

# Mind, Society and Behaviour: Implications for Malaysian Household Debt and Savings

By

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On 22 June 2015, *The Star* reported that close to 25,000 Malaysians below age 35 have become bankrupt over the past five years.<sup>i</sup> This trend was marked by their inability to settle personal loans and loans for cars and houses, as well as being the guarantors for other loan defaulters.

Financial planning habits of the income earner were studied in the *State of Households Report* published by Khazanah Research Institute last November. The study looked at household expenditure, the impact of rising prices as well as housing affordability and debt of Malaysian households.

The report revealed that 78 per cent of households own cars, 66 per cent own motorcycles, 96 per cent own refrigerators and 91 per cent own washing machines. Almost every household owns a television (98 per cent) and a mobile phone (95 per cent). The report also stated that 57 per cent were tied to ASTRO subscriptions while 39 per cent have internet subscriptions.<sup>ii</sup>

Most low-income households acquired the items and services on credit. The trend was also accompanied by low personal savings, where nearly three million Employee Provident Fund (EPF) accounts were reported to have low savings.<sup>iii</sup>

The World Bank Group's *2015 World Development Report: Mind, Society and Behaviour* focuses on the way humans think (the processes of the mind) and how history shapes thinking (the influence of society). These factors affect one's spending and saving behaviour. The study features the notion that people's decision making is influenced by contextual cues, local social networks and social norms as well as shared mental models.<sup>iv</sup>

## **Towards a behavioural study of the economic actor**

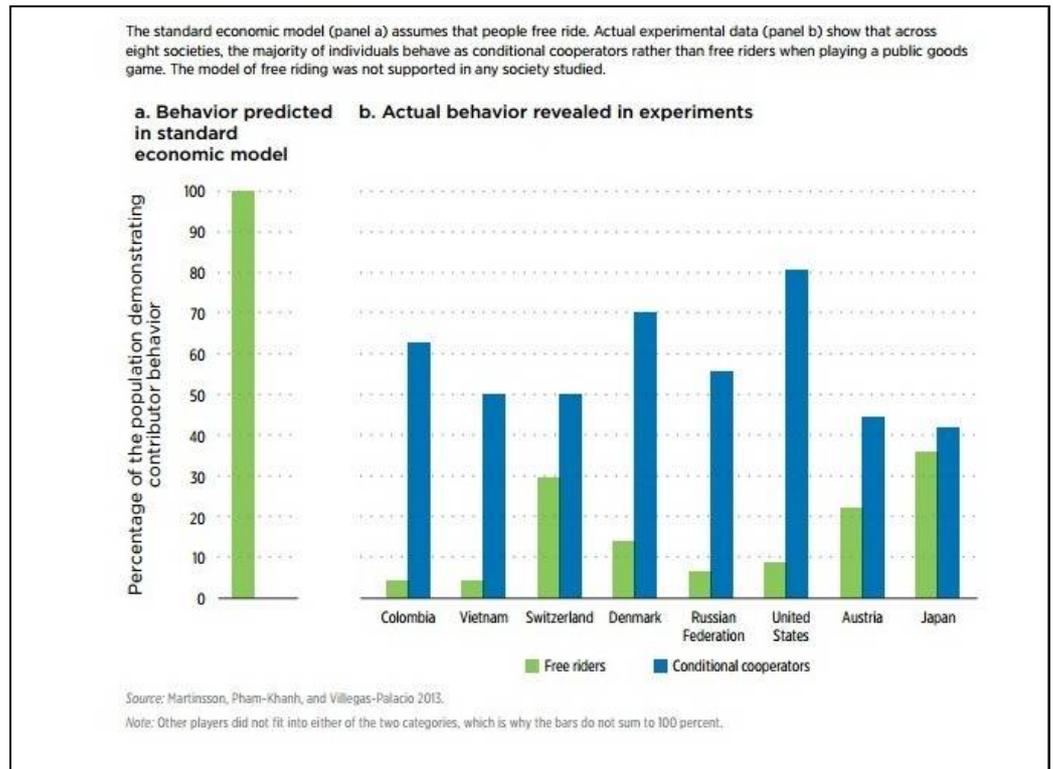
The foundational work of economist Adam Smith explored psychological and social influences on human decision making. Yet the approach was rejected in much of the 20th century literature. The economic actor was once seen as one who was "dispassionate, rational, and purely self-interested". These were the particular characteristics of the ideal economic being; individuals who did not behave in this way were believed to be driven out of the market by those who did.<sup>v</sup> This economic being, equipped with perfect calculation skills and self-regarding preferences, became an assumed entity in standard economic models. However, the cognitive processes of the economic being have proven to be more complicated. Economists assume we are all selfish — in actual fact not everyone in the society is a free rider (see Figure 1).

