Behavioral Economics and Finance

Master's Course

17 February 2011

(2-hour, closed book exam)

The exam consists of 3 different questions (with sub-questions). Answer as much as you can.

Good luck.

(1) Ambiguity Aversion:

    (1a)   Describe the Ellsberg Paradox and use it to explain ambiguity aversion.

    (1b)   It has been found that the strength of ambiguity aversion depends on different factors. What are these factors and how do they influence the strength of ambiguity aversion? What could potentially be a source of ambiguity aversion? Explain.

    (1c)   Gilboa and Schmeidler (1989) develop Maxmin Expected Utility Theory. Explain how this theory can explain the ambiguity aversion in the Ellsberg experiment.

(2) A broader model of human behavior: In the last 30 years a lot of experimental evidence has been found which shows that people also care about what other people get. On the basis of this e.g. Fehr and Schmidt (1999) have developed their theory of inequality aversion and Charness and Dufwenberg (2006) have suggested their theory of guilt aversion.

    (2a)   Explain the theory of inequity aversion presented by Fehr and Schmidt (1999)

    (2b)   Describe the evidence Falk at al (2008) present in their article 'Falk, A., Fehr, E. & Fischbacher, U. (2008), Testing theories of fairness--Intentions matter, Games and Economic Behavior, 62(1), 287-303' and explain why this is in contradiction with classical assumptions about human behavior

    (2c)   Explain the difference between the theory of guilt aversion by Charness and Dufwenberg (2006) and the theory of inequality aversion by Fehr and Schmidt (1999)

(3) Self control problems: In the course we also talked about the recent finding that people have self-control problems (present-biased preferences)

    (3a)   Explain why self-control problems can lead to an under-investment into e.g. retirement savings. Furthermore, explain why commitment devices might help sophisticated agents to overcome their self-control problem. Give an example of such a commitment device.