Experimental and Behavioural Economics

(L12316)

Dr. Daniel Schoch

Module description and content

This module is available to second year undergraduates in the School of Economics.

It provides a foundation in behavioural economics and in the role of experimental methods in economics. The traditional approach in economics is to explain market outcomes and economic decision-making using simple theoretical models based on perfectly rational, self-interested agents who maximise their well-being by carefully weighing up the costs and benefits of different alternatives. Behavioural economics, on the other hand, aspires to relax these stringent assumptions and develop an understanding of how real people actually make decisions. Analogously, experimental economics also contrasts with the approach that, until recently, was more standard. It uses laboratory techniques as a supplement or alternative to drawing data exclusively from the field.

The module covers three areas

0. **Risk Preferences**
   In the first section we consider classical rationality postulates in decisions under risk and uncertainty and investigate how they are being violated in laboratory experiments as well as in real-world investment situations. We identify several influencing subjective factors, such as the person's percieved status quo, individual risk attitude, and the "animal spirit".

1. **Social Preferences and Reciprocation**
   In this section we show how the classical view of the lone self-interested agent fails to desribe the reality when the welfare of other people matters. Social preferences can be either sympathetic (altruistic) or antipathetic (envious), inequality averse or loving, and people reciprocate positively or negatively depending on how they were treated in the past. Ultimatum games, dictator games and charitable giving games form a class of games where the roles of the participants are asymmetrical.

2. **Public Good Experiments**
   A different class of games are characterized by common interests and symmetric roles of the players. Players invest into a public fund, and receive at the end an equal share of a certain multiple of the fund. Surprisingly, the equilibrium of common free riders is rarely observed. In some variants each player has the opportunity to withdraw the common investment.

There is no single textbook which covers the complete content of this course. Literature will be announced during lecture. A basic introduction to the required foundations on preferences under risk and game theory will be part of this course. Assessment is based on the final examination only.