

# THE TRANSPARENCY OF POLITICAL INSTITUTIONS

## The Perils of Transparency in Bureaucracies

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Many countries have recently enacted or proposed reforms aimed at increasing the availability of information on the quality of some public sector services. Transparency has been a buzzword among international organizations and public sector reformers.<sup>1</sup> For example, the disclosure of school and teacher quality has generated a heated public debate. In the United States, No Child Left Behind Act (NCLB) requires learning progress be measured for every child and results from students' tests be made available in annual report cards, so that parents can evaluate school performance. Similar reforms have also been proposed for many other public services. In the United Kingdom, legislation introduced in 2000 requires the performance of each local government be reviewed and results made public, not only with regards to provision of services such as fire, police, housing, social services, and education, but also the condition of roads, average time taken to remove fly-tips, and the amount of household waste recycled.<sup>2</sup>

Most of these reforms have been opposed by the affected public sector employees. In the United States, the largest teachers union (the National Education Association) spent more than \$8 million in an effort to derail NCLB. In the United Kingdom, public service unions greeted reforms with increased scepticism and hostility.

More generally, it is difficult to find groups of public sector workers or trade unions lobbying the government to disclose *more* information about quality. In contrast with the private sector, it is much less common to see even the highest quality providers (e.g., hospitals and schools) trying to distinguish themselves and offer information about their quality to the public. This may be puzzling, especially in light of the fact that much of the information about quality can be made observable at a relatively small cost.

This paper investigates the consequences of transparency of government services, and we argue there might be efficiency justifications for the opposition by public sector employees to the transparency reforms, although, of course, these may not be the reasons driving the opposition. We focus on one feature that tends to differentiate government services from market setting. The former typically are not allocated through prices, and high-powered incentives for government employees are the exception rather than the rule. This implies that increasing the availability of information on quality of public services leads to increased demand for the services of the high-quality providers. While in typical private sector settings this is beneficial to the high-quality producers, in the public sector this increase may lead to rationing and therefore the final consequences are less immediate, and depend on the specific setting.

We provide two simple models that capture two distinct aspects of these phenomena. In the most basic model, the department of motor vehicles (DMV) model, several public offices that differ in efficiency provide services to homogeneous citizens. When efficiency is exogenous, under no disclosure delays are lower in more efficient offices, while under disclosure delays are equalized among all offices, and average delays are lower. Citizens are better off under the policy that discloses the efficiency of all offices. The most efficient offices end up having

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<sup>1</sup> The International Monetary Fund published a book in 2001 titled *Manual on Fiscal Transparency*. The Organisation for Economic Co-operation and Development published a similar volume in 2000 titled *Best Practices for Budget Transparency*. Transparency International is an organization for which the goal is to fight corruption and "promote transparency in elections, in public administration, in procurement, and in business" ([http://www.transparency.org/about\\_us](http://www.transparency.org/about_us)).

<sup>2</sup> See <http://www.bvpi.gov.uk/pages/index.asp>.

a higher workload when information is revealed, however. This implies that the incentives to invest in quality are reduced when information is revealed, and so citizens might be better off when there is no information about quality.

The second model can be viewed as a highly simplified model of a school system: schools differ in qualities, students differ in abilities, and students' payoffs exhibit complementarity between their ability and quality of the school they attend. When each school has a fixed capacity and an oversubscribed school must allocate slots through lotteries, the allocation is more efficient when information on school quality is not revealed. The opposite is true if oversubscribed schools allocate slots via (informative) testing, however. The first-best outcome can be achieved when information is revealed. This points to the increased importance of the way rationing is resolved for oversubscribed schools when information is transparent. It also highlights the fact that a focus on improving information about service quality may be counterproductive, unless these reforms are accompanied by a careful review of the process dealing with over-demand and rationing of the best-quality providers. The incentives for principals to invest in school quality may also be reduced by the disclosure of information.

In both models, the higher-quality providers may be opposed to increasing transparency. In the first model, this is because this leads to higher workloads, in the second, this is because it may lead to lower average student quality for the top schools.

**I. A Model of Delays in Public Services**

*A. Exogenous Efficiency*

Consider an environment in which there are several offices that provide a service. For concreteness, we will talk about the motor vehicle services. Other examples in which waiting times are important considerations (various document offices, emergency rooms) can also be sensibly thought of this way, however.

