"Low Quality as a Signal of High Quality"
Response to Referee Report 2
Matthew Clements

I thank the referee for the thoughtful comments. My numbered responses below correspond to the referee's numbered comments.

A. The referee is not convinced that traditional wine packaging is low quality, but does not explain why. There are two senses in which alternative packaging for wine is better than traditional packaging: it takes more time and effort to uncork a bottle than to unscrew a cap, and wine in an opened box stays fresh longer than wine in an opened bottle. Clearly any wine consumer would prefer more convenient packaging and longer-lasting wine (although the strength of the preference may vary). The only sense in which wine consumers prefer traditional packaging is that it is associated with high-quality wine. I.e. consumers do not prefer the glass bottle and cork in themselves, but they may be more likely to buy wine packaged in this way because they assume that the wine inside is higher quality than wine in a box. The referee makes the same criticism of the beer example, and I have a similar response. It is definitely easier to unscrew the cap than to remove it with a bottle opener (and screw-off caps can be opened with an opener also, so there is no reason to prefer the pry-off cap). I do appreciate the referee's mention of the inconvenience of obtaining high-quality products such as wine or cigars, and I would like to incorporate these examples into the paper.

B. 1. I agree that the assumed distribution is not the most satisfactory; but it is a legitimate distribution, it incorporates crucial characteristics, and it is the only tractable model specification I was able to find. I did try working with the binomial, among others; finding a tractable model was the most time-consuming part of the project.

B. 2. I can clarify the equilibrium concept in a revision of the paper.

C. It is true that, in separating equilibria, goods with high unobservable quality have a higher price than those with low unobservable quality, and that observable quality is only used as a signal when price is used as a signal also. In that sense, one could say that signaling is done "mainly" through price. The point of this paper is to show when observable quality is used as a signal in addition to price. I think that the insights provided in that regard are valuable.

D. I can certainly be more explicit about the refinement criteria, and discuss them in the model section of the paper. As for assessing the robustness of the results with respect to equilibrium refinements, I could do this for the sake of completeness, although I am not sure how valuable an exercise this would be. I used refinements that restrict the set of equilibria in the most intuitively appealing way. I suspect that different refinements would either lead to the same results but in a more roundabout way, or would lead to less intuitive results. The referee specifically mentions a situation in which the probability of low unobservable quality is very low. The model currently does not assign any prior probability of low quality and thus would need to be expanded to investigate pooling

equilibria fully. Again, this could be done for the sake of completeness. Since the paper focuses on when low quality is used as a signal, I thought that the most interesting point to make about pooling equilibria was that it is not possible to have pooling at low observable quality (Proposition 4).