

## Unfolding Of Behavioral Economics: Outset Of New Interfaces Of Flux

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### A B S T R A C T

The paper is going to have a brief idea on the application of Behavioral Economics into the welfare of the masses through policy formulations. Behavioral Economics adds a paradigm shifting revolution in the field of Economics with more insights from psychology, neuroscience and microeconomic theory. It has been often argued that traditional economics with their models of “rational decision making” fail to take into considerations that how people make important choices. The notion in this branch of Economics is more like old wine in a new bottle. The cognizance from Behavioral Economics is now being able to make a vigorous influence on policy making through nudging. The evolution of Behavioral Economics is not a latter day postulation rather its existence can be tracked down in the times of Adam Smith and had a continuation through the time of Irving Fisher and John Maynard Keynes in the 1930s. The paper would also like to have a pilot study on the relevance of this branch of Economics in the other sections as well along with its future prospects. It also identifies the analysis of emergence of Behavioral Economics in the new era. This proceeding would like to initiate the notion

that Behavioral Economics increases the revelatory power of the subject by bringing on the effects of cognitive, cultural, psychological foundation that introduces a realistic approach.

Keywords – Behavioral Economics, Nudging, Psychology, Future prospects.

## **1. INTRODUCTION**

The domain of Behavioral Economics has transformed drastically over the recent years. It has been often argued that traditional economics with their models of “rational decision making” fail to take into considerations that how people make important choices. The notion in this branch of Economics is more like old wine in a new bottle. The cognizance from Behavioral Economics is now being able to make a vigorous influence on policy making through nudging. The evolution of Behavioral Economics is not a latter day postulation rather its existence can be tracked down in the times of Adam Smith and had a continuation through the time of Irving Fisher and John Maynard Keynes in the 1930s. The journey from the sub-field of the mainstream Economics to the emergence of a new independent branch and its future prospect, there is a lot to know on the insights of this mixture of psychology and economics which has come to be known as Behavioral Economics. The application of the tools of Behavioral Economics has been widely used into the policy advising for the Government. The intrigue of social scientists, natural scientists, and from neuroscientists to behavioral ecologists, is keenly shown to inculcate behavioral economists into the multidisciplinary items so that they can build up a connection of their study with the understanding from Behavioral Economics. It is so because Behavioral Economics does not only bring a change in the outlook of the traditional economics but combines a unique interlinkage with the domain from other social sciences as well. This amalgamation with the other branches of social sciences brings the economists’ powerful analytical tools to gather which was traditionally applied in regulated direction to

untie the economic incentives. The modern economists have tried to bring out the insights from psychology to understand how the economic incentives and motives are often changed by the psychological influence and how do the people at the micro and macro levels respond to the changes. Herbert Simon came up with some head ways in reconceptualization the concept of rationality in Economics through the idea of “bounded rationality” which is rationality bounded by limitations in information accessible or in cognitive processing potentiality. The realm of Economics and Psychology cannot be segregated rather they go hand in hand. Neither of them can stand alone. Economics lacks external consistency and intuitive appeal without psychology and without Economics, Psychology lacks analytical structure and direction especially in the case of quotidian decision making. The combination of both the fields help us to have an insight on how people think, how do they react, speculate to the modification, what do they choose and decide. The footprint of Behavioral Economics can be traced in every nook and cranny of Economics. For example, the laws in Microeconomics, Intertemporal choice, decisions under uncertainty, risk, behavioral game theory and other sub branches as well. The unavoidable outcome of letting go the concept of perfectibility is Behavioral Economics. The presumption of perfect agent rationality is a similar idea to perfect information and competition. In Economic theory, a helpful limiting case extending those suppositions to take consideration imperfect competition and expensive information was difficult, time-consuming and effective, undermining the idea that everything was fine.

## **2. OBJECTIVES -**

- a) To analyze the contrast of Behavioral Economics over the traditional Economic Theory.
- b) To study the qualitative assessment on the emergence of Behavioral Economics.
- c) To consider the future of Behavioral Economics and its applications in the policy making by the Government.

## **3. DATA AND METHODOLOGY-**

The methodology and data analysis that the proceeding follows is basically from having an outlook on the different initial works by many contributors to Behavioral Economics. The methodology of this proceeding relies on the secondary work. The quantitative assessment for the evolution of Behavioral Economics with a rise in popularity within the theoretical economics as a whole and coming out of the mainstream Economics is done by analyzing the absolute and relative citations, references and frequencies of the main term Behavioral Economics.

