Inspection in Markets for Experience Goods

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Abstract

We consider a simple dynamic “collective reputation” model of a market for an experience good into which we introduce imperfect quality inspections. In each period two markets operate: a prime market for sellers with a good reputation, and a regular market for all other sellers. In every period, the quality of produced goods is inspected, and producers who have been found to produce low quality goods are barred from selling in the prime market in the next period. We demonstrate that the average quality of the good in both markets may decrease as inspection technology improves. A few applications of the model are discussed.

Keywords: collective reputation, certification, inspection, standards, enforcement

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