

# SOME CRITICISMS REGARDING THE SOCIAL COST OF TRANSPARENCY

FRANK J. PALLADINO

ABSTRACT. We consider certain arguments presented regarding the social cost of transparency and assess the need for a more dynamic interpretation of market events.

frank@math.uri.edu

## 1. INTRODUCTION

Economic transparency is a salient issue in the current economic and political atmosphere. At present, there is ongoing debate regarding the implementation of legislation which will have some noticeable effect on economic transparency. Economic transparency is generally considered to be beneficial. However, there have been arguments that under certain circumstances economic transparency may be deleterious. These arguments cannot be dismissed out of hand. They must be addressed.

In fact this identifies the proper framework of the current debate. The social cost of both transparency, and lack of transparency must be estimated and then weighed against each other.

We consider a model presented in [1] and point out certain concerns we have regarding the possible accuracy and validity of the model presented. We conclude with some criteria which would bolster our confidence in said model. The model we address is a Wicksellian model presented in section 2 of [1].

## 2. A WICKSELLIAN MODEL

In section 2 of [1], the author introduces a model wherein the economy consists of  $N$  individuals and  $N$  time periods; where  $N$  is an integer,  $3 \leq N < \infty$ . Before the fact, all individuals are identical; after the fact, they are divided into  $N$  types; with each individual having an equal probability of realizing type  $j \in \{1, \dots, N\}$ .

The author goes on to introduce a twist which is the incorporation of a private signal labeled news, occurring at the beginning of date 1.

---

*Date:* January 14, 2010.

**<sup>o</sup>Keywords:** Transparency, Non-disclosure.

**JEL Codes:** E41, E42, E44

The argument regarding the social cost of transparency outlined in section 2.2 appears to have at least one severe logical problem.

At the outset it is given that the individuals are only divided into  $N$  types after the fact. In this model that might correspond to time  $N + 1$ , as there are  $N$  time periods. However when assessing reaction to the news, which is given on date 1, the ex post structure is assumed. In other words the ex post structure is assumed and in fact central to the argument before it even exists! Understanding this is critical since it is quite possible that a very different ex post structure may arise due to the news given. It is quite possible that under these circumstances a single or perhaps small number of individuals are excluded from the chain, however primarily the chain is unaffected. This is a possibility, however we have not collected any experimental evidence to support this claim. It should be considered only as an alternative possible outcome. Unless strong evidence is presented to contradict such a possibility it must be considered to hold as much validity as the scenario proposed in section 2 of [1].

### 3. CONCLUSION

As is stated on the cover page of [1], [1] is a preliminary work and is circulated to stimulate discussion and critical comment. In that spirit we make the following two suggestions for the article. We suggest that the author adjust the model to be more dynamic in nature to allow for a more realistic circumstance where the structure of economic interactions changes in response to the news disseminated on date 1. This change would not only make the model more mathematically interesting, involving areas of mathematics such as dynamics and graph theory, it would be a more realistic economic model, and thus a more interesting economic model. As it stands currently the model has a fatal self contradiction when used as presented in [1] with the news component presented there. At the very least this contradiction should be somehow addressed.

We also suggest that the author make more use of empirical evidence, such as experimental evidence or macroeconomic data from prior economic cycles. This would lend some credibility to his arguments.

## REFERENCES

- [1] D. Andolfatto, On the Social Cost of Transparency in Monetary Economies, Federal Reserve Bank of St. Louis Working Paper 2010-001A. (accessed January 2010).