

Reputation-based Governance. A Primer

Lucio Picci¹

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Index

About this document.....	2
1. A definition of Reputation-based Governance	3
2. Implications of Rebag.....	6
A shift in the production of statistical information.....	6
New methods for the evaluation of public policies	6
Public procurement.....	6
Rents and Corruption.....	7
Democratic participation	7
Public vs. private provision of services	8
3. A Roadmap to Rebag.....	9
4. System-wide transformations.	10
5. Rebag-Ware	10
References.....	11

¹ Università di Bologna, Dipartimento di Scienze Economiche. Strada Maggiore 45, 40125 Bologna. E-mail: lucio.picci@unibo.it. Personal page: www.spbo.unibo.it/picci

About this document

Availability

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Aim

The purpose of this document is to illustrate the basics of Reputation-based Governance, its applications, its relations with issues related to governance, and aspects of its implementation.

This document represents a first source of general information on Rebag, and it's intended for a public not familiar with the concept. More detailed information on the several issues addressed here can be found in the project's Web site (<http://ei.unibo.it/rebag>). Eventually, to each of the main issues there will correspond one or more dedicated papers, that will also be available on the Web.

This document also constitutes the introductory chapter of Picci (2007), a book that I'm writing and that should be available in draft form by the end of 2006.

1. A definition of Reputation-based Governance

Reputation-based Governance (from now on, Rebag) is a framework to address governance issues that hinges on the reputation of the actors involved. In principle, Rebag can be applied both within the public and the private sector. However, emphasis here is placed on public governance and, more to the point, on the management of "policies". Policies can be either "projects", i.e., initiatives having a goal well specified in advance and lasting a definite amount of time (such as, the building of a new bridge), or "programs", i.e., services that are delivered over a period of time (for example, an educational degree by a public university).

The desire to build and to maintain a good reputation may be a powerful tool to ensure that collective action delivers socially desirable results. The individual, or organization, that values its reputation, has an incentive to behave well in order not to squander what amounts to a costly investment for the future. Implicit in private calculations on what course of action to take there is a weighting between the short-term gain that can be obtained from a dishonest and predatory behaviour, and the long-term loss that follows from losing the trust of one's acquaintances. The more important is the reputation of an actor of governance, the higher is the chance that the balance tilts in favor of virtuous behaviors. If this happens, the actors who are involved in the exchange are better off, and society as a whole also often receives a benefit.

Reputation not only helps in eliciting honest behaviors from agents that, somehow cynically, decide whether to be good or bad according only to their self-interest. Reputational considerations may also help in improving the average quality of the actors of governance. Very often the quality of a product or service is not clear beforehand, and it becomes fully known after its delivery has taken place or, sometimes, only after a prolonged use. For example, we fully learn about the quality of our car after having used it for several years, and a movie, in order to be judged, needs to be watched to the end. Performances that are characterized by different levels of quality may be explained not only by differing efforts, but also, obviously, by the differing skills of the performers. However, performers with differing skills may be able to deliver indistinguishable promises for product delivery. Two film

makers may be able to write similar descriptions of a movie, but the eventual outcome may differ greatly, if one creator is a top rated professional, while the other is an unknown Z movie film maker.

If reputation considerations are present, however, the outcomes of past performances influences today's outcomes, and this helps in discriminating between high and low quality suppliers. Such discrimination has obvious market consequences: Given similar plots for a movie, we would probably choose to pay only to watch the creation by the highly reputed film maker, and forget about the other. Such a condition helps in setting in motion those market selection forces that weed out from the competition the least fit. Film makers who are not able to secure an audience for their creations would have to find a new job. Uncompetitive firms would lose importance and, eventually, go out of business, and mediocre bureaucrats would find it hard to obtain a promotion.

The reputation of the actors of governance plays a significant role in most real-life governance contexts, to the point that it would be difficult to think of situations where they are completely absent. A series of classic works in economic history, for example, elegantly explain how reputation considerations were of paramount importance in determining trading in the middle ages (Greif, 1993; Greif et al., 1994), and the relevance of reputation considerations in explaining human interactions surely dates to the early days of human experience.

