

How to Promote Trade in Durable Goods Markets: Evidence from the Used Car Market

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EEA Bordeaux 2025
Bordeaux School of Economics
August 2025

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- In frictionless economy, intermediaries have no role—yet in reality, they exist
- Prior research examined the role of intermediaries, typically focus on a setting with a single type of intermediary, and thus *cannot explain the coexistence of multiple types*
- This paper fills that gap by studying the coexistence of two distinct intermediary types in the car market: leasing companies and car dealers

Research questions

- 1 Why do multiple intermediary types coexist (e.g., leasing firms and dealers)?

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- ③ What can policymakers and firms learn from intermediary dynamics?

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 - ▶ Includes both theoretical and empirical analysis
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- I then *test these predictions* using difference-in-differences (DiD) regressions
- Finally, I estimate the model using the Method of Simulated Moments (MSM)

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- Both leasing companies and car dealers may facilitate trade, but they are imperfect substitutes
- The exogenous tax change that increase sharply leasing costs led to greater use of dealers, but also to a decline in turnover, reducing overall efficiency
- Structural estimation shows that individuals have heterogeneous trading frictions and that the welfare loss exceeds the revenue gain from the tax

Roadmap

① **Background & institutional details**

② Theoretical framework

③ Data and empirical analysis

Unique features & market structure of durable goods

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- Literature attributes low turnover to *trading frictions* (“*trading / transaction costs*”)
- Unique *market structure*:
 - ▶ Consumers can either *purchase* or *lease* the good
 - ▶ Used versions of the goods are resold in secondary markets
 - ▶ Secondary markets suffer from significant *trading frictions*
 - ▶ These frictions also influence decisions in the primary market

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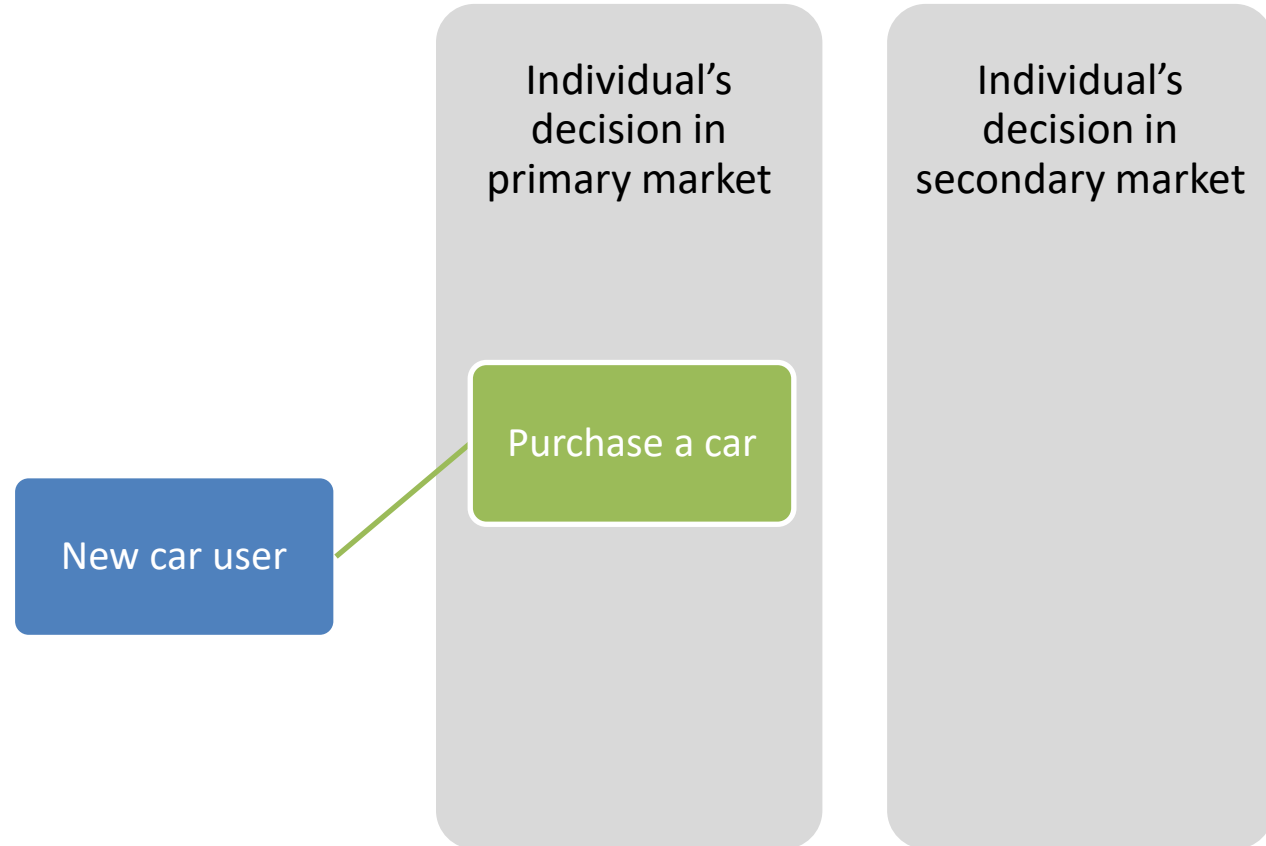
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 - ▶ Individuals who sell their used car also purchase a new one
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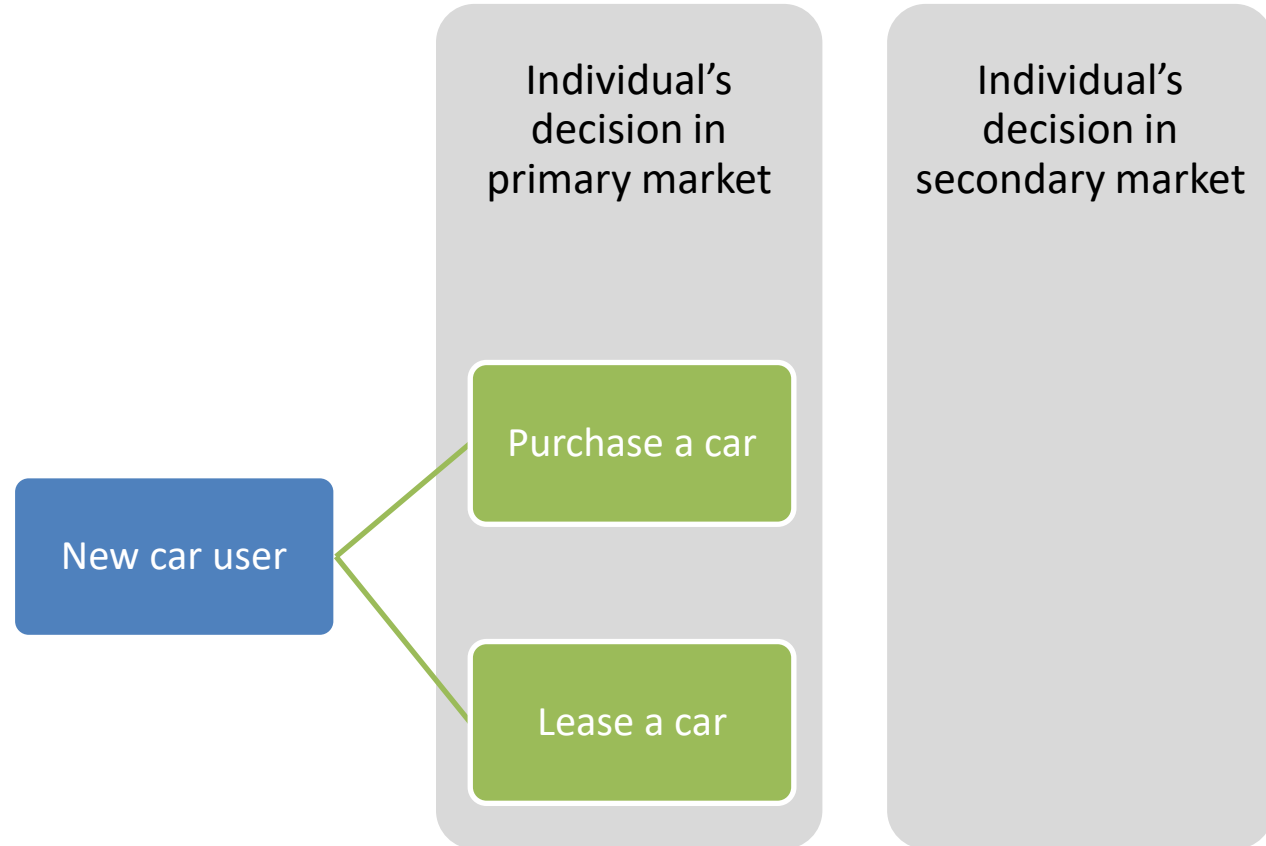
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 - ▶ Individuals who sell their used car also purchase a new one
 - ▶ Individuals take it into account their future trading costs
 - ▶ In practice, individuals who wish to consume a new car over time *choose from 3 “bundles”*: (1) buy new, resale independently; (2) Buy new, resale via dealer; (3) *Lease* a new car

