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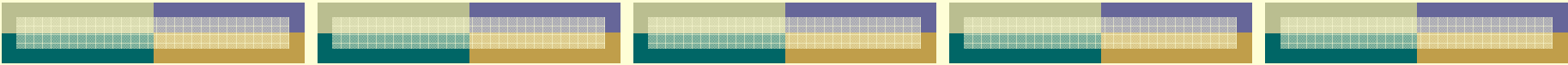
# How to Avoid Financial Crises in the Future

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# **How to Avoid Financial Crises in the Future**

Professor Costas Markides  
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## **A Few Examples to start us off:**

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- The murder of Kitty Genovese, New York city, 1964
  - The hit-and-run victim in Hartford, Connecticut, May 2008.
  - The priest experiments in New Jersey, 1972.
- 




## We all agree:

- These are sub-optimal behaviors (that we, ideally, want to improve)
  - These suboptimal behaviors arose NOT because the individuals concerned did not know what the optimal behavior is.
- 



## What can we do?

- Suppose that as policy makers, we want to ensure that people behave properly in the future?
  - The question is: What can we do to ensure that we do not get such sub-optimal behaviors in the future?
- 



## **Several Policy Options:**

- Educate, educate, educate...








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## **Several Policy Options:**

- Educate, educate, educate...
  - Regulation: If you don't help, you will be punished (e.g. pay a fine or "name and shame") [such a law exists in Quebec].
  - Special incentives (e.g £100 if you stop to help!)
- 



## Will these solutions work?

- Yes.
  - We cannot predict the behavior of a single individual and we will not get everybody to do it but we know that on average, more people will stop to help if you reward such behaviors than if you don't.
- 




## Are you happy now?

- Yet, there is something deeply dissatisfying with these proposed solutions!
- Why?






## **A Possible Reason:**

- Over and above the moralistic arguments against the proposed solutions...
  - We are offering remedies without first identifying the underlying reasons to the “disease”.
  - As a result, even if the remedies work in the short run, they will not eradicate the disease.
- 




## **Therefore:**

- If we are to really improve suboptimal behaviors, we need to step back and identify the underlying factors (i.e the source) of the suboptimal behaviors.
  - It is only by rectifying the underlying factors that we can hope to rectify the problematic behaviors.
- 



## What drives our Behaviors?

- There's been a lot of research on this issue so we know what determines how we behave:
  - At most, our personality can only explain 30% of our behaviors.
  - The remaining 70% is explained by the “social context” (or “situation” or “underlying environment”) in which we find ourselves.
- 



# **Implication:**

- If you want to change how people behave, change the underlying “social context”







## A few examples:

- Will you be willing to kill someone if I ask you to?



# Obey Authority





## Another example:

- When are you more likely to intervene and help a woman in need in the middle of the night—when you are alone or when you are with 5 of your buddies?





When will you intervene?



