Human progress has made decision-making a crucial part of both personal and community life. Human nature is complex, and many factors influence our choices. We must consider that our feelings and perspectives often mix with our reason, changing our decisions. Economics has always believed in logic and efficiency for decision-making. But this approach has shifted to consider human factors. Behavioral economics argues our decisions aren't always the best ones because psychological, social, mental, and emotional aspects affect them. With this paper, we want to highlight the extensive effects of decision-making on societies and economies.

The Rational Vs. Irrational Choice

Making decisions based on rational or irrational thought has influenced human history for centuries. Economic theory traditionally relied on the concept of rational choice, assuming individuals always made logical decisions that provided them the greatest benefit. This foundational belief shaped policies and strategies in various spheres, from finance to politics.

In the 1970s, psychologists Daniel Kahneman and Amos Tversky challenged this concept. They introduced the prospect theory, demonstrating through experiments that humans often make irrational decisions influenced by emotions, perceptions, and biases. This groundbreaking recognition shattered the belief in purely rational human behavior, leading to the emergence of behavioral economics. This field studies the effects of psychological, social, cognitive, and emotional factors on economic decisions.

Understanding the Concept of Rational and Irrational Choices

We often make these decisions based on our biases or logical thinking. Make your decisions smartly by considering all possible logical outcomes with the aim of maximizing benefit, like investing in a retirement fund for future security. On the other hand, we sometimes make decisions contrary to logic, affected by emotional or mental biases. A good example is impulse buying when immediate pleasure is more important than long-term financial effects. Behavioral economics involves both these aspects, studying how rational and irrational choices exist together.

Analyzing the Factors Influencing Rational and Irrational Decision-Making

If we look at psychology and how people behave when dealing with money, we see that most sensible choices come from studying the facts, being sure about the information, and guessing what might happen. These things can help people make choices that are good for them and avoid any harm. But, sometimes, people can make choices that don't make sense because they are affected by feelings, biases, and wrong ideas. Feeling scared or angry can affect your judgment and lead to quick, thoughtless choices.

In the same way, thinking you are always right or only agreeing with things that you believe can change the way you see things and make for bad choices. Wrong ideas, either because you don't understand something or because you have wrong information, can also lead to irrational choices. So, decision-making, whether it makes sense or not, can be influenced a lot by your psychology and behavior.

Neuroscience behind Decision Making

These functions largely relate to neuroscience and behavioral economics. These two subjects help us understand decision-making psychology. Learn about the biological side of making decisions through neuroscience. Key brain areas like the prefrontal cortex, the anterior cingulate cortex, and the limbic system are crucial for decision-making. Specifically, the prefrontal cortex helps with rational thinking, assessing options, and predicting the results of a decision.

The limbic system, on the other hand, is in charge of emotional responses and greatly affects our choices, particularly when emotions run high. Behavioral economics highlights how our psychology and our cultural and social environment affect economic decisions. This area of study goes against the idea that humans always act logically in making choices—a typical belief in traditional economics. Instead, behavioral economics shows that people often act based on their personal biases.

For example, some individuals wrongly prefer the current situation over any possible change because they have a strong bias against change. Combine neuroscience and behavioral economics for a complete understanding of decision-making. This combination links the perspectives offered by neuroscience, psychology, and socio-economic studies.

A Model Shift in Understanding Human Choices

It changes the way we understand people's choices, unlike the old economic theory that presumes people always act logically and have all the needed information. The main focus of behavioral economics is how people make decisions. It recognizes that people, given our emotions, biases, social impacts, and limited knowledge, often make choices not fully logical but based on mental shortcuts, or heuristics. These shortcuts include making decisions based on quick information, being swayed by how a problem is defined, or overestimating the likelihood of certain events based on memorable incidents.

Take loss aversion as an example. It's a common behavior in behavioral economics that people are more likely to avoid losses than they are to make gains. Though this may be illogical in traditional economics, it aligns with human psychology. Including psychology in economic study proves that markets don't always work efficiently and people don't always seek the greatest benefit.

Key Behavioral Economic Theories and Their Relevance in Decision-Making

It gives perspective on a handful of key theories that shed light on these decision patterns. The prospect theory focuses on how people view gains and losses. This theory states that losses affect people twice as hard as gains, which is why many people prefer not to take risks and stick with what they have, despite logic suggesting they could make a better choice. The bounded rationality theory suggests that humans don't always make the best choice because their time and brain power are limited.

Instead, they take shortcuts to simplify hard decisions, which sometimes results in mistakes or biases. Examine the price elasticity theory. People's demand for a product doesn't always drop when prices increase, unlike what traditional economics suggests. This might be because of how they think or how they view the product's quality, which reveals that people's choices aren't always based on logic. The mental accounting theory explains how individuals sort out their personal finance and budgets. People often divide their money into separate mental 'accounts' like daily expenses, savings, or holiday budgets.

Psychological Triggers and Biases Influencing Decision-making

In behavioral economics, these factors also greatly affect our decision-making process. One factor is the psychology of scarcity. When things are in short supply, we tend to make quick choices to grab them. This is why marketers say items are in "limited stock." It creates a sense of urgency and makes customers buy quickly. Pay attention to another bias called confirmation bias too. This happens when we pay attention to information that supports our belief and ignore anything that contradicts it. It shapes our decisions to affirm our beliefs, which can sometimes harm us.

There's also something called anchoring bias. This is when we depend mostly on the first essay of information we get (the anchor) in decision-making. For example, the first price we see while shopping affects our view of the item's worth and whether we should buy it or not. consider the availability heuristic. It's a mental shortcut that we use to determine the chances of events happening based on how easy it is to think of examples.

Real-Life Applications of Behavioral Economics

Unlike the old idea that people always make decisions based on logic or personal benefit, behavioral economics shows that people often don't follow this logic or self-interest principle. Take a look at Richard Thaler's research on the "Endowment Effect." His work shows that people typically want more money to let go of something they own compared to what they would pay to get it. This challenges the old economic belief of consistency in choice and shows how mental elements, like the bias of ownership, can affect our decisions. Behavioral economics is also used in real-life situations like health and fitness.

For instance, gym memberships are often paid in advance. This is because businesses know that we tend to be overly confident about our future actions and overstate how disciplined we will be—this is known as the "time inconsistency" principle. Take note of how behavioral economics shapes government actions too. The UK Government, for example, has used subtle strategies called "nudges" to increase tax payments. They sent out letters telling people that most others in the area had already paid their taxes. By doing this, they used the psychological concept of peer influence to persuade people to pay.

Rounding it Up

It shows us that our decisions aren't just based on logical thinking but also on personal biases, feelings, and our surroundings. Use what we learn from behavioral economics and psychology to better understand and foresee human choices, which can help people and businesses improve results. There's a lot more to discover about the hidden systems that essay our decisions.