



1 Individual economic decision making

Case studies

Case study 1.1

- 1 Scarcity can be defined as a situation in which demand for a good exceeds supply. Marginal utility is the extra satisfaction, pleasure, fulfilment of need or economic welfare received when consuming an additional unit of a good.
- 2 Opal and ruby.

Case study 1.2

- 1 The seller of a second-hand car knows more about the car's defects than a prospective buyer. The buyer has an incentive to fear the worst about the car and to offer a lower price than the seller wishes to receive. To persuade the buyer to offer a higher price, the seller is likely to provide a full service history extending over the car's past life.
- 2 Markets for second-hand houses and second-hand pleasure boats.

Case study 1.3

- 1 When individuals are automatically enrolled onto pension schemes but can choose to opt out, they are much more likely to end up with a pension plan than if they have to actively opt in. With an opt-in default choice, due to inertia, many young workers may not bother to opt out. A large percentage of young workers will thus have pension plans, which will be in both their own and the government's interest when they get closer to retirement age.
- 2 When applying for a driving licence, applicants are opted in to organ donation in the event of their death. They have to opt out if they don't want to donate their organs.

A large national railroad in Europe made a small change to its website so that seat reservations would be included automatically with ticket purchases, unless the customer unchecked a box on the online booking form. Whereas 9% of tickets included reservations before the change, 47% did so afterwards.

Test yourself

Test yourself 1.1

The correct answer is D. Some people display the behavioural characteristic of gaining pleasure (utility) as a result of being seen by people similar to themselves as being an early buyer of a good — such as buying a ticket for a rock concert as soon as tickets for the event are released onto the market.

Test yourself 1.2

Pleasure items: chocolate; daffodil bulbs.

Fulfilment of need: medicine; electric light bulbs; washing-up liquid.

Test yourself 1.3

The best answer is provided by statement B. A norm is an accepted standard or a way of behaving or doing things that most people agree with. In this sentence it is informal.

Questions

- 1 An individual's demand curve for a good shows how much of the good he or she plans to buy at different possible prices. Individual demand curves generally slope downward to the right, showing that as the price falls, more of the good is demanded. Conversely, less is demanded when the good's price increases.
- 2 Because of the problem of scarcity, consumers face a number of constraints which restrict the choices they make in the market place. The constraints are limited income, a given set of prices, a budget constraint, fixed tastes and preferences, limited time available and limited availability of goods and services.
- 3 Maximising behaviour by an individual, a firm or even a government is acting in a way that is consistent in achieving the best possible outcome for the economic agent involved. Satisficing behaviour, by contrast, is acting in a way which aims to achieve a satisfactory outcome, rather than the best possible outcome.
- 4 According to the economist Paul Ormerod, behavioural economics involves the application of the insights of experimentally based behavioural psychology to the analysis of economic decision making. It goes beyond the utility-maximising assumption of orthodox (neoclassical) theory, which assumes that individuals always act in their self-interest. Nevertheless, the orthodox utility-maximising theory can be treated as a special case in the wider behavioural theories.

Again according to Ormerod, the orthodox theory of decision making makes simplifying assumptions about the world. Some key assumptions are that the tastes and preferences of each individual are fixed, and are not susceptible to being altered by the preferences of others. When making a decision, people are able to gather and process all available information about the various alternatives. Comparing these with their personal preferences, and subject to constraints such as income, they make the best possible decisions. The theory is both a description of how rational individuals *ought* to behave, and at the same time one of how people actually behave in practice. Behavioural economics, by contrast, identifies situations where people take decisions deviating systematically from those predicted by standard theory.

- 5 A 'nudge' is an action, often undertaken by governments, but also by other organisations such as charities, which aims to change people's behaviour in a desirable way through suggestion and non-forced compliance. A food business such as a food-processing company might promote healthy eating by prominently including the health benefits of its products on food packaging. Ideally, these should contain the seal of approval of a relevant government department or an industry watchdog. A supermarket company might decide to display only healthy foods in its checkout areas.
- 6 In 2015 Welsh law was changed so that citizens have to opt out of the donation of organs, in the event of their death, replacing the previous system of opt-in.

To encourage charitable giving, the UK government's tax-collecting agency, HMRC, has sent taxpayers messages from their colleagues who had already joined their employers' Payroll Giving Scheme, together with their colleagues' photographs, to nudge them into joining the scheme. The pictures were especially effective, doubling the rates of enrolment.