**PREP MICROECONOMICS**

Introduction to Behavioural Economics

**TASK (10 minutes): Read the following and answer the question in the box below**

All economic behaviour involves decision-making by individuals, and traditional (neo-classical) theories of economic behaviour assume that economic agents apply rational thought to each and every decision to achieve the maximisation of personal benefit (utility) or, in the case of producers, the maximisation of profits. The assumption of the rational individual ('economic man' or homo economicus) is central to most micro-economic theory, and can be seen most clearly in marginal analysis. Marginal analysis suggests that economic agents carefully weigh-up the expected costs and benefits of alternative decisions based on accurate information, and select the option that maximises their personal gain. In other words, individual economic agents are driven by self-interest, and if all agents are driven by self-interest based on all the information they have, each marginal decision will be rational.

This idea underpins the theory of how markets work to allocate scarce resources, and is the basis of micro-economics, yet the real world seems full of examples of where decision making does not seem rational, nor in the individual’s self-interest. The cases of cigarette smoking, over-eating, and failing to save enough for retirement are just a few of the apparently irrational decisions routinely made by individuals across the developed world. Behavioural economics challenges the long held view in mainstream economics that individuals are ‘unemotional’ maximisers who make rational decisions – rational actors being identified as homo economicus. It also offers suggestions as to how individuals can be ‘nudged’ towards more effective decision-making.

Behavioural economics does not replace traditional economics but is more a supplement to the traditional theory and makes economic models more complex. It can be a good evaluation argument in an essay to why a market leads to an efficient allocation of resources.

In one sentence describe ‘behavioural economics’?

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**TASK (30 minutes): Watch this** [**VIDEO**](https://www.youtube.com/watch?v=dqxQ3E1bubI) **(Click on the link or search “Behavioural Economics Crash Course Econ 27”) and complete the table below. You may need to watch the clip twice; it is only 10 minutes:**

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| **What are the following?** | **Define this term** | **Why does this challenge traditional economic theory?** | **Examples used in the video** |
| **Bounded Rationality?** |  |  |  |
| **Framing** |  |  |  |
| **Loss Aversion** |  |  |  |

N.B. Other terms include ‘anchoring’, altruism, herding behaviour, availability bias amongst others as to why an economic agent would not necessarily act ‘rationally’.

**Behavioural Economics Example Debate: Altruism….**

**TASK (10 minutes): Read these definitions and understand them!**

* ALTRUISM: a selfless concern for the well-being of others. For example, giving to a charity would be an act of altruism. You are giving something selflessly.
* UTILITY: We assume that consumers in economics want to maximise utility (satisfaction)
* PROFIT: We also assume that firms want to maximise profits

**TASK (30 minutes): Think about these questions, think of arguments for and against, and have an opinion for a class discussion (using the resources below for help if needed)**

* Do you think that altruism exists? Are consumers maximising their utility and are firms maximising profits if they give away money for free to charities etc.?

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| **Write down your thoughts here – arguments for and against the concept of altruism and perhaps a conclusion?** |

* Utility and profit maximisation are key economic theories which help to explain the supply and demand model amongst other things and are the fundamental building blocks of ‘the market’ and why it is efficient. Does the concept of altruism challenge these assumptions?

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| **Write down your thoughts here – arguments for and against the concept of altruism and perhaps a conclusion?** |

**Extra Resources to Help (click on ARTICLE to access the link):**

[ARTICLE 1:](http://www.economicshelp.org/blog/148/economics/altruism-and-behavioural-economics/) Economics Help – Altruism and Economics

[ARTICLE 2:](https://www.theguardian.com/voluntary-sector-network/2015/mar/23/the-science-behind-why-people-give-money-to-charity) The Guardian – “The science behind charity”