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**Seminar**  
**Labor Economics and Emotional-based Decisions**  
**(Winter Term 2011/12)**

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**Organizers**

Ass. Prof. Abniash Borah (Ph.D.)/Alexey Cherepnev/Michael Lamprecht/Prof. Dr.  
Klaus Wälde

**Important Dates**

Introductory Session: Monday, the 9th January 2012 (RW 6)

Deadline for turning in the thesis (by email and in written form): Monday, the 6th  
February 2012

Presentation: 15th and 16th February 2012 (RW 6)

**Target Audience**

The seminar is for bachelor students in the 3rd year. Knowledge of dynamic optimization methods is useful for some topics.

**Content**

The seminar serves as a preparation for the bachelor thesis. The thesis has to be written directly after the end of the seminar. For the seminar, the students have to write an Exposé of their bachelor thesis. Furthermore, the students have to present their Exposé. The presentation and the Exposé can be in English or in German. The bachelor thesis can be written in German.

**Contact**

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## Topics

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### 1 Labor Economics

Labor economics is the study of a market in which labor services are exchanged for wages. It embraces topics as wages, employment, unemployment, the cost of labor, the number of hours worked per week and so on.

In this seminar, we analyze how workers and firms coordinate on the labor market and how wages are determined. Especially, we want to understand why vacancies exist and what determines wages in such economies.

#### 1.1 The Diamond-Mortensen-Pissarides Model

An approach which can explain the existence of vacancies on labor markets is known as the DMP(Diamond-Mortensen-Pissarides)-Model. The key idea of this theoretical framework is that markets are frictional. Therefore, buyers and sellers have to search before a contract can be signed. This gap in time between announcing an offer and signing a contract can explain the existence of vacancies on labor markets. In this section, the DMP model and some extensions are presented.

**Topic 1 (Diamonds Paradox)** The basis for this type of models is the work of Diamond (1971). In his paper, he analyzes the price setting on incomplete markets. It is expected that the student presents the model and the key results of this paper. Furthermore, the student has to discuss the impact of the “Diamond Paradox” on labor economic research.

**Topic 2 (The Dynamics of Unemployment)** Based on the result of Diamond (1971), Pissarides (1985) developed a theoretical framework explaining the dynamics on labor markets. Therefore, he introduced a matching technology describing the random search process on the labor market. It is expected that the student presents the key ideas, the results and the impact of this paper on current research.

**Topic 3 (On-the-Job Search)** Pissarides (1994) extended his classical search-theoretic framework by introducing on-the-job search. In contrast to his earlier work, workers have an incentive to search for better paid jobs. Therefore, unemployed people are not the only persons which are searching for a job on a labor market. It is expected that the student presents the model and the key results of this paper. It is also expected, that the student discuss the impact of this paper on the field of labor economics.

**Topic 4 (Business Cycles in a Search-Theoretic Framework)** Another application of the DMP model is presented by Cole and Rogerson (1999). They use the DMP approach to analyze the impact of business cycles on the labor market dynamics. It is expected that the student presents the theoretical framework and the results of this paper. Furthermore, it is expected that the student presents the impact of this model on current research.

## 1.2 Directed Search and Posting

In the last section, we have presented papers in which searching is random. In this section, we consider frameworks in which agents can direct their search to the most attractive alternatives.

**Topic 5 (Competitive Search Equilibrium)** As one of the first papers, Moen (1997) analyzes the effect of directed search. It is expected that the student is presents this paper and its key results. Furthermore, the impact of this paper on current research has to be discussed.

**Topic 6 (Simultaneous Search)** In the paper of Moen (1997), individuals can only direct their search in one direction. But it may be efficient that agents search simultaneous for different jobs. A model which analyzes the efficiency of simultaneous search is the paper of Kircher (2009). It is expected that the student presents the theoretical framework and the results of this paper. Furthermore, it is expected that the student presents the impact of this model on current research.

**Topic 7 (Directed Search)** There are several other theoretical frameworks which use the direct search approach. A good overview is given by Rogerson, Shimer and Wright (2005). It is expected that the student presents one of these models which were not discussed in previous topics. It is expected that, the student discusses the relevance of this model on labor economic research.

### 1.3 Wage determination

A key problem in the search literature is the determination of wages. We are interested on the following questions: how wages are bargained and which factors influence the wage payments? In this section, we present some papers which analyzing the effect of different bargaining solutions on wage payments in a search-theoretic framework.

**Topic 9 (The Burdett-Mortensen Model)** The papers we have discussed before, cannot explain why similar workers are paid differently. Burdett and Mortensen (1998) have presented a search-theoretic model which can explain this stylized fact. It is expected that the student presents the theoretical framework and the results of the Burdett-Mortensen model. Furthermore, it is expected that the student discusses the impact of this paper on current research.

