common. Yet all targeted transparency policies include these characteristics:

- mandated public disclosure
- by corporations or other private or public organizations
- of standardized, comparable, and disaggregated information
- regarding specific products or practices
- to further a defined public purpose.

When they achieve their objectives, these policies all work in the same way, incorporating the following sequence of events or “action cycle”:

- Information users perceive and understand newly disclosed information
- and therefore choose safer, healthier, or better-quality goods and services.
- Information disclosers perceive and understand users’ changed choices
- and therefore improve practices or products
- that in turn reduce risks or improve services.

While new in its broad information-age applications, targeted transparency is not a new idea in governance. In 1913 Louis D. Brandeis, the

“people’s attorney” and later Supreme Court justice, wrote in *Harper’s Weekly* that “sunlight is . . . the best of disinfectants.” Brandeis recommended new laws to require public companies to disclose their profits and losses in order to stop insider deals that deceived investors. He pointed to an even earlier law, the 1906 Pure Food and Drug Act, which required listing ingredients on interstate shipments of foods, as an example of government-mandated “sunlight” to reduce public risks.<sup>13</sup>

President Franklin D. Roosevelt quoted Brandeis’s words twenty years later when he urged Congress to require new corporate financial disclosure rules after millions of Americans lost their savings in the stock market crash of 1929. The 1933 and 1934 Securities and Exchange Acts ordered publicly traded companies to disclose assets and liabilities at regular intervals and in a standardized format.<sup>14</sup> Corporate financial disclosure as required by those laws, which remains at the core of U.S. securities policy, has become the United States’ most sophisticated – though still imperfect – example of targeted transparency policy.

#### TRANSPARENCY AS MISSED OPPORTUNITY

However, targeted transparency policies can also do more harm than good. Such policies are always the products of political compromise. When the information from the tug and pull among many interests is incomplete, inaccurate, obsolete, confusing, or distorted, it can contribute to needless injuries or deaths or to large economic losses.

Four years before successful use of targeted transparency to reduce auto rollovers, Congress tried to enlist the power of information to reduce another serious safety risk – disease outbreaks from contaminated public water supplies. This time Congress failed.

Drinking water safety became national news in 1993 when a microbe called cryptosporidium infested the drinking water of Milwaukee, Wisconsin, sickening an astounding 400,000 individuals and killing as many as 110 within a matter of weeks. Congress responded in 1996 by demanding that water authorities inform their customers about contaminants in the water supply.<sup>15</sup>

That time, though, Congress crafted a requirement that employed technical terms, produced inaccurate and out-of-date information, failed to link contaminant data to health risks, and did not provide comparability from one community to another. Instead of receiving clear information that was comprehensible at a glance, like the five-star auto rollover rankings, consumers seeking information about the relative safety of their tap water faced



