Accepted Manuscript

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PII: S0022-0531(17)30029-7
DOI: http://dx.doi.org/10.1016/j.jet.2017.02.012
Reference: YJETH 4647

To appear in: *Journal of Economic Theory*

Received date: 18 January 2016
Revised date: 30 January 2017
Accepted date: 18 February 2017

Information about Sellers' Past Behavior in the Market for Lemons

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January 2017

Abstract

This paper studies the role of time-on-the-market information in dynamic trading environments under adverse selection. I consider a sequential search model in which (informed) sellers receive price offers from (uninformed) buyers and analyze both the case in which buyers receive no information about sellers' trading histories and the case in which buyers observe sellers' time-on-the-market. I analyze how the observability of time-on-the-market influences agents' trading behavior and investigate its welfare implications in both the single-seller environment and the stationary market environment.

JEL Classification Numbers: C78, D82, D83.

Keywords : Adverse selection; sequential search; time-on-the-market.

1 Introduction

Consider a buyer (he) facing a seller (she) who possesses superior information about the quality of her good. Adverse selection complicates the buyer's problem. A low price entails the risk of being rejected by the seller, while a high price runs the risk of overpaying for a lemon. One way to mitigate this problem is to rely on the information he has about the seller's past behavior. If she had rejected a reasonable price in the past, it would indicate that her good is likely to be worth purchasing. However, access to such information is often limited. Regulation or market practice may not allow it, or relevant records may be difficult to obtain or verify. Nevertheless, a particular piece of information is often accessible: sellers' time-on-the-market. For example, the number of days that a given property has been on the market is publicly available in the real estate market. In

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