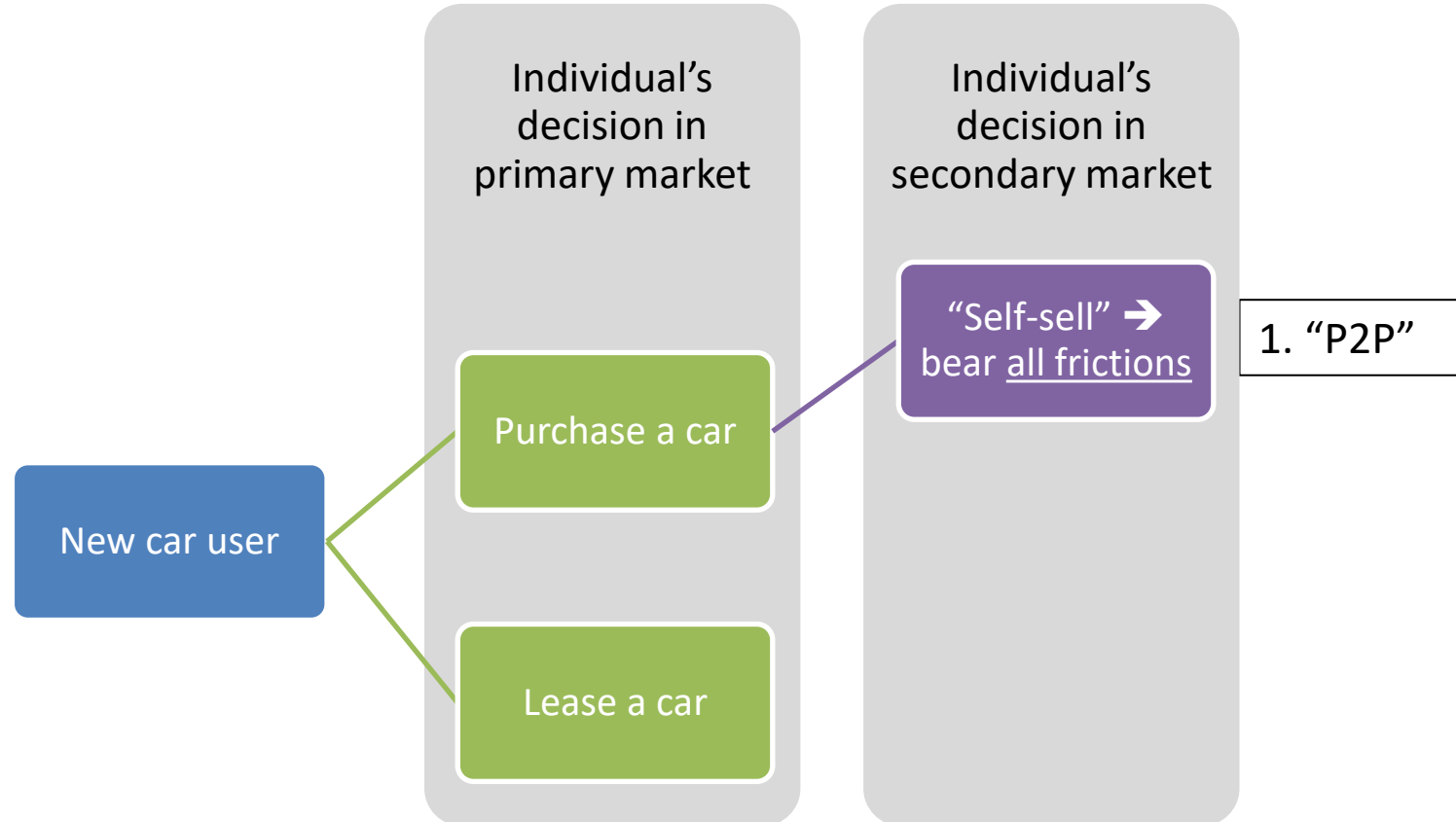
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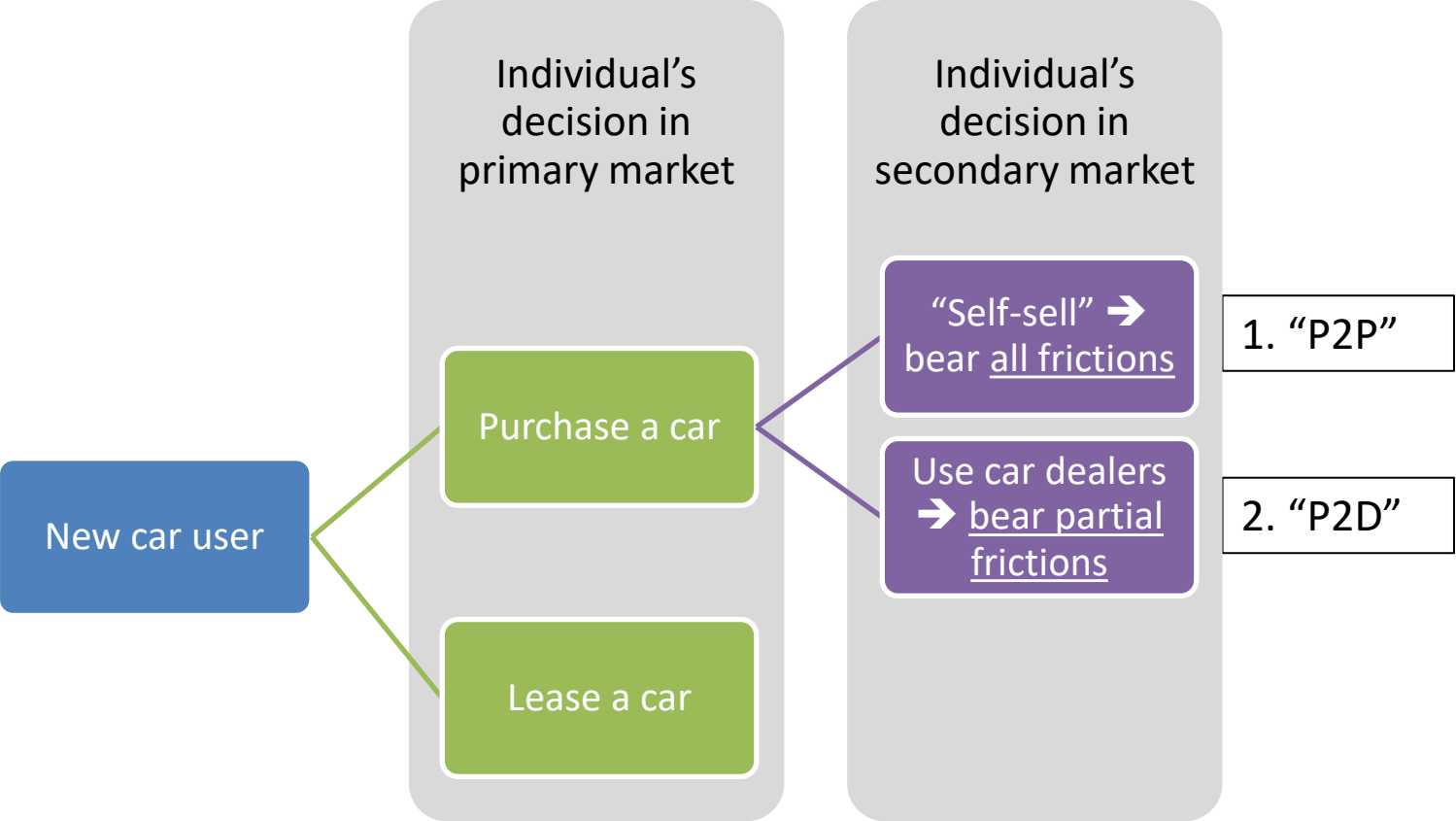
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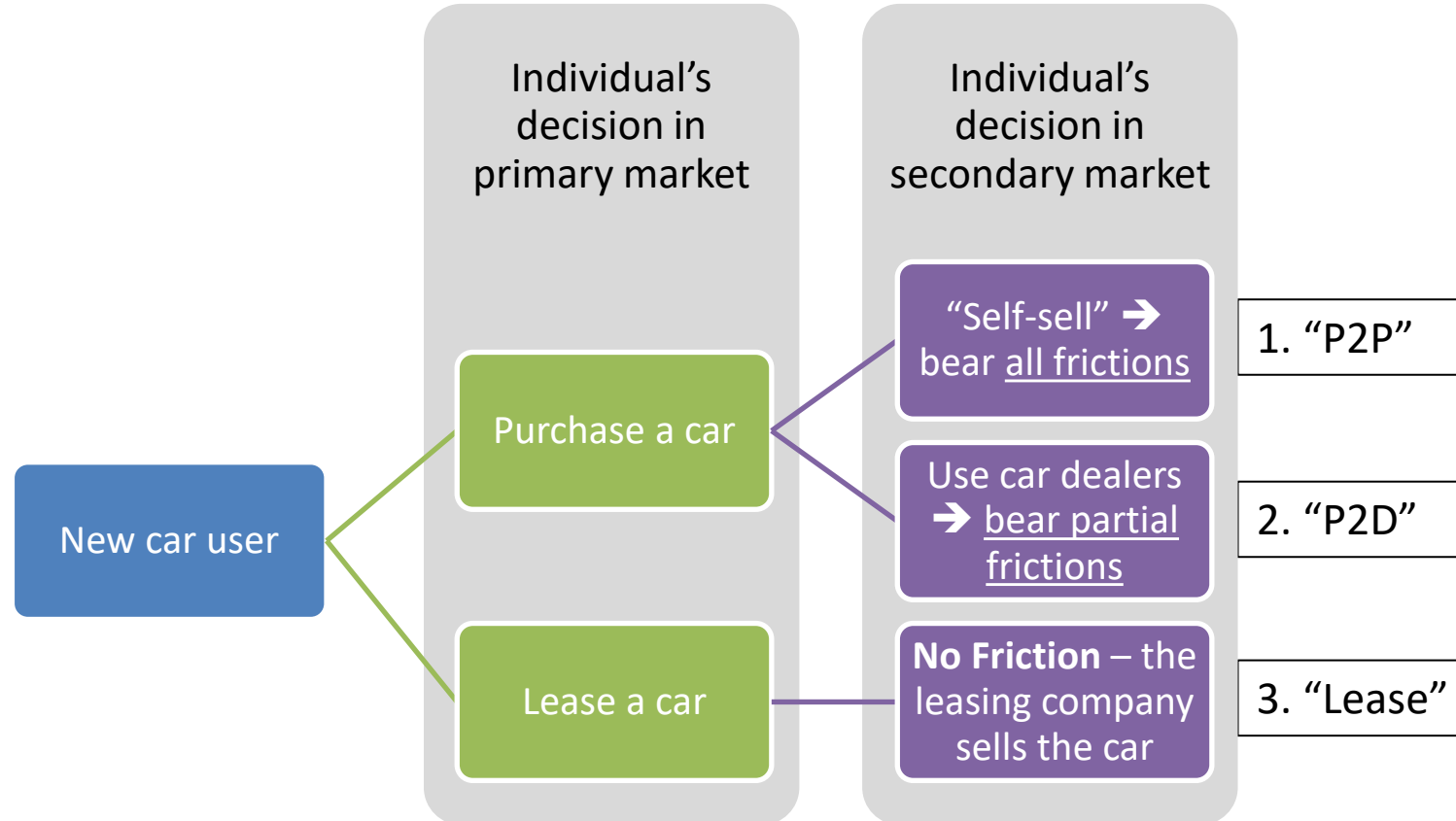
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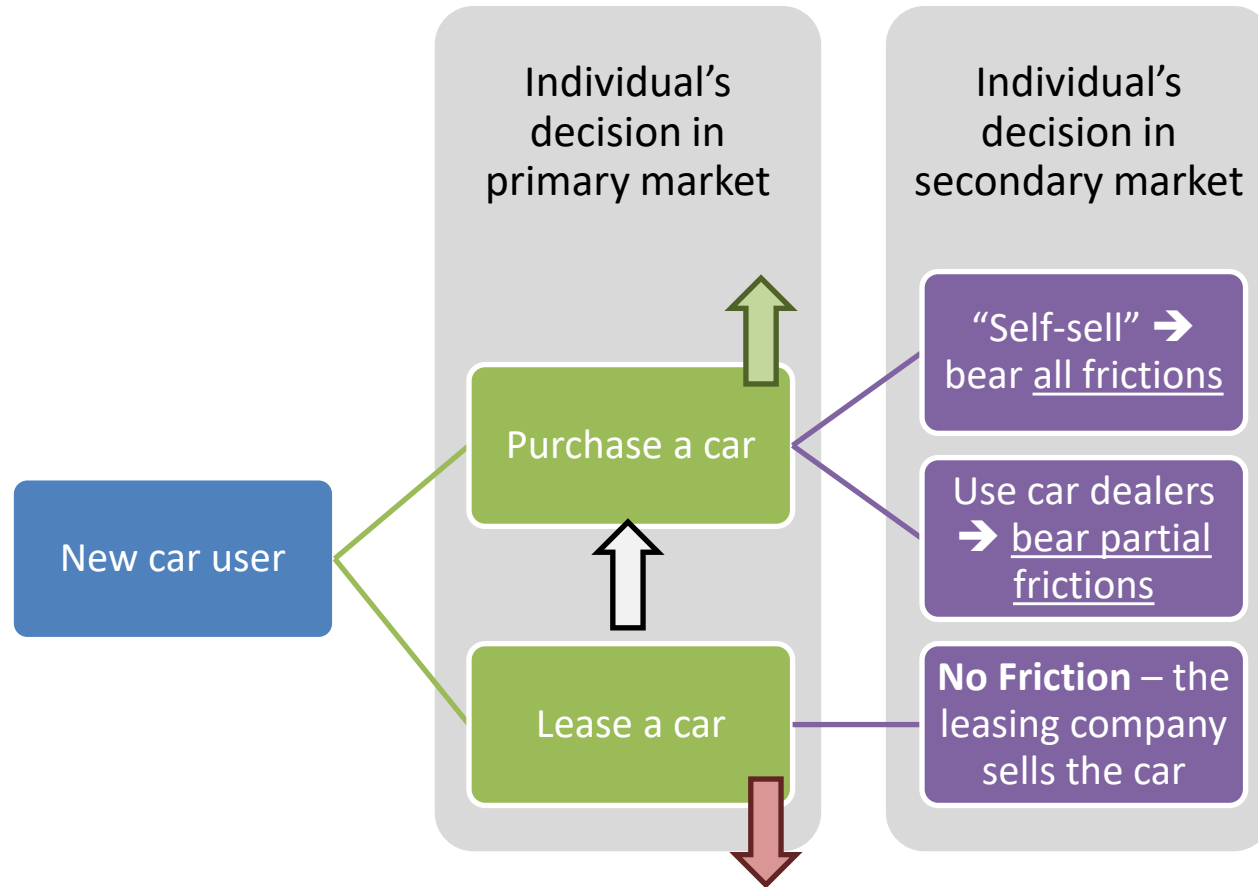
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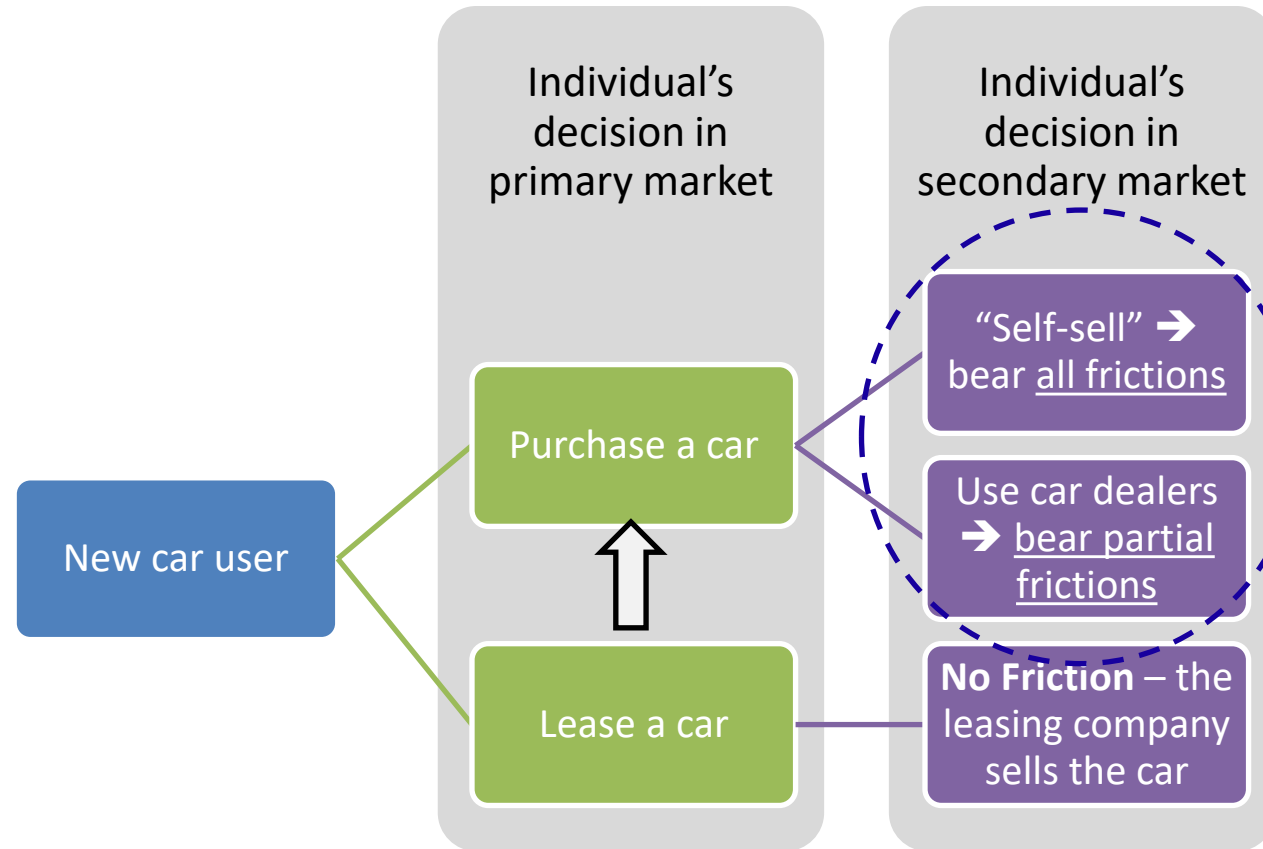


