

Quality Signaling through Certification. Theory and an application to agricultural seed markets.

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January 27, 2003

Abstract: We examine the problem of signaling the quality of goods and services when quality is never observable to consumers. The solution to this problem is certification, which acts to transform unobservable credence attributes into observable search attributes. We study the impact of certification systems on market structure and performance. It turns out that the costs of certification, sunk in order to achieve credibility, play a key role in producing an oligopolistic market. We next show that since it involves increasing return to scale, certification is better achieved by an independent body which can either be a private firm or a public agency. We examine the two ways in which quality provision through certification may be financed (i.e. public and private), and identify the conditions under which each is most efficient. Finally we examine the relevance of the model by studying the role of certification in quality seed provision for agriculture. Overall, model predictions are compatible with the conclusions of this empirical study.

JEL Classification Numbers: D11, D21, L11, L15.

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