## **The economic actor, the automatic thinker**

People think automatically. This process may seem like common sense due to the instantaneity one reaches a decision. However, social sciences suggest that an individual's cognitive calibration is shaped through learned contexts, such as social

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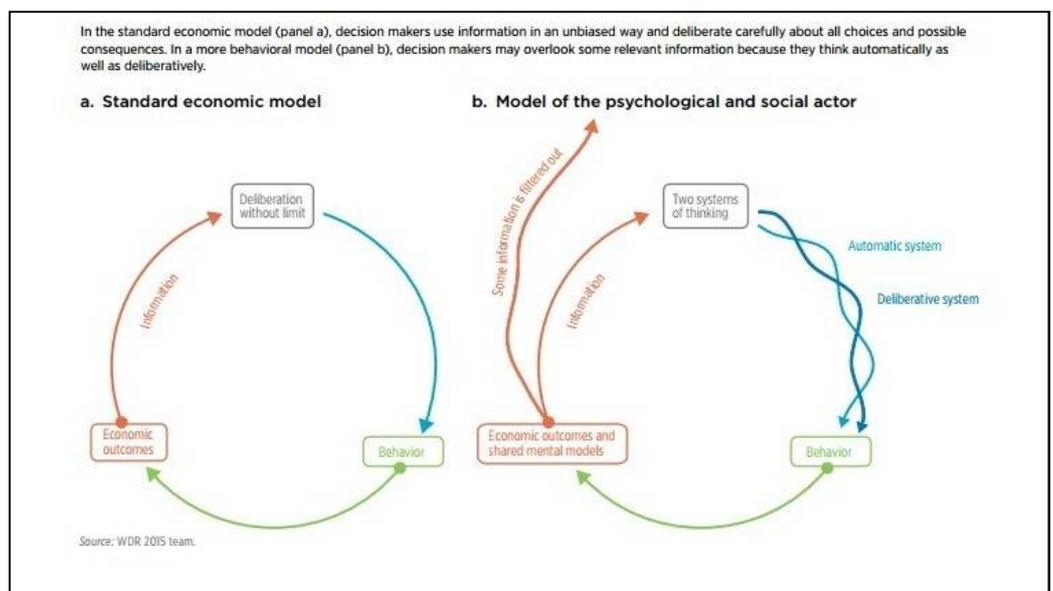
**Figure 1: In experimental situations, most people behave as conditional cooperators rather than free riders**



interactions, social beliefs as well as internalised concepts and symbols found within society.

Psychologists have distinguished two distinct thinking systems in the mind. The first is the automatic system that considers what automatically comes to mind (narrow frame). It is effortless, associative and intuitive. The second is the deliberative system that contemplates a broad set of relevant factors (wide frame). It is effortful, based on reasoning and reflective. Many may regard themselves as deliberative thinkers. Yet it is the first system that is most utilised in every day choices (see Figure 2).

