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BEHAVIOURAL ASPECTS OF THE CRISIS

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Abstract: *The present economic crisis has shaped the world as we know it, differently: the theories arguing the complete rationality of economic decisions face serious counter-arguments. Neither a perfect market, governed by equilibrium and rationality, nor an economic field without behavioural assumptions, is viable. When making decisions of all types, and especially financial ones, one must also consider the behavioural approach. Behavioural economics has changed the way the economists conceptualize today's world. Relevant features of human behaviour absent in so far assessments have been taken into account. Behavioural aspects focus on human behaviour and thereby it should be applied to all fields.*
Key words: *crisis, rationality, psychology, debtors, creditors*

1. INTRODUCTION

The globalisation that started more than 25 years ago had, in time, significant positive as well as negative consequences on the economic and financial activity all over the world. Recent empirical researches show that the deepening and intensification of financial flows through international markets brought unquestionable benefits to developing countries by triggering economic growth and inducing a sustainable financial stability.

But, the positive effects of financial flows appear only if a number of preconditions already exist: a macroeconomic environment stimulating growth, structural imbalances are mitigated; market mechanisms allow competition, a sustainable operational and supervised financial system is set up, there are well established financial institutions and mechanisms, domestic markets are globally integrated. Under such circumstances, the domestic market allows the entry of healthy capitals and is less vulnerable to speculative ones seeking high profits (Cerna *et al.,* 2008). Nevertheless, the globalization may induce vulnerabilities by contagion and import of other markets frailties. The interaction of markets also means a higher exposure to risks that are often difficult to deal with, fuelling instability all over the world because of: risk contagion, information asymmetry, herd behaviour, speculative attacks on national currencies and are often leading to unsustainable imbalances.

The main identified determinants of the present financial crisis lay in the subprime mortgages and the credit crunch. The symptoms, though ignored, were obvious and similar to previous crisis: *increase of interest rates, decline of stock prices, unanticipated reduction of prices inducing a reduction of assets' value, housing and mortgage, uncertainty, bank panic*. But, besides these determinants, we think that there are several other *behavioural* determinants that triggered the credit crunch and the present crisis. Therefore, the analysis should go beyond the empirical data and also consider determinants that are not obvious at first sight. Such an approach certainly requires the inclusion in the analysis of various factors like: psychology, culture, customs and habits, historical evolution. Certainly, these determinants may complete the picture of the present crisis.

