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# An economic theory of privacy

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Much ink has been spilled in trying to clarify the elusive and ill-defined concept of "privacy." I will sidestep the definitional problem by simply noting that one aspect of privacy is the withholding or concealment of information. This aspect is of particular interest to the economist now that the study of information has become an important field of economics. It is also of interest to the regulator, and those affected by him, because both the right to privacy and the "right to know" are becoming more and more the subject of regulation.

Heretofore the economics of information has been limited to topics relating to the dissemination and, to a lesser extent, the concealment of information in explicit (mainly labor and consumer-good) markets—that is, to such topics as advertising, fraud, price dispersion, and job search. But it is possible to use economic analysis to explore the dissemination and withholding of information in personal as well as business contexts, and thus to deal with such matters as prying, eavesdropping, "self-advertising," and gossip. Moreover, the same analysis may illuminate questions of privacy within organizations, both commercial and noncommercial.

I shall first attempt to develop a simple economic theory of privacy. I shall then argue from this theory that, while personal privacy seems today to be valued more highly than organizational privacy (if one may judge by current legislative trends), a reverse ordering would be more consistent with the economics of the problem.

## Theory

People invariably possess information, including the contents of communications and facts about themselves, that they will incur costs to conceal. Sometimes such information is of value to other people—

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that is, other people will incur costs to discover it. Thus we have two economic goods, "privacy" and "prying." We could regard them as pure consumption goods, the way turnips or beer are normally regarded in economic analysis, and we would then speak of a "taste" for privacy or for prying. But this would bring the economic analysis to a grinding halt because tastes are unanalyzable from an economic standpoint. An alternative is to regard privacy and prying as intermediate rather than final goods—instrumental rather than final values. Under this approach, people are assumed not to desire or value privacy or prying in themselves but to use these goods as inputs into the production of income or some other broad measure of utility or welfare. This is the approach that I take here; the reader will have to decide whether it captures enough of the relevant reality to be enlightening.

### *Not so idle curiosity*

Now the demand for private information (viewed, as it is here, as an intermediate good) is readily understandable where the existence of an actual or potential relationship, business or personal, creates opportunities for gain by the demander. These opportunities obviously exist in the case of information sought by the tax collector, fiancé, partner, creditor, competitor, and so on. Less obviously, much of the casual prying (a term not used here with any pejorative connotation) into the private lives of friends and colleagues that is so common a feature of social life is, I believe, motivated—to a greater extent than we usually think—by rational considerations of self-interest. Prying enables one to form a more accurate picture of a friend or colleague, and the knowledge gained is useful in one's social or professional dealings with that friend or colleague. For example, one wants to know in choosing a friend whether he will be discreet or indiscreet, selfish or generous. These qualities are not necessarily apparent on initial acquaintance. Even a pure altruist needs to know the (approximate) wealth of any prospective beneficiary of his altruism in order to be able to gauge the value of a gift or transfer to him.

The other side of the coin is that social dealings, like business dealings, present opportunities for exploitation through misrepresentation. Psychologists and sociologists have pointed out that even in everyday life people try to manipulate other people's opinion of them, using misrepresentation. The strongest defenders of privacy usually define the individual's right to privacy as the right to control the flow of information about him. A seldom-remarked corollary to a right to

misrepresent one's character is that others have a legitimate interest in unmasking the misrepresentation.

Yet some of the demand for private information about other people seems mysteriously disinterested—for example, that of the readers of newspaper gossip columns, whose "idle curiosity" has been deplored, groundlessly in my opinion. Gossip columns recount the personal lives of wealthy and successful people whose tastes and habits offer models—that is, yield information—to the ordinary person in making consumption, career, and other decisions. The models are not always positive. The story of Howard Hughes, for example, is usually told as a morality play, warning of the pitfalls of success. That does not make it any less educational. The fascination with the notorious and the criminal—with John Profumo and with Nathan Leopold—has a similar basis. Gossip columns open people's eyes to opportunities and dangers; they are genuinely informative.