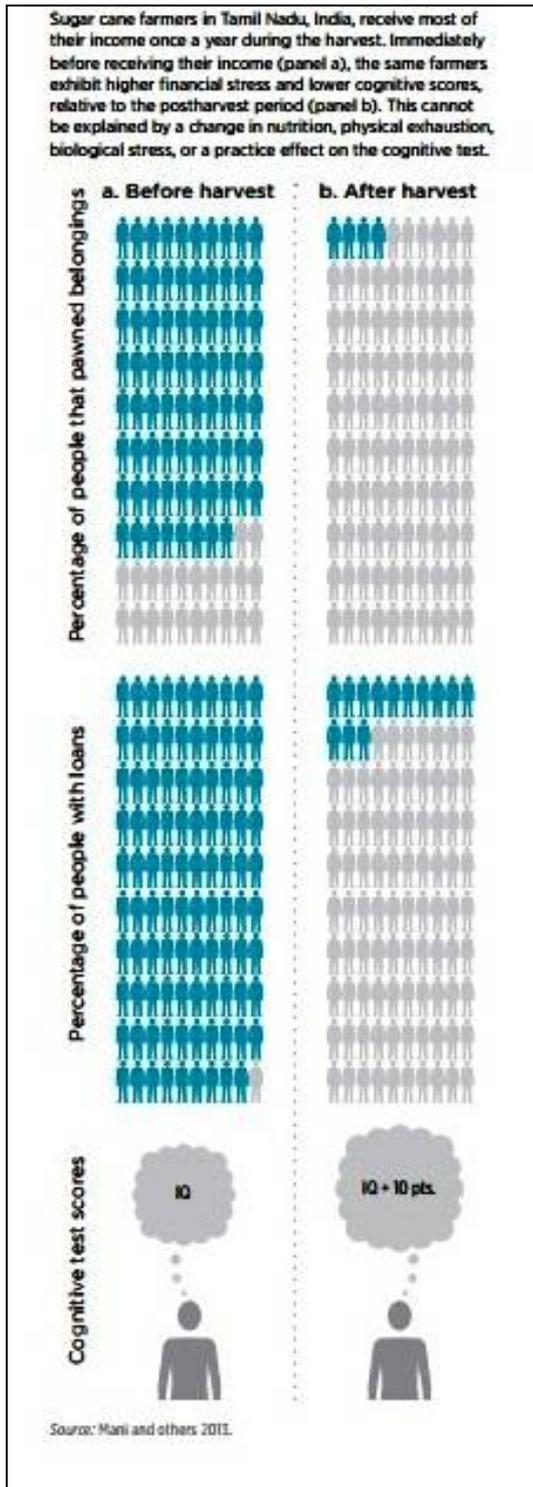
**Figure 2: A more behavioural model of decision making expands the standard economic**



## Biases, context and physical conditions

In the area of finance, the human approach is usually driven by biases. These biases are in the decision makers' preconceived notions of loss and gain, time, approach to choices, and the social psychology of the advice relationship. Living conditions due to poverty also influence the economic actor's thinking processes.

Figure 3: Financial scarcity can consume cognitive resources



Potential losses often seem larger than gains. There is also the issue of overweighting the present. Take the case of sugar cane farmers in India for instance. The farmers typically receive their income once a year, at the time of harvest. Right before the harvest, they were found to be much more likely to have taken on loans and pawned their belongings. The financial distress just before harvest time reduced one's thinking capacity to a score that is equivalent to roughly 10 IQ points (see Figure 3). For these farmers, a great deal of mental energy was exerted every day just to ensure their survival and access to necessities such as food and clean water. In this sense, they were left with less mental energy for careful deliberation or focus on investment matters.

