Economics may be considered a branch of psychology since it usually boils down to the motives and behaviour of individuals. Sir Thomas Gresham was an early contributor to behavioural economics with his explanation to Queen Elizabeth I as to why the realm was depleted in silver. “Good money drives out bad”, he maintained. Henry VIII had “cut” the silver coins with 40% base metals in order to fund his wars. Since both old and new coins remained in circulation, people tended to spend the debased money and keep the “good” money for themselves, or else transfer it out of the country.

Share movements are marked by the tendency to jump on and off bandwagons (a kind of social contagion or herding instinct). The typical stock market bubble (e.g., tulips, the South Seas and dot.coms) begins with professional investors identifying a promising company that seems undervalued. The “smart money invests when the price is low, causing it to rise. Media attention generates enthusiasm among the wider public, which grows into greed-driven mania, sometimes delusional in proportion, as the price of the stock spirals upwards. Then a tipping point is reached (perhaps triggered by institutional selling according to computerised criteria) and the value of shares begins to fall. At this stage, enthusiasm is replaced by the emotion of fear among private investors. They bail out simultaneously to complete the “bear market” before there is a return to the original trend-line (Rodrique, 2006). During the entire boom-bust sequence the valuation of the shares is determined less by the economic strength of the company than the emotions of the investors (greed, euphoria, fear and panic).

People behave irrationally with respect to money (Ariely, 2008). Having made an investment decision they selectively seek information that confirms that it was the correct one, thus avoiding the discomfort of cognitive dissonance. Knox & Inkster (1968) showed that people at a race track who had already placed a bet rated their horse’s chances of winning higher than people about to place a similar bet.

An optimistic bias operates within commerce (Kahneman, 2011). This generates wishful thinking, including the illusion of control (the belief we are in control of our destiny, not the playthings of luck) and the planning fallacy (tendency to underestimate the completion time and costs of a project and overestimate its benefits). Even though it may be irrational, optimism is good for individuals (optimists are more resilient, have stronger immune systems and live longer) and probably also society (helping to drive capitalism).

The sunk cost effect is a tendency to “throw good money after bad”, persisting with a project that has been started rather than admitting it is untenable (e.g., Concorde). This form of irrationality is more apparent in adult humans than young children or non-human animals. It may be a dissonance avoidance strategy or it could be due to humans’ overgeneralising of the “waste not” rule (Arkes & Ayton, 1999).

The perception of money is easily distorted by its value. Bruner & Goodman (1947) found that poor children saw coins as larger than rich people (presumably because they viewed them as more valuable). This study has not been reliably replicated but it triggered many others on the estimation of money size. Furnham (1983) found that British people remembered the old pound note as bigger than the present one, presumably because inflation has reduced its value over the years. Molz (2007) found that German people saw their own Euro as bigger than those of other countries, especially that of Portugal, a country that is both small and struggling economically.

High inflation makes people insecure about the value of their money. Countries that redenominate are usually in economic difficulty (e.g., Zimbabwe). The Euro-illusion refers to that fact that countries that changed their own currency to the Euro generally think that this fuelled inflation because it was hidden in the changeover (Gamble, 2007). It is higher for countries where the exchange rate was extreme (e.g., Italy as opposed to Ireland). Ease of conversion is also important; charitable donations increased 11% in the Netherlands in 2004, apparently because the 2.2 exchange was thought of as dividing by 2. Tourists in countries where the exchange rate is a multiple of their own currency (e.g. 3SSP = 1EU) tend to underspend relative to those where it is a fraction (.33). (Raghbir & Srivastava, 2002).

Money is more than just a means to an end. It prompts behaviour that cannot be explained by its utilitarian value. People rolling in money still seek more of it, as though they can never get enough. They will sacrifice other values such as family and friends in favour of accumulating money. They chase money for the sake of money or perhaps to keep ahead of the Joneses.

Money evokes conditioned emotional responses. We become attached to its form and resist changes in notes and coins. People become obsessive about money – it gives them a buzz like an addiction (Lea & Webley, 2008). It has commonalities with food, which might suggest an evolutionary origin for our craving. When hunger is aroused by delicious aromas people become fiscally tighter (Briers et al, 2006).

