

BEHAVIOURAL ECONOMIC THEORY AS A TOOL FOR ECONOMIC ACTION ENLIGHTENING : CASE OF LATVIA RURAL ENTREPRENEURS

¹IGO CALS

*University of Latvia, Riga, Faculty of Economics and
Management, boulv. Aspazijas 5, Riga, Latvia, LV-1050
email: "igo.cals@vaderstad.com; igo@inbox.lv*

Abstract: The task of every scientific theory is to explain the observed practices and to forecast possible development trends of the researched object. Hence, economics theory has to provide a theoretical support to those processes that are carried out by economic activity units on daily basis. The neo-classical economics theory encompasses a belief system of both economical processes and a rational choice model of separate economic entities explaining an economic activity as an attainment of maximum financial results within given resources. However, empirical data studies demonstrate the fact that economic decisions made by enterprises cannot be substantiated through rational choice theory which has been appropriated by classical economics theory. Behavioural economics is an instrument that can theoretically explain real economic practices of agents and rural entrepreneurs serve as an excellent proof of a theoretical concept of behavioural economics working in practice.

Keywords: *Behavioural economics, rural entrepreneurs, economic practices, rational choice.*

1 Introduction

Theoretical stance of behavioral economics does not contradict paradigms of classical economics. In principle, behavioural economics disputes a single postulate of classical economics that economic actors are rational in making every economic decision. Classical economics treat economic activity subjects as indisputable rational beings whose decision making is a purposeful process. The essence of entrepreneurship according to classical economics is expressed as a desire to attain maximum income within restricted resources. However, one should pose a question: Does entrepreneurship always set a goal to maximise financial income and, consequently, make every decision accordingly? Is rationality solely linear? Behavioural economics poses the following arguments:

- First, the notion of rationality is a relative one. The comprehension of a rational behaviour significantly differs among different subjects;
- Second, rationality has got a restricted nature: its comprehension depends on a person's knowledge, experience, intuition and the environment where decisions are made;
- To a great extent, economic activity decisions by subjects are not only determined by economic and financial parameters but also by a social field where the subject operates and where normatives are adopted;
- Declared values (socially adopted by the society) are not always accepted by economic entity subjects and, consequently, decisions can essentially differ from the perceived rational norms;
- Socio-economic decision makers have got different personalities. Whereas the classical economics discourse ignores the notion of personality, real practices affirm the impact of individual comprehension in making economic decisions. Consequently, economic activities of similar economic subjects have got expression forms that substantially differ since each individual has got a different comprehension of work and life values.

The classical economics theory acknowledges the given problem; however, it avoids its institutionalization. Yet, it is impossible to come to a unified economics theory paradigm without inclusion of the given discourse under behavioural economics concept (Ariely, 2008).

According to the classical economics theory, an individual is not a personality with its flaws, mistaken views and undefined values but a "superrational" subject lacking human behavioural norms. Behavioural economics treat a person as a real human being acting both rationally and irrationally, whose decisions are often irrational and have not been modelled in the past.

Consequently, economic processes cannot just be explained by exact definitions and linear extrapolation; instead, they are subjected to individual decisions of different economic actors that have got a common vector of progress but with substantial individual deviations.

Social norms is another essential factor determining behavioural stereotypes of a single person, including economic decisions. The objective of entrepreneurship is not merely to ensure economic benefits but also to present a social status and to gain a higher position within the hierarchy of the social network. Through economic activities, an entrepreneur attempts to multiply not only financial, but also social and symbolic capitals.

Behavioural economics concept analyses economic activity according to this complex comprehension. Thanks to such specific factors of entrepreneurial environment as a finite social field, attachment to a certain location, specific regulations by public administration and transparency of entrepreneurship, rural entrepreneurs are a successful analysis object of economic decisions in the context of behavioural economics theory.

2 Behavioural Economics as Theoretical Tool

Behavioural economics is a sub-division of economics theory that studies the effects of social, cognitive and emotional factors on the economic decision of individuals and institutions. (). The study of behavioral economics includes how market decisions are made and the mechanisms that drive choices.

"Bounded rationality" concept (Simon, 1955, 1957, 1991) presented a novel treatment of economic processes: humans acted according to their knowledge, assumptions and experience. Rationality is not an absolute but a relative category. Cognitive power is limited and certainly non absolute, especially in the context of a separate economic activity subject. Consequently, the neo-classical economics theory has got limitations as it does not allow relativity of rationality.

