Econ 142 - Behavioral Economics

Fall 2016

Instructor: Isabel Trevino

Email: itrevino@ucsd.edu

Office: Department of Economic, room 225.

Time and location: Tu Th 3:30 pm – 4:50 pm, Pepper Canyon Hall (PCYNH) 120.

Office hours: Thursday, 2:00 pm – 3:00 pm.

Course description:

This class is intended to give students a broad introduction to Behavioral Economics (also referred to as Psychology and Economics). This is a relatively new area of research that incorporates psychological findings into economic models. Some of the main assumptions of standard economic models are that agents are rational, they act based on self-interest, and behave consistently over time. There is a body of evidence (initially coming from psychology) that shows that human beings do not exhibit the rationality that the models require and tend to care about others. In this class we will study the evidence against certain common assumptions of standard economic models, and the way in which this evidence has been incorporated into new economic models.

The applications of Behavioral Economics are many. The topics in this syllabus are more than what we will be able to cover, with the idea that we can choose together the direction of the course. For example, you might prefer to spend more time studying topics in behavioral finance to learn how the stock market overreacts to certain types of information, or to study the problem of individual self-control and the need to set commitment devices and deadlines.

In a typical class, we will discuss the empirical evidence (coming from experiments in economics or psychology) that shows some irregularity in behavior that does not conform to typical economic assumptions. We will discuss this evidence and then study how economists have incorporated these findings to write more realistic models of human behavior.

Because Behavioral Economics is a relatively new area of study, there are no undergraduate-level text books. Before each class, I will provide you with a set of assigned readings for the next class and you are expected to read these before the class. You will have to read some research papers that are published in specialized economics journals. Since the level of these papers is sometimes too advanced, I will tell you beforehand which sections to read and which to skip. I am not assuming that you are mathematicians, but I do assume that you understand and have worked with models of game theory and intermediate microeconomics, and that you feel comfortable with concepts in probability, statistics and econometrics.

Given the nature of this class (and the size), participation in class is very important.

Homework assignments:

There will be two reading assignments where you will have to turn in an analytical summary of the reading required for the class. These are not meant to just summarize the text, but to provide a critical view of the reading. You should form an opinion about the text and justify it (there are no right or wrong opinions, as long as they are justified). This are individual assignments, so you cannot submit the same summary as another classmate. If you do, then the grade of the assignment will be equally split among the students who submitted the same summary. These summaries should be 1-3 pages long.

Grades:

30%: Final exam (Monday, December 5: 3 pm – 6 pm)

30%: Midterm (Tuesday, November 1 during class)

20%: 2 reading assignments

20%: Participation in class discussion

Topics

0. **Introduction to Behavioral Economics**

   Preface in "Choices, Values and Frames", D Kahneman and A. Tversky (eds.). 2000. Cambridge University Press.

   Chapter 1 in "Advances in Behavioral Economics", C Camerer, G Loewenstein and M Rabin (eds.). 2004. Princeton University Press.

   Rabin, M. 1998. "Economics and Psychology" *Journal of Economic Literature*, 36(1).

   DellaVigna, S. 2009. "Psychology and Economics: Evidence from the Field" *Journal of Economic Literature*, 47(2).

1. **Social preferences**
2. **Time inconsistency**
3. **Heuristics and biases: Behavioral finance**
4. **Prospect theory**

Administrative issues

1. If you have a documented disability, please come to talk to me as soon as possible so that I can make suitable accommodations for you. If you believe that you have a disability and desire accommodation, please register with the Office for Students with Disabilities.

2. Students found guilty of academic dishonesty will earn a failing grade for the course. In addition, the Council of Deans of Student Affairs will impose a disciplinary penalty.
3. If you need to miss the midterm for a verifiable medical/legal/sports reason, your midterm grade will be the grade you obtain on the final. Failure to notify me promptly that you will miss the midterms will results in a zero grade for that midterm. Unexcused absences will also result in a zero.
4. If you arrive late to an exam, I will allow you to take the exam in the time that remains as long as no one has turned in his/her exam and left the room. Once a classmate has turned in his/her exam, you will earn a zero on that test if you arrive late.
5. After the university add deadline, students with extraordinary circumstances or with documentation of a university error may petition the Department of Economics to add courses. Extraordinary circumstances do not include: not being added to the course from the waitlist, forgetting to add a course, etc. Students with extraordinary circumstances may submit a completed petition, with a written explanation (and documentation, if applicable) to Sequoyah Hall, room 245.