City of Cambridge Water Department  
2005 Annual Drinking Water Quality Report

250 Fresh Pond Parkway  
Cambridge, MA 02138

DEP PWS ID#3049000

June 2006



24 Hour Emergency/Customer Service  
Phone Number 1-617-349-4770

Cambridge Water Department - Consumer Confidence Report 2005 Data								
<b>Lead and Copper</b>	Units	90% Value	Range	Action Level(AL) <sub>90%</sub>	MCLG	Violation	Sites exceeding AL	
Copper	ppm	0.035	0.001-1.09	1.3	0	NO	0 of 60	
Lead	ppb	7	0 - 157	15	0	NO	2 of 60	
Corrosion of household plumbing.								
Corrosion of household plumbing.								
<b>Regulated - Inorganic Contaminants</b>	Highest	Range	MCL	MCLG	Violation			
Barium	ppm	0.047	0.035-0.047	2	2	NO	Erosion of natural deposits.	
Fluoride	ppm	1.3	0-1.3	4	4	NO	Water additive to promote strong teeth.	
Nitrate as Nitrogen	ppm	0.74	0.29-0.74	10	10	NO	Runoff from fertilizer use.	
Nitrite as Nitrogen	ppm	0.015	0-0.015	1	1	NO	Runoff from fertilizer use.	
<b>Unregulated - Inorganic Contaminants</b>	Average	Range						
Sulfate	ppm	25	23-27					
Sodium	ppm	70	60-92					
Erosion of natural deposits. road salt.								
<b>Unregulated - Organic Contaminants</b>	Average	Range						
Bromodichloromethane	ppb	2.8	1.6-4.6					
Bromoform	ppb	1.8	0.9-3.4					
Chloroform	ppb	1.4	0.7-3.0					
Dibromodichloromethane	ppb	3.9	2.3-6.3					
By-product of drinking water chlorination. By-product of drinking water chlorination. By-product of drinking water chlorination. By-product of drinking water chlorination.								
<b>Regulated - Volatile Organic Contaminants</b>	Highest Ave	Range	MCL	MCLG	Violation			
Total Trihalomethanes (THMs)	ppb	10.3	4.8-18	80	0	NO	By-product of drinking water chlorination.	
Haloacetic Acids (HAA5)	ppb	8.7	3.5-20	60	0	NO	By-product of drinking water chlorination.	
<b>Unregulated - Inorganic Contaminants</b>	Highest Ave	Range	MRDL	MRDLG	Violation			
Chlorine as Chloramine	ppm	3	1.3 - 3.0	4	4	NO	Water additive used to control microbes.	
<b>Regulated - Radioactive Contaminants (2002)</b>	Violation							
Gross Alpha Activity	pCi/L	0.3	n/a	15	0	NO	Erosion of natural deposits.	
Gross Beta Activity	pCi/L	14	n/a	AL = 50	0	NO	Decay of naturally occurring deposits.	
<b>Turbidity</b>	TT	Lowest Monthly %	Highest Daily Value	Violation				
Daily Compliance (NTU)	1		0.16	NO				
Monthly Compliance	At least 95%	100		NO				
Suspended matter from soil runoff. Suspended matter from soil runoff.								
<b>Bacteria</b>	Highest % Positive in a Month	Total # positive	MCL	Violation	MCLG			
Total Coliform	1%(April)	1	>5%	NO	0	Naturally occurring in the environment.		

Figure 1.2. Drinking Water Safety Report – Cambridge, Massachusetts. *Source:* Excerpts from City of Cambridge report, June 2006, [http://www.cambridgema.gov/CityOfCambridge\\_Content/documents/CCR2005\\_web.pdf](http://www.cambridgema.gov/CityOfCambridge_Content/documents/CCR2005_web.pdf)

the daunting task of interpreting complex documents like that shown in Figure 1.2. Just at the time when electronic monitoring and the Internet made real-time reporting feasible, water authorities' lobbying as well as careless planning by policymakers produced partial and hard-to-decipher information that was as much as a year out of date.<sup>16</sup>

As a result, some customers who relied on assurances that tap water was safe actually suffered *increased* health risks. In a particularly troubling series of incidents, media reports in 2004 revealed that tens of thousands of children in Washington, D.C., Boston, and other big cities were drinking water contaminated with unreported high levels of lead, an especially dangerous toxin that could cause severe neurological damage in children. In the nation's capital, federal and local officials admitted they had known about the lead contamination for years but had neither informed



customers nor taken steps to remedy the problem. Instead, the city's contaminant reports assured customers, "Your Drinking Water Is Safe." One reason that risks remained hidden was because contaminant reports did not include information about microbes or toxins that entered water after it left the filtration plant – as it passed through hundreds of miles of old lead pipes.<sup>17</sup>

Drinking water reports represent a missed opportunity with serious consequences. According to the National Centers for Disease Control and Prevention, up to 30 percent of reported disease outbreaks each year can be attributed to problems of public water systems, affecting as many as nine hundred thousand people. In 2005, Stephen L. Johnson, the new administrator of the federal Environmental Protection Agency, estimated that at least 10 percent of Americans regularly drink unhealthy water.<sup>18</sup> All in all, as many as 50 million Americans drink water containing industrial solvents and related chemicals that may have long-term health effects.<sup>19</sup>

In the largest water systems, the mixture and levels of contaminants vary greatly from week to week as weather and waste discharges change. Accurate and current contaminant reporting can be critical for those most vulnerable – the very young, the very old, and people on chemotherapy, suffering from AIDS, or with otherwise compromised immune systems. Such individuals – who together make up roughly 20 percent of the U.S. population – are at special risk from bacteria or toxins in drinking water.

