

Perspectives of economics – behavioural economics

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Abstract. *The present turning point, accentuated by the crisis, has revitalized the interdisciplinary study of economics and determined the reconsideration of its fundamental bases as a social science. The economists have abandoned the traditional neoclassical sphere and have directed towards understanding the behaviour resorting to psychology and developing in this manner a new field - behavioural economics. This article examines whether this economic sub-discipline is a viable research direction and the extent to which it may increase the explanatory power of science by providing a realistic database for analysis, taking into account the complexity of the human factor.*

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REL Classification: 5K.

Introduction

In the last decades, the relatively new discipline of behavioural economics raised a series of challenges for the dominant theory, namely neoclassical economics. Although, behavioural economics has its origins in the opera of the classics and its beginnings (as a distinct area of interest) in the works of Simion (in the '60s) and Kahneman and Tversky (in the 70s), it drew an increased attention with the onset of the 2007 global financial crisis. Then, the question of whether the actual economic analyze is build on the inadequate premise of unlimited rationality became increasingly evident.

This article briefly discusses the accomplishments of behavioural economics until now and tries to analyze if this new field of economics can be assimilated by the traditional direction of study, or it constitutes a new and distinctive one. The paper aims to present the principal themes and characteristics that constitute the background of this new economic field. Furthermore, it tries to carefully compare some principles of behavioural economics to the correspondent ones of traditional economics.

1. Background elements that supported the present momentum of behavioural economics

Lately the reconsideration of economics status was more intense than ever, not only among scientists, but also among general public (it is known the invasive character of ordinary life in economics, which is stronger than in any other social science). This was due to, primarily, the onset of the financial and economic crisis in 2007, and, secondly, the continuing need to reassess the public policies because the current century is marked by the intensification of phenomena such globalization and economic liberalization. By accepting these realities, the scientific body of economists recognized that one of the major challenges of the current period is to find ways in which economics can increase its explicative and practical basis attempting to reconcile the need for scientifically approach (which according to experts has led to, for example, an excessive utilization of the mathematical skills and abstractization) with the need for reflecting the practical reality, without losing its character of human science, whose both starting point and purpose is the human being.

Economists, leaving the traditional sphere drawn by neoclassicism, have directed towards understanding economic decisions and behaviours resorting increasingly to psychology and developing in this manner a field known in the literature as behavioural economics.

2. Some theoretical arguments of behavioural economics

As the name indicates, behavioural economics is a “hybrid area of research” (Francisco, Madden, Borrero, 2009, p. 277) that incorporates principles, concepts and ideas mainly from psychology (but also from other social sciences like sociology, philosophy or politics) into economic theory, in order to enhance the realism of the economic assumptions.

Behavioural economics is usually referred as a field centered on the “conviction that increasing the realism of the psychological underpinnings of economic analysis will improve the field of economics *on its own terms* - generating theoretical insights, making better predictions of field phenomena and suggesting better policy” (Camerer, Loewenstein, 2004, p. 3).

Behavioural economics aims to join together and to adapt the basic principles of neoclassical economics with the realities imposed by the complex human nature. This is why it appeals not only to evidences discovered by psychology, but also from other social sciences that study individual in its multiple forms of manifestations. It generally integrates theoretical concepts and findings from psychology with neoclassic theory. Its multidisciplinary approach encourages the dialog and tries to enhance the realism of the traditional theory. However, although behavioural economics agrees with some presumptions of the mainstream economics, it opposes and modifies others (or their context).

Behavioural economics tries to explain (and ultimately to apply these findings into practice) why individuals frequently make irrational choices, and why and how their behaviour does not match the patterns predicted by neoclassical models. In the study of this research area there are notable scientists such as Herbert Simon (who promoted the concept of *bounded rationality* and postulated toward a reunification between psychology and economics), Daniel Kahneman and Amos Tversky (who developed *the prospect theory* and identified the main cognitive factors for common human errors with the help of heuristics and bias), Richard Thaler (who was the first economist that distinguished his work and behavioural economics, on one hand, from experimental economics of, for example, Vernon Smith, on the other hand) or George Akerlof (who identified and analyzed the principal problems that affect markets characterized by asymmetrical information), etc. (Heukelom, 2007).