References to papers discussed in class

1. Social preferences

Akerlof A. 1982. Labor Contracts as Partial Gift Exchange. The Quarterly Journal of Economics 97(4): 543–569.

Andreoni J and J Miller. 2002. Giving According to GARP: An Experimental Test of the Consistency of Preferences for Altruism. Econometrica 70(2): 737–753.

Bandiera O, Barankay I and I. Rasul. 2005. Social Preferences and the Response to Incentives: Evidence from Personnel Files. Quarterly Journal of Economics 120(3): 917–962.

Bolton GE and A Ockenfels. 2000. A theory of equity, reciprocity, and competition. American Economic Review 90(1): 166-193.

Charness G and M Rabin. 2002. Understanding Social Preferences with Simple Tests. Quarterly Journal of Economics 117(3): 817–869.

Dana J, Cain DM and RM Dawes. 2006. What you don't know won't hurt me: Costly (but quiet) exit in dictator games. Organizational Behavior and Human Decision Processes 100: 193–201.

Dana J, R Weber and J Kuang. 2007. Exploiting moral wiggle room: experiments demonstrating an illusory preference for fairness. Economic Theory 33(1): 67-80.

DellaVigna S, JA List, and U Malmendier. 2012. Testing for altruism and social pressure in charitable giving. The Quarterly Journal of Economics 127(1): 1-56.

Engelmann D and M Strobel. 2006. Inequality aversion, efficiency, and maximin preferences in simple distribution experiments. American Economic Review 94(4): 857–869.

Falk A, Fehr E and U Fischbacher. 2003. On the nature of fair behavior. Economic Inquiry 41(1): 20–26.

Fehr E and KM Schmidt. 1999. A Theory of Fairness, Competition, and Cooperation. Quarterly Journal of Economics 114(3): 817–868.

Fehr E and S Gächter. 2002. Altruistic Punishment in Humans. Nature 415(6868): 137–140.

Fehr E, Klein A and KM Schmidt. 2007. Fairness and contract design. Econometrica 75(1): 121–154.

Fehr E, Kirchsteiger G and A Riedl. 1993. Does fairness prevent market clearing? An experimental investigation. The Quarterly Journal of Economics 108(2): 437–459.

Fisman R, S Kariv and D Markovits.2007. Individual Preferences for Giving. American Economic Review 97(5): 1858-1876.

Forsythe R, Horowitz JL, Savin NE and Sefton M. 1994. Fairness in Simple Bargaining Experiments. Games and Economic Behavior 6: 347–369.

Gneezy U and J List. 2006. Putting behavioral economics to work: Testing for gift exchange in labor markets using field experiments. Econometrica 74(5): 1365–1384.

Güth W, Schmittberger R and Schwarze B. 1982. An experimental analysis of ultimatum bargaining. Journal of Economic Behavior and Organization, 3(4): 367-388.

Hamman JR, G Loewenstein and R Weber. 2010. Self-interest through delegation: An additional rationale for the principal-agent relationship. American Economic Review 100(4): 1826-46.

Kahneman D, Knetsch JL and RH Thaler. 1986. Fairness as a Constraint on Profit Seeking: Entitlements in the Market. American Economic Review 76: 728–741.

Krupka EL and R Weber. 2013. Identifying Social Norms Using Coordination Games: Why Does Dictator Game Sharing Vary? Journal of the European Economic Association 11(3): 495-524.

Levine DK. 1998. Modeling Altruism and Spitefulness in Experiments. Review of Economic Dynamics 1(3): 593–622.

Levitt SD and JA List. 2007. What Do Laboratory Experiments Measuring Social Preferences tell us about the Real World? Journal of Economic Perspectives 21(2): 153–174.

