Syllabus

Features of this course

This course is the continuation of the 219A class in *Psychology and Economics – Theory*, taught by Botond Koszegi. As in 219A, we will keep emphasizing the psychological evidence as the basis for sound economic analysis. This should surprise nobody, given the name by which the course (and the field) goes. We will also insist on the importance of neoclassical theory as a very successful benchmark that you are required to know. Finally, several topics of this course are designed to be the empirical counterpart of the theory covered in 219A. This is in particular true for the sections on Self Control, Reference Dependent Preferences, and Social Preferences.

There are two main differences between 219A and 219B. First, this class has largely an empirical orientation, as opposed to the theoretical orientation of 219B. The emphasis on data just reflects the empirical status of economics. In particular, the success of the Psychology and Economics approach will depend on the empirical explanatory power of its theories. Can this approach explain evidence that the neoclassical model struggles with? Can it do so using parsimonious models? In 219B I will present empirical papers drawn from a variety of fields to try to address these questions. We will touch on consumption, public economics, labor economics, industrial organization, political economy, asset pricing, and corporate finance.

The second main feature of the course will be its emphasis on dissertation writing. This will be apparent in the exposition of the topics. More often than not, we will note that the available empirical evidence barely scratches the surface. While this is a drawback for the field, it is a great opportunity for students planning to work in the area. In very few other fields there are so many important questions that still go unanswered. Throughout the course I will do my best to point out what seem to me like good directions for empirical research. In addition, as an incentive to get you started, one of the requirements of the course is a paper on an applied topic. More on this below.
Rules of the game

As a general rule, you should have taken the 219A course before you take this course. If you have not, but are interested in taking this course, please come and talk to me. The prerequisites of the 219A course, that is, an understanding of the economics of uncertainty, contract theory, and game theory at the level of 201B, apply to this course as well. In addition, it is important that you have had exposure to econometrics and empirical research. You should be familiar with OLS estimation, panel data models, and discrete choice models. For example, you should have no uncertainty as to what fixed effects do in a regression. Although it is not a requirement for this course, I recommend taking at least one labor economics course to anyone contemplating doing empirical research.

Throughout the course, I will assign a few required readings each week. The required readings are starred in the reading list below. The non-starred readings are optional, but I suggest that you at least read the abstract. So much of a paper is in the abstract (if the abstract is well-written).

There are four requirements for the course: weekly assignments, an empirical problem set, a presentation, and a paper. The assignments are as follows. Every week I will assign a conference-style discussion of one of the required readings. The discussion is only due on eight of the thirteen weeks of the course, at your choice. In the discussion you should focus your attention on the content, the empirical strategy, or possible extensions of the paper. You do not need to summarize the paper. Given the high frequency of the assignment, the format requirements will be minimal. The discussion should be one- to two-pages long, and can be in a bullet format. The discussion is due to me by noon on Tuesday before lecture. This allows me to read them before class and try to integrate your comments in the lecture. You can either slide the discussion under my door or email it to me.

The other assignment is a one-time empirical problem set. This year, the problem set will focus on earning announcements and the response of stock prices to the new information contained in the announcements. We may also have, in alternative, another empirical problem set on the effect of the media. You can work on the assignment in groups of up to three people, but each one should hand in a solution. I will distribute the problem set at the beginning of March. The data will be in Stata format. I will assume that you have a working knowledge of Stata.

The second requirement is a 25-minute class presentation of the weekly reading. The presentation should have three parts: a. summary of the content of the paper; b. criticism of the paper; c. suggestions for new research. I will elicit your preferences on the topic for the presentation. These short presentations are a good practice for many to come in your academic career.

The third requirement for the course is an empirical paper. As a student, I hated courses that required a paper, but was very happy ex post that I had been forced to write one. As an attempt to make this commitment device more palatable, here are two technological innovations:

- The paper can be written in groups of up to 3 students.
- I encourage you to come up with your own topic for the paper. However, if you prefer more guidance, I have a few suggested paper topics that I can assign.

As for the timing, each person/group should come to see me by February 18. You should feel free to either come during office hours or to schedule an appointment via email. A two-page written proposal is due by March 17. The final 10-15 page paper is due on May 22. The ideal paper contains a novel idea, the empirical strategy, and preliminary empirical results. However, I will accept significantly less as long as you show significant effort.
A natural presentation outlet for these papers is the Psychology and Economics Lunch. You are strongly encouraged to attend this lunch if you are interested in making Psychology and Economics one of your fields. In addition, you should attend the Psychology and Economics Seminar (Tu 2-4) as much as you can. Spots to go for lunch with the speaker are available for sign-up.

