Abstract

The theory of classical economics treats entrepreneurs as subjects who make rational economic decisions. Empirical surveys prove the fact that daily economic decisions made by a separate economic entity can be explained by concepts of behavioral economics rather than classical economics. The economic behavior of entrepreneurs happens to be based on bounded rationality instead of financial justification. The objective of an economic activity presented as economically efficient can turn out to be socially important to a specific entrepreneur and not to national economy as a whole. In the EU countries, agriculture is a subsidised industry of national economy. In this light, status consumption and purchase of positional goods should create a special interest among economists. The objective of this article is to present true reasons of economic decisions made by rural entrepreneurs and to analyse the value hierarchy of Latvian rural entrepreneurs through carrying out a field work and with the help of set of instruments developed by modern economics theory.

Keywords: Behavioral Economics, Bounded Rationality, Conspicuous Consumption, Positional Goods, Rural Entrepreneurs

1. Introduction

Rural economic activity has got several peculiarities which set it different from other types of economic activity:
- Territorial seclusion;
- Living and economic activity being attached to a certain social field, professional activity and lifestyle being united;
- A substantial visualization of production means and an output i.e., a possibility for others (such as neighbours, competitors and the other ones interested) to watch production processes;
- Entrepreneurship’s legal support by the state and supranational institutions in the form of subsidies;
- A possibility to start and develop a sustainable entrepreneurship with a relatively low human capital's potential;
- Restricted availability of the land - the main production means.

In view of the aforementioned circumstances, daily decision making practices in the rural entrepreneurial environment are specific and can be explained with a discourse of behavioral economics theory rather than rationality paradigms of the neo-classical economics theory. When making economic decisions in the rural environment, rationality is explicitly
bounded and, to a great extent, determined by the social hierarchy instead of financial means. Agents of rural farms often justify their economic decisions not only with an economic utility but also with a certainty of the social status presentation. Being aware of the subsidies that are granted in different forms by the national and the European Union institutions for the purchase of production means necessary in agricultural manufacturing, agents employ them for the acquisition of goods whose social importance prevail over financial advantage in order to raise their status in the surrounding social field.

The land as the main production means of rural entrepreneurs has always got a limited availability. Historically, it has often become an ownership of a particular rural entrepreneur as an inheritance or a historical succession instead of an employment of entrepreneurial resources. Consequently, the material prosperity of rural entrepreneurs (in reference to the big share of subsidies of the total income structure) is, to a great extent, determined by external circumstances instead of a set of competences. Rural entrepreneurs acknowledge the land resource as positional goods and psychologically construct an attitude towards other products and production means as positional goods.

In this aspect, positional goods can be any material values and services whose usage objective (along with an efficient consumption) is to demonstrate the owner’s social status with the aim to raise one’s hierarchical status in the social environment (Veblen, 1899).

The particular decision making process by economic agents can be explained with the belief system of behavioral economics which interprets real economic decision making practices on a microeconomics level.

2. Theoretical Background

By making economic decisions rural manufacturers acknowledge empirically the topicality of the theory of bounded rationality developed by Herbert A. Simon (1957; 1997). Simons was the first to characterise the subjective nature of the decision making process in economics. Economic agents make decisions on the basis of their knowledge, life and managerial experience, educational level, social circumstances, available information and several other non-economic factors. Economic decisions are personified and not always optimal for both micro and macro levels. The subjective vision of entrepreneurs is determinant in relation to economic rationality vector being interpreted classically.

Proceeding with Simons’ bounded rationality concept Huw Dixon (1992) observed that with the value \( U(s) \) assumed to be rational in the sense of neoclassical economics, it equalled \( U^* \) (daily empirical decision) solely when \( \varepsilon = 0 \). In this case, \( \varepsilon \) is a subjective input of a separate economic agent in the decision making process.

\[
U(s) \geq U^* - \varepsilon \tag{1}
\]

Consequently, an optimal economic decision is practically impossible for the subjective factor always creates

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U(s) \neq U^* \tag{2}
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Through the course of decision making process, the knowledge, experience and social status’ demonstration of entrepreneurial agents play a more important role than financial calculations of economic profitability.