Institutional details (2/2)



- The 2010-11 tax change doubled the tax on leased vehicles with a list price below ~\$55K
- As a result, the share of new cars purchased by individuals rose from 44% in 2009 to 56% in 2014, at the expense of leasing

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This paper focuses on the effect of the tax change on the secondary market:

- 1 How do individuals who shift from leasing to purchasing new cars dispose of their vehicles? Will they sell *privately (P2P)* or through *dealers (P2D)*?
- 2 What is the impact on trade volume and allocation efficiency?

Roadmap

- ① Background & institutional details
- ② **Theoretical framework**
- ③ Data and empirical analysis

Theoretical framework – background

- Build on existing trade models in durable goods markets (e.g., Hendel & Lizzeri 1999; Peterson & Schneider 2017)
- Two types of goods: new and used
- Individuals differ in their taste for quality (θ_i)
- While θ is continuous the literature divide individuals into two distinct groups:
 - ▶ Individual with high taste for quality (high θ) buy new goods and replace when quality drops and individual with low taste for quality purchase used goods
- High θ individual = individual who “always want to upgrade” in frictionless market:
 - ▶ $(\text{Utility gain})_i \geq (\text{Cost}) \forall i$ with high taste for quality
 - ▶ *Empirical implication*: 100% resell turnover each period

Simple model of trade – effect of homogenous TC

- In absence of trading frictions, buyer upgrades if:

$$\underbrace{\theta(Q^n - Q^u)}_{\text{increase in utility}} > \underbrace{(P^n - P^u)}_{\text{upgrading cost}} \Rightarrow \theta^{*FT} > \frac{P^n - P^u}{Q^n - Q^u}$$

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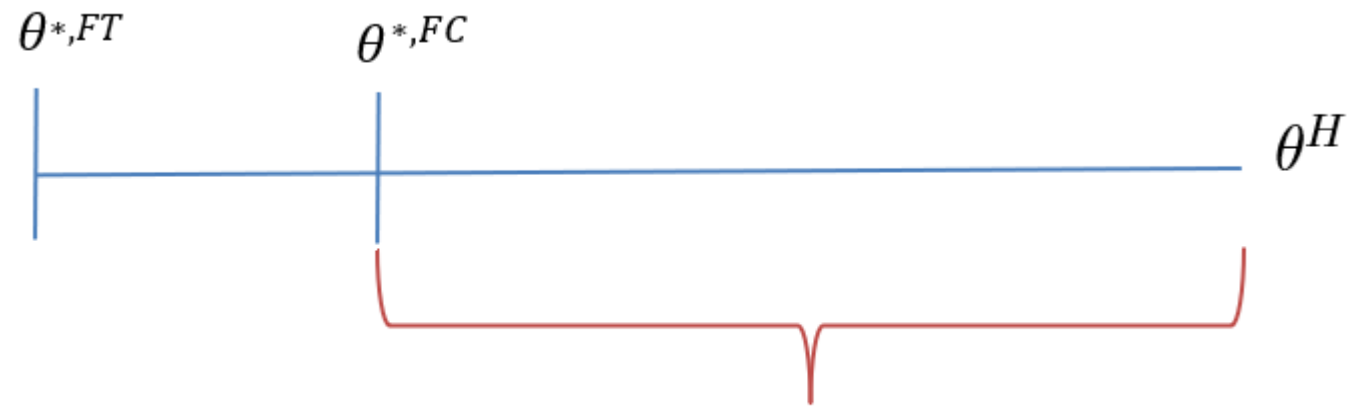
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Individual that upgrade with frictions