### Thinking with mental models

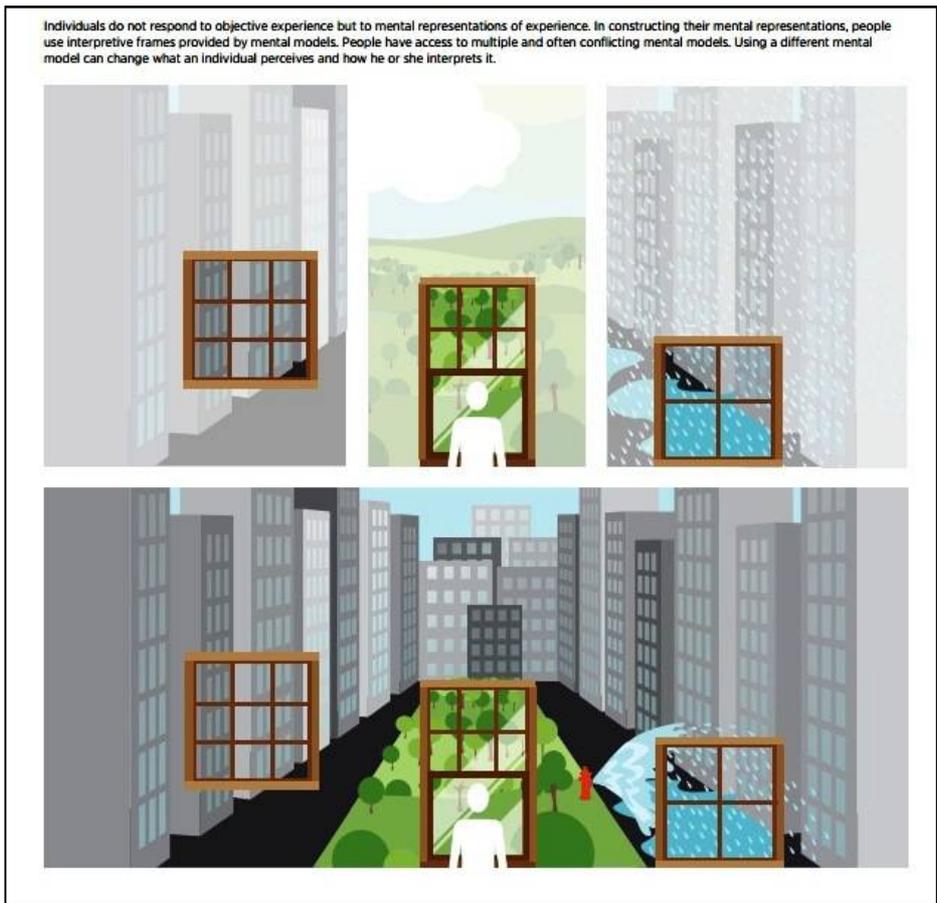
Mental models affect what individuals perceive and how they interpret what they perceive (see Figure 4). These models come from the cognitive side of social interactions, which people often refer to as culture. For instance, the manner in which one speaks to children, the types of risks to insure, and the identities or stereotypes one carries, are very much influenced by cultural factors. People's mental models shape their understanding of what is right, what is natural, and what is possible in life. While many mental models are useful, others are not and contribute to the intergenerational transmission of poverty.

Decisions concerning daily life and the household are then made based on these mental models. In finance, for example, there is a heavier bias on losses in comparison with gains. In an experiment, half the sample received a free mug and half did not. The groups were given the option of selling or buying a mug, respectively, if a determined price was acceptable to them. Those who had received a free mug were willing to sell, but only at a price that was twice the amount the potential buyers were willing to pay. Some even refused monetary compensation because they had become attached to the item.

