

ECON6110U Behavioral Economics

Department of Economics, HKUST

Course Description

Behavioral economics stresses the need to incorporate psychological considerations into economics. The course covers three topics: (1) decision making under risk (loss aversion, probability weighting, reference dependence); (2) decision making across time (self-control, timing preference), (3) other-regarding preference (altruism, fairness, reciprocity). Evidence from financial market, saving behavior, labor market and other areas will be used to show how behavioral economics can be fruitfully applied to yield important insights into behavior under different settings. Overall, this course aims to help you develop skills on (1) how to incorporate psychology could help explain economic behavior, (2) how to apply behavioral economics to various economic and business settings.

Time: Tuesday, 13:30-15:20, 6/2/2024, 20/2/2024 to 7/5/2024

Venue: 4503 (near lift 25/26)

Instructor: ZHONG Songfa

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Office: LSK6009

Office hours: By appointment

Assessment

10%: Participation

20%: Homework

20%: Group Presentation

50%: Project

Participation

Attendance will be taken during the class.

Individual Homework

There will be 4 assignments.

Group Presentation

Each group is required to have one presentation. Each Presentation is 20 minutes including Q&A.

The presentation should contain two parts:

- Summary of readings:
 - The specific research question.
 - The important findings of the paper itself.
- Discussion:
 - Questions specific to the papers: What is good about the paper?
 - Broader economic questions: What have we learned?
 - What could you do to improve/extend the paper (this could be your research-proposal)?

Project

You are required to submit a project (10-15 pages, font size 12; line spacing double; due date is Tuesday of week 13). As behavioral economics emphasizes on the interplay between theory and experimental/empirical evidence, your project could be about either theory, experiment, or both. You do not have to develop the full results/models. You do need to explain your idea in details. I would like to encourage you to follow those topics discussed in the lectures and tutorials. Based on my experience, most of the proposals are about experiment. Here I would give you some guidelines for experimental proposals. If you are interested in theory, you can discuss with me in person. You can provide experiments to test the theories in our class, or to apply behavioral economics in the field. You can talk about your hypotheses, experimental design, and statistical tests to be used. Your group project should contain two parts:

- Literature review:
 - What is the specific research question in your mind?
 - The state of the field up to the point, both theoretical and empirical.
- Your contribution:
 - Provide specific hypotheses.
 - Discuss what is needed for the implementation of your idea.
 - Possible some data and specific results.

Reading list

I do not expect you to read all the papers. This list is meant to serve as a comprehensive reading guide so that you can better understand the lectures. While the exam will be solely based on the slides, you are encouraged to read the papers to have a more complete understanding of the topics. Below are some suggestions.

Required readings: The required readings are the key to the lectures. I would suggest read them carefully for those parts I cover in the slides.

Supplementary readings: The supplementary readings are related to some evidence I cover briefly in the class. I would suggest you read the introduction part to get some behavioral intuition from the papers.

Tutorial Readings: The readings in tutorial are required only for the presenting group. These readings are usually closely related to our lectures. These presentations could provide us opportunities to have some more discussions, and help you understand the lectures, and develop ideas for your project.

Reference Books: There is no textbook for this class. I would like to recommend you the following popular readings.

Ariely, D (2008). *Predictably Irrational: The Hidden Forces That Shape Our Decisions*. HarperCollins.

Kahneman, D. (2011). *Thinking, fast and slow*. Macmillan.

Thaler, R. H. (2015). *Misbehaving: The Making of Behavioral Economics*. WW Norton & Company.

Kahneman, D., Sibony, O., & Sunstein, C. R. (2021). *Noise: a flaw in human judgment*. Little, Brown.

Course Outline (Tentative)

Week 1: Introduction to Behavioral Economics

Required reading: Kahneman, D. (2003). Maps of bounded rationality: Psychology for behavioral economics. *American Economic Review*, 93(5), 1449-1475.

Supplementary reading: Tversky, A., & Kahneman, D. (1974). Judgment under uncertainty: Heuristics and biases. *Science*, 185(4157), 1124-1131.

Week 2: Prospect Theory

Required reading: Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 47(2), 263-291.

