



Gains and Losses in Behavioral Economics

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Introduction to Behavioral Economics

Behavioral economics combines insights from psychology and economics to understand how individuals actually make decisions, often deviating from purely rational models.

Unlike classical economics, which assumes fully rational agents maximizing utility, behavioral economics explores cognitive biases, emotions, and social factors influencing choices.

This approach challenges traditional assumptions and enriches our understanding of economic behavior in real-life scenarios.



Understanding Gains and Losses

In behavioral economics, **gains** and **losses** refer to outcomes relative to a reference point, which is a baseline that individuals use to evaluate changes.

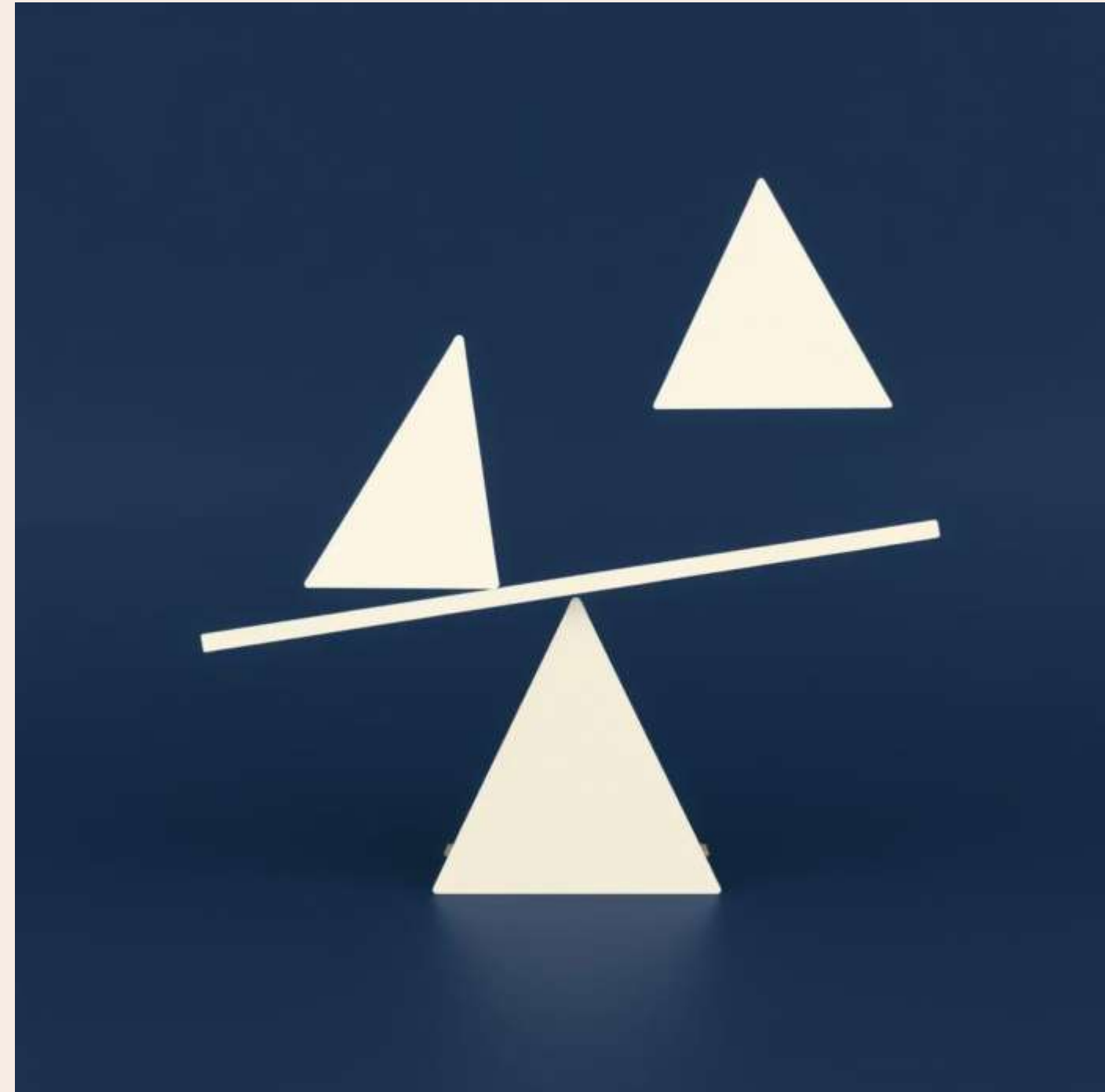
The concept of reference points explains why people evaluate choices based on perceived improvements or deteriorations rather than absolute outcomes.

This relative evaluation dramatically affects decision-making, as the same outcome can be perceived differently depending on the reference frame.

Utility curves illustrate how gains and losses impact individual satisfaction:

Gains produce positive but diminishing marginal utility.

Losses often produce stronger negative utility compared to equivalent gains.



Loss Aversion

Loss aversion is the phenomenon where individuals experience losses more intensely than gains of the same size.

This means that the pain of losing \$100 typically feels stronger than the pleasure of gaining \$100, impacting risk-taking and economic choices.

"Losses loom larger than gains." - Daniel Kahneman

Loss aversion explains behaviors such as reluctance to sell losing stocks or preference for avoiding losses over acquiring equivalent gains.

