

The economy

COMPARED with some branches of psychology, the concerns of the economic psychologist may seem mundane and a little lacking in mystique or theoretical depth. We are not ashamed of that; in fact we are proud of it. We believe that Everyday Things Matter: the simple economic actions people are engaged in from day to day have profound influences on, and are influenced by, their psychological states and processes.

It was pioneering work in the USA that first made governments aware that the study of psychological variables might have useful implications for macro-economic policy (Katona, 1975). Now much can be said about individual economic behaviour and cognition (see Webley *et al.*, 2001). In this article we look at practical recommendations springing from research in several areas of economic behaviour.

Income tax evasion

Income tax evasion is a serious and longstanding problem. Even in Victorian England, when the tax rate was extraordinarily low, evasion was rife: in 1871 only 20 per cent of income tax returns in Exeter were satisfactory (Webley *et al.*, 1991). Estimating the amount of evasion is not easy of course, but the best guess is between 3 per cent and 5 per cent of GDP.

So how might we reduce this?



Left to right: Brian Young; Carole Burgoyne; Paul Webley; Stephen Lea

STEPHEN LEA, CAROLE BURGUYNE, PAUL WEBLEY and BRIAN YOUNG offer practical recommendations for change on economic policy.

Following Elffers and Hessing (1997), we suggest that:

1. *Tax authorities could simply withhold too much tax and refund it later.*

Many people voluntarily opt for this in the USA, and it is a straightforward application of prospect theory (Kahneman & Tversky, 1979), which states that losses loom larger than equivalent gains from a specific reference point. If taxpayers expect a refund, they are about to gain and will go for the safe option of making an accurate return. If, on the other hand, they expect a bill, the evidence suggests that they are more likely to go for the risky option and try to evade.

Crime

Tony Blair's notion that Saturday night louts be marched to cashpoint machines by

the police and forced to hand over up to £100 may not lead to the desired reduction in antisocial behaviour. Recent research suggests that financial penalties can in fact have the opposite effect to that intended.

In Gneezy and Rustichini's (2000) study in a daycare centre, parents would sometimes arrive late to collect their children. After the introduction of a monetary fine, the number of parents arriving late increased significantly (and the number stayed up even after the fine was removed). This surprising finding suggests that introducing the fine monetised the behaviour: instead of being seen as a penalty, the fine became a price you could pay for being late. Hence:

2. *Wherever possible, social norms and 'contracts' should be used to control antisocial behaviour, since economic incentives and deterrents to encourage good citizenship can backfire.*

Debt and poverty

Most debt is incurred through expenditure on children (e.g. Lea *et al.*, 1993). People who will make every kind of economy on their personal expenditure will run themselves into debt to avoid depriving their children relative to their peers. The system of loans for essential household purchases can aggravate family poverty, since these have to be repaid from already low incomes. The application procedures for means-tested benefits are complex and damage self-esteem, and the resentment they arouse can encourage the abuse of the system. Therefore:

3. *Many of the benefits to poor families could be replaced by a significant increase in child benefit (widely accepted and almost always taken up).*

In the light of the recent proposal to provide a 'nest-egg' for new babies:

4. *Families could also be offered a state-sponsored route for saving their allowances towards their future contribution to the costs of their children's higher education and, for those with higher incomes, child benefit could be treated as taxable income.*

Research on homelessness shows that being without a home is experienced as a major psychological loss. However, there are 'secondary gains' to homelessness which act to make it more difficult for people to get themselves out of the situation (Lea & Bulewski, 2000). These include friendships and freedom from responsibilities, but also financial factors.

5. *'Secondary gains' to homelessness need to be addressed.*

The interaction of hostel rents and benefit rules creates another version of the 'poverty trap'. Given the very low numbers of people involved and the extreme distress many of them are in, changes in the arrangements for withdrawing benefits as income increases could be effected at relatively low cost.

