SFB63 Credence Goods, Incentives, and Behavior

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Label Credence Good

Credence goods markets are characterized by an informational disadvantage for consumers that is not necessarily resolved after trade.

Expert Credence Good: Buyers do not know what they need and may never learn whether the treatment proposed by the seller is appropriate and adequately priced.

Label Credence Good: Consumers know what they want but may never find out whether they indeed get what the seller promises to supply.

Relevant contexts include…
- environmentally friendly food production,
- socially responsible or sustainable investments,
- the involvement of child labor in the production process,
- generation of electricity using low-emissions technologies,
- scientific research following the state of the art code of conduct.

Theoretical Predictions

The model:

Firm(s) choose
- Production technology brown (low cost) or green (high cost)
- Label (green or brown) and price p

Consumer(s) observe label and price (but not the production technology)

The brown technology induces a loss of h for a third party

A firm or consumer of type $\theta \in [o,h]$ faces a cost of θ from brown production/consumption
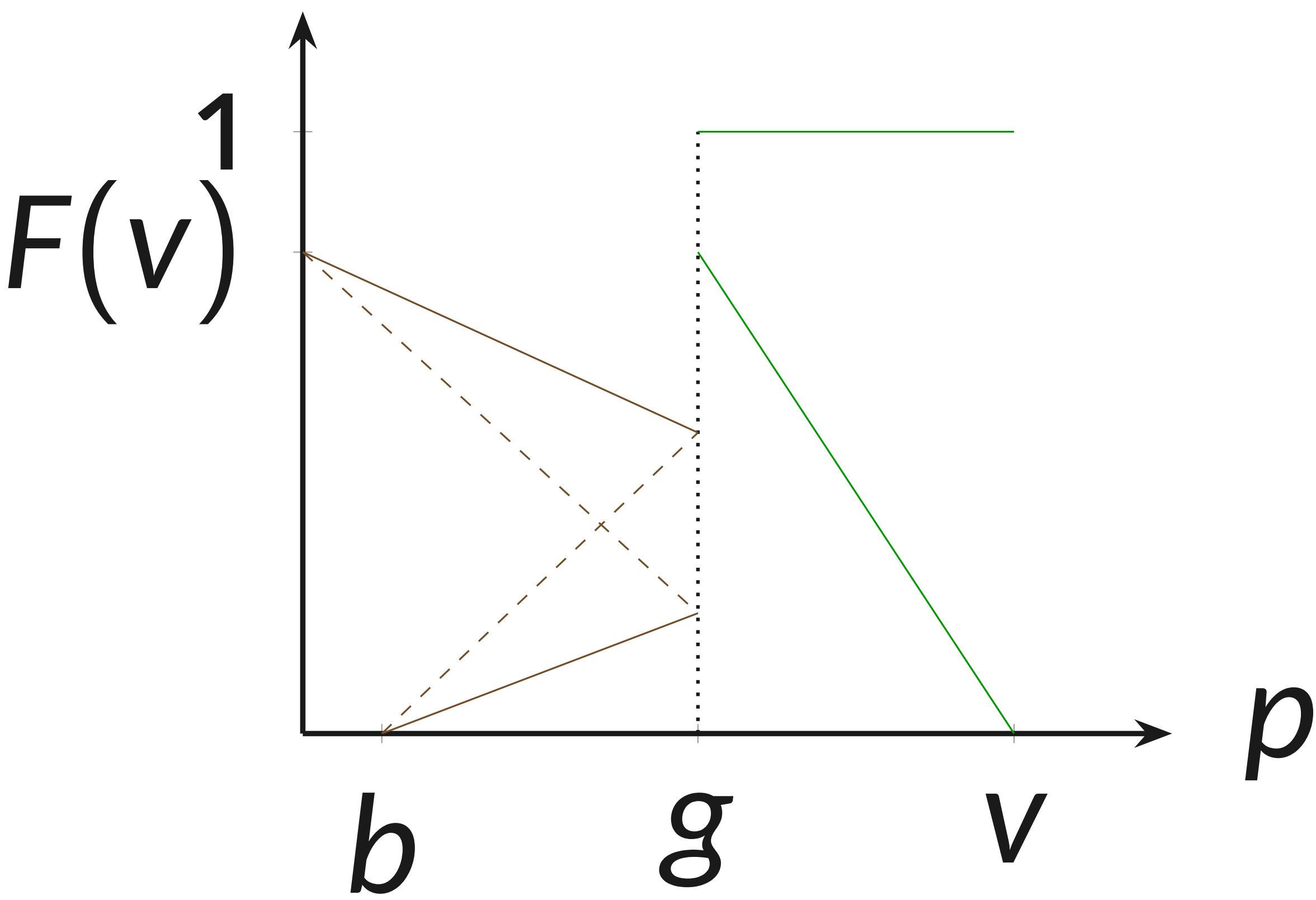
Market Power: Unique equilibrium with

