

Written Exam for the M.Sc. in Economics winter 2014-15

**Behavioral Economics and Finance**

Master's Course

19/12/2014

(2-hour closed book exam)

Please note that the language used in your exam paper must correspond to the language of the title for which you registered during exam registration. I.e. if you registered for the English title of the course, you must write your exam paper in English. Likewise, if you registered for the Danish title of the course or if you registered for the English title which was followed by "eksamen på dansk" in brackets, you must write your exam paper in Danish.

**This exam question consists of 4 pages in total**

**1) Prospect Theory and Myopic Loss Aversion:**

1.a) What is “loss aversion” and what is “myopic loss aversion”?

1.b) Explain how prospect theory captures myopic loss aversion?

1.c) Explain why expected utility theory does not capture loss aversion?

## **2) Ambiguity Aversion.**

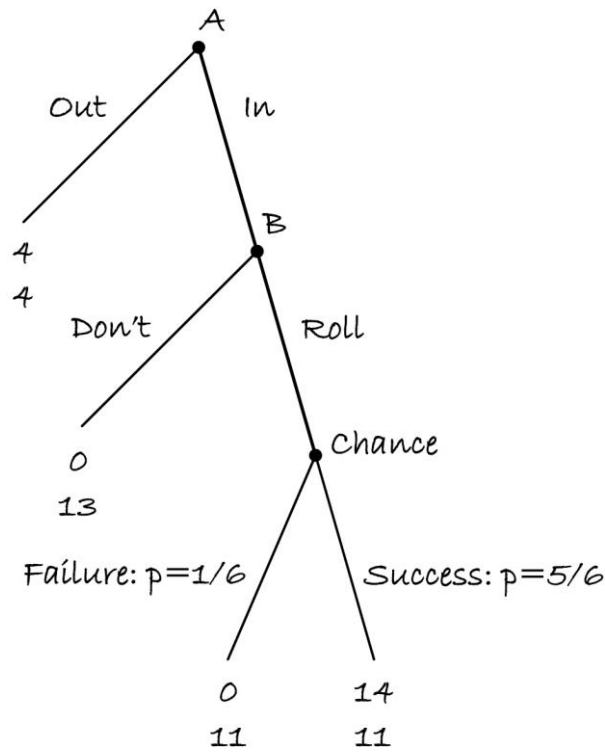
2.a) Please explain what ambiguity aversion is and give examples highlighting the consequences of ambiguity aversion for our behavior outside the laboratory it is usually tested in.

2.b) Trautmann et al. (2008) [Trautmann, Vieider & Wakker (2008), Causes of Ambiguity Aversion: Known Versus Unknown Preferences, *Journal of Risk and Uncertainty*, 36 , 225-243] describe a certain factor that might cause ambiguity aversion. In their experimental analysis they specifically test for the importance of this factor. Please explain this factor, explain their experiment and their findings.

2.c) Explain how the “Maxmin Expected Utility” by Gilboa and Schmeidler (1989) captures ambiguity aversion.

### 3) Guilt Aversion.

3.a) Charness and Dufwenberg (2006) [Charness & Dufwenberg (2006), Promises and Partnership, *Econometrica*, 74(6), 1579-1601] use a trust game to test their idea regarding guilt aversion. Please explain their idea of guilt aversion using the following trust game:



In particular (i) explain the importance of higher order beliefs in the context of their model of guilt aversion and (ii) explain the significance of the “chance move” in their game.

3.b) Please explain their experimental set-up (i.e. the treatments) and explain the connection between communication and the model of guilt aversion they test for.

3.c) Explain their experimental results.