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IRRATIONAL HUMAN BEHAVIORS

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Abstract:

Neo Classical economists used to posit that, since consumers are rational, they make decisions to maximize their pleasure (utility). Opposing to Neo Classical understanding, Behavioral Economists argue that, consumers are infect not rational, but prone to all sort of biases and habits that pull them being rational. For instance, there are too many irrational choices made by the Turkish consumers like; expensive wedding parties given by low income families; although riding bicycle is healthy and cheap, but people buy expensive cars; it is cheaper staying at a hotel or a timeshare, however people buy expensive summer houses, where they stayed only few weeks a year. These type of irrational behaviors adversely affect the decisions on savings, investments and economic growth. On the consumers irrationality, Tversky and Daniel Kahneman, winner of the 2002 Nobel Prize in Economics, wrote Prospect Theory. They developed a cognitive psychological model to explain divergences from neoclassical economics. They claimed that people take decisions under psychological, social, emotional and economic factors that affect market prices and resource allocation. In order to explain the irrational behaviors of Turkish consumers, I utilized some concepts such as conspicuous consumption (or keeping up with Johns), Veblen Effect, Bandwagon Effect, bounded rationality, 20 to 80 Law and ethical considerations developed by Behavioral Economists and Heterodox Economics. Thus, I came to conclusion that why the free market economic understanding fails in Turkey by giving some examples and economic reasons stated in the last section of this paper.

Keywords: *Behavioral Economics; Heterodox Economics; Conspicuous Consumption; Veblen Effect; Bandwagon Effect*

1. Introduction:

Adam Smith's Unseen Hand Doctrine dominates the Classical Economics Thoughts, as being the foundation of the capitalism. Perfect Market Mechanism of the capitalist system depends on the rational behaviors of the people. In real life, this understanding doesn't hold true as claimed by the behavioral economists and heterodox economics thought. Although, free market economic understanding failed during the Great Depression and in later economic crisis, however it is being supported by monetary economists, big business and financial capital. Deregulation of public services, privatization of state economic enterprises and financial liberalization policies resulted in worldwide economic and debt crisis. For this reason, the aim of this paper is to explain why the free market understanding based on rational human behavior can not be justified. In order to support my view, I summarize the basic views of behavioral economics and heterodox economics popular after 1970's. Based on irrational human behaviors, I also employed principles of public economy in defending my thesis on why free market understanding can not solve economic problems in the conclusion section.

In the first section, irrational behaviors of the consumer as explained by Kahneman, Tversky, Veblen, Akerlof, Pareto and Minsky are summarized (Şener 2015). All these economists claim that consumers are not rational as Adam Smith formulated. They argue that, consumer behaviors are determined by social value judgments, social values, habits, and non economic factors. These behaviors take the different forms of showing offs such as conspicuous consumption motivations, Veblen, Bandwagon, and Snob Effects. The second section includes some concepts, against rational human behavior understanding, developed by heterodox economist such as Lorenz and Minsky. These concepts are : Bounded Rationality, The Market for Lemons, 20 to 80 Law (Power Law), Happiness, Crash-Prone, and some ethical considerations, leading to inefficiencies that the market mechanism is potentially generating.

In the conclusion section of this paper, I support the above mentioned economists by giving some examples related to market imperfections, and irrational behaviors of Turkish consumers.

2. Behavioral Economics

Contrary to Adam Smith's Invisible (unseen) Hand Theory, behavioral economists argue that people are not taking rational actions. These economists claim that, people take decisions based on social values, habits and noneconomic psychological factors. For this reasons, they argue that as proclaimed by Adam Smith; "people behave along with their self-interest, selfishness and rational motivations" doesn't hold true in real life. There are many examples of irrational human behaviors, that don't fit this theory as follows.

• Although cigarette smoking is harmful, but many people are obese smokers.

• Trap prices like 99.90 Liras attracts people, especially those thinking of it is less than 100 Liras.

• Much type of competitions in business don't rest on economic grounds, but they are related to some

psychological and social factors.

• Especially in developing countries people are likely to behave in line with the conspicuous consumption or 'keeping up with Jones' motivations.