Moreover, the expression "idle curiosity" is misleading. People are not given to random undifferentiated curiosity. Why is there less curiosity about the lives of the poor (as measured, for example, by the infrequency with which poor people figure as central characters in popular novels) than about those of the rich? One reason is that the lives of the poor do not provide as much useful information for the patterning of our own lives. What interest there is in the poor is focused on people who were like us but who became poor, rather than on those who were always poor; again, the cautionary function of such information should be evident.

Samuel Warren and Louis Brandeis once attributed the rise of curiosity about people's lives to the excesses of the press (in an article in the *Harvard Law Review,* 1890). The economist does not believe, however, that supply creates demand. A more persuasive explanation for the rise of the gossip column is the increase in personal income over time. There is apparently very little privacy in poor societies, where, consequently, people can readily observe at first hand the intimate lives of others. Personal surveillance is costlier in wealthier societies, both because people live in conditions that give them greater privacy and because the value (and hence opportunity cost) of time is greater—too great, in fact, to make the expenditure of a lot of it in watching the neighbors a worthwhile pursuit. An alternative method of informing oneself about how others live was sought by the people and provided by the press. A legitimate and important function of the press is to provide specialization in prying in societies where the costs of obtaining information have become too great for the Nosy Parker.

*Who owns secrets?*

The fact that disclosure of personal information is resisted by (is costly to) the person to whom the information pertains, yet is valuable to others, may seem to argue for giving people property rights in information about themselves and letting them sell those rights freely. The process of voluntary exchange would then ensure that the information was put to its most valuable use. The attractiveness of this solution depends, however, on (1) the nature and source of the information and (2) transaction costs.

The strongest case for property rights in secrets is presented where such rights are necessary in order to encourage investment in the production of socially valuable information. This is the rationale for giving legal protection to the variety of commercial ideas, plans, and information encompassed by the term "trade secret." It also explains why the "shrewd bargainer" is not required to tell the other party to the bargain his true opinion of the values involved. A shrewd bargainer is, in part, one who invests resources in obtaining information about the true values of things. Were he forced to share this information with potential sellers, he would get no return on his investment and the process—basic to a market economy—by which goods are transferred through voluntary exchange into successively more valuable uses would be impaired. This is true even though the lack of candor in the bargaining process deprives it of some of its "voluntary" character.

At some point nondisclosure becomes fraud. One consideration relevant to deciding whether the line has been crossed is whether the information sought to be concealed by one of the transacting parties is a product of significant investment. If not, the social costs of nondisclosure are reduced. This may be decisive, for example, on the question whether the owner of a house should be required to disclose latent (nonobvious) defects to a purchaser. The ownership and maintenance of a house are costly and productive activities. But since knowledge of the house's defects is acquired by the owner costlessly (or nearly so), forcing him to disclose these defects will not reduce his incentive to invest in discovering them.

As examples of cases where transaction-cost considerations argue against assigning a property right to the possessor of a secret, consider (1) whether the Bureau of the Census should be required to *buy* information from the firms or households that it interviews and (2) whether a magazine should be allowed to sell its subscriber list to another magazine without obtaining the subscribers' consent. Re-

quiring the Bureau of the Census to pay (that is, assigning the property right in the information sought to the interviewee) would yield a skewed sample: the poor would be overrepresented, unless the bureau used a differentiated price schedule based on the different costs of disclosure (and hence prices for cooperating) to the people sampled. In the magazine case, the costs of obtaining subscriber approval would be high relative to the value of the list. If, therefore, we are confident that these lists are generally worth more to the purchasers than being shielded from possible unwanted solicitations is worth to the subscribers, we should assign the property right to the magazine, and this is what the law does.

