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On Financial Frauds and Their Causes

Investor Overconfidence

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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)

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.

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