The good news is, there is no exam for this course!

The course webpage is an important instrument for this course (http://emlab.berkeley.edu/users/webfac/dellavigna/e219b_sp04/e219b.shtml is the address of last year’s). On the website you will find updated lists of readings, the assignments, and the revised lecture notes in pdf format.

After class, I invite you to join me for a coffee at 3pm to chat about Berkeley, Psychology and Economics, Bush policies, Chicago economics, or any other favorite topic of yours.
Grading

The written discussions will be graded on a scale from 0 to 5 (excellent). The final grade will be an average of your best 5 discussions. You therefore have a bonus of three discussions which will not be counted. The class presentation and the paper are also graded on a scale from 0 to 5.

The final grade will be an average with weight 25% on the written discussions, 20% on the problem set, 15% on the class presentation, and 40% on the paper.

Tentative schedule of classes

The schedule will vary somewhat as the class unfolds. The syllabus will be updated on the web and will be available on the course webpage at http://emlab.berkeley.edu/users/webfac/dellavigna/e219b_sp04/e219b.shtml. (the course webpage)

January 19 – Lecture 1
   Introduction
   Good and Bad Psychology and Economics
   Present-Biased Preferences, Part 1

January 28 – No Lecture

February 2 – Lecture 2
   Present-Biased Preferences, Part 2

February 9 – Lecture 3
   Present-Biased Preferences, Part 3

February 16 – Lecture 4
   Present-Biased Preferences, Part 4
   Reference Dependence, Part 1

February 23 – No lecture

March 2 – Lecture cancelled for illness

March 9 – Lecture 5
   Reference Dependence, Part 2
   Effect of Experience

March 16 – Lecture 6
   Reference Dependence, Part 3
   Risk Aversion

March 23 – Spring Break – No Lecture

March 30 – Lecture 7
Framing and Narrow Framing

April 6 – Lecture 8
  Introduction to Behavioral and Empirical Corporate Finance
  Introduction to Behavioral and Empirical Accounting
  Financial Data Sets
  Empirical Problem Set Handed Out (Earnings Announcement)

April 13 – Lecture 9
  Introduction to Behavioral Asset Pricing
  Noise Traders
  Event Studies

April 18 – Lecture 10 (Notice: Monday, 12-2, Evans 4)
  Market Reaction to Biases, Part 1

April 20 – Lecture 11
  Market Reaction to Biases, Part 2

April 25 – Lecture 12 (Notice: Monday, 12-2, Evans 4)
  Economics of Media and attention

April 27 – Lecture 13
  Attention II
  Social Preferences
  Persuasion and Social Learning
  Empirical Problem Set Collected (Earnings Announcement)

May 4 – Lecture 14
  Overconfidence
  Choosing Topics for Dissertation
  Conclusion
Readings

*designates required readings.

Some of the readings will be taken from the textbook used in the previous semester of 203, that is, from *Choice, Values and Frames*:

*Kahneman and Tversky* *Choices, values and frames*, (henceforth CVF).

For those of you who are looking for a background book in social psychology to complement the content of the Psychology and Economics sequence, I recommend:


Introduction


1. Present-Biased Preferences

*Theory overview*  


http://elsa.berkeley.edu/~rabin/retire.pdf

*Status-Quo Bias in Financial Decisions*  


http://mitpress.mit.edu/catalog/item/default.asp?ttype=6&tid=7463

*James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick “Optimal Defaults and Active Decisions”*  
http://post.economics.harvard.edu/faculty/laibson/papers/AD_Dec1.pdf
Consumer Behavior

Wertenbroch, Klaus, “Consumption Self-Control by Rationing Purchase Quantities of Virtue and Vice,” Marketing Science, 17 (4), 317-337


Payday effect

Barenstein and Huffman “Beer, Steak and Whisky: Evidence of a Payday Spending-Spree”


Labor Economics

Public Economics


http://emlab.berkeley.edu/users/botond/attraction.pdf


Life-Cycle Consumption

http://econ-www.mit.edu/faculty/angelet/papers.htm

http://post.economics.harvard.edu/faculty/laibson/papers/msmpaper021004.pdf

Karlan et al.

