What Makes Transparency Sustainable?

We have seen this pattern repeatedly: Enron and WorldCom accounting scandals trigger Sarbanes-Oxley reporting reforms. The chemical catastrophe in Bhopal, India triggers toxic pollution reporting in the United States. A rash of deaths from microbes in drinking water triggers a national water safety disclosure. A wave of SUV-related deaths triggers a rollover rating system.

Transparency systems are often tacked together in times of crisis. They emerge out of high-stakes political debates driven by newly perceived needs for public action. As a result, they often begin as half-baked compromises, missing crucial elements and suffering from flawed design. After the crisis passes from the headlines, the transparency system is typically neglected and necessary improvements go unaddressed.

It is not particularly surprising that transparency systems fail, for two reasons. First, transparency typically imposes costs on a small group of information disclosers in the hope of generating benefits for a large and dispersed class of information users. Since the stakes are higher for the potential disclosers, they dominate the political processes that shape transparency systems over time. Second, transparency conflicts with other core values – the need to protect trade secrets and personal privacy, for example – that can tip the balance toward keeping information confidential. Under these circumstances, it is remarkable that some relatively robust targeted transparency systems actually emerge from legislative deliberations and survive.

In fact, many targeted transparency systems that are flawed in the beginning manage to improve over time and ultimately deliver the public benefits that policymakers hoped for. This chapter investigates why some transparency policies gain accuracy, scope, and use over time, becoming, in our terms, *sustainable*, while others degenerate into costly exercises in paper pushing or excuses for avoiding real action.
Crisis Drives Financial Disclosure Improvements

The accounting scandals at Enron, Tyco, WorldCom, and other large corporations that rocked capital markets in 2001–2002 demonstrate that the system of corporate financial disclosure in the United States – the nation’s most respected and most mature targeted transparency system – is far from perfect. Yet few would dispute that corporate financial disclosure has improved markedly in scope, accuracy, and usefulness during the seven decades since its adoption. Improvement has not followed a smooth and continuous path, however. Instead, it has advanced by fits and starts, driven by the push and pull of conflicting investor and corporate interests. Crises like the collapse of conglomerates in the 1960s, bribes and illegal campaign contributions in the 1970s, and corporate accounting scandals have spurred episodic reforms. A look at the checkered history of financial disclosure rules suggests how transparency policies can become sustainable.

Improvements in financial disclosure have followed a common scenario: Changes in markets produce new business practices, accompanied by creative accounting methods that obscure risks to investors. Then sudden revelations or market reversals direct public attention to the new practices, producing a crisis of confidence. To restore public trust, government agencies, institutional investors, and members of Congress demand more accurate and complete information, and reformers seize the moment to make permanent changes in the system. As a result, the scope of transparency becomes broader, information becomes more accurate, and the number of users increases.

In the 1960s, for example, the scope of disclosure was broadened when a sudden collapse in conglomerate stock prices after an unprecedented wave of mergers created pressures for better information. Between 1962 and 1969, 22 percent of Fortune 500 companies were acquired in mergers, during which the value of the combined companies was often inflated by creative accounting methods. Conglomerates like Gulf and Western and Ling-Temco-Vought produced instant earnings growth by using accounting techniques that obscured the full cost of mergers. In addition, the profitability of specific product lines, previously reflected 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 rules. The Federal Trade Commission (FTC), charged with enforcing anti-trust laws, called conglomerate accounting a “tool of deception” and urged the Securities
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and Exchange Commission (SEC) to outlaw it. Newsweeklies decried “profits without honor.”¹ In this crisis atmosphere, pressure from the FTC and other regulators, institutional investors, and financial analysts proved stronger than opposition by some large accounting firms and conglomerate interests. 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. This law was strengthened two years later by lowering the reporting threshold to 5 percent. In addition, the SEC required companies to disclose product-line data.²

Over time, the accuracy of disclosed information also improved, though slowly. Congress gave the SEC authority to establish uniform accounting standards in 1934. But for the next forty years companies continued to exercise broad discretion in the way they reported assets and liabilities to the public, and the SEC left accounting professionals broad discretion to interpret government reporting rules. Until 1963, companies were not even required to disclose the accounting methods they employed.³

In 1969–1970, however, as the speculative fever of the “go-go years” gave way to rapid decline in stock values and the Dow Jones average fell 35 percent, investors began to flee the market. To restore public trust in the transparency system, the Accounting Principles Board, an outdated instrument of accounting industry self-governance, was replaced by the Financial Accounting Standards Board (FASB). The new board had broader representation and funding, a larger professional staff, and a better system of accountability.⁴

