FOCUS

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THE USED CAR RIP-OFF

by

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The sale of a used car is a classic stereotype of consumer fraud in America. And, indeed, only 3% of the public (less than for any other industry) seem to feel that the used car industry is doing a good job of serving the consumer.

The quality of the used car market is, however, more than a laughing matter. It is a $33 billion-a-year industry—as large as the new car market. It is also an industry that is relatively important to the well-being of the poorer of us. Next to housing, the automobile is the most expensive purchase most people make. And the poorer you are the more likely it is that you will have to make that purchase in the used car market. In spite of all this there has historically been no reliable study of the extent or nature of the exploitation in the buying and selling of used cars.

A new data source now permits examination of this and an important related issue. As the prices of new cars skyrocket, more middle income buyers can be expected to enter the used car market. It is reasonable to expect these more affluent buyers to exert greater leverage, financial and otherwise, to get fair treatment. This, in turn, can be expected to produce more regulation of standards in the industry. The question is: Does increased regulation improve the quality of the market?

A trend toward more regulation is already apparent. And the institution of minimum performance standards and consumer disclosure for used cars in Wisconsin presents the opportunity to look for answers to this question.

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The purpose of FOCUS is to acquaint a wide audience with the work of the Institute for Research on Poverty, by means of short essays on selected pieces of research.

The material in any one issue is, of course, just a small sample of what is being done at the Institute. It is our hope that these summaries will whet the appetite of the reader to learn more about the research itself, and more about other research on poverty—an area of vital social concern—by Institute staff.

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The Data

The Federal Trade Commission awarded a contract to the Center for Public Representation in Madison[1] to assess the effect of Wisconsin's 1974 used car disclosure law in raising the fairness standard in the Wisconsin used car market. This law requires dealers to inspect used cars before sale, to repair safety-related defects, and to disclose other defects to the consumer. In fulfillment of this contract the Center surveyed more than 1,000 used car buyers in Wisconsin (both before and after the law went into effect) and in the neighboring states of Iowa and Minnesota. The focus of the study for the FTC, carried out for the Center by David Trubek and John R. Nevin, was whether consumers in the aggregate got greater value per dollar in the used car market after the law went into effect than before. (The deterrent effect of the disclosure system does seem to have influenced dealer behavior in ways that benefit consumers as a whole.) Additional research designed by Kenneth McNeil and conducted with Lauren Edelman and the original researchers used the information thus collected to look within the group called "consumers" to see whether some people did worse than others and, in particular, whether how well off you are affects how well you do in the used car market.

The Poor Do Pay More

The data from all three states (including both prelaw and postlaw data in Wisconsin) show that the poor do pay more for the purchase of a used car. This is true independently of the age and condition of the car, the age, sex, and other demographic characteristics of the buyer, or whether the car was bought from a dealer or a private seller. Those with annual incomes under $6,000 paid almost 5% more for the equivalent car than those with annual incomes between $12,000 and $18,000. They paid almost 10% more for the same car than those with incomes over $24,000 a year.

Even more startling, although the disclosure law in Wisconsin did improve the used car deals people of all income levels were able to get, it reduced the disparity among income groups not at all.

Why Do the Poor Fare Worse?

What is it that prevents the poor from doing as well as the nonpoor in purchasing a used car? After all, having less money to spend certainly makes the potential buyer need a better deal and can be expected to make that buyer go to greater lengths to get one.

Several possibilities come to mind. Perhaps the poor make their purchases in different markets. Do they trade with dealers more than the nonpoor, or is it the other way around? Perhaps their relative lack of means makes them more hesitant to complain. Do the poor make fewer complaints than the rest of us? Perhaps they are less aware of the defects in the cars they choose. Do the poor notice fewer defects in their cars, either prior to purchase or after they have got the car home? Perhaps they are less successful in getting recompensed for defects they do complain about. The answers the researchers got to these and other questions are instructive, and may be counterintuitive to some.

Kenneth McNeil, John Nevin, David Trubek, and Lauren Edelman, "Bargaining Power and Consumer Protection: The Poor, Used Cars, and Wisconsin Disclosure Law," Institute for Research on Poverty Discussion Paper no. 486-78.

The markets they deal in. The evidence shows that those who trade with a dealer get a worse deal than those who buy from a private seller. But this is not the answer to our income difference puzzle, because the poor buy from dealers at the same rate that the nonpoor do.

Their willingness to complain. The poor do not complain less (or more) than the rest of us, at least not about their treatment in the used car market. Of the 395 buyers in the sample who became aware of a defect, low income buyers voiced complaints about as often as the nonpoor.

Their awareness of defects. According to the study, 43% of buyers notice defects before purchase. More people (46%) notice defects after they have bought the car. But neither group is composed disproportionately of the poor.