Consumers dislike waiting but otherwise have homogeneous preferences across offices. There is a unit mass of consumers and a finite number of offices numbered 1, ... ,N. Workers in office *i* can process each "problem" in *t<sub>i</sub>* time

units. Without loss of generality, we assume that *t<sub>1</sub>* < ... < *t<sub>N</sub>*: lower indexed offices are more efficient. In order to get served, consumers must line up when the office opens and the order of service is randomly determined. Thus, if a mass *M<sub>i</sub>* of consumers show up in office *i*, the average waiting time for a consumer is (*t<sub>i</sub>M<sub>i</sub>*/2).

Absent any information about the efficiency of the different offices, consumers are allocated randomly. Thus, each office receives 1/N consumers and the average waiting time in office *i* is *t<sub>i</sub>*/2N. More efficient offices have shorter waits. The average waiting time across all offices is then given by

$$(1) \quad t^{ND} = \frac{1}{N} \sum_{i=1}^N \frac{t_i}{2N}.$$

Assume that information about the efficiency of the different offices is revealed to everyone. In equilibrium, waiting times must be equated across offices; otherwise some consumers would prefer changing office. Thus, *M<sub>i</sub>* must be such that *t<sub>i</sub>M<sub>i</sub>*/2 = *k* or *M<sub>i</sub>* = 2*k*/*t<sub>i</sub>*. Since  $\sum_{i=1}^N M_i = 1$ , we must have

$$2k \sum_{i=1}^N \frac{1}{t_i} = 1,$$

which implies that *k* = 1/[2 $\sum_{i=1}^N$ (1/*t<sub>i</sub>*)]. We can thus conclude that

$$(2) \quad M_j = \frac{1}{t_j \sum_{i=1}^N \frac{1}{t_i}}.$$

Since *M<sub>j</sub>* is decreasing in *t<sub>j</sub>*, more efficient offices receive more consumers, but all consumers wait the same amount in every office. The average waiting time in every office is given by

$$(3) \quad t^D = \frac{1}{2 \sum_{i=1}^N \frac{1}{t_i}}.$$

**PROPOSITION 1:** (i) *The number of visitors is increasing in the efficiency of the locations when information about waiting times is public,*

while the number of visitors is independent of location when information is not revealed.

(ii) Average waiting times are shorter when information is revealed.

**PROOF:**

Part (i) is an immediate consequence of equation (2) and of the fact that allocations have to be independent of locations in the absence of any information. For part (ii), comparing equations (1) and (3),  $t^D < t^{ND}$  holds if and only if  $1/[(1/N)\sum_{i=1}^N(1/t_i)] < (1/N)\sum_{i=1}^N t_i$ . This is true since the left-hand side is the harmonic mean of efficiencies, while the right-hand side is the arithmetic mean of efficiencies.

The intuition is straightforward. When information is revealed, the most efficient offices process more consumers. Thus, average waiting times decrease.

In this model, the most efficient offices receive more visitors when information about waiting times is public. Since there is no reward for processing more visitors, it is then plausible that preferences for disclosure of quality are inversely related to quality. The most efficient offices are the most averse to disclosure.

*B. Endogenous Efficiency*

An important consequence of the model in which efficiency is exogenous is that efficiency is “rewarded” when information is not public because the most efficient employees, on average, work less. Instead, payoffs for office employees may be decreasing in efficiency when information is disclosed. This perverse force might reduce the incentives to invest in efficiency when efficiency is endogenous, and lower investment might lead to overall higher waiting times when information is revealed.

To understand these effects, consider an extension of the previous model where, in a prior stage, each office makes a decision that affects its efficiency. For instance, assume that, in the second stage, payoffs for the manager of office  $i$  are given by  $T - (t_i - x_i)M_i$ , where  $T$  is the available time common to all offices,  $t_i$  is the skill level of office  $i$  absent any investment, and  $x_i \geq 0$  is the investment. The interpretation is that each manager enjoys free time left over after all customers are served. Assume that all employees within the same office are identical

and that, in the first stage, the manager invests in choosing  $x_i$ . Assume that the cost of investment is given by  $c(x, t_i)$  with  $\partial c/\partial x > 0$ , i.e., investment is costly, and  $\partial^2 c/\partial x \partial t_i > 0$ : lowered indexed managers have lower marginal cost. For simplicity, assume the following functional form:  $c(x, t_i) = \gamma t_i x_i^2/2$ , where  $\gamma > 0$  is a parameter.

