Credit-Information Reporting

Why Free Speech Is Vital to Social Accountability and Consumer Opportunity

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A gossiper is someone thought to gossip too much. But everyone gossips to some extent. Everyone chats with coworkers, neighbors, and friends. Gossiping is often part of doing one's job.

Gossip serves the vital function of creating accountability. Usually when people interact, there is no referee overseeing the interaction. If one party fails to meet his obligations, the other party is the only person able to report it. Reporting the failure helps to form the reputation of the chiseler and creates accountability against chiseling. Anthropologist Sally Merry (1984) writes that "the individual seeks to manage and control the information spread about him or her through gossip" (275). One way to avoid a reputation for chiseling is not to chisel.

Civilized society depends on accountability mechanisms such as gossip. No one denies that many individuals will meet their obligations even if no social mechanisms exert accountability; people do have a conscience and a sense of honor. But where do those virtues come from? They are not endowed at birth. We are not born saints, and few of us die saints. Without some external system of accountability, people do not

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cultivate the practices and habits necessary to develop internal accountability. Before learning honor we learn prudence.

Moreover, the extent of our obligations is often unclear, even to the most scrupulous among us. Our knowledge of what is expected, what is customary, and what is appropriate in a particular situation depends on the signals that accountability mechanisms provide us. We might be willing to do good but may be unsure which actions are good.

And even if most of us have a strict sense of honor, without social accountability mechanisms a few wanton souls could greatly manipulate and upset civil society. Indeed, there will always be people who act irresponsibly and fail in their obligations—a fact we must candidly recognize if we are to understand why social accountability mechanisms are necessary. Such mechanisms police our own scruples and protect us against deliberate predation.

The news media practice a kind of gossip. Television and newspaper journalists tell of good deeds and wicked ones, thereby creating reputations that give rise to rewards and punishments. Accountability also works in the realm of scholarship and science when peers evaluate and gossip about scholarly products at professional conferences and seminars and in professional journals and books. Letters of recommendation also serve as checks on employability. Yet another accountability mechanism is the criminal justice system. Police officers go undercover, detectives ask questions, attorneys cross-examine, and witnesses make public testimony. The community hears the details of private transactions. Finally, court decisions are reached, penalties imposed, and criminal records made public.

All social accountability mechanisms work to reward good behavior and punish bad behavior. To function effectively, they must obtain information about who did what to whom. They ask questions, assess the validity of responses, and judge the credibility of character. Sometimes they infringe on civil liberties. All social accountability mechanisms collide with privacy, although each does so to a different extent.

Another social accountability mechanism is the credit-reporting agency (or credit bureau). Creditors, employers, landlords, and insurers may be willing to make opportunities available to consumers as prospective credit users, employees, tenants, and policyholders, but only if they can obtain information on their trustworthiness. Creditors, employers, and others pay credit bureaus for information about consumers, especially information about whether prospective consumers have met past credit obligations. In the United States, three large companies dominate the credit-reporting business: Equifax, Experian, and TransUnion. They work through more than five hundred local offices and contracted affiliates, which send them information from virtually every creditor. Hence, the flow of information is two-way.

Credit bureaus also help marketers—such as L. L. Bean, the National Braille Press, the Children's Television Workshop (*Sesame Street Magazine*), and the Sierra Club—identify consumers likely to be interested in certain products and assemble marketing lists for these companies and organizations.

Policy Issues Concerning Credit-Reporting Agencies

The credit-reporting industry is the subject of much controversy. Consumers in general know very little about how credit reporting works, and they tend to be suspicious about it (Dunkelberg, Johnson, and DeMagistris 1979). Some consumer activists, journalists, and public officials charge that credit bureaus violate people's privacy, report false or incomplete information, share information with inappropriate parties, and fail to respond to consumer inquiries and disputes. Critics claim to be protecting consumers from losing out on opportunities such as mortgage or car loans.

The range of information included on credit reports is smaller than many suppose. Credit reports usually include only the following kinds of information:

- consumer's name, address, Social Security number, place of employment, and spouse's name
- open credit lines, outstanding credit balances, credit limits, history of timeliness of payments, and amount of last payment
- bankruptcies, liens, child-support payments, and public judgments against the consumer

Reports do not include information about the consumer's lifestyle, religion, political affiliation, driving record, or, except in special cases, medical history—some of the things that a casual acquaintance might come to know. The Fair Credit Reporting Act (passed in 1970, amended in 1996) specifies that credit reports may be purchased only by those entities with a "permissible purpose"—notably creditors, employers, landlords, and insurers. Terms of strict confidentiality surround the use of reports by these parties. Consumers need not fear that any neighbor can read their credit report.

About ten thousand creditors supply information to credit bureaus each month. The bureaus almost always report that information faithfully. In rare cases the reporting is faithful but erroneous because creditors occasionally supply inaccurate information. The creditor may have failed to record or update consumer payments or delinquencies. Other errors surface in reports assembled by the bureaus, who bear the brunt of complaints. Errors in the broadest sense occur for many reasons: public records are faulty, consumers neglect to have their mail forwarded, consumers misplace bills, outgoing mail fails to find its way to the mailbox, mail is improperly delivered, mail is improperly forwarded, and so on. Credit bureaus themselves are fallible, but for the most part the hostility directed at them because of errors on reports amounts to blaming the messenger.

The credit bureaus have made it easy for consumers to review their own credit reports, often at no charge (and federal law sets a maximum charge of eight dollars).

