

Breaking the Rationality Assumption

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Abstract

This paper explores the role of Behavioural Economics in understanding how psychological factors influence consumer decisions, often leading to irrational choices. Traditional economics assumes rational decision-making, but in reality, emotions, cognitive biases, and social factors drive behaviour. The paper highlights how illiteracy impacts decision-making, forcing short-term thinking over long-term benefits. It also discusses how psychological barriers like overconfidence, peer pressure, and emotional responses prevent rational decisions. Several Indian government policies, such as the Population Control Policy, Reservation System, and Demonetization, are reviewed to show how poor execution can lead to negative consequences. The paper concludes by emphasizing the need for better education, critical thinking, and informed policymaking to improve decision-making and empower people to make rational choices. Effective decision-making requires understanding both economic and psychological factors, which can lead to more balanced, thoughtful choices for the betterment of society.

Roadmap

Dan Ariely quoted, "Behavioural Economics tries to blur the line between economics and psychology. It's only by understanding why people behave irrationally that we can begin to know how they behave." Traditional economic theory assumes consumers make rational decisions based on their interests. However, in this quote, Ariely emphasizes how people often act irrationally.

So, what is the role of Behavioural Economics in this?

Firstly, what is Behavioural Economics? It seeks to understand how psychological factors drive consumer decisions. It challenges the notion that humans are fully rational agents and instead explores how emotions, cognitive biases, and social factors influence decisions.

Secondly, is illiteracy driving consumers to make irrational decisions? In my view, literacy plays a vital role in decision-making. Literacy provides the knowledge and context necessary for rational choices, allowing consumers to better analyse the consequences of their actions, evaluate risks, and avoid manipulation.

We assume consumers act rationally, but are they actually making rational choices? What about impulsive buying, decisions driven by psychological or emotional factors, and the illiteracy of consumers at the grassroots level in many parts of India? How do these influence their choices? Often, irrational decision-making is worsened by a lack of information and critical thinking skills.

Objective of this Paper

The objective of this paper is to highlight:

- **How illiteracy impacts consumer decisions:**

Illiteracy forces people to think irrationally. For example, rather than analysing long-term benefits, people make decisions based on short-term needs, which can impact their lives in the long run. These decisions

can lead to setbacks. As India is a developing nation, it is crucial for the country to uplift education, empowering individuals to make rational choices and think more logically.

- **The need to minimize the influence of psychological factors:**

Emotional and psychological barriers often lead to disturbances in logical decisions or choices. For example, acting on instant gratification can lead to unnecessary spending—money that could have been used more wisely. Behavioural Economics sheds light on these psychological influences.

- **Behavioural Economics: Making rational or irrational decisions:**

Behavioural Economics explains that people often make choices which appear irrational from the traditional economic assumption of consumers acting rationally. By understanding these patterns, we can develop strategies to promote more rational and logical decision-making.

Irrational Government Policies Led to Setbacks in India

Several government policies have been criticized for poor decision-making, leading to setbacks in India's development and literacy rates. Some examples include:

- **Population Control Policy in 1970s**

During Prime Minister Indira Gandhi's rule, the Indian government launched population control measures under the name "Family Planning Programme," aimed at controlling India's rising population. Forced sterilizations were involved, primarily targeting rural poor men. In my view, while the concern was legitimate, the implementation of the policy was poor, leading to forced sterilization procedures without consent.

As a result, its impact on lower literacy rates was noticeable. People feared government policies, even those related to education, which were meant for their benefit. Due to this fear, people's focus shifted from education and literacy to the threat of forced, non-consensual sterilization. There is always a better way to provide information, such as conducting informative sessions to help people understand the importance of population control, rather than forcing it upon them.

- **Caste based Reservation System**

India implemented policies to provide reservations for the backward sections of society, including Scheduled Castes (SCs), Scheduled Tribes (STs), and Other Backward Classes (OBCs). This initiative aimed to reserve seats for them in prestigious institutions and government jobs. While it was intended for their benefit, the policy overlooked the importance of primary-level basic education.