Saving and borrowing

Though the situation is not so bad in the UK as in other countries, pay-as-you-go pensions are clearly going to run into problems over the next few decades because of changes in the age profile. It is believed that fostering a culture of saving would alleviate this problem. It is not easy to make recommendations to reverse the long-term trend acting against saving, since this is one area where all the complexities of micro-and macro-economic and non-economic factors come into play. However, Ranyard and Craig (1995) have shown that it is the size of the regular payments rather than the total cost of borrowing that currently determines people's choices, so there may be some merit in suggesting:

6. *Companies should be legally obliged to highlight the true total cost of credit.*

People overvalue immediate events and underweight the future (which makes them less likely to save), but this tendency can be overcome if individuals choose specific patterns of behaviour, such as a commitment to regular saving over time, rather than individual acts. Thus:

THE PLAN IN BRIEF

- Tax evasion could be reduced by withholding too much tax and refunding it later.
- Social norms and 'contracts' should be used to control antisocial behaviour.
- Many of the benefits to poor families could be replaced by an increase in child benefit.
- There should be a state-sponsored savings route for children's higher education.
- The 'secondary gains' and poverty trap of homelessness need to be addressed.
- Companies should be legally obliged to highlight the total cost of credit arrangements.
- The government should focus less on one-off savings decisions and more on fostering commitments to regular savings schemes.
- A bursary to be recovered through post-graduation tax may avoid students' socially undesirable shift in attitudes towards debt.
- Money is not just an abstract symbol – its form and other attributes matter.
- If we switch to the euro, how information about any change is disseminated will need careful attention based upon psychological insights.
- More prominence should be given to financial issues in citizens' advice.

7. *The government should focus less on one-off decisions (e.g. buying ISAs) and more on fostering commitments to regular savings schemes.*

change in government expenditure, but might avoid the socially undesirable shift in attitudes towards debt.

Student finance

Extensive psychological research on student debt has shown that the current system of student finance in England and Wales is unsatisfactory. Students initially have strongly hostile attitudes towards debt, but are rapidly forced to take out loans. They

One advantage of our earlier suggestion of encouraging wealthier parents to save child benefit towards their share of student financing is that students tend to be most careful in spending what they perceive as their parents' money.

Notes and coins

When the new £1 coin was introduced, we predicted that these would be spent more quickly than the old notes (see Lea *et al.*, 1987). Participants volunteered to provide their wallets or purses for inspection every working day for a month. Each coin and note was marked with invisible ink and its dwell time in the purse was calculated: the coins were spent more quickly than the notes. This is not earth shattering, but it is an interesting example of how a change in an apparently irrelevant aspect of money (its physical form) can alter economic behaviour. So:

9. *The idea that money is just an abstract symbol and its form and other attributes do not matter has to be discarded. Unexpected and unwanted effects might be avoided if governments commissioned research before such changes.*

This leads us to consideration of the euro. If the government decides that it will be in Britain's best interest to adopt the euro, then it may have to work hard to persuade a largely sceptical public. Moreover, as the Conservatives showed in their 'Keep the

subsequently tend to develop more tolerant attitudes to debt (Davies & Lea, 1995) and take on more than they strictly need to (often for social expenses), overestimating their ability to pay it back quickly after graduation (Lea *et al.*, 2001).

8. *Allocating each student a reasonable bursary and recovering it through tax after graduation would require no net*

pound' campaign, the national currency can be a powerful symbol of political and economic independence as well as national identity. Economically and symbolically, many will perceive the loss of the pound as larger than any apparent gains from an unfamiliar currency. Another use of prospect theory suggests that:

10. Emphasising the potential losses of not switching to the euro, rather than the possible gains of adopting it, may shift people into a 'risk-seeking' mode in which they may be more willing to embrace such a change.

However, those with a stronger 'cultural' attachment (to symbols of present or past glories) are less likely to accept this than those with more 'instrumental' attachment (Routh & Burgoyne, 1998) and may need reassuring that relinquishing the pound is not a threat to their cultural identity.

11. If a referendum produces a 'yes' response on the euro, careful attention will need to be given to how information is disseminated.

Information will need to be tailored for different audiences and take account of the way that people actually use it. For example, a credit-card type of conversion table might be more useful than a leaflet. Brief, focused information should be used in readily digestible amounts for maximum

impact and memorability. All available media (including popular 'soaps' and magazines) should be used for concrete, case-oriented messages with personal relevance. Children should be encouraged to 'educate' their parents and grandparents.

Any period of dual-pricing should be kept relatively short to facilitate learning (Burgoyne *et al.*, 1999). Information may be seen as more credible and trustworthy if provided by consumers' organisations, especially if they are given a role in monitoring price conversions: 1972, the year after decimalisation, was seen as a year of 'diddling and swindling' (*The Guardian*, 12 April 1972).