Federal law requires that the credit bureau supply to the consumer at no charge a copy of the credit report that was used in a decision that resulted in an adverse action (such as being turned down for credit) because of information in the report.

When a consumer disputes information in the credit report, a verification process begins. The dispute is usually submitted in writing. The verification process flows from the consumer to the bureau to the creditor and back again. Consumers with valid complaints have good cause to feel some frustration, but they must realize that credit bureaus do not know beforehand whether a complaint is valid or spurious. If they revised their records simply from a complaint received by phone, scam artists would claim to be the victim of errors. The 1996 amendments of the federal law require that the bureau verify disputed information within thirty days or delete it from the records. Barry Connelly (1997), president of Associated Credit Bureaus, claims that in most cases disputes are verified or resolved within two weeks. When adverse information is verified and the consumer believes there is more to the story, he may write a brief statement to be included in the record (usually limited to one hundred words). Also, when a consumer disputes information with the creditor, the creditor must report the account information as "in dispute."

Credit-reporting services are restricted by state and federal laws. Critics of the system continually seek to add further restrictions, including measures to do the following:

- impose penalties or assign liability to credit bureaus for errors in reports
- require credit bureaus to notify or get permission from consumers before using information about the consumer
- specify rigid procedures for credit-bureau operation, including how long information may be retained on reports, how credit reports are written, who may use the reports, how consumers are notified of credit decisions, and how consumer inquiries and disputes are handled
- provide consumers with their credit reports at no charge or at reduced prices
- require credit bureaus to respond to consumer inquiries within a specified time or face penalties
- create government bureaucracies to police the credit bureaus and formulate new regulations of their operations

The 1996 amendments include many, but not all, of these restrictions; they are fifty pages long (www.ftc.gov/os/statutes/fcra.htm). Although state laws vary, the foregoing list gives a flavor of the types of restrictions sought or currently imposed. Lawsuits and policy initiatives concerning credit bureaus are multitudinous and can be expected to continue indefinitely. Credit reporting has become a major public issue only in the last ten years, but now the issue is here to stay.

Credit bureaus are organized as for-profit businesses; they are regulated as businesses and are criticized by consumer activists who routinely attack businesses. They are faulted for being interested in profits but not in consumers. Compared to other business firms, such as McDonald's, General Motors, or Microsoft, credit bureaus do play an important role in decisions that affect consumers' lives, and they do impinge on privacy. *But other large business firms are not social accountability mechanisms.* The critics recognize only dimly that credit bureaus, aside from being businesses, are social accountability mechanisms. With respect to infringement on privacy and the prevalence of erroneous information transmission, credit bureaus ought to be compared to other social accountability mechanisms: gossip, the news media, the courtroom. In such comparisons, the credit bureaus excel in reliability and discreetness. They convey only the most pertinent information to only the most relevant parties in a highly standardized, impersonal, and professional manner.

An understanding of accountability illuminates the far-reaching benefits that credit bureaus make possible. Credit bureaus make opportunities—credit, employment, housing, insurance—more available and more affordable to everyone. Credit bureaus elicit the provision of such opportunities by creating accountability. Because institutions such as credit bureaus are part of the foundation of civil society, the policy debate over their operation is of paramount importance.

Once we understand the importance of credit bureaus as a kind of social accountability mechanism, we are more inclined to regard the criticisms leveled against them as unreasonable and even fundamentally inconsistent. To some extent, social accountability mechanisms can be honed to greater accuracy and precision, yet a fundamental tension exists between making information better and making it more dependent on the privacy and permission of the individual consumer. If laws guaranteed complete privacy, our freedom of speech would be obliterated. Specifically, we would be prohibited from warning others about those who have failed to meet their obligations. (Even worse: Imagine how you would feel if victims in your neighborhood had to respect the privacy of a baby-sitter who had been previously convicted of molesting children.) It is unreasonable to demand better information *and* greater protection of privacy. The two goals conflict. The need for accountability mechanisms in credit provision is underscored by the startling increase in filings for personal bankruptcy, which tripled between 1986 and 1997 (Connelly 1997).

Credit bureaus serve two kinds of functions. First, as social accountability mechanisms, they help businesses decide whether a consumer's application should be approved. The charge against the bureaus in this connection is that consumers are sometimes denied credit or other opportunities because of inaccurate adverse information. Second, as marketing scouts, credit bureaus compile lists for marketers. The charge against the bureaus in this connection is that the privacy of the consumer is invaded. I explore in turn each function of the credit bureau and suggest that restrictions in either area of activity are likely to have a negative impact on consumers.

Origin and History of Credit Bureaus

The connection between credit reporting and gossip is not only conceptual, but also historical. Before credit bureaus existed, creditors, merchants, and landlords had to rely on word of mouth, letters of reference, and other forms of gossip to assess the trustworthiness of a consumer. Everyone had to do his own gossiping: information had to be gathered, interpreted, formatted, stored, retrieved, and transmitted. Creditors and others could gather information on regular customers and local parties, but their information and hence their confidence were limited. They made opportunities available only to those who were thoroughly screened.

Robert H. Cole, the author of *Consumer and Commercial Credit Management* (1988), explains that without credit bureaus, credit provision itself was very limited: "credit bureaus grew and developed slowly prior to World War II. . . . [F]ew retailers sold on credit, and those that did confined their credit business to well-known customers" (184). Creditors kept their own accounts and engaged in information exchanges with each other, sharing lists of names of those known to be poor credit risks. But crisscrossing exchanges are inefficient. Far more efficient is the use of a centralized agency that serves as a hub for all creditors and merchants. The hub-and-spoke pattern of information flow greatly reduces the redundancy, inconsistency, and unnecessary variation in communication.