New crises brought further improvements. In the late 1970s, congressional investigations raised questions about FASB’s domination by big business. In response, the board opened its meetings, began accepting public comment on proposals, started publishing its schedules and technical decisions, framed industry-specific accounting standards, began to analyze economic consequences of proposed actions, and eliminated a requirement that a majority of its members be chosen from the accounting profession.⁵

Finally, users of accounting information increased as capital markets expanded domestically and internationally. Institutional investors became increasingly important players in public markets. Pension funds poured billions of dollars into stock markets, and with those investments came greater scrutiny of the practices and value of public companies. The demand for financial information was further increased by the growth in the number of financial advisers, media commentators, and, later, Web-based advisers who sought to help individual investors – and themselves – make money by providing assistance on the complexities of Wall Street. In the 1990s,
increases in individual investing and the rise of online investing led the SEC to adopt “plain English” disclosure rules, which required prospectuses to be written in short, clear sentences using nontechnical vocabulary and featuring graphic aids. In September 2006, the SEC announced that the agency was adopting a dynamic real-time electronic filing and search system that would make it easier for individual investors to analyze companies’ financial data without expert advisers.

Viewed from a cost/benefit perspective, the history of financial disclosure is a surprising one. The disclosure rules impose large costs on individual firms, some of which have much to gain from concealing or misrepresenting various aspects of their finances. At the same time, the benefits to investors and other users of such information are very broadly diffused. Under the circumstances, one might predict that mandated disclosure requirements would be weak and would erode over time, especially when disclosers possess significant political power. Yet the history of financial disclosure is one of episodic but steady improvement. What factors explain its growing strength?

SUSTAINABLE POLICIES

Transparency policies tend to evolve over time. Often, they degenerate, for reasons we have discussed. Sometimes, however, they become more effective, as illustrated by the positive response of financial disclosure to changing markets, technology, public priorities, and company executives’ discovery of loopholes.

Although it is difficult to find consistent ways to measure the dynamics of transparency across the diverse range of policies that are the focus of this book, we define a sustainable system as one that improves over time along three important dimensions:

- expanding scope of information relative to the scope of the problem addressed;
- increasing accuracy and quality of information; and
- increasing use of information by consumers, investors, employees, political activists, voters, residents, and/or government officials.

The transparency policies we have studied exhibit a range of improvement along these dimensions. Some policies, like corporate financial disclosure, mortgage lending disclosure, and school performance report cards, have improved in all three dimensions. Other policies, like toxic chemical disclosure, nutritional labeling, and campaign finance disclosure, have improved
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in some dimensions but not others. Still other policies, such as labor union finances disclosure and workplace hazards reporting, have improved little since they were enacted.

For reasons described in Chapter 4, policies that improve along all three dimensions may still be ineffective. For example, the terrorist threat reporting system has improved somewhat in accuracy since its creation in 2002. Yet that system has so far produced only marginal changes in the targeted behavior of individual users, although it has had a more significant impact on first responders and other government agencies with security responsibilities. Sustained improvement is, therefore, a necessary but not sufficient condition for the success of transparency policies.

THE POLITICS OF DISCLOSURE

From a political perspective, the creation of effective, sustainable transparency policies is hard to achieve for two reasons. First, as we have noted, transparency policies are usually produced by the convergence of unusual and short-lived circumstances. They are created in moments of crisis or scandal that throw open the arenas of narrow group politics and private deal making to broader public scrutiny. Such crises reveal flaws in existing regulatory arrangements that allow political entrepreneurs to gain sufficient support for their disclosure remedies to translate them into laws and regulations. But the dependence of disclosure requirements upon momentary public attention also makes them vulnerable. As crisis fades, so does support.

The second reason that transparency laws tend to degrade over time arises from the distribution of disclosure costs and benefits. As we have noted, transparency typically imposes costs upon a small group of disclosers in the hope of generating benefits for a large group of dispersed users. For example, nutritional labeling requirements direct food processing companies to reveal product information to millions of food consumers. In The Politics of Regulation, James Q. Wilson suggested that such conditions of concentrated costs and dispersed benefits allow targeted parties to capture regulatory systems and turn them to their advantage. When industry is the target, industry associations and organizations make collective political action easier still. As a general matter, then, those who suffer the costs of mandatory disclosure policies usually enjoy a substantial political advantage over those who benefit from them. As Wilson noted, “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.”

8
The history of targeted transparency includes many stories of powerful disclosers using their political clout to limit the scope of disclosure systems. Take, for example, the case of toxic pollution reporting. This disclosure requirement represented a small part of a legislated emergency response system for chemical accidents enacted by Congress. The requirement was supported by key senators, by right-to-know groups, and by some environmental organizations but was opposed by the Reagan administration’s federal Environmental Protection Agency and by manufacturers who regarded it as burdensome.