So, what is new about reputation-based governance, if all governance systems that we observe today are, at least to some extent, already based on reputation? What sets apart Rebag from current practices is the presence of a coherent framework that not only contemplates the use of reputational considerations for governance purposes, but that effectively puts reputation *at the center of governance*. In order for this to happen, it is essential that policies and their effects are accurately monitored and assessed. Within Rebag, such an assessment is carried out by the people who are affected by the policies. For example, the end users of a public work - say, for a school, the local community where a school is located would be able to voice their opinion on how it was built, while the recipients of a training program would rate the program itself. What the actors do is assessed, and the assessments are visible and

contribute to the formation of reputations. Reputations, in turn, influence the allocation of resources and of power. The emphasis on keeping track of policies and of assessing their outcomes indicates that Rebag can also be described as a framework that enhances the accountability of persons and of organizations within a governance system.

Within Rebag, the assessments of the outcomes of policies are procedurized, and are coded into an appropriate information system that all the interested parties may access using the World Wide Web. Such a system caters for the organization, flows, and publicity of all the relevant information. Such an Internet-based informational infrastructure is an integrant part of Rebag. This is another element of Rebag that casts it apart from other practices of governance where reputation plays a role. While the Internet, in general, is not needed for a governance method to be influenced by reputational considerations, the availability of an appropriate Internet-based informational infrastructure is an integral part of Reputation-based Governance as defined here.

The nature of such an information system is best explained by referring to an existing example, the eBay auction site (www.ebay.com). On eBay, both sellers and buyers have an incentive to be honest because they are subject to the evaluation of their business counterpart: a seller receiving many negative comments from previous buyers would find it difficult to stay on the market, and a buyer in the same predicament would have a hard time doing his shopping. Fear of acquiring a bad reputation represents a strong incentive favoring virtuous behavior, and the observed equilibrium on E-Bay is one where most people correctly describe the merchandise that they plan to sell, efficiently ship it, and pay their bills.

E-Bay is a well studied example of the more general concept of "Internet-based Reputation System" (IBRS)(see Dellarocas, 2003). IBRSs and Rebag are related, in the sense that they provide an interesting but partial example of Rebag. With respect to IBRSs, Rebag represents a broader framework and concept, because it addresses public governance from a very general point of view and is concerned with its many facets. The very general nature of Rebag's framework allows to develop

precious insights on a set of disparate issues that are related to governance. To these we now turn.

2. Implications of Rebag

A shift in the production of statistical information

Rebag changes the way we obtain and represent quantitative information on variables that are relevant to policies. Since within Rebag all the relevant data are recorded in digital form, there occurs a shift from the present situation where the statistical data are “gathered” and then “processed”, to a situation where statistics are a “view” of the data already contained within a suitable information system. Such a shift has important implications that are in part related to the societal role played by statistical information. See Picci (2006) for a preliminary treatment of this issue.

New methods for the evaluation of public policies

The (quantitative) evaluation of public policies and of their effectiveness has traditionally proven to be difficult, in part due to a lack of data. Within Rebag, the presence of abundant objective digitalized information on several policy dimensions, and the emphasis on the recording of the opinions on the effects of the policies, allow for the development of methods to quantify the effects of policies.

Public procurement

Public procurement is subject to a set of constraints that private enterprises do not face in securing for themselves goods or services. In particular, the public sector is almost always forced to use public bids for its procurement, while private negotiations prevail within the private sector. Public bids and auctions have optimal characteristics when the goods or services required can be specified in all their details and, in general, when the transaction is described by a complete contract. Complete contracts, however, are just an abstraction. In most real life cases, it would be beneficial to consider the past reputation of potential contractors, so as to constrain

their actions by the thought that if they underperform in the fulfillment of their current obligations, they will find it more difficult to secure future contracts.

Rebag provides the appropriate framework to obtain such results, and its adoption, by introducing a higher degree of accountability both of firms and of the public officials interacting with them, would allow for a shift towards more flexible private negotiations and away from auctions, at least for those projects that are complex and risky (see Picci, 2006).

Rents and Corruption

Rent seeking behaviours often plague public governance, by subtracting valuable resources from productive ends and by tilting private choices towards the pursue of rents. Rent seeking often takes the form of corruption. The damages of corruption are widely documented, and derive in part from its immediate drain of public resources and, probably more importantly, from the distortionary effects that it has on both public and private choices. Rebag, seen as a system providing reputation-based incentives, raises the costs of rent-seeking and of corruption. Seen as a coherent framework to produce and organize policy-related information, Rebag also provides a framework to compute on a regular basis objective measures of corruption. See Picci (2006) for a preliminary treatment of the issue.