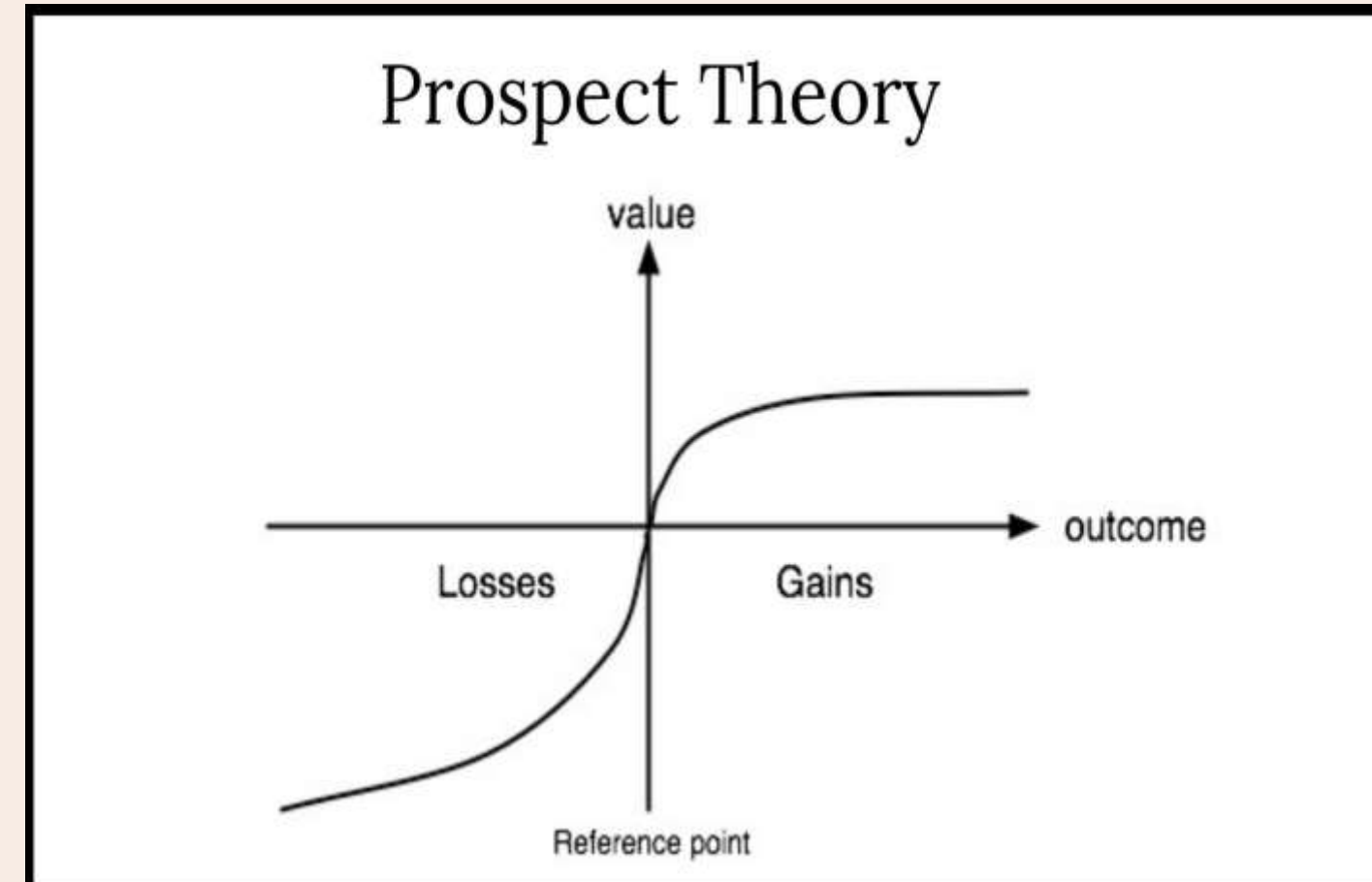


Prospect Theory Overview

Developed by Kahneman and Tversky, Prospect Theory models decision-making under risk, improving on expected utility theory by incorporating psychological biases.

Key features include:

- **Reference Dependence:** Outcomes are framed as gains or losses relative to a reference point.
- **Diminishing Sensitivity:** The value function is concave for gains and convex for losses, reflecting decreasing sensitivity as amounts increase.
- **Loss Aversion:** Losses have a greater impact than gains.




Real-Life Applications: Marketing

Marketers strategically use gain and loss framing to influence consumer behavior.

- **Gain Frame:** “You save ₹200” emphasizes benefits and appeals to positive motivation.
- **Loss Frame:** “Don’t miss out on ₹200 savings” leverages fear of losing value, often creating urgency.

Understanding these frames enables companies to shape perceptions, increase conversion rates, and enhance customer engagement.





Real-Life Applications: Public Policy

Governments and policymakers use framing effects to nudge citizens toward desired behaviors, particularly in taxation and compliance.

- **Tax Penalties:** Framed as losses, increasing the perceived cost of noncompliance and encouraging timely payment.
- **Tax Discounts:** Framed as gains, motivating voluntary compliance through rewards.

Such framing can improve policy effectiveness by shaping public attitudes and responses.

Conclusion: The Power of Perspective

Behavioral economics shows how psychology influences decisions. People are more driven to avoid losses than to gain the same value—a concept used by marketers and policymakers through framing and loss aversion.

Understanding these biases helps us design better messages, influence behavior, and think critically about how information is presented.

Thank You!