The political compromise these warring groups reached created a narrowly defined system, limiting the number of chemicals to be reported and the companies required to report. The law did not require reporting of overall chemical use and permitted companies to estimate toxic pollution using a variety of techniques that could be changed without notice. Finally, the law required reporting only of total pounds of releases and did not require manufacturers to assess exposure or toxicity risks.

Similarly, in the case of nutritional labeling, political compromise produced a disclosure system limited in scope and too complex for many users to understand. 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 the convenience foods offered by such places were often particularly high in harmful fats. Pressured by groups such as the American Beef Cattlemen’s Association, Congress also did not require labeling for fresh meats, poultry, and seafood, even though red meats were among the most significant sources of 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 to foods high in fat, sodium, and other nutrients 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.

Of course, many proposed disclosure systems never get off the ground at all, even if they address extremely serious risks. An urgent call by the prestigious Institute of Medicine in 1999 for a new disclosure system for medical mistakes in hospitals, the eighth largest cause of accidental deaths in the United States, met insurmountable political obstacles. Key groups representing doctors and hospitals lobbied strenuously against public disclosure.
HUMBLE BEGINNINGS: PROSPECTS FOR SUSTAINABLE TRANSPARENCY

As we have seen, political pressures often lead to the creation of weak transparency policies. But over time some policies do improve. Policies that evolve so as to transform the typical imbalance between concentrated costs and diffuse benefits can change the political dynamic in the direction of sustainability. How does that happen?

First, transparency systems improve when some of their target organizations champion more accurate, complete, and useful disclosure. There are several factors that may push disclosers to press for improvements in transparency over time. Of particular importance, competitive, political, and social factors may convince some that improved transparency will give them advantages over other disclosers. Disclosers’ divergent interests in providing full rather than partial disclosure can create a dynamic that fractures the political coalition opposing transparency.

Second, dispersed users of information may form political coalitions that press effectively for better disclosure. New crises often coalesce users’ interests in a national debate and force reexamination and improvement of disclosure. Permanent user coalitions, represented by consumer or public health groups, for example, can exert continuing pressure for improvement to gain perceived economic or political benefits. Such groups are often formed or strengthened in the wake of crises. Finally, because of their personal stake in the issue, entrepreneurial politicians may choose to continue to act on the behalf of information users in hopes of achieving political benefits.

In the absence of either divergent interests among disclosers or the emergence of organized user groups, transparency policies tend to remain trapped in James Q. Wilson’s political dead end of dispersed benefits and concentrated costs and have poor prospects for improvement over time. If those conditions remain unchanged, policies will be underutilized, implemented weakly, and subject to gradual erosion. But even these targeted transparency policies can improve – and therefore become sustainable – when conditions change in ways that undermine the common interests that concentrated costs impose on disclosers or create mechanisms that allow interest groups to integrate the diffused benefits to users.

One way of depicting the sustainability prospects of specific targeted transparency systems is shown in Figure 5.1. The axes in this figure represent two possible sources of political support: (1) the extent to which disclosers reap benefits from the transparency policy (the vertical axis) and (2) the extent to which user groups champion the policy (the horizontal
 axis). Figure 5.1 plots the fifteen U.S. targeted transparency policies we have studied along both dimensions.

The two axes divide the space into four regions. Policies in the upper-right region (high political sustainability) enjoy political support from two sources: user interest groups and subsets of disclosers who benefit from disclosure. Because diverse coalitions that cut across discloser and user boundaries frequently support these policies, they will, as a general rule, reliably improve over time by expanding their scope, enhancing the quality of information they provide, and enlarging the base of users.

Federal requirements for nutritional labeling of packaged foods fall into this region because some food manufacturers have come to support the disclosure policy, both to avoid having to disclose under multiple state standards and also because uniform labeling opens new marketing channels for healthier foods. These motivations have created common ground between some food producers and public health and consumer advocates. Similarly, under the mortgage lending disclosure system, some urban banks
have become quite adept at serving high-risk borrowers and now are recognized as leaders in the fair-lending arena by regulators and the general public. These banks not only accept mortgage lending disclosure as part of their regulatory environment but have occasionally offered public support for the policy.

The lower-right-hand region (moderate political sustainability) is characterized by politically organized user groups and a near absence of disclosers who benefit from transparency. In this region, interest groups of users and disclosers oppose one another politically. The result is usually a fitful pattern in which disclosure requirements advance and retreat according to momentary political advantages occasioned by issue visibility, friendly or hostile officials, and crises of legitimacy.

