

General Studies-3; Topic: Indian economy – growth and development

Behavioural Economics

1) Introduction

- Behavioural economics is the effects of psychological and emotional factors on the economic decisions of individuals and institutions
- The study of behavioural economics includes how market decisions are made and the mechanisms that drive public choice.
- Example: Often perfectly rational people tend to behave irrationally, by simply reducing the price from ₹1,000 to ₹999.99 which increases sales
- In another case, people get attracted to higher discount rates rather than the markup price in different shops.
- Behavioural economist Richard Thaler, is the winner of the Nobel Prize in Economics this year.

2) Why Behavioural Economics?

- Behavioural economics blends insights of psychology and economics, and provides some valuable insights that individuals are not behaving in their own best interests.
- It's kind of the opposite to the rational decision makers that are usually described in economic theory.
- It provides a framework to understand when and how people make errors.
- Lessons from behavioural economics can be used to create environments that nudge people toward wiser decisions and healthier lives.
- This could be savings or pension schemes that have penalties for early withdrawal; or making it harder to reach the shelves with unhealthy food in school canteens or grocery stores; or membership schemes in the gym where customers agree to pay more if they miss their scheduled workouts.
- An experimental study showed that by providing three options: no savings account, a normal savings account, and a commitment savings account that locked up the money until a certain date - the farmers picked the third option.
- This led to greater purchase of agricultural inputs in the next period, and higher earnings after the next harvest.
- UK, US, Singapore and Australia have setup behavioural economics unit which serve as policy toolbox.

3) Advantages

- The theory is useful for companies and marketers looking to increase sales by making small changes to alter the buying habits of consumers.
- Behavioural economics can be used in policy-making to influence behaviours.
- Swachh Bharat will succeed truly if behaviours change. For which mindsets must change.
- Experiments conducted in some states show that application of behavioural economics successfully changed the sanitation mindset.
- Improve tax returns through small changes to reminder messages.
- They can have a powerful impact on our biggest societal challenges.
- Behavioural science can lead to a substantial reduction in the levels of unnecessary antibiotic prescriptions.

- Behavioural economics will have an impact even on macroeconomics, thereby influencing on issues like monetary and fiscal policies.
- It has the potential to solve many real-life problems like saving for retirement and inducing organ donation.
- Changing citizen behaviour in areas as diverse as cleanliness, use of digital money and education of the girl child.
- Taking behavioural biases into account in tackling poverty.

4) Criticism

- It relies on individual choice instead of overt state intervention.
- Behavioural economics allows for irrational actions
- Discoveries about the past from behavioural experiments do not easily generalise to the future - the social context for one generation is often different from another.
- The diversity of the country means that what works in one state may not work in another.

5) Way Forward

- Behavioural economists should take on economic problems that have begged solutions for long. Any success on this front will establish the applicability of behavioural economics to tough challenges.
- Behavioural economics should be taught in many more educational institutions.
- Behavioural economists have shown that people prefer avoiding losses compared with making gains. Swachh Bharat messages could be focused on the risks rather than the gains.

