Master Course: Behavioral Economic Theory

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Objectives

Traditionally, the exchange of goods and services was based on bilateral and repeated interaction that – to a large extend – resolved informational asymmetries between sellers and buyers. But the more globalized and digitalized our economic transactions, the fewer consumers know personally about a producer or service provider but the more information is dispersed in the market and may – at least in principle – be available "online". Informational asymmetries between sellers and buyers are in particular relevant in markets where a potential buyer knows less than a seller about the quality of the good or service not only before but also after the transaction and even after consumption. Consider, for instance, buyers who care for negative production externalities and prefer goods that are produced in a more environment-friendly way (e.g., green electricity, sustainable fishing, shadowed coffee growing) or consumers who care for the producers corporate social responsibility. Even after consuming electricity, fish, coffee, or the product of a firm with a certain degree of corporate social responsibility, the consumer may not know about the above-described positive or negative attributes of the consumption good or service. At least gradually, such unresolved information asymmetries are also present in financial advice or the media. Because of the trust needed for trade in such markets (and the emergence of labels as the most frequent remedy) markets with this particular information asymmetry are referred to as markets for *label credence goods*.

In this course, we will identify potential (behavioral) reasons for market failure in markets with these information asymmetries and discuss the impact of different institutional settings (e.g., competition, regulation, self-declaration, certification, NGOs) to overcome potential welfare losses.

Evaluation

Presentation Each course participant will work on a particular research question (see list of topics). For every research question, you will find at least one paper in the list of topics. Students are asked to present the main findings and model characteristics of this paper and search the literature for related contributions and in particular empirical evidence that also has to be presented. Presentations are expected to last 60 minutes.

Discussion Each participant acts as a discussant for one of the presentations. Discussants are expected to provide their own assessment and interpretation of the findings presented by

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the student in charge for the corresponding research question. Discussions are expected to last 10 minutes (at least). Furthermore, students are expected to prepare the literature for each meeting and to contribute to the in-class discussions.

Research paper After the course, students have to prepare a short paper (6 to 10 pages) with a proposal for a research project (e.g., a laboratory experiment, a field study, or an application of a model to a specific context).

The final grade consists of a grade for the presentation (40%), the paper (30%), the discussion (20%) and in-class participation (10%).

Topics

1. *Do markets reveal all the private information of firms?*
   Producing a good or service of higher quality than what is provided by competitors should motivate firms to credibly reveal their own quality information to differentiate their product from low quality products. This session will address theoretical arguments (and empirical findings) in favor and against this assertion.

   (a) Information revelation: Grossman (1981) and Danove and Jin (2010)

   (b) Limits to information revelation: Benndorf et al. (2015), Schipper and Li (2017)

2. *Is there an intrinsic motivation to act responsible in markets?*
   Unregulated (anonymous) market exchange is often blamed to crowd-out the frequent intrinsic motivation of individuals to behave in a socially responsible way. More specifically: Do we observe a lack of social responsibility only if individuals are protected by the anonymity of markets?

   Sandler (1998), Kirchler et al. (2016), Bartling et al. (2015)

3. *Does competition enhance responsible behavior?*
   When facing competitors, socially responsible behavior may serve as part of a firm's brand identity and provide a competitive edge. In this session, we will discuss the theoretical preconditions and empirical prominence of this positive impact of firm-side competition.

   Amacher et al. (2004) and Pigors and Rockenbach (2016)

4. *Should governments regulate misinformation?*
   If firms do not face sufficient incentives to actually act in a socially responsible way and try to hide this with misinformation, should this trigger a government intervention (e.g., law-enforcement, taxation, or information campaigns?)

   Cutler and Glaeser (2006), Glaeser and Ujhelyi (2006)

5. *How good is it to have "green markets"?*
   A particular measure to guarantee the quality of goods and services is trade at so-called "green markets" where the market platform certifies or monitors suppliers (e.g., of green electricity or fair-trade products). Research demonstrates that these platforms may also induce welfare detrimental effects and interact non-trivially with traditional regulatory measures.

Kotchen (2006), Hamilton and Silberman (2006)

6. *Should firms engage in self-certification, third-party certification or brand building?*
When is it more promising for firms to ask for third-party certification of the quality of the good or service and when should the firm rather view quality as part of its brand identity or create their own label?

   (a) Etile and Teyssier (2016), Cason and Gangadharan (2002), and Rode et al. (2008)
   (b) Arguedas and Blanco (2017), Baski and Bose (2007), and Baksi et al. (2016)

7. *Should governments enforce third-party certification?*
When is it superior for social welfare that governments enforce mandatory certification by a third party and when should it rely on self-labeling or certification by the firms?

   (a) Voluntary contribution and social pressure: Baron (2011) and Cason and Gangadharan (2016)
   (b) Voluntar vs mandatory disclosure: Polinsky and Shavell (2013)

8. *What is the impact of (NGO) activists?*
What is the welfare impact of NGOs who provide information about product and service quality?

   Feddersen et al. (2001)

9. *What is a good label (or certificate)?*
As the standard for a label or certificate greatly influences compliance and consumer awareness, we will discuss some issues on the optimal design of standards.

   (a) Quality measurement: Glazer et. al (2008)
   (b) Consumer confusion: Harbaugh et al. (2011)

10. *Can there be too many labels (or certificates)?*
When NGOs or rating agencies compete with each other, more information may be provided to consumers but competition may reduce the quality of information provision.

   (a) Competing NGOs: Fischer et al. (2014) and Heyes and Martin (2016)
   (b) Competing Rating agencies: Farhi et al. (2013)