ABSTRACT

LEMONS IN THE USED CAR MARKET: THEORY AND EVIDENCE

by

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This dissertation presents a simple theory for a used car market with asymmetric information and tests the theory using Tobit censored regression model and OLS. The novel contribution of the dissertation is that a consumer not only has a choice of buying or leasing a new car, but also can choose to buy a used car or a certified pre-owned car (CPO). The theoretical analysis implies that the average quality of traded used cars can be either higher or lower than the average quality of non-traded cars. Consistent with this prediction, the empirical analysis finds that cars that were acquired used required no more maintenance expenditures than those that were acquired new of a similar age. The analysis further examines the possible impacts of the institutions of leasing and CPO on the average quality of traded used cars. The analysis finds that institutions such as leasing and certification may have substantially improved the information acquisition and transmission mechanism between buyer and seller, which in turn,
may have contributed to mitigating the consequences of adverse selection and improving the average quality of traded cars in the used car market.

The main conclusions of this dissertation are: first, lemons hypothesis may or may not hold; second, leasing and CPO are the institutions that have developed as envisaged by Akerlof to counteract quality uncertainty; third, a possible market equilibrium can be shown in this market.