The mere thought of money seems to make us mean. Reminders of great wealth (e.g., a money-themed screensaver in the background) seem increase feelings of social detachment (Vohs et al, 2008). Money-primed subjects seek greater space from other people, in the manner of an animal that has acquired a kill and wants to protect it from competitors. This may underlie the stereotype of the wealthy miser (e.g., Scrooge).

Many animals (esp. rodents and birds) cache food for times when it may be scarce. Bouissac (2006) has suggested that this is the basis human hoarding, especially when it is solitary rather than social. However, it may be more equivalent to saving, where money is accumulated to be used for later purposes, such as taking a holiday or buying a house. Accumulating money just to allay anxiety, with no intention ever to spend it, is a form of obsessional-compulsive disorder. Psychoanalysts have suggested that “parsimony” may be due to overly strict toilet-training in childhood but there is no persuasive evidence to support such an idea (Eysenck & Wilson, 1973).

Factor analysis of questionnaires has identified various attitudes with respect to money and their personality correlates. For example, people who value money for the power and prestige that is brings tend to be Machiavellian in personality, those who are future and security oriented are more likely to be anxious types and those who are concerned with retention of money (hoarding) tend to be obsessional in personality (Yamauchi & Templar, 1982). People high on “Work ethic” are inclined to be obsessed with money and to believe that it can be gained by effort and ability (Furnham, 1984). Income relates negatively to frugality and anxiety and positively with forward planning and saving (Baker & Hagedorn, 2008) though the directions of cause and effect are unclear.

The value of a monetary reward diminishes exponentially with the delay in its delivery (Green & Myerson, 2004). This is called delay discounting and it is one reason that immediate lump-sum pension payments are set at less than long-term payments. Generally, poorer people discount more than wealthy, perhaps because they are not in a position to put anything aside.

DD is a good measure of impulsiveness as a personality trait, impulsive and extravert individuals placing more of premium on immediate gratification. Not surprisingly, drug addicts, alcohol abusers and smokers show steeper DD functions than their non-addicted counterparts (Reynolds et al, 2004). Even the children of smoking mothers display more DD than children of non-smokers, implying a genetic connection.
Compulsive shopping is an impulse-control disorder related to depression and OCD which can result in problems of debt. It is disproportionately female (80%). The most common target items are clothing, shoes and jewellery for women and electronics for men. Shopping is a mood-enhancing experience, relief being felt when a purchase in made (Black, 2007). It relates to low self-esteem and depression and is heightened during the PMS phase of the female cycle. Once a problem is acknowledged, treatment with SSRI antidepressants or CBT may be effective.

The availability of credit cards contributes to shopaholism (Lo & Harvey, 2011). Credit cards are more likely to be used and luxury goods purchased when self-esteem is threatened. Pettit & Sivananth (2010) gave feedback on task performance that was either ego-enhancing or damaging to subjects’ self-worth. The latter led to a 30% greater likelihood of choosing expensive designer jeans than ordinary ones and 60% increased likelihood of using a credit card for the purchase. This might account for some of overspending difficulties that people of low socioeconomic status get themselves into.

Trade was originally conducted with commodities like cattle and wheat. This gave way to precious metals like gold and silver, which were later cast as coins that served as units of money. Next came notes promising a certain amount of precious metal (e.g., a pound of silver), which could be passed around as currency without redemption ever being called upon. More recently we have added handwritten cheques, credit cards and cashless transactions such as web transfers and mobile phone payments. Khan & Craig-Lees (2009) argue that the further we get away from awareness of the real value of the commodities being traded the more people spend extravagantly, run up debts and create inflation. This trend towards a cashless society may well have contributed to the recent economic collapse.

Kleptomania is similar to compulsive shopping but features an impulse to steal things rather than purchase them (shop-lifting or taking money). Again, the act of stealing is accompanied by a sense of relief, though the goods or money taken may not really be needed (c.f., Winona Ryder). Kleptomania is associated with mood, eating and addictive disorders and is also more common in females (about 3X) and also varies with cycle phase (Talih, 2011).

References

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