Behavioral Economics and Finance

FINC-GB.2111.20, Spring 2015 (second half).

Venue: 44 W 4th St, room KMEC 3-60

Wed 3-5.50pm, March 25-May 6.

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Administrative assistant: Olivia Domba odomba@stern.nyu.edu, KMEC (near 9-72)

Requirements: There will be 2-3 problems sets, and a short term paper. I may ask some of your to be “scribes” for some lectures.

There is no textbook.

This is the preliminary syllabus: March 20, 2015 version.

We shall study the main behavioral facts and models. We will discuss the empirical evidence, but we’ll emphasize the models – especially the novel, promising approaches, rather than a review of past successes.

Topics will include: bounded rationality, inattention, imperfect understanding of probabilities, non-rational expectations, narrow framing, boundedly rational dynamic programming, dynamic reference point; and more specialized finance models: limits of arbitrage, aggregate stock market behavior, cross-sectional stock market behavior, loss aversion in stock trading, behavioral corporate finance.

The course can be followed by students with little knowledge in finance

We’ll try to follow the following plan. Please let me know if there’s (potentially additional) material that particularly interests you.

The latest version of the syllabus is at: http://pages.stern.nyu.edu/~xgabaix/papers/BehavioralPhDGabaixSyllabus.pdf

1. Introduction [0.5]
2. Bounded rationality [1]
a. Facts  
b. Inattention, slow adjustment  
c. Sparsity approach  
d. Entropy-based modeling of inattention: Sims, Woodford  

3. Dual-self models: Laibson, Gul-Pesendorfer, Fudenberg-Levine, etc. [0.5] 
4. Loss aversion and dynamic reference point. [1]  
   a. Kahneman-Tversky’s basic prospect theory  
   b. Koszegi Rabin: endogenous reference point  
   c. Difficulties of dealing with small probability events:  
      a. Barberis, Fehr-Duda  
      b. Overvaluation of small stocks etc.  

5. Formation of expectations [0.5]  
   a. Some facts.  
   b. Macro-models for expectations  
   c. Beshears, Laibson et al.  
   d. BR updating of probabilities, what comes to mind  
   e. Rabin, Rabin and Vayanos: law of small numbers.  

6. Household finance [0.25]  

7. Agents in the markets, behavioral IO [0.25]  

8. Implications in Finance [2]  
   a. Limits of arbitrage, price pressure: Shleifer Vishny, Gromb Vayanos  
   b. The aggregate stock market  
   c. The cross-section of stocks  
   d. Propensity to sell winners rather than losers: Barberis, Odean, Hirshleifer:  
      reluctance to sell losers, and the modeling of that.  
   e. Corporate finance implications  

Recommended texts (optional).  


**Introduction**  


**Bounded rationality**


**Limited attention and salience**


Koszegi, B. and A. Szeidl A Model of Focusing in Economic Choice QJE 2013

**Mental accounts and decision vs experienced utility**
Farhi, E. and Xavier Gabaix “Optimal Taxation with Behavioral Agents” (with Emmanuel Farhi) https://www.dropbox.com/s/1r02vbs3nq0q9s4/BR-Taxes.pdf

**Inattention, slow adjustment**


**Entropy-based rational inattention**


Woodford, M. “Inattentive Valuation and Reference-Dependent Choice,” February 2012.


Please also look for updates from Andrew Caplin’s web page.

**Some other approaches**


Jehiel, Philippe. Analogy-Based Expectation Equilibrium JET 2005


**Dual Self Models**


Attitudes towards Risk and reference-dependence
Rabin, M. “Diminishing marginal utility cannot explain risk aversion”, CVF 11. You can consult also:

Reference point and its dynamics
Andries, M. and V. Haddad Information Aversion 2014

The formation of expectations
Barberis, Nicholas, Robin Greenwood, Lawrence Jin, and Andrei Shleifer
"X-CAPM: An Extrapolative Capital Asset Pricing Model", JFE 2015

Woodford, M. “Macroeconomic analysis without the rational expectations hypothesis.” Annual review of economics, 2013.


Household finance


Annamaria Lusardi’s facts: http://www.dartmouth.edu/~alusardi/pub.html

Behavioral agents in the market


Spiegler, Rani. Bounded Rationality and Industrial Organization

**Finance models**

**Limits of arbitrage**
Inefficient markets, Ch. 2, 4.


**Full-Scale macro / finance models**


The cross-section of stocks


Propensity to sell winners

Barberis, N. and Huang, M. "Realization Utility." JFE 2012.


Behavioral corporate finance

Potential Other topics

Post-earnings announcement drift
Inattention: Dellavigna Pollet, Cohen et al.