

Topics in Economic Theory I-Part I: Choice Theory

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Course 2011-2012

The theory of choice plays a central role in modern economics. The classical rational choice theory views the decision-maker as having a stable well-behaved preference relation, making choices by maximizing such a preference relation. Over the last decades, however, mounting evidence has been accumulated documenting systematic violations of this notion of rationality.

In this course we review the latest developments on boundedly rational choice theory under certainty. The focus is theoretical, but at the same time we will emphasize the connections with the empirical evidence, and other sorts of motivations for the new theoretical developments.

The outline of the course is the following:

1. Introduction: objectives, motivation, and methodology.

2. A brief review of classical rational choice theory.

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Mas-Colell, A., M. Whinston and J. Green, *Microeconomic Theory*. Oxford University Press, Oxford 1995. Chapter 1

Rubinstein, A. *Lecture Notes in Microeconomic Theory*. Princeton NJ: Princeton University Press 2006. Lectures 1, 2, and 3.

3. Questions on the classical rational choice theory: empirical evidence.

Beshears, J., J. Choi, D. Labison, B.C. Madrian (200), "A Primer on 401(k) Loans," mimeo.

Bushong, B., L. M. King, C.F. Camerer, and A. Rangel (2010), "Pavlovian Processes in Consumer Choice: The Physical Presence of a Good Increases Willingness-to-Pay," *American Economic Review*, 100(4): 1556-71.

Grether, D.M. and C.R. Plott (1979), "Economic Theory of Choice and the Preference Reversal Phenomenon," *American Economic Review*, 69:623-638.

Huber, J., J.W. Payne, and C. Puto (1982), "Adding Asymmetrically Dominated Alternatives: Violations of Regularity and the Similarity Hypothesis." *Journal of Consumer Research*, 9(1): 90-98.

Iyengar, S. and E. Kamenica (2010), "Choice proliferation, simplicity seeking, and asset allocation," *Journal of Public Economics* 94 (2010) 530-539.

Iyengar, S. and M. Lepper (2000), "When choice is demotivating: Can one desire too much of a good thing". *Journal of Personality and Social Psychology*, 76, 995-100.

Kahneman, D., J.L. Knetsch, and R.H. Thaler (1990). "Experimental Tests of the Endowment Effect and the Coase Theorem," *Journal of Political Economy*, 98: 1325-48.

Knetsch, J.L. (1989). "The Endowment Effect and Evidence of Nonreversible Indifference Curves," *American Economic Review*, 79(5):1277-84.

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May, K.O. (1954), "Intransitivity, Utility, and the Aggregation of Preference Patterns," *Econometrica*, 22:1-13.

Simonson, I. (1989), "Choice Based on Reasons: The Case for the Attraction and Compromise Effects." *Journal of Consumer Research*, 16(2): 158-74.

Tversky, A. (1969), "Intransitivity of Preferences," *Psychological Review*, 76:31-48.

Tversky, A. and E. Shafir (1992). "Choice under conflict: The dynamics of deferred decision." *Psychological Science*, 3, 6, 358-361

4. Reference-dependent models.

Apesteguia, J. and M.A. Ballester (2009), "A Theory of Reference-Dependent Behavior," *Economic Theory*, 40:427-455.

Bleichrodt, H. (2007), "Reference-Dependent Utility with Shifting Reference Points and Incomplete Preferences," *Journal of Mathematical Psychology* 51:266-276.

Bossert, W. and Y. Sprumont (2003), "Non-Deteriorating Choice," *Mathematical Social Sciences*, 45:131-142.

Dean, M. (2008), "Status Quo Bias in Large and Small Choice Sets", mimeo.

Giraud, R (2010), "Money matters: an axiomatic theory of the endowment effect" *Economic Theory*, forthcoming.

Köszegi, B. and M. Rabin (2006), "A Model of Reference-Dependent Preferences", *Quarterly Journal of Economics*, 121:1133-1165.

Mandler, M. (2004), "Status quo maintenance reconsidered: changing or incomplete preferences," *Economic Journal*, 114, 518-535.

Masatlioglu, Y. and E. Ok (2005), "Rational Choice with Status Quo Bias", *Journal of Economic Theory*, 121, No. 1, 1-29.

Masatlioglu, Y. and E.A. Ok (2011), "A Canonical Model of Choice with Initial Endowments," mimeo.

Munro, A. and Sugden, R. (2003), "On the Theory of Reference-Dependent Preferences," *Journal of Economic Behavior and Organization*, 50:407-428.

