Understanding Behavioural Economics

Behavioural Economics · Practice Test · 15 Questions

1. Which of the following is a key principle of behavioural economics that challenges traditional economic assumptions about rationality?

A) People always act in their own long-term best interest.
B) Human decisions are purely driven by logical analysis.
C) People are systematically influenced by cognitive biases and heuristics.
D) Markets are always perfectly efficient and self-regulating.

2. The 'endowment effect' describes the tendency for people to value an item more highly simply because they own it. This is an example of which behavioural economics concept?

A) Loss aversion
B) Framing effect
C) Status quo bias
D) Availability heuristic

3. Which cognitive bias describes the tendency to rely on the first piece of information offered (the 'anchor') when making decisions, even if that information is arbitrary?

A) Confirmation bias
B) Anchoring bias
C) Hindsight bias
D) Bandwagon effect

4. Nudges, as proposed by behavioural economists like Richard Thaler, are best described as:

A) Mandatory regulations that enforce specific behaviours.
B) Financial incentives and penalties to influence choices.
C) Subtle changes in the choice architecture that steer people towards certain decisions.
D) Extensive public awareness campaigns to educate citizens.

5. Prospect theory, developed by Kahneman and Tversky, suggests that people weigh potential losses more heavily than equivalent potential gains. This is known as:

A) Present bias
B) Framing effect
C) Loss aversion
D) Availability bias

6. The 'availability heuristic' is a mental shortcut where people estimate the likelihood of an event based on:

A) The ease with which relevant instances come to mind.
B) Thorough statistical analysis of past data.
C) Advice from trusted experts and authorities.
D) The perceived social consensus on the event.

7. When individuals consistently prefer immediate rewards over larger, later rewards, they are exhibiting a behaviour known as:

A) Overconfidence bias
B) Present bias (or hyperbolic discounting)
C) Self-serving bias
D) Bandwagon effect

8. The 'framing effect' demonstrates that people's choices can be influenced by how information is presented. For example, a medical treatment described as having a '90% survival rate' is often perceived more favourably than one with a '10% mortality rate', even though they are statistically identical. This is an example of:

A) Anchoring bias
B) Confirmation bias
C) Framing effect
D) Status quo bias

9. In behavioural economics, 'defaults' are significant because they leverage which principle?

A) Loss aversion
B) Optimism bias
C) Status quo bias (or inertia)
D) Availability heuristic

10. Which of the following best describes the 'bandwagon effect'?

A) Individuals are more likely to adopt a belief or behaviour because many other people are doing so.
B) People tend to overestimate their own abilities or achievements.
C) Decision-makers prefer to stick with the current state of affairs.
D) The tendency to favour information that confirms pre-existing beliefs.

11. The concept of 'bounded rationality' in behavioural economics suggests that people's decision-making is limited by:

A) Perfect information and unlimited cognitive processing power.
B) Access to complex economic models and algorithms.
C) Time, cognitive limitations, and incomplete information.
D) The absence of any emotional influence on choices.

12. What is 'social proof' in the context of behavioural economics?

A) A form of cognitive dissonance where individuals reject new information.
B) The tendency to trust and be influenced by the actions and opinions of others.
C) The preference for options that are perceived as the 'default' or standard.
D) The tendency to avoid losses more than seeking equivalent gains.

13. When a person avoids buying lottery tickets because they focus on the high probability of losing money, even though they understand the potential for a large gain, they are primarily demonstrating:

A) Anchoring bias
B) Present bias
C) Loss aversion
D) Confirmation bias

14. The 'hindsight bias' is also known as the 'I-knew-it-all-along' phenomenon. It refers to the tendency to:

A) Overestimate the likelihood of positive outcomes.
B) Perceive past events as having been more predictable than they actually were.
C) Seek out information that supports existing beliefs.
D) Value owned items more than similar unowned items.

15. Behavioural economics uses insights from psychology to explain economic phenomena. A prime example is the understanding that economic agents are not always perfectly rational. This approach is often contrasted with:

A) Theories of game theory.
B) Classical and neoclassical economic models.
C) The principles of microeconomics.
D) The study of market dynamics.