

## **Topics in behavioral economics (Fall term)**

**Instructor's name: Anton Suvorov (lectures)**

Class Times and Locations: TBA

Lectures: TBA

Classes: by groups

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Office Hours: TBA

Course type: elective

### **Section 1. General information about the course**

The neoclassical paradigm, dealing with rational economic agents who have stable preferences and always make optimal decisions, is a dominant approach in mainstream economics. "Behavioral Economics" (or "Psychology and Economics") is a new field, not an easy one to define. What unifies the different research programs associated with it is an attempt to bring psychological realism to economic analysis. Some papers document *systematic* departures of the actual human behavior from the one predicted by mainstream economic models. Others incorporate more realistic, psychologically grounded assumptions into economic models to investigate their implications. Yet others are interested in explaining seemingly irrational behavior using tools of economics and game theory with some minor departures from conventional assumptions.

The course is somewhat eclectic. We shall both discuss theoretical models and look at many empirical (mostly, experimental) results. There is no textbook, all references will be to recent papers published in the leading international journals or yet unpublished.

### **Section 2. Course goals, learning objectives, expected learning outcomes**

The objectives of the course are:

- Acquaintance with the main issues in behavioral economics, both theoretical and empirical
- Deeper understanding of classical approach, its power and limitations
- Ability to convey this understanding in written form

By the end of the course students are expected:

- To know the main theses of all the papers in required reading and several additional papers
- To be able to critique papers in behavioral economics (note: not only to criticise, but to evaluate objective limitations in studying behavioral phenomena)

Prerequisites: Good command and sound knowledge of classical microeconomic theory (especially consumer theory and game theory) and econometrics (understanding benefits and drawbacks of experimental setting, preferably understanding of the terms “control group”, “endogeneity”, “internal\external validity”).

### **Section 3. Course Outline**

No	Topic	Week	Course format			Readings
			Lectures	Classes	self-study	
1	Introduction	1	4	2	8	Reading: Tirole (2002)  Additional reading: Rabin (2002), Fehr and Falk (2002), Camerer et al. (2004), Kahneman and Tversky (2000).
2	Reference-dependent utility, loss aversion; framing effects. Endowment effect. Endogenous reference standards.	2	4	2	8	Reading: Kahneman and Tversky (1979), Kahneman, Knetsch and Thaler (1990), Plott and Zeiler (2005), Camerer et. al. (1997), Farber (2005), Kőszegi and Rabin (2006).  Additional reading: List (2003), Kahneman and Tversky (2000), Goette, Huffman and Fehr (2004), Falk and Knell (2004).
3	Attitude to information. Beliefs as an argument of utility functions. Heuristics and biases	3	4	2	8	Reading: Akerlof and Dickens (1982), Kőszegi (2006), Ariely et al. (2003), Frederick (2005).  Additional reading: Eliaz and Spiegel (2006), Brocas and Carrillo (2004).

4	Social preferences: fairness, reciprocity, social signaling.	4	4	2	8	Reading: Fehr and Schmidt (2003), Fehr and Falk (2002), Bernheim (1994). Additional reading: Kahneman, Knetsch and Thaler (1986), Charness and Rabin (2002), Dana-Weber-Kuang (2003).
5	Intertemporal choice, self-control. Imperfect memory. Overconfidence.	5,6	4	2	8	Reading: O'Donoghue and Rabin (1999), Benabou and Tirole (2002), Laibson (1997), Van de Steen (2005). Additional reading: Hirshleifer and Welch (2002), Fudenberg and Levine (2004), Biais et al. (2005).
6	Incentives, motivation.	7	4	2	8	Reading: Benabou and Tirole (2003), Fehr and Falk (2002). Additional reading: Gneezy and Rustichini (2000a, 2000b).
7	Some applications. Miscellaneous topics.	8	4	2	8	Reading: Laibson (1997), Benartzi-Thaler (2001), Mullainathan and Shleifer (2005). Additional reading: Thaler (1999).

### **Description of course methodology and forms of assessment to be used**

While teaching the course the following teaching methods and forms of study and control are used:

- ⇒ lectures (4 hours a week);
- ⇒ self-study;
- ⇒ office hours;
- ⇒ essay;
- ⇒ written test

Assessment and grade determination (see section 5 for more details):

- Essay [25%]
- Presentation of the essay [25%]
- Final test [50%]

### **Section 4. Texts, readings and other informational resources**

Required readings

1. Tirole J. (2002) "Rational Irrationality: Some Economics of Self-Management", *European Economic Review*, 46: 633-655.

