The Economics of Reputational Information

Prof. Eric Goldman
Director, High Tech Law Institute
http://www.ericgoldman.org • http://hightechlaw.scu.edu
egoldman@gmail.com
What is Reputational Information?

- Reputational information = information about an actor’s past performance that helps predict the actor’s future ability to perform/satisfy preferences

- Examples:

<table>
<thead>
<tr>
<th>Unmediated</th>
<th>Mediated</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Word of mouth</td>
<td>• Credit scores</td>
</tr>
<tr>
<td>• Recommendation letters and job references</td>
<td>• Investment ratings (bonds, mutual funds)</td>
</tr>
<tr>
<td>• Student evaluations</td>
<td>• GPAs</td>
</tr>
<tr>
<td></td>
<td>• Consumer product reviews and ratings (Amazon star ratings; Ratemyprofessor.com; Avvo; Ripoff Report; BBB)</td>
</tr>
<tr>
<td></td>
<td>• Voting systems? PageRank, Digg</td>
</tr>
</tbody>
</table>
Why Reputational Information Matters

- The market’s invisible hand is predicated on consumers rewarding good producers and punishing poor ones
  - Reputational information = invisible hand of the invisible hand

- Hypotheses
  - #1: Anomalies in reputational information supply and demand hinders invisible hand
  - #2: Inconsistent regulation of reputational information should be examined for unwarranted dichotomies
Selected Reputational Information Regulations

- **Stimulate supply**
  - Whistleblower laws and other immunizations (ex: 47 USC 230)
  - Mandatory disclosure laws (ex: mandatory job references)

- **Suppress supply**
  - Defamation
  - Mandatory non-disclosure laws (ex: anti-blacklisting laws)

- **Stimulate demand**
  - Mandatory consulting of reputational information

- **Suppress demand**
  - Privacy laws
Regulatory Dichotomies

- **#1: Job references**
  - Defamation/tortious omission but immunization for “good faith” references
  - But miscalibrated immunization suppresses job reference supply and drives hirers to alternative supply sources

- **#2: Amazon product reviews**
  - Individuals face defamation liability but Amazon protected by 47 USC 230

- **Why the differences?**
  - Mediation
  - Differential knowledge about legal consequences of reviewing
  - Defendant’s wealth
  - Relative bargaining power between reviewer/reviewee
  - Economic consequences of erroneous bad review
  - Number of legitimate reviewers
  - Objectivity of review criteria
Correcting Undersupply

Why does reputational information remain non-public information?
- Benefits: usually only psychic rewards (pulls towards love it or hate it)
- Costs: time, vendor retribution, norms against public criticism, privacy, legal risks

Possible regulatory solutions
- Recalibrate legal risks
  - Raise standards for legal claims
  - Give potential defendants more tools to counterattack bogus threats
  - Protect intermediaries facilitating production of reputational information
- Make consumer adoptions/defections public information (ex: Beacon)
- Increase channels for anonymous dissemination of reputational information
- Government funding of reputational information production