BEPP 620: BEHAVIORAL ECONOMICS, MARKETS, AND PUBLIC POLICY

University of Pennsylvania The Wharton School

Professor Judd Kessler
judd.kessler@wharton.upenn.edu

Behavioral economics has revealed a variety of systematic ways in which people deviate from being perfectly selfish, rational, optimizing agents. These findings have important implications for government policy and firm behavior. This class will explore these implications by answering two main questions: (1) What does behavioral economics imply for when and how the government should intervene in markets? (2) What does behavioral economics imply for firms' pricing and production decisions? The course will present the standard economic approaches to answering these questions and explore how answers change when we consider that people act in behavioral ways. Towards the end of the course, we will investigate specific policy questions, allowing us to debate optimal policy solutions while hearing from policy makers operating in a world of behavioral agents.

Reading: Most classes will require readings to be done in advance (usually articles from newspapers; sometimes executive summaries of policy reports, short research articles, excerpts from longer academic research articles, and chapters of the text listed below).

Note: Readings listed in this syllabus are tentative and subject to change.

The reference text for this course will be: *Policy and Choice: Public Finance through the Lens of Behavioral Economics*, William J. Congdon, Jeffrey R. Kling and Sendhil Mullainathan, Brookings Institution Press 2011. Free electronic copy available for download from: https://www.brookings.edu/wp-content/uploads/2016/07/policyandchoice_book.pdf

Grading: Grades will come from four sources:

First exam	20%
Second exam	30%
Homework	30%
Class participation	20%

The exams will cover material from Sessions 1-14 (first exam) and all Sessions (second exam). Homework will include problems, policy analysis, and a final group project.

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

Prerequisites: This course will assume a basic understanding of economic concepts.

Course Outline

Part 1: Foundational Concepts with Behavioral Agents

Session 1: Course Introduction

1. Overview of the course
2. What is behavioral economics?

Text: *Policy and Choice*, Chapter 2: Psychology and Economics

Session 2: Welfare Economics

3. Utility
4. The Pareto frontier
5. The first and second welfare theorems and their assumptions

Text: *Policy and Choice*, Chapter 3: Behavioral Economics and Public Finance

Session 3: Inequality and Redistribution

1. Marginal utility of income
2. Welfare weights
3. Altruism and social preferences

Article: Introduction of Ilyana Kuziemko et al. "How Elastic Are Preferences for Redistribution? Evidence from Randomized Survey Experiments" *American Economic Review* 2015, 105(4): 1478-1508.

Text: *Policy and Choice*, Chapter 6: Poverty and Inequality

Session 4: Externalities, Internalities, and Public Goods

1. Externalities
2. Internalities
3. Public goods

Article: Jonathan Gruber "Smoking's 'Internalities'" *Regulation* Winter 2002-2003, 25(4): 52-57.

Text: *Policy and Choice*, Chapter 5: Externalities and Public Goods

Session 5: Asymmetric Information

1. Moral hazard
2. Adverse selection
3. Uninformed, biased, and overconfident agents

Text: *Policy and Choice*, Chapter 4: Asymmetric Information

Session 6: Market Power

1. Natural monopolies, government granted monopolies, and market power
2. Deadweight loss
3. Customer outrage

Article: "Outcry Over EpiPen Prices Hasn't Made Them Lower" Charles Duhigg, New York Times, 6/4/2017.

Article Pair: "Stop the Bots From Killing Broadway" Lin-Manuel Miranda, New York Times, 6/7/2016 and "Hey, Miley Cyrus...wanna make more money?" Suzanne McGee, Chicago Booth Review, 5/20/2014.

Part 2: Government Policy Making in a World of Behavioral Agents

Session 7: Taxation I

1. Efficiency costs of taxation and tax burden
2. Optimal taxation

Text: *Policy and Choice*, Chapter 7: Taxation and Revenue

Session 8: Taxation II

1. Tax salience
2. Tax aversion and framing
3. Tax compliance and avoidance

Article: "The 'tax aversion' effect is real, and can sway our opinion on anything" Stian Reimers, The Conversation, 5/11/2016.

Article: Introduction to Amy Finkelstein "E-ZTax: Tax Salience and Tax Rates" *Quarterly Journal of Economics* 2009, 124(3): 969-1010.

Session 9: Pigouvian Taxation and the Coase Theorem

1. Pigouvian taxation
2. Coase theorem and transaction costs
3. Endowment effects

Article: "Externalities: Prices Do Not Capture All Costs" Thomas Helbling, International Monetary Fund, 7/29/2017.

Article Pair: "Don't Want Me to Recline My Airline Seat? You Can Pay Me" Josh Barro, New York Times, 8/27/2014. and "The economics of reclining your airplane seat aren't so simple" James Johnson, Washington Post, 9/4/2014.