2. Kahneman D. and A. Tversky (1979) 'Prospect Theory', *Econometrica*. Reprinted in Kahneman and Tversky (2000)
3. Ariely, D., G. Loewenstein, and D. Prelec (2003): "Coherent Arbitrariness: Stable Demand Curves without Stable Preferences", *Quarterly Journal of Economics*, 118(1).
4. Benabou R. and J. Tirole (2002) "Self-Confidence and Personal Motivation", *Quarterly Journal of Economics*, 117(3): 871-915.
5. Benabou R. and J. Tirole (2003) "Intrinsic and Extrinsic Motivation", *Review of Economic Studies*, 70: 489-520.
6. Fehr E. and K. Schmidt (2003) "[Theories of Fairness and Reciprocity - Evidence and Economic Applications](#)", in M. Dewatripont, L. Hansen and St. Turnovsky (Eds.), *Advances in Economics and Econometrics - 8th World Congress*, Econometric Society Monographs, Cambridge, Cambridge University Press 2002.
7. Brocas I. and J. Carrillo (2004) "Biases in perceptions, beliefs and behavior", mimeo.

#### Additional readings

1. Akerlof J. and W. Dickens (1982) "The Economic Consequences of Cognitive Dissonance", *American Economic Review*, 72(3), 307-319.
2. Bernheim D. (1994) "A Theory of Conformity", *Journal of Political Economy*, 102: 842-877.
3. Biais B, D. Hilton, K. Mazurier and S. Puget (2005) "Judgmental overconfidence, self-monitoring and trading performance in an experimental financial market", *Review of Economic Studies*, 72: 287-312.
4. Camerer C., Babcock L, Loewenstein G. and R. Thaler (1997) "'Labor Supply of New York City Cabdrivers: One Day at a Time", *Quarterly Journal of Economics*, 112 (May), pp. 407-41.
5. Camerer C., Loewenstein G. and M. Rabin eds. (2004) *Advances in Behavioral Economics*, Russell Sage Foundation, Princeton University Press.
6. Charness, G., and M. Rabin (2002): "Understanding Social Preferences with Simple Tests", *Quarterly Journal of Economics*, 117(3): 817-869.
7. Dana J., R. Weber and J. Kuang (2003) "Exploiting moral wriggle room: Behavior inconsistent with a preference for fair outcomes", mimeo.
8. Eliaz K. and R. Spiegel (2006) "Can Anticipatory Feelings Explain Anomalous Choices of Information Sources?", *Games and Economic Behavior*, 56, pp. 87-104.
9. Elster, J. and G. Loewenstein eds. (1992) *Choice Over Time*, Russell Sage Foundation.

10. Falk A. and M. Knell (2004), "Choosing the Joneses: Endogenous Goals and Reference Standards", *Scandinavian Journal of Economics*, 106 (3), pp. 417-435.
11. Farber H. (2005) "Is Tomorrow Another Day? The Labor Supply of New York City Cabdrivers", *Journal of Political Economy*, 113(1), pp. 46-82.
12. Fehr E. and A. Falk (2002) "Psychological Foundations of Incentives", *European Economic Review*, 46: 687-724.
13. Frederick, S. (2005) "Cognitive Reflection and Decision Making", *Journal of Economic Perspectives*, 19(4), pp. 25-42
14. Fudenberg D. and D. Levine (2006) "A Dual Self Model of Impulse Control", *American Economic Review*, 96: 1449-1476.
15. Gneezy, U. and Rustichini, A. (2000a), "A Fine is a Price", *Journal of Legal Studies*, 29 (1) (part 1), 1-17.
16. Gneezy, U. and Rustichini, A. (2000b), "Pay Enough or Don't Pay at All", *Quarterly Journal of Economics*, 115(3), 791-810.
17. Goette, L, D. Hummond and E. Fehr (2004) "Loss Aversion and Labor Supply", *Journal of European Economic Association*, 2(2-3), pp. 216-228.
18. Hertwig, R., & Ortmann, A. (2003). "Economists' and psychologists' experimental practices: How they differ, why they differ and how they could converge" In I. Brocas & J. D. Carillo (Eds.), *The psychology of economic decisions* (pp. 253-272). New York: Oxford University Press.
19. Hirshleifer D. and I. Welch (2004) "An Economic Approach to the Psychology of Change: Amnesia, Inertia, and Impulsiveness", *Journal of Economics & Management Strategy*, Volume 11, Number 3, 379-421
20. Kahneman, D., J. Knetsch and R. Thaler (1986) "Fairness as a Constraint on Profit Seeking: Entitlements in the Market", *American Economic Review*, 76(4), pp. 728-741.
21. Kahneman, D., J. Knetsch and R. Thaler (1990) "Experimental Tests of the Endowment Effect and of the Coase Theorem", *Journal of Political Economy*, 86(6), pp. 1325-48.
22. Kahneman D. and A. Tversky, eds. (2000) *Choices, Values and Frames*, Russell Sage Foundation, New York.
23. Kőszegi, B. (2006) "Ego Utility, Overconfidence, and Task Choice", *Journal of the European Economic Association*, 4(4), pp. 673-707
24. Kőszegi, B. and M. Rabin (2006) "A Model of Reference-Dependent Preferences", *Quarterly Journal of Economics*, 121 (4), pp. 1133-1166.

