Product Ratings and Externalities”

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Abstract: We investigate how information regarding production externalities (e.g. ecolabels) can be presented to create market pressure on firms to reduce said externalities. Specifically, we ask whether integrating information regarding externalities and consumer product ratings into one rating, can result in pressure to reduce externalities from all consumers, not just ‘green/activist’ consumers. Theoretically we show that an equilibrium exists where producers invest in both high product quality and low production externality. However, we show that with separate ratings, this equilibrium requires a high share of ’green’ consumers who only wish to purchase products with low production externalities, whereas with combined ratings it does not. Experimentally we confirm the prediction that both separate and combined ratings help overcome the product quality asymmetric information problem, and find investments in externality reduction were substantially higher in the combined rating treatment.