

Psychology and Economics: Foundations – Econ 219B  
Spring 2010  
Wednesday 12-3, 608-7 Evans Hall

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## **Schedule of classes (Stefano's Part – Updated on 4/7/10)**

The schedule will vary somewhat as the class unfolds. The syllabus will be updated periodically on course webpage. Grading for my part of the course will be 20% on one problem set, 50% on the final exam, and 30% on your choice of an empirical problem set or a short (5-10 page) proposal for an empirical paper. The proposal can be on any topic we touched on in the class, or a related topic, and can be joint in a group of up to 3 students. The paper can also be of an applied theory type, applying one of the models covered in the class (including in Matthew's part) to a specific topic (such as labor supply, consumption, taxation, etc.)

A reminder that the grade for my part will depend on

February 24 – Lecture 1

**Non-Standard Preferences**

Present-Biased Preferences, Part 1

Status-Quo in Financial Decisions

Consumption Choices

Methodological Topic: Reading the Psychology Journals

March 17 – Lecture 2

Present-Biased Preferences, Part 2

Consumption Choices

Life-Cycle Savings I

Summary of the Applications

Methodological Topic: Common Errors in Applying Present-Biased Preferences

**Non-Standard Beliefs, Part 1**

Overconfidence I

March 24 – Spring Break – No Lecture

March 31 – Lecture 3

Non-Standard Beliefs, Part 2

Overconfidence II

Law of Small Numbers

Projection Bias

Methodological Topic: Clustering Standard Errors

**Non-Standard Decision-Making**

Limited Attention, Part 1

Simple model

eBay Auctions

April 7 – Lecture 4

Limited Attention, Part 2  
Consumer Behavior  
Financial Market Evidence  
Methodological Topic: Portfolio Methodology  
Framing  
Menu Effects, Part 1  
Excess Diversification  
Choice Avoidance  
Methodological Topic: Clustering of Standard Errors  
Problem set assigned

April 14 – Lecture 5  
Menu Effects, Part 2  
Preference for Familiar  
Preference for Salient  
Confusion  
Persuasion  
Social Pressure  
Methodological Topic: Human Subjects Approval  
Empirical problem set assigned

April 21 – Lecture 6  
**Market Response to Biases**  
Behavioral IO  
Behavioral Labor  
Behavioral Finance  
Behavioral Corporate Finance  
Behavioral Political Economy  
Problem set due

April 28 – Lecture 7 (Matthew and Stefano)  
Behavioral Welfare Economics  
Emotions  
Empirical Methodologies in Psychology and Economics  
Methodological Topic: Five Ways to Write a Psychology and Economics Paper

May 5 – In-class exam

May 12 – Empirical problem set or paper proposal due

## Readings

\*designates required readings.

The following paper covers, in a dense manner, the topics covered in the class:

\* DellaVigna, Stefano, "Psychology and Economics: Evidence from the Field", *Journal of Economic Literature*, 2009.

### February 24 – Lecture 1

#### Present-Biased Preferences: Status-Quo Bias in Financial Decisions I

\* Madrian, Brigitte C. and Dennis F. Shea. 2001. "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior." *Quarterly Journal of Economics*, 116(4): 1149-1187.

\* Choi, James J., David Laibson, Brigitte C. Madrian and Andrew Metrick. 2006. "Saving for Retirement on The Path of Least Resistance," in Ed McCaffrey and Joel Slemrod, eds., *Behavioral Public Finance: Toward a New Agenda* New York: Russell Sage Foundation, pp. 304-351.

\* O'Donoghue, Ted and Matthew Rabin. 2001. "Choice and Procrastination," *Quarterly Journal of Economics*, 121-160.

O'Donoghue, Ted and Matthew Rabin. 1999 "Doing It Now or Later," *American Economic Review*, 89(1), 103-124.

Ted O'Donoghue and Matthew Rabin. "Procrastination in Preparing for Retirement", in *Behavioral Dimensions of Retirement Economics*, Henry Aaron, editor, The Brookings Institution, 1999.