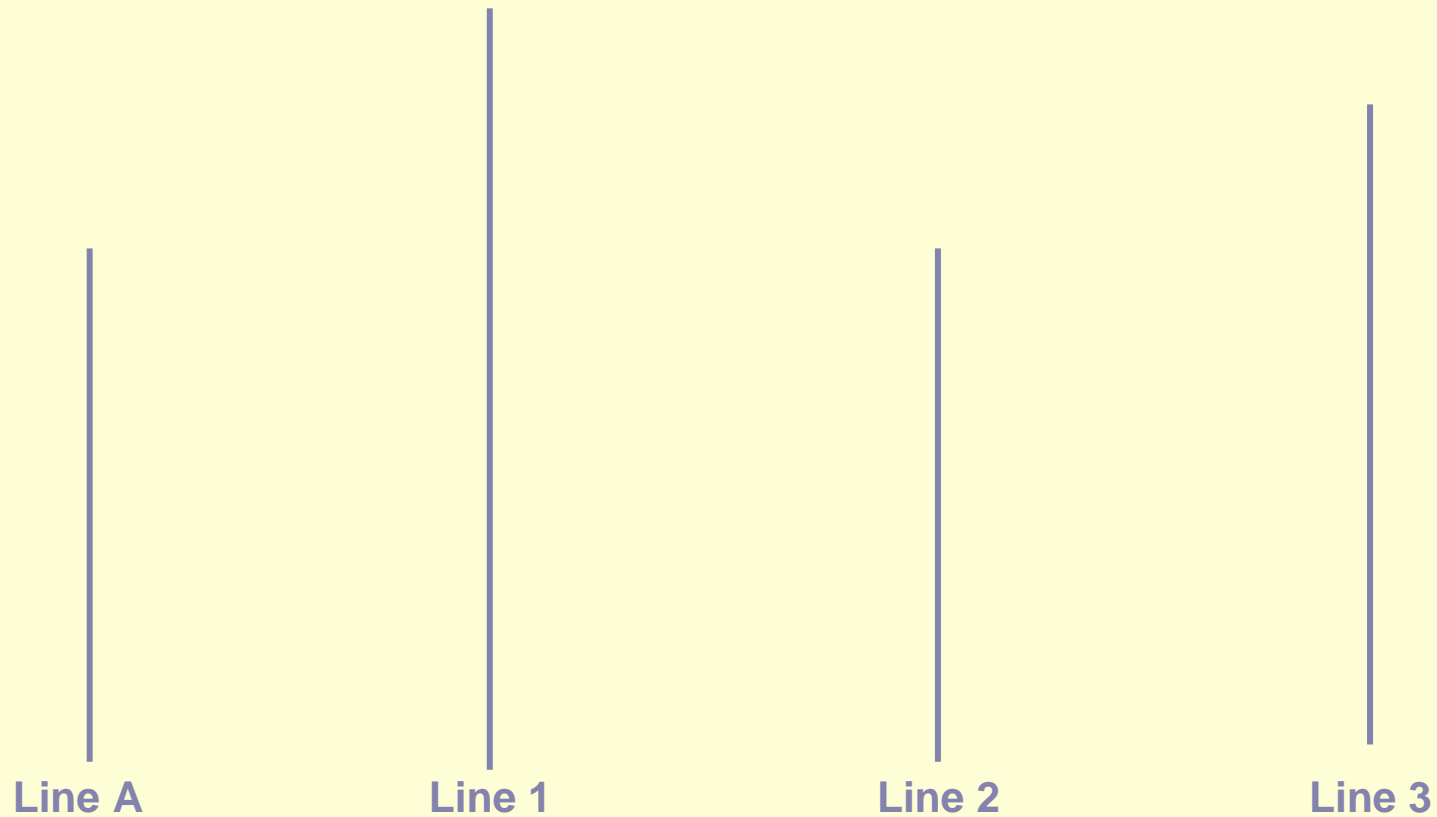


## Last example:

- Will you be willing to stick your neck out and tell people they are wrong if you know for sure that they are wrong?




# Conformity



- ☐ Line A is equal in length to Line 1
- ☐ Line A is equal in length to Line 2
- ☐ Line A is equal in length to Line 3



# Results

- (1) On one-third of the trials, the subject conformed to the incorrect majority view
  - (2) When the size of the group was only 2 people, the subject never changed his/her position
  - (3) When the size of the group was 3, the subject conformed to the majority view, 13% of the time
  - (4) When the size of the group was 4, the subject conformed on 33% of the trials
  - (5) The addition of one more dissenter, reduced conformity to one fourth of what it was before.
- 




# Conformity in Action








## **Back to where we started:**

- The underlying structure of a system determines the behaviors in that system.
  - To change behaviors, we need to change the underlying structure (or social context) of that system.
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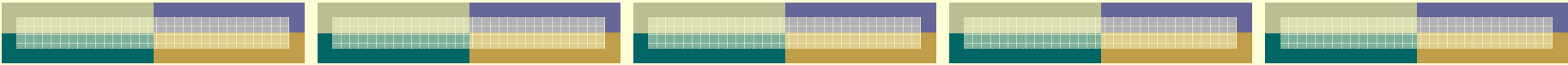
# What is a system:

- A system is an interconnected set of elements that is coherently organised in a way to achieve something.
- 



# **The structure of a system:**

- Its objective or purpose.
  - Its elements or physical make-up.
  - Its interconnections (such as its values, norms, culture, incentives and information flows).
- 



# **An Example: Changing the structure of the system**

- Do you know this man?







# Hans Monderman

<http://www.wired.com/wired/archive/12.12/traffic.html>

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## His experiment:

- Drachten, Netherlands
- 17<sup>th</sup> century village that grew to 40,000 inhabitants
- **Build roads that seem dangerous and they will be safer.**












## The Financial System

- We observed lots of suboptimal behaviors in the last 2 years (selling things you shouldn't be selling; taking unnecessary risks, etc).
  - Will more regulation improve things?  
On average, yes.
  - Will people do it again? Yes, in 15 years.
- 



# The structure of the system:

- Its objective or purpose: To maximize shareholder value.






# The structure of the system:

- Its elements or physical make-up:  
The number of players and the size of these players (too big to fail?).






# The structure of a system:

- Its interconnections (such as its values, norms, culture, incentives and information flows):
    - Who are the “heroes” in this system?
    - What are the values in this system?
    - What are the incentives in this system?
- 



# **Who is responsible for changing the underlying structure?**

- The Government?
  - Schools?
  - The family?
  - Individuals?
- 



## The good news:

Small changes in the underlying structure of a system could have a big impact on how people behave.





## One Last Example:

- How to get people to use the stairs rather than the escalator?





# Make Work Fun!





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