

Psychology 458
The Psychology of Economic Decisions
Wednesdays 10:30 – 12:20, Fall 2007

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Throughout our lives we are faced with difficult economic decisions, both major (selecting a pension plan) and minor (buying a new DVD player). How do people make such decisions, and are there ways in which their decisions could be improved? Psychologists and economists have developed an increasingly sophisticated and influential depiction of the processes by which people make choices under conditions of uncertainty and conflicting objectives. This seminar provides a survey of recent research on the psychology of economic decision making, with an emphasis on the ways in which people's financial decisions systematically deviate from those expected under a "rational" economic analysis. We will attempt to understand, among other things, why cab drivers quit earlier on profitable than on unprofitable days, why having more financial options is not always better than having fewer, and how seemingly small changes to a pension plan can have big effects on how much employees save for retirement.

Each week we will read and discuss three original research articles on a common topic, with a focus on generating new research ideas based on the work reported in the articles. Note that readings in this course frequently use mathematical notation to characterize how decisions are and ought to be made.

Course requirements are as follows.

Discussion Leadership

Each assigned reading will have an associated discussion leader. The leader should prepare a presentation (of no more than 10 minutes' duration) covering what was done in the study, why, and what conclusions were drawn by the authors. A lottery system will be used to assign a discussion leader (or possibly a pair of leaders) to each article we will be reading. A data projector and built-in computer (Nexus station) are available in our seminar room for use in making your presentation.

Weekly Assignments: Study Proposals

Students will be asked, for an assigned reading, to produce a one-page description of a follow-up study (typically an experiment) that could further the investigation in an informative way, such as testing an alternative interpretation, establishing the generalizability or boundary conditions of the results reported in the target article, or addressing an unresolved issue raised by the original study.

Development of these study proposals (and discussion of them in class) is the central focus of this course, so it is expected that some considerable time and thought be put into them each week. The critical mindset required to produce a good study proposal is an important research skill, and in turn requires a different approach to reading the target article. (You'll probably want to read the article at least twice, once for a basic understanding of what the authors did and what they concluded from their research, and a second time with a greater focus on what might have been done differently and how that might have affected the conclusions drawn from the study.)

What matters as much as the study you propose is the argument you make for its usefulness. Top marks will go to those papers that provide a clear, compelling rationale for why the proposed follow-up study would be informative. There are many, many possible follow-up studies that could be conducted; your task is to make a compelling case for the one you have proposed. Avoid proposing follow-up studies relying on formulaic changes to methodology (e.g., increased sample size, use of more realistic stimuli, change in subject population) unless a clear case can be made for why it would help to address some interesting research question.

Each study proposal must be no more than one page long. (The ability to write concisely is also an important research skill.) Single spacing is acceptable, but please use a reasonably large font in that case and space between paragraphs. One page is not a lot of space, obviously, so do not waste any of it summarizing the target article—you can safely assume that your reader is familiar with the article.

Students will be asked to share their proposed study with the rest of the class. It is intended that discussion of

these proposed studies will be a major focus of discussion in the seminar. Students will be assigned (by lottery) to a target article for their study proposal from the set of assigned readings, so that we have several study proposals for each assigned reading. Discussion leaders each week should produce a study proposal for the article they will be presenting in class.

Study proposals are due in class the day they are discussed. Penalties will apply to late submissions. The worst mark across the 11 weekly assignments will be dropped in computing final grades.

In-Class Participation

Students are expected to actively contribute to the seminar discussion each week. This means not only describing your study proposal, but also commenting on the proposals of other students, and contributing to the discussion of articles other than the one for which you wrote a study proposal.

By definition, of course, you need to attend the seminar in order to participate in the discussion. Absences (except in cases of documented medical or family emergencies) will result in loss of participation credit. If you do have to miss a class, you can still submit your study proposal (due before the class begins) by e-mail to the instructor, so that you do not lose credit for the assignment as well as for participation.

Final Course Paper

In a brief, final course paper, students are asked to write an additional follow-up study proposal. The major difference is that, in this case, students may choose the target article on which they wish to base their study proposal. Target articles are to be selected from 2006 or 2007 issues of one of two journals: *Journal of Behavioral Decision Making* (on-line access available through the UW Library) or *Judgment and Decision Making* (an open-access journal available at <http://journal.sjdm.org>). Please choose an empirical article (one in which data are presented), ideally one reporting the results of an experiment. If you would prefer to choose a target article from another journal (from 2006 or 2007), please contact the instructor first.