Thus, when information is not revealed, payoff from investment is

$$\pi_i^{NR} \equiv T - \frac{(t_i - x_i)}{N} - \frac{\gamma t_i x_i^2}{2}.$$

When information is revealed, by a simple modification of equation (2), payoff is

$$\pi_i^R \equiv T - \frac{1}{\sum_{i=1}^N \frac{1}{t_i - x_i}} - \frac{\gamma t_i x_i^2}{2}.$$

When information is not revealed, the first-order condition for  $x_i$  implies

$$(4) \quad \gamma x_i t_i = \frac{1}{N}.$$

When information is revealed, the first-order condition for  $x_i$  implies

$$(5) \quad \gamma t_i x_i = \frac{1}{\left( (t_i - x_i) \sum_{j \neq i} \frac{1}{t_j - x_j} + 1 \right)^2}.$$

In many cases, the system of first-order conditions (5) are not sufficient for a maximum of the payoff function. In particular, often the optimal  $x_i$  is at the boundary, i.e.,  $x_i = 0$ .

In any event, it is clear that the incentives to invest in productivity are lower when waiting times are revealed. To illustrate the point, consider the following numeric example. Assuming  $N = 2$ ,  $t_1 = 3$ ,  $t_2 = 4$ , and  $\gamma = 1/5$ , we obtain that when information is revealed the optimal

$x_1$  and  $x_2$  are interior and by equation (5) are  $x_1 = 0.635$  and  $x_2 = 0.182$ . When information is not revealed, we can use equation (4) to obtain  $x_1 = 0.833$  and  $x_2 = 0.625$ .

We can also compute waiting times in the two scenarios. When information is not revealed, we have that  $t_1 - x_1 = 1.9 - 0.833$  and  $t_2 - x_2 = 1.8 - 0.625$ , so that average waiting time is

$$t^{ND} = \frac{1}{N} \sum_i \frac{(t_i - x_i)}{2N} = 0.280.$$

Under revelation, we have  $t_1 - x_1 = 1.9 - 0.635$  and  $t_2 - x_2 = 1.8 - 0.182$ , so that average waiting time is

$$t^D = \frac{1}{2 \sum_{i=1}^N \frac{1}{t_i - x_i}} = 0.355,$$

and therefore citizens are better off when information about quality is not disclosed.

## II. A Model of School Choice

Assume that there is a unit mass of students and  $N$  schools numbered  $1, \dots, N$ . Students differ in ability  $a$  with distribution  $F$ . Schools differ in quality  $q$  with  $q_1 > \dots > q_N$ . If a student of ability  $a$  attends a school of quality  $q$ , the outcome the student receives (wage or opportunities) is given by  $a \times q$ .

In contrast with the previous model, we assume that each school has a capacity. For simplicity, we assume that capacity is the same for all schools, and it is denoted by  $C$ . We assume that  $NC \gg 1$  but  $C \ll 1$  so that no school can accommodate all the students, but the school system is large enough that all students can find at least one school.

Schools are also differentiated along an additional dimension that is perfectly observed by everyone (e.g., distance). For simplicity, we assume this dimension is swamped by quality. In other words, if a student has no information on quality, he chooses based on distance. If he has information on quality, he chooses based on quality.

We assume that the environment in which information is not public is more complex than

in the previous model. Specifically, we assume that the parents of each of the students receive a signal. With probability  $p(a)$  the signal reveals the quality of all the schools; with probability  $1 - p(a)$  the signal reveals nothing. We assume that  $p(a)$  is increasing so that parents of higher-ability students are more likely to be informed about quality. We believe that this assumption is realistic, and it is meant to represent the fact that parents who care more about education are more likely to have high-ability students and to acquire information both via word of mouth and because they are better able to process the information obtained via school visits and other informal ways of obtaining information.

We assume that everyone is allowed to apply to all schools. We need to specify what happens when a school is oversubscribed. Under both transparency regimes, we distinguish two scenarios. In the first scenario, oversubscribed schools run a lottery and the winners are offered a slot. In the second scenario, each school runs a perfectly informative test, and the higher-ability applicants are offered slots.<sup>3</sup>

When information is not public, those who have information end up going to the highest-quality school to which they are offered a slot. Those who do not have information go to the closest school that offers them a slot.<sup>4</sup> When information is public, all students go to the best school that offers them a slot.