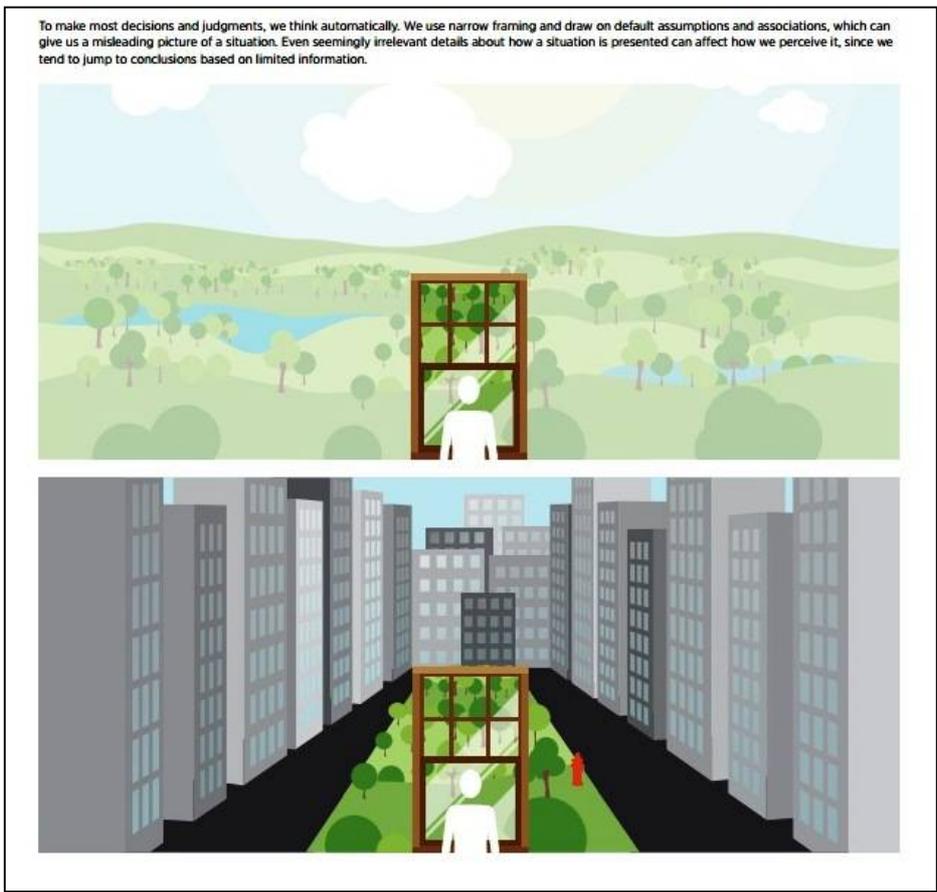
### Narrow framing

Using these mental models, the economic actor engages in automatic thinking. Problems are oftentimes narrowly framed in accordance with culture, previous experiences, casual narratives and worldviews. Unfortunately, in such assessments, one's information could be based on wrong assumptions about the world. People who engage in automatic thinking can make what they themselves believe to be large and systematic mistakes. One

**Figure 4: Thinking draws on mental modes**



**Figure 5: Automatic thinking gives us a partial view of the world**



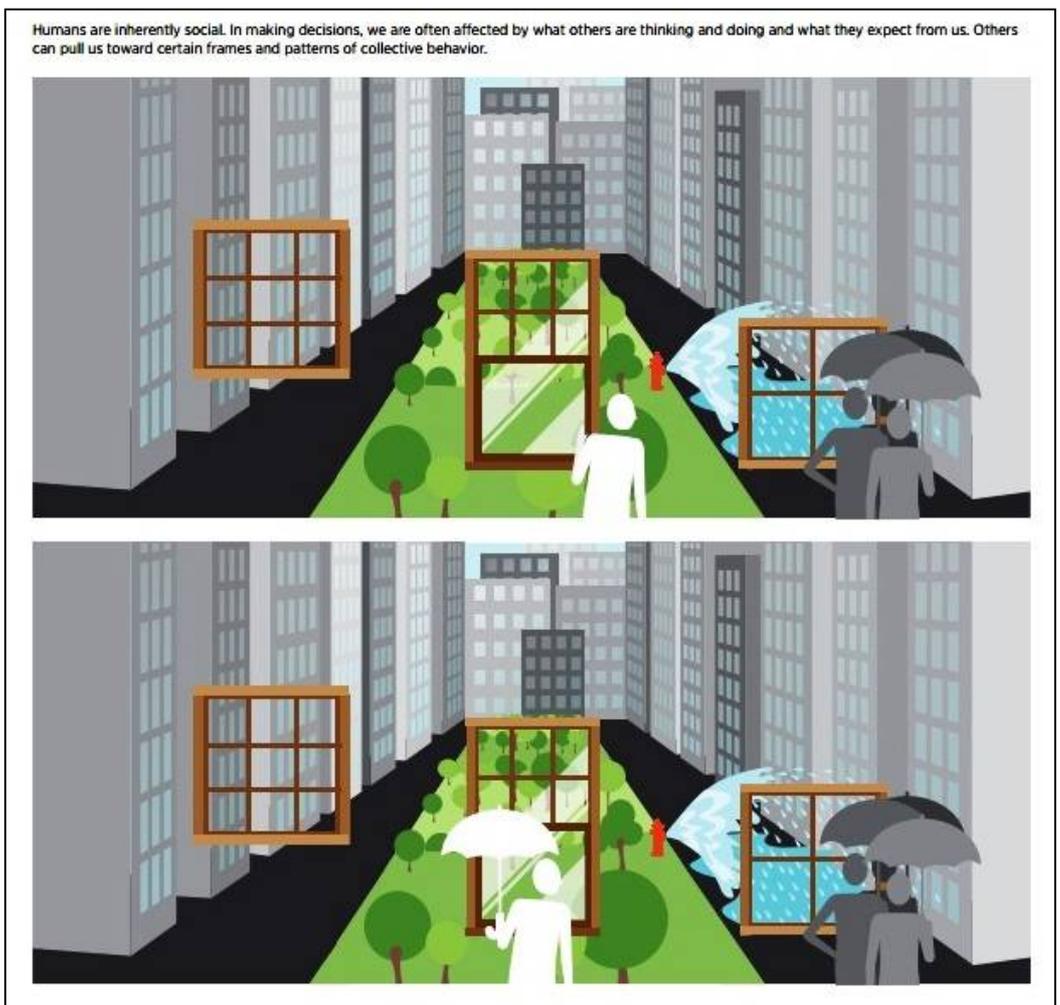
can look out on the world from a window and assume the world looks as such. This can cause one to form a mistaken picture of a situation (Figure 5).