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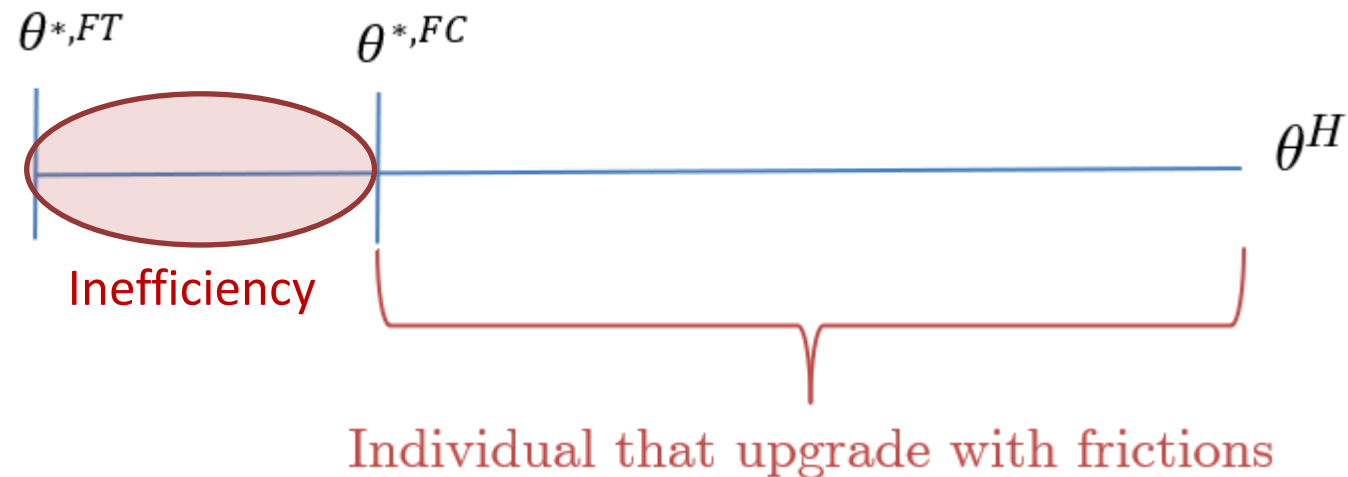
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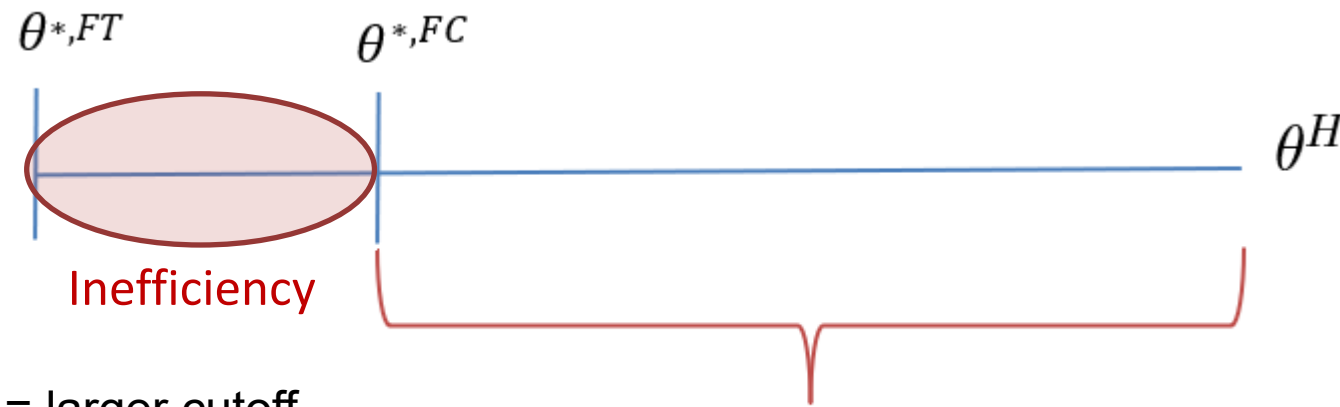
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Larger c = larger cutoff
= lower resale-rate

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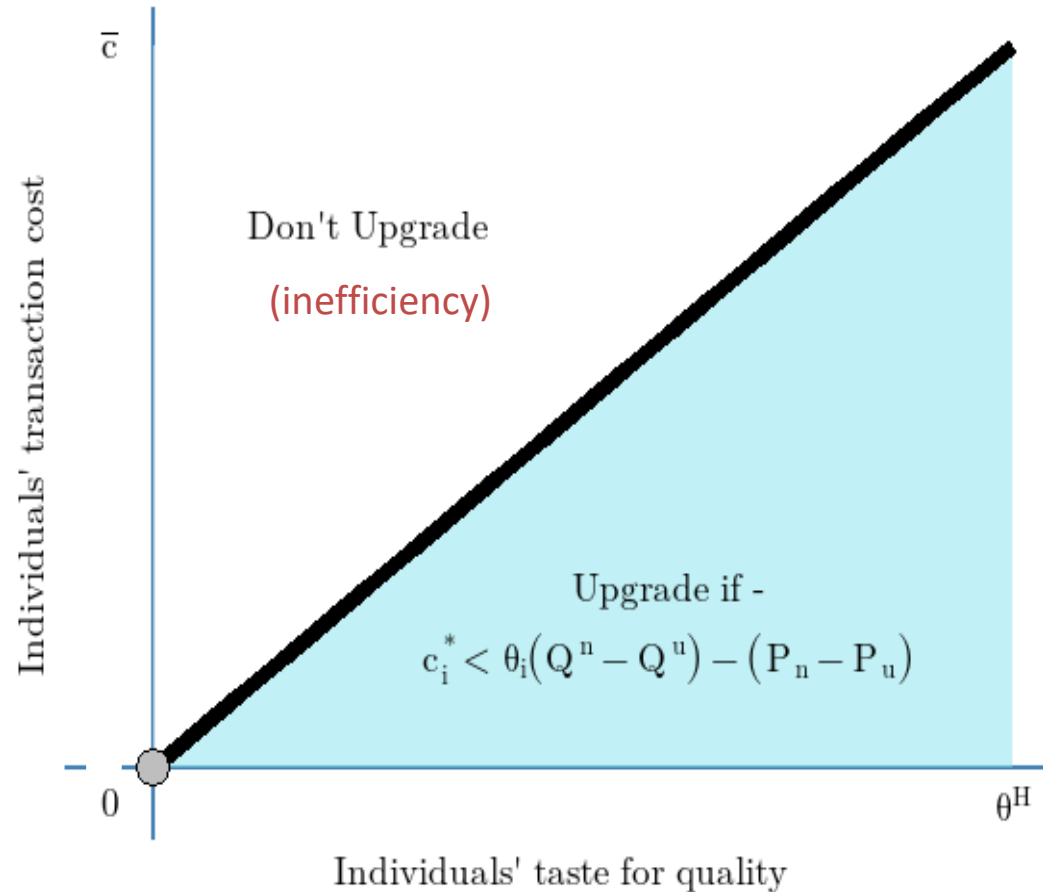
Extensions

Heterogeneous trading cost

- Assume heterogeneous trading costs, $c_i \sim [\underline{c}, \bar{c}]$, with $\underline{c} \geq 0$
- Now, the decision rule includes *two variables* that vary with the individual's index i :

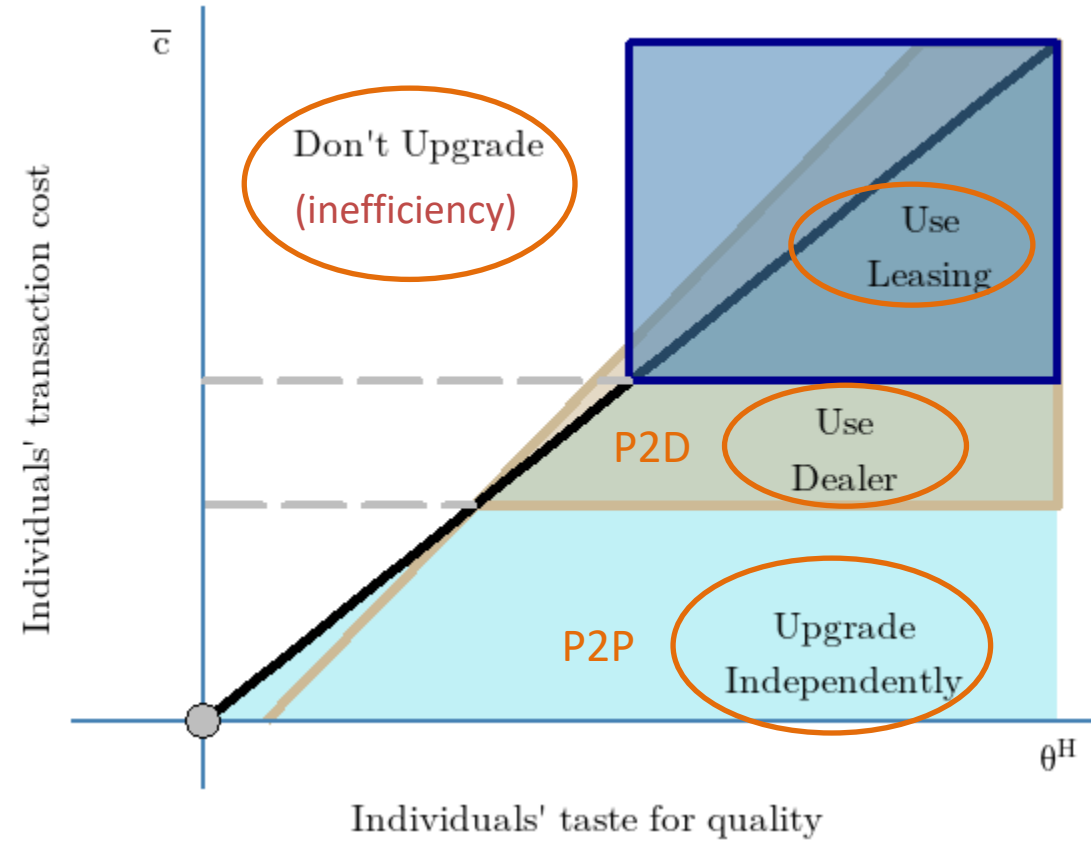
$$(1) \theta_i(Q^n - Q^u) \geq P^n + c_i - P^u$$

$$c_i^{*,Self} \leq \underbrace{\theta_i(Q^n - Q^u)}_{\text{Utility gain of new vehicle}} - \underbrace{(P^n - P^u)}_{\text{Monetary cost of upgrade}}$$