\* Carroll, Gabriel D.; Choi, James J. and David Laibson and Brigitte Madrian and Andrew Metrick. 2007."Optimal Defaults and Active Decisions," *Quarterly Journal of Economics*, forthcoming.

Cronqvist, Henrik, and Richard H. Thaler. 2004 "Design Choices in Privatized Social-Security Systems: Learning from the Swedish Experience." *American Economic Review Papers and Proceedings*, Vol. 94(2), pp. 424-428.

Abadie, Alberto, and Sebastien Gay. 2006. "The Impact of Presumed Consent Legislation on Cadaveric Organ Donation: A Cross-Country Study" *Journal of Health Economics*, 25(4): 599--620.

#### Comparison to Effect of Financial Education

Duflo, Esther and Emmanuel Saez. 2003. "The Role Of Information And Social Interactions In Retirement Plan Decisions: Evidence From A Randomized Experiment." *Quarterly Journal of Economics*, 118(3): 815-842.

Choi, James J., David Laibson, Brigitte C. Madrian and Andrew Metrick. 2006. "Saving for Retirement on The Path of Least Resistance," in Ed McCaffrey and Joel Slemrod, eds.,

*Behavioral Public Finance: Toward a New Agenda* New York: Russell Sage Foundation, pp. 304-351.

*Present-Biased Preferences: Consumer Behavior I (Investment Goods)*

\* Ariely, Dan and Wertenbroch, Klaus (2002), "Procrastination, Deadlines, and Performance: Self-Control by Precommitment, *Psychological Science*, 13 (May), 219-224

**March 17 – Lecture 2**

*Present-Biased Preferences: Consumer Behavior I (Investment Goods)*

\* DellaVigna, Stefano and Malmendier, Ulrike. 2006. "Paying Not To Go To The Gym", *American Economic Review*, 96(3): 694-719.

*Present-Biased Preferences: Consumer Behavior II (Leisure Goods)*

\* Ausubel, Lawrence. "Adverse Selection in the Credit Card Market", Working Paper, University of Maryland, June 1999.

*Present-Biased Preferences: Life-Cycle Consumption and Savings Decisions I*

\* David Laibson, Andrea Repetto and Jeremy Tobacman, "Estimating Discount Functions from Lifecycle Consumption Choices" January 26, 2004.

Laibson, David. 1997. "Golden eggs and hyperbolic discounting", *Quarterly Journal Of Economics*, Vol. 112(2), pp. 443-77.

Angeletos, George-Marios, David Laibson, Jeremy Tobacman, and Stephen Weinberg. 2001. "The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation." *Journal of Economic Perspectives*, 15(3).

\* Ashraf, Nava, Dean Karlan, and Wesley Yin. 2006. "Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines." *Quarterly Journal of Economics* 121, no. 2.

*Methodology: Common Errors in Applying Present-Biased Preferences*

Fang, Hanming, and Dan Silverman. 2004. "Time-inconsistency and Welfare Program Participation: Evidence from NSLY." *Cowles Foundation Discussion Papers No 1465*.

Shui, Haiyan, and Ausubel, Lawrence. "Time Inconsistency in the Credit Card Market", Working Paper.

*Overconfidence I*

Camerer, Colin, and D. Lovallo (1999) "Overconfidence and Excess Entry: An Experimental Approach," *American Economic Review*, 89:1 (March), 306-318.  
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Cowgill, Bo, Justin Wolfers, and Eric Zitzewitz. 2008. "Using Prediction Markets To Track Information Flows: Evidence from Google" Working Paper.

**March 31 – Lecture 3**

### Overconfidence II

\* Malmendier, Ulrike, and Geoffrey Tate. 2008. "Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction," *Journal of Financial Economics*.

Malmendier, Ulrike, and Geoffrey Tate. 2005. "CEO Overconfidence and Corporate Investment." *Journal of Finance*, 60 (6): 2661-2700.

\* Odean, Terrance. 1999. "Do investors trade too much?" *American Economic Review*, 89: 1279—1298.