#### **4. RESULTS AND FINDINGS –**

The proceeding has come to its findings from the time series displayed in the figure below that the story that had been affirmed in the history of thoughts in Behavioral Economics is indeed pertinent. This is specifically due to two reasons as the title of the field itself and its underlying notion. The relevance of the field can also be traced down from the fact that the top journals interestingly hold a lofty proportion of the papers using the terms almost throughout the whole observation. Over the past two decades, it is observed that the field Behavioral Economics rose in an well known way. The opposite happens for the case of Bounded rationality which had already begun its slower scramble in the 1980s. In a nutshell, these observations show the increased discussion of Behavioral Economics in the literature and raising a question of inclusion of these translated into the developments in economic policy. The following figure portrays relative frequencies of papers stating “Behavioral Economics” and “bounded rationality”, 1950-2010 by JSTOR category and in the top 10 journals.

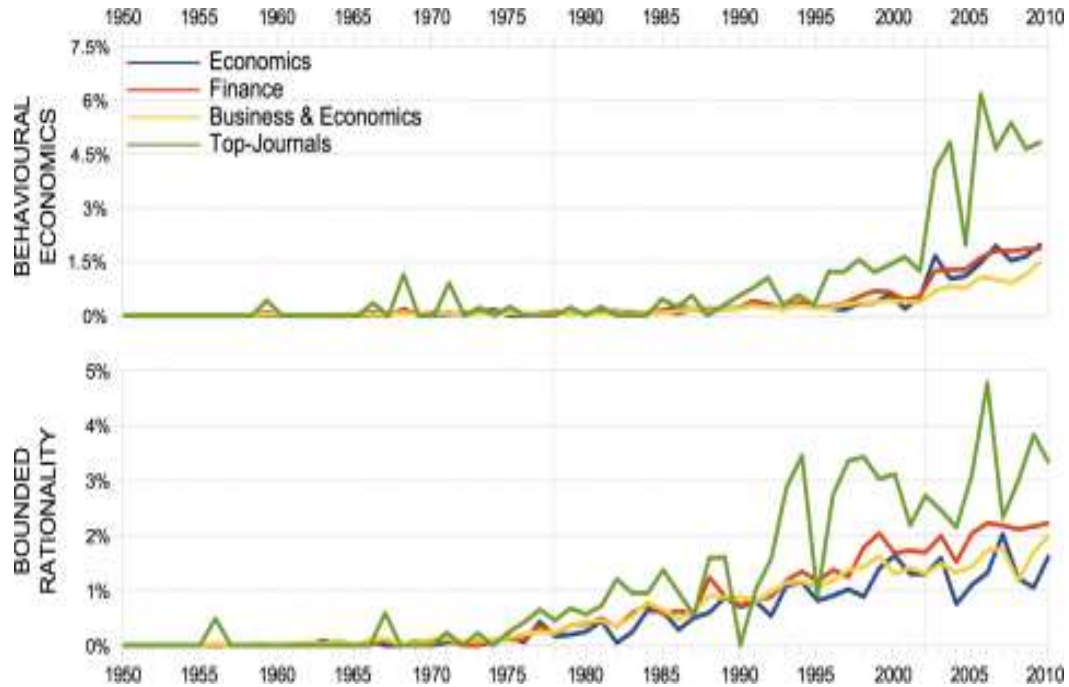


Figure 1: Frequencies stating “Behavioral Economics” and “Bounded Rationality” in Research Articles

Source: JSTOR DfR (Data for Research); Geiger, N. (2014)

The next finding is meeting the objective of the contrast of Behavioral Economics over the classical Economic theory. In classical Economics, it is presumed that the production and consumption are determined by the cost and benefit at the margin. The producer and consumer are supposed to make rational decisions. Classical Economics is all about balance and the initiatives taken by the market forces to make resource allocation as efficient as possible. There are some cases of full or partial market failure. The Classical Economics believed in traditional measures such as taxation and subsidy by changing the relative prices. There are three basic tenets at the core of traditional approach that are collectively known as the economic model of Human Behavior –

- a) Everyone is rational
- b) The modifications line up with what is best for them
- c) The contemplation are shaped around new information

These notions are being nullified by Behavioral Economics since they are not considered so realistic. This is supposed

to be the most important difference between the two approaches. There has been an underpinning exhibited by Kahneman and Tversky (1979) in a seminal paper that the decisions taken by humans somehow or the other affect their human behavioral tendencies and therefore they must be a part of economic and financial models. They propose that the psychological realities such as framing, heuristics and biases must be incorporated into these models.