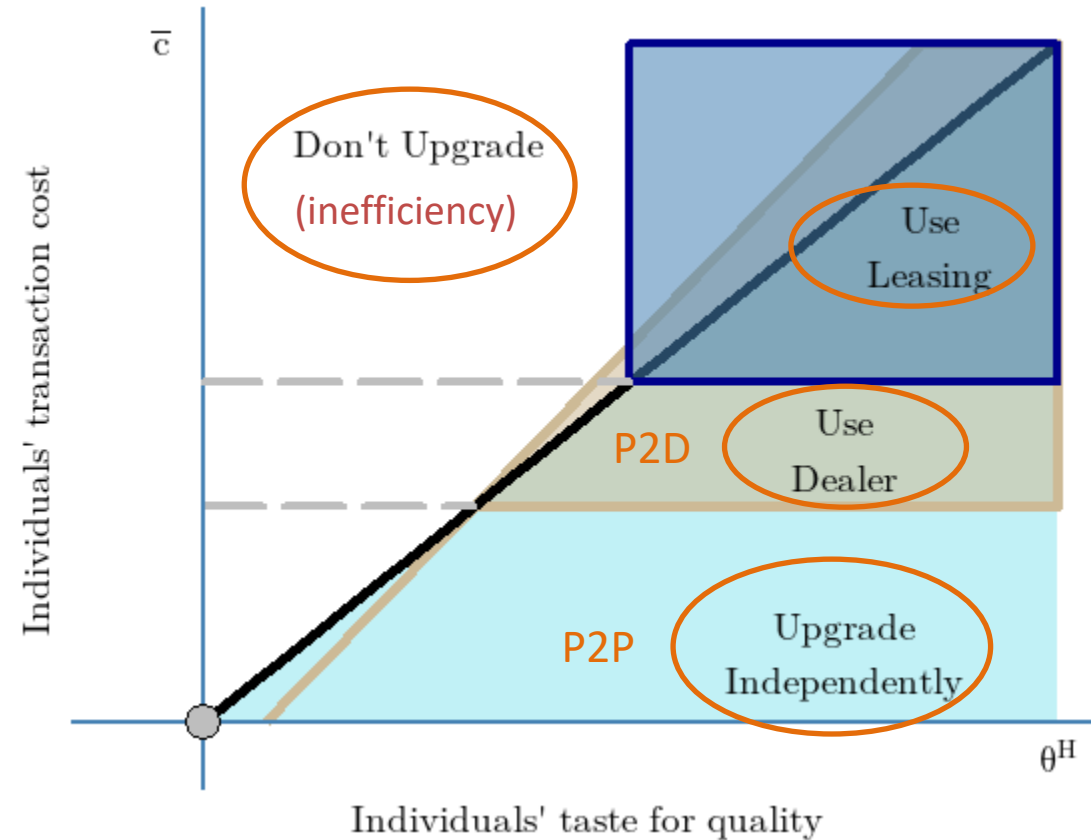
Market outcomes with leasing companies & dealers

- Both leasing companies and car dealers may reduce inefficiency and enhance turnover



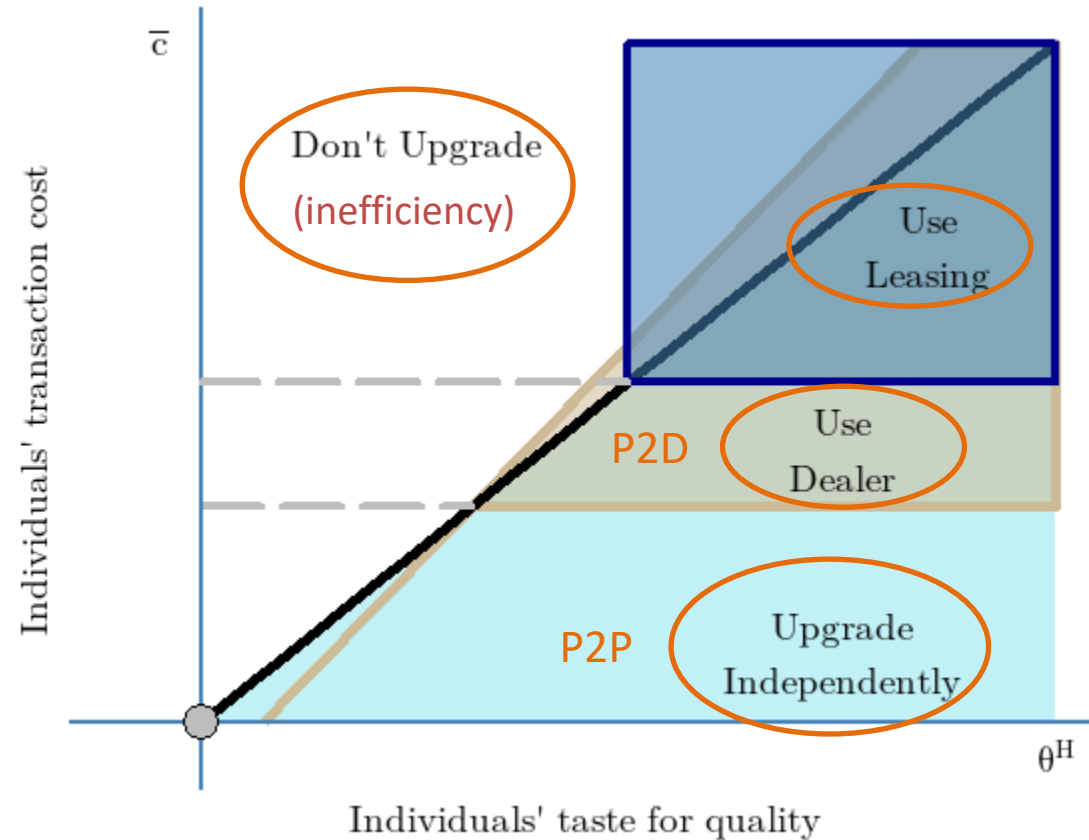
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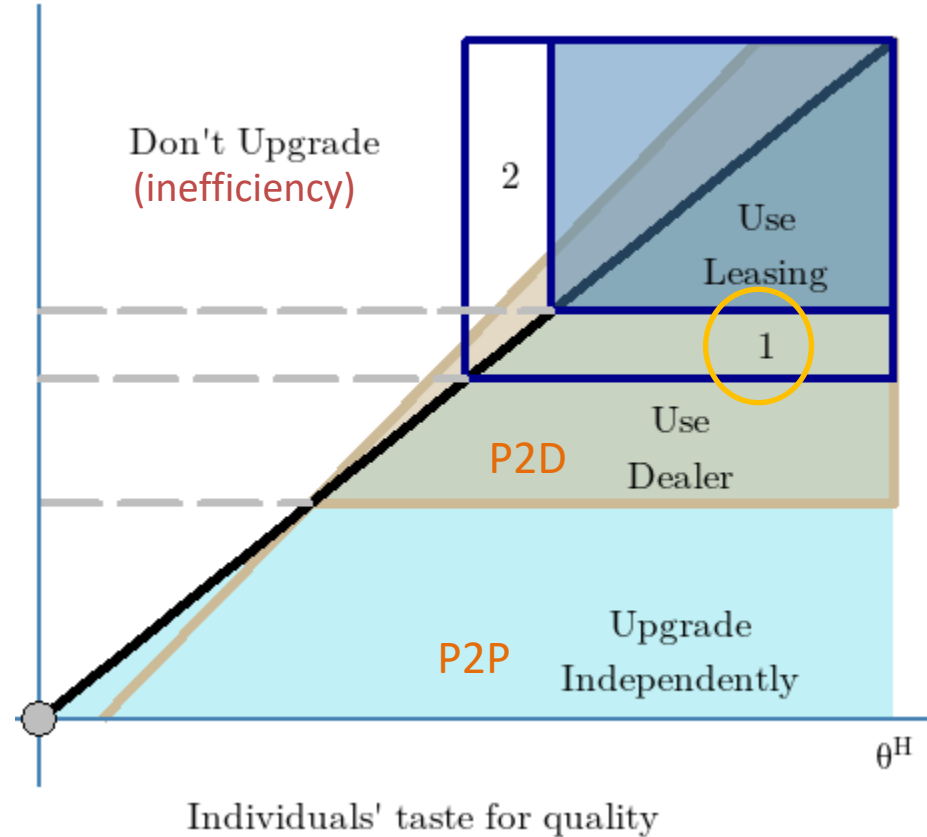
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- Individuals' choices shaped by:
 - ▶ Individual trading costs c_i
 - ▶ Individual taste for quality θ_i



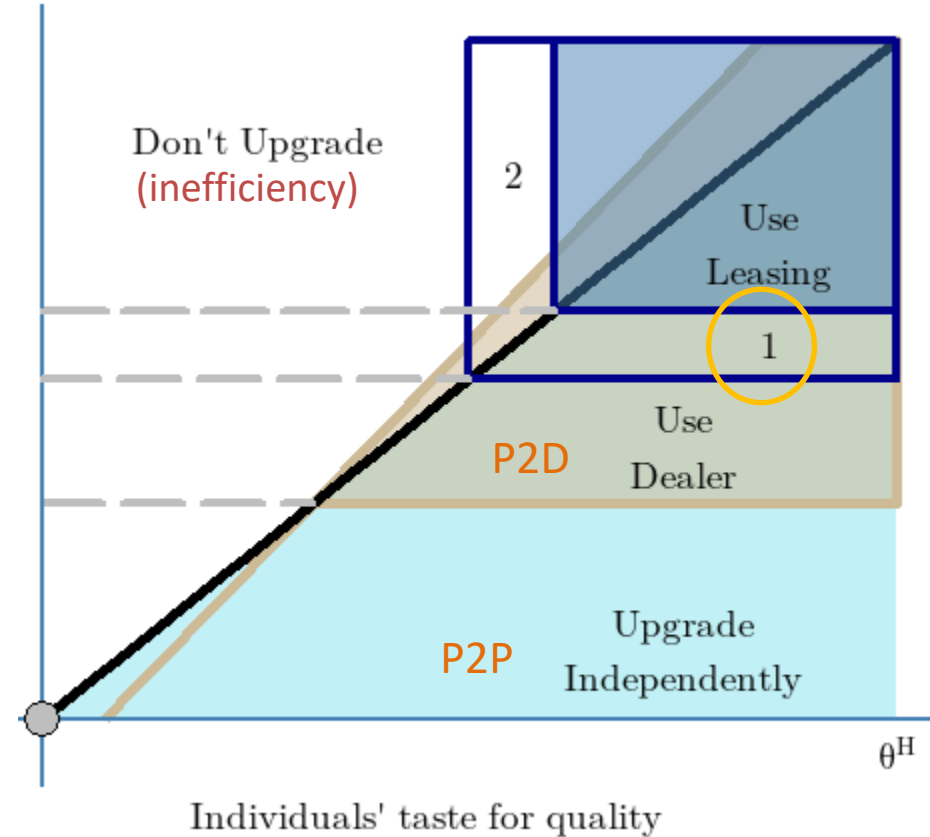
Testable predictions for the effect of the tax change

- **H1:** “Substitution effect” – individuals in “Area 1” shift from leasing to dealer-assisted resale (P2D) – empirical implication: *an increase in P2D transactions*



