

BEPP 220: BEHAVIORAL ECONOMICS, MARKETS, AND PUBLIC POLICY
University of Pennsylvania
The Wharton School
TTh 12-1:20pm, SHDH 1201

Professor Jeremy Tobacman
tobacman@wharton.upenn.edu
Office Hours: After class, W 2-3pm,
or by appointment, 1409 SHDH

TA Vicki Chen
cvicki@wharton.upenn.edu
Office Hours: M 2-3pm

Course Description: Behavioral economics applies insights from psychology to the study of economic phenomena. This course will take the possibility of deviations from rational, self-interested behavior as a starting point, and explore two main questions: How does psychology play out in markets, where sophisticated and unsophisticated consumers and firms interact and compete? And what does behavioral economics imply for public policy?

Markets have the potential to protect consumers from their biases, when firms compete to give biased consumers the best deal. In addition, markets allow for the emergence of informational intermediaries that give biased consumers advice. We will examine whether and how competition is a miracle remedy, in a diverse array of markets.

Behavioral economics also affects what governments should do and what governments actually do, when they address market failures, combat poverty and inequality, and raise revenue. This course therefore also explores “Behavioral Public Finance” – optimal policy in the presence of biases – and “Behavioral Political Economy” – how biases affect the choices of politicians and regulators themselves.

Reading: The main text for this course will be:

Policy and Choice: Public Finance through the Lens of Behavioral Economics, William Congdon, Jeffrey Kling and Sendhil Mullainathan, Brookings Institution Press 2011.

This is available for purchase or free pdf download from:

<http://www.brookings.edu/press/Books/2011/policyandchoice.aspx>, and is referred to below as *Policy and Choice*. Other required readings are indicated below, and all should be downloadable from the links indicated.

General (optional) background sources:

1. Matthew Rabin, "Psychology and Economics," *Journal of Economic Literature* 36, 11-46, March 1998. <http://www.jstor.org/stable/pdfplus/2564950.pdf>
2. A public economics textbook. I recommend Gruber, *Public Finance and Public Policy*.

Other required course materials, including occasional additional readings and slides from the lectures, will be posted on Canvas. Slides may be posted before or after the relevant class meeting.

Grading:

First Exam	20%
Second Exam	40%
Homework	30%
Class Participation	10%

The closed book exams will cover material from Sessions 1-13 (first exam) and all Sessions (second exam). Homework assignments will be announced during the semester. You will always have at least one week to complete each assignment. Unless otherwise indicated, all assignments must be submitted via Canvas. Late assignments will not be accepted. You are encouraged to collaborate with fellow classmates in discussing homework assignments, but (i) such collaboration must be acknowledged at the top of your homework submissions, and (ii) you must write up your work independently.

Class Participation: You must come to class prepared. All reading must be completed before class, and you should be ready to discuss the concepts and applications when you arrive. Expect cold-calling. Successful participation in class will reflect positively on your class participation grade, as will regular attendance and on-time arrival.

Prerequisites: Introductory microeconomics and univariate calculus. Prior exposure to consumer and producer optimization, as covered in an intermediate microeconomics course like BEPP 250, would be useful but is not required.

Add/Drop and Withdrawal Deadlines: As per Wharton / Penn policy, you may drop a course with no notation on your transcript until Friday, October 3, 2014. From Saturday, October 4, 2014 through Friday, November 7, 2014, you may withdraw from the course, but only with the written permission of Professor Tobacman. Withdrawals appear on the transcript as a W and are not calculated in the GPA. After November 7, 2014, withdrawals will not be permitted.

Exam Regrades: Exams will be scanned and returned to you via Canvas. To submit a regrade request for an exam, as a comment on your exam in Canvas you must upload a signed regrade affidavit (see the course Canvas for the template), including a written memorandum explaining why you think that the exam grading was in error. This request must be submitted within 5 business days after the graded examination papers have been made available to you. Your entire exam will then be reviewed, and your grade may go down, go up, or remain unchanged.

Missing an Exam: Students may miss scheduled examinations only with a University-approved excuse; such valid excuses include direct conflicts with another course offered at Penn that cannot be rescheduled as well as a varsity (but not club) sport competition (but not training). In particular, job interviews are not a legitimate reason to miss an exam. Missing an exam without a University-approved excuse will result in a zero for the exam.