Although quotas were available for higher education, many people never reached that stage in their lives due to the poor quality of primary and secondary education provided by the government. Instead of focusing solely on reservations, the government should have prioritized improving primary and secondary education, which would have strengthened children's foundational understanding. This policy, in its current form, contributed to divisions in Indian society.

It is extremely crucial for policy makers and authority holders to understand what contributions or strategies are rational and can uplift or benefit the people of society rather than pulling them down.

- **The Right to Education (RTE) Act (2009)**

The Right to Education Act made education free and compulsory for children between the ages of 6 and 14, which was a great initiative by the government to increase literacy and provide basic education to every child. However, the implementation was poor and inconsistent. It lacked adequate funding, infrastructure, and highly qualified educators. What is the point of this initiative if institutions are

understaffed, even as the enrolment of children increases? Instead of improving literacy rates, it led to higher dropout rates.

There should have been progressive measures for recruiting quality educators and staff. In the end, even though the right to education was established for every child, many still lacked true literacy.

- **Demonetization (2016)**

From our stats, we can see that in November 2016, the government demonetized ₹500 and ₹1000 notes, which constituted 86% of the country's cash supply. This step caused disruption across the country, especially in rural areas. Many families in rural regions faced difficulties managing their savings, which led to an increase in school dropouts, contributing to a decline in India's literacy rate.

Sudden actions like this forced people, particularly in rural areas, to shift their focus from essential sectors such as education to dealing with the immediate effects of demonetization. If only policymakers had thought through the decision more thoroughly and rationally, the situation could have been handled better. The role of the government is to provide the people with the best resources it can offer.

Conclusion of the ‘Policies’

When I reflect on these policies, I notice a similarity: every policy was well-intentioned and aimed for the greater good, but the lack of rational, long-term thinking led to poor implementation and failed execution. This resulted in outcomes opposite to what was expected. This proves how crucial it is for policymakers to think critically and rationally, ensuring that policies truly benefit people and help them rise higher. More rational, critical, and well-thought-out initiatives would be greatly appreciated and would genuinely benefit our society.

‘Psychological Barriers’ to Rational Decision-Making

- **Overconfidence**

As we all know, confidence is taken as a very important personality pursuit, but if we get a little extra confident, which is termed as overconfidence, it can sabotage our decision-making. Being overconfident, we often don't realize the things in front of us. It's like our senses convince us that anything we have thought of or decided is probably good, leading us to believe our own beliefs. This overconfidence doesn't allow us to consider the possibilities and consequences right before our eyes. From my view, when we are in a state of overconfidence, our impulsiveness gets worse.

- **Social Factors**

What will people think? What if I go wrong? These are major questions that arise when we face life-changing decisions. People's opinions and ideas can significantly influence us. However, trusting yourself and resisting external influences is crucial. By evoking your highest potential in critical thinking, you can make decisions that are best for yourself and others. This self-trust enables you to evaluate situations more clearly, consider all possibilities, and ultimately lead to more fulfilling choices.

- **Brain wired to take shortcuts**

Our brain is wired to take shortcuts, which can lead to impulsive and irrational decision-making. This tendency can impact our lives in various ways. As many philosophers and theories suggest, there is no harm in taking the time to make decisions for the betterment of ourselves and others. However, relying on shortcuts or searching for loopholes will ultimately get us nowhere; it will only leave us feeling stuck. Taking the time to reflect and evaluate our choices allows for more thoughtful and effective decisions, fostering growth and progress in our lives.

- **Peer Pressure**

As mentioned earlier, instead of worrying about what our friends or colleagues might say, it's far more beneficial to take action and take control of our own lives. Focusing on our own goals and values allows us to make decisions that align with who we truly are. By prioritizing our own aspirations over external opinions, we empower ourselves to pursue paths that lead to personal fulfilment and growth. Taking charge of our lives can foster resilience, enhance our decision-making skills, and ultimately help us create a life that reflects our true potential.

- **Emotions**

As we all know, our emotions have a big impact on our decisions, and our emotional and mental well-being is crucial for making rational choices. It's important to be emotionally strong so we can make decisions that help us grow and succeed, rather than letting our feelings take control. By building emotional resilience, we can think more clearly and confidently, ensuring that our choices align with our long-term goals. This understanding helps us navigate challenges better and creates a more fulfilling life. Ultimately, managing our emotions allows us to make better decisions and shape a brighter future.