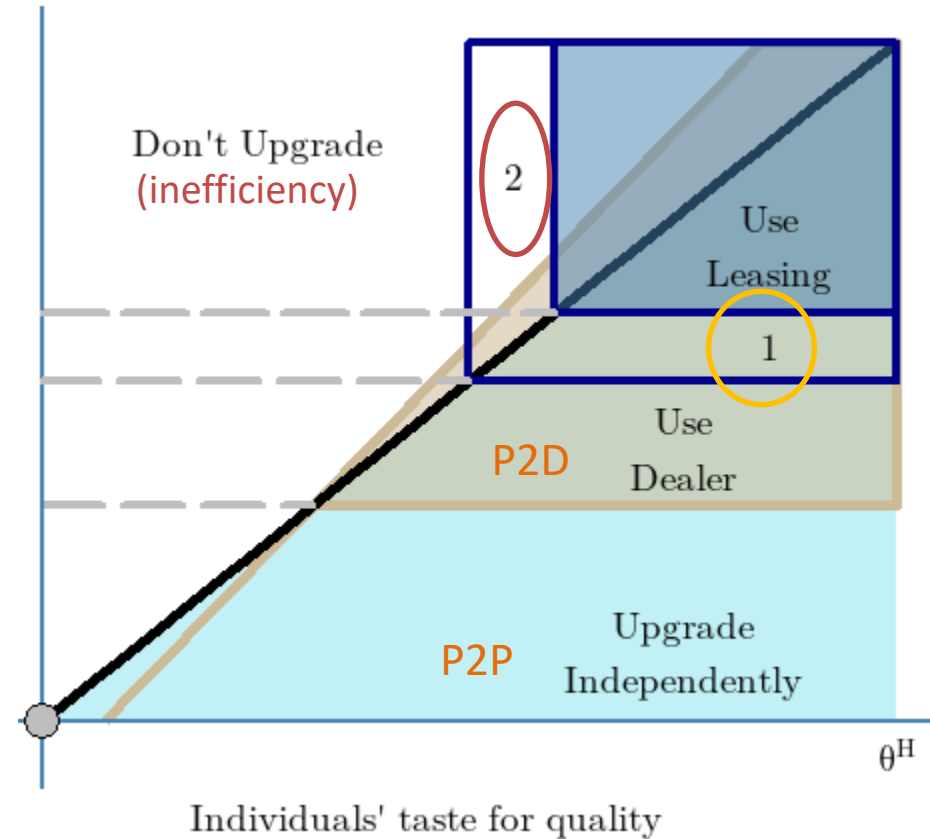
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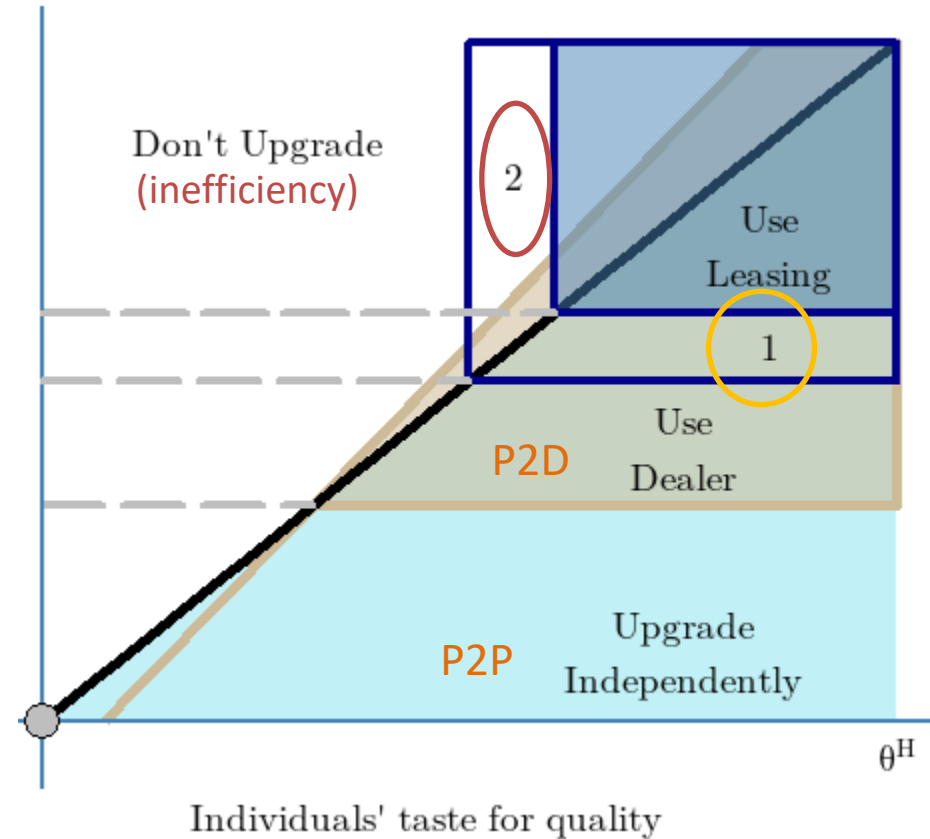
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- **H3:** Lower resale rate of new cars post-tax change (“Area 2”)

Note: H1 & H2 focus on P2D transactions; H3 on the entire market



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- ③ **Data and empirical analysis**

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 - ▶ The control group comprises vehicles priced above \$55K

Empirical strategy

- Test the model hypotheses using a difference-in-differences regression:

$$y_{i,t,k} = \beta_0 + \beta_1 \times (Group_k) \times (POST_t) + \beta_2 Group_k + brand_i + quarter_t + \epsilon_{i,t}$$

Where $y_{i,t,k}$ is:

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Where $y_{i,t,k}$ is:

- ▶ H1: share of dealers & ln(# of transactions)
- ▶ H2: age on resale
- ▶ H3: resale rate

Main results

	H1		H2	H3
	(1)	(2)	(3)	(4)
Dependent variable	ln(transactions)	% of dealers	Age on Resale	Resale Rate
Estimation Approach	DID	DID	DID	DID
DID = After * Treat	0.508*** (0.068)	0.101*** (0.012)	-0.202*** (0.034)	-0.052*** (0.012)
After				
Treat	2.357*** (0.061)	-0.062*** (0.012)	0.136*** (0.035)	0.120*** (0.011)
Year — Quarter FE	Yes	Yes	Yes	Yes
Manufacturer FE	Yes	Yes	Yes	Yes
Observations	1,666	1,666	1,666	1,823
Adjusted R-squared	0.844	0.506	0.237	0.230

- # of P2D transactions +50% ; share of dealers +10 percentage points
- Avg age-on-resale declined by 2.4 months, “marginal” age 6 months
- Resale rate declined by 5.2%

Estimating the model's parameters

Individuals' decision rule

- Based on the model, the decision rule for each individual i is:
 - ▶ Choose Lease, if $\theta_i > \frac{P^n + L - Q^u}{Q^n - Q^u}$ & $c_i > \frac{L - D}{1 - \gamma}$ (eq. 4-5), else
 - ▶ Choose P2D, if $c_i \leq \theta_i \frac{(Q^n - Q^u)}{1 - \gamma} - \frac{P^n + D - P^u}{1 - \gamma}$ & $c_i > \frac{D}{\gamma}$ (eq. 2-3), else
 - ▶ Choose P2P If: $c_i \leq \theta_i(Q^n - Q^u) - (P^n - P^u)$ (eq. 1), else
 - ▶ Choose Unsold (if no condition is fulfilled)

Structural estimation

- Employing a two-step strategy for estimation:
 - ▶ First-step: calibrate parameters which can be cleanly identified / assumed without using the model

$$\hat{\chi} = (\underbrace{P^n, P^u}_{observed}, Q^u = P^u, Q^n = 0.95P^n)$$

- ▶ Second step: search for optimal vector $\hat{\Delta} = (\hat{\Delta}_1, \hat{\Delta}_2)$ that minimize deviation between simulated moments and moments in the data (Method of Simulated Moments)
 - $\hat{\Delta}_1$ include the *heterogeneous* variables θ_i & C_i
 - Assumption: θ_i & C_i follow a normal distribution
 - $\hat{\Delta}_1 = (\mu_\theta, \sigma_\theta, \mu_c, \sigma_c)$
 - $\hat{\Delta}_2 = (L, D, \gamma)$ *homogenous* parameters