List JA. 2007. On the interpretation of giving in dictator games. Journal of Political Economy 115(3): 482–493.

Mas A. 2006. Pay, Reference Points, and Police Performance. Quarterly Journal of Economics, 121(3): 783–821.

Rabin M. 1993. Incorporating Fairness into Game Theory and Economics. American Economic Review 83(5): 2181–1302.

Roth AE, Prasnikar V, Okuno-Fujiwara M and Zamir S. 1991. Bargaining and Market Behavior in Jerusalem, Ljubljana, Pittsburgh, and Tokyo: An Experimental Study. American Economic Review 81: 1068-1095.

2. Time inconsistency

Ariely D and K Wertenbroch. 2002. Procrastination, Deadlines, and Performance: Self-Control by Pre-Commitment. Psychological Science 13(3): 219–224.

DellaVigna S and U Malmendier. 2006. Paying Not to Go to the Gym. American Economic Review 96(3): 694–719.

Frederick S, Loewenstein G and T O'Donoghue. 2002. Time Discounting and Time Preference: A Critical Review. Journal of Economic Literature 40(2): 351–401.

Fudenberg D and DK Levine. 2006. A dual-self model of impulse control. The American Economic Review, 96(5): 1449-1476.

Gine X, D Karlan, and J Zinman. 2010. Put your money where your butt is: A commitment contract for smoking cessation. AEJ: Applied Economics 2(4): 213-235.

Glaeser EL. 2006. Paternalism and Psychology. University of Chicago Law Review 73: 133–156.

Kaur S, M Kremer, and S Mullainathan. 2014. Self-control at work. Journal of Political Economy, forthcoming.

Laibson D. 1997. Golden Eggs and Hyperbolic Discounting. Quarterly Journal of Economics 112(2): 443-477.

Loewenstein G and D Prelec. 1992. Anomalies in intertemporal choice: evidence and an interpretation. The Quarterly Journal of Economics 107(2): 573-597.

Meier S and C Sprenger. 2010. Present-Biased Preferences and Credit Card Borrowing. American Economic Journal: Applied Economics 2(1): 193–210.

Mischel W, Shoda Y and ML Rodriguez. 1989. Delay of Gratification in Children. Science 244(4907): 933–938.

O'Donoghue T and M Rabin. 1999. Doing It Now or Later. American Economic Review 89(1): 103–124.

Shapiro J. 2005. Is There a Daily Discount Rate? Evidence from the Food Stamp Nutrition Cycle. Journal of Public Economics, 89(2): 303–325.

Thaler R. 1981. Some empirical evidence on dynamic inconsistency. Economics Letters 8: 201-207.

Thaler R and S Benartzi. 2004. Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving. Journal of Political Economy, 112: 164–187.

Thaler R and HM Shefrin. 1981. An economic theory of self-control. Journal of Political Economy, 89(2): 392-406.

3. Prospect theory

Camerer C. 2000. Prospect Theory in the Wild: Evidence from the Field. Ch. 16 in D Kahneman and A Tversky, eds., Choices, Values, and Frames.

Camerer C, L Babcock, G Loewenstein, and R Thaler. 1997. Labor supply of NYC cab drivers: One day at a time. Quarterly Journal of Economics 112(2): 407-441.

Genesove D. and C Mayer. 2001. Loss Aversion and Seller Behavior: Evidence from the Housing Market. Quarterly Journal of Economics 116(4): 1233–1260.

Kahneman D and A Tversky. 1979. Prospect theory: An analysis of decision under risk. Econometrica 47(2): 263-292.

Kahneman D, Knetsch JL and RH Thaler. 1991. Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias. Journal of Economic Perspectives 5(1): 193–206.

Kahneman D, Knetsch JL and RH Thaler. 1990. Experimental Tests of the Endowment Effect and the Coase Theorem. Journal of Political Economy 98(6): 1325–1348.

Köszegi B and M Rabin. 2006. A Model of Reference-Dependent Preferences. Quarterly Journal of Economics 121(4): 1133–1165.

