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## BEHAVIORAL ECONOMICS: REUNIFYING PSYCHOLOGY AND ECONOMICS

‘Behavioral economics’ improves the realism of the psychological assumptions underlying economic theory, promising to reunify psychology and economics in the process. Reunification should lead to better predictions about economic behavior and better policy prescriptions.

Toward a Reunification

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Four Principles of Economic Behavior.

One goal of behavioral economics is to suggest mathematical alternatives with firm psychological foundations to rationality assumptions.

Four rational principles used in economics, along with four behavioral principles that are ready to be included in textbook discussions and tried out in modeling applications.

- a) Expected Utility Theory.
- b) Exponential Discounting.
- c) Social Utilities.
- d) Equilibrium.

Utility maximization and Bayesian updating have admittedly proved harder to replace, but there are many ideas in the air, and progress is likely.

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## CRISIS IN BELARUS IN 2014: PSYCHOLOGICAL VIEW

Economic psychology is a perspective and quickly developing area of social and behavioural sciences. It studies the psychological mechanisms that underlie economic behaviour. This science is developing with the belief that economic behaviour can be best understood by interdisciplinary approach based on both economics and psychology.

Psychological phenomena have a great influence on economic behaviour and economic situation as a whole. Reflexivity in social system, the crowd effect, and the level of trust in authorities are among the most influential.

George Soros in his book 'The Crisis of Global Capitalism' claims that reflexivity implies dependency of social reality on both present state of economy and public attitude and expectations. People's thoughts, values and beliefs are reflected in their economic behaviour which in turn changes economic reality.

The principles of people's behaviour in the crowd was for the first time formulated by Gustave Le Bon. He described these principles in the book 'The Crowd: A Study of the Popular Mind'. Gustave Le Bon believed that the psychology of men in a crowd differs essentially from their individual psychology. When a person becomes part of a crowd, he loses almost all of his individuality, autonomy and personal judgement. He undergoes collective, often irrational influence.

The level of trust in authorities and economic policy in a country defines the way people handle their money. High level of trust (optimism) results in people's preference to spend and invest money rather than save it, while low level results in the opposite. Besides the belief in the government and its decisions defines how much people tend to follow its recommendations and how easily the authorities can govern people.

The situation in Belarus in December 2014 evidently illustrated all these phenomena. At the end of November Russian rouble slumped. Belarusian people were realizing high dependence of their economy on the economy of Russia and were expecting consequent falling of Belarusian rouble. Further to this, people desired to take advantage of purchasing goods traded in Russia that abruptly fell in price. These led to increasing demand for foreign currency. The balance on financial market was undermined. Dollar rate increase and expectation of even bigger increase made people buy dollars in order to save their money. Thus people unconsciously triggered unfavorable processes: escalation of inflation, foreign exchange deficit, and emergency measures of the government.

This situation was stressful for people and the majority of them were reluctant to make their own decision. They lost the independence of judgment and were mainly guided by collective consciousness. People's behaviour became irrational and even destructive for the economy. The people stood in huge queues in order to buy currency and bought consumer goods in Belarus and Russia in enormous quantity without thinking whether they needed them or not. The panic was spread like pandemia in the society where collective mind started to dominate.

Confidence of the society was shattered by the way the government dealt with this situation. Imposition of 30% fee on currency purchase and prohibition to raise prices for goods stopped the panic on the foreign exchange market but it undermined business activity. Now the society does not believe in the ability of the government to cope with economic problems without deteriorating economic climate and standard of living. On March 4, 2015 an annual meeting of entrepreneurs took place in Minsk. At this meeting the results of a survey conducted some days before were announced. According to the survey, only 1.9% of entrepreneurs think that in 2015 situation in

business will improve, 10.8% consider that nothing will change, whereas 77.6% are sure that the situation will worsen. People are becoming reluctant to do business in unfavorable environment where they cannot be sure in the future. They prefer stable and safe work rather than venture investments and start-up of new projects.

Knowledge of the way these three psychological phenomena mentioned above function is important for members of society, especially for scientists and rulers of countries. Authorities can use it as a tool to achieve their objectives. They can better control and manage social consciousness and behaviour and turn the development of economy to a necessary direction. If they do not, the economy develops in spontaneous, chaotic, unpredicted way and it can even lead to economic collapse.

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