Meanwhile, the public's trust in the nation's water supply continues to erode. A quarter of Americans reported in 1999 that they never drank tap water. Sixty-five percent of those who did drink tap water reported that they drank bottled water or filtered tap water some of the time.<sup>20</sup>

Transparency gaps that increase serious risks are common. Some other prominent examples:

- Millions of investors lost savings and retirement funds in 2001 and 2002 not only because corporate executives at some of the nation's largest and best-known companies fraudulently withheld information but also because the financial accounting system allowed them to hide – and profit from – information about financial risks in their companies.
- Millions of people have unknowingly increased their risk of heart disease because nutritional labels have not told consumers when cookies, muffins, and other fast foods contain trans fats, the most dangerous fats on the market. For two decades, scientists have known and warned of trans fat risks.

- Despite twenty years of alarming evidence that more people in the United States die from medical errors in hospitals than from auto accidents and findings that some institutions are ten times safer than others, hospitals are still not required to disclose mistakes that cause death or serious injury.
- Five years after the September 11, 2001, terrorist attacks in New York City and Washington, D.C., government officials still rely on a five-color terrorist threat warning system that does not provide the public with needed information for self-protection – leaving information gaps that could cost thousands of lives.

The cases we have drawn together illustrate both the promise and the perils of a new generation of targeted transparency. By requiring auto rollover ratings, Congress invented a means of communicating complex information in a simple format that helps car buyers compare models and make safe choices. By requiring reports on drinking water safety, Congress settled for a compromise that produced out-of-date and incomplete information that confuses and sometimes misleads customers. Such distorted disclosure not only impairs public health. It also undermines one of democracy's central tenets – that citizens can trust their government as a source of reliable, timely information.

#### A REAL-TIME EXPERIMENT

What makes the difference between transparency success and failure and how can its effectiveness be improved? We have written this book to answer these questions.

We have scrutinized a carefully selected group of transparency policies using a multidisciplinary approach. We have analyzed the effectiveness of fifteen major targeted transparency policies in the United States and three international policies. Out of the universe of policies that fit our definition of targeted transparency, we chose a set of relatively mature cases, distributed across a range of public policy areas, with potentially important consequences, and whose varied effectiveness has been assessed in rigorous empirical studies.

We reviewed the legislative history and legal requirements of each policy and examined the politics surrounding initial approval and later amendments. We assessed each policy's regulatory structure and the incentives that structure provided for accurate reporting by disclosers, as well as the

kind of information it ultimately provided to users. We also analyzed the decision-making processes of users and disclosers in order to understand their actual responses to newly released information. Finally, we identified the drivers of effectiveness by analyzing hundreds of empirical studies and by interviewing policymakers, scholars, and diverse users and disclosers of information. This approach has allowed us to develop a theory of targeted transparency effectiveness that explains the varying outcomes of existing policies and can provide the basis for future research. Table 1.1 provides an overview of the eighteen targeted transparency policies that form the analytic core of this book, and the Appendix contains our detailed descriptions of them.

Our analysis has limitations. We did not attempt to construct a random sample of all targeted transparency policies or undertake a formal meta-analysis of studies. Such approaches were neither tenable nor desirable given the diversity of transparency policies we examined. The benefits of using a multidisciplinary approach and rooting our conclusions in well-grounded studies outweighed the inevitable biases that arose from choosing a subset of all possible cases.

We conclude that the effectiveness of targeted transparency depends heavily on two factors that form the book's two major themes.

- First, targeted transparency policies succeed when they are *user-centered*. Successful policies focus first on the needs and interests of information users, as well as their abilities to comprehend the information provided by the system. Such policies also focus on the needs, interests, and capacities of disclosing organizations. They seek to embed new facts in the decision-making routines of information users and to embed user responses into the decision making of disclosers. Successful transparency policies thus place the individuals and groups who will use information at center stage.
- Second, effective transparency policies must be *sustainable* to be effective. Sustainable policies are those that gain in use, accuracy, and scope over time. Such improvement is important because policies inevitably start as flawed compromises, because markets and public priorities change, and because policymakers constantly need to fill loopholes discovered by reluctant information disclosers.

