Commitment Costs and the Basic Independence Assumption: Evidence from the Field

John List

Enterprises

Have I got a deal for you!

Commitment Costs and the Basic Independence Assumption: Evidence from the Field

Or

Have We Been Observing Dynamic WTP & WTA's, But Interpreting Them as Static?

Our Story

Non neoclassical explanations for WTP-WTA disparity pose significant challenge to welfare analysis

Standard neoclassical derivation of WTP and WTA static, but consumers live and act in a dynamic world

Is there a dynamic explanation for the disparity? Is it present in a real transactions?

A Static WTP Story

Story: Jojo considers buying a sports card. Jojo would like to impress his economist friends at a party in 3 weeks with a sports card, but the dealer looks pretty shady….

Jojo assesses:

50% chance of bragging rights = $G,
50% chance that List is ripping him off, value= $0

Simple expected value is $G/2 = Jojo's max WTP for the card

A Dynamic WTP Story

Suppose

- In 2 weeks, can get advice on value from his expert friend
- Knows the dealer will still be here in 2 weeks with same or equivalent card
- Can't easily resell the card if he buys it today

What is his max WTP today? $0

WTP does not equal expected surplus!

A Dynamic WTA Story

New Story: Jojo finds a card in his attic. Jojo's neighbor (John List) offers to buy it for $G/2, standing offer.

Scenario:
•50% chance the card is worth $G
   to a dealer
•50% chance the card is junk

In 2 weeks he can attend a card show and
   find out for sure.

What is Jojo's WTA to sell today? $G

Can this Story Explain Experimental and CVM Disparities?

- Be uncertain about value, but have some ability to learn in future

- If so, clear predictions from theory

  1. WTP increases in perceived difficulty of delay

intuition: if costly to wait and buy later, WTP more now

  2. WTP decreases in perceived difficulty of reversal

intuition: if costly to sell if made mistake, WTP less now

Comparative Statics for WTA

1. WTA **de**creases in perceived difficulty of delay

intuition: if costly to wait and sell later, WTA less now

2. WTA **in**creases in perceived difficulty of reversal

intuition: if costly to buy if made mistake, WTA higher

WTP and WTA depend critically on costs of delaying and reversing transactions

Specifically

1. WTA >> WTP   if costly to reverse, but easy to delay both
2. WTP>>WTA   if hard to delay, but easy to reverse both
3. WTA=WTP   if symmetric transaction costs
                          (delay cost in WTP= reversal cost WTA
                           and delay cost in WTA= reversal cost WTP)

Could compute these costs or simply ask participants their
   perception of how the ease of reversal and delay

Question:Have we been observing dynamic WTP & WTA's, but interpreting them as static?

- Can we find evidence of dynamic behavior in formation of WTP and WTA values?

- Is this dynamic behavior consistent with WTP/WTA "anomaly"?

Empirical Investigation

Market: Sportscard show in Baltimore, Oct 2001

Good: Cal Ripken, Jr 1983 Topps baseball card

BDM: Nth Price Auction

1. Each participant submits bid (offer)

2. Each bid/offer ranked from low to high

3. Monitor randomly draws n [2, T]

4. WTP: monitor sells 1 unit of good to each
   of n-1 highest bidders at nth price

   WTA: monitor buys from each of n-1 lowest
   offers and paths nth lowest price