Written Exam for the M.Sc. in Economics Winter 2012-2013

Behavioral Economics and Finance

Master's Course

Date: 10 January 2013

(2-hour, closed book exam)

The exam consists of 3 different questions (with sub-questions).

Good luck.

(1) Overconfidence:

(a)   Define overconfidence and explain the three facets of overconfidence discussed during the course.

(b)   Explain how overconfidence is tested for in the experimental paper by Camerer and Lovallo (AER, 1999)

(c)   Explain the type of overconfidence discussed in Malmendiera & Tate (JFE, 2005)'s article entitled `CEO Overconfidence and Corporate Investment´ and its consequence for the investment decisions of overconfident managers.

(2) Myopic Loss Aversion: Consider the idea of myopic loss aversion discussed during the class.

(a)   Explain the concept of myopic loss aversion and why prospect theory implies that people are myopic loss averse.

(b)   Explain the equity premium puzzle and explain how myopic loss aversion has been used to `rationalize´ it.

(c)   Explain how the implications of myopic loss aversion have been tested for in economic experiments. In particular refer to the experimental papers discussed in class: (i) Gneezy, Kapteyn & Potters (JF, 2003) and Haigh & List (JF, 2005).

(3) Self control problems: Consider the discounted-utility model as well as the $\beta\delta$-model of intertemporal choice discussed during the course.

Imagine you have a 3-day holiday and you can spend some time with your friends. You friends have already organized an activity for each day. Unfortunately you know that you have to skip one activity, because you have to visit your parents. Participating in your friends' activity today gives you a utility of $u_0=3$, participating in the activity tomorrow gives you a utility of $u_1=5$ and participating in the activity on the last day of your holiday gives you a utility of $u_2=8$. Assume that $\beta=\frac{1}{2}$ and $\delta=1$.

(a) When would you visit your parents, if you were a discounted utility maximizer? Explain why.

(b) When would you visit your parents, if you were a naïve $\beta\delta$ maximizer? Explain why.

(c) When would you visit your parents, if you were a sophisticated $\beta\delta$ maximizer? Explain why.