The sudden bankruptcies of Enron, WorldCom, and other large and respected companies in the 2001 and 2002 illustrate how costly transparency failure can be. While no disclosure system can prevent fraud or intentional

Table 1.1. *Targeted Transparency Systems: Overview of Eighteen Transparency Policies*

Disclosure System	Year Enacted	Public Policy Objective	Information Disclosed	Primary Disclosers	Primary Users
<i>U.S. Targeted Transparency Systems</i>					
Corporate Financial Disclosure <sup>a</sup>	1933, 1934	Reduce hidden risks to investors, improve corporate governance	Company financial data	Public companies trading in U.S.	Investors, financial intermediaries
Union Finances Disclosure <sup>b</sup>	1959	Reduce corruption, increase accountability of labor union officers	Financial revenues and expenditures, union governance information	Labor unions	Labor union members, prospective members
Campaign Finances Disclosure <sup>c</sup>	1971	Reduce corruption, increase accountability of national political candidates	Contributions to candidates by individuals, organizations	Candidates for national office	Opposing candidates, journalists, political parties, interest groups
Mortgage Lending Disclosure <sup>d</sup>	1975	Reduce mortgage lending discrimination	Lending activity demographics	Banks, other lending institutions	Community groups, regulators
Workplace Hazards Disclosure <sup>e</sup>	1983	Reduce worker exposures to chemical hazards	Information on workplace hazardous chemicals	Manufacturers, employers	Workers, employers
Toxics Releases Disclosure <sup>f</sup>	1986	Reduce toxic pollution	Quantities of releases by chemical and factory	Chemical manufacturers, users	Regulators, environmental groups, communities
Plant Closing, Mass Layoff Disclosure <sup>g</sup>	1988	Lower costs of major economic dislocations from closures/layoffs	Plans of large-scale layoffs/facility closings	Large companies	Affected workers, communities
Nutritional Labeling <sup>h</sup>	1990	Reduce risks of chronic disease	Nutrients in most processed foods	Manufacturers of packaged foods	Consumers, schools, employers, hospitals
Patient Safety Disclosure (NY, PA) <sup>i</sup>	NY: 1990 PA: 1992	Improve cardiac surgery performance	Mortality rates, etc., in patient treatment	Hospitals, doctors	Patients, doctors, insurers, governments
School Performance Disclosure <sup>j</sup>	1994 (federal); various years (states)	Improve school performance and accountability	School-level performance data	Schools, school districts	Parents, prospective residents, governments

Sex Offender Place of Residences Disclosure <sup>k</sup>	WA: 1990 (Other states – various years)	Reduce public safety risks from released sex offenders and other felons	Place of residence of dangerous ex-offenders	Police departments, sex offenders	Community residents
Drinking Water Contaminant Disclosure <sup>l</sup>	1996	Improve quality of public drinking water supplies	Water supply contaminants	Public, private water authorities	Consumers, schools, employers, hospitals
Restaurant Hygiene Disclosure <sup>m</sup>	Los Angeles County: 1997	Reduce risk of food-borne illnesses	Letter grades reflecting hygiene inspection results	Restaurants	Consumers
Automobile Rollover Disclosure <sup>n</sup>	2001	Lower risk of death, injuries from auto rollovers	5-star ratings of new-model rollover propensity	Auto companies selling in U.S.	Consumers, fleet purchasers
Terrorism Threat Disclosure <sup>o</sup>	2002	Reduce risks of, minimize damage from terrorist attacks	Color-coded national, local terrorist threat levels	Department of Homeland Security	Federal, state, local governments, companies, public
<i>International Targeted Transparency Systems</i>					
International Corporate Financial Disclosure <sup>p</sup>	2002	Reduce hidden investor risks, improve corporate governance	Company financial data	Public multinational, EU-headquartered companies	Investors, financial intermediaries
Genetically Modified Foods Labeling <sup>q</sup>	2004	Increase food safety, environmental protection	Presence/absence of genetic modification of crops	Farmers, exporters, importers, consumers, grocery stores	Consumers, national governments
Infectious Disease Surveillance <sup>r</sup>	2005	Reduce international spread of serious infectious diseases	Location, character of disease outbreaks	National governments, public health personnel, citizens	World Health Organization, public health personnel, citizens

*Note:* Dates are years of initial policy enactment; see the Appendix for a discussion of amendments or supplemental legislation in subsequent years.