Land is the main production means of the economic activity of rural entrepreneurs. Given the restrictive nature of land areas, the land employed in agriculture can be regarded as positional goods. The classical theory treats goods having an impact upon a person’s hierarchical evaluation in a social group as positional goods (Hirsch, 1976). Therefore, rural manufacturers a priori carry out their economic activities utilising advantages of positional goods (the land). In order to increase their position in the system of social hierarchy, rural
entrepreneurs acquire other production means in view of both economic utility and social significance. The acquisition of positional goods to gain recognition among neighbours, potential competitors and other important agents of the respective social field, has more significance than the neo-classical economic efficiency (Kahneman and Tversky, 1979).

Conspicuous consumption, i.e., the purchase and exploitation of luxury goods and services in order to present a social significance and economic power, is a widespread argument in making economic decisions (Trigg, 2001). Given that Latvian rural manufacturers have got a personal prosperity level above the average in the country, the demonstration of one’s social status is a significant element that constructs economic decision making.

3. Results of the Empirical Study

The social construction of the economic decision making process has been verified by the study that was carried out in the rural Latvia between 2009 and 2013. 44 large-scale farms were surveyed with the use of an open interview and participant observation methods. The objects of the study were the following enterprises:

- Members of the farm produce market and not the players of subsistence farming;
- The ones who cultivate minimum 300 hectares of land and can be regarded as large-scale farmers and, consequently, are significant agents of their territorial and social field;
- The ones who receive the European Union’s supranational and the Latvian national subsidies.

The results of the empirical study confirmed the acknowledgement of rural entrepreneurs that the source of economic decision making was not only an economic utility but also a social significance. Through the process of self-reflection, the majority of surveyed farmers discovered the construction process of the decision making where the acquisition of the products having a luxury goods’ status in the eyes of neighbours and competitors, played an important role. 87 % of all surveyed respondents reflected in interviews that the purchase of agricultural equipment for work needs was more impacted by evaluation and comparison of the purchased goods with other agents of the respective social field than such economic characteristics as price and efficiency. Rural entrepreneurs are ready to pay a premium for status goods in order to raise their social status in the respective hierarchy. Moreover, rural entrepreneurs acknowledge the fact that with agriculture being subsidised by the state, they use public means in order to demonstrate a personal social significance. Rural entrepreneurs themselves acknowledge the availability of these subsidies justifying it with agricultural manufacturing being excessively dependant on weather conditions. Solely 18% or 8 of the surveyed entrepreneurs confirmed that the assessment of economic benefits was the key decision making factor in the purchase of manufacturing means.

Empirical results confirmed the original assumption that rural entrepreneurs whilst educated in agricultural disciplines (such as agriculturists or technical specialists) were poorly educated in economic decision making. Merely 5 (or 11 %) of all surveyed 44 entrepreneurs, next to their formal education have also mastered the basics of economics and economic activities. Mostly respondents make their economic decisions on the basis of their experience, traditions, advice of neighbours instead of fundamental evaluation of causal relationships. Consequently, it proved the original assumption that economic decision making of rural entrepreneurs was based on bounded rationality. Despite being able to make numerous significant economic decisions, rural entrepreneurs due to their limited economic knowledge do not always evaluate economic processes adequately and make decisions that could be treated as rational in the context of neoclassical economics.
4. Conclusion

The reigning economic efficiency standard is the assumption that the decisions involving economic activity are thought out according to the doctrine on maximum income gain with applying minimum resources. However, real life practices prove such assumption being unable to explain the essence of decisions related to daily economic management. The rationality comprehension of economic management subjects does not always match the given belief system. Social factors and strategies demonstrating social significance of entrepreneurs is an essential source of making economic decisions. Solely modern socio-economic theories such as bounded rationality concept, conspicuous consumption and the concept of positional goods can explain real economic decision making practices.

Considering that agriculture as an economic sector in the European Union countries is subsidised from the common tax payer resource pool, it is essential to understand needs of rural entrepreneurs and priorities of economic decisions. Such parties regulating economic policy of agriculture as the state and supranational organizations regard the sector from the neoclassical economical rationality perspective expecting that the resources assigned to the industry will be invested with an aim to support the industry and to promote their rational utilization. In this case, rationality is understood as utilization of means assigned to the industry with an objective to gain maximum economic benefit. In the meantime, rural entrepreneurs regard the assigned means as a support to meet economic objectives and to increase private social capital. Such approach can be precisely explained with behavioral economics concept.

However, it does not answer the question whether such approach on a macroeconomics level is beneficial to the society and should be supported. Whereas assumptions of behavioral economics help to understand daily economic practices and is a great tool in the analysis of microeconomics processes, neoclassical economics concept remains valid on national economy or macroeconomics level with regards to the question of rational utilisation of public means under restricted availability.

References


