



PART 1

Read the text below and answer questions 1–13.

THE FOUNDATIONS OF BEHAVIOURAL ECONOMICS

A

Classical economic theory long depended on a simplified portrait of decision-making. The figure of *Homo economicus*—calculating, consistent, and relentlessly self-interested—was assumed to compare all relevant options, process information without distortion, and select the alternative that maximises utility. This model proved powerful for building neat theories, but it struggled to describe how people actually behave when attention is divided, information is incomplete, and choices are presented under pressure. Behavioural economics grew from this mismatch between elegant assumptions and stubborn reality, arguing that departures from perfect rationality are not random noise but systematic deviations that can be observed, predicted, and incorporated into explanation.

B

A central turning point came from the collaboration of psychologists Daniel Kahneman and Amos Tversky, whose work described patterns of cognitive bias that repeatedly steer judgement away from statistical logic. They showed that people often rely on heuristics, meaning mental shortcuts that reduce effort when facing complexity. These shortcuts are not inherently “bad”: they can be adaptive in daily life, allowing fast decisions when time and knowledge are limited. The crucial claim, however, is that the same shortcuts also generate predictable errors, particularly when people substitute an easier question—“How does this feel?” or “What example comes to mind?”—for a harder one such as “What does the evidence actually indicate?”

C

One of the most influential examples is the availability heuristic. When people estimate probability, they frequently use ease of recall as a guide: events that are vivid, recent, or heavily reported feel more common than they truly are. Dramatic news coverage can therefore distort risk perception, making rare dangers seem frequent and routine dangers seem negligible. A person may fear flying after repeated reports of a plane crash yet remain unconcerned about everyday hazards that receive little media attention. In financial markets, striking stories of sudden fortune or catastrophe can shape expectations more strongly than base rates, encouraging overreaction even when the underlying statistics point in the opposite direction.

D



While heuristics research examined judgement, prospect theory—also associated with Kahneman and Tversky—reframed how people evaluate outcomes. Instead of treating value as an objective function of final wealth, the theory proposes that individuals judge gains and losses relative to a reference point, commonly the status quo or an expectation about what “should” happen. This shift matters because perceived value becomes sensitive to framing: the same outcome can feel like a gain or a loss depending on the comparison. Prospect theory also formalised loss aversion: the psychological impact of losses is typically stronger than the pleasure of equally sized gains. The asymmetry helps explain why people may reject fair gambles, cling to declining investments, or demand disproportionate compensation to give up something they already possess.

E

The idea that cognition is limited does not begin and end with prospect theory. Behavioural economics also draws on Herbert Simon’s concept of bounded rationality, which argues that decision-making is constrained by time, attention, and computational capacity. In many real situations, the “optimal” choice is not merely unknown; it is too costly to search for. People therefore tend to satisfice: they set an aspiration level and stop searching once an option seems good enough. Choosing a familiar brand, accepting a default, or following a recommendation can be understood as an efficient response to information overload. The point is not that people do not care about outcomes, but that the mental and practical costs of exhaustive optimisation often exceed the benefits.

F

These descriptive insights became influential in policy through the idea of choice architecture: the observation that the way choices are structured can steer decisions without eliminating freedom. Popularised by Richard Thaler and Cass Sunstein under the banner of libertarian paternalism, “nudge” approaches aim to make beneficial choices easier while preserving the option to decline. Defaults are the most cited example. If pension enrolment requires employees to opt in, participation may remain low because inaction is easy and paperwork is unpleasant. If the default is reversed—employees are enrolled unless they actively opt out—participation often rises sharply, not because preferences changed overnight but because the path of least resistance changed.

G

Yet the same tools that can help individuals can also be used against them, which raises ethical and political questions. If humans are systematically influenced by framing, defaults, and salience, then steering can slide into manipulation, especially when the “architect” has incentives that conflict with the chooser’s welfare. Firms may design



subscription systems that exploit inertia, present pricing in ways that hide true costs, or structure menus to push consumers toward higher-margin options. Digital environments intensify the dilemma: online platforms can test variations of wording, timing, and layout at scale, learning which cues maximise clicks or spending. Behavioural economics therefore offers not only a richer theory of decision-making, but also a warning: understanding predictable bias creates responsibility for how that knowledge is deployed.

Questions 1–5

The text has seven paragraphs, **A–G**. Which paragraph contains the following information? Choose the correct letter, **A–G**.

- 1** A reason people may settle for a satisfactory choice instead of searching for the best possible one.
- 2** The idea that people feel losses more intensely than gains of the same size.
- 3** The identification of two researchers associated with the study of mental shortcuts and biases.
- 4** A contrast between a fully rational economic model and evidence of systematic departures from it.
- 5** An example showing how changing a default can strongly influence participation.

Questions 6–9

Complete the summary below. Choose **NO MORE THAN TWO WORDS** from the text for each answer.

Key Concepts in Decision-Making

Behavioural economics examines predictable patterns in decision-making. It shows that people rely on mental **6**, which can lead to systematic errors. In prospect theory, outcomes are judged relative to a **7**, and people tend to feel **8** more strongly than equivalent gains. Because information and attention are limited, individuals may **9** rather than optimise.

Questions 10–13

Choose **TRUE** if the statement agrees with the information given in the text, choose **FALSE** if the statement contradicts the information, or choose **NOT GIVEN** if there is no information on this.



10 The passage presents departures from perfect rationality as random noise that cannot be predicted.

11 The passage states that Kahneman and Tversky conducted their research together for over 30 years.

12 The availability heuristic is linked to people overestimating risks after dramatic news coverage.

13 Some firms may use behavioural insights in ways that exploit predictable biases.

Answer Key

1. E

2. D

3. B

4. A

5. F

6. shortcuts

7. reference point

8. losses

9. satisfice

10. FALSE

11. NOT GIVEN

12. TRUE

13. TRUE