Geiger (2014) has obtained over the years from 1950-2010 that JSTOR has over 100,000 research articles in the Economics category. Almost 180,000 of the research articles are from Finance and a sum of over 500,000 in Business and Economics. There are about 315,000 research articles in Social Sciences Citation Index (SSCI) over the same period. The quantitative assessment on the evolution of Behavioral Economics can be followed up from the above figure. The years from 1950 to 2010, the presence of Behavioral Economics as the key term in top journals has been marking an increasing trend over all with some crashes as well. The highest mark can be noted in the year 2005 at 6%. On the contrary the case for Economics is something different. The trend can be seen quite static, only with a slight increase between 2005 at 1.5% and 2%. This actually depicts the need for the field to be prominent more widely. Continuous work and research would introduce a new dimension of Behavioral Economics to the world which later would be advantageous.

The scenario is a bit different for the thought Bounded Rationality. The concept was used in the top journals recklessly from the year 1980 with signs of fluctuations in the part of citations. The same trend is followed for the remaining fields raised above. But the magnitude of using the term is comparatively low. It has been noticed that in the later years both the terms Behavioral Economics and Bounded Rationality were used in a complementary way but bringing the comparison on the table, the application of the notion Bounded Rationality was quite higher.

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The insights of Behavioral Economics via nudging have a dynamic future especially in the sphere of policy formulations by the Government. Nudging is basically a theory that provides understanding about nudging people towards desirable behavioral even while preserving their liberty to choose. The role of Behavioral Economics in the policy formulation is appreciable. Economic policy is primarily framed and implemented by individual countries in which different administrative departments, boards of advisers are the key players. The following are some of the case histories of countries like United States, United Kingdom, and India etc. The trace of application of Behavioral Economics in US can be seen on the Pension Protection Act of 2006. In United Kingdom, a team has been formed named as “Behavioral Insights Team” (BIT) after David Cameron elected as the Prime Minister in May 2010. It was set as part of UK’S cabinet office. The BIT was labeled as Britains’ “Ministry of Nudges” or the “Nudge Unit” by different outside sources and the main function would advise other Government departments on the application of Behavioral Economics in policy formulation sustaining the realistic models of human behavior. Another example can be the case of India where the application of Behavioral Economics is escalating up. Some of the examples for India

are Swachh Bharat Mission and Beti Bachao Beti Padhao Mission.

## **5. CRITICAL APPRAISAL –**

Behavioral Economics is basically the result of constant negotiation of neoclassical economics if we consider the experimental results of the field. The results of Behavioral Economics are considered mostly as biases as the empirical content of the branch is a collection of deviations of behavior from the predictions of neoclassical economics. This is because behavioral economics was framed in the initial stages by the need to reject the conclusions of neoclassical economics and therefore the need for this systematic refutation. It appears that Behavioral Economics has not advanced to a higher stage. Looking at the current scenario, Behavioral Economics is defined by its refutation of neoclassical economics and it is therefore indefinite weakness from it.

## **6. CONCLUSION –**

The seminal paper can be concluded in a way that Behavioral Economics is somewhere between Economics and Psychology. There have been many greater works by economists in the history of Economics just like in 2002 economist Vernon L. Smith and psychologist Daniel Kahneman, in 2013 economist Robert J. Shiller and in 2017 economist Richard Thaler. A total of six Nobel Prizes have been awarded for the Behavioral research. In brief it can come to a closure that Behavioral Economics introduces a new outlook to the traditional Economics and it is widely being welcomed in different disciplines. Behavioral Economics has a lot of potential to improve the effectiveness of public health policy even. The conventional Economics presumes that all the people are rational and selfish and this is one of the significant reasons for its failure. The various concepts of Behavioral Economics like heuristics, satisfying, directed cognition, elimination by aspect and many other heuristics and cognitive effects, studies the biases, tendencies and heuristics that affect the decisions that people make to improve the traditional theory.

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