<sup>a</sup> Securities Act (1933) and Securities and Exchange Act (1934); <sup>b</sup> Labor Management Reporting and Disclosure Act; <sup>c</sup> Federal Election Campaign Act; <sup>d</sup> Home Mortgage Disclosure Act; <sup>e</sup> Hazard Communication Standard – promulgated under the Occupational Safety and Health Act; <sup>f</sup> Emergency Planning and Community Right-to-Know Act – the Toxics Release Inventory is a database established by the act; <sup>g</sup> Worker Adjustment and Retraining Notification Act; <sup>h</sup> Nutrition Labeling and Education Act; <sup>i</sup> New York Cardiac Surgery Reporting System and Pennsylvania Guide to Coronary Artery Bypass Graft Surgery; <sup>j</sup> Federal School Report Card law; <sup>k</sup> Megan’s Law; <sup>l</sup> Amendments to the Safe Drinking Water Act of 1974; <sup>m</sup> Los Angeles County Restaurant Hygiene Grade Cards; <sup>n</sup> Transportation Recall Enhancement, Accountability, and Documentation Act; <sup>o</sup> Homeland Security Presidential Directive 3 (HSPD-3), as amended by Homeland Security Presidential Directive 5 (HSPD-5); <sup>p</sup> International Accounting Standards Board reorganization; <sup>q</sup> European Union labeling system; <sup>r</sup> International Health Regulations.

misrepresentation, those scandals represent a failure of the corporate financial disclosure policy – the nation’s most respected targeted transparency system – to keep pace with changing markets. A proliferation of off-balance sheet entities, unreported stock options, and other arguably legal market innovations hid risks and inflated reported earnings. As a result, millions of investors lost their savings while a few executives profited from inside knowledge. The 2002 Sarbanes-Oxley Act represented a belated and still controversial attempt by Congress to repair the financial transparency system so that it could catch up with market innovations.

### TRANSPARENCY SUCCESS AND FAILURE

Whether effective or not, targeted transparency is likely to proliferate as the preferred remedy for a wide variety of public risks and service flaws. That is why it is worth taking the time and effort to understand how these policies work and how to improve their effectiveness. The legislative histories of the policies we have studied suggest that three long-term trends help explain why such an unlikely innovation is occurring now and why it is likely to last.<sup>21</sup>

First, transparency policies are gaining strength because conventional forms of government intervention – for example standards-based regulatory systems or performance-based tax policies – are sometimes ill suited to the kinds of risks and performance flaws that policymakers now identify for action. Problems that are widely dispersed and locally variable, or characterized by wide differences in consumers’ and citizens’ preferences, may not lend themselves to uniform rules, subsidies, or taxes. For example, Congress required auto rollover ratings in 2000 when national publicity about hidden risks created a demand for public action, when no immediate consensus could be reached about the feasibility and provisions of a minimum rollover performance standard, and when car buyers’ safety preferences varied widely. Congress required nutritional labeling in 1990 when scientists linked deaths from heart disease and cancer to unhealthy diets, consumers’ food choices varied widely, and outlawing saturated fats or taxing donuts was neither feasible nor desirable. Congress required disclosure of drinking water contaminants, albeit ineffectively, when existing minimum safety standards proved inadequate to prevent locally variable spikes in contamination. In such circumstances, transparency policies often represent pragmatic compromises.

Second, transparency policies have been propelled by the transforming power of computers and the Internet. Even as large corporations employ

information technology to gather personal data about their customers, the public – through transparency laws – is using technology to mine the files of public companies, chemical manufacturers, hospitals, schools, water authorities, banks, and other public and private organizations.

The Internet provides new ways to customize and share information about the risks companies create and the quality of the products and services they provide. In the public domain as in the private sector, electronic capabilities to layer, customize, and share information have shattered the settled assumption that in-depth information can be communicated only among small groups of experts while broad audiences should receive only superficial ideas or simple warnings.<sup>22</sup> Internet users can now search for toxic pollution by zip code and factory, chemical, or health effect, with opportunities to add comments or communicate with members of Congress.<sup>23</sup> Likewise, Internet users can quickly compare airlines' safety records and on-time and baggage-handling records before buying a ticket – or add information about a safety problem they have observed.<sup>24</sup> The Internet may ultimately help create a new generation of more effective collaborative transparency policies.<sup>25</sup>

Third, transparency policies are becoming more prevalent because they represent a politically viable means of responding to emerging risks or public service flaws in the context of widespread skepticism about the capacity of government alone to solve those problems.<sup>26</sup> When party loyalty and trust of elected representatives are declining and opportunities to participate in public decisions are taking new forms, it makes sense that voters and community residents would demand better factual information on which to base decisions about community services or candidates for office. Targeted transparency offers an opportunity to harness the decisions of private individuals and organizations to achieve public purposes. As we will see, many transparency policies successfully operate in this political middle ground. Others, however, create an illusion that a problem has been addressed while producing minimal impact.