Low types produce and consume brown but label green

High types produce and consume green and label green

Competition:

Low price equilibrium with purely brown production and consumption

High price equilibrium as without competition but with lower prices

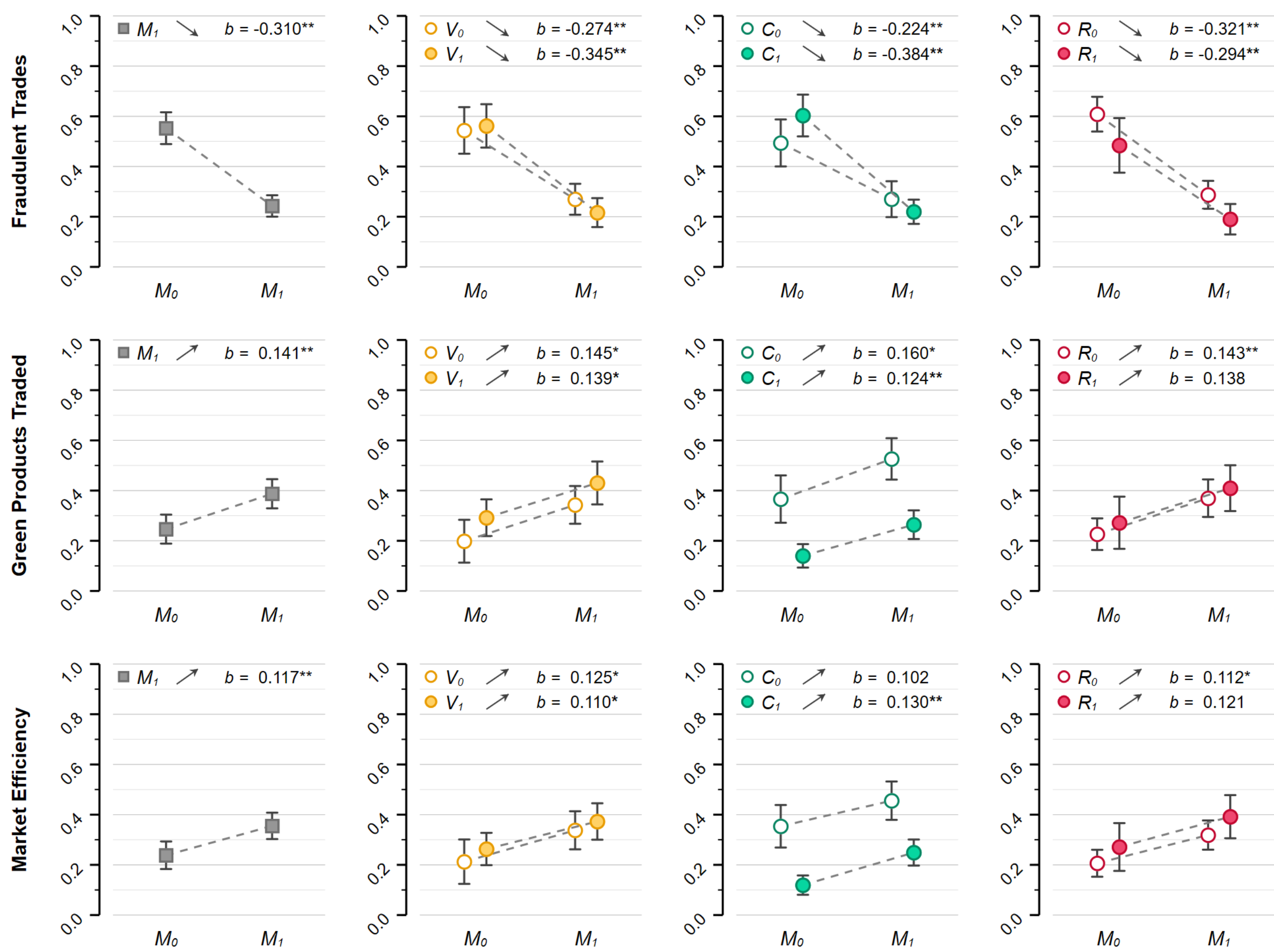**Monitoring** amplifies the impact of competition