2. PSYCHOLOGICAL DETERMINANTS OF THE ECONOMIC BEHAVIOUR

Undoubtedly, crises do not occur unless a number of preconditions exist in the economic and financial environment. The tensions, accumulated in time, lead to financial turmoil and possibly to crises, built up starting from relatively obvious economic and financial determinants. But, the area of determinants is larger, including *psychological, cultural, historical ones*. Basically, they can be recognised according to the extent of *asymmetric information, moral hazard and adverse selection* noticeable on one or several markets (Mishkin,1992). Rationally, economists show that the economic decision making process depends entirely on the market conditions, on demand and supply, yields, risk-profitability relationship, etc. Indeed, these are truly specific and not to be neglected determinants for each economic estimate, but they are not sufficient, since the final decision can ignore these aspects, and rely on a less profitable alternative, but one which would fit the psychological structure of the decision maker. Under these circumstances, the economic behaviour is not an optimum one. The most common example, although it is not treated as an aspect of behavioural finance, is the "free rider" attitude. Presently, researchers admit that the market has its boundaries in influencing the human behaviour (Forbes W., 2009). Individuals' standard economic behaviour relies on three unrealistic aspects: boundless rationality, boundless willpower, and boundless selflessness. The unrealism of these characteristics rises from the fact that individuals do not have unlimited capabilities of processing information and, so, it cannot be expected of them to act optimally. This means that rationality cannot be more than a relative concept which considers the abilities of each individual, in a world where absolute rationality does not exist. One of the key issues when discussing the financial crisis is the propensity to save *vs.* the propensity to consume and borrow. In this context, saving is a process through which the individuals postpone present consumption, in order to financially secure their future, in case of retirement for example. The theory of life cycle shows that in the first years of career, when there is an expectation of revenue growth, there is a tendency to use a part of these revenues for savings, postponing consumption, while, towards the end of the life cycle, because of the decreasing revenues, the tendency is reversed. Nevertheless, often, people are not willing to adopt such an attitude, preferring to use their revenues for immediate consumption. In order to cover their increasing needs, they often engage in costly borrowing and agree to pay considerable interest for the advantage to getting, immediately, the goods they are aiming for, or postponing other liabilities towards various creditors (suppliers, banks, tax administration, etc.). The influence of the psychological factor on the financial behaviour draws the attention on a largely debated situation: the relationship debtor-creditor. This relationship is influenced strongly by the attitude of the debtor regarding the payment of the debts, irrespective of the nature of creditor (Summers B. *et al*. 2005). The debtor is influenced, in his actions, by the level of liquidities of which he can dispose of and of his propensity to pay or not his debts. In the case in which the payment of a debt is postponed or refused, this means that such an action is not regarded as the best allocation of resources, when there are other alternatives for their engagement. The probabilities associated to each alternative are important (for example, it is up to the attitude of the lender if he will or will not initiate a juridical action against the non paying debtor). As a result, it is proven that the debtor's past actions are determinant when taking the decision. Another possible determinant is the near closing date of the debt, the debtor's attitude being determined also by the maturity of the debt. The possibilities to negotiate the debt and the eventual postponing of the payment are also considered. If the debtor considers he can reach a favourable agreement with his creditor, he will start such an action, unless he assumes the consequences of not paying the debt. The necessary time to decide whether to negotiate with the creditors or ignore them is also considered. Subjective influencing factors take into account the deviation of the debtor's behaviour from the rules society abides by. According to these rules, the debtor evaluates the consequences of his attitude starting from his perception regarding his power of control on external events. The rules society abides by are accepted by the group or by the community, especially those who are concerned by the community's perception regarding their attitude, the others preferring a certain degree of deviation from these perceptions. Moreover, the financial behaviour is influenced by the feeling of belonging to a certain community. Also, the anticipated negative emotions (fear, anxiety) in case of not paying the debt or positive ones (satisfaction) in case of the debt's restitution are capable of guiding the future behaviour. The regret triggered when starting one action or another or the reproach of having adopted an unsuitable attitude may shape the debtor's attitude towards his creditor and, the anticipation of this feeling, might change profoundly the debtor's future behaviour. Encouraging the feeling of regret when taking an action, might incline the debtor to ignore any sort of counselling which would determine him to act against his better judgement. When selecting the available alternatives, the debtors consider, mostly, the degree of control they have on a given situation. In this context, the ability to determine the course of actions, self-suggestion can play an important role in the debtor's perception regarding his abilities to negotiate with his creditors and to reach the expected result. To these endogenous determinants a number of exogenous factors are added, which consider also the circumstances in which negotiations take place. These objective factors are often more powerful in determining the future behaviour then the subjective ones, especially when they favour a certain action. Explaining the choice of an alternative behaviour depends on the way the individual perceives the situations in which he is involved in and which can be influences by internal and external factors, stable and unstable, specific and unspecific. Given these facts, it means that individuals and managers act under bounded rationality inducing unpredictability on markets and, what is more important, lack of credibility, because they do not posses all the necessary information and because they cannot predict the outcomes of their actions. Therefore, one should grant greater attention to the less obvious variables that determine decisions, such as the behavioural ones because people are incapable of taking optimal decisions and are bounded in many dimensions, like: rationality, willpower and self-interest (Mullainathan S., Thaler R.., 2000).

3. LESSONS TO BE LEARNED FROM THE PRESENT CRISIS

Though the present financial crisis (turned into an economic one) is far from being solved, and no obvious solutions can be given until the last part would have been played, it is mandatory that the international community must cooperate. The present crisis, rooted in the subprime mortgage market, is the result of a number of risky and irrational economic behaviour pursued, in time, by financial institutions, public decision makers and individuals, all disregarding the economic consequences of risks' spreading through the open markets. The accumulating tensions spread, by contagion, to the whole world, eventually affect the global economy and the living standards.

Still, a number of lessons can be learned: *Firstly*, the crisis should not be treated emotionally but rationally, setting up a smooth restoration of macroeconomic balance. Consumption should be restored cautiously and preconditions for savings should prevail in order to mitigate the lack of external funding. *Secondly*, no financial institutions are "too big to fail" so, prudential supervision of the financial markets should be revisited and adjusted to present conditions. *Last,* but not least, the credibility problem should be at the core of either of the above approaches because the national as well as the international financial system cannot function, in a global environment, unless its conduct is transparent, accountable and most of all promotes credibility among partners.

4. CONCLUDING REMARKS

The behaviour models of individual choice could help understand how financial decisions are made, how institutions function, based on the financial needs of individuals. Because real life situations are more about the concept of "bounded rationality", the behavioural approach introduces an indispensable element when analysing decisions: the human factor, which is incapable of taking a decision under strict rationality. When analysing a situation as rational, one is only attempting to simplify it and ignore complex factors which would make the analysis much harder because it assumes difficult to quantify determinants like emotions, desires, past activity influences, morality, intuition, coercion, deception, mistake, randomness. In complex situations, complex decisions are made, which have little in common with rationality. Unfortunately, real life decisions are not rational and cannot be rationalized; therefore cannot be modelled throughout linear models regressions. It is subject to constant change and variation, to everyday surprise, both positive and negative; they can alter all prior assumptions.

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