**Topic 8 (Dynamic Bargaining)** The classical approach in modeling wage bargaining is the Nash Bargaining solution. Another solution method, called strategic bargaining is presented in the paper of Coles and Masters (2006). It is expected that the student presents the model and results in this paper. Furthermore, it is expected that the student discusses the difference between the classical approach and the bargaining solution presented in this paper.

**Topic 10 (Sequential Auctions)** Another bargaining solution is called sequential auction. It was firstly presented in the paper of Postel-Vinay and Robin (2002). It is expected that the student presents this paper. Furthermore, it is expected that the student discusses the difference between the classical approach and the bargaining solution presented in the paper of Postel-Vinay and Rabin (2002).

## 2 Emotional-based Decisions

In the current economic research, there are several models which analyze the effect of emotions on economic decision. This type of models try to answer the following question: What is the role of emotions on economic decisions? In this section, we present some papers which discuss the effect of emotional-based decision on economic behavior.

### 2.1 Emotions in other Research Fields

But before we can analyze the effect of emotions on economic behavior, we have to understand what emotions are. Therefore we consider different approaches which have their

origin in other research fields.

**Topic 11 (Emotions in Psychology)** We start with a discussion of the paper of Loewenstein and Lerner (2003). In this paper, the psychological perspective of emotions is presented. It is expected that the student discuss how emotions are defined in psychology. The student has to explain the differences between the physiological and the cognitive approach.

**Topic 12 (Emotions and Neuroscience)** Bechara and Damasio (2005) analyze the impact of “somatic marker hypothesis” from neuroscience on economic decisions. The student is expected to present this paper. It is expected that he discusses the impact of this hypothesis on economic research.

## 2.2 Emotions in Economics

In this section, we discuss the impact of different types of emotions on economic behavior.

### 2.2.1 Modeling Emotions

There are different approaches how emotions are modeled in economic research. In this part of the section, we present some of these theoretical frameworks.

**Topic 13 (The Axiomatic Approach)** Firstly, we discuss the classical approach without emotions. In this framework, economic behavior is rational. Rationality is described by an axiomatic system. A good description of this axiomatic system and its implications is given in Mas-Colell, Whinston and Green (1995). It is expected that the student presents this axiomatic system. Furthermore, the student has to present recent axiomatic approaches related to the topic of emotions.

**Topic 14 (Emotions in Expectations)** If we consider emotions we can distinguish three different types of emotional processes: ex-ante, ex-post and ex-nunc emotions.

1. Ex-ante Emotions: Caplin and Leahy (2001) have presented an axiomatic approach for modeling ex-ante emotions. It is expected that the student presents this paper. He/She has also to discuss other approaches which try to model ex-post emotions.
2. Ex-post Emotions: As one of the first, Loomes and Sudgen (1982) have introduced ex-post emotions in economic research. It is expected that the student presents this paper and current research in this area.

3. Ex-nunc Emotions: One approach in modeling ex-nunc emotions is presented in the paper of Laibson (2001). It is expected that the student presents the theoretical framework of Laibson (2001) and compare his results with other approaches of ex-nunc emotions.

**Topic 15 (Reference-Dependence Preferences)** Reference-dependent utility is based on the Nobel-prize winning work of Kahnemann and Tversky (1979). Recent papers by Botand Koszegi, Paul Heidhues and others extend this work and provide theoretical foundations. The objective of this thesis consists in understanding saving behaviour of individuals who are described by these empirically more relevant approaches.

**Topic 16 (Dual-Self Models)** It seems obvious to many that one individual often has conflicting views when it comes to one issue or decision. The economists view on this can be seen in Brocas and Carrillo. It is expected that the student presents this paper.

**Topic 17 (Self-Control)** In models of self-control, individuals should follow some ideal action but are victims of temptations. A recent empirical paper referring to many theoretical studies is by Ameriks, Caplin, Leahy and Tyler (2007). It is expected that the student is presenting this paper. Furthermore, the student has to present theoretical approaches related to this empirical study.

### 2.2.2 Emotional-based Decisions

In the previous part of this section, we have discussed different approaches in modeling emotions. Now, we present some applications in economic research.

**Topic 18 (Addiction)** Addiction can also be understood as a state which causes an individual to lose self-control and to continue to behave in a way that may even damage his health. The most striking example in this sense is a heroin addict. At first glance addiction does not seem to be consistent with the usual concept of what we understand as rational behavior. However, as Becker and Murphy (1988) show, addictive behavior can also be rational. It is expected that the student presents this paper.

**Topic 19 (Politics and Hate)** So far, we have learned how emotions affect human behavior. Politicians are aware of this and can use emotions in order to discredit opponents. Glaeser (2005) developed a theoretical model related to this empirical fact. It is expected that the student presents this paper

**Topic 20 (Fear and the Response to Terrorism)** Becker and Rubinstein (2010) offer a rational model of fear and provide empirical evidence to support it. The student is expected to present this paper.

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