The paper should be no longer than two pages. Approximately half of the first page can be used to provide a summary of those aspects of the target article results and conclusion that are the focus of your study proposal. The remainder of the paper should be dedicated to your study proposal, which will be marked based on the same criteria as used in marking the weekly assignments.

The paper is due by 4pm on Monday, December 10. Papers may be left in the instructor's mailbox in PAS 3021A. They may also be submitted by e-mail; if using e-mail, please be sure that you receive confirmation of receipt by the instructor. (Excuses that the paper was sent by e-mail but disappeared "in transit" are not acceptable.) Penalties will apply to late papers.

Evaluation

study proposals (best 10 @ 6%)	60%
discussion leadership	15%
final paper (brief)	15%
participation	10%

Schedule and Readings

All readings can be downloaded from the Psych 458 site on UW ACE.

Week 1 (September 12): **Introduction**

Overview of normative and descriptive models of decision making

Week 2 (September 19): **Loss Aversion**

Kahneman, D., Knetsch, J. L., & Thaler, R. H. (1991). The endowment effect, loss aversion, and status quo bias. *Journal of Economic Perspectives*, 5, 193-206.

List, J. A. (2004). Neoclassical theory versus prospect theory: Evidence from the marketplace. *Econometrica*, 72, 615-625.

Johnson, E. J., Haubl, G., & Keinan, A. (2007). Aspects of endowment: A query theory of value construction. *Journal of Experimental Psychology: Learning, Memory, and Cognition*, 33, 461-474.

Week 3 (September 26): **Mental Accounting**

Tversky, A., & Kahneman, D. (1981). The framing of decisions and the psychology of choice. *Science*, 211, 453-458.

Camerer, C., Babcock, L., Loewenstein, G., & Thaler, R. (2000). Labor supply of New York City cab drivers: One day at a time. In D. Kahneman and A. Tversky (Eds.), *Choices, Values, and Frames*. Cambridge: Cambridge University Press.

Thaler, R. H., & Benartzi, S. (2004). Save More Tomorrow: Using behavioral economics to increase employee saving. *Journal of Political Economy*, 112, S164-S187.

Week 4 (October 3): **Repeated Decisions**

Gneezy, U., & Potters, J. (1997). An experiment on risk taking and evaluation periods. *Quarterly Journal of Economics*, 112, 631-645.

Hertwig, R., Barron, G., Weber, E. U., & Erev, I. (2004). Decisions from experience and the effect of rare events in risky choice. *Psychological Science*, 15, 534-539.

Haigh, M. S., & List, J. A. (2005). Do professional traders exhibit myopic loss aversion? An experimental analysis. *Journal of Finance*, 60, 523-534.

Week 5 (October 10): **Preference Construction**

Shafir, E., Simonson, I., & Tversky, A. (1993). Reason-based choice. *Cognition*, 49, 11-36.

Barber, B. M., Heath, C., & Odean, T. (2003). Good reasons sell: Reason-based choice among group and individual investors in the stock market. *Management Science*, 49, 1636-1652.

Ariely, D., Loewenstein, G., & Prelec, D. (2003). Coherent arbitrariness: Stable demand curves without stable preferences. *Quarterly Journal of Economics*, 118, 74-105.

Week 6 (October 17): **Maximization and Choice Overload**

Hsee, C. K., Yu, F., Zhang, J. & Zhang Y. (2003). Medium maximization. *Journal of Consumer Research*, 30, 1-14.

Iyengar, S., Jiang, W., & Huberman, G. (2004). How much choice is too much? Contributions to 401(k) retirement plans. In O.S. Mitchell & S. Utkus (Eds.), *Pension Design and Structure: New Lessons from Behavioral Finance* (pp. 83-95). Oxford University Press.

Iyengar, S.S., Wells, R.E., & Schwartz, B. (2006). Doing better but feeling worse: Looking for the "best" job undermines satisfaction. *Psychological Science*, 17, 143-150.

Week 7 (October 24): **Anticipating Future Experiences**

- Kahneman, D., Fredrickson, B.L., Schreiber, C.A., & Redelmeier, D.A. (1993). When more pain is preferred to less: Adding a better end. *Psychological Science*, 4, 401-405.
- Hsee, C. K., & Zhang, J. (2004). Distinction bias: Misprediction and mischoice due to joint evaluation. *Journal of Personality and Social Psychology*, 86, 680-695.
- Kermer, D. A., Driver-Linn, E., Wilson, T. D., & Gilbert, D. T. (2006). Loss aversion is an affective forecasting error. *Psychological Science*, 17, 649-653.