In commercial credit reporting—that is, reporting on whether merchants and companies are reliable in meeting obligations to wholesalers and suppliers—the evolution occurred earlier and somewhat differently. In the 1800s, wholesalers selling on credit relied on word of mouth, information exchanges, and letters of reference. Wholesalers and suppliers in cities kept accounts of their own buyers. In Manhattan during the 1830s, Lewis Tappan handled the credits in his brother's wholesale silk business and developed extensive credit records in their line of business (Brisco and Severa 1942, 159). Tappan recognized that this aspect of their wholesale business could be extended to other suppliers who needed information. By detaching the credit-information activity and serving many suppliers, Tappan realized economies of scale and helped to found the business of credit reporting in the United States (Norris 1978, 10–20). He contracted with agents and correspondents throughout the country to "gossip" about the solvency, prospects, and character of local businesses. He established an information hub that could rapidly respond to new inquiries and add new information. Tappan's agency later became known as R. G. Dun & Co. and merged in 1933 with the Bradstreet Company to form Dun & Bradstreet, which now dominates commercial credit reporting (see Newman 1956).

In consumer credit reporting, the same potential for realizing economies of scale existed. In the twentieth century the exchange of credit information was carried out by separate organizations, usually local merchants' associations and other cooperative organizations rather than business firms (Brisco and Severa 1942, 105ff.). As Ronald

Cole (1988) observes, "In the past, most credit bureaus were community cooperative or nonprofit associations operated for the benefit of the users. Others were owned by local chambers of commerce, which operated them for the benefit of their members" (186). A national association called Associated Credit Bureaus (ACB) was organized in 1937. Today, virtually every consumer credit bureau is a member of the ACB.

Why did commercial credit bureaus develop directly as for-profit enterprises, whereas consumer credit bureaus evolved through a phase of not-for-profit service? The answer, no doubt, has to do with the more personal nature of consumer-credit information. The authors of the 1942 textbook *Retail Credit* write: "It must be remembered that handling retail [consumer] applications is a more delicate task than that of checking wholesale or bank [commercial] credits. Individual customers shopping for their personal requirements are less willing to furnish complete credit information than the businessman seeking wholesale goods or a bank loan. Individuals are easily offended when too many questions are asked, or when they learn that an investigation is being made regarding them" (Brisco and Severa 1942, 156). In dealing with consumer information, a cooperative organization, such as a merchants' association, arouses less suspicion and resentment than does a for-profit business. Furthermore, at its inception, a credit bureau may face a significant collective-action problem in inducing credit-granting businesses to participate, and cooperative appeals may have been especially effective (Klein 1992). Even today, in Tampa, San Antonio, and elsewhere, the local affiliates of the three industry giants are cooperative associations.

Only after decades of development by cooperative organizations was consumer credit reporting ready to operate on a commercial, for-profit basis. During the 1950s, 1960s, and 1970s, with the boost of new technologies in communications, big companies entered the field by buying the operations of regional organizations. TRW (now Experian), for example, broke into the business by taking over the Michigan Merchants' Credit Association. Experian, TransUnion, and Equifax have worked to integrate regional operations and have developed a uniform nationwide service. The histories of other social accountability mechanisms reveal a similar pattern of development—from informal gossip to local associations to efficient integrated systems serving an entire society (Klein 1997, 3–7).

Although most credit bureaus today operate on a for-profit basis, their fundamental function has not changed: the provision of information that permits two parties, who may be complete strangers, to trust each other and hence to engage in mutually advantageous exchange.

Two Types of Error

Suppose credit bureaus were compelled to pay consumers exorbitant damages for inaccurate adverse information in credit reports. The result might be information that was less complete and less accurate. The point is shown in figure 1.

Figure 1

The credit bureau faces a trade-off between two types of inaccuracies involving adverse information.

A creditor communicates a piece of adverse information to the credit bureau. That information is:

The credit bureau decides whether to	**Accurate**	**Inaccurate**
Include the information	The bureau makes the right decision	*Type-1 Error*: inclusion of inaccurate information (the identifiable consumer may suffer significantly)
Exclude the information	*Type-2 Error*: exclusion of accurate information (many *other*, unidentifiable consumers may suffer)	The bureau makes the right decision

A creditor communicates some adverse information about a consumer to the credit bureau, which decides whether to include or exclude that information in the consumer's credit report. The information may be accurate or inaccurate. If it is accurate, the correct decision is to include the information (the case corresponds to the northwest corner of figure 1). If the information is inaccurate, the correct decision is to exclude it (corresponding to the southeast corner of the figure). But the bureau never knows for certain whether the information is accurate. It deals with billions of bits of information and must weigh two types of error, both to some extent inevitable. If the information is inaccurate and the bureau includes it, corresponding to the northeast corner, an inaccuracy (of sorts)[1] enters the record, and the consumer is apt to suffer. Yet if the bureau excludes the information, it risks a second type of error: omitting accurate information (corresponding to the southwest corner of the figure).