Federal campaign contribution disclosure rules exemplify the policies in this quadrant. Few disclosers (predominantly incumbents in Congress) have any incentive to press for improvement in the system absent political crises. Instead they share a strong common interest in limiting disclosure. But a wide array of groups representing particular political interests (from the National Rifle Association, right-to-life groups, and the Christian Coalition on the right to the AFL-CIO, Handgun Control Inc., and the Sierra Club on the left) have an interest in improving disclosure. The resulting conflict has led to infrequent but occasionally significant shifts in disclosure rules, usually triggered by some new scandal.

The upper-left region (low political sustainability) mirrors the lower-right. Transparency policies here benefit some of those compelled to disclose information, but organized groups of users who support the policies are lacking. Policies with these underlying political dynamics are unlikely to be sustainable.

As we have discussed, a potential disclosure policy for hospital mistakes emerged as a viable proposal briefly in this quadrant after release of an Institute of Medicine report in 1999 documenting the significant extent of medical errors in the United States.

Major purchasers of medical services, including companies like General Electric and General Motors, had strong incentives to reduce errors. They could have become advocates for a federal and state medical mistakes disclosure system. However, within months, conflicting interests brought about a political stalemate. The apparent consensus for national action splintered into conflicts among the groups representing disclosers (doctors and hospitals), which generally opposed disclosure, and a more diverse and fractured group representing users (public health advocates, state interests, insurers, employers, consumers, and trial lawyers). When the debate
Two Illustrations

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. Large employers, potentially powerful advocates of a disclosure requirement, instead chose to create their own advocacy groups for changing hospital practices. The temporary alliance of users was not cohesive enough to overcome opposition from potential disclosers.

As this story illustrates, transparency policies in this quadrant will usually be unable to develop in a sustained fashion. In part, that is because disclosers who benefit from transparency policies generally do so only after they have accepted disclosure as part of their operating environment and developed new skills and strategies in response. Significant incentives for disclosers to support transparency do not materialize until a viable system is in place or seems inevitable. The lower-left quadrant (lowest political sustainability) is where transparency policies have the poorest prospects, since they are supported neither by organized users nor by factions of disclosers. Though policies in this region may be created by effective political entrepreneurs following a crisis or scandal, the underlying politics will make it difficult for them to improve over time. Absent changes by either users or disclosers, these policies will be underutilized, implemented weakly, and subject to gradual erosion.

Two Illustrations

Two cases help illustrate the political dynamics that can lead to improvement or stagnation of transparency policies. Mandatory disclosure of the current addresses of sex offenders (“Megan’s Laws”) appear in the upper-right-hand quadrant of Figure 5.1. They have proven sustainable – although they remain highly controversial. By contrast, disclosure of unions’ internal financial and governance information has languished for most of the past forty years in the lower-left-hand quadrant.

State-level policies that require disclosure of information to the public about the current residences of released sex offenders typically operate in a political environment that pushes them toward continual increases in the quantity, quality, and scope of information. Often created in the wake of highly publicized and particularly heinous sexual assaults committed by ex-offenders, they are created in a context where politicians have strong incentives to push for disclosure of detailed personal information. Police
departments, which retain control over this information, have limited incentives to restrict its disclosure, since they act more as the agents of users (the public) than of the true disclosers (the ex-offenders themselves). Groups that champion the interests of the unusual disclosers, such as the American Civil Liberties Union or prisoners’ rights groups, usually have relatively little political influence and can therefore exercise only weak countervailing pressure. Meanwhile, information users – often residents of communities where ex-offenders are believed to be living – have strong incentives to organize and press for greater disclosure.\footnote{12}

In Washington State, one of the first to approve a sex offender community notification law, the political crisis arose from a series of highly publicized sexual assault cases in the late 1980s. The first case involved the abduction, rape, and murder of a young Seattle businesswoman in 1988. The killer, Gene Raymond Kane, had been on work release for two months after completing a thirteen-year sentence for attacking two women. The resulting public outrage was so intense that Governor Booth Gardner was forced to act quickly. To “channel the citizens’ outrage into a more measured, reasonable process,” he convened a task force charged with developing proposals on how the state could better protect communities from predatory sex offenders. To underscore the bipartisan nature of the issue and to satisfy critics in both parties, Governor Gardner, a Democrat, appointed Norm Maleng, the Republican who had challenged him in the previous gubernatorial race, to head the task force. After a series of public hearings at which 151 victims testified, David Boerner, a University of Puget Sound law professor, drafted the bill that was approved by the state legislature in January 1990.\footnote{13}

The same dynamic has driven steady expansion in the accuracy and scope of the policy from 1993 to 2005:\footnote{14}

1993: Police initiate “community notification meetings” to provide information to communities in which sex offenders live.