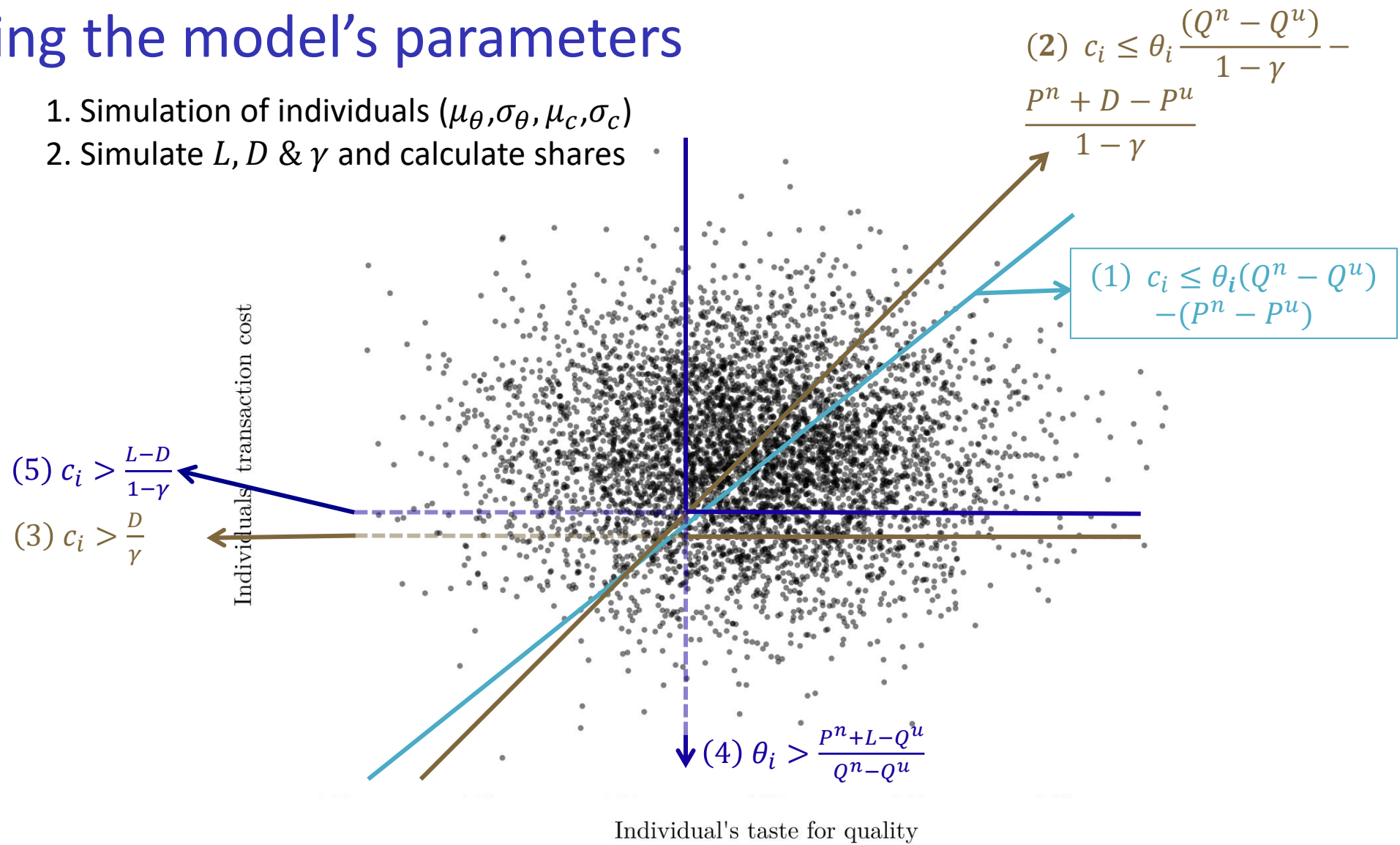
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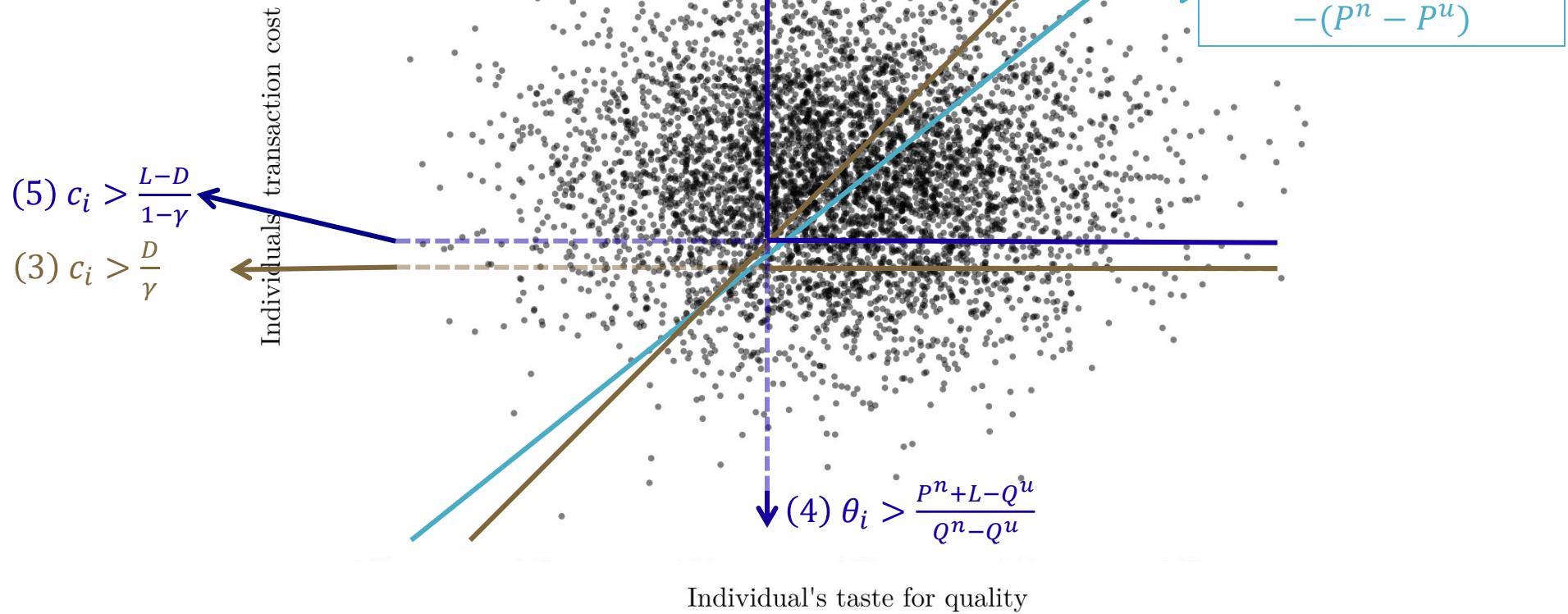
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2. Simulate L, D & γ and calculate shares

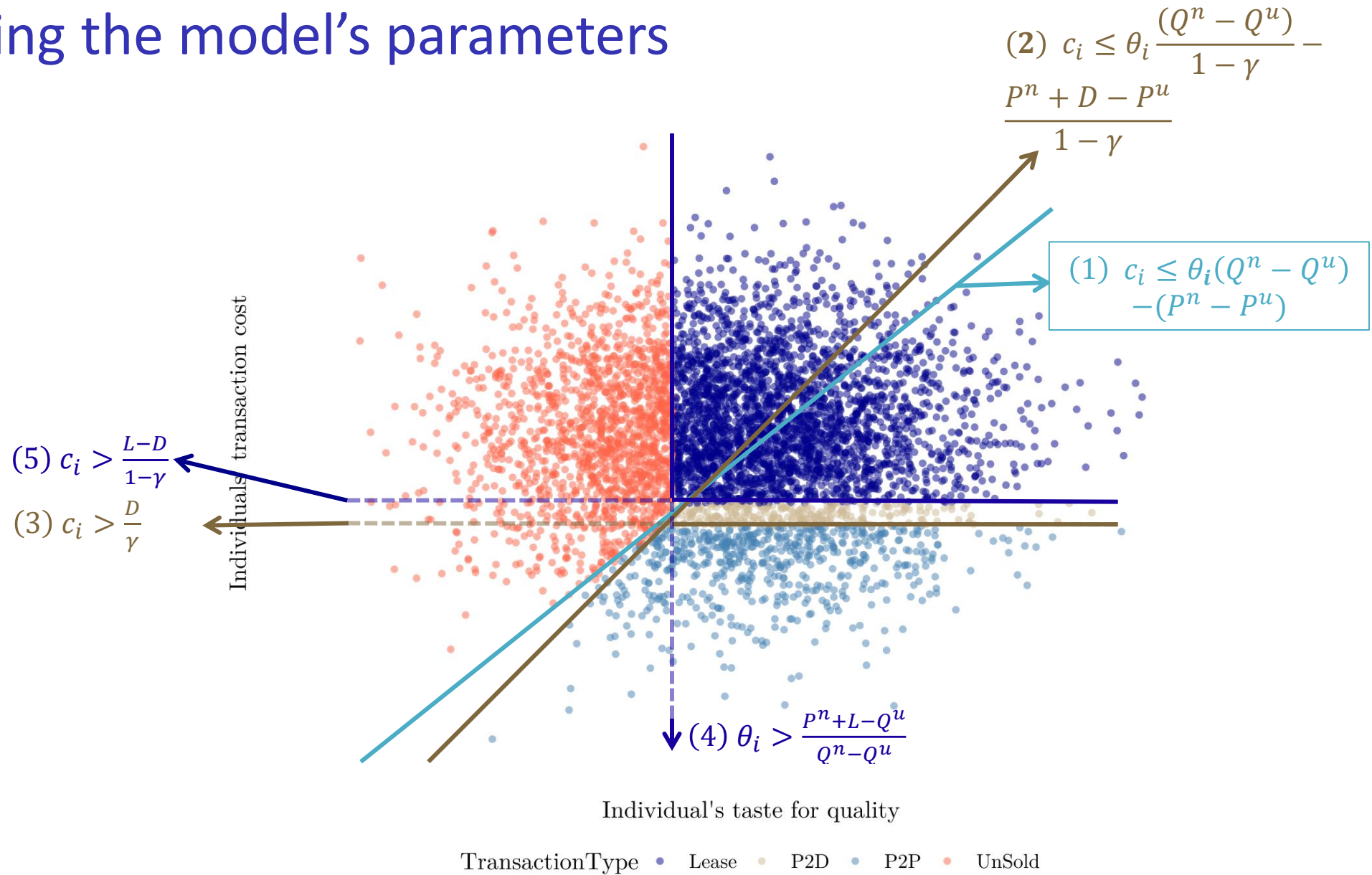


Estimating the model's parameters

1. Simulation of individuals $(\mu_\theta, \sigma_\theta, \mu_c, \sigma_c)$
2. Simulate L, D & γ and calculate shares
3. Search for $\mu_\theta, \sigma_\theta, \mu_c, \sigma_c, L, D$ & γ that minimizes error