Behavioral economics examines the irrational economic activities of people as shown by these examples. This new economic theory is based on both economics and psychological factors, rather than traditional and mainstream economics principles. In fact, these new approaches highly affect the theories on savings and economic policies both in market and public economies. It also provides insights into the explaining very complex economic behaviors of human beings. Tversky and Kahneman were the pioneers in establishing the basis principles of this new branch of economics in 1970s. They successfully developed and adopted theories based on brain process information. According to them, when the people face uncertainty, they tend to behave randomly related to their mental shortcuts based on experience. They state that, people are strongly influenced by a certain proposition called 'framing', while taking decisions (Kahneman and Tversky 2003).

Another branch of behavioral economics known as 'neuroeconomics' becoming popular in explaining human economic motivations. Accordingly, the brain reacts to high price offers, as it reacts to abhorrent or disgusting smell.

The other branch of behavioral economics is called 'nudge economics' that explains the decisions based on their self interest or of their own preferences are closely related to their experiences and environmental preconditions. This means that, the assumptions explaining the human behavior rationality doesn't rest on self-interested motivation as formulated by Adam Smıth, because people are very complex.

3. Approaches against Rationality

Although, production was the concern of classical economist, early neoclassical economists analyzed the consumer preferences based on their behaviors. Especially, institutional economists studied the subject matter and its relevance to physiology and sociology. Although, mainstream economists assume that human being are rationale in making decisions; however they are not in their real life. The reason is, a rational human being logically reasons or employs the principles of reasoning consciously based on their daily life. The following cases such as conspicuous consumption motivation and Veblen's Effects are the examples of irrational behaviors of consumers.

4. Conspicuous Consumption

If you buy goods that fit your true preferences, as economists assumed, your behavior is rational. However, there are many types of consumer behaviors that can't be accepted as rational. For instance, if you by a Mercedes car because your neighbor has one, but your purchasing power is not high enough to support. Then, your welfare will decrease since you are paying interest to banks, and maintenance costs such as insurance, depreciation, gas etc. On the other hand, your conspicuous consumption behavior not only reduces your welfare but it also wastes the limited sources of the society. Veblen used this term to explain the behavior of the wealthy people. He argued that, rich people are likely to display their economic and social power by buying very expensive consumption goods called statue goods. Some people buy goods to show off that they are "the part of the society" termed by bandwagon effect. There are also some people, exhibiting their consumption behavior to distinguish themselves from the society known as snob effect (Bagwell and Bernheim 2003). Women enforce their husbands to buy luxury car or villa as their neighbor has, called keeping up with Johns effect as in the case of USA and Turkey. Sometimes a consumer's demand for a good is connected to other people's perception. This happen to be when a consumer wants to show off his high status. Thus, a status good can only be owned by him, but the others can't. Suppose that, somebody else buys this good, he should buy another good that no one could own it. For instance, some rich people urge the restaurant owners, to increase the prices as much as possible, so that nobody could access to the service easily. All these types of consumer behaviors violates traditional price setting theory based on supply and demand laws. Above cases show that, demand curve becomes upward sloping, rather than downward sloping as economic theory assumed. The upward sloping demand curve displaces Veblen Effect. According to this effect, higher prices means better quality and thus higher demand for goods and services opposing to the demand law. This is why the expensive goods like mobile phones are even demanded by low-income families. Some economists opposed to principle of utility maximization based on the rational behavior of consumers. They prefer to use satisfying characteristics of a good rather than their marginal utility. This means that, a satisfying quantity is a good criterion to be used instead of utility maximization.

Another group of economists argue that, consumer behavior is shaped by social forms, value judgments and advises of some friends etc. For instance, during the fasting month demand for the food increases in Muslim countries. On the other hand some economists prefer to use the term of bounded rationality instead of rational consumer assumption. Keynes also used this notion of propensity to consume not in the sense of rational consumer behavior, but in psychological mean.

5. Heterodox Economics

History of economics has been dominated by orthodox economists who supported neoclassical economic theory. However, in 1970s economics thoughts was divided into two branches; orthodox and heterodox economics. Heterodox economists strongly opposed to the mainstream economists, who assumed that market mechanism is the best way to optimize consumer utility and profit maximization goal of the firms. Mainstream neoclassical economics thoughts are based on the following assumptions, which are rejected by the heterodox economists.

- Markets are perfectly competitive,
- Supply and demand drives the prices to equilibrium,
- People behave rationally,
- Free markets optimize utility and profit maximization

Although, Orthodox economists became very influential at the universities and financial institutions, but they neglected socio economics and social justice issues. Thus, starting in 1970s, a number of heterodox branch of economics thoughts have been developed outside the mainstream economics. They developed many branches of heterodox issues such as, behavioral economics, asymmetric information, Power Law, happy economics, financial instability and complex systems of uncertainties.

