Topics in Economic Theory I:

Bounded Rationality in Choice-Part I

2017-2018 Academic Year
Master of Research in Economics, Finance and Management

1. Description of the subject

- Topics in Economic Theory I
- Total credits: 3 ECTS
- Type of subject: Optative
- Department of Economics and Business
- Teaching team: José Apesteguía

Code: 32074
Workload: 75 hours
Term: 1st
2. Teaching guide

Introduction

The traditional models of decision-making in economics are being seriously revised, in light of recent developments in psychology and behavioral economics. In this course we cover key theoretical developments in modeling non-standard decision-making.

This class is designed both for students with a theoretical, empirical and experimental inclination towards the understanding of decision-making, and for students with an interest in applying behavioral decision-making models to various economic settings.

This course is supposed to be taken together with the course Topics in Economic Theory II: Bounded Rationality in Choice-Part II, taught by Larbi Alaoui. In addition, the courses of Robin Hogarth (Behavioural Decision Making) and Rosemarie Nagel (Experimental Economics) complement the material covered in these two topics courses, emphasizing other aspects of choice and adopting a more experimental approach.

This course is divided in four blocks, as outlined below in section 2. Section 2 gives a short intro to each block and lists a number of key papers in the literature, especially those signaled as "Main readings". In addition to the papers listed below, I will made available in the course Box folder the key recent working papers in the field. These are the very last papers, the ones that are currently being presented in the relevant forums, and represent the state of the art in the field.

Contents

2.1 Review of the classical foundations for decision-making under certainty and uncertainty.
We begin with a review of the seminal models of decision-making under certainty and uncertainty, which serve as a foundation for subsequent frameworks.

Readings:


2.2 Bounded Rationality. The focus of this section is the revealed preference theory of bounded rationality. We will present the most influential boundedly rational models, and discuss the implications of bounded rationality for welfare analysis and the measurement of rationality.

Main readings:


Others:


2.3 Reference-dependence behavior. In this section we adopt a more applied approach, and will focus on what has arguably been the most influential contributions of the bounded rationality and behavioral economics literatures: reference-dependence behavior. We will lay down the basics of the reference-dependent models and emphasize their applications to a number of settings, including finance, labor, insurance, etc.

Main readings:


Others (General):


Applications of reference-dependent models:


2.4 Stochastic Choice. There is renewed interest in understanding choice as the outcome of some random process. Stochastic choice models allow the treatment of choice variability in a stylized way, which ultimately facilitates the introduction of certain behavioral considerations.
We will review the classical contributions in psychology and economics. We will then introduce
the new developments in the area.

**Main readings:**
in I. Olkin et al, eds., Contributions to Probability and Statistics: Essays in Honor of Harold


**Others:**


Approach to Decision Making in an Uncertain Environment,” Psychological Review, 100.3:432–
459.


(2): 651–691.


Econometrica, 82: 1873-1912.


Provider: John Wiley & Sons, Ltd


Assessment and Grading System

When dealing in class with the four broad topics outlined above, students will select a paper from the reading list to be presented in class, either from the above reading list of from the papers posted in the course Box folder.

The core of the evaluation will be based on a research project to be presented at the end of the term and turned in. The research project should consist on an original idea that could potentially be converted into a research paper. The content can be theoretical, empirical, or experimental, or combinations of the former. The student is supposed to present one research project for Topics in Economics Theory I and II-

Class participation is also an important component of the course, and is highly valued.