Behavioral and Experimental Economics

Syllabus

Fall 2013/2014

Author: Ksenia Panidi, e-mail: kpanidi@hse.ru Office hours: by appointment

General information about the course:

This course is an introduction to Behavioral and Experimental Economics. Behavioral Economics has emerged as a discipline studying situations in which the behavior of people does not correspond to the predictions of standard economic theory. Mainstream economics is based on several assumptions. First, economic agents are assumed to maximize their own utility. Second, agent's behavior is not influenced by social or emotional factors. Third, agents have unlimited cognitive abilities allowing them to choose optimally from all available alternatives. Since 1970s researchers have accumulated a lot of evidence showing that the *observed* human behavior is at odds with what is predicted based on these assumptions. People often make "irrational' choices with respect to their insurance, saving plans, health, participation in lotteries, etc. In this course we will consider the new concepts that help to explain the observed anomalies of human behavior. Since large part of these anomalies has been detected with the help of economic experiments, we will spend a lot of time discussing this methodology and its examples.

Course goals and learning objectives:

This course has several learning objectives. First of all, it aims at developing interdisciplinary thinking. Behavioral Economics (broadly defined) combines knowledge from several disciplines, such as Economics, Psychology, Sociology and Neuroscience. Students will learn how to formalize the concepts from social sciences outside Economics (e.g., fairness, reciprocity, trust, envy etc.) and how to incorporate them into economic models. Second, the course is focused on understanding what is an economic experiment. Students will discover various types of experiments (lab, field, natural, etc.) and learn how to use experiments to test economic theories. Finally, the course helps to develop critical thinking with respect to the results of economic research. Students will have a chance to train their ability to be conscious readers of economic studies and integrate evidence from various sources.

Who can benefit from this course?

This course is for anyone who wants to broaden their understanding of human economic behavior. Since Behavioral Economics gets more and more incorporated into many areas of economic research anyone has a chance to come across its basic notions in their field of interest. The course implies that you have taken a course in Microeconomics as well as a course calculus and statistics.

Teaching language: English

Length: 1 term (2 modules)

Course outline:

(This is a new course; the outline is approximate and may change during the term.)

Lectures 1-2: Introduction to Behavioral Economics. Applying experimental methods in Economics.

The history of Behavioral Economics and the history of experimental methodology in Economics. How BE is different from mainstream Economics? We will see how the insights from psychology challenged the basic assumptions of economic theory. Types of experiments: lab, field, natural.

Lectures 3-4: Paradoxes of riskless choice. Endowment effect.

People often have to make choices in a riskless environment where very little uncertainty is involved, e.g. a choice whether to participate in an exchange or which of the two products to consume. We will consider the notions of willingness-to-pay and willingness-to-accept and the discrepancy between them that is called the endowment effect.

Lectures 5-7: Paradoxes of choice under risk. Prospect Theory.

Examples when the expected utility theory does not work. Main ingredients of Prospect Theory: reference-dependence, loss aversion, probability weighting. Examples of how PT works in real life.

Lectures 8-10: Other-regarding preferences.

Standard economic theory assumes that agents are completely selfish; they do not care about the utility of others. Two simple experiments – the Dictator and the Ultimatum game – have shown that this assumption does not correspond to reality. We will consider possible explanations of the observed willingness to share money with strangers: altruism, following social norms and inequity aversion (Fehr-Schmidt utility function).

Lectures 11-12: Trust and reciprocity.

Measuring trust is a tricky task. Generally people are asked to state whether they agree with the statement that others can be trusted. Economists have come up with an experiment allowing to measure the degree of trust and trustworthiness without asking for subjective assessments. We will consider the experimental trust and "lost wallet" games as well as the concept of a gift exchange economy.

Lectures 13-14: Public good experiments.

Standard economic theory suggests that in the absence of external control free-riding behavior should be observed. Economic experiments have shown however that people are often willing to contribute to the production of a public good. To what extent do people cooperate? What types of cooperation do we observe? What are the conditions that promote cooperation in the lab and in the field?

Lectures 15-16: Fairness and social preferences.

There are two main approaches to defining fairness: outcome-based and intention-based. Fairness implies punishment for what is considered as unfair behavior or allocation. We will focus on experiments that study when people are willing to punish others and to what extent. We will learn about various criteria for social preferences and how to disentangle them: inequity aversion, efficiency and maximin.

Lectures 17-18: Experiments on discrimination.

This topic demonstrates how experimental economics can be used to study social phenomena that have a large economic impact, such as discrimination. We consider various experiments that help to distinguish between various types of discrimination: animus, statistical or bargaining ability discrimination.

Lectures 19-21: Time-inconsistent preferences and the self-control problem.

We observe many examples of the self-control problem in real life: procrastination, failing to give up smoking, failing to meet deadlines, etc. This behavior is hard to explain assuming complete rationality. We will consider two approaches used to model the time-inconsistency of preferences: hyperbolic discounting and dual-self.

Lectures 22-23: Nudging: using Behavioral Economics to improve policy-making.

How can the insights from Behavioral Economics be used to nudge people to make better decisions? What is meant by the "soft paternalism"? What are the costs and benefits of this approach?

Lectures 24-25: Economics enters Psychology

Economic modeling can be used to understand and explain certain psychological phenomena, such as motivational crowding-out or inadequate self-esteem or self-confidence.

Lectures 26-27: The basics of Neuroeconomics.

Neuroeconomics is a new field that has started to emerge as an intersection between Neuroscience and Economics. How can these fields of research inform each other? We will consider the basic methods of observing the brain activity and measuring the physiological response of a human in the situations involving economic choice.

Evaluation:

Evaluation of this course consists of three parts.

(1) You will be asked to write a referee report on one of the research papers of your choice (from the list that I will provide). You may work individually or in a group of two. Your task will be to summarize the results of an experimental study recently published in a top-journal, explain the methodology used and the hypotheses tested, as well as discuss its potential drawbacks and flows, and provide possible cures for them.

(2) You will be asked to make a presentation on your report during seminar classes.*

*This part will depend on the availability of time and on the number of students that sign up for the course.

(3) Final test in the end of the term.

Final grade will be a sum of grades for each part with the following weights:

Referee report - 40%
Presentation – 20%
Final test – 40%

Attendance policy:

Although attendance is not included in the evaluation of this course, it is strongly recommended to attend all classes.