Distributive justice

There is a plurality of justice principles that people use in different contexts, but a surprising degree of consensus (e.g. over

90 per cent in both the UK and USA) that health care for life-threatening illnesses should not be based on ability to pay. Given the current funding for the NHS, this raises the thorny issue of rationing and the criteria for deciding who gets treatment, and for what. Here there seems to be a clear divide between the general public, who take a patient-centred perspective and feel that decisions should be made on clinical grounds by medical staff, and service providers, with their emphasis on priority-setting for the allocation of resources (Burgoyne, 1997). Reconciling these incompatible perspectives is a real challenge for policy in this area. Transparency and a proper debate are essential first steps towards this, but the government also needs to be aware that much depends on how the issue is framed.

Despite widespread inequalities in marriage which tend to disadvantage women financially, a clear expectation among single people is for marriage to live up to the rhetoric of total equality (Burgoyne & Routh, 2001). The government recently launched a brochure called *Marriedlife*, and although some kind of education to encourage more realistic expectations certainly seems to be needed, perhaps we could advise as a general rule:

12. More prominence should be given to financial issues in government-sponsored citizens' advice.

In conclusion, we are of course aware that changes in policy can have unexpected effects, so we would like to echo Etzioni's (1988, p.244) call for humility: 'Most times we lack the knowledge for sound decisions [and] must proceed carefully'.

■ Professor Stephen E.G. Lea, Dr Carole B. Burgoyne, Professor Paul Webley and Dr Brian M. Young are in the School of Psychology, University of Exeter. E-mail: s.e.g.lea@exeter.ac.uk.

References

- Burgoyne, C.B. (1997). Distributive justice and rationing in the NHS: Framing effects in press coverage of a controversial issue. *Journal of Community and Applied Social Psychology*, 7, 119–136.
- Burgoyne, C.B. & Routh, D.A. (2001). Beliefs about financial organisation in marriage: The 'equality rules OK' norm? *Zeitschrift für Sozialpsychologie*, 32, 162–170.
- Burgoyne, C.B., Routh, D.A. & Ellis, A.-M. (1999). The transition to the euro: Some perspectives from economic psychology. In T. Vissol (Ed.) *The euro: Consequences for the consumer and the citizen* (pp.91–116). Dordrecht: Kluwer Academic.
- Davies, E. & Lea, S.E.G. (1995). Student attitudes to student debt. *Journal of Economic Psychology*, 16, 663–679.
- Elffers, H. & Hessing, D.J. (1997). Influencing the prospects of tax evasion. *Journal of Economic Psychology*, 18, 289–304.
- Etzioni, A. (1988). *The moral dimension: Towards a new economics*. New York: The Free Press.
- Gneezy, U. & Rustichini, A. (2000). A fine is a price. *Journal of Legal Studies*, 29, 1–17.
- Kahneman, D. & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica*, 47, 263–291.
- Katona, G. (1975). *Psychological economics*. New York: Elsevier.
- Lea, S.E.G. & Bulewski, A.P.L. (2000, July). *Secondary gains from homelessness: The view from on and off the streets*. Paper presented at the conference of the International Association for Research in Economic Psychology, Baden-bei-Wien, Austria.
- Lea, S.E.G., Tarpy, R. M. & Webley, P. (1987). *The individual in the economy*. Cambridge: Cambridge University Press.
- Lea, S.E.G., Webley, P. & Bellamy, G. (2001). Student debt: Expecting it, spending it and regretting it. In A.J. Scott, A. Lewis & S.E.G. Lea (Eds.) *Student debt*. (pp.37–48). Bristol: Policy Press.
- Lea, S.E.G., Webley, P. & Levine, R.M. (1993). The economic psychology of consumer debt. *Journal of Economic Psychology*, 14, 85–119.
- Ranyard, R. & Craig, G. (1995). Evaluating and budgeting with instalment credit: An interview study. *Journal of Economic Psychology*, 16, 449–467.
- Routh, D.A. & Burgoyne, C.B. (1998). Being in two minds about a single currency: A UK perspective on the euro. *Journal of Economic Psychology*, 19, 741–754.
- Webley, P., Robben, H.S.J., Elffers, H. & Hessing, D.J. (1991). *Tax evasion: An experimental approach*. Cambridge: Cambridge University Press.
- Webley, P., Burgoyne, C.B., Lea, S.E.G. & Young, B.M. (2001). *The economic psychology of everyday life*. Hove: Psychology Press.