The decision to assign the property right away from the individual is further supported, in both the census and subscription-list cases, by the fact that the costs of disclosure to the individual are low. They are low in the census case because the government takes precautions against disclosure of the information collected to creditors, tax collectors, or others who might have transactions with the individual in which they could use the information to gain an advantage over him. They are low in the subscription-list case because the information about the subscribers that is disclosed to the list purchaser is trivial and cannot be used to impose substantial costs on them.

Even though the type of private information discussed thus far is not in general discreditable to the individual to whom it pertains, we have seen that there may still be strong reasons for assigning the property right away from that individual. Much of the demand for privacy, however, concerns discreditable information—often information concerning past or present criminal activity or moral conduct at variance with a person's professed moral standards—and often the motive for concealment is, as suggested earlier, to mislead others. People also wish to conceal private information that, while not strictly discreditable, would if revealed correct misapprehensions that the individual is trying to exploit—as when a worker conceals a serious health problem from his employer or a prospective husband conceals his sterility from his fiancée. It is not clear why society in these cases should assign the property right in information to the individual to whom it pertains; and under the common law, generally it does not. A separate question, taken up a little later, is whether the decision to assign the property right away from the possessor of guilty secrets implies that any and all methods of uncovering those secrets should be permitted.

An analogy to the world of commerce may clarify why people should not—on economic grounds in any event—have a right to conceal

material facts about themselves. We think it wrong (and inefficient) that a seller in hawking his wares should be permitted to make false or incomplete representations as to their quality. But people "sell" themselves as well as their goods. A person professes high standards of behavior in order to induce others to engage in social or business dealings with him from which he derives an advantage, but at the same time conceals some of the facts that the people with whom he deals need in order to form an accurate picture of his character. There are practical reasons for not imposing a general legal duty of full and frank disclosure of one's material personal shortcomings—a duty not to be a hypocrite. But each of us should be allowed to protect ourselves from disadvantageous transactions by ferreting out concealed facts about other individuals that are material to their implicit or explicit self-representations.

It is no answer that, in Brandeis's phrase, people have "the right to be let alone." Few people want to be let alone. They want to manipulate the world around them by selective disclosure of facts about themselves. Why should others be asked to take their self-serving claims at face value and prevented from obtaining the information necessary to verify or disprove these claims?

Some private information that people desire to conceal is not discreditable. In our culture, for example, most people do not like to be seen naked, quite apart from any discreditable fact that such observation might reveal. Since this reticence, unlike concealment of discreditable information, is not a source of social costs and since transaction costs are low, there is an economic case for assigning the property right in this area of private information to the individual; and this is what the common law does. I do not think, however, that many people have a *general* reticence that makes them wish to conceal nondiscrediting personal information. Anyone who has sat next to a stranger on an airplane or a ski lift knows the delight that some people take in talking about themselves to complete strangers. Reticence appears when one is speaking to people—friends, family, acquaintances, business associates—who might use information about him to gain an advantage in business or social transactions with him. Reticence is generally a means rather than an end.

The reluctance of many people to reveal their income is sometimes offered as an example of a desire for privacy that cannot be explained in purely instrumental terms. But I suggest that people conceal an unexpectedly low income because being thought to have a high income has value in credit markets and elsewhere, and they conceal an unexpectedly high income in order to (1) avoid the attention of tax

collectors, kidnappers, and thieves, (2) fend off solicitations from charities and family members, and (3) preserve a reputation for generosity that would be shattered if the precise fraction of their income that was being given away were known. Points (1) and (2) may explain anonymous gifts to charity.