The World Bank Report suggested that policymakers pay close attention to factors that frame people's options and the default options. Perhaps the State can better its decision making by restructuring the environment and how society grapples with the free flow of information.

### Social people and social thinkers

Many economic policies assume individuals are self-regarding, autonomous decision makers. Hence economic policies generally focus on external material incentives, like prices. According to the World Bank Report, human sociality implies that behaviour is also influenced by social expectations, social recognition, patterns of cooperation, care of in-group members and social norms. People often behave as conditional cooperators, where individuals prefer to cooperate as long as others are cooperating.

**Figure 6: What others think, expect, and do influences our preferences and decisions**



Social preferences and social influences can lead societies into self-reinforcing patterns of behaviour. Microfinance clients in India, who were randomly assigned to meet weekly rather than monthly after the first loan cycle ended, were found to be three times less likely to default on their second loan. For these individuals, meeting weekly rather than monthly reinforced a motivated environment (see Figure 6).

The power distance between civil society and authority also affects the circulation of ideas and suggestions. People getting information from peers were found to be more likely to act than when receiving it from the government.

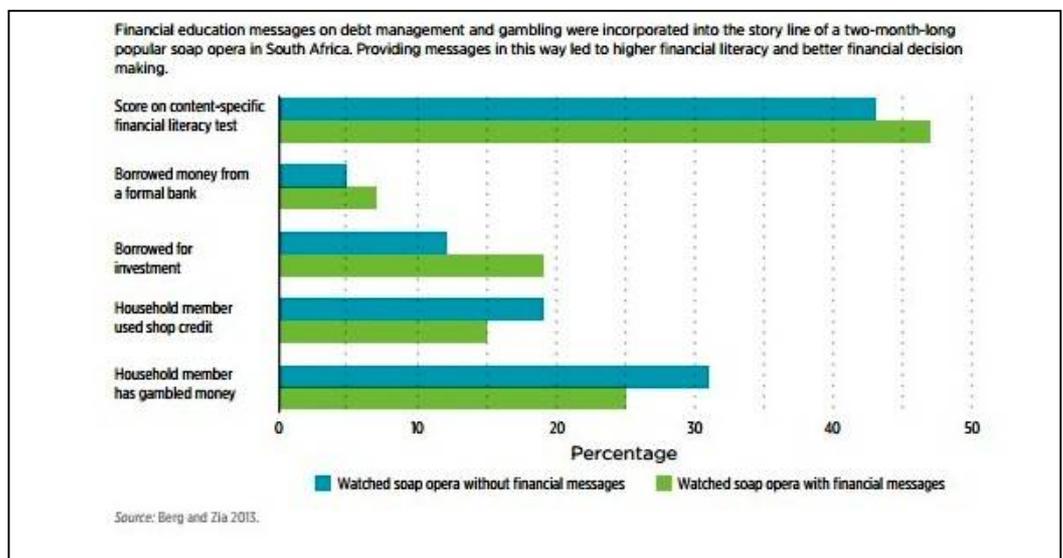
The Report, however, underlined that these patterns — based on trust and shared values — can be jeopardised by group behaviour, which can then influence individual preferences. Coordinated activity around a focus that is specific to an interest group can be ill-advised or even destructive for a community.

