

Regulating False Disclosure

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Abstract: Firms communicate private information about product quality through a combination of pricing and disclosure where disclosure may be deliberately false. In a competitive setting, we examine the effect of regulation penalizing false disclosure. Stronger regulation reduces the reliance on price signaling, thereby lowering market power and consumption distortions; however, it often creates incentives for excessive disclosure. Regulation is suboptimal unless disclosure itself is inexpensive and even in the latter case, only strong regulation is welfare improving. Weak regulation is always worse than no regulation. Even high quality firms suffer due to regulation.