### *Prying, eavesdropping, and formality*

To the extent that personal information is concealed in order to mislead, the case for giving it legal protection is, I have argued, weak. Protection would simply increase transaction costs, much as if we permitted fraud in the sale of goods. However, it is also necessary to consider the *means* by which personal information is obtained. Prying by means of casual interrogation of acquaintances of the object of the prying must be distinguished from eavesdropping (electronically or otherwise) on a person's conversations. A in conversation with B disparages C. If C has a right to hear this conversation, A, in choosing the words he uses to B, will have to consider the possible reactions of C. Conversation will be more costly because of the external effects and this will result in less—and less effective—communication. After people adjust to this new world of public conversation, even the Cs of the world will cease to derive much benefit in the way of greater information from conversational publicity: people will be more guarded in their speech. The principal effect of publicity will be to make conversation more formal and communication less effective rather than to increase the knowledge of interested third parties.

Stated differently, the costs of defamatory utterances and hence the cost-justified level of expenditures on avoiding defamation are greater the more publicity given the utterance. If every conversation were public, the time and other resources devoted to ensuring that one's speech was free from false or unintended slanders would rise. The additional costs are avoided by the simple and inexpensive expedient of permitting conversations to be private.

It is relevant to observe that language becomes less formal as society evolves. The languages of primitive peoples are more elaborate, more ceremonious, and more courteous than that of twentieth-century Americans. One reason may be that primitive people have little privacy. There are relatively few private conversations because third parties are normally present and the effects of the conversation on them must be taken into account. Even today, one observes that people speak more formally the greater the number of people present. The rise of privacy has facilitated private conversation and thereby enabled

us to economize on communication—to speak with a brevity and informality apparently rare among primitive peoples. This valuable economy of communication would be undermined by allowing eavesdropping.

In some cases, to be sure, communication is not related to socially productive activity. Communication among criminal conspirators is an example. In these cases—where limited eavesdropping is indeed permitted—the effect of eavesdropping in reducing communication is not an objection to, but an advantage of, the eavesdropping.

The analysis here can readily be extended to efforts to obtain people's notes, letters, and other private papers; communication would be inhibited by such efforts. A more complex question is presented by photographic surveillance—for example, of the interior of a person's home. Privacy enables a person to dress and otherwise disport himself in his home without regard to the effect on third parties. This economizing property would be lost if the interior of the home were in the public domain. People dress not merely because of the effect on others but also because of the reticence, noted earlier, concerning nudity and other sensitive states. This is another reason for giving people a privacy right with regard to the places in which these sensitive states occur.

### *Ends and means*

The two main strands of my argument—relating to personal facts and to communications, respectively—can be joined by remarking the difference in this context between ends and means. With regard to ends, there is a prima facie case for assigning the property right in a secret that is a by-product of socially productive activity to the individual if its compelled disclosure would impair the incentives to engage in that activity; but there is a prima facie case for assigning the property right away from the individual if secrecy would reduce the social product by misleading others. However, the fact that under this analysis most facts about people belong in the public domain does not imply that intrusion on private communications should generally be permitted, given the effects of such intrusions on the costs of legitimate communications.

Admittedly, the suggested dichotomy between facts and communications is too stark. If you are allowed to interrogate my acquaintances about my income, I may take steps to conceal it that are analogous to the increased formality of conversation that would ensue from abolition of the right to conversational privacy, and the costs of these

steps are a social loss. The difference is one of degree. Because eavesdropping and related modes of intrusive surveillance are such effective ways of eliciting private information and are at the same time relatively easy to thwart, we can expect that evasive maneuvers, costly in the aggregate, would be undertaken if conversational privacy were compromised. It is more difficult to imagine people taking effective measures against casual prying. An individual is unlikely to alter his income or style of living drastically in order to better conceal his income or private information from casual or journalistic inquiry. (Howard Hughes was a notable exception to this generalization.)

We have now sketched the essential elements of an economically based legal right of privacy: (1) Trade and business secrets by which businessmen exploit their superior knowledge or skills would be protected. (The same principle would be applied to the personal level and would thus, for example, entitle the social host or hostess to conceal the recipe of a successful dinner.) (2) Facts about people would generally not be protected. My ill health, evil temper, even my income would not be facts over which I had property rights, though I might be able to prevent their discovery by methods unduly intrusive under the third category. (3) Eavesdropping and other forms of intrusive surveillance would be limited (so far as possible) to the discovery of illegal activities.