Odean, T. "Boys will be Boys: Gender, Overconfidence, and Common Stock Investment" with Brad Barber, *Quarterly Journal of Economics*, February 2001, Vol. 116, No. 1, 261-292.

Daniel, Kent D., David Hirshleifer, and Avanidhar Subrahmanyam. 1998. "Investor psychology and security market under- and over-reactions", *Journal of Finance*, 53: 1839--1886.

### Law of Small Numbers

Terrell, Dek. 1994. "A Test of the Gambler's Fallacy -- Evidence from Pari-Mutuel Games," *Journal of Risk and Uncertainty*, 8(3): 309-317.

\* Benartzi, Shlomo. 2001. "Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock" *Journal of Finance*, 56(5):1747-1764.

Barberis, Nicholas, Andrei Shleifer and Robert Vishny. 1998. "A model of investor sentiment", *Journal of Financial Economics*, 49: 307-345.

### Projection Bias

\* Conlin, Michael, Ted O'Donoghue, and Timothy J. Vogelsang. Forthcoming. "Projection Bias in Catalog Orders." *American Economic Review*.

### Limited Attention: eBay Auctions

\* Hossain, Tanjim and John Morgan. 2006. "...Plus Shipping and Handling: Revenue (Non) Equivalence in Field Experiments on eBay," *Advances in Economic Analysis & Policy*, 6(2): 1429-1429.

Hossain, Tanjim and John Morgan. 2007. "Shrouded Attributes and Information Suppression: Evidence from Field Experiments" Working Paper.

## **April 7 – Lecture 4**

### Limited Attention: Consumption Behavior

\* Chetty, Raj, Looney, Adam, and Kroft, Kory. 2007. "Salience and Taxation: Theory and Evidence from a Field Experiment".

Lacetera, Micola, Devin Pope, and Justin Sydnor. 2009. "Inattention in the Used Car Market" working paper.

### Limited Attention: Financial Market Evidence

Huberman, Gur, and Tomer Regev. 2001. "Contagious Speculation and a Cure for Cancer: A Nonevent that Made Stock Prices Soar." *Journal of Finance*, 56(1): 387-396.

\* Cohen, Lauren, and Andrea Frazzini. Forthcoming. "Economic Links and Predictable Returns", *Journal of Finance*, 63, no. 4 (August 2008).

\* DellaVigna, Stefano and Joshua Pollet. 2007. "Demographics and Industry Returns" *American Economic Review*, 97: 1167-1702.

DellaVigna, Stefano and Joshua Pollet. Forthcoming. "Investor Inattention and Friday Earnings Announcements" *Journal of Finance*.

Hirshleifer, David A., Sonya S. Lim, and Siew Hong Teoh. 2007. "Driven to Distraction: Extraneous Events and Underreaction to Earnings News" Mimeo.

Menu Effects: Excess Diversification

\* Benartzi, Shlomo and Richard H. Thaler. 2001. "Naive Diversification Strategies in Defined Contribution Saving Plans." *American Economic Review*, 91(1): 79-98.

\* Huberman, Gur, and Wei Jiang. 2006. "Choices in 401(k) Plans: Equity Exposure and Number of Funds." *Journal of Finance*, 61(2): 763-801.

**April 14 – Lecture 5**

Menu Effects: Choice Avoidance

Iyengar, Sheena and Mark Lepper. 2000. "When Choice is Demotivating: Can One Desire Too Much of a Good Thing?" *Journal of Personality and Social Psychology*, 79(6): 995-1006.

Choi, James J., David Laibson, and Brigitte C. Madrian. 2006. "Reducing The Complexity Costs of 401(k) Participation Through Quick Enrollment" NBER Working Paper No. 11979.

Iyengar, Sheena S., Gur Huberman, and Wei Jiang. 2004. "How Much Choice Is Too Much? Contributions to 401(k) Retirement Plans," in *Pension Design and Structure: New Lessons from Behavioral Finance*, ed. by O. S. Mitchell, and S. P. Utkus, chap. 5. Oxford University Press.