The core assumption of behavioural economics is based on the bounded (limited) rationality of individuals in general and of markets in particular, which is opposed to the central presumption of mainstream economics, that of rational choice theory. Bounded rationality should not be confused with irrationality. Herbert Simon advanced the term specifically to demonstrate that although it seems that

individual's choices are irrational, they actually act rationally from their point of view (because their intention is to act rationally) as the author said: "On the contrary, I think there is plenty of evidence that people are generally quite rational; that is to say, they usually have reasons for what they do" (Simion, 1985, p. 297).

The innovative concepts developed inside this area of research are founded on the work of classical economists. For instance, Adam Smith ([1776], 2011), the father of modern economics, developed in his most influential book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, not only a study of economics, but also an absolute analyze of human social psychology. The author also advocates psychological explanation of the economic behaviour and ideas about the psychology of ethics in economics (Smith, [1759] 2006).

Furthermore, even notable representatives of the neoclassical body of theory, such as Irving Fisher, recurrently promote psychological arguments in order to sustain their main principles.

3. The status of behavioural economics into the economic disciplines

In its effort to develop a new theory of choice behavioural economics faces some difficulties like: the determined variables are very numerous and no common understanding has been developed in terms of variables to be included in the model (Etzioni, 2010, p. 53). However, some specialists argue that the sub-discipline of behavioural economics is a new economic school of thought, distinct and separate from neoclassical economics, but in an early stage of development (Tomi, 2007, p. 478).

Some of the principal concepts and assumptions in behavioural economics are (Camerer, 2005, Maky, 2001, Schwartz, 2007):

- *Bounded rationality* – the idea proposed by Herbert Simion became one of the pylons on which behavioural economics is set. This idea advocates that rationality of people is a priori limited by given factors like the access to information, their finite amount of time, and the cognitive limitations of their minds;
- *Complete preferences* – here, the behaviourists advocate the need to endow the model of the utility function by taking into account preferences;
- *Non-egoistic behaviours* (such as altruism) – oppose/or oppose in some given circumstances to one of the main hypothesis of neoclassicism, namely self interest (behavioural economics advocates that self-interest have limits and imperfections);

- *Emotions, ethics, justice, well-being and social preference* are also important variables that affect the decision making process;
- *Inter-temporal choice*, which describes how people act when they make decisions with future repercussions;
- *Choice under risk and/or ambiguity*, it was shown that the type and amount of information people capture can sometimes transfix the decision-making process;
- *Equilibrium* is a central issue that implies this relative new discipline has to advance beyond individual choice, up to the analysis of the market.

Since its emergence as an independent sub-discipline, behavioural economics has known a remarkable expansion. The current directions that are influenced by behavioural economics are, for example, game theory, neuroeconomics, behavioural welfare economics, behavioural finance, experimental economics, etc. Furthermore, although the proposed analysis of behavioral economics has microeconomic foundations, lately it has expanded its scope, also encompassing macroeconomic analysis.

Behavioural economists are concerned not only with the theoretical study, but also with the practical one. So they went forward, including into their analyses public policies and choices, which represent another form of economic decision-making process.

Conclusions

In recent years, behavioural economics has increased its presence as a distinct research area, its study being animated by the technological advances of the last decades (that helped to a better understanding of the human brain and behaviours), and by the more frequent economic crisis (that have accentuated the need to uncovering that beyond any abstract, formal or mathematic model, economics is a scientific study which deals with the economic human aspects of the world). If, on one hand, this discipline is meant to be a continuation of the classical work, on the other hand, it creates its own concepts by exploiting the knowledge of psychology and other social sciences.

The ultimate goal of this discipline is to increase the explanatory power of economics by furnishing it with more suitable psychological basis, given that human behaviour concerns all the social sciences. However, because it is still in an early stage of development, its status, role and implications may not yet be fully assessed.

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