Expectations: All students must become familiar with and adhere to the Penn Code of Academic Integrity. See http://www.upenn.edu/academicintegrity/ai_codeofacademicintegrity.html Class attendance and punctuality are expected. Table tents must be brought to class. Use of laptops during class will be permitted for course-relevant tasks.

Course Outline and Schedule

Session 1: Th 8/28

Introduction: Behavioral Economics, Markets, and Public Policy

Policy and Choice, Chapter 1

Richard Thaler, "The Psychology and Economics Conference Handbook," *Journal of Business*, (1986), 54:2 pt 2, S279-S284.

<http://faculty.chicagobooth.edu/Richard.Thaler/research/pdf/The%20Psychology%20and%20Economics.pdf>

Session 2: T 9/2

Behavioral Welfare Economics

Daniel Kahneman and Richard Thaler, "Anomalies: Utility Maximization and Experienced Utility," *Journal of Economic Perspectives*, 20:1 (Winter, 2006), pp. 221-234

<http://www.jstor.org/stable/30033642>

Policy and Choice, Appendices A&B and Chapter 2

Session 3: Th 9/4

Old-Age Insurance

Policy and Choice, Chapter 3

Ayşe İmrohoroglu, Selahattin İmrohoroglu and Douglas Joines, "Time-Inconsistent Preferences and Social Security," *Quarterly Journal of Economics*, 118:2 (May, 2003), pp. 745-784. <http://www.jstor.org/stable/25053919>

Policy and Choice, Chapter 4

Session 4: T 9/9

Asymmetric Information: Old-Age Insurance, Continued

Policy and Choice, Chapter 4

Session 5: Th 9/11

Asymmetric Information: Health Insurance and Unemployment Insurance

Policy and Choice, Chapter 4

Session 6: T 9/16

Externalities and Internalities

Policy and Choice, Chapter 5

Jonathan Gruber, "Smoking's 'Internalities'," *Regulation*, 25(4), Winter 2002-2003, p. 52-57. <http://economics.mit.edu/files/6441>

Session 7: Th 9/18

Public Goods, Education

Policy and Choice, Chapter 5

Session 8: T 9/23

Psychology and Social Welfare

Policy and Choice, Chapter 6

Th 9/25: Rosh Hashanah - No meeting. Make-up to-be-confirmed, tentatively Th 10/2

Session 9: T 9/30

Behavioral Economics and Transfer Policy

Policy and Choice, Chapter 6

Raj Chetty and Emmanuel Saez, "Teaching the Tax Code: Earnings Responses to an Experiment with EITC Recipients," *American Economic Journal: Applied Economics*, 5(1): 1-31, 2013. <http://obs.rc.fas.harvard.edu/chetty/eitcblock.pdf>

Session 10: Th 10/2

Taxation and Revenue

Raj Chetty, "Salience and Taxation: Evidence and Policy Implications," Testimony for the Committee of Finance, United States Senate.

<http://www.finance.senate.gov/imo/media/doc/033011rc.pdf>

Raj Chetty, Adam Looney, and Kory Kroft. 2009. "Salience and Taxation: Theory and Evidence." *American Economic Review*, 99(4): 1145-77.

<http://pubs.aeaweb.org/doi/pdfplus/10.1257/aer.99.4.1145>

Session 11: Thursday 10/2 at **4:30pm (Tentative Rosh Hashanah make-up date)**

Guest Lecture: Alex Rees-Jones

Alex Rees-Jones. 2014. "Loss Aversion Motivates Tax Sheltering: Evidence from U.S. Tax Returns." <http://ssrn.com/abstract=2330980>

Session 12: T 10/7

Taxation and Revenue, cont.

Policy and Choice, Chapter 7

Th 10/9: Fall Break

Session 13: T 10/14

Taxation and Revenue, cont.

Webley, Adams, and Elffers, "Value Added Tax Compliance," Chapter 7 of *Behavioral Public Finance*, Eds. Joel Slemrod, Edward J. McCaffery, 2006, Russell Sage Foundation. <http://muse.jhu.edu/books/9781610443852/9781610443852-14.pdf>

Session 14: Th 10/16

FIRST EXAM, in class, covering content from Sessions 1-13

Session 15: T 10/21

Behavioral Finance Whirlwind

Andrei Shleifer, *Inefficient Markets*, Chapters 1-2

Session 16: Th 10/23

Social Comparisons

Kelly Shue, "Executive Networks and Firm Policies: Evidence from the Random Assignment of MBA Peers." *Review of Financial Studies* (2013) 26 (6): 1401-1442. doi: 10.1093/rfs/hht019 <http://rfs.oxfordjournals.org/content/26/6/1401.full.pdf+html>