1994: The state legislature amends the law to require local law enforcement officials to notify the public at least fourteen days prior to an offender’s release into a community.\footnote{15}

1997: The state legislature again amends the law, creating more objective and standardized “risk-level” factors to determine whether ex-offenders should be included in the disclosure system.\footnote{16} A separate amendment expands it to include kidnappers.\footnote{17}

1999: The law is strengthened again to require ex-offenders to notify the county sheriff within fourteen days of becoming homeless or transient, or changing county location.\footnote{18}
2001: The law is strengthened to require county sheriffs to publish Level III sex offender notices in local newspapers and to require newspapers to publish this information when an offender moves into a new community. A separate bill requires Level III offenders to provide written notice to landlords prior to entering rental agreements.\(^\text{19}\)

2002: The law is amended to require hotel and motel owners to notify all other guests if they are lodging a Level III sex offender.\(^\text{20}\)

2005: The law is amended to require ex-offenders who attend or plan to attend an educational institution to notify the sheriff within ten days of enrolling or prior to arrival at the school, which triggers notification of the school principal and staff.\(^\text{21}\)

The public demand for additional information and the positive incentives facing police and state governments have led to passage of similar laws in every state and the District of Columbia over the past decade.\(^\text{22}\) What is more, the pattern of benefits and costs facing users and disclosers continues to drive many of these systems to improve in the quantity, quality, and scope of information released.

The story of union financial reporting illustrates a very different political dynamic. The Labor Management Reporting and Disclosure Act requires unions to reveal to their members information regarding financial practices and governance procedures.\(^\text{23}\) Its goal: to use transparency to reduce corruption in union activities. The law was enacted in 1959 in response to public outrage about charges of corruption in some of the nation’s most powerful unions (in particular the International Brotherhood of Teamsters), revealed in Senate hearings. A number of rising politicians, including John F. Kennedy and his brother Robert Kennedy, built their political reputations around the issue. However, legislative compromise produced a disclosure requirement that was relatively narrow in scope and that placed significant barriers in the way of use of the information by rank-and-file union members.

The disclosure law required each level of a union with governance responsibility to provide separate disclosure of financial activity (revenues and expenses) at that level. This disaggregated reporting made it difficult for users examining reports from union locals to locate information regarding related activity at regional and national levels. The law also focused narrowly on each union’s balance sheet (such as loan activity, officer salary, and line-item disbursements) rather than on programmatic expenditures (like political action, organizing, and member servicing) of more direct interest to members.\(^\text{24}\)
Neither disclosers (the unions themselves) nor users (primarily union members) had much incentive or opportunity to support or seek to strengthen the reporting policy. There was little incentive for unions to promote financial disclosure beyond that required by their own by-laws and constitutions, and many union leaders regarded the law as part of a conservative and business backlash against the labor movement. At the same time, very few unions had strong internal political units that could act on behalf of union members to push for broader or more easily accessible financial data.

Until 2000, when information became available on the Internet, union members seeking data under the disclosure law had to visit a reading room at the Labor Department in Washington, D.C., travel to a regional office of the department, or make a request by mail and pay a per-page charge. Since the typical LM-2 form (the reporting document filed by the union) runs well over a hundred pages, it might cost fifteen dollars or more to purchase. A user who wanted reports from several different reporting levels of the union might pay much more. But these out-of-pocket expenses were relatively small compared to the investment of time and energy needed to interpret the documents once they were obtained. High user search costs made the system moribund for decades, with few calls from union members for strengthening or expansion of its disclosure requirements.

In 2003, the Bush administration undertook the first major change of union financial reporting when the secretary of labor, Elaine Chao, used her authority under the disclosure policy to require far greater detail in reporting, a move toward programmatic reporting, and broader coverage of the law (for example, by expanding reporting requirements to smaller unions). The Bush reforms were supported by nonunion business interests rather than by union members or union officers and were perceived by some as aiming to thwart unionization efforts, rather than to promote the interests of users. In fact, even some of the individuals and groups that had long fought for greater internal union democracy and disclosure opposed the Bush administration changes.

Thus, in contrast to Megan’s Laws like those in Washington State, union financial reporting lacked strong support from its inception, and the relative benefits and costs to users and disclosers have changed little over time. It remains to be seen whether recent attempts to strengthen and expand the disclosure system will last.