Ok, E.A., P. Ortoleva and G. Riella (2010), "Revealed (P)reference Theory," mimeo.

Sagi, J. (2006), "Anchored Preference Relations," *Journal of Economic Theory*, 130:283-295.

Tversky, A. and D. Kahneman (1991), "Loss Aversion in Riskless Choice: A Reference Dependent Model," *Quarterly Journal of Economics*, 106, 1039-1061.

5. Sequential models.

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Cherepanov, V., T. Feddersen and A. Sandroni (2008) "Rationalization", mimeo.

Eliaz, K., M. Richter and A. Rubinstein (2011) "Choosing the Two Finalists," *Economic Theory*, 46: 211-219.

Manzini, P. and M. Mariotti (2007), "Sequentially Rationalizable Choice," *American Economic Review*, 97:1824-1839.

Manzini, P. and M. Mariotti (2011), "Choice by lexicographic semiorders" *Theoretical Economics*, forthcoming.

Manzini, P. and M. Mariotti (2011). Categorize Then Choose: Boundedly Rational Choice and Welfare. *Journal of the European Economic Association*, forthcoming

Masatlioglu, Y., D. Nakajima and E.Y. Ozbay (2010), "Revealed Attention," *American Economic Review*, forthcoming.

Tversky, A. (1972), "Elimination By Aspects: A Theory of Choice," *Psychological Review*, 79:281-299.

Tyson, C.J. (2011), "Salience Effects in a Model of Satisficing Behavior" mimeo.

6. Other multi-criteria models.

Ambrus, A. and K. Rozen (2011) "Rationalizing Choice with Multi-Self Models" mimeo.

Apesteagua, J., Ballester, M. (2010). The computational complexity of rationalizing behavior. *Journal of Mathematical Economics* 46, 356-363.

de Clippel, G. and K. Eliaz (2011) "Reason-Based Choice: A Bargaining Rationale for the Attraction and Compromise Effects" *Theoretical Economics*, forthcoming.

Demuynck, T., (2011). "The computational complexity of verifying boundedly rational choice behavior." *Journal of Mathematical Economic*, forthcoming

Green, J.R. and D.A. Hojman (2009), "Choice, Rationality and Welfare Measurement," mimeo.

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Xu, Y. and L. Zhou (2007), "Rationalizability of Choice Functions by Game Trees," *Journal of Economic Theory*, 134:548-556.

7. Search.

Caplin, A. and M. Dean (2011), "Search, Choice and Revealed Preference" *Theoretical Economics*, 6: 19-48.

Caplin, A., M. Dean and D. Martin (2011), "Search and Satisficing" *American Economic Review*, Forthcoming

Masatlioglu, Y., and D. Nakajima (2009). "Choice by Iterative Search." Mimeo.

Papi, M. (2011), "Satisficing Choice Procedures." Mimeo.

Rubinstein, Ariel and Yuval Salant (2006), "A Model of Choice from Lists", *Theoretical Economics*, 1, 3-17.

8. Measures of rationality.

Afriat, S.N. (1973), "On a System of Inequalities in Demand Analysis: An Extension of the Classical Method," *International Economic Review*, 14:460–472.

Apestequia, J and M.A. Ballester (2011), "A Measure of Rationality and Welfare," mimeo.

Beatty, T and I. Crawford (2010), "How Demanding is the Revealed Preference approach to Demand?," *American Economic Review*, forthcoming.

Dean, M. and D. Martin (2010), "How Rational are your Choice Data?," mimeo.

Houtman, M. and J.A. Moks (1985), "Determining All Maximal Data Subsets Consistent with Revealed Preference." *Kwantitatieve Methoden*, 19:89–104.

Varian, H.R. (1990), "Goodness-of-Fit in Optimizing Models," *Journal of Econometrics*, 46:125–140.

9. Behavioral welfare analysis.

Apestequia, J and M.A. Ballester (2011), "A Measure of Rationality and Welfare," mimeo.

Baldiga, K.A. and J.R. Green (2010), "Choice-based Measures of Conflict in Preferences," mimeo.

Bernheim, B.D. and A. Rangel (2009), "Beyond Revealed Preference: Choice-Theoretic Foundations for Behavioral Welfare Economics" *Quarterly Journal of Economics*, 124:51-104.

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Manzini, P. and M. Mariotti (2009), "Choice Based Welfare Economics for Boundedly Rational Agents" mimeo.

Rubinstein, A. and Y. Salant (2011), "Eliciting Welfare Preferences from Behavioral Datasets," *Review of Economic Studies*, forthcoming.