Köszegi B and M Rabin. 2007. Reference-dependent risk attitudes. American Economic Review 97(4): 1047-1073.

List JA. 2004. Neoclassical Theory Versus Prospect Theory: Evidence from the Marketplace. Econometrica 72(2): 615–625.

Pope D and M Schweitzer. 2011. Is Tiger woods loss averse? Persistent bias in the face of experience, competition, and high stakes. American Economic Review 101(1): 129-157.

Plott C and K Zeiler. 2005. The WTP-WTA gap, the endowment effect, subject misconceptions, and experimental procedures for eliciting valuations. American Economic Review 95(3): 530-545.

Plott C and K Zeiler. 2007. Exchange asymmetries incorrectly interpreted as evidence of endowment effect and prospect theory?. American Economic Review 97(4): 1449-1466.

Rabin M and RH Thaler. 2001. Anomalies: Risk Aversion. Journal of Economic Perspectives 15(1): 219–232.

Sprenger C. 2014. An endowment effect for risk: Experimental tests of stochastic reference points. Mimeo.

Thaler, RH. 1980. Toward a Positive Theory of Consumer Choice. Journal of Economic Behavior and Organization. 1: 39-60.

4. Heuristics and biases / Behavioral finance

Barber B and T Odean. 2000. Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors. Journal of Finance 55(2): 773-806.

Barberis N, A Shleifer, and R Vishny. 1998. A model of investor sentiment. Journal of Financial Economics 49(3): 307-343.

Barberis N and R Thaler. 2003. A Survey of Behavioral Finance. Handbook of Economics and Finance 1(18): 1053-1128.

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Camerer C. 1987. Do Biases in Probability Judgment Matter in Markets? Experimental Evidence. American Economic Review 77(5): 981-97.

Camerer C. 1989. Does the basketball market believe in the `hot hand'?. American Economic Review 79(5): 1257-1261.

Camerer C and D Lovallo. 1999. Overconfidence and excess entry: An experimental approach. American Economic Review 89(1): 306-318.

Daniel K, D Hirshleifer, and A Subrahmanyam. 1998. Investor Psychology and security market under- and over-reactions. Journal of Finance 53(6): 1839-1885.

De Bondt W and R Thaler. 1985. Does the stock market overreact? Journal of Finance 40(3): 793-805.

Fama E and K French. 1992. The Cross-section of expected stock returns. Journal of Finance 47(2).

French K and J Poterba. 1991. Investor diversification and international equity markets. American Economic Review 81(2): 222-226.

Gilovich T, R Vallone and A Tversky. 1985. The hot hand in basketball: On the misperception of random sequences. Cognitive Psychology 17: 295-314.

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Heaton JB. 2002. Managerial optimism and corporate finance. Financial Management 31: 33-45.

Kahneman D and A Tversky. 1972. Subjective probability: A judgment of representativeness. Cognitive Psychology 3: 430-454.

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Kahneman D, P Slovic and A Tversky (eds). 1982. Judgment under uncertainty: Heuristics and biases. Cambridge University Press.

Kruger J and D Dunning. 1999. Unskilled and unaware of it: How difficulties in recognizing one's own incompetence lead to inflated self-assessments. Journal of Personality and Social Psychology 77(6): 1121-1134.

Langer EJ. 1975. The Illusion of Control. Journal of Personality and Social Psychology 32(2): 311-328.

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Malmendier U and G Tate. 2005. CEO overconfidence and corporate investment. Journal of Finance 60(6): 2661-2700.

Odean T. 1998. Are investors reluctant to realize their losses?. Journal of Finance 53(6): 1887-1934.

Rabin M. 2002. Inference by believers in the law of small numbers. Quarterly Journal of Economics.

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Savage LJ. 1954. The Foundations of Statistics. New York: John Wiley & Sons.

Tversky A and D Kahneman. 1971. Belief in the law of small numbers. Psychological Bulletin 76: 105-110.

Weinstein ND. 1980. Unrealistic optimism about future life events. Journal of Personality and Social Psychology 39(5): 806-820.