Credible **certification** by a third party reduces the impact of competition

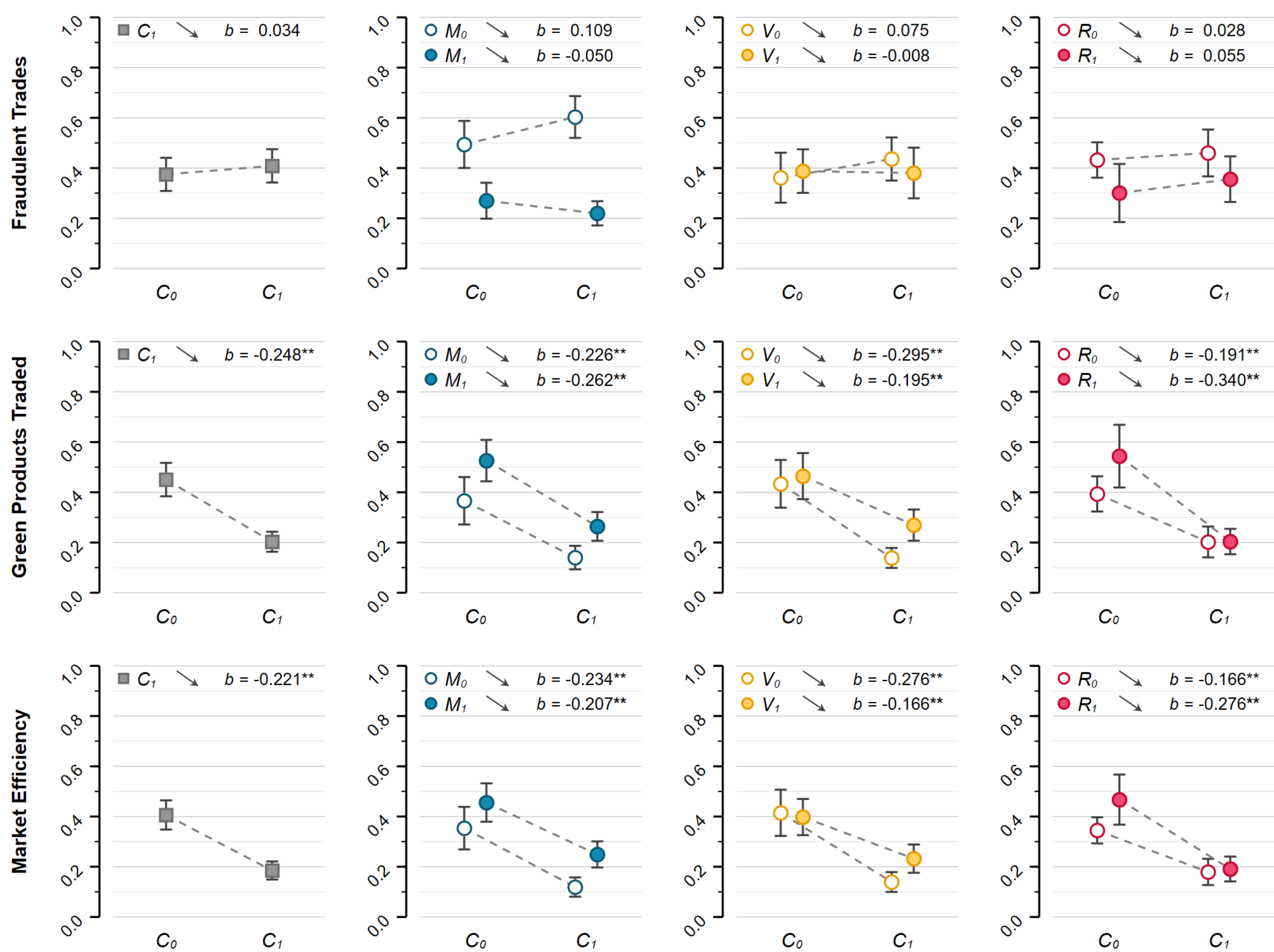The opportunity to build **reputation** amplifies the impact of competition

	Mon.	Ver.	Comp.	Rep.
Share of fraudulently used labels	↗	↘	↘	↘
Share of green products traded	↗	↘	↘	↗
Market efficiency	↗	↘	↘	↗

Experimental Findings

Monitoring

Competition

Reputation