## Application

To what extent is the economic theory developed above reflected in public policy? To answer this question, it is necessary to distinguish sharply between common law and statutory responses to the privacy question.

### *The common law*

The term common law refers to the body of legal principles evolved by English and American appellate judges in the decision of private suits over a period of hundreds of years. I believe, and have argued in greater detail elsewhere, that the common law of privacy is strongly stamped by the economic principles (though nowhere explicitly recognized by the judges) developed in this article. That law contains the precise elements that an economically based right of privacy would include. Trade secrets and commercial privacy generally are well protected. It has been said by one court: "almost any knowledge or information used in the conduct of one's business may be held by its

possessor secret." In another well-known case, aerial photography of a competitor's plant under construction was held to be unlawful, and the court used the term "commercial privacy" to describe the interest it was protecting.

An analogy in the personal area is the common law principle that a person's name or photograph may not be used in advertising without his consent. The effect is to create a property right which ensures that a person's name or likeness (O. J. Simpson's, for example) will be allocated to the advertising use in which it is most valuable. Yet, consistent with the economics of the problem, individuals have in general no right in common law to conceal discrediting information about themselves. But, again consistent with the economics of the problem, they do have a right to prevent eavesdropping, photographic surveillance of the interior of a home, the ransacking of private records to discover information about an individual, and similarly intrusive methods of penetrating the wall of privacy that people build about themselves. The distinction is illustrated by Ralph Nader's famous suit against General Motors. The court affirmed General Motors' right to have Nader followed about, to question his acquaintances, and, in short, to ferret out personal information about Nader that the company might have used to undermine his public credibility. Yet I would expect a court to enjoin any attempt through such methods to find out what Nader was about to say on some subject in order to be able to plagiarize his ideas.

When, however, we compare the implications of the economic analysis not with the common law relating to privacy but with recent legislation in the privacy area, we are conscious not of broad concordance but of jarring incongruity. As noted, from the economic standpoint, private business information should in general be accorded greater legal protection than personal information. Secrecy is an important method of appropriating social benefits to the entrepreneur who creates them, while in private life it is more likely simply to conceal legitimately discrediting or deceiving facts. Communications within organizations, whether public or private, should receive the same protection as communications among individuals, for in either case the effect of publicity would be to encumber and retard communication.

### *The trend in legislation*

But in fact the legislative trend is toward giving individuals more and more privacy protection with respect to facts and communications, and business firms and other organizations (including government

agencies, universities, and hospitals) less and less. The Freedom of Information Act, sunshine laws opening the deliberations of administrative agencies to the public, and the erosion of effective sanctions against breach of government confidences have greatly reduced the privacy of communications within the government. Similar forces are at work in private institutions such as business firms and private universities (note, for example, the Buckley Amendment and the opening of faculty meetings to student observers). Increasingly, moreover, the facts about an individual—arrest record, health, credit-worthiness, marital status, sexual proclivities—are secured from involuntary disclosure, while the facts about business corporations are thrust into public view by the expansive disclosure requirements of the federal securities laws (to the point where some firms are "going private" in order to secure greater confidentiality for their plans and operations), the civil rights laws, "line of business" reporting, and other regulations. A related trend is the erosion of the privacy of government officials through increasingly stringent ethical standards requiring disclosure of income.

The trend toward elevating personal and downgrading organizational privacy is mysterious to the economist (as are other recent trends in public regulation). To repeat, the economic case for privacy of *communications* seems unrelated to the nature of the communicator, whether a private individual or the employee of a university, corporation, or government agency, while so far as *facts* about people or organizations are concerned, the case for protecting business privacy is stronger, in general, than that for protecting individual privacy.