Behavioural Economics: Critical Thinking

'Behavioural Economics' looks at how people actually make decisions, especially when they don't act logically, and how emotions and feelings affect decision-making.

How are people actually thinking or behaving in response to environmental factors? How are they making decisions? What are the thoughts that lead people toward the path of rational or irrational decisions?

For instance, the most well-known example is the 'Law of Demand.' Let us now dive into it. We all know that we want reasonable prices, and the satisfaction or utility from the goods/services should be equal to the amount we are spending on them.

As mentioned earlier in the paper, in traditional microeconomics, every law assumes that consumers think rationally and logically. On the other hand, sellers or producers perceive things quite differently, known as the 'Law of Supply.' This law reflects that as the price increases, sellers become excited and try to maximize their sales in order to earn more and more.

What do people actually want? First, they always want to earn more than they are already making, and secondly, they don't want to spend more than the utility or satisfaction they are experiencing—or better yet, they are even happier getting things for free. This is how the majority of people behave, in my perspective. As economics also states, humans are never fully satisfied with what they already have.

Is this really critical and rational thinking, or is it just about our own utility? For example, when we go to the vegetable seller, we don't think about how the seller might be struggling with money or whether he is able to feed his family properly. All we think about is how we can buy the vegetables at the lowest price possible. Another example is our house helpers—we never consider that the helper coming to our home to do our chores might not even have the necessary facilities that we do. This is how most people's minds work.

Counterarguments to the Paper

- Firstly, we emphasize that literacy is crucial for effective decision-making. However, we also see our mothers—often housewives, perhaps not highly educated—who possess a deep understanding of what is best for their children and how to manage a household within a budget. They make rational decisions despite their limited formal education.

- Secondly, sometimes listening to our family and peers can lead us to make better decisions than if we were to go it alone. Rather than merely influencing our choices, their insights can provide us with valuable perspectives on various matters. Therefore, decisions derived from empathy and other psychological factors can also lead to good outcomes.
- Thirdly, some people are emotionally strong and have practical personality traits, which makes them unaffected by society's opinions.
- Furthermore, there are people who think empathetically toward others, rather than focusing solely on their own benefit and utility.

This paper can present many contradictions. As in debates, there are arguments both for and against any theory. In my view, every theory has its advantages and disadvantages, allowing us to either support or challenge it. Ultimately, we all seek to maximize our satisfaction and happiness while navigating through these complexities in our decision-making processes.

Conclusion of the Paper

Famous line in every household, our parents say when you will earn your own money then you will understand.

And when we start to earn, yes, we do understand automatically how to spend or save money. I think psychologically we spent money more irrationally when it's not our own hard-earned income, when we are depended upon our parents, family or even spouse. The sense of spending and saving money is very important to handle your own household. If you ask me, each and every person should be taught how to save or spend money carefully and more efficiently earlier in their life. So, they can spend quality life with their loved ones.

To help improve decision-making for everyone, we can adopt several strategies.

- Firstly, we need to strengthen education. Teaching people how to think critically can help them make better choices and avoid falling for biases.
- Secondly, raising awareness about behavioural economics can help individuals understand why they make certain decisions. By recognizing the psychological factors at play—like overconfidence and social pressure—people can make smarter choices.
- Furthermore, encouraging conversations within families and communities can provide valuable insights. Sharing experiences can lead to better decision-making by combining different perspectives.
- Finally, policymakers should engage with people to truly understand their needs. By listening and involving people in the decision-making process, policies can be created that not only address immediate issues but also support long-term growth.

While making rational decisions is challenging, we can improve this process through education, awareness, collaboration, and thoughtful governance. By understanding both economic and psychological factors, we can empower individuals to make choices that lead to greater happiness and well-being for everyone.

References (APA Style)

1. Ramsinghani, S. (2024). *Breaking the Rationality Assumption*. Unpublished manuscript, Sophia Girls' College (Autonomous), Ajmer.