Tutorial 0: Tversky, A., & Kahneman, D. (1981). The framing of decisions and the psychology of choice. *Science*, 211(4481), 453-458.

Homework assignment 1

Week 3: Endowment Effect

Required reading: Kahneman, D, JL. Knetsch, and R Thaler. 1990. Experimental Tests of the Endowment Effect and the Coase Theorem.” *Journal of Political Economy*, 98: 1325-48.

Supplementary reading: Plott, CR., and Z Kathryn. 2005 “The Willingness to Pay/Willingness to Accept Gap, the “Endowment Effect, Subject Misconceptions and Experimental Procedures for Eliciting Valuations”, *American Economic Review*, 95: 530-545.

Supplementary reading: List, JA. 2003. Does Market Experience Eliminate Market Anomalies? *Quarterly Journal of Economics*, 118(1): 41-71.

Tutorial reading 1: Rottenstreich, Y., & Hsee, C. K. (2001). Money, kisses, and electric shocks: On the affective psychology of risk. *Psychological Science*, 12(3), 185-190.

Tutorial for homework assignment 1

Week 4: Reference Dependence

Supplementary reading: Köszegi, B., & Rabin, M. (2006). A model of reference-dependent preferences. *The Quarterly Journal of Economics*, 121(4), 1133-1165.

Supplementary reading: Abeler, J., Falk, A., Goette, L., & Huffman, D. (2011). Reference points and effort provision. *American Economic Review*, 101(2), 470-92.

Supplementary reading: Camerer, Colin, Babcock, Linda, Loewenstein, George, and Thaler, Richard. "Labor supply of New York City Cabdrivers: One day at a time, 1997, *Quarterly Journal of Economics*, pp. 407-42.

Tutorial reading 2: Benartzi, S., & Thaler, R. H. (1995). Myopic loss aversion and the equity premium puzzle. *The Quarterly Journal of Economics*, 110(1), 73-92.

Tutorial reading 3: Odean, T. (1998). Are investors reluctant to realize their losses?. *The Journal of Finance*, 53(5), 1775-1798.

Homework assignment 2

Week 5: Behavioral Games and Inequity Aversion

Required reading: Camerer, C. (2003). Dictator, ultimatum, and trust games. Behavioral game theory: Experiments in strategic interaction, 43-117.

Supplementary reading: Henrich, J. (2000). Does culture matter in economic behavior? Ultimatum game bargaining among the Machiguenga of the Peruvian Amazon. *American Economic Review*, 90(4), 973-979.

Supplementary reading: Fehr, E and K. Schmidt (1999), A theory of fairness, competition, and cooperation, *Quarterly Journal of Economics* 114, 817–68

Tutorial reading 4: Hong, H., & Kacperczyk, M. (2009). The price of sin: The effects of social norms on markets. *Journal of Financial Economics*, 93(1), 15-36.

Tutorial for homework assignment 2

Week 6: Fairness

Required reading: Camerer, C. (2003). Dictator, ultimatum, and trust games. Behavioral game theory: Experiments in strategic interaction, 43-117.

Supplementary reading: Rabin, M (1993), Incorporating fairness into game theory and economics, *American Economic Review* 83, 1281–02

Supplementary reading: Falk, A., Fehr, E., & Fischbacher, U. (2003). On the nature of fair behavior. *Economic Inquiry*, 41(1), 20-26.

Supplementary reading: List, J. A. (2007). On the interpretation of giving in dictator games. *Journal of Political economy*, 115(3), 482-493.

Supplementary reading: Hoffman, E., McCabe, K., & Smith, V. L. (1996). Social distance and other-regarding behavior in dictator games. *The American economic review*, 86(3), 653-660.

Supplementary reading: Hamman, J. R., Loewenstein, G., & Weber, R. A. (2010). Self-interest through delegation: An additional rationale for the principal-agent relationship. *American Economic Review*, 100(4), 1826-46.

Tutorial reading 5: Talhelm, T., Zhang, X., Oishi, S., Shimin, C., Duan, D., Lan, X., & Kitayama, S. (2014). Large-scale psychological differences within China explained by rice versus wheat agriculture. *Science*, 344(6184), 603-608.