6. Bounded Rationality

Using psychological principles raised by Daniel Kahneman and Amos Tversky tested the rational behavior assumption, assumed by neoclassical economists. They found that, people don't behave rationally and they referred to this attitude known as “bounded rationality”. They stated that, consumers have asymmetric attitude towards loss and gain. So, they often miss out on good opportunities. And, Tversky says that, we also dislike change, which explains why investors often find it hard to let go of under performing shares (Kahneman and Tversky 2003). Thus, people just couldn’t let go of the rationality.

7. The Markets for Lemon

Neoclassical economists assumed that, perfect competition conditions exist in markets. They argued that large number of firms compete to sell the identical products. However, George Akerlof argued that, many people may not access to the same information about the markets. He investigated what happens when the people are unable to reach the same information. Based on his studies he developed a theory known as the “Markets for the Lemons”. He considered a market where the good and bad used cars (or lemons) are sold. If the buyer has less information than the seller has, then the buyer would guess that car is of average quality. So, he is likely to pay the price of an average used car price. If the seller has good quality used car, he won’t get high enough price, due to buyer’s lack of information (Akerlof 1970). The result will be as Gresham stated for money: “The bads will drive out goods from the market”.

8. 20 to 80 Law

Neoclassical economist didn’t make necessary investigation on the income inequality, which leads growing disparities of wealth between rich and poor. The neoclassical economists rest on the Adam Smith’s wealth distribution, while the heterodox economists argue that it does not hold true in industrial economies. Smith argued that an unseen (invisible) hand of the markets will divide the wealth between the rich and poor. Opposing to Smith’s ideas about wealth distribution, Vilfredo Pareto formulated a law known as “20 to 80 Law” or Power Law. Accordingly, 20 per cent of the population holds 80 per cent of the total wealth. Although, Pareto stated this law in 19th century, however it holds true in the 21stcentury. For instance, after the 1970s too high salaries paid CEOs in rich countries. While the median salaries stagnated and people around the world struggled to feed. Amartya SEN believed that starvation is the characteristics of some people not having enough food to eat.

9. Happy Economics

After 1950s economists argued that there wouldn’t be strong relations between happiness and GNP level. Thus, classical economists’ interpretation of happiness related to material well being is criticized by heterodox economists (Luigino 2008). Studies on life satisfaction revealed that, Americans were much more happier during the 1950s and 1960s, even though GNP level was less than in later decades. Surveys show that, once society reaches a certain level of average income, say 15 000 to 25 000 dollars per year, then happiness increases. Economists argue that, based on decreasing utility of income, happiness decreases above this income level. Then, any further increase in income has no significant effect on happiness levels. Veblen argued that, use of advertisement and marketing techniques makes people unhappy by buying new products. Conspicuous consumption behavior of people also makes them unhappy, because they by goods that actually they don’t need.

10. Feminist Economics

A politician Marilyn WARING argues in her book “Counting for Nothing” many services performed by women and housewives are not included in GNP, because they are not paid. Examples of these includes bearing children, looking after sick, aged and disabled family members etc. However, most of these services of women are paid or tax exempted in Scan and in some social democratic countries in Europe. Feminist economists highly criticized neoclassical economic theory because, it favors for rational economic man. Thus, they promote male values such as competitiveness and individualism. Contrary to neoclassical economists they argue that women’s contribution to social capital needs to be taken into account.

11. Crash-Prone

In 1990s economists claimed that, economy is not fundamentally stable as assumed by neoclassical economists. Hyman MINSKY (1919-96) argued that the economy is prone crashes and bubbles. He stated that, "During to prosperous times, debt accumulates in the economy as success breeds increasing confidence as Keynes's "animal spirit". According to him this process, known as the Minsky Moment, continues until it finally reaches a crisis point. When the debts get called in and the economy crashes. Minsky's claim that the economy is crash-prone has been evidenced through many bubbles. Mortgage bubble in the USA, Dutch Tulip Mania in 17th Century and British South Sea bubble are the historical evidences that supporting the Minsky's claim (Minsky 1986). Efficient Market Hypothesis assumed by neo classical economists was strongly criticized by Benoit Mantelbrot. He argued that since 1960 economic data on price changes didn't follow the Bell Curve analysis as predicted by that hypothesis (Mantelbrot 1999). This means that, Efficient Market Hypothesis doesn't hold true the hypothesis has foreseen. He believed that, 20-80 Law distribution is a better tool to predict the crashes. He also argued that, although the price changes are small, if all prices of goods are considered, then income distribution will be adversely affected. Because, Power Law effect becomes very important in developing crashes.