Some of the differences in the protection accorded governmental and personal privacy may, to be sure, simply reflect a desire to reduce the power of government. Viewed in this light, the Freedom of Information Act is perhaps supported by the same sorts of considerations that are believed by some to justify wiretapping in national security or organized crime cases. But only a small part of the recent legislative output in the privacy area can be explained in such terms.

A good example of legislative refusal to respect the economics of the privacy problem is the Buckley Amendment, which gives students (and their parents) access to their school records. The amendment permits students to waive, in writing, their right to see letters of recommendation, and most students do so. They do so because they know that letters of recommendation to which they have access convey no worthwhile information to the recipient. The effect on the candor and value of communication is the same as would be that of a rule that allowed C to hear A and B's conversations about him. Throwing

open faculty meetings or congressional conferences to the public has the identical effect of reducing the value of communication without benefitting the public, for the presence of the public deters the very communication they want to hear.

As another example of an economically perverse legislative response to privacy issues, consider the different treatment of disclosures of corporate and of personal crime. The corporation that bribes foreign officials must make public disclosure of the fact, even though the crime may benefit the corporation, its shareholders, the United States as a whole, and even the citizens of the foreign country in question. Yet the convicted rapist, the recidivist con artist, and even the murderer "acquitted" by reason of insanity are not only under no duty to reveal to new acquaintances their criminal activities but are often assisted by law in concealing these activities.

Through the Fair Credit Reporting Act, credit bureaus are forbidden to report to their customers a range of information concerning applicants for credit—for instance, bankruptcies more than fourteen years old and all other adverse information (including criminal convictions and civil judgments) more than seven years old. These restrictions represent an extraordinary intervention in the credit process that could be justified only if credit bureaus systematically collected and reported information that, because of its staleness, had negligible value to its customers in deciding whether credit should be extended. No such assumption of economic irrationality is possible.

These examples could be multiplied, but the main point should be clear enough. Legislatures are increasingly creating rights to conceal information that is material to prospective creditors and employers, and at the same time forcing corporations and other organizations to publicize information whose confidentiality is necessary to their legitimate operation.

### *A contrary view*

I know of only one principled effort to show that individual privacy claims are stronger than those of businesses and other organizations. Professors Kent Greenawalt and Eli Noam of Columbia, in an unpublished paper, offer two distinctions between a business's (or other organization's) interest in privacy and an individual's interest. First, they say that the latter is a matter of rights and that the former is based merely on instrumental, utilitarian considerations. The reasons they offer for recognizing a right of personal privacy are, however, utilitarian—that people need an opportunity to "make a new start"

(that is, to conceal embarrassing or discreditable facts about their past), that people cannot preserve their sanity without privacy, and so on. Yet Greenawalt and Noam disregard the utilitarian justification for secrecy as an incentive to investment in productive activity—the strongest justification for secrecy and one mainly relevant, as I have argued, in business contexts.

The second distinction they suggest between the business and personal claims to privacy is a strangely distorted mirror of my argument for entrepreneurial or productive secrecy. They argue that it is difficult to establish property rights in information and even remark that secrecy is one way of doing so. But they do not draw the obvious conclusion that secrecy can promote productive activity by creating property rights in valuable information. Instead they use the existence of imperfections in the market for information as a justification for government regulation designed to extract private information from business firms. They do not explain, however, how the government could, let alone demonstrate that it would, use this information more productively than firms, and they do not consider the impact of this form of public prying on the incentive to produce the information in the first place.

## Conclusion

Discussions of the privacy question have contained a high degree of cant, sloganeering, emotion, and loose thinking. A fresh perspective on the question is offered by economic analysis, and by a close examination of the common law principles that have evolved under the influence (perhaps unconsciously) of economic perceptions. In the perspective offered by economics and by the common law, the recent legislative emphasis on favoring individual and denigrating corporate and organizational privacy stands revealed as still another example of perverse government regulation of social and economic life.