\* Bertrand, Marianne, Dean Karlan, Sendhil Mullainathan, Eldar Shafir, and Jonathan Zinman. 2006. "What's Psychology Worth? A Field Experiment in the Consumer Credit Market." Working paper.

Simonson, Itamar and Tversky, Amos. Choice in Context: Tradeoff Contrast and Extremeness Aversion, *Journal of Marketing Research*, Vol. XXIX, 1992

Menu Effects: Preference for Familiar

French, Kenneth R. and Poterba, James M. 1991. "Investor Diversification and International Equity Markets" *American Economic Review*, 81: 222-226.

Huberman, Gur. 2001. "Familiarity Breeds Investment," *Review of Financial Studies*, 14(3): 659-680.

Benartzi, Shlomo. 2001. "Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock" *Journal of Finance*, 56(5):1747-1764.

Menu Effects: Preference for Salient

Ho, Daniel E., and Kosuke Imai. "The Impact of Partisan Electoral Regulation: Ballot Effects from the California Alphabet Lottery, 1978-2002.", 2004.

\* Barber, Brad and Odean, Terry. "All that Glitters: The Effect of Attention and News on the Buying Behavior of Individual and Institutional Investors", April 2002.

#### Menu Effects: Confusion

\* Shue, Kelly and Erzo Luttmer. 2007. "Who Misvotes? The Effect of Differential Cognition Costs on Election Outcomes," NBER Working Paper No. 12709.

Michael S. Rashes. 2001. "Massively Confused Investors Making Conspicuously Ignorant Choices (MCI--MCIC)." *Journal of Finance*, 56(5): 1911-1927.

#### Persuasion

Cain, Daylain, George Loewenstein, and Don Moore. 2005. "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest," *Journal of Legal Studies*, 34, 1-25.

\* DellaVigna, Stefano and Kaplan, Ethan. 2007. "The Fox News Effect: Media Bias and Voting", *Quarterly Journal of Economics*.

Malmendier, Ulrike, and Devin Shanthikumar. 2007. "Are Small Investors Naive about Incentives?", *Journal of Financial Economics*, 85(2), 457-489.

Duflo, Esther and Emmanuel Saez. 2003. "The Role Of Information And Social Interactions In Retirement Plan Decisions: Evidence From A Randomized Experiment." *Quarterly Journal of Economics*, 118(3): 815-842.

#### Social Pressure

Asch, "Opinions and social pressure," *Scientific American*, 193, 1955.

Milgram, Stanley. 1963. "Behavioral study of obedience." *Journal of Abnormal and Social Psychology*, 67: 371-378.

Garicano, Luis, Ignacio Palacios-Huerta, and Canice Prendergast. 2005. "Favoritism Under Social Pressure," *Review of Economics and Statistics*, 87(2): 208-216.

Armin Falk, Andrea Ichino, "Clean Evidence on Peer Pressure", *Journal of Labor Economics*, 2006.

\* Mas, Alexander and Moretti, Enrico. "Peers at Work", *American Economic Review*, forthcoming.

### **April 21 – Lecture 6**

#### Market Response to Bias: Pricing

\* DellaVigna, Stefano and Ulrike Malmendier. 2004. "Contract Design and Self-Control: Theory and Evidence." *Quarterly Journal of Economics*, 119: 353-402.

Ellison, Glenn. 2006. "Bounded Rationality in Industrial Organization" in Blundell, Newey and Persson (eds.), *Advances in Economics and Econometrics: Theory and Applications*, Ninth World Congress, Cambridge University Press.

Eliasz, Kfir and Spiegel, Ran. "Contracting with Diversely Naive Agents," *Review of Economic Studies*, 2006.

Gabaix, Xavier and David Laibson. "Competition and Consumer Confusion", March 2004.

Gabaix, Xavier, and David Laibson. 2006. "Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets." *Quarterly Journal of Economics*, 121(2): 505-540.

Heidhues, Paul, and Botond Köszegi. 2005. "The Impact of Consumer Loss Aversion on Pricing." Working Paper.

