Master Course: Behavioral Economic Theory

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Objectives

In many markets, customers do not learn the quality or type of a good or service even after consumption while sellers know about quality or type when transacting with the customer. As examples consider food produced in an ecologically friendly manner (e.g., dolphin-save tuna, low emission electricity production etc.) or with corporate social responsibility (e.g., textile production without child labor, ethical investments etc.). Since transacting in the presence of such an information asymmetry needs – in the absence of any regulating institution – credence of the seller and since market participants often try to bridge the asymmetry with the use of labels (e.g., for environmentally or socially responsible production), goods or service in such markets are referred to as label credence goods. A similar information asymmetry also exists between the providers and recipients of scientific expertise or advice (e.g., data generation and analysis according to professional standards). As a result, great challenges of our time (e.g., fighting global warming with low CO2 emissions, maintaining ecological diversity and social standards, or fighting a pandemic based on scientific advice) feature informational asymmetries of label credence goods or services. In this course we will investigate the impact of different institutions on the provision of label credence goods. Specifically, we will address the following research questions:

1. What is the role of **social preferences** in markets for label credence goods?

2. In how far can **information transmission** by firms (e.g., labels, advertisement, information revelation) increase the quality of label credence goods?

3. What are the pros and cons of introducing **3rd party certification** in markets for label credence goods?

4. Is **reputation building** a promising way to promote high-quality production and efficiency in markets for label credence goods?

5. Does **competition** between firms improve welfare in markets for label credence goods?

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Evaluation

Presentation   Each course participant will work on one of the research questions (research questions and a supervisor will be allocated via a first-come-first-serve doodle in the first week of the term). Students are asked to

- provide an overview about the (theoretical and empirical) literature that tries to answer the research question,

- present in detail one theoretical paper that addresses the research question, and

- discuss in how far hypotheses that can be derived from this paper have been tested or could be empirically tested.

Presentations are expected to last 90 minutes including discussion and should be done in teams of two students. Once a research question is allocated, students are asked to contact the corresponding supervisor to schedule a first meeting. Presentations will be scheduled for January 2021.

Discussion   Each participant acts as a discussant for one of the other presentations (discussants are allocated randomly by the course coordinators). Discussants are expected to provide their own assessment and interpretation of the findings presented by the student in charge for the corresponding research question. Discussions are expected to last 10 minutes (at least). Furthermore, students are expected to prepare the literature for each meeting and to contribute to in-class discussions. All papers mentioned in the syllabus are downloadable on the course's OLaT page.

Research paper   After the course, students have to prepare a short paper (6 to 10 pages) with a proposal for a research project (e.g., a laboratory experiment, a field study, or an application of a model to a specific context).

The **final grade** consists of a grade for the presentation (40%), the paper (30%), the discussion (20%) and in-class participation (10%).

Preparation   All course participants are asked to carefully read the following overview articles to provide a common starting point for in-class discussions:

1. Benbou, R. and J. Tirole (2010), Individual and Corporate Social Responsibility, Economica 77, 1–19.

2. Crifo, P. and V. Forget (2014), The Economics of Corporate Social Responsibility: A Firm Level Perspective Survey, Journal of Economic Surveys 29 (1), 112-130.

3. Yokessa, M. and S. Marette (2019), A Review of Eco-labels and their Economic Impact, International Review of Environmental and Resource Economics 13, 119-163.

4. Kitzmueller, M. and J. Shimshack (2012), Economic perspectives on corporate social responsibility, Journal of Economic Literature 50 (1), 51-84.

5. Dranove, D. and G.Z. Jin (2010), Quality disclosure and certification: Theory and practice, Journal of Economic Literature 48 (4), 935-963.

6. Bonroy, O. and C. Constantatos (2014), On the economics of labels: How their introduction affects the functioning of markets and the welfare of all participants, American Journal of Agricultural Economics 97(1), 239–259.

Literature List The following list is an (incomplete) collection of theoretical papers that contain answers to the research questions.

1. Albano, G., Lizzeri, A. (2001), Strategic certification and provision of quality, International Economic Review 42(1), 267-283.

2. Amacher, G.S., E. Koskela, and M. Ollikainen (2004), Environmental quality competition and eco-labeling, Journal of Environmental Economics and Management 47 (2): 284-306.

3. Arguesdas, C. and E. Blanco (2020), Credence goods, fraud, and certification, mimeo.

4. Arora, S. and Gangopadhyay, S. (1995), Toward a theoretical model of voluntary overcompliance, Journal of Economic Behavior and Organization, 28(3), 289-309.

5. Baksi, S., Bose, P. (2007), Credence goods, efficient labelling policies, and regulatory enforcement, Environmental and Resource Economics 37 (2), 411-430.

6. Baksi, S., P. Bose, and D. Xiang (2016), Credence goods, misleading labels, and quality differentiation, Environmental and Resource Economics 1-20.

