

The role of diagnostic ability in markets for expert services

Alexander Rasch, Fang Liu & Christian Waibel

Abstract: In credence goods markets, even though experts have better information about the appropriate quality of treatment than their customers, fraud can be prevented in many market environments. We analyze whether this positive result carries over when expert types, who provide both the diagnosis and the treatment, differ in their diagnostic abilities (low or high). Indeed, efficient market outcomes are always possible. However, depending on the probability of a major problem and the probability with which a low-ability type performs the accurate diagnosis, inefficient equilibria can also exist. When such equilibria are played, better diagnostic abilities (on average) result in greater inefficiencies.