1. Suppose the creditor tells the credit bureau the consumer did not pay her bill, and the bureau takes note of that information in a credit report. Whether the credit report contains an error depends on how one interprets a credit report. A first interpretation is that the credit bureau is stating that the consumer did not pay her bill, in which case the bureau's statement is inaccurate. A second interpretation is that the credit bureau is stating that the creditor has said that the consumer did not pay her bill, in which case the bureau's statement is accurate. Given that those who read credit reports understand that credit bureaus essentially just relay the information they receive, there is a strong case for saying that the bureau is not making an inaccurate statement. Analogously, when a newspaper reporter writes, "Jackson says Jones stole the car," if Jones did not steal the car, but Jackson said he did, the reporter is making an accurate statement. The distinction here may seem shifty, but for the chained conveyance of billions of bits of information whose final accuracy can never be known with certainty, it becomes important to think carefully about which interpretation of the information is most appropriate.

If bureaus are made to pay exorbitant damages for the first kind of error, their response will be to omit more information, increasing the incidence of the second type of error. Creditors, employers, and others would know less about consumers and would have less confidence in transacting with them. They would make fewer opportunities available. Opportunity would disappear *even for consumers who had used credit responsibly.* Restrictions of free speech would eliminate opportunities for the trustworthy and the untrustworthy alike.

Furthermore, exorbitant damages may encourage scams. Perhaps only one consumer in ten thousand would consider such a scam, but such a consumer could make himself appear to be the victim of credit-card fraud, all the while intending to "win the lottery" in court as a hapless consumer who had suffered from the first kind of error. Exorbitant damages create these hazards and lead to higher prices and higher interest rates for everyone.

By focusing exclusively on one type of error, critics engage in asymmetric thinking. If bureaus were made to pay exorbitant damages to consumers harmed by the inclusion of inaccurate information, should bureaus not also be made to pay damages to businesses harmed by the exclusion of accurate information? Imposing symmetrical responsibility would put the credit bureaus in a no-win situation and might strangle the goose that lays the golden eggs.

There is another asymmetry in the complaints against credit bureaus: given that credit bureaus make possible much of the opportunity that consumers enjoy, why should consumers be able to sue credit bureaus when reports have errors, but not have to pay rewards to credit bureaus when reports do not have errors? Critics are asserting, in essence, that consumers are entitled to have their credit report maintained without serious inaccuracies, but, symmetrically, one could assert that credit bureaus are entitled to rewards from consumers when reports are accurate. It is wiser to drop the entitlement mentality and think in terms of contractual obligations.

Consumer Opportunity Depends on Accountability Mechanisms

Restrictions on free speech and free commerce have many consequences. In *Economics in One Lesson*, Henry Hazlitt (1979) writes that commentators such as consumer activists "are presenting half-truths. They are speaking only of the immediate effect of a proposed policy or its effect upon a single group." The great challenge is to supplement and correct "the half-truth with the other half." But to consider all the consequences of a proposed policy, Hazlitt observes, "often requires a long, complicated, and dull chain of reasoning" (18).

Only by appreciating and taking into account the consequences that are unintended and nonobvious can policymakers serve consumers. The art of economics is to elucidate such consequences.

Suppose Consumer B seeks credit. His financial position is sound but not obviously strong. His credit history involves no failures, but sometimes he is late in paying bills. He applies for a loan. If the credit report is accurate and complete, the creditor will approve the application. If the credit report is *erroneous* and contains some inaccurate adverse information, the creditor will turn down the application.

To protect Consumer B from an unfair outcome, consumer activists propose safeguards, but they overlook how the proposed safeguards can influence several more basic decisions that affect Consumer B—and other consumers. In order for Consumer B to be considered for credit, certain institutions, practices, and preceding decisions must be in place.

Let us go back in time, step by step. Prior to reading the erroneous credit report, the creditor has in hand Consumer B's application. At that point, he decides either to turn down the application or to proceed to the purchase of Consumer B's credit report. In making that decision, the creditor weighs the strength of the application, which indicates Consumer B's financial position. But several other factors also affect the decision to purchase the credit report:

1. If the price of credit reports is high, the creditor might opt to deny the application without purchasing a credit report. The result for Consumer B is just as unfortunate as in the case where a credit report is ordered, has errors, and leads to a denial of credit. Some of the restrictions that consumer activists propose would increase the cost of reporting and therefore the price of credit reports.

2. If purchasing and using a credit report involves a great deal of additional paperwork, again the creditor might opt to deny the application without purchasing a credit report. Some of the proposed restrictions would increase the paperwork involved and expose creditors to other hassles and risks; that is, the restrictions would increase transaction costs for the creditors.

3. If the creditor has less confidence that reports present credit histories accurately and fully, again he might opt to deny the application without purchasing a report. Only God is ever absolutely certain that a piece of information is accurate. Laws that punish the credit bureaus for reporting adverse information that is inaccurate will cause them to report adverse information less often, *including adverse information that is accurate*. Hence, credit reports in general will be less complete and less adverse. The effect resembles that of grade inflation in colleges: when everyone gets As or Bs, getting a B doesn't reflect well on the recipient. The deterioration in the quality of reporting causes the creditor to have less confidence in Consumer B for two reasons. First, the creditor knows less about Consumer B's creditworthiness because it is now more likely that the credit report is silent on adverse episodes in his credit history. Second, the deteriorated quality of credit reports in general

> means that credit opportunities in the future will be less common and less dependent on consumers' credit performance. Consumers therefore are less vigilant in meeting their obligations because they perceive that failing in their obligations will be less likely to result in the loss of future opportunities. Because the social accountability mechanism is less effective, consumers in general become less trustworthy.