7. Baron, D., 2011, Credence attributes, voluntary organizations, and social pressure, Journal of Public Economics 95 (11), 1331-1338.

8. Bonroy, O., Constantatos, C. (2008), On the use of labels in credence good markets, Journal of Regulatory Economics, 33(3), 237-252.

9. Bottega, L. and De Freitas, J. (2009), Public, private and nonprofit regulation for environmental quality, Journal of Economics and Management Strategy, 18(1), 105–123.

10. Bottega, L., Delacote, P., and Ibanez, L. (2009), Labeling policies and market behavior: quality standard and voluntary label adoption, Journal of Agricultural and Food Industrial Organization, 7(2).

11. Farhi, E., Lerner, J., Tirole, J. (2013), Fear of rejection? Tiered certification and transparency, The RAND Journal of Economics 44 (4), 610-631.

12. Feddersen, T., Gilligan, T. (2001), Saints and markets: Activists and the supply of credence goods, Journal of Economics and Management Strategy 10 (1), 149-171.

13. Fischer, C., Lyon, T. (2014), Competing environmental labels, Journal of Economics and Management Strategy 23 (3), 692-716.

14. Fishman, Michael J., and Kathleen M. Hagerty (1990), The optimal amount of discretion to allow in disclosure, The Quarterly Journal of Economics 105 (2): 427-444.

15. Glaeser, E., Ujhelyi, G. (2010), Regulating misinformation, Journal of Public Economics 94 (3–4): 247-257.

16. Grossman, S. (1981), The informational role of warranties and private disclosure about product quality, Journal of Law and Economics 24, 461-483.

17. Grossman, S. and O. Hart (1980), Disclosure laws and takeover bids, The Journal of Finance 35, 323-334.

18. Hamilton, S. and D. Zilberman (2006), Green markets, eco-certification, and equilibrium fraud, Journal of Environmental Economics and Management 52 (3), 627-644.

19. Harbaugh, R., Maxwell, J., Roussillon, B. (2011), Label confusion: The groucho effect of uncertain standards, Management Science 57 (9), 1512-1527.

20. Heyes, Anthony G., and John W. Maxwell (2004), Private vs. Public regulation: Political economy of the international environment, Journal of Environmental Economics and Management 48 (2), 978-996.

21. Heyes, Anthony G., and Steve Martin (2017). Social labeling by competing ngos: A model with multiple issues and entry, Management Science 63 (6), 1800-1813.

22. Janssen, Maarten , and Santanu Roy (2017), Regulating false disclosure, CEPR Discussion Paper No. DP12450.

23. Krupka, Erin, Thomas Lyon, and Arnab Mitra (2020), Fraudulent Production of Credence Goods in Markets with Collective Reputation, mimeo.

24. Li, Y. and van't Veld, K. (2015), Green, greener, greenest: Eco-label gradation and competition, Journal of Environmental Economics and Management, 72, 164-176.

25. Lizzeri, A. (1999), Information revelation and certification intermediaries, RAND Journal of Economics, 30 (2), 197-213.

26. Lozano, Javier, Ester Blanco, and Javier Rey-Maquieira (2010), Can ecolabels survive in the long run?: The role of initial conditions, Ecological Economics 69 (12), 2525-2534.

27. Lyon, T., Maxwell, J. (2011), Greenwash: Corporate environmental disclosure under threat of audit, Journal of Economics and Management Strategy 20 (1), 3-41.

28. Mason, Charles F. (2006), An economic model of ecolabeling, Environmental Modeling and Assessment 11 (2), 131-143.

29. Matthews, Steven, and Andrew Postlewaite (1985), Quality testing and disclosure, The RAND Journal of Economics 16, 328-340.

30. Milgrom, P. (1981), Good news and bad news: Representation theorems and applications, Bell Journal of Economics 12(2), 380-391.

31. Okuno-Fujiwara, Masahiro, Andrew Postlewaite, and Kotaro Suzumura (1990), Strategic information revelation, The Review of Economic Studies 57, 25-47.

32. Piccolo, Salvatore, Piero Tedeschi, and Giovanni Ursino (2015), How limiting deceptive practices harms consumers, The RAND Journal of Economics 46 (3), 611-624.

33. Piccolo, Salvatore, Piero Tedeschi, and Giovanni Ursino (2018), Deceptive advertising with rational buyers, Management Science 64 (3), 1291-1310.

34. Rhodes, Andrew, and Chris M. Wilson (2018), False advertising, The RAND Journal of Economics 49 (2), 348-369.

35. Roe, B. E., M. F. Teisl, and C. R. Deans (2014), The economics of voluntary versus mandatory labels, Annual Review of Resource Economics 6(1), 407–27.

36. Sedjo, Roger A., and Stephen K. Swallow (2002), Voluntary eco-labeling and the price premium, Land Economics 78 (2): 272-284.