2.1. Herbert Simon's "Bounded Rationality"

Herbert A. Simon was granted the Nobel Memorial Prize in Economic Sciences in 1978 for his decision making process studies in economic organizations. Instead of analysing available resources and decision making consequences in a scrupulous way, actors mainly think of the decision's impact upon themselves and hereto, in a short term perspective. The decision making is impacted by a numerous number of factors with boundless possibilities for analysis. Therefore, a decision is made on the basis of a "bounded rationality", not an absolute one. While explaining actions of economic subjects, one has to realize that the value system is personalized and that the rationality is determined by a complex ambiguous number of factors and, more importantly, the cognition power is limited due to human biological and social factors. Herber Simon's concept started a whole new trend in economics science and laid foundations of behavioural economics perspective and socio-economic processes. Instead of a theoretical science, economics became an applied science providing real explanations of economic decision making practices.

2.2. Symbolic Capital by Bourdieu

The notion of symbolic capital can be derived from the social capital theory (Bourdieu, Putnam, Coleman) where symbolic capital is an important capital type, along with culture and knowledge capitals, and social ties. The researchers could not ignore the fact that a successful economic activity was ensured not only by an access to financial capital, technologies and suitable labour resources (as stressed by neo-classical economics theory) but also a series of social factors that are available to an entrepreneur.

Nowadays, nobody challenges the importance of social capital in ensuring a successful and sustainable entrepreneurship. Social capital is the expected collective or economic benefits derived from the preferential treatment and cooperation between individuals and groups. The social capital's essence can be treated either from individual viewpoint (Bourdieu) or through a set of social ties in the respective social field (Coleman, Putnam). One of the key elements forming social capital is symbolic capital which has been most precisely described by Bourdieu (1984).

Symbolic capital accumulates primarily from the fulfillment of social obligations that are themselves embedded with potential for prestige. Objects may also possess symbolic capital. Hence, decisions about purchasing different manufacturing tools carry not only a financial weight but also a symbolic value. The symbolic angle enriches the purchased product with social capital and creates an additional immaterial value.

$$\Omega = f(Y; Y_c; Y_s) \quad (1)$$

Utility (Ω) is a function not only of individual utility Y but also Y_c which stands for the criteria by which the individual views the welfare of his community (Georgescu-Roegen, 1960) and Y_s which shows social capital gains in one's community (Bourdieu,).

$$Y_s = f(\Sigma(Y_{sym}, Y_{cul}, Y_{know}, e.t.c)), \quad (2)$$

Where social capital is made of different interconnected capital forms such as symbolic capital (Y_{sym}), cultural capital (Y_{cul}), knowledge capital (Y_{know}) and other relative capital forms (Bourdieu, 1984).

According to Time-inconsistent theory (Laibson, 1997), consumers prefer benefits that can be gained in the shortest possible time. Out of all variable, uncertain and interrelated capital forms, symbolic capital can be presented in the shortest possible time by purchasing status goods relevant to one's social field. Possibly bigger future financial gains are rated lower than symbolic assets that raise one's social status.

Solely behavioural economics' conceptual comprehension provides explanation behind real practices when, for the purposes of economic activities, entrepreneurs purchase manufacturing tools of both high efficiency and symbolic value that is transformed into social capital.

2.3. Prospect Theory

Prospect theory can be regarded also as a part of behavioural economics, with Daniel Kahneman (The Nobel Memorial Prize in Economic Science, 2002) and Amos Tversky (1979) being the biggest contributors. Prospect theory is a behavioural economic theory that describes the way people choose between probabilistic alternatives that involve risk, where the probabilities of outcomes are known. The theory states that people make decisions based on the potential value of losses and gains rather than the final outcome (Kahneman; Tversky, 1979). Throughout the course of the decision making and under equal probability, fear to suffer a loss is proportionately bigger than desire to make a maximum profit. On the one hand, such approach stops people from taking an increased risk; on the other hand, a possibility to gain additional income from investments into economic processes is un-proportionately underrated. Such decision making process can be explained with the aid of theoretical concepts of behavioural economics.

2.4. Summary : Theoretical Concepts and Practices of Rural Entrepreneurs

Agricultural industry is strictly regulated in the European Union. It is seemingly one of the national economics' industries with the highest impact of public administration upon economic decisions of economic entities. Through its public power and financial regulations, the state attempts to coordinate the industry's

sustainable development to the interest of entire national economics. Agricultural entrepreneurship is specific due to its territorial attachment and farmer location in a certain social field – a social territory where social values have got a special meaning. The land as the key manufacturing agent cannot be relocated. Rural entrepreneurs often combine economic manufacturing with rural lifestyle (Georgescu-Roegen, 1960). In its turn, through applying different instruments such as subsidies, support programmes and aid in infrastructure maintenance, public administration influences both rural entrepreneurial processes and rural lifestyle as a certain value.

