**PAPER REVIEW**

**On**

**Toward a Positive Theory of Consumer Choice**

**In**

**Principles of Economics**

**BACHELOR OF TECHNOLOGY**

**IN**

**Artificial Intelligence and Machine Learning**

SUBMITTED BY

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| **Sl No** | **Topic** | **Page Number** |
| **1** | **About Paper** | **3** |
| **2** | **Objectives** | **3** |
| **3** | **Research Questions** | **3** |
| **4** | **Major Findings** | **4** |
| **5** | **Theoretical and Practical Implications** | **5** |
| **6** | **Summary and Conclusion** | **5** |

**Index of Contents**

**About Paper**

The paper titled “**Toward A Positive Theory Of Consumer Choice**” was authored and revised by **Richard Thaler** through the years 1978 – 1979. This paper is sourced from the Journal of **Economic Behaviour and Organization**, Volume 1, Issue 1, Page 39 - 60, which was published in March 1980.

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**Objectives**

The objective of Richard Thaler's paper "Understanding How People Make Choices" is to show that traditional economic ideas about how people decide what to buy or do aren't always consistent with actuality. This paper elaborates on how decision making of the general public may not always seem rational and why it is the way it is. Thaler also tries to introduce new ideas that will help us understand better why people make the choices they do.

**Research Questions**

1. **Why do traditional ideas about how people make decisions not always match up with what we see in real life?**

Traditional economics assumes that people always make rational choices based on perfect information. However, in real life, people often make choices that seem irrational or don't follow traditional economic theories. Thaler explores why this happens.

1. **What things in our minds affect how we choose things?**

Thaler investigates the psychological factors that influence decision-making. He looks at how things like emotions, biases, and limited attention span can impact the choices people make.

1. **Can we come up with a new way of thinking about how people choose things that works better than the old way?**

Thaler proposes the idea of prospect theory as an alternative to traditional economic theories. He explores whether this new approach, which considers how people react to gains and losses, might provide a more accurate explanation of decision-making behaviour.

**Major Findings**

Thaler finds that there is a significant difference between what traditional economics assumes and the decisions people make in real life. In contrast to tradaitional economics that says that people always make rational decisions, it was found that the decisions people make are very often driven by emotion, cognitive biases and their limited cognitive resources which arent accounted for in the tradtional economic theories.

A multitude of psychological factors play a role in decision making. **Cognitive biases** involves loss aversion which explains the tendency of people prefering to avoid losses instead of taking risks to make comparable amounts of profits. **Anchoring** is another idea seen where people tend to rely and make decisions based on the first piece of information they receive. Similarly, emotions such as fear and excitement can sway the judgement and the resultant outcome of decisions which end up seemingly irrational.

Thaler proposes the **Prospect Theory** as an alternative framework which suggests that people evaluate choices based on potential gains and losses relative to a reference point instead of just considering the final outcome. It also explains how people exhibit risk seeking behaviour when faced with losses and risk evading behaviour when making gains which was called as the **Reflection** **Effect.**

This theory also talked about how instead of weighing the pros and cons of the availabe options, people often rely on shortcuts or **Rule of Thumb** to make quick decisions. This can prove to be highy sub optimal and is ignored while making decisions leading to deviated decision making of indivisuals.

In general, Thaler’s **Prospect Theory** brings light to the complexity of decision making and proves how cognitive resources, situational factors and emotions influence decision making.

**Theoretical and Practical Implications**

Richard Thaler’s research challenges traditional economic assumption that people always make decisions based off complete information. He proved that the presence of cognitive limits, psychological biases play an important role in decision making and this creating a spectrum of seemingly illogical decisions. This work brings a new perspective that allows economists to study human behaviour in the economy in a nuanced manner by acknowledging that decisions that are made are often deviated from the expectations set by traditional economic models.

By understanding Thale’s proposed Prospect theory and behavioural economics, businesses can improve consumer welfare and design services that meet consumer’s needs and expectations. This can be done by simplifying the decision-making process for the consumer instead of letting them think. One such method is to phrase the pricing of goods and services such that it emphasizes perceived value which can enhance consumer satisfaction and loyalty.

Thale’s research has heavy implications for policy makers in the field of finance and healthcare. Behavioural insights can be used to design interventions that promote better decision-making outcomes and can also help in combating challenges in society.

**Summary and Conclusion**

Richard Thaler’s work explains the lack of ability of traditional economic models to explain real-world decision-making behaviour. It explores psychological factors that affect decision making and also proposes the Prospect Theory as an alternative method to understand illogical behaviour. Understanding such factors helps make better strategies to counter problems in the field of economics. This provides valuable insights for both theoretical and practical implications. Thaler’s work opens up new approaches of understanding human behaviour in the economic market and helps design interventions that lead to better decision outcomes.

This study also inherently proves and is the basis of the fact that the economy is a function of many factors which includes choices made by consumers.