25. Laibson D. (1997) "Golden Eggs and Hyperbolic Discounting", *Quarterly Journal of Economics*, 112, 443-478.
26. List J. (2003) "Does Market Experience Eliminate Market Anomalies?" *Quarterly Journal of Economics*, 118(1), pp. 41-71.
27. Mullainathan S. and A. Shleifer (2005) "The Market for News", *American Economic Review*, 95(4): 1031-1053.
28. O'Donoghue T. and M. Rabin (1999) "Doing it now or later", *American Economic Review*, 89(1): 103-124.
29. Plott C. and K. Zeiler (2005) "The Willingness to Pay-Willingness to Accept Gap, the "Endowment Effect," Subject Misconceptions and Experimental Procedures for Eliciting Valuations", *American Economic Review*, 95(3), pp. 530-545.
30. Rabin M. (2002) "A Perspective on Psychology and Economics", *European Economic Review*, 46: 657-685.
31. Thaler R. (1992) *The Winner's Curse: Paradoxes and Anomalies of Economic Life*. Free Press, New York.
32. Thaler R. (1991) *Quasi-Rational Economics*. Russell Sage Foundation, New York.
33. Thaler, R., (1999) "[Mental Accounting Matters](#)", *Journal of Behavioral Decision Making*, Vol. 12:183-206.
34. Thaler, R. and S. Benartzi (2004) "[Save More Tomorrow: Using Behavioral Economics to Increase Employee Savings](#)", *Journal of Political Economy*, Vol. 112:1, 164-187.

## **Section 5. Examination/Evaluation**

### **Sample test questions**

Define a pair of the behavioral biases that produce the opposite empirical predictions (Hint: what is the most probable outcome of a dice roll after two consecutive rolls that both rolled six?). How we can distinguish mistakes (random noise) from predictable behavioral biases in this situations?

What are the common biases that can be observed in stock market participants? Name three biases with examples.

Discuss the advantages and disadvantages of "libertarian paternalism" in some specific policy measure (for example, default option for pension account).

What theory is the main contribution of D.Kahneman to the behavioral economics? (Hint: remember the asymmetric graph)

Write the general form of Fehr-Schmidt preferences. Describe the elements and the general purpose of using this form of preferences in modelling.

### **Grading system and how both the course and final test will be graded**

Essay will be based on a paper chosen by the student from a suggested list of papers (that will be distributed). Essays can be written in groups of 2 students. The 50% for the essay is the result of two grades: for the written essay itself (25%) and for its presentation in class. The essay should briefly communicate the main ideas and results (with intuition) of the paper it is based on, report a constructive critique of the paper and, eventually, contain a brief original extension done by the student(s) herself. Normally the essay should be 5-10 pages long.

Final test is graded out of 100 points.

If the final course mark is below 4 out of 10 then the student can sit one written make-up test in the end of January/beginning of February set in accordance with the HSE's [Internal Regulations](#). This test covers all the material studied in the course.

### **Policies on late work**

Late essays are marked but are not counted towards total points.

### **Section 6. Academic Integrity**

The Higher School of Economics strictly adheres to the principle of academic integrity and honesty. Accordingly, in this course there will be a zero-tolerance policy toward academic dishonesty. This includes, but is not limited to, cheating, plagiarism (including failure to properly cite sources), fabricating citations or information, tampering with other students' work, and presenting a part of or the entirety of another person's work as your own. HSE uses an automated plagiarism-detection system to ensure the originality of students' work. Students who violate university rules on academic honesty will face disciplinary consequences, which, depending on the severity of the offense, may include having points deducted on a specific assignment, receiving a failing grade for the course, being expelled from the university, or other measures specified in HSE's [Internal Regulations](#).