SHIFTING CONDITIONS DRIVE CHANGES IN SUSTAINABILITY

As we have seen, the sustainability of targeted transparency systems is shaped by political conditions at the time of legislative enactment and at later
legislative moments when an established system is revised. However, the scope, accuracy, and use of information may also change as a result of shifts in the relationship between costs and benefits to users and disclosers owing to changes in such elements as market structure, the strength of intermediary organizations, and information technology. Such shifts in discloser or user benefits and costs can affect the larger political environment, and thus strengthen or weaken disclosure.

Changing Costs and Benefits for Disclosers

Typically, disclosers’ costs increase with the amount, scope, and level of detail of information they provide to users. For example, firms providing financial information incur costs in gathering, processing, and releasing that information that rise with the stringency of disclosure requirements. The more information required and the more frequently reports must be created, the higher the costs. The average incremental costs of disclosure requirements under the Sarbanes-Oxley accounting reform law were originally estimated by the SEC to be ninety thousand dollars, but more recent estimates put the number at many multiples above that.28

In one sense, the costs of disclosure arguably have fallen for many disclosers as a result of advances in information technology that reduce the costs of gathering, processing, and storing data. If technology were the only driver of the costs of disclosure, these advances might lower the threshold for information a typical discloser might be willing to provide. However, disclosers face still more significant costs associated with competitive or political risks arising from reporting – for example, the risk of a company revealing strategic information useful to competitors or a politician exposing herself in the thick of an election to potential embarrassment because of a particular campaign donor. Providing more detailed information may also open the discloser to greater pressure from certain user groups to adopt costly changes in policies.

The potential benefits of disclosure to target organizations may also change substantially following the introduction of a new transparency requirement. In particular, organizations may gain “first mover” advantages from providing more information than competitors and then attempting to raise the bar of voluntary or mandated disclosure for others. For example, a firm may gain investors from being more forthcoming about financial returns once others are required to disclose some financial information. Although the benefits of complete disclosure must still be balanced against the competitive downside of providing too much detailed knowledge, some firms may conclude that transparency represents a net gain.
The SEC’s decision in early 2006 to require full disclosure of executive pay, including pensions, illustrates how changes in the benefits and costs of disclosure can lead to improvement.\textsuperscript{29} Consumer advocates, labor unions, and shareholder advocates have long called for greater transparency in executive compensation to little effect. However, recent controversial cases involving exceedingly high-compensation executives (e.g., Richard Grasso, former chairman of the New York Stock Exchange, who received an estimated $187 million pay package)\textsuperscript{30} brought investor and financial community calls for greater transparency, including appeals from former Federal Reserve Chairman Alan Greenspan and legendary investor Warren Buffett.\textsuperscript{31}

As a result, the benefits of increased disclosure of CEO compensation packages began to shift for individual companies. Coca Cola, Inc., an early mover, announced in 2002 that it would voluntarily list executive stock options as an expense item in its future accounting statements, a reform advocated by many critics of the current reporting system. Although this move lowered Coca Cola’s reported profitability, it also gave the company a comparative advantage with investors increasingly worried about the accuracy and completeness of corporate financial statements, and a political stake in pushing for wider disclosure. Other companies followed suit, providing investors with detailed accounts of their compensation practices voluntarily, in part to quell growing concern about the negative consequences of excessive compensation on profitability but also to gain a competitive leg up on growing demands for mandatory disclosure. Thus, an increasingly divided discloser community led to a more politically conducive environment for increasing disclosure.\textsuperscript{32}

We have seen similar dynamics in other targeted transparency cases. Several of the largest food companies pushed for expansion of nutritional labeling to other sectors not covered by requirements. Corporations in the forefront of toxic use reduction and the pollution prevention effort pushed successfully for expansion of toxic pollution reporting to industrial sectors exempted under the original act. Even in Los Angeles, eating and drinking associations that originally opposed restaurant hygiene reporting have recently fought efforts by certain ethnic restaurant organizations to exempt themselves from parts of the grading system because of their different standards and methods of food preparation.\textsuperscript{33}

**Changing Costs and Benefits for Users**

As we saw earlier, using new information is often costly and yields benefits only when it improves the decisions made by consumers and other
information users. As a result, users will push for further improvement in disclosure systems only if their perceived benefits from the information provided outweigh their costs. The key drivers of benefits and costs for information users are the following:

- User benefits tend to rise as more information is provided. However, there is a limit beyond which users receive little additional benefit from additional information.
- User costs may rise, fall, or stay the same as more information is provided.
- Because the benefits of information flow to more individuals than just the direct consumers of information (the “public good” aspect of information), users may tend to underconsume disclosed data unless third-party agents act for groups of users in collecting, interpreting, and disseminating information.