### New doors for policymakers

Recognising the human factor in decision making and behaviour has interrelated repercussions. Experts, policymakers and development professionals, like everyone else, are themselves subject to biases, thinking automatically, thinking socially and using mental models. Indeed, trust is a large factor in policymaking. Perhaps one can consider trust as a mental model or trust per capita GDP as a foundation for policymaking.

Additionally, small details in design can sometimes have big effects on individual choices and actions. Policymakers could also leverage on the nation’s communication landscape to ensure that the methods of disseminating messages are well received. Social media, soap operas and woman-to-woman peer groups are some examples of effective methods of disseminate messages concerning financial well being (see Figure 7).

**Figure 7: Popular media can improve financial decisions**



The concept of time can also match societal convenience. In the case of the Indian sugar cane farmers, distributing their pay throughout the year rather than a single payment after harvest time could influence their perception of time and need. Where Malaysia’s EPF and Private Retirement Schemes (PRS) are concerned, a campaign could be carried out in conjunction with people’s bonuses.

Society is very much laden with a free flow of information, which affects one’s judgment and decision making. Too much information causes a cognitive overload, which leads to a paralysis, hence the reliance on automatic thinking to get through decisions. Any number of interested parties exploit people’s tendency to think

automatically. With these forces at work, governments should not play the role of a neutral referee.

*On 24 June 2015, ISIS Malaysia was privileged to have Dr Varun Gauri, Senior Economist with the World Bank Development Research Group, present the World Bank Group's 2015 World Development Report — Mind, Society and Behaviour — in an ISIS International Affairs Forum. Also the co-director of the report, Dr Gauri related three principles of human decision making to the audience: (i) thinking automatically; (ii) thinking socially; and (iii) thinking with mental models. This article highlights these principles and some examples put forward at the forum. Though the World Bank's research has not been localised into nation-specific contexts, its report aimed to inspire and guide researchers towards a different approach in the implementation of development policies.*

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**Notes:**

<sup>i</sup> <http://www.thestar.com.my/News/Nation/2015/06/22/Becoming-bankrupt-before-35-Worrying-trend-of-about-25000-Gen-Y-Msians-in-debt-over-the-last-five-ye/>

<sup>ii</sup> The report can be accessed here: [http://www.krinstitute.org/kris\\_publication\\_State\\_of\\_Households.aspx](http://www.krinstitute.org/kris_publication_State_of_Households.aspx)

<sup>iii</sup> <http://www.themalaysianinsider.com/malaysia/article/debts-a-way-of-life-according-to-khazanah-report-on-income-inequality>

<sup>iv</sup> Report is accessible at <http://www.worldbank.org/content/dam/Worldbank/Publications/WDR/WDR%202015/WDR-2015-Full-Report.pdf>

<sup>v</sup> <http://www.worldbank.org/content/dam/Worldbank/Publications/WDR/WDR%202015/WDR-2015-Full-Report.pdf>

\*All images in this article were taken from the *2015 World Development Report: Mind, Society and Behaviour*.