In all these ways, Consumer B might suffer the same outcome: not getting credit. In these three cases, difficulty befalls Consumer B at the hand of those who have appointed themselves to protect him.

As we trace the reasoning back further, we find that the harm of "protection" extends even wider. If credit reports are more expensive, more costly to handle, and less informative, a business that had been giving credit might decide to withdraw from doing so. Again, the result is no credit not only for Consumer B, but for the consumers who used credit from that business. Furthermore, in rare cases, the business—say, a retail store—may shut down operations altogether. It no longer provides goods and services to consumers, nor jobs to workers.

The consequences of the proposed restrictions, therefore, go far beyond the provision of the intended protection. Our story of Consumer B is embedded in the wider view shown by figure 2. Most of the decision tree concerns the decisions of a business owner. The business may be any kind of organization that might enter into trusting relationships with consumers and use credit reports in deciding whether to do so.

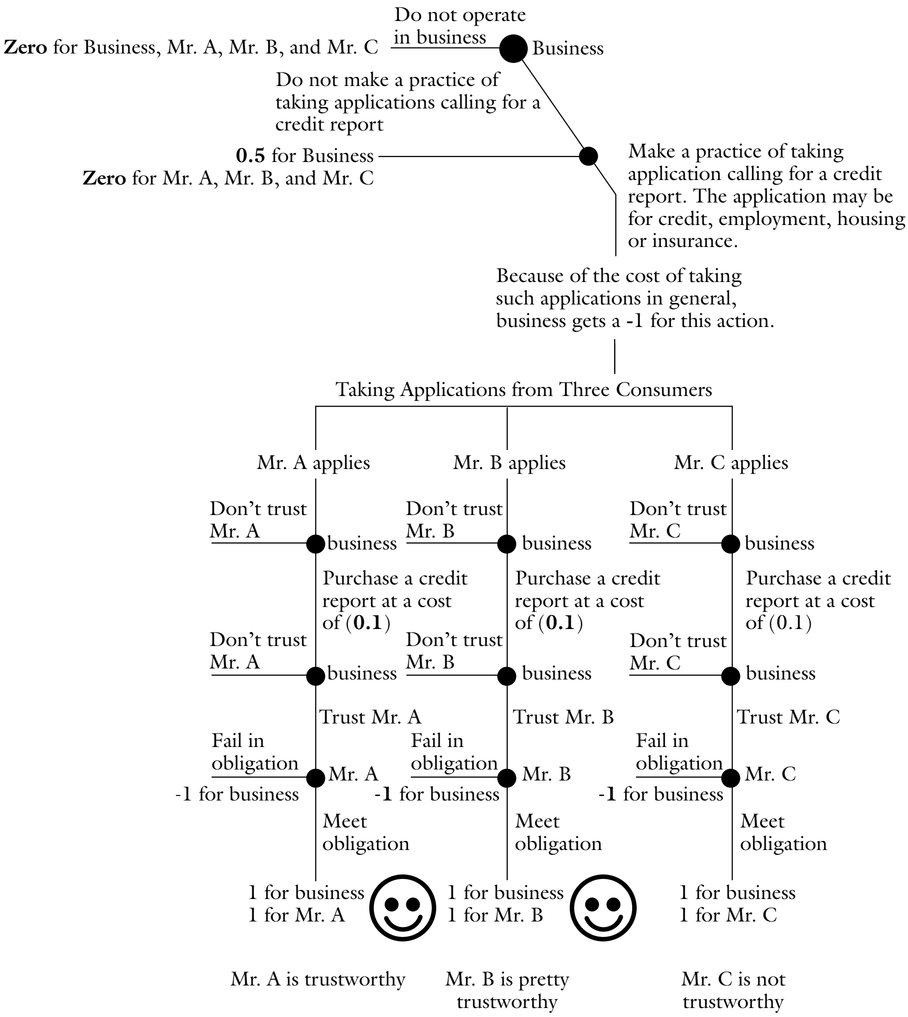
The diverse trustworthiness of consumers is represented by Consumer A, who is very trustworthy; Consumer B, just described, who is fairly trustworthy; and Consumer C, who is not trustworthy. If the business trusts all three, only the first two meet their obligations. As shown at the bottom of the decision tree, when a consumer meets his obligations, the business adds 1 to its total payoff. When a consumer fails in his obligations, the business has to subtract 1.

Start at the top of the tree and suppose the business were to go forward. What would be its total payoff? It starts by deciding to operate in business as, say, a retail store or small apartment house. It then considers whether to make a practice of taking applications from consumers who are not local or well known to the owners or their associates. The business needs to see a credit report before trusting an unfamiliar consumer. In deciding to take such applications routinely, the business gets an associated -1, representing the cost of making arrangements with credit bureaus, subscribing to the service, handling applications, and exposing itself to related lawsuits.

The business then receives applications from the three consumers. In each case, it proceeds to purchase a credit report, getting an associated –0.1 for each report purchased. Upon reading the reports, the business decides to trust only Consumers A and B. The two trusted consumers meet their obligations satisfactorily. The total payoff for the business is as follows:

Figure 2

Business/Consumer Decision Tree



cost of routinely considering applications from unfamiliar customers	=	−1.0
cost of three credit reports (three multiplied by −0.1)	=	−0.3
gain from dealings with Consumer A	=	1.0
gain from dealings with Consumer B	=	1.0
total payoff	=	0.7

The payoff of 0.7 is what the business achieves by proceeding down the decision tree. At its second decision point, point Y, it could have chosen to operate its business without routinely trusting unfamiliar consumers. In the current story, we assume that the business has accurate expectations about there being one consumer of each degree of trustworthiness. At point Y the business is essentially choosing between 0.5 and 0.7. It proceeds down the tree, bringing opportunities and benefits to Consumers A and B.

