Topics in applied economics and finance

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Informal institutions, financial decisions and financial development

Course purpose and description

This course reviews a recent trend of literature on the determinants of investors' financial decisions and the role of informal institutions – such as trust and social capital – in shaping the adoption of financial instruments, the working of financial markets and financial development. There is no reference textbook. The focus is on applications rather than on theory.

Course purpose and description

This course reviews basic retail investors financial choices and the recent trend of literature on the determinants of investors' financial decisions and the role of informal institutions – such as trust and social capital – in shaping the adoption of financial instruments, the working of financial markets and financial development. The sequence is a 20-hour course based on lecture notes and the direct reading of a number of articles from the literature.
There is no reference textbook.
Students will be required to read thoroughly one of the papers in the reading list and present and discuss it in class.

Grading policy

Grades will be based on the presentation of the paper and participation in class discussion and on the performance on a final exam. The presentation and discussion counts for 20% of the grade, the exam for the remaining 80%.

Topics and readings

The list of topics and readings is tentative and is still subject to change but gives you a fair idea of what the contents of the course will be.
The course is divided into two parts. The first deals with households financial decisions, portfolio allocation, financial markets participation. The second with social interactions, trust, culture and finance.

A. Household finance

1. What is Household finance about

An introduction to household finances. Provides definition of what household finances is about, main empirical features of household financial wealth and financial choices, definitions of financial markets and how households rely on financial markets to achieve their objectives.

Material: slides and (*) reading

Readings


2. Portfolio Choice

Discusses households portfolio choice in the simplest scenario of one safe and one risky assets when choice is made in a frictionell word.

Material: slides and Gollier chapter.

Readings
3. **Preferences for risk and risk aversion**

Defines risk aversion of the utility function when endowment is certain and how risk attitudes are affected by background risk. Discusses thoroughly how preferences for risk can be elicited at the level of the single investors and the pros and cons of various elicitation strategies.

**Material:** slides and starred readings.

**Readings**

2. (* Luigi Guiso and Monica Paiella (2005), “Risk aversion, wealth and background risk”, mimeo R
3. Charles Holt and Susan Laury “ Risk aversion and incentive effects”, American Economic review R

4. **The stockholding puzzle**

Explains the stockholding puzzles and proposes one solution to the puzzles: the presence of fixed participation costs. Argues that participation costs can explain certain key features of the data but not all.

**Material:** slides and starred readings.

**Readings**


5. Topics

Discusses three topics in household finance. A) the portfolio of the rich; B) the effect of information on financial decisions and the choice of how much information collect; C) behavioral finance, providing an introduction to basic concepts in psychology and finance, such as loss aversion, ambiguity aversion and overconfidence and a discussion of their effects of financial decisions.

Material: slides and starred readings.

Readings

4. (*) Luigi Guiso and Tullio Jappelli (2005), “Information Acquisition, Overconfidence and Portfolio Performance”, mimeo R

B. Social capital, trust and business behavior

(Informal institutions, financial decisions and financial development)

a. Trust, social capital and social interactions: what they are and why they matter
Discusses the meaning of informal institutions, their relation to each other and their link to financial decisions and financial markets.

Readings: slides and starred articles

4) * Adam, F., Roncevic, B. (2005), Social Capital: Recent Debates and Research Trends, Social Science Information, 42(2), 155-183.

b. Measuring trust and social capital

Shows how trust and social capital can be measured following various strategies.

Readings: slides and starred papers


The Effect of Trust on Finance and Trade
Determinants of financial development. The Role of the Law and Social capital

a. The role of the law

Readings:

b. The role of social capital

Culture and Financial and Economic Outcomes

Readings:
2) Lauren Cohen “Loyalty based portfolio choice”, 2005 Yale University