#### HOW THE BOOK IS ORGANIZED

We begin by placing targeted transparency in context. Chapter 2 documents the increasing use of targeted transparency as a policy instrument in the United States through a survey of Federal Register entries from 1996 to 2005. The chapter explains how this political innovation evolved from first-generation “right-to-know” requirements that aimed to inform the

public about the workings of government. We find that both first- and second-generation policies defy assumptions that transparency is simple and inevitably beneficial. Instead, openness evolves through political struggle in continuous competition with values that favor secrecy, beset by practical difficulties in making information truly accessible, outpaced by disclosers' discoveries of new loopholes, and challenged by changing markets and public priorities.

We explain that recent research has helped to provide a rationale for government intervention to correct information imbalances. Targeted transparency policies have drawn strength from recent economic analysis challenging the idea that markets efficiently provide all the information that participants need. In addition, cognitive psychologists and economists have persuasively challenged the notion that individuals and groups automatically use available information to make rational choices, documenting an array of cognitive shortcuts that distort the processing of new data. Legislated transparency is intended to help remedy these problems.

In Chapter 3, we describe the architecture of targeted transparency policies and distinguish them from more conventional forms of government intervention. Targeted transparency employs communication as a regulatory vehicle, works through both market and political channels, and purposefully does *not* provide clear guidance to target organizations concerning what actions they should take. Conventional mandates, by contrast, employ rules and penalties or financial incentives, work through market channels, and do provide clear guidance to organizations concerning what actions they should take.

We then turn to the book's central question: what makes transparency policies effective? In Chapter 4, we construct a model showing the steps by which the mandated provision of new information can reduce risks or improve the performance of public institutions. We find that effective targeted transparency policies embed new information in the decision routines of both information disclosers and users. Our research suggests why it is difficult to achieve this goal. Because information disclosers and users have limited time and energy, they are likely to act on new information only if it has value to them, is compatible with the way they make choices, and is easily comprehensible. Providing information at a convenient time and place and in a useful format can improve chances of effectiveness. Even when new information is well embedded, however, conflicting preferences, distortions, and other obstacles may interfere with its effective use. Nonetheless, we find that some transparency policies prove highly effective and others moderately so.



To be effective, targeted transparency policies must also become sustainable, meaning that they improve over time in scope, accuracy, and usefulness. Chapter 5 explains that all transparency policies are inherently dynamic. However, they may be more likely to weaken than to improve. That is because information disclosers usually have stronger motivations and better capacity to influence transparency policies than do information users. Our research suggests that effective intermediaries who represent users' interests, the presence of some disclosers who find improved transparency advantageous, and periodic crises that concentrate users' interests can lead to improvement in transparency policies over time.

In Chapter 6, we examine whether targeted transparency can work across national boundaries and how the analytical framework we have developed can help in analyzing international policies. We find that both the structure and the functioning of international targeted transparency policies parallel those of national systems. However, because many international transparency policies emerge outside the usual structures of international law, such policies struggle to gain legitimacy – a formidable challenge to their effectiveness. Nonetheless, analyses of the improving systems of international corporate accounting and infectious disease surveillance suggest that international transparency policies can sometimes succeed.

Finally, we look to the future. Leaps in information technology are making possible a third generation of collaborative transparency in which communities of information users play an active role in shaping the content and format of information they need and in acting as disclosers themselves. Chapter 7 suggests that collaborative transparency policies will create both new potential benefits and potential dangers. Constantly updated access can increase accuracy and informational coverage, but it can also ignite public scares based on false or misleading facts. As information users take charge, government must still play an important role as the steward of transparency policies by compelling disclosure of needed information when participants cannot obtain it, fostering common definitions and accurate metrics, and providing feedback and analysis to encourage transparency improvement. Because we foresee growing use of targeted transparency in the future, Chapter 8 concludes with our recommendations for crafting policies to further crucial public priorities.

A detailed Appendix summarizes the eighteen cases we have analyzed. It describes each policy's government mandate, public purpose, targeted disclosers and users, information structure, and vehicle for communication. It also summarizes the politics that surrounded the creation of each policy, how each works, and whether and how each has changed over time.

The future of targeted transparency remains uncertain. The next generation of technology-enhanced transparency holds promise. However, technology won't untangle gerrymandered or poorly designed policies that squander the public's trust. Transparency's future remains a matter of political choice. Without leadership, imagination, and public scrutiny, the disinfecting power of disclosure soon fades.