Each credit report costs 0.1, but several restrictions would increase the cost of reports. Laws imposing penalties or liabilities on credit bureaus, specifying procedures for bureau operation, specifying how consumer inquiries and disputes are to be handled, and requiring bureaus to give free reports to consumers—all would increase the bureaus' cost of providing the service. Such laws would probably increase the price of reports. If the business incurred a cost of 0.2 for each report, it would no longer find it advantageous to order credit reports and would not consider taking applications from unfamiliar consumers such as A, B, and C.

The cost to the business might go up to 0.2 per report, not because of a price increase, but because of an increase in paperwork. Some of the restrictions specify how businesses are to notify consumers of credit decisions. The legal specification of this procedure creates inconveniences, reduces flexibility, and chokes off opportunities to enhance efficiency. Furthermore, legally mandated procedure exposes businesses to lawsuits in which plaintiffs claim that the procedure was not properly followed. Scam artists learn to exploit such formalities, and lawyers ferret out hapless consumers whose "rights" have been violated. The result again is business withdrawal and loss of benefits for Consumers A and B.

If credit bureaus are exposed to liability for including adverse information on reports, the accuracy of which can *never* be absolutely established, they will expunge more adverse information, including some accurate information. The deterioration in quality could lead the business to reject Consumer B's application even when it purchases the corresponding credit report. Furthermore, consumers in general become less circumspect in meeting their obligations because they know that adverse information is less reliably reported. The quality deterioration could lead the business to withdraw from considering applications by unfamiliar consumers.

Suppose the business is a homeowner whose children have grown up and moved out, leaving several rooms in the house empty. He considers converting the house into three units and renting out two. There are millions of potential homeowners-cum-landlords who could expand the supply of housing and reduce its price. Minor aspects of the venture will affect some potential landlords' decisions. If credit reports are expensive, involve hassles, or involve legal or procedural uncertainties, the homeowner might decline to make accommodations available. In the decision tree, the owner decides at the initial decision point not to operate a business at all. (Suppose the payoff of not operating were, in this case, 0.6 rather than zero.) If credit reports were more affordable, easier to use, or of higher quality, he would have made housing available to consumers.

There are yet other ways that hardship befalls consumers because of restrictions. If credit reports are more expensive or less informative, then businesses that trust consumers will be operating at higher cost and suffering more losses from delinquencies, defaults, and other failures to meet obligations. Increases in the cost of doing business give rise to higher prices for consumers. When consumers do get credit—which will be less often—they will pay higher interest rates. When they get housing, they will pay higher rental rates. When they get employment, they will receive lower salaries. The injury to each consumer may be small, but that small injury must be multiplied by the great number of consumers who are affected. And increased business costs may affect the prices of any of the items a creditor sells. If Sears, for example, has higher costs because credit reports are more expensive or because more accounts become delinquent, all Sears customers may pay higher prices at Sears.

Tracing the results of the proposed restrictions shows that the consequences go far beyond the intended effect. The exercise does not pretend to *quantify* the consequences. It is intended only to illustrate a fuller range of consumer consequences. In advocating restrictions, consumer activists do not attempt to demonstrate that their proposed restrictions will do more good than harm. Ordinarily, they do not even acknowledge any harm.

The Importance of Self-Correcting Systems

The foregoing discussion stresses that, in addition to an error of commission (that is, the inclusion of inaccurate adverse information), there is an error of omission of accurate adverse information, and that error also harms consumers. It would be foolish to minimize the first type without minding the effects on the incidence of the second type.

Yet the second type of error should be not only acknowledged but perhaps regarded as even more pernicious than the first type. F. A. Hayek, Armen Alchian, and Israel Kirzner have stressed that the strength and flexibility of an economic system depend on its propensities to correct its own errors. In the credit-reporting system, an error of commission tends to be corrected: it leads to consumer disappointment (such as being denied credit), consumer inquiry, consumer complaint or dispute, credit bureau investigation, correction of the record, and renewed evaluation of the consumer's application for credit. An error of omission, on the other hand, does not lead to any specific or readily identifiable problem; it brings a general deterioration of the system, and its harms fall broadly on the system's many users. Credit bureaus have a profit incentive to correct both types of errors, but in managing the trade-offs between them they are wise to take into account that the first type of error has an inherent tendency to self-correct, whereas the second type does not. The difference in propensity for correction provides a good reason for concerned parties, in managing the trade-offs between the two types of error, to be especially vigilant against policies and procedures that would introduce errors of omission.

In my opinion, extant and proposed restrictions on credit reporting do or will harm consumers. Everyone involved in these transactions has an interest in consummating them. It is not to the advantage of a business that a trustworthy consumer be wrongly denied credit or other opportunities. Such a result would entail a loss not only for the consumer but also for the business. Nor is it to the advantage of the credit bureau to furnish reports with errors. All parties have clear incentives to make the information correct. (Do not believe the animadversions issuing from activist organizations and replayed in the press. See, for example, Mierzwinski 1990, 1991; Golinger with Mierzwinski 1998; and Consumers Union 1991. For a detailed criticism of such animadversions, see Klein and Richner 1992.) If additional restrictions on credit reporting were to spare a few consumers hardship, those restrictions would do so by placing greater hardship on consumers as a whole.