Tutorial reading 6: Mousa, Salma. "Building social cohesion between Christians and Muslims through soccer in post-ISIS Iraq." *Science* 369, no. 6505 (2020): 866-870.

Homework assignment 3

Week 7: Gift Exchange

Required reading: Fehr, E., Goette, L., & Zehnder, C. (2009). A behavioral account of the labor market: The role of fairness concerns. *Annual Review of Economics*, 1(1), 355-384.

Supplementary reading: Fehr, E., Kirchsteiger, G., & Riedl, A. (1993). Does fairness prevent market clearing? An experimental investigation. *The Quarterly Journal of Economics*, 108(2), 437-459.

Supplementary reading: Gächter, S., & Falk, A. (2002). Reputation and reciprocity: Consequences for the labour relation. *Scandinavian Journal of Economics*, 104(1), 1-26.

Supplementary reading: Gneezy, U., & List, J. A. (2006). Putting behavioral economics to work: Testing for gift exchange in labor markets using field experiments. *Econometrica*, 74(5), 1365-1384.

Supplementary reading: Falk, A. (2007). Gift exchange in the field. *Econometrica*, 75(5), 1501-1511.

Supplementary reading: Kube, S., Maréchal, M. A., & Puppe, C. (2012). The currency of reciprocity: Gift exchange in the workplace. *American Economic Review*, 102(4), 1644-62.

Tutorial reading 7: Gneezy, U., Leonard, K. L., & List, J. A. (2009). Gender differences in competition: Evidence from a matrilineal and a patriarchal society. *Econometrica*, 77(5), 1637-1664.

Tutorial for Homework assignment 3

Week 8: Dark Side of Incentive

Required reading: Gneezy, U., & Rustichini, A. (2000). A fine is a price. *The Journal of Legal Studies*, 29(1), 1-17.

Supplementary reading: Gneezy, U., & Rustichini, A. (2000). Pay enough or don't pay at all. *The Quarterly Journal of Economics*, 115(3), 791-810.

Supplementary reading: Falk, A., & Kosfeld, M. (2006). The hidden costs of control. *American Economic Review*, 96(5), 1611-1630.

Supplementary reading: Ariely, D., Gneezy, U., Loewenstein, G., & Mazar, N. (2009). Large stakes and big mistakes. *The Review of Economic Studies*, 76(2), 451-469.

Tutorial reading 8: Falk, A., & Szech, N. (2013). Morals and markets. *Science*, 340(6133), 707-711.

Tutorial reading 9: Cameron, L., Erkal, N., Gangadharan, L., & Meng, X. (2013). Little emperors: behavioral impacts of China's One-Child Policy. *Science*, 339(6122), 953-957.

Week 9: Time Preference and Self-control

Required reading: O'Donoghue, T., & Rabin, M. (1999). Doing it now or later. *American Economic Review*, 89(1), 103-124.

Supplementary reading: Ericson, K. M., & Laibson, D. (2019). Intertemporal choice. In Handbook of Behavioral Economics: Applications and Foundations 1 (Vol. 2, pp. 1-67). North-Holland.

Tutorial reading 10: Yeager, D. S., Hanselman, P., Walton, G. M., Murray, J. S., Crosnoe, R., Muller, C., ... & Dweck, C. S. (2019). A national experiment reveals where a growth mindset improves achievement. *Nature*, 573(7774), 364-369.

Tutorial reading 11: Duckworth, A. L., Peterson, C., Matthews, M. D., & Kelly, D. R. (2007). Grit: perseverance and passion for long-term goals. *Journal of personality and social psychology*, 92(6), 1087.

Homework assignment 4

Week 10: Commitment Devices

Required reading: Charness, G., & Gneezy, U. (2009). Incentives to exercise. *Econometrica*, 77(3), 909-931.

Supplementary reading: Ariely, D., & Wertenbroch, K. (2002). Procrastination, deadlines, and performance: Self-control by precommitment. *Psychological science*, 13(3), 219-224.