Session 10: Forced Savings (e.g., Social Security)

1. Permanent income hypothesis
2. Quasi-hyperbolic discounting

Article: "Why Don't Americans Save More Money?" Derek Thompson, The Atlantic, 4/19/2016.

Article: Introduction of Ayşe İmrohoroğlu, Selahattin İmrohoroğlu and Douglas H. Joines "Time-Inconsistent Preferences and Social Security" *Quarterly Journal of Economics* 2003, 118(2): 745-784.

Session 11: Regulation

1. Worker and customer safety
2. Equal protection rules
3. Omission vs. commission

Article: General Nondiscrimination Requirements Section of "ADA Update: A Primer For Small Business" U.S. Department of Justice, Civil Rights Division, Disability Rights Section

Article: "Fur and fury at 40,000 feet as more people bring animals on planes" Karin Brulliard, Washington Post, 1/22/2018.

Session 12: Bans and Mandates

1. Paternalism
2. Repugnance
3. Norms

Article: "Vaccination rate jumps in California after tougher inoculation law" Soumya Karlamangla and Rong-Gong Lin II, Los Angeles Times, 4/13/2017.

Article: "Why ban payment to kidney donors but not football players?" Philip Cook and Kim Krawiec, The News&Observer, 2/1/2018.

Article: Alvin E. Roth "Repugnance as a Constraint on Markets" *Journal of Economic Perspectives* 2007, 21(3): 37-58.

Session 13: Licensing Requirements

1. Costs and benefits of licensing
2. Limits to customer information
3. Reputation systems

Article: "Occupational licensing blunts competition and boosts inequality" The Economist, 2/17/2018.

Article: Executive Summary of "Occupational Licensing: A Framework For Policymakers" Department of the Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor, 7/2015.

Session 14: Review Session

Session 15: First Exam

Part 3: Firm Behavior in a World of Behavioral Agents

Session 16: Pricing to Biased Consumers

1. Two-part tariffs
2. Quasi-hyperbolic consumers
3. Naïves vs. sophisticates

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

Session 17: Shrouded Attributes

1. Bundled pricing
2. Myopia vs. sophistication

Article: "How Terrible Is Spirit Airlines, Really?" Derek Thompson, The Atlantic, 11/7/2013.

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

Session 18: Behavioral Workers and Managers

1. Social comparisons
2. Pay inequity

Article: Introduction of David Card et al. "Inequality at Work: The Effect of Peer Salaries on Job Satisfaction" *American Economic Review* 2012, 102(6): 2981-3003.

Session 19: Moral Hazard in the Firm

1. Principal-Agent problem and solutions
2. Gift Exchange
3. Gamification

Article: "If Workers Slack Off, the Wristband Will Know. (And Amazon Has a Patent for It.)" Ceylan Yeginsu, New York Times, 2/1/2018

Article: "Lotto Tickets Are Nice, Boss, but Can I Have My Bonus?" Noam Scheiber, New York Times, 3/11/2018

Part 4: Applications

Note: These lectures will be organized around a central question, usually include a guest speaker and involve a combination of debate and discussion as we use the tools developed in the previous lectures to pursue optimal policy design.

Session 20: Should we tax soda? [Guest speaker, Professor Benjamin Lockwood]

Article: "Soda taxes popping up around the U.S." Rachel Hinton and Amanda Svachula, Chicago Sun Times, 7/23/2017.

Article: Introduction to Hunt Allcott, Benjamin B. Lockwood, and Dmitry Taubinsky "Regressive Sin Taxes, with an Application to the Optimal Soda Tax" 2018, working paper.

Session 21: What should affordable housing look like? [Guest speaker TBD]

Article: First 10 Sections of "How Burrowing Owls Lead To Vomiting Anarchists (Or SF's Housing Crisis Explained)" Kim-Mai Cutler, Tech Crunch, 4/14/2014

Session 22: How should we regulate guns? [Guest speaker, Professor Philip Cook]

Article: Philip J. Cook and Jens Ludwig. "The social costs of gun ownership." *Journal of Public Economics* 2006, 90(1-2): 379-391.

Session 23: How should we address climate change? [Guest speaker TBD]

Article: "Reckoning with climate change will demand ugly tradeoffs from environmentalists — and everyone else" David Roberts, Vox, 1/27/2018

Session 24: What public goods should cities provide? [Guest speaker TBD]

Article Pair: "Tennessee Firefighters Watch Home Burn" Robert Mackey, New York Times, 10/6/2010 and "Why Firemen Let That House Burn Down" Editorial Board, New York Times, 10/6/2010.

Session 25: How much market power is too much market power? [Guest speaker TBD]

No reading required

Session 26: Group Project Presentations

Session 27: Group Project Presentations

Session 28: Review Session