The social accountability mechanisms that serve consumers and businesses alike depend on layers of institutions and practices. Consumer activists pretend that those institutions and practices would go on keenly serving consumers even if hamstrung by restrictions. They take for granted many of the blessings of the modern economy.

Privacy and the Issue of Marketing Lists

Many companies, especially those conducting business on the Internet, now accumulate information about their customers and sell marketing lists to other businesses. The issue is often couched in terms of "privacy," but whatever consumer resentment exists probably has more to do with businesses profiting in new ways without giving the consumers a "cut." Over time, such resentment will likely subside as consumers become more sophisticated about the information by-products of their interactions with vendors and discover how to capture some of the gain from the exploitation of that by-product (Hagel and Rayport 1997).

Meanwhile, activists, citing practice in Europe, seek to restrict free speech in the name of privacy. In the European Union, consumers have to "opt in" in order to be included in list-making services (Singleton 1998, 5; Branscomb 1994, 181–82). Instead of the European "opt-in" rule, credit bureaus in the United States practice an "opt-out" rule: by notifying the three credit bureaus, consumers can exclude themselves from all mailing lists generated by the bureaus. (For full instructions on how to opt out of such lists and certain telemarketing lists, consult the website of the Direct Marketing Association.)

Activists have long attacked credit bureaus for making personal information available to marketers, who send offers and advertisements—otherwise known as "junk mail." A Consumers Union salvo against credit bureaus, for example, is entitled *What Are They Saying about Me?* (Consumers Union 1991). Activists play on the paranoia of consumers and voters, who know little about how the system actually works. Knowledge of the situation suggests that the privacy issue is really a red herring (at least as far as the credit bureaus are concerned). And the proposed free-speech restrictions would hurt consumers, as they do in Europe.

What does L. L. Bean or the Sierra Club really find out about consumers from credit bureaus? Practically nothing. Such marketers specify consumer characteristics and request a list of individuals who match those characteristics (or some combination of them). For example, the characteristics may be number of credit cards, zip code of residence, or positive payment history. The characteristics may be refined and detailed, but the marketer never sees credit reports. Indeed, *the marketer usually does not see the list.*

The credit bureau is not eager to share its stock in trade. It guards the exclusivity of the information. Most lists go to a third-party fulfillment house, which sends the marketer's catalogs to consumers on the list. In such cases, only the fulfillment house sees the list. How can credit bureaus know that the fulfillment house does not resell the list? The credit bureau seeds each list with decoy names and addresses. If catalogs other than those associated with the original order show up at the decoy addresses, the credit bureau knows that the fulfillment house cheated on the contract. The fulfillment house is then subject to penalties or loss of repeat business from the credit bureau. (Notice how reputational mechanisms cascade throughout the system to assure promise-keeping and discreetness.) The suppleness of contract allows people in commerce and industry to overcome problems in ways undreamt of by interventionists.

It is mildly annoying sometimes to find one's mailbox stuffed with advertisements and catalogs, but an "opt-in" requirement (à la Europe) would be a restriction of free speech. It would impose a burden on consumers who gain from commercial information. Because opting in would require added time, attention, and effort, many consumers would simply miss the opportunity to opt in. The default option would be non-participation. Often they would miss out on information to improve their condition. Indeed, it is by virtue of the prescreening services provided by credit bureaus that the credit-card industry is as competitive as it is: competitors offer consumers lower interest rates, no annual fees, rebates, and tie-in services such as frequent-flier awards.

In 1991, the Consumers Union wrote in its magazine *Consumer Reports:* "readers said that they enjoy reading catalogs from different companies." Although everyone has a certain disdain for junk mail (especially when the mailbox contains no packages or love letters), catalogs help consumers to discover and acquire available products without leaving home. They are especially valuable to people with disabilities, the elderly, parents with families to look after, and people without cars.

Consumers Union acknowledges the benefits of list-making services: "[W]hen catalogers narrow the market, they reduce mailing costs, raise the percentage of sales, and make a higher profit. That knowledge has spawned some 10,000 specialty catalogs, selling everything from apples to automobiles to waders to wine. There are catalogs for tall people, short people, left-handed people, people with physical limitations, and people who wear uniforms" (*Consumer Reports* 1991, 643). The development of specialty products and the very existence of specialty firms often depends on list-making services. Without such services, not only would more consumers remain unaware of existing products, but there would be fewer products to be aware of.

Junk mail is really a mailbox issue. Unwanted materials are being placed in the mailbox, and the recipient must dispose of them. But the mailbox is not the property of the resident. Officially, it belongs to the federal government, and its use is restricted by the government monopoly that delivers the mail. Complaints about junk mail should be directed to the organization that stuffs unwanted materials into "our" mailbox. Anne Wells Branscomb (1994) reports: "When I asked the post office employees to stop stuffing the post office box with unsolicited mail addressed to 'occupant,' duplication of the same occupant mail overstuffing my mailbox at home, I was informed that they could not legally comply with my request" (11).

Unlike a government monopoly, a private, competitive delivery service would strive to spare its customers the burden of unwanted materials. There would be an opt-out option at the most relevant and opportune point, that of delivery. Customers would notify the delivery company that unsolicited commercial mail was not to be delivered. Such an arrangement would benefit not only the customer but also the sender and the delivery company. We see this development on the Internet. Net servers screen out e-mail junk mailers or "spammers" (McGath 2000). The U. S. Postal Service is government owned and privileged against competition; as socialist enterprises usually do, it responds poorly to consumer preferences. If consumers could choose whether unsolicited catalogs would be delivered, the majority would probably accept them and feel less resentment about receiving them. American consumers who are upset by junk mail may contact the three bureaus to remove their names from the lists they generate.

