Econ 885-13: Psychology and Economics
Syllabus and Reading List

Todd Sarver

Dates: March 3 - April 16, 2014
Days and Times: MW 10:05-11:20 am
Location: Perkins LINK 2-085 seminar 2
Office Hours: TBA

Course Description: This course will focus on recent papers incorporating psychological biases and constraints into economics. Topics can be adjusted somewhat based on student interests, but will include some of the following: dynamic inconsistency and time preferences; behavioral IO; belief distortion and self-signaling; risk preferences and reference-dependent utility; welfare; cognitive constraints and imperfect memory; evolution of preferences.

Prerequisites: Completion of the first-year Economics PhD core courses, or comparable. We will be studying models that extend the standard fully-rational agent paradigm to incorporate psychological biases and bounded rationality. Therefore, understanding of the standard models and techniques from advanced microeconomics (required) and macroeconomics (recommended) is a critical prerequisite to success in this course.

Evaluation: At this stage, you should ideally be transitioning from test-based assessment to developing your own research. Following that philosophy, course evaluation will be based on: (1) a referee report (i.e., a 2-4 page summary and critical review) on one of the papers on the reading list (or another related paper we agree upon), and (2) a take-home final exam. The goal is for the requirements of this course to complement (not substitute) the development of your own research ideas.

Reading List: Below is a fairly long (but by no means comprehensive) list of topics and papers related to Psychology and Economics. We will only have time to cover a small number of them in this module -- the articles in bold will likely be the main focus of the lectures. However, I will also try to paint a picture of bigger literature and discuss how other papers fit into it. The first section lists some books and surveys that may be useful, but no text is required.

Books and Surveys

- Spiegler (2011) - Bounded Rationality and Industrial Organization
- Rubinstein (1998) - Modeling Bounded Rationality
- Conlisk (1996) - Why Bounded Rationality
- Rabin (1998) - Psychology and Economics
- Barberis & Thaler (2003) - A Survey of Behavioral Finance
- Pesendorfer (2006) - Behavioral Economics Comes of Age

Time Inconsistent Preferences, Temptation, and Hyperbolic Discounting [4 lectures]
- Strotz (1955) - Myopia and Inconsistency in Dynamic Utility Maximization
- Phelps & Pollak (1968) - On Second-Best National Savings and Game-Equilibrium Growth
- Pollak (1968) - Consistent Planning
- Peleg & Yaari (1973) - On the Existence of a Consistent Course of Action when Tastes are Changing
- Laibson (1997) - Golden Eggs and Hyperbolic Discounting
- O'Donoghue & Rabin (1999) - Doing it Now or Later
- O'Donoghue & Rabin (2001) - Choice and Procrastination
- Gul & Pesendorfer (2001) - Temptation and Self-Control
- Harris & Laibson (2001) - Dynamic Choices and Hyperbolic Consumers
- Ariely & Wertenbroch (2002) - Procrastination, Deadlines, and Performance: Self-Control by Precommitment
- Amador, Angeletos, & Werning (2005) - Commitment vs. Flexibility
- Fudenberg and Levine (2006) - A Dual Self Model of Impulse Control
- Gul & Pesendorfer (2007) - Harmful Addiction
- Noor (2007) - Commitment and Self-Control
- Ali (2011) - Learning and Self-Control
- Ozdenoren, Salant, & Silverman (2009) - Willpower and the Optimal Control of Visceral Urges

**Behavioral IO [2 lectures]**

- DellaVigna & Malmendier (2006) - Paying Not to Go to the Gym
- Ellison (2005) - A Model of Add-on Pricing
- Spiegler (2006) - Competition over Agents with Boundedly Rational Expectations
- Gabaix and Laibson (2006) - Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets
- Grubb (2009) - Selling to Overconfident Consumers
- Grubb & Osborne (2013) - Cellular Service Demand: Biased Beliefs, Learning, and Bill Shock

**Self-Deception and Self-Signalling [2 lectures]**

- Carrillo & Mariotti (2000) - Strategic Ignorance as a Self-Disciplining Device
- Benabou & Tirole (2002) - Self-Confidence and Personal Motivation
- Brunnermeier & Parker (2005) - Optimal Expectations

**Anomalous Attitudes toward Risk [2 lecture]**

Prospect Theory (and paradoxes: common ratio, common consequence, etc.)

- Kahneman & Tversky (1979) - Prospect Theory: An Analysis of Decision under Risk
Three related properties of expected utility: Rabin’s paradox, the equity premium puzzle, and risk-neutrality for infinitesimal gambles

Reference-Dependent Utility [2 lectures]

Endogenous Reference Points

- Benartzi and Thaler (1995) - Myopic Loss Aversion and the Equity Premium Puzzle
- Barberis, Huang, and Santos (2001) - Prospect Theory and Asset Prices
- Barberis & Huang (2008) - Stocks as Lotteries: The Implications of Probability Weighting for Security Prices
- Koszegi & Rabin (2006) - A Model of Reference-Dependent Preferences
- Koszegi & Rabin (2007) - Reference-Dependent Risk Attitudes
- Koszegi & Rabin (2009) - Reference-Dependent Consumption Plans
- Sarver (2012) - Optimal Reference Points and Anticipation
- David Freeman (2013) - Revealed Preference Foundations for Expectations-Based Reference-Dependence

Related Models in Non-Expected-Utility Theory

- Quiggin (1982) - A Theory of Anticipated Utility
- Chew (1983) - A Generalization of the Quasilinear Mean with Applications to the Measurement of Income Inequality and Decision Theory Resolving the Allais Paradox
- Yaari (1987) - The Dual Theory of Choice Under Risk
- Gul (1991) - A Theory of Disappointment Aversion
- Starmer (2000) - Developments in Non-Expected Utility Theory (survey)
- Diecidue & Wakker (2001) - On the Intuition of Rank-Dependent Utility
- Wakker (2010) - Prospect Theory for Risk and Ambiguity
- Cerreia-Vioglio, Dillenberger & Ortoleva (2013) - Cautious Expected Utility and the Certainty Effect
Background Risk and Narrow Framing

- Safra and Segal (2006) - Calibration Results for Non-Expected Utility Theories
- Dillenberger (2010) - Preferences for One-Shot Resolution and Allais-Type Behavior

Welfare

- Gul & Pesendorfer (2007) - Welfare without Happiness
- Gul & Pesendorfer (2008) - The Case for Mindless Economics
- de Clippel (2012) - Behavioral Implementation

Psychological Games

- Geanakoplos, Pearce & Stacchetti (1989) - Psychological Games
- Rabin (1993) - Incorporating Fairness into Game Theory and Economics

Rational Explanations for Apparent Biases

- Kamenica (2008) - Contextual Inference in Markets: On the Informational Content of Product Lines
- Benoit & Dubra (2011) - Apparent Overconfidence