Week 8 (October 31): **Self-Control**

- Heath, C., & Soll, J. (1996). Mental budgeting and consumer decisions. *Journal of Consumer Research*, 23, 40-52.
- Ariely, D., & Wertenbroch, K. (2002). Procrastination, deadlines, and performance: Self-control by precommitment. *Psychological Science*, 13, 219-224.
- McClure, S. M., Laibson, D. I., Loewenstein, G., & Cohen, J. D. (2004). Separate neural systems value immediate and delayed monetary rewards. *Science*, 306, 503-507.

Week 9 (November 7): **Intuition and Deliberation**

- Bechara, A., Damasio, H., Tranel, D., & Damasio, A.R. (1997). Deciding advantageously before knowing the advantageous strategy. *Science*, 275, 1293-1294.
- Dijksterhuis, A. (2004). Think different: The merits of unconscious thought in preference development and decision making. *Journal of Personality and Social Psychology*, 87, 586-598.
- Frederick, S. (2005). Cognitive reflection and decision making. *Journal of Economic Perspectives*, 19, 25-42.

Week 10 (November 14): **Affect**

- Rottenstreich, Y., & Hsee, C. K. (2001). Money, kisses, and electric shocks: On the affective psychology of risk. *Psychological Science*, 12, 185-190.
- Lerner, J. S., Small, D. A., and Loewenstein, G. (2004). Heart strings and purse strings: Carry-over effects of emotions on economic transactions. *Psychological Science*, 15, 337-341.
- Bateman, I., Dent, S., Peters, E., Slovic, P., & Starmer, C. (in press). The affect heuristic and the attractiveness of simple gambles. *Journal of Behavioral Decision Making*.

Week 11 (November 21): **Conflict and Cooperation**

- Fehr, E., & Gaechter, S. (2002). Altruistic punishment in humans. *Nature*, 415, 137-140.
- Sanfey, A. G., Rilling, J. K., Aaronson, J. A., Nystrom, L.E., & Cohen, J. D. (2003). The neural basis of economic decision-making in the ultimatum game. *Science*, 300, 1755-1758.
- Vohs, K. D., Mead, N. L., & Goode, M. R. (2006). The psychological consequences of money. *Science*, 314, 1154-1156.

Week 12 (November 28): **Egocentrism**

- Babcock, L., & Loewenstein, G. (1997). Explaining bargaining impasse: The role of self-serving biases. *Journal of Economic Perspectives*, 11, 109-126.
- Camerer, C., & Lovo, D. (1999). Overconfidence and excess entry: An experimental approach. *American Economic Review*, 89, 306-318.

Moore, D. A., & Kim, T. G. (2003). Myopic social prediction and the solo comparison effect. *Journal of Personality and Social Psychology*, 85, 1121-1135.

Note on avoidance of academic offences (from the Associate Dean of Arts, Undergraduate Studies):

All students registered in the courses of the Faculty of Arts are expected to know what constitutes academic integrity, to avoid committing academic offences, and to take responsibility for their actions. When the commission of an offence is established, disciplinary penalties will be imposed in accord with Policy #71 (Student Academic Discipline). For information on categories of offences and types of penalties, students are directed to consult the summary of Policy #71 which is supplied in the Undergraduate Calendar (section 1; www.adm.uwaterloo.ca/infousec/Policies/policy71.htm). If you need help in learning what constitutes an academic offence; how to avoid offences such as plagiarism, cheating, and double submission; how to follow appropriate rules with respect to “group work” and collaboration; or if you need clarification of aspects of the discipline policy, ask your TA and/or your course instructor for guidance. Other resources regarding the discipline policy are your academic advisor and the Undergraduate Associate Dean, as well as the following Arts Faculty Web page, “Avoiding Academic Offences” (http://arts.uwaterloo.ca/arts/ugrad/academic_responsibility.html).

Student’s right to grieve: Students who believe that they have been wrongfully or unjustly penalized have the right to grieve; refer to Policy #70, Student Grievance, <http://www.adm.uwaterloo.ca/infousec/Policies/policy70.htm>.