

Behavioral Industrial Organization
Central European University
Spring 2018

Team:

Instructor: **Botond Kőszegi**
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Requirements:

Problem Sets. There will be two problem sets. The problem sets will not be graded or collected, but it is extremely useful for understanding the material that you do them. Roughly, you should be able to complete Problem Set 1 by the middle of the course, and Problem Set 2 by the end. If you have questions about the problem sets, please ask me during office hours.

Idea Logs. You will also be required to write two “idea logs.” These are mini research ideas or intelligent observations about the economic world that should be closely connected to the topics in the course. For each log, find an economic puzzle, fact, or unaddressed question that you think could be addressed using material in the course. This does not have to be some major research idea; it could be as simple as a mistaken statement you have seen in the press or a weird business policy you have observed at a restaurant. But the ideas must be original, and you should check the literature to make sure that no one has addressed the same issue before. In addition, the logs should address an *economic* question, not just be about the underlying psychology or about the business strategy of an individual firm. I realize that this is somewhat of an arbitrary distinction, so if you are unsure whether a topic is economic enough, feel free to shoot me an email or talk to me (at least three days before the due date). Write up a 1-2 page description of the issue and how it connects to the course. Please send the idea log to me over email before the beginning of lecture on the due date.

Final. There will be a final during the exam period.

Grading:

The grade will be determined 60% by the final and 20% each by the idea logs.

Prerequisites:

Preparation in the following is necessary or useful to get the most out of the course. I will not enforce formal prerequisites; it is your responsibility to judge whether you are prepared, and to prepare sufficiently if you are not.

Microeconomics. Basic game-theoretic concepts and standard oligopoly models such as Hotelling, Salop, Cournot, and Bertrand.

Behavioral Economics. You should know about hyperbolic discounting, loss aversion, projection bias, etc., and basic issues and modeling ideas in behavioral economics.

Industrial Organization. It would be useful to have taken Industrial Organization as well, but it is not essential.

Goals of the Course:

To familiarize you with the issues, results, and methods of applying behavioral-economics models of individual decisionmaking to industrial organization. The course will be exclusively about economics questions, not business strategies such as marketing.

Learning Outcomes:

Understanding the basic implications of psychological phenomena for competition between firms, for the market interaction between firms and consumers, and for optimal policy interventions. Learning techniques to solve behavioral industrial organization models. Developing an ability to spot when psychological phenomena may be important in a market situation, to think about how to conceptualize the situation, and to identify the types of data that are useful for quantifying the importance of the phenomenon. At the end of the class, you should have a good idea of the research frontier in behavioral industrial organization, be capable of evaluating research in the field, and to start own projects in the area in case you are interested.

Readings:

The course will roughly follow the organization of the survey article “Behavioral Industrial Organization” that Paul Heidhues and I wrote for the Handbook of Behavioral Economics. There is also a comprehensive graduate textbook “Bounded Rationality and Industrial Organization” by Ran Spiegler (2011, Oxford University Press). This book is focused more on the theoretical issues at play than we will do in the course, but it should be extremely useful if you plan to do research in the field. Other, topic-specific readings will also be assigned.

Topics:

This is an ambitious list of topics. We will probably not cover everything.

1. Introduction

2. Basic Economics of Hidden Prices

- Framework and Safety-in-Markets Benchmark
- Limitations on Competition for Naive Consumers
- Heterogeneous Sophistication and Distributional Effects
- Distortions
- Deriving the Additional Price from Primitives

Identifying Hidden Prices from Market Data

3. Price Discrimination

Second-Degree Naivete-Based Discrimination

Third-Degree Naivete-Based Discrimination and Privacy

4. Perception Externalities

Educating, Confusing, and Manipulating

Endogenously Determined Attention

5. Responding to Consumer Preferences

Loss Aversion

Preferences for Commitment, Flexibility, and Indulgence

Conspicuous Consumption

6. Behavioral Managers and Firms

7. Policy Issues and Implications (interspersed within the other topics)

The Inadequacy of Market Solutions to Consumer Mistakes

Soft Paternalism and Consumer Education

Regulating Contracts or Firm Conduct

Modifying Classical Policy Recommendations