Economics 594: Behavioral Economics (Theory)
(also known as:
Psychology & Economics)
Spring 2009

Course Information

Instructor: Zack Grossman
Office: NH 3049
Email: my last name
OH: W 11am - noon, and others times by appointment
Lectures: T,R 3:30 - 4:45pm, NH 2212

Description

This course provides an overview of topics in behavioral economics, which integrates insights from psychology and other social sciences into models of economic behavior. The focus will be on modeling the findings of research demonstrating departures from rationality, self-interest, and other classical assumptions, such as time consistency, outcome-based preferences, etc. We will motivate each topic by looking at the behavioral evidence, then examine formal assumptions reflecting this evidence in a way that can be used by economists. Because of time constraints, we will not be able focus much on applications and empirical tests and, acknowledging the current lack of a complementary course on economic applications and empirical methods, I have provided a reading list of relevant empirical papers for most topics.

This course does not present an alternative to mainstream economics. Rather it is proudly mainstream. While the material may be unlike what you’ve seen in other courses, that is merely because it addresses psychological phenomena that are not yet totally integrated into economic analysis. The goal is to improve the psychological realism of formal economic assumptions in certain areas where it is importantly lacking, so as to use classical economic approaches to improve our answers to classical economic questions. This course is not about the philosophy or methodology of economics, non-psychological models of bounded rationality, evolutionary economics, or experimental economics. These are generally useful and interesting topics, but not the direct focus of this course.

Requirements

- **Readings**: There is no textbook per se, but many of the readings will be drawn from *Choices, Values, and Frames* (2000), edited by Daniel Kahneman and Amos Tversky (hereafter CVF). I strongly recommend that you purchase this book. Most other readings are available online. Those that are not available online I’ll distribute in class a week in advance.

- **Problem Set Answers**: You will complete two problem sets, each worth 15% of your grade. Problems aren’t meant to be simple. You are encouraged to work together on the problems and to come see me for help before they are due. You are to write them up separately, though, and what you hand in should reflect you own understanding.

  Please make some effort to write legibly and to present your answers clearly and succinctly. Problems will frequently require substantial math; you are welcome and encouraged to hand in all the work you did to reach an answer, but please make some effort to provide guidance through your steps of reasoning, and to flag work that will be superfluous to the reader (me). The technical difficulty the problems will largely be on par with what you encounter in the first-year micro sequence. In this course, though, your goal is not to demonstrate that you have acquired the skills to solve the problems. Instead, I want you to explore the insights and intuition we can draw from our modeling approach. Thus, the math merely plays the role of the tool (as it almost always should) that delivers the insight.
• **Problem Set Questions:** (Negative problem sets? Jeopardy problem sets?) You will compose two problem-set questions, each worth 10% of your grade, with accompanying solutions and relating to material covered in this course. The questions should be tailored towards someone with the skills and background of an advanced undergraduate economics major. The questions may be long-ish: you should design the question so as to guide the student through the logic/insight of the main theoretical results of a paper from the psychology & economics literature. It may be helpful to incorporate multiple parts, a brief description of the motivating evidence, or to contrast the predictions that follow standard versus more-psychologically-realistic assumptions. **One** question must be based on one of the papers that we discuss in class (the required readings on the syllabus) and **one** question must be based on a paper published in the last five years, but not included in the required readings (the suggested further readings = ok).

• **Referee Reports:** You will write two 2-3 page referee reports, each worth 10% of your grade, in which you summarize a recent working paper (i.e. unpublished) in behavioral economics, assess its strengths and weaknesses, and make suggestions for improvement. The first report will be on a paper of your choosing. It does not have to be exclusively theoretical, though you should be able to comment on its theoretical or modeling approach. I encourage you to discuss your selection with me before committing. Here are some suggested places to find suitable working papers:

  – Seminar websites: UCSB (your best bet is to look for people invited by Gary or me); other universities have dedicated behavioral/P&E seminars, e.g. Berkeley, Harvard, Princeton
  – Homepages of authors of papers listed in the syllabus, or authors of papers cited in papers listed on the syllabus. Find out what they’re working on now.
  – RePEc’s NEP list for cognitive & behavioral economics: http://econpapers.repec.org/scripts/nep.pl?list=nep-cbe

The second report will be on a paper of my choosing. Your audience for each of these reports will be your professional peers. I will compile and distribute to the class the set of reports that we generate.

• **Take-home Final:** At the last class meeting (Thursday, June 4) I will hand out a take-home final exam, due five days later (Tuesday, June 9) at 5pm in my mailbox, office or inbox. I am sensitive to the fact that you may have other commitments during this period so it is not designed to take five days to complete. It will consist mostly of problem-set style questions, upon which you are free to work with others, though as always you must write-up your answers individually.

**Schedule**

• Problem sets:
  – PS1 posted: April 9; due & solutions posted: April 28; returned: May 5
  – PS2 posted: May 5; due & solutions posted: May 26; returned: June 2

• Referee reports & PS questions:
  There are three assignments for which you can choose your own subject: one of the referee reports and the two PS questions. You are free to hand these in at any point before our last class meeting (June 4) with the following restrictions: you must hand in at least one of these by April 14 and a second by May 12. As for the referee report on the paper that I choose: I will announce the paper on May 22 and the report is due at the beginning of our last class (June 4).

**Topics, Reading List**

Please complete readings associated with each topic, ideally before class. Readings marked with a * are supplementary and optional. For the most part they provide applied/field-empirical tests of the theories developed in the required readings. The number in brackets is the expected number of classes devoted to the topic.
I. Introduction

- Overview of Psychology & Economics [1]

II. Reference-Dependent Preferences

- Prospect Theory [2]

- Beliefs-based Preferences I [1]

- Expectations as the Reference Point [1]

- Narrow Framing, Choice Bracketing, and Mental Accounting [1]
III. Present-Bias Preferences & Time Inconsistency [3]


IV. Social Preferences


V. Nonstandard Beliefs [3]


VI. Behavioral Game Theory [4]

– TBA