Session 17: T 10/28

Pricing to Biased Consumers

Stefano Dellavigna and Ulrike Malmendier. "Contract Design and Self-Control: Theory and Evidence," *Quarterly Journal of Economics*, 119, May 2004, pp.353-402.
<http://www.jstor.org/stable/pdfplus/25098689.pdf>

Session 18: Th 10/30

Shrouded Attributes and the Persistence of Erroneous Beliefs

Xavier Gabaix and David Laibson. "Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets," *Quarterly Journal of Economics* 121 (2), May 2006, pp. 505-540. <http://www.jstor.org/stable/pdfplus/25098799.pdf>

Session 19: T 11/4

Consumer Financial Protection

John Campbell, Howell Jackson, Brigitte Madrian, and Peter Tufano. 2011. "Consumer Financial Protection." *Journal of Economic Perspectives*, 25(1): 91–114. DOI:10.1257/jep.25.1.91

Paul Heidhues and Botond Koszegi, "Exploiting Naivete about Self-Control in the Credit Market." *American Economic Review* (2010), 100(5), pp. 2279-2303.
<http://www.jstor.org/stable/pdfplus/41038763.pdf>

Session 20: Th 11/6

Sports Betting and Prediction Markets

Richard Thaler and William Ziemba, 1988. "Parimutuel Betting Markets: Racetracks and Lotteries," *Journal of Economic Perspectives*, vol. 2(2), pages 161-74, Spring.
<http://www.jstor.org/stable/pdfplus/1942856.pdf>

Session 21: T 11/11

Informational Intermediaries

Sendhil Mullainathan, Markus Noeth, Antoinette Schoar. "The Market for Financial Advice: An Audit Study," NBER Working Paper No. 17929, 2012,
<http://www.nber.org/papers/w17929.pdf>.

Session 22: Th 11/13

TBD

Sessions 23-24: T 11/18, Th 11/20

Money Illusion and Monetary Policy

George Akerlof, "Labor Contracts as Partial Gift Exchange," *Quarterly Journal of Economics* (November 1982). <http://www.jstor.org/stable/pdfplus/1885099.pdf?src=epv&item=1>

George A. Akerlof, William T. Dickens, George L. Perry, Robert J. Gordon and N. Gregory Mankiw, "The Macroeconomics of Low Inflation," *Brookings Papers on Economic Activity*, Vol. 1996, No. 1 (1996), pp. 1-76. <http://www.jstor.org/stable/2534646>

Supreet Kaur, "Nominal Wage Rigidity in Village Labor Markets," Harvard Working Paper, 2011, http://www.supreetkaur.com/files/Kaur_WageRigidity.pdf?attredirects=0

Session 25: T 11/25

Political Competition and Manipulation

Edward Glaeser, "The Political Economy of Hatred," *Quarterly Journal of Economics*, 2004,
<http://www.jstor.org/stable/pdfplus/25098731.pdf>

Th 11/27 – Happy Thanksgiving!

Session 26: T 12/2

Principled Agents?

Daniel Benjamin and David Laibson (2003): “Good Policies for Bad Governments: Behavioral Political Economy,” in *How Humans Behave: Implications for Economics and Economic Policy*, FRBB Conference Series 48.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=696361

Session 27 Th 12/4

Happiness

Betsey Stevenson & Justin Wolfers, 2008. “Economic Growth and Subjective Well-Being: Reassessing the Easterlin Paradox,” *Brookings Papers on Economic Activity*, vol. 39:1 (Spring), pp. 1-102. <http://www.jstor.org/stable/pdfplus/27561613.pdf>

Daniel Kahneman, Alan B. Krueger, David Schkade, Norbert Schwarz and Arthur Stone (2004): “Toward National Well-Being Accounts”, *American Economic Review (Papers and Proceedings)*, 94 (2), 429-434. <http://www.jstor.org/stable/pdfplus/3592923.pdf>

Session 28 T 12/9

Review

Ryan Bubb and Richard Pildes, “How Behavioral Economics Trims Its Sails and Why,” *Harvard Law Review*, 127:6, April 2014.

http://cdn.harvardlawreview.org/wp-content/uploads/2014/04/vol127_bubb_pildes.pdf

Final Exam

During Exam Period, as specified by the Penn Registrar

<http://www.upenn.edu/registrar/finals/index.html>

M 12/15, 12:00-2:00pm