Corporate Finance

Neural Evidence
*Samuel M. McClure, David Laibson, George Loewenstein and Jonathan D. Cohen) Separate Neural Systems Value Immediate and Delayed Monetary Rewards. Science 306, October 15 2004
Mixed Readings

2. Reference Dependence

Labor supply
CVF 20.


Goette, Lorenz and Huffman, David “Reference-Dependent Preferences and the Allocation of Effort Over Time”, 2004.

Market experience


Markets
http://finance.wharton.upenn.edu/~mayerc
Camerer, Colin. “Prospect theory in the wild: Evidence from the field”  
CVF 16

*Asset Pricing*
CVF 21

Heath, C., Huddart, S., and Lang, M., “Psychological factors and stock option exercises”,  


CVF 17.


Barberis, N. and Huang, M., “Mental Accounting, Los Aversion, and Individual Stock Returns”  

*Time preferences*

*Neural evidence*

### 3. Framing and Narrow Framing

*Risk Aversion*


*Constructed Preferences*
Loewenstein, George and Simonsohn, Uri. "Mistake #37: The Effect of Previously Faced Prices on Current Housing Demand".
http://www.mit.edu/~uws/housing121802.pdf


Framing / Anchoring


Bargaining

http://sds.hss.cmu.edu/faculty/Loewenstein/downloads/bargainingImpasse.pdf

Flypaper effect
Singhal, Monica. Special Interest Groups and the Allocation of Public Funds, mimeo.

4. Behavioral Finance


Empirical and Behavioral Corporate Finance I: CEOs
Jensen and Murphy (1990): "Are CEOs paid like Bureaucrats?"


See also:


Empirical and Behavioral Corporate Finance II: Boards

Empirical and Behavioral Corporate Finance III: Investment and Mergers
Andrade-Mitchell-Stafford, JEP, 2001

Empirical and Behavioral Corporate Finance IV: Financing and Dividends

Behavioral Asset Pricing


Event Studies


5. Market Reaction to Individual Biases

*Do biases matter?*
Becker, 1962


*Experienced and Inexperienced Agents*

*Pricing*
http://emlab.berkeley.edu/users/sdellavi/wp/self_control_dec03.pdf


*Corporate Decisions*


**Employers**


**Betting**


**Politicians**


**Welfare Maximization**


6. Attention and the Media

**Theory and Experiments**


Gabaix, Xavier and David Laibson “Bounded rationality and directed cognition”, Mimeo.


Financial Markets


Rewarding for Luck

Justin Wolfers, Are Voters Rational? Evidence from Gubernatorial Elections, Stanford GSB.

Labor Supply

Media Coverage and Government Behavior


Media Bias


Matt Gentzkow


7. Persuasion and Social Learning

Model

DeMarzo, Peter, Vayanos, Dimitry, and Zwiebel, Jeff. “Persuasion Bias, Social Influence, and Uni-Dimensional Opinions”, July 2002
http://web.mit.edu/dimitriv/www/PERSU.pdf

Implicit Persuasion

Huberman, Gur.

http://mitpress.mit.edu/catalog/item/default.asp?ttype=6&tid=7463

*Duflo, Esther and Saez, Emmanuel, "The Role of Information and Social Interactions in Retirement Plan Decisions: Evidence From a Randomized Experiment", Forthcoming, Quarterly Journal of Economics

Social Learning (not covered this year – see David Card’s Labor Economics class)
Bruce Sacerdote, “Peer effects with random assignment: Results for Dartmouth roommates”, Quarterly Journal of Economics, May 2001


Social Pressure

Luis Garicano, Ignacio Palacios-Huerta, and Canice Prendergast, "Favoritism Under Social Pressure"

Bernardo A. Huberman, Christoph H. Loch, and Ayse Önçüler “Status as a Valued Resource”, mimeo.


8. Social Preferences

*Gift exchange*


*Charitable donations*

*Andreoni, James. “Philantropy”, mimeo, 2004


*Field experiments*

9. Overconfidence

*Entrepreneurs*

*Investors*

*Managers*

*Additional Topics*

*Neuroeconomics*


*Samuel M. McClure, David Laibson, George Loewenstein and Jonathan D. Cohen) Separate Neural Systems Value Immediate and Delayed Monetary Rewards. Science 306, October 15 2004