Advertisement

The American Journal of Economics and Sociology / Volume 57, Issue 4 / pp. 405-421

On Financial Frauds and Their Causes

Investor Overconfidence

Steven Pressman

First published: 03 July 2006

https://doi.org/10.1111/j.1536-7150.1998.tb03373.x

Professor Pressman's interests include macroeconomic policy, poverty and income distribution, and the history of economic thought. His publications include *Economics and Its Discontents* (edited with Richard Holt, Elgar, 1998) and *Quesnay's Tableau Economique: A Critique and Reconstruction* (Kelley, 1994)

PDF

Abstract

Abstract This paper examines two possible explanations for why investors are so often and so easily taken by the likes of Robert Bennett and his New Era fraud or Nick Leeson's sinking of the esteemed Barings Bank. I rule out the traditional explanations offered by neoclassical economics such as asymmetric information in a world of calculable risk. I argue that the literature on empirical psychology, which emphasizes how people make choices in a world characterized by uncertainty provides a more plausible explanation for why financial fraud is so prevelant. The paper emphasizes the interdisciplinary aspects of financial frauds and concludes with some policy prescriptions for preventing financial fraud.

References

Daniel Akst, *Wonder Boy Barry Minkow (The Kid Who Swindled Wall Street)* (New York : Charles Scribner's Sons,

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Bulkeley William M., “Nonprofits sue Prudential over New Era,” *Wall Street Journal*(May 9, 1996), pp. A3, A6.

Google Scholar

John Coughan, “The Fairfax Embezzelment,” *Management Accounting*, Vol. **64** (May 1983), pp. 32–39.

Google Scholar

Paul Demery, “Accountant Blows Lid Off New Era,” *The Practical Accountant* (July 1995), pp. 6–8.

Google Scholar

Joe Domanick, *Faking It in America: Barry Minkow and the Great ZZZZ Best Scam* (New York : Contemporary Books, 1989).

Google Scholar

Baruch Fischhoff, Paul Slovic, and Sarah Lichtenstein, “ Knowing What You Want: Measuring Labile Values,” in *Cognitive Processes in Choice and Decision Behavior*, ed. T. Wallenstein (Hillsdale , NJ : Erlbaum, 1980), pp. 117–41.

Google Scholar

Thomas Gilovich, *How We Know What Isn't So: The Fallibility of Human Reason in Everyday Life* (New York : Free Press, 1991).

Google Scholar

Thomas Gilovich, Robert Vallone, and Amos Tversky, “The Hot Hand in Basketball: On the Misperception of Random Sequences,” *Cognitive Psychology*, Vol. **17**, #3 (1985 July), 295–314.

Web of Science® Google Scholar

Hershey J.C. and Shoemaker P.J., “Risk Taking and Problem Context in die Domain of Losses: An Expected Utility Analysis,” *Journal of Risk and Insurance*, Vol. **47** (1980), pp. 111–32.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Irving L. Janis and Leon Mann, *Decision Making: A Psychological Analysis of Conflict, Choice and Commitment* (NewYork : Free Press, 1977)

Google Scholar

Philippe Jorion, *Big Bets Gone Bad* (San Diego : Academic Press, 1995)

Google Scholar

Daniel Kahneman and Amos Tversky, "Subjective Probability: A Judgment of Representativeness," *Cognitive Psychology*, Vol. **3** (1972), pp. 430–54.

Web of Science® Google Scholar

Knecht G. Bruce and Jeffrey Taylor, "SEC Charges New Era, Bennett Defrauded Charities, Big Investors," *Wall Street Journal* (May 19, 1995), pp. A3–A4.

Google Scholar

Nick Leeson, *Rogue Trader: How I Brought Down Barings Bank and Shook the Financial World* (Boston : Little Brown, 1996).

Google Scholar

Carol Loomis, " Untangling die Derivatives Mess, *Fortune*" (March 20, 1995), pp. 50–68.

Google Scholar

Peter Michelmore, "On the Trail of a Scam," *Reader's Digest* (March 1996), pp. 110–5.

Google Scholar

Jay Robert Nash, *Hustlers and Con Men* (New York : M. Evans, 1976).

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Google Scholar

Joe Queenen, “Positively Insane: The Absolutely Incredible Saga of Crazy Eddie,” *Barron's*, Vol. **68** (June 13, 1988), pp. 15, 22–6.

Google Scholar

Matthew Rabin, “Psychology and Economics,” *Journal of Economic Literature*, Vol. **36**, #1 (March 1998), pp. 11–46.

Google Scholar

Rethans A., An Investigation of Consumer Perceptions of Product Hazards (doctoral dissertation, University of Oregon, 1979).

Google Scholar

Thomas Schelling, *The Strategy of Conflict* (New York : Oxford University Press, 1960).

Google Scholar

Paul Slovic, Baruch Fischhoff, and Sarah Lichtenstein, “Accident Probabilities and Seat Belt Usage: A Psychological Perspective,” *Accident Analysis and Prevention*, Vol. **10** (1978), pp. 281–5.

Web of Science® Google Scholar

Paul Slovic, Baruch Fischhoff, and Sarah Lichtenstein, “ Facts versus Fears: Understanding Perceived Risk,” in *Judgement Under Uncertainty: Heuristics and Biases*, ed. Kahneman Daniel, Slovic Paul and Tversky Amos (New York : Cambridge University Press, 1982), pp. 463–89.

Web of Science® Google Scholar

Robert Sobel, *Dangerous Dreamers* (New York : John Wiley, 1993).

Google Scholar

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Google Scholar

Stewart James B., *Den of Thieves* (New York : Simon & Schuster, 1991).

Google Scholar

Amos Tversky and Daniel Kahneman, “Judgement Under Uncertainty: Heuristics and Biases,” *Science*, **Vol 185**, #4157 (September 1974), pp. 1124–31.

Google Scholar

Amos Tversky and Daniel Kahneman, “ Judgments of and by Representativeness,” in *Judgment Under Uncertainty: Heuristics and Biases*, ed. Kahneman Daniel, Slovic Paul, and Tversky Amos (New York : Cambridge University Press, 1982), pp. 84–98.

Google Scholar

Weinstein N.D., “Unrealistic Optimism About Future Life Events,” *Journal of Personality and Social Psychology*, Vol. **39** (1980), pp. 806–20.

Web of Science® Google Scholar

Citing Literature

Download PDF

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential

Copyright © 1999-2026 John Wiley & Sons, Inc or related companies. All rights reserved, including rights for text and data mining and training of artificial intelligence technologies or similar technologies.

WILEY

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. Privacy Policy

Manage Preferences

Accept All

Reject Non-Essential