Evidence acquisition under private information: When do test monitoring and mandatory disclosure improve market information?

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November 28, 2018

Abstract

We consider two kinds of policy interventions in a market when a seller can generate evidences about the good's quality by conducting costly tests. To maximize the amount of information revealed to the buyer, the policy maker can make (i) the seller's test activities public or (ii) the disclosure of the evidences obtained mandatory. We argue that the optimal intervention in this case depends crucially on the amount of private information the seller possesses. Moreover, the two policy instruments must be applied in the right combination to obtain the desired effect. Test monitoring and mandatory disclosure together are useful when the seller is perfectly informed prior to testing as they enable signaling through evidence acquisition. But they dampen the incentive for information acquisition when the seller does not have superior information. We further discuss the intermediate case when the seller is imperfectly informed.

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