Taking into account the above written, the comprehension of the classical economics theory can be inadequate when analysing rural entrepreneurship. To explain true reasons behind economic decisions of rural entrepreneurs, it is very important to comprehend behavioural economics since the rationality of economic decisions, and its social and symbolic meanings can be only understood through the comprehension of behavioural economics concepts. Public administration whose impact upon rural entrepreneurial environment is essentially important still bases its actions on paradigms of neo-classical economics. Both parties have got a different comprehension of rationality and, consequently, their collaboration is relatively complicated.

The given thesis addresses the problem that decisions made by rural entrepreneurs can be exclusively explained by concepts of behavioural economics whereas public administration consistently adopts comprehension of classical economics rationality.

3. Research Methodology

Behavioural economics, in difference to classical economics, mostly applies qualitative research methods. Through the course of this study in the time period between autumn 2011 and April 2013, 44 representatives of Latvian rural farms were interviewed by applying in-depth and unstructured interview methodology. The total size of the farm land of researched farms exceeded 300 hectares and in a country like Latvia, those farmers could be regarded as major entrepreneurs. The unstructured interview was held as a discussion on the company's long-term development prospects. The farm owners were sole representatives in 27% of cases, with their family members and also employees joining them for unstructured interviews in the rest of cases. All farms were selling their produce in the marketplace; hence, they could be classified as follow:

- Rural entrepreneurs and
- Manufacturers for natural consumption.

A bigger part of the interview was devoted to the discussion of rural lifestyle being a non-material income factor for rural entrepreneurs; however, it has not become a focus of this study. All farms receive funds from the state and international rural development organizations and additionally make real income out of rural entrepreneurship.

Throughout the study, 5 respondents representing Rural Support Service, an institution regulating rural entrepreneurship, were interviewed. Those respondents gave their evaluation of rural entrepreneurship's aspects from a controversial viewpoint of transactions. Nevertheless, representatives of regulatory bodies equally belong to the common social field of rural entrepreneurship.

4. Discussion and Findings

The qualitative part of the study indisputably confirms that both parties impacting economic processes of rural entrepreneurship employ different paradigms towards their comprehension of a real situation in agriculture.

On 37 occasions corresponding to 84% of all respondents, one of the main discussion topics covered an ability of entrepreneurs to accommodate value systems set by the state regulatory bodies in

order to gain income that could be converted into different non-financial capital forms, with symbolic capital occupying a special place. An example is an application for grants towards the purchase of a new equipment where the key criteria set by regulatory bodies is a necessity to obtain the cheapest possible equipment that is capable to carry out analogical technological operations. Rural entrepreneurs, however, revealed that they had carried out all possible (including fictitious) transactions in order to obtain grants for the purchase of the most expensive and most prestigious rural equipment. The course of discussions confirmed that rural entrepreneurs regarded such economic indices as profitability, depreciation norms, technology productivity and even the price as less important than the brand of the equipment, a possibility to purchase luxury extras and especially their own value in the eyes of neighbours. It was the added social value that impacted the choice of the equipment. Only 7 or 16% of all respondents saw a potential future risk from the more expensive technology or investments. Despite an attempt to structure the discussion of the interview with the use of economic indices, it was clearly obvious that rural entrepreneurs had a relatively short term approach towards economic development and a superficial knowledge on economic categories. Furthermore, they preferred such capital forms as social and symbolic capitals to a possibility of attaining bigger financial results with cheaper resources. The qualitative study indisputably revealed the value system of Latvian rural entrepreneurs and their respective economic decisions subjected to the conceptual basis of behavioural economics.

The outcome of discussions with representatives of the state regulatory body confirmed that their value system certainly belonged to classical economics viewpoint. The representatives of the state regulatory body declared that the objective of economic activities of rural entrepreneurs was to make a maximum income through applying minimum resources and that the objective of support programmes was to promote entrepreneurship through the given aspect. The representatives of the regulatory body having an essential impact on the industry tried to ignore the fact that real practices of rural entrepreneur did not always correspond to the classical economics viewpoint.

5. Conclusion

The agricultural production in the European Union countries has not historically been a free market and different national and international regulatory bodies have been impacting the development of the particular industry with a help of different support programmes and subsidies.

Rural entrepreneurs and representatives of regulatory bodies are the main actors of the rural entrepreneurship's social field. Unfortunately, they have got a completely different comprehension of economic and life value systems. Whereas economic activity expressions of rural entrepreneurs can be analysed by concepts of behavioural economics, representatives of regulatory bodies regard economic processes from the classical economics viewpoint. A contradiction arises between these belief systems.

Due to the fact that a numerous amount of public resources are used towards the support of agriculture, conceptually different approaches to entrepreneurial values create a contradiction between objectives of granting means and motives of utilisation. It cannot be hidden from the society resulting in incomprehension.

The methodology and belief system of behavioural economics is an instrument explaining real economic practices of rural entrepreneurs.

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