Users, like disclosers, will balance the perceived benefits and costs of information. If the benefits of information rise over time (for example, if consumers become more aware of risks and more eager to learn how to avoid them) or the costs of acquiring the information fall (for example, as Internet access has become widely available), the demand for more detailed, more accurate, and broader information is likely to increase.

There is a close link between the degree to which disclosed information is embedded in users’ decision routines and the demand for better information, as illustrated by restaurant hygiene, auto rollover, and nutritional labeling systems. In all three cases, the costs of obtaining information for users are quite low. And because many users value the information, not only is it embedded in their decisions, but it also provides a basis for demanding further disclosure improvements. By contrast, there are fewer demands for improvement where information is not embedded in user decisions or where active intermediaries who pool user interests are lacking.

Understanding the benefits and costs to information disclosers and users makes it possible to anticipate whether a particular targeted transparency system will tend to improve over time. Where users do not value the information provided and fail to incorporate it in their decisions, there is little reason to expect demands for improvement. But where information is embedded in user decisions, we expect users (or their representatives) to push for more and better information. During crises that reveal the limitations of the existing transparency policy, these pressures provide political opportunities for the expansion of disclosure requirements.
The Importance of Intermediaries

Organizations of those who benefit from information provide an important source of political support for transparency policies. The larger the perceived benefits to specific, well-organized groups or coalitions of potential users, the more likely it is that users’ interests will be reflected in the initial structure of transparency policies. But if the potential users are an undefined “public interest” that has not coalesced into organized groups, users’ impact on policy improvement is likely to be far more limited. This is the case with school performance report card policies, where the intended beneficiaries—parents of students—are a highly diffuse and relatively unorganized group.

Sometimes disclosure policies begin without deep or well-organized political backing but gain such backing when advocacy groups or associations of users come to recognize how transparency can advance their own agendas. The emergence of such political intermediaries can then underwrite the continuous improvement of transparency regulation by shifting the regulatory politics from Wilson’s entrepreneurial mode (concentrated costs, disbursed benefits) to a more evenly matched interest-group contest between organized users and disclosers.

There are many examples of political interest groups that have found that transparency policies create tools they can use to advance their causes. For example, urban community organizations have used the information provided by mortgage lending disclosure to publicize the extent of discriminatory lending. This information has helped them build public opposition to these bank practices, forge alliances with bank regulators, identify and embarrass discriminatory lenders, and negotiate with specific lending institutions to improve credit access for previously excluded groups. Broad-based community reinvestment task forces in Washington State, Rhode Island, New Jersey, and Michigan have forged partnerships among community organizations, lending institutions, and state and local governments to address problems of access to credit.

Other types of intermediaries, such as investigative reporters and financial analysts, have also used mortgage lending information to document pervasive patterns of discriminatory lending and the exodus of banks from minority neighborhoods. In 1988, for example, two reporters for the Atlanta Journal-Constitution reported on widespread redlining in The Color of Money, a series of articles that received national attention. In 1992, a rigorous study conducted by the Boston Federal Reserve concluded that race had a strong influence on lending decisions. The report received broad media coverage, confronting banks with discrimination allegations.
from a particularly authoritative source. All these uses of lending information by organizations that represent users’ interests have made such organizations into champions of the disclosure policy and advocates of its improvement.

Similarly, transparency policies have strengthened the political stature of environmental organizations with respect to corporations, public health advocates with respect to food producers, and proponents of campaign finance reform with respect to candidates and donors. When transparency requirements alter the political terrain in ways that favor particular interest groups, they can create users who are organized and motivated and have resources to defend the disclosure policies and press for improvements.

In some cases, particular industry-segment users may favor transparency as an economic weapon against disclosers in another industry segment. Corporate financial disclosure illustrates this dynamic. In that case, investors as a class have a strong financial interest in obtaining accurate information about companies where they may buy stock. They are thus natural supporters of strong and continuously improving financial disclosure. Large pension funds, mutual funds, and other institutional investors, increasingly prominent investor groups, have become powerful advocates of financial disclosure. Similarly, industry associations representing major manufacturers that use hazardous chemicals in production and fear potential liability from their use have been the primary advocates for improvement of workplace chemical hazard reporting.39

User intermediaries can also reduce the costs of information acquisition and interpretation. Unlike other goods and services, information has a value that does not diminish when it is consumed by additional parties. Economists refer to this as non-rival consumption, one of two prerequisites for a public good. (The second is a relatively high cost for excluding other users from consumption once the good has been produced. With the recent explosion of information technology, especially the Internet, this second prerequisite is becoming increasingly applicable to information as well.)

Non-rival consumption means that the information provided to users by disclosers will tend to be underconsumed from a social perspective. Why? Because individuals who use the information may not realize that others might also benefit from the same information or from its effects on decision making. These ancillary benefits are referred to as spillover effects.