12. Ethics

The neoclassical understanding of the economy as stable, rational and self-regulation turned out to be highly misleading. Some fund managers like Soros and Jean-Philipe Bouchaud believed that, neoclassical economics failed to predict what is going on in the markets. The big shock from the subprime crises proved that, it was resulted due to unreliable behaviors of the big traders. Some of the Wall Street traders like Goldman Sachs was accused of misleading the investors in financial markets. Traders and mortgage brokers pushed the investors to sign contracts, that the investors didn't understand, leading to asymmetric information problems, in 2010 subprime crises. Speculations and manipulations undertaken by traders in Turkish financial markets also resulted in collapsed in many years. Thus, some economists believe that, these problems are due to lacking of ethical behaviors, not considered during the formation of neoclassical theories. This is due to fact that, ethical considerations emphasized by Aristotle and Scholastics economics were removed by the neoclassical economists. For this reason, the invisible hand doctrine is not reliable and not satisfactory as far as ethical behaviors are concerned. Thus, a new kind of economics is being emerging nowadays. Because, rational man assumptions as believed by neoclassical economists is being replaced by behavior of real people motivations. Thus, instead of seeing the economy as competition between disconnected people, sustainability of resources and value judgments of people is becoming important.

13. Examples Of Irrational Behaviors

There are many examples of irrational behaviors of Turkish consumers that fit to above mentioned cases;

- Boys start to smoke, thinking of they are accepted as a grown up man by the society.
- Trap prices attract many consumer as in Western societies.
- According to a survey conducted in 2000s, Turkish consumers ranked number 1, all over the European countries in buying Nokia mobile phones.
- Number of the cars is the highest in Turkey as compared to European countries.
- Consumers buy houses with one extra room to be allocated to guests.
- Members of low income families buy very expensive mobile phones.
- Number of the summer houses owned by the middle class, in costal areas exceeds 2 millions, even though most of them are used only few weeks in a year.
- Number of the Mercedes cars in Turkey, exceeds the total number of the same brand cars in European countries.
- Rich families generally send their kids to universities abroad, without considering the quality of the education.
- Wives urge their husbands to buy luxury cars, villas, and yachts to keep up with their neighbors.

• Businessmen never report their counterparts who evade taxes and conducting unofficial and illegal economic activities.
• Framing and false advertisements changes the true preferences of consumers in buying goods that they actually need.
• Although Turkey is rich in grape product, however wine production is the least in EU.
• Many investors never deposit their savings at bank, but they prefer to receive profit shares from the İslamic banks, which is more or less equal to market interest rate.
• Workers, governmental employees, low income families support the right wing political parties. Whereas intellectuals support social democratic party.
• Turkish workers abroad support social democratic and left wing parties, whereas they support right wing political parties at home.
• Many people in Turkey buy medicine on the recommendation from the friends, neighbors or pharmacists.
• Some rich people urge luxury restaurants to charge highest prices, so that everyone wouldn't support to eat there.

14. Conclusion

During the Adam Smith time there were no monopolistic and oligopolistic market structure. For this reason, he didn't consider market imperfections. Natural monopolies such as state economic enterprises decreases the cost of production more than the market firms, due to economics of scale. On the other hand, social allocation can only be efficient under decreasing marginal cost production by the natural monopolies. Positive and negative externality generating economic activities can not be priced by the market mechanism. For instance, goods and services produced under zero marginal cost must be provided free of charge, opposing to the profit maximization motivation of market firms. Asymmetric information misleads the consumers, because seller know much about the characteristics of the goods, than the buyers. For instance, consumers are not likely to read the manuals of medicines, insurance policies and mobile phones etc. Waste and mismanagement in government and in market economy increase the cost of production, reducing the efficiency in public and private economies. Corruption tempts the bureaucrats to behave in line with the Veblen and Bandwagon Effects give rise to conspicuous consumption motivation to operate. Existence of unfair income distribution as formulated by 20 to 80 Law, result in low purchasing power in market economy leading to decrease in effective demand and inefficient market conditions. All these examples call for regulating some of consumer's irrational behaviors and governmental intervention in order to improve market conditions

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