Supplementary reading: Giné, X., Karlan, D., & Zinman, J. (2010). Put your money where your butt is: a commitment contract for smoking cessation. *American Economic Journal: Applied Economics*, 2(4), 213-35.

Tutorial reading 12: Moffitt, T. E., Arseneault, L., Belsky, D., Dickson, N., Hancox, R. J., Harrington, H., ... & Caspi, A. (2011). A gradient of childhood self-control predicts health, wealth, and public safety. *Proceedings of the national Academy of Sciences*, 108(7), 2693-2698.

Tutorial for Homework assignment 4

Week 11: Neuroeconomics

Required reading: Camerer, C., Loewenstein, G., & Prelec, D. (2005). Neuroeconomics: How neuroscience can inform economics. *Journal of economic Literature*, 43(1), 9-64.

Supplementary reading: Ebstein, R. P., Israel, S., Chew, S. H., Zhong, S., & Knafo, A. (2010). Genetics of human social behavior. *Neuron*, 65(6), 831-844.

- Supplementary reading: Benjamin, D. J., Cesarini, D., Chabris, C. F., Glaeser, E. L., Laibson, D. I., Age, Gene/Environment Susceptibility-Reykjavik Study:, ... & Lichtenstein, P. (2012). The promises and pitfalls of genoconomics. *Annual Review of Economics.*, 4(1), 627-662.
- Tutorial reading 13: Gailliot, M. T., Baumeister, R. F., DeWall, C. N., Maner, J. K., Plant, E. A., Tice, D. M., ... & Schmeichel, B. J. (2007). Self-control relies on glucose as a limited energy source: willpower is more than a metaphor. *Journal of personality and social psychology*, 92(2), 325.
- Tutorial reading 14: Danziger, S., Levav, J., & Avnaim-Pesso, L. (2011). Extraneous factors in judicial decisions. *Proceedings of the National Academy of Sciences*, 108(17), 6889-6892.

Week 12: Behavioral Household Finance

- Required reading: Thaler, R. H., & Benartzi, S. (2004). Save more tomorrow™: Using behavioral economics to increase employee saving. *Journal of Political Economy*, 112(S1), S164-S187.
- Supplementary reading: Ashraf, N., Karlan, D., & Yin, W. (2006). Tying Odysseus to the mast: Evidence from a commitment savings product in the Philippines. *The Quarterly Journal of Economics*, 121(2), 635-672.
- Supplementary reading: Carroll, G. D., Choi, J. J., Laibson, D., Madrian, B. C., & Metrick, A. (2009). Optimal defaults and active decisions. *The Quarterly Journal of Economics*, 124(4), 1639-1674.
- Tutorial reading 15: Cole, Shawn, Benjamin Iverson, and Peter Tufano. "Can gambling increase savings? Empirical evidence on prize-linked savings accounts." *Management Science* (2021).
- Tutorial reading 16: Dur, R., Fleming, D., van Garderen, M., & van Lent, M. (2021). A social norm nudge to save more: A field experiment at a retail bank. *Journal of Public Economics*, 200, 104443.

Week 13: Behavioral Development Economics

Required reading: Banerjee, A. V., & Duflo, E. (2007). The economic lives of the poor. *Journal of Economic Perspectives*, 21(1), 141-168.

Supplementary reading: Mani, A., Mullainathan, S., Shafir, E., & Zhao, J. (2013). Poverty impedes cognitive function. *Science*, 341(6149), 976-980.

Supplementary reading: Carvalho, L. S., Meier, S., & Wang, S. W. (2016). Poverty and economic decision-making: Evidence from changes in financial resources at payday. *American Economic Review*, 106(2), 260-84.

Supplementary reading: Ashraf, N., Berry, J., & Shapiro, J. M. (2010). Can higher prices stimulate product use? Evidence from a field experiment in Zambia. *American Economic Review*, 100(5), 2383-2413.

Supplementary reading: Banerjee, A., Duflo, E., Goldberg, N., Karlan, D., Osei, R., Parienté, W., ... & Udry, C. (2015). A multifaceted program causes lasting progress for the very poor: Evidence from six countries. *Science*, 348(6236).