It is easy to see that in the transparent regime, if oversubscribed schools must allocate slots through lotteries, the allocation is less efficient than when information is not transparent. On the other hand, if schools can allocate slots through testing, the most efficient regime is the transparent regime.

<sup>3</sup> One could think of alternative matching algorithms that incorporate, to varying degrees, the preferences of the schools. See Atila Abdulkadiroglu, Parag A. Pathak, and Alvin E. Roth (2005), and Abdulkadiroglu et al. (2005) for a discussion of a reform of matching in Boston and New York.

<sup>4</sup> Some care must be taken since the specific way in which rationing is resolved across several schools could affect the outcome. One simple way to solve this is sequential offers. The top school offers slots (either via lottery or testing) to  $C$  students. Given our assumptions above, these are all accepted. Then, the process is repeated for the remaining  $N - 1$  schools and  $1 - C$  students.

We can conclude there are two dimensions of transparency in this model. There is transparency of school quality and transparency of student quality. If oversubscribed schools must offer slots based on lotteries, this means they cannot use information on ability. The most efficient system is one in which there is two-sided transparency. The least efficient system is one in which only school quality is transparent.

It is clear that, if principals care about the average quality of the students they receive, when slots are offered through lotteries, principals of high-quality schools prefer the nontransparent regime.

When school quality is endogenous, as in the model of delays, when slots are offered through lotteries, the incentives to invest in school quality may be reduced by transparency.

### III. Related Literature

Several recent papers are concerned with the effects of inferior information on politicians' actions (e.g., Timothy Besley and Robin Burgess 2002, Gavazza and Lizzeri 2006a,b) or politicians' quality (e.g., Andrea Mattozzi and Antonio Merlo 2006). Similarly, Gilat Levy (2006) analyzes the effect of the transparency of the decision-making process in committees on the decisions that are eventually taken. Other papers consider models with an agent of uncertain ability and discuss the effect of imperfect information on the incentives of the agent and on screening (e.g., Andrea Prat 2005). David Strömberg (2004) discusses the role of mass media in informing voters, and shows that more informed voters obtain higher transfers.

Outside the political economy literature, David Dranove et al. (2003) examine the effects of report cards on health care providers. They show that the additional information has led to worse health outcomes by pushing doctors to select among patients. Heski Bar-Isaac, Guillermo Caruana, and Vicente Cuñat (2006) suggest that, when goods have multiple characteristics, firms might underprovide some characteristics when consumers become more informed about other characteristics, and this might decrease welfare.

Canice Prendergast (2002) provides a model of oversight of public sector workers, and offers evidence that in the Los Angeles police department,

policemen reduced their crime prevention activities as a response to increased oversight.

### IV. Concluding Remarks

We have presented two very stark models focusing on some aspects of transparency in bureaucracies. These show that transparency may have some potential perverse effects unless accompanied by reforms of the incentives facing the bureaucrats. In the models, the highest quality providers may be opposed to transparency.<sup>5</sup>

We believe the forces highlighted by our models do not apply to the public sector only, but, more generally, might shed some light on several instances in which prices do not fully adjust. For example, it is interesting to note that the theoretical literature on voluntary quality disclosure (Sanford J. Grossman 1981, and Boyan Jovanovic 1982) predicts that all high-quality firms should reveal their private information about quality. In contrast to this "unraveling" prediction, several empirical studies (Ginger Zhe Jin 2005, and Mo Xiao 2006) have found that voluntary disclosure is incomplete in reality. This might seem puzzling at first sight, but if prices cannot fully adjust in response to quality differences, our model suggests one reason for why such nondisclosure might persist in a market equilibrium.

Moreover, allocations are not driven entirely by prices within organizations, and in markets such as most health care services, where insurers' bargaining power limits the prices that doctors charge to their patients. Our analysis calls for further research to understand fully how provision of quality and disclosure of information interact in these contexts. For instance, an extension of our analysis suggests that voluntary disclosure of high quality should be more prevalent for health specialties, where services are generally not covered by insurers and where prices can adjust more rapidly to increases in demand, i.e., plastic surgeons more than pediatricians.

<sup>5</sup> In both models, the lower-quality providers benefit from transparency. It is easy to think of reasons, such as internal promotional concerns, why they may not want to broadcast their inefficiency.

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