Econ 885-12: Psychology and Economics
Syllabus and Reading List

Spring 2015

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Dates: January 7 - February 25, 2015 (first class January 14)
Days and Times: Wednesday 8:45-11:30am
Location: Social Sciences 327
Office Hours: Following class or by appointment

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. I was also distribute some problem sets, but these will not be collected or graded.

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 are those that will most likely be the main focus of the lectures, but we may make some changes as we go based on your interests and mine. As we proceed, 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

- Rubinstein (1998) - *Modeling Bounded Rationality*
- Spiegler (2011) - *Bounded Rationality and Industrial Organization*
- 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
- Strotz (1955) - Myopia and Inconsistency in Dynamic Utility Maximization
- Phelps & Pollak (1968, RESTUD) - On Second-Best National Savings and Game-Equilibrium Growth (http://www.jstor.org/stable/2296547)
- 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, AER) - Doing it Now or Later (http://www.jstor.org/stable/116981)
- O'Donoghue & Rabin (2001, QJE) - Choice and Procrastination (http://qje.oxfordjournals.org/content/116/1/121.short)
- Harris & Laibson (2001, ECMA) - 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

Time Inconsistent Preferences, Temptation, and Hyperbolic Discounting
- Noor (2007) - Commitment and Self-Control
- Carroll, Choi, Laibson, Madrian & Metrick (2009, QJE) - Optimal Defaults and Active Decisions
- Ozdenoren, Salant, & Silverman (2009) - Willpower and the Optimal Control of Visceral Urges
- Ali (2011, QJE) - Learning and Self-Control (http://qje.oxfordjournals.org/content/126/2/857.short)
- Harris & Laibson (2013, QJE) - Instantaneous Gratification

**Behavioral IO**

- DellaVigna & Malmendier (2006, AER) - Paying Not to Go to the Gym (http://www.jstor.org/stable/30034067)
- Ellison (2005) - A Model of Add-on Pricing
- Gabaix and Laibson (2006) - Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets
- Eliaz & Spiegler (2006, RESTUD) - Contracting with Diversely Naive Agents
- Spiegler (2006) - Competition over Agents with Boundedly Rational Expectations
- Ellison (2006) - Bounded Rationality in Industrial Organization (survey)
- Heidhues & Koszegi (2010, AER) - Exploiting Naivete about Self-Control in the Credit Market
- Grubb & Osborne (2013) - Cellular Service Demand: Biased Beliefs, Learning, and Bill Shock

**Anomalous Attitudes toward Risk**

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

- Kahneman & Tversky (1979, ECMA) - Prospect Theory: An Analysis of Decision under Risk (http://www.jstor.org/stable/1914185)
Reference-Dependent Utility

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 (2001) - Mental Accounting, Loss Aversion, and Individual Stock Returns
- Koszegi & Rabin (2007) - Reference-Dependent Risk Attitudes
- Barberis & Huang (2008) - Stocks as Lotteries: The Implications of Probability Weighting for Security Prices
- Koszegi & Rabin (2009) - Reference-Dependent Consumption Plans
- David Freeman (2013) - Revealed Preference Foundations for Expectations-Based Reference-Dependence
- Ok, Ortoleva & Riella (2012) - Revealed (P)Reference Theory

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
- **Sarver (2013) - Optimal Reference Points and Anticipation**

_Beckground 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

_Self-Deception and Self-Signalling_

- Benabou & Tirole (2002, QJE) - Self-Confidence and Personal Motivation
- Benabou & Tirole (2003, RESTUD) - Intrinsic and Extrinsic Motivation
- Benabou & Tirole (2004, JPE) - Willpower and Personal Rules
- Brunnermeier & Parker (2005) - Optimal Expectations
- Benabou & Tirole (2011, QJE) - Identity, Morals, and Taboos: Beliefs as Assets

_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