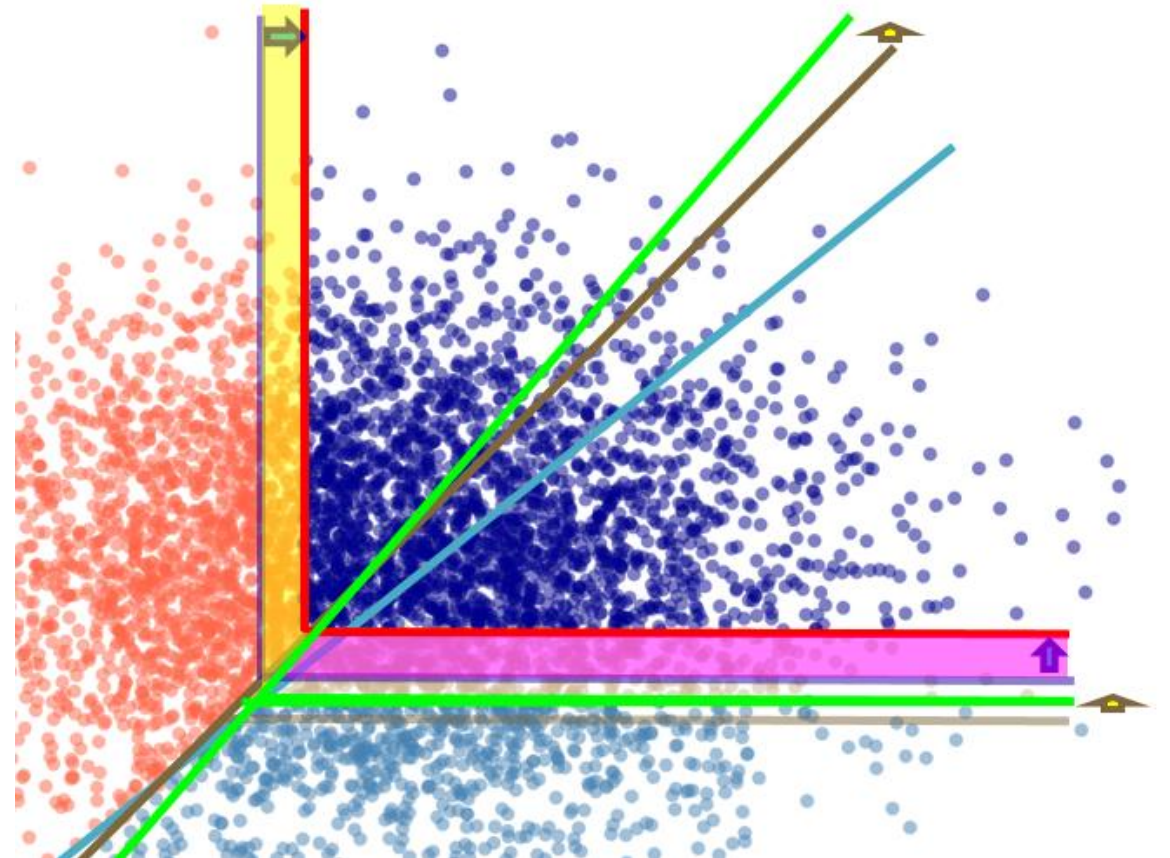


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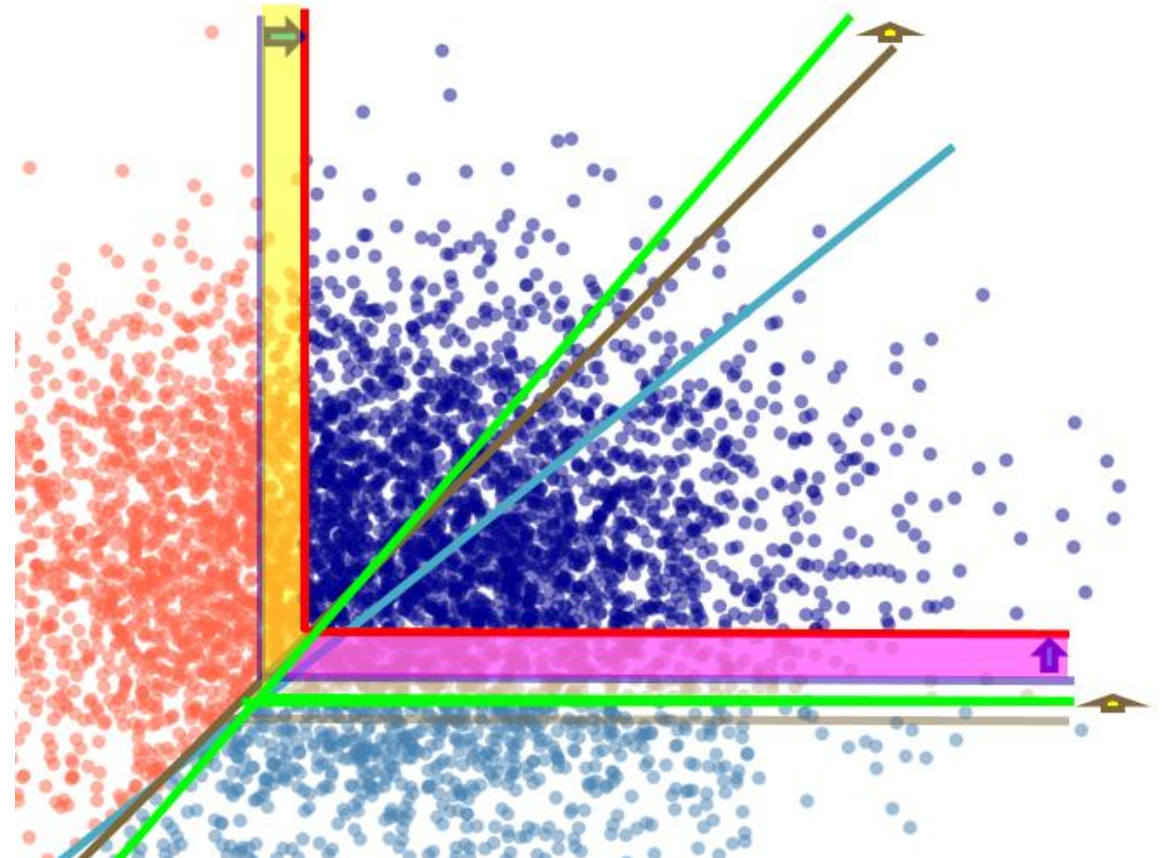
Did the tax change improve welfare?

- Tax collection:
 - ▶ Overall tax revenue increased by ~\$85m



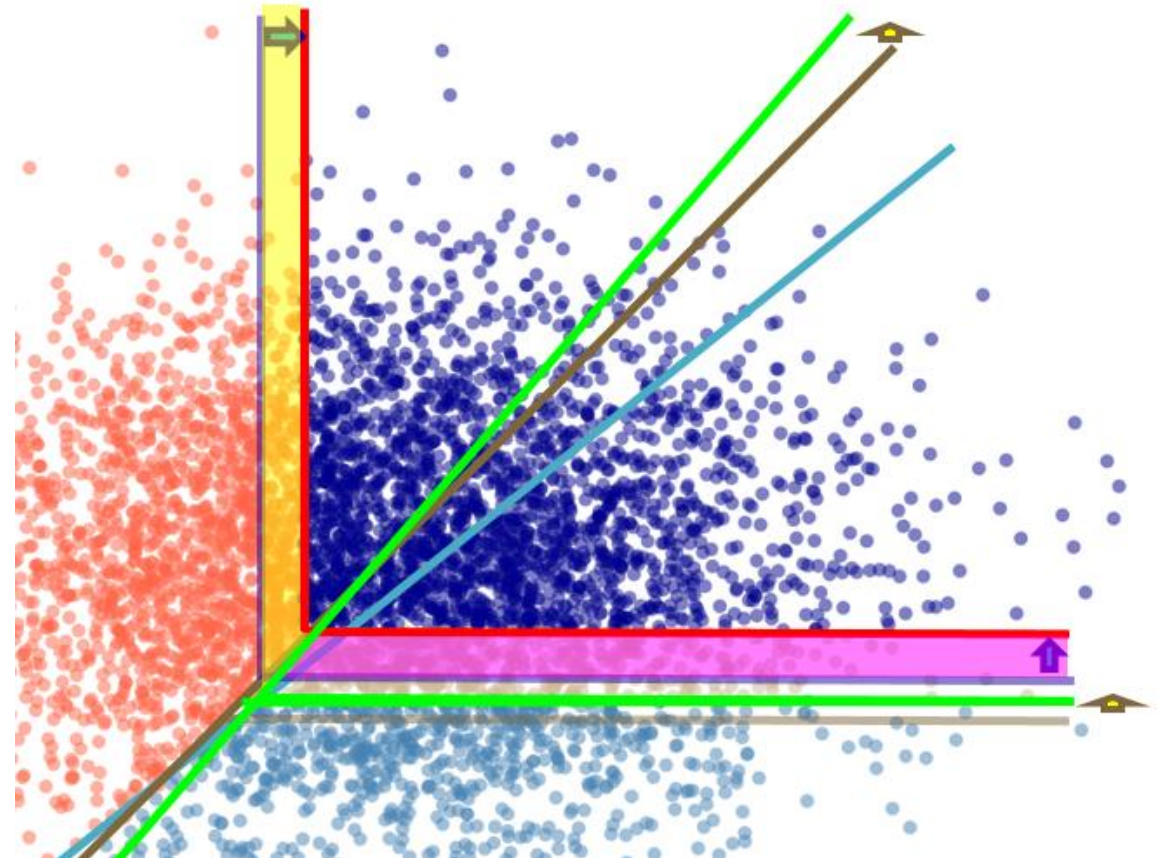
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- Utility loss:
 - ▶ Inefficient allocation costs ~\$115m (yellow area)



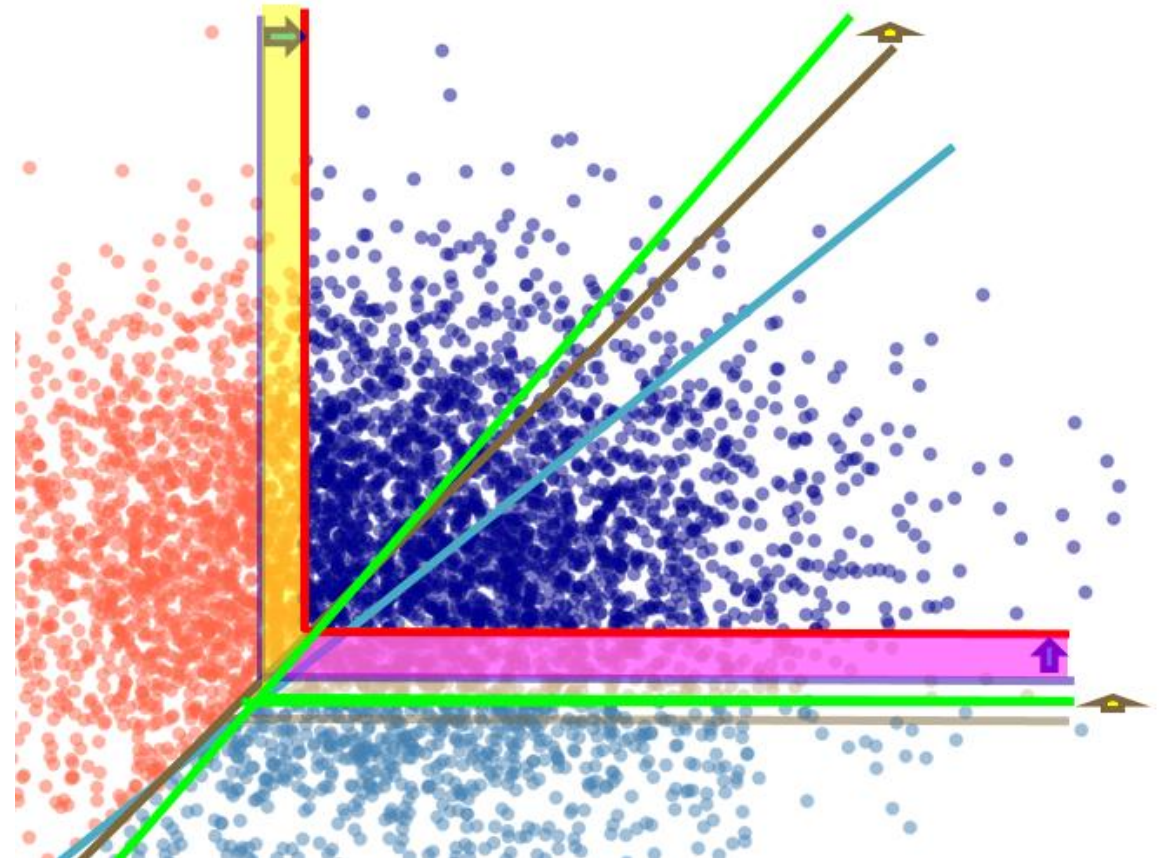
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- Different type of intermediaries serves different individuals
- Policymakers should consider the effect of their policies also on the secondary markets
- Entrepreneurs could identify untapped market opportunities by understanding individuals' transaction costs better

Thank you!

Comments are welcome at:

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