Democratic participation

Rebag is based on the presence of structured voice activities, i.e., on procedures that allow citizens and other actors of governance to express structured opinions on policies affecting them, within a framework where such opinions are made to import. Voice activities on policy outcomes, first of all, provide an *ex-post* check on the actions of the people and organizations that are responsible for their accomplishment, since by helping in uncovering any wrongdoing it could, for example, direct formal auditing activities. Such *ex-post* checks would also obviously provide *ex-ante* incentives, for example by affecting an administrator's prospects of being promoted, or a politician's chances of being reelected, goals that would presumably be pursued by putting more effort on the job.

These types of incentives, when systematically applied, may have a profound impact on both the design and the output of policies. In fact, by no means should we imagine that the profound changes in governance here proposed would simply deliver the same policies of yore, only more efficiently executed. To the contrary, a change of governance would quite likely change some fundamental characteristics of the policies that are carried out.

To complicate matters further, within Rebag we may desire that voice activities be allowed during the policy design phase, creating room for participatory design practices. When this is possible, and when the financial aspects of alternative policies is adequately aggregated and made public, Rebag also allows for participatory budgeting procedures.

Public vs. private provision of services

Over the last decade, capitalistic economies have shifted away from the public provision of a host of services, increasing the range of action of the market. Also, particularly in the field of public utilities, there has been a shift away from their provision by monopolistic firms, towards situations characterised by regulated oligopolistic competition. Such trend has been beneficial insofar as market competition provides incentives that are typically absent within a (public) regulated monopoly. However, this has come at the cost of duplication of essential facilities, of considerable regulatory overhead, of significant transaction costs, and of search costs by consumers who have to districate themselves among often complicated competing tariff plans.

The optimal choice on the mode of provision of a given service should aim at obtaining an appropriate balancing of the benefits and costs of the alternatives that are available. The introduction of Rebag could modify the present perceptions of where such an optimum is. On the one hand, by improving the appropriate incentives within the public administration, Rebag could cause a swing back from regulated markets. On the other hand, the introduction of elements of a reputation-based governance within the regulated (private) sector could have the opposite effect, because the wider amount of information (on the private regulated firms) automatically generated by the

information system would reduce the informational asymmetry between the regulator of a market and the regulated firms, which is one of the main obstacles to effective regulation.

Rebag and economic planning

Rebag lends itself to a reconsideration of the debate on planned economies. One early issue in that debate was the concern with the "computing skills" that the central planner should have. Several authors (such as Bergson, 1966) pointed out that modern computers would have alleviated such computing requirements. Another prominent problem, whose lack of solution was ultimately one of the main causes for the demise of the Soviet block, was the need for a set of strong incentives - to individuals, and to firms, given their "soft budget constraint" (with reference to Kornai, 1980). It is worth enquiring whether a reputation-based governance, with its strong incentives and data abundance, could contribute to a debate whose intellectual relevance has not been cancelled by the demise of the Soviet system.

3. A Roadmap to Rebag

Introducing advanced information systems within complex organizations (or, in the case at hand, within whole sectors of a public administration), always runs in difficulties that are only in part technological and, more importantly, have to do with the successful management of the needed accompanying organizational changes. An important issue, then, has to do with the definition of a roadmap toward the establishment of forms of reputation-based governance.

We distinguish between two dimensionness of completeness of rebag's application. If, within a given policy domain, Rebag with all its characteristics is in use, than we say that, within that domain, Rebag's application is "full". Otherwise, it is "partial". If Rebag is applied to all possible policy domains, either fully or partially, than we say that the application of Rebag is "generalized". Otherwise, its application is only "sectoral". Note that Rebag can be applied in a generalized fashion, but only partially within different sectors.

For a policy maker aiming at a generalized and full application of Rebag, there is then a general problem of whether to proceed by privileging first its full application within a subset of candidate sectors, or whether to proceed gradually across all policy domains.

4. System-wide transformations.

The implications of Rebag that have been summarized refer to changes that would accompany even a sectoral application of reputation-based governance, that is, its adoption within single policy domains. On the other hand, when the prevalent model of governance is reputation-based, specific Rebag-induced changes would interact and add in a systematic way, with the resulting outcome being more than a simple summation of its constituent parts. An interesting endeavour, then, is the attempt to visualize and describe such a systematic changes.

5. Rebag-Ware

Rebag is made possible by an appropriate Internet-based information system. A prototype of such a system for the management of public works, or *Rebag Ware*, is currently under construction (see http://ei.unibo.it/rebag/index.php/Rebag_Ware). The expected date of release of Version 0.1 is December, 2006.

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