Imagine a worker who has obtained information about hazardous chemicals at her workplace through the disclosure process. Her awareness of the increased health risks she faces will inform her subsequent decisions, including assessment of her personal risk/cost equation: If she plans to have
a baby, should she request a transfer to another facility before becoming pregnant? If she does, will she face the risk of losing her job or her seniority? How should the economic and health factors be balanced? Our hypothetical worker has clearly benefited from the information she has obtained. But she may not consider that other women in her workplace could also benefit from the same information. If she does not take this wider set of beneficiaries into account (by sharing the data, for example), her incentive to invest in acquiring this information will be too low from a social point of view.

In such situations, an organized group can help by serving as an agent for users. For example, a labor union or an employee health counselor might produce a special booklet or conduct an informational meeting for workers in their childbearing years to discuss the potential dangers of exposure to hazardous chemicals during pregnancy. In fact, labor unions have been shown to substantially increase workers’ exercise of rights provided under labor statutes.40

The greater the spillover effects, the more important an organized group may be. In some instances, the spillovers from information are limited. For example, the spillover benefits from nutritional data on a food package are likely to be small, since not all consumers will find the information relevant to their health status and objectives. User intermediaries are less important in such cases. (An exception might arise if there is a subset of consumers who have special needs requiring additional, specialized information, such as those with food allergies. We discuss this case later.)

An important factor in the role of user intermediaries is the alignment of their interests with those of the individuals they represent. The more fully such groups’ incentives mirror those of individual users, the more likely it is that the groups will be able to correct the problems posed by the non-rival character of information. Unions, for example, operate under political incentives as well as statutory requirements that push them toward considering the interests of workers. The politics of union organizations impel their leaders to consider the interests of the median voter in setting union policies, and the “duty-of-fair representation” requirement arising from labor law penalizes union officials who fail to represent both members and nonmembers covered by collective bargaining agreements.41

In some cases, however, user representatives’ interests are not aligned with those of individual users. Once again, financial disclosure offers a clear example. Some institutional investors – pension fund managers, for example – have incentives to use the information they collect for the benefit of all their clients. But this may not be the case with some investment advisers. For example, stockbrokers who earn commissions from the sale of shares
sometimes face incentives to withhold negative information about a company from their clients. 

User intermediaries can also help reduce information costs. In many arenas, especially as Internet use becomes more pervasive, the costs of collecting information are low, but processing and disseminating that information can be expensive. For example, anyone can log on to the Web site of the Federal Election Commission (FEC) to download information about financial contributions to congressional candidates. But it takes time to learn how to use the Web site, how to specify the correct reporting period, and how to aggregate contributions into relevant categories (for example, money donated by anti-gun-control organizations). What is more, disclosers have gamed the system by donating under multiple organizational names, intentionally confusing users. As a result, the time and costs of gathering and analyzing contribution data are substantial.

In this situation, organizations can help by applying their expertise to the tasks of gathering and analyzing information and reporting it in easy-to-grasp form to concerned users. For example, a pro-gun-control organization might publicize a simple, annotated list of the congressional candidates who have received the largest donations from anti-gun-control groups. In parallel fashion, advocacy groups in other areas from consumer rights to the environment are mining FEC data and translating it into a format that users find easy to digest.

Even where the costs of aggregating information are not substantial, interpreting the data so that users can incorporate them into their individual decisions may be costly or complicated. In many areas of risk-related disclosure systems, such as toxic pollution or drinking water safety reporting, translating complicated information into comprehensible formats is essential. There is also significant misuse of information because of hidden complexities – for example, in the interpretation of school report card data. In response, a variety of parent and community groups in different states have created Web sites that allow parents to compare their children’s schools with other schools with similar characteristics. These groups turn disclosed data into the kind of information parents can use in making location decisions or in seeking greater involvement in the schools.

To sum up, targeted transparency policies are often born in crisis, usually as political compromises reflecting the relative power of organized representatives of potential disclosers and weak coalitions of potential users. Improving such policies over time is similarly hampered by the distribution of political power. Yet new market conditions and corporate strategies can alter the
benefits and costs for disclosers, empowering some interests and threatening others, thereby rearranging the political environment that surrounds transparency systems and occasionally opening opportunities for improvement. Improvement also depends on the growth of user constituencies and intermediaries that stand to benefit from greater access to more accurate and complete information. One requirement for transparency effectiveness, therefore, is that the dynamics of the system favor sustainability.

To this point, our analysis has focused almost entirely on transparency systems within the United States. Now we expand the discussion with a look at attempts to use targeted transparency as a strategy for furthering international priorities.