Confidentiality and Contract

As stated previously, privacy is mainly a red herring. But even if infringements on privacy were serious, we should be wary of the privacy activists. They are peddling restrictions that do not conform with coherent principles and that violate other key principles. The activists often suggest that consumer information should be treated as the property of the consumer, but people cannot rightly be said to own information about themselves. Pure information is not a form of property and hence cannot be owned. As Solveig Singleton (1998) says, "[I]f someone buys a lawn mower from Sears . . . two parties engage in the transaction—the customer and Sears. Why should the information about the sale belong only to the customer and not to Sears as well? If the customer were to complain about the transaction to Consumer Reports, he would not have to ask Sears's permission. Why cannot Sears boast of the transaction to its creditors?" (15).

Information exists only inasmuch as a thinking human mind reacts to certain external events. Legal rules may influence external events, but to think of information itself as someone's property is incoherent. The same goes for *privacy,* as the term is used in these debates. As Robert Cole (1988) writes in his textbook on credit management, "[since the passage of a federal law in 1971] a clear and definable [idea] of privacy has eluded governmental and private organizations" (8). Law professor Eugene Volokh (2000) thoroughly analyzes proposals for stopping people from communicating supposedly "private" information about others—proposals that are sometimes, though not always, cast as creating "property rights in information." He concludes that those proposals would violate current First Amendment law and, if ratified by the courts, would foster still more and broader speech restrictions. Privacy protections created through contract, however, are in his view constitutionally sound.

Legal rules may treat the external events that go into the creation and conveying of information, but before searching for restrictions on freedom, let us ask: Does the freedom of contract provide an effective framework for dealing with privacy issues? People can form contracts that specifically forbid their trading partners from reconveying information. Then the concerns about "privacy" become issues of *confidentiality.* Illegitimately reconveying the information would then be a breach of contract—a failure to keep a promise—not a misuse of someone's property. Contract provides a coherent principle. A system of freedom (including freedom to compete in mail delivery) would accommodate consumers' preferences about receiving junk mail and learning about products.

In seeking to Europeanize information services in the United States, activists tend also to Europeanize consumption opportunities and living standards. American consumers are much better served by the safeguarding and revitalizing of the American customs of free speech, free enterprise, and opportunity, along with a tort system that responds to errors arising from negligence or contract breach.

Conclusion

The norms and culture of our society are rooted in and dependent on information about our doings. Our communities exist in large part by generating, managing, and utilizing information. The stories of our lives are forms of information. We can find meaning in those stories only if others share and respond to them.

In a vast society such as the United States, opportunity depends critically on strangers, but strangers will trust each other only if they can find signs of trustworthiness. Credit bureaus evolved in this country in accordance with the principles of free speech and free enterprise. In the early days the bureaus were run as cooperative organizations. As they developed into for-profit enterprises, they continued to act discreetly and professionally in the sharing of consumer information. Credit bureaus have a strong incentive to maintain exclusive control of the information and have developed clever ways to achieve that goal. An understanding of how the institutions actually work reveals that credit bureaus rarely make errors and impinge only trivially on privacy.

Credit reporting is akin to gossip in that it gathers, interprets, formats, stores, retrieves, and transmits information. It generates reputations of individuals and provides the assurance necessary to induce strangers to cooperate. It is a social accountability mechanism, and all such mechanisms necessarily collide with privacy. But as a social accountability mechanism, credit reporting is remarkably discreet. Compared to the sensational tactics of the press, the entrapment and wiretapping practiced by the police, the public disclosure of legal testimony, and the taintedness of gossip, credit reporting deserves to be deemed a remarkably unintrusive and dignified means of promoting responsible behavior in society.

Activist groups such as the Public Interest Research Group and the Consumers Union smear credit bureaus for being irresponsible gossipers, but they pay no attention to the social accountability function that accusation would imply. In other words, they liken credit reporting to gossip only to underscore the unfavorable likeness, which is slight, while ignoring the favorable likeness, which is great. Their criticisms show little sense of fairness or proportion. The actions of the Consumers Union are particularly ironic. The group's advocacy wing attacks credit bureaus as irresponsible gossipers, yet its own product-reporting wing engages in very similar activity. *Consumer Reports* "gossips" about manufacturers and their products—basing its statements to a great extent on unverified "hearsay" from their annual subscribers' questionnaire—often with flair and a touch of invective. God bless *Consumer Reports* and free speech. Notice that the Consumers Union does not stand up for liabilities for magazine errors and "privacy rights" when it comes to gossiping about the makers, rather than the buyers, of products.

The activists are promoting slogans and agendas that do not provide coherent principles for law, expectations, and social interaction. Protection of privacy is not a coherent legal maxim. The appropriateness of privacy claims depend on the particular situation and context of communication. Hence, regulations issued by remote government agencies and legislatures can scarcely "protect" privacy. The attempt to do so creates red tape, kills opportunity, and breeds litigation. As activists make headway in imposing restrictions, the coherent and highly beneficial principles of freedom of contract, confidentiality agreements, and freedom of speech become ever more eroded. I have described here the impact on consumer opportunity and well-being. The impact on the culture and the polity goes further.

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