Referee Report on
Experience goods and provision of quality
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Description

This note studies a model of a market for lemons in which each seller in a unit mass of sellers decides the quality (high or low) of the unit good he produces and sells by auction. Buyers arise randomly at each auction (according to a Poisson whose lambda is equal to the mass of buyers), observe a signal of the good's quality, and bid. In the equilibrium of a single buyer auction, the buyer bids zero and wins the object; in the equilibrium of a multiple buyers auction, buyers bid their reservation value. Thus, an equilibrium of the market is identified by the fraction ω of sellers who choose to produce a high quality unit. Kultti solves the indifference equation that identifies ω as a function of the mass of buyers, the precision of the signal, and the differences in value and cost of high and low quality, and shows that under some parameter restrictions there are two equilibria that can be ranked by the surplus they generate. The solution to the central planner's shows that the most efficient equilibrium is inefficient. Numerical exercises illustrate how the relative efficiency of the efficient equilibrium, as well as the differences in efficiency of the two equilibria, depend on the measure of buyers and the signal's accuracy.

Assessment

The paper presents and interesting exercise illustrating the impact of adverse sellection, and showing the effects of the accuracy of the signal and the size of demand. I do not understand why Kultti chooses to explore the conclusions via numerical exercises rather than studying the comparative static properties of equilibrium, given that he obtains equilibrium in closed form. Perhaps this is more difficult that I presume. Also it would have been interesting to consider the case where each buyer gets an independent signal of quality, rather than all buyers observing the same signal; this would make the equilibrium calculation more interesting – I suppose one has to avoid the winners' course. Also, the paper's presentation can be improved with a bit more work. In any case, whether the author chooses to pursue any of these suggestions, I think this note is informative and interesting, and deserves to be published.