Market Response to Biases: Behavioral Finance

\* Barberis, Nicholas and Richard Thaler. 2003. "A Survey of Behavioral Finance." *Handbook of the Economics of Finance*.

\* DeLong, B. Shleifer, A., Summers, L., and Waldman, R., "Noise trader risk in financial markets", *JPE*, v98 n4, Aug 1990, p.703-38. Reprinted in Richard H. Thaler, ed., *Advances in Behavioral Finance*, Russell Sage Foundation, 1993.

Shleifer, Andrei, Summers, Lawrence. "The Noise Trader Approach to Finance". *Journal of Economic Perspectives*, Spring, 1990.

Shleifer, Andrei. *Clarendon Lectures: Inefficient Markets*, Oxford University Press, 2000.

Market Response to Biases: Employers

Kahneman, Daniel, Jack L. Knetsch, and Richard H. Thaler. 1986. "Fairness and the assumptions of economics." *Journal of Business*, 59(4): S285-S300.

Bewley, Truman F. 1999. *Why Wages Don't Fall During a Recession*, Harvard University Press.

Card, David, and Hyslop, D. "Does inflation grease the wheels of the labor market?" in C. D. Romer and D. H. Romer (eds.), *Reducing Inflation: Motivation and Strategy*. NBER, Studies in Business Cycles, 30. Chicago: University of Chicago Press.

Market Response to Biases: Corporate Decisions

\* Baker, Malcolm, Richard Ruback, and Jeffrey Wurgler. 2006. "Behavioral Corporate Finance: A Survey." In *The Handbook of Corporate Finance: Empirical Corporate Finance*, edited by Espen Eckbo. New York: Elsevier/North Holland.

Baker, Malcolm, and Jeffrey Wurgler (2000), "Market Timing and Capital Structure," *Journal of Finance* 57, 1-32

DeGeorge, Francois, Patel, Jay, and Zeckhauser, Richard. "Earnings Management to Exceed Thresholds," *Journal of Business*, 1999.

Market Response to Biases: Politicians

\* Eisensee, Thomas and David Strömberg. 2007. "News Floods, News Droughts, and U.S. Disaster Relief" *Quarterly Journal of Economics*.



Glaeser, Edward “The Political Economy of Hatred”, *Quarterly Journal of Economics*, 2005, 120, pp. 45-86.

Methodology: Do Markets Eliminate Biases?

**April 28 – Lecture 7 (Stefano and Matthew)**

Market Response to Biases: Welfare Maximization

\* Benartzi, Shlomo and Richard Thaler. 2004. “Save More Tomorrow (TM): Using Behavioral Economics to Increase Employee Saving.” *Journal of Political Economy*, 112(S1): S164-S187.

Glaeser, Edward. 2006. “Paternalism and Psychology” *The University of Chicago Law Review*, 73(1): 133-156.

Emotions: Mood

Loewenstein, George and Jennifer Lerner. 2003. “The Role of Affect in Decision Making,” in *Handbook of Affective Science*, eds. Richard J. Dawson, Klaus R. Scherer and H. Hill Goldsmith, Oxford: Oxford University Press, 619-42.

Saunders, E. M. J., 1993. “Stock Prices and Wall Street Weather”, *American Economic Review*, 83, 1337-1345.

\* Hirshleifer, David A. and Tyler Shumway. 2003. “Good Day Sunshine: Stock Returns and the Weather”, *Journal of Finance*, 58(3), 1009-1032.

Edmans, Alex, Diego Garcia, and Oyvind Norli. 2007. “Sports Sentiment and Stock Returns” *Journal of Finance*, 62(4).

Simonsohn, Uri. 2007. “Weather to Go To College”, Working Paper.

Emotions: Arousal

Ariely, Dan and George Loewenstein. 2005. “The Heat of the Moment: The Effect of Sexual Arousal on Sexual Decision Making”, *Journal of Behavioral Decision Making*, 18(1), 1-12.

\* Dahl, Gordon and Stefano DellaVigna. 2007. “Does Movie Violence Increase Violent Crime?”, Working Paper.