Their ability to get satisfaction.. Here the researchers did find a difference. Although the poor and nonpoor are equally adept at finding defects and although both groups complain about them at the same rate, the poor spend significantly more money on repairs during the three months immediately following the purchase than do the nonpoor. The poor, thus, seem to have less success in getting objective satisfaction with respect to the complaints they voice, in that they have to spend more of their own money correcting the defects that caused the complaints.

Equally sadly, on subjective measures of satisfaction the poor also fare less well. No matter what the price or age of the car they buy, or what market they buy it in, the poor feel more dissatisfied with their purchase than the nonpoor. (Dissatisfaction is also greater among older buyers, for transactions taking place in the dealer market, and for newer and more expensive cars.) And more of them than the nonpoor, irrespective of the objective facts of their purchase, sense that something about the purchase was misrepresented.

Delving deeper into why the poor are discriminated against both with respect to the price they pay and with respect to the satisfaction they receive when they complain, the researchers have two possible explanations. Although they cannot be tested with the FTC survey data, they certainly deserve further study.

One is the possibility that the poor are not as skillful in bringing leverage on a seller—whether because they are less articulate or because the seller realizes they are poor and therefore easy prey.

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level—improve relative ranking in terms of aiding low income groups when earnings capacity is used to define the target group. These results call into question the usefulness of the criterion of target effectiveness based on money income for evaluating income transfer programs.

Finally, the concept of earnings capacity is used to evaluate the contribution of labor market discrimination to black-white earnings differences. The estimates presented lead to several conclusions. If economic status is presumed to be better reflected in earnings capacity than in current income, the disparity between blacks and whites is even greater than income differences imply. Perhaps even more serious, the disparity in status between blacks and whites is greater for low capacity families than for high capacity families. This disparity between the races is caused in large measure by discrimination against blacks in labor markets: Between 43% and 60% of the gap for men and between 30% and 39% of the gap for families is attributable to such discrimination. The authors conclude that policies designed to reduce labor market discrimination should play a prominent role in the overall effort to reduce racial differences in income. Garfinkel and Haveman also examine the degree to which the severity of labor market discrimination varies with earnings capacity and find no clear-cut pattern. They argue, consequently, that there is no justification for focusing antidiscrimination policy on a particular part of the distribution of earnings capacity.

As Robert Lampman notes in his foreword to the book, the earnings capacity study "contributes to the long tradition of research designed to improve the measurement of economic status and inequality, a tradition that has experienced a major increase in interest in the last decade." Lampman also says:

> By criticizing the standard approach to measuring economic position and inequality, and suggesting an alternative to it, the volume fits what Alice Rivlin has termed "forensic social science." Because such an approach does not provide the sorts of arguments and evidence present in a legal brief for the opposition the reader will need to test the authors' arguments as he goes along. . . . For what sorts of policy issues, for instance, is a longer term indicator of economic status, such as earnings capacity, more appropriate than an indicator of current need, such as annual money income? The alert and questioning reader will find this study a challenging one that stimulates reexamination of both social policy goals and social practices.

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The other is a "rotten dealer" explanation. It is quite plausible that certain dealers consciously seek out the poor in order to exploit them. They may bribe the poor, say, with better credit terms but charge them higher prices and remain unresponsive when defects show up later. As the authors warn:

> If this second explanation for discrimination is true, then disclosure regulation as a strategy for giving leverage to the low-income consumer would be misplaced. It may only increase restrictions on decent dealers who would abide by the law to maintain their reputation, while rotten dealers would continue to ignore the legal regulations in all but the most symbolic ways.

The FTC study shows that direct consumer complaints to government agencies are rare. Of the 220 or so who complained—89% of whom bought from a dealer—only 6 said they had contacted a public remedy agent. However, the study suggests that state inspectors do offer secure benefits for the relatively few consumers who complain officially.

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[1] The nonprofit Center for Public Representation in Madison was founded in 1974 to provide representation for groups of citizens whose lack of organization or resources prevent them from financing their own representation before state and local administrative agencies. The Center engages in advocacy, research, and citizen education. It also trains law students through a clinical placement program that provides experiences in state and local administrative law and public interest advocacy, while helping them to develop a substantive knowledge of crucial areas of law.

SELECTED PAPER

"On the Efficiency of Income Testing in Tax-Transfer Programs," by Jonathan R. Kesselman and Irwin Garfinkel. Institute for Research on Poverty Discussion Paper no. 339-76.

This paper demonstrates that target efficiency is a conceptually flawed measure of economic efficiency with respect to tax-transfer programs. It thus casts doubt on the widely shared view that income-tested programs are more efficient than non-income-tested ones. To illustrate some quantitative aspects of the economic efficiency of income testing the authors calculate several feasible overlapping negative income taxes and corresponding credit income taxes. They show that the difference in welfare loss between the two types of programs is invariably small—less than one-half of 1% of aggregate earnings. This leads to a major implication for policy formulation—specifically, that any differential economic efficiency costs between a credit income tax (non-income-tested) and a negative income tax (income-tested) may well be dominated by other program differences.