Course Outline

Subject to change. This version November 30, 2017 at 4:34PM

Problems should be turned in for grading on the day they are discussed in class.

Part 1. Introduction

1. Tuesday, August 22 Assumptions: Behavioral, Equilibrium, and Structural


   Reference: Greek letters and pronunciation
2. Thursday, August 24 Framing
   \textit{Read}: Demski, Chapter 8
   

   \textit{Problems}: 8–2, 8–5, 8–6, 8–9, 8–10, 8–11

   Blackwell Informativeness Criterion

3. Tuesday, August 29 Uncertainty I
   \textit{Read}: Demski, Chapter 9

   Mathematica Tips and Pointers

   \textit{Problems}: 9–11 (Note the typo. The problem should read: \(U(w) = 10 - \exp(-0.001w)\)), 9–12, 9–14, 9–15


4. Thursday, August 31 Uncertainty II

   Sure-thing principle Powerpoint

   Terms of Likelihood

   \textit{Inspect}: EllsbergPsychiatristCabinet.JPG

   \textit{View}: Donald Rumsfeld on known unknowns:
   \url{https://www.youtube.com/watch?v=GiPe1OiKQuk}


   \textit{Problems}: 9–16, 9–17, 9–18, 9–19, 9–20
Part 2. Contracting

5. Tuesday, September 5  
Strategic Interaction  
**Read:** Demski, Chapter 10  
**Skim:** Robert Forsythe, Russell Lundholm, and Thomas Rietz.  
**Problems:** 10–1, 10–6, 10–11  
**Class Experiment:** Demski’s Heirloom transfer (to illustrate no-trade theorem, belief revision, strategic use of information, and consequent inference dealing with fundamental and strategic uncertainty) Also, heirloom with an audit signal (to illustrate the value of information)

6. Thursday, September 7  
Strategic Interaction II  
**Problems:** 10–12, 10–13, 10–14, 10–16  
**Class Experiment:** Beauty contest (closest to 2/3 of the average of the number selected) to illustrate strategic interaction

7. Tuesday, September 12  
Performance Evaluation  
**Read:** Demski, Chapter 13  
**Problems:** 13–1, 13–2, 13–3, 13–4, 13–5, 13–6, 13–7, 13–8, 13–9, 13–10

8. Thursday, September 14  
Performance Evaluation II  
**Problems:** 13–13, 13–14, 13–15  
Tax planning and employee contracting problem  
Taxation of stock options problem

9. Tuesday, September 19  
Information  
**Read:** Kreps, Chapter 16  
Demski, Chapter 14  
**Demski Ch. 14 typos:** There are two typos on p. 355. First, in the last line of Table 14.5, \( \frac{25}{75} \) should be \( \frac{25}{50} \). Second, the line after eqn. (14.11) should read \( LR_g = 0.4 > LR_b = 1.6 \), not \( LR_g = 2 > LR_b = 0 \).  
**Problems:** 14–9, 14–10, 14–11, 14–12, 14–13, 14–14
10. Thursday, September 21  Task Allocation and LEN Models

Read: Demski, Chapter 15
Negative exponential utility functions and normally distributed wealth


Problems: 15–4, 15–5, 15–6, 15–7, 15–9, 15–13

11. Tuesday, September 26  LEN Models II


Problems: Accounting in Partnerships

12. Thursday, September 28  Equity Compensation

Problems: Gamblers’R’Us: Devote particular effort to questions 15 through 24 of this problem. For these questions, you may try to state and solve an agency problem.

13. Tuesday, October 3  Controllability

Read: Demski, Chapter 16

Problems: 16–7, 16–11, 16–12

Page 4
14. Thursday, October 5  Communication  
    Read: Demski, Chapter 17  
          Florin Şabac and Joyce Tian, 2015, On the Stewardship Value of Communicating Post-Decision Information,  
    Problems: 17–4, 17–5, 17–13, 17–16  
    Demski Ch. 17 typos:  
        p. 416, fourth line from the bottom: “70” s/b “0.70”  
        p. 419, third line from the bottom: “E[U|H,m]” s/b “E[U|a,m]”  
        p. 420, first paragraph after the table: “Relative to the public case, the information is used less aggressively. This is reflected in the fact the largest payment occurs in the public case, as does the lowest payment. The information is used in a mooted fashion” s/b “Relative to the public case, the information is used less aggressively. The information is used in a muted fashion”

15. Tuesday, October 10  Coordination and Renegotiation  
    Read: Demski, Chapters 18 and 19  

16. Thursday, October 12  Bayesian Updating and Equilibrium  
    Read: Conditional Distributions and Bayesian Updating Equilibrium Notes  
    Problems: Work through the problems in both notes.  
    Class Experiment: Monty Hall game 3-door and 100-door, to illustrate belief revision (in general) and Bayesian updating (in particular)
Part 3. Markets and Disclosure

17. Tuesday, October 17  Disclosure Complexity and Information Acquisition 1
   Note: Class led by Hong Qu

18. Thursday, October 19  LEMA Colloquium

19. Tuesday, October 24  Disclosure Complexity and Information Acquisition 2
   Problems: Hong Qu’s “Information Acquisition in Beauty Contests”

20. Thursday, October 26  Exam 1. Maybe.

21. Tuesday, October 31  Higher-order Beliefs
   Problems: Hong Qu’s “Higher-order Beliefs” [zzWhere is this problem? zzA simpler problem would be better.]

Page 6
22. Thursday, November 2

The Market Response to Disclosure

**Read:** The market response to disclosure


**Problems:** Work through the problems in the note.

23. Tuesday, November 7

Information and Prices

**Read:** Some Know and Some Don’t Part 1: Kyle Model

Albert S. Kyle, 1985, “Continuous auctions and insider trading” *Econometrica* 53: 6 1315–1336. (Focus on the analysis leading to the first result.)


**Problems:** Work through the problems in the note.

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¹ At time of writing, respectively, Associate Director, Division of Enforcement and Senior Counsel, Division of Enforcement, U.S. Securities & Exchange Commission
24. Thursday, November 9
   NO CLASS

25. Tuesday, November 14
   Information Gathering
   Problems: What information should I chase?

26. Thursday, November 16
   Mandatory Disclosures
   Problems: Public information in capital markets

27. Tuesday, November 28
   Earnings Management I
   Problems: Shooting Yourself in the Foot (or Not) The Curse of the Revelation Principle

28. Thursday, November 30
   Earnings Management II
   Ginger Zhe Jin, Michael Luca, and Daniel Martin, 2015, Is No News (Perceived as) Bad News? An Experimental
Investigation of Information Disclosure, NBER working paper w21099.


**Problem:** Cheap Talk Problem

29. Tuesday, December 5  Black Box Earnings
   

   **Problem:** Dr. Blackwell does Dr. Markov’s books

30. Thursday, December 7  Ethics and social norms
   
   **Read:** Social norms for ethical behavior in business settings
   
   Hong Qu and Steven Huddart, 2014, Rotten apples and sterling examples: Moral reasoning and peer influences on honesty in managerial reporting, working paper, Penn State.


   **Problems:** What if bad behavior is contagious?

   **Social Norms in a LEN Setting**

   **Fischer Huddart typos:** p. 1462 RHS of eqn. (5), numerator and denominator, $a_iS_i$ should be $\alpha_iS_i$
   
   p. 1464. The address for the Web Appendix is:
   http://www.aeaweb.org/articles.php?doi=10.1257/aer.98.4.1459

Wednesday, December 13  Final examination 2:00 p.m. to 6:30 p.m.