

A REVIEW OF THE EFFECTS OF POVERTY ON ECONOMIC DECISION-MAKING

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Abstract:-

This review focuses on the problem of how poverty affects financial judgment. The authors develop a structural model outlining the cognitive process behind how poverty adversely affects economic decision-making by critically assessing current research. They also examine the data that forms the foundation for this model's development.

***Keywords:** poverty, economic decision-making, time- discounting, scarcity, poverty trap, cognitive load, executive functions, risk preference*

INTRODUCTION

Poverty is researched economically globally. Poverty research on children focuses on family and societal contexts. Poverty's psychological causes and effects on mental health and cognition have been studied. In a recent study, Haushofer and Fehr (2014) stressed the need of addressing poverty persistence, which is generally overlooked in favor of economic analysis. Thus, it is important to continue investigating characteristics that may explain poverty persistence. These include a person's viewpoint on issues, actions, experiences, and abilities, which may worsen or alleviate poverty. Mani et al. (2013) suggest that many unproductive habits, such as poor financial judgment or lack of healthcare, may perpetuate poverty. These factors—especially financial ones—often contribute to poverty. In this article, we hypothesize that the causes and consequences of poverty may be reciprocal, with the latter triggering the former (e.g., bad affect, stress, or reduced cognitive abilities) to create a poverty cycle, or poverty trap.

According to Mani et al. (2013) and Haushofer and Fehr (2014), poverty's effects on economic decision-making are crucial to understanding poverty's psychological roots. To analyze poverty and economic decision-making effectively, you must be aware of other issues not included here. This research examines poverty's effects on economic decision-making on four basic levels and presents a theoretical framework.

POVERTY DEFINITION AND ASSESSMENT

Based on our examination of mostly psychological literature, poverty is first perceived as economic, then psychological (or socio-behavioral). Poverty's operational (or conceptual) definition is still debated since most literature doesn't define it. Therefore, international organization poverty definitions are most important. General poverty is a complex concept that includes insufficient income, a lack of resources to live a dignified lifestyle, hunger, deteriorating health and inadequate healthcare, restricted access to education, substandard housing, and social discrimination, according to the UN (1995).

Researchers utilize several objective poverty levels to quantify poverty. Poverty lines don't represent people's perception of poverty, which is important.

Mani et al. (2013) revealed that subjective poverty is more strongly associated with cognitive impairment than objective poverty indicators. Thus, to assess poverty as a multidimensional construct, economic indicators should be supplemented by subjective psychosocial measures

like subjective well-being poverty (Shams, 2015) or subjective social status (Diemer et al., 2013). Since poverty is temporary, it's crucial to measure how long individuals think it's been around and how frequently it comes back.

POVERTY AND COGNITIVE LOAD IN THE FORM OF EXPERIENCING NEGATIVE AFFECT AND STRESS

Cognitive load is cognitive stress. Cognitive burden from solving a problem and focusing on one stimulus may hinder attention to other inputs. Studies on long-term poverty have linked cognitive burden to negative experiences (Shah et al., 2012). Haushofer and Fehr (2014) found that extended exposure to adverse economic and social events increases the risk that poor people may experience cognitive load in the form of stress and unpleasant affect. Thus, negative feelings and stress may relate poverty to financial choices.

Poverty creates cognitive stress from economic uncertainty. Poverty-related concerns may lock a person in a cycle of negative emotions and cognitive drain.

Financial stress, economic fragility, and social hardship cause bad feelings and anxiety. Poverty might make it difficult to address immediate and long-term challenges. This may require individuals to deal with negative emotions as well as the problems.

Poverty is strongly linked to short- and long-term negative affect and stress. Cognitive strain may cause ego depletion. Poverty may affect executive skills including attention, working memory, self-control, and decision-making due to cognitive burden.

POVERTY AND EXECUTIVE FUNCTIONS

Only a few authors (Shah et al., 2012; Mani et al., 2013) have focused on adult subjects in studies that have traditionally been conducted on children (e.g., Evans et al., 2005; Ayoub et al., 2009; Dickerson and Popli, 2016; Kaya et al., 2016). We have identified 3 executive functions based on prior research that may be key players in the process between poverty and economic decision-making.

Attention

Attention is the ability to focus on relevant information and ignore irrelevant information. In simulated and real-world studies on poverty and attention, resource-poor people played games less actively, were more tired, took longer to make decisions, and performed worse on an attention test than controls. If resources are few, a job may become unhealthy. This focus may lead to disregarding other inputs. This narrowing may lead to imprudent borrowing, missing bill payments, and thoughtless purchases, especially in a tough economy.

Stress also affects attentiveness. Mani et al. (2013) relate poverty to a broader definition of stress, even if stress does not fully explain cognitive decline. The authors suggest that compulsive thinking and mental resource depletion may result from focusing on shortage. According to Braunstein-Bercovitz (2003), cognitive load increases stress, selective attention to stressors, and the inability to switch attention. The kind of stressor and duration of exposure may affect attention (see Chajut and Algom, 2003).

Working Memory

Working memory permits you "to retain information in the mind and to manipulate it mentally while this information is not immediately accessible by a sensory apparatus." Poverty dramatically decreases working memory in children. This may be because socioeconomic hardship decreases hippocampus development. Engel de Abreu et al. (2014) offer two psychological theories. Poor cognitive stimulation lowers working memory. Since

disadvantaged children score lower on standardized examinations, poverty may effect test results. Culture-fair technologies minimize inequality.

Evans and Schamberg (2009) discovered that stress affects the connection between childhood poverty and early adult working memory. In an alternative model, working memory did not moderate the poverty-allostatic load association, suggesting a causal relationship.

Financial concerns impact performance and working memory, although they may not alter procedural cognitive functions (Dang et al., 2015). Dang et al. (2016) discovered that poverty and distractions impair poor people's cognition. They claim financial worries impede working memory. Distractions may aid learning (Markman et al., 2006). Dang et al. (2016) found that repetition and conditioning help disadvantaged learners. This may not help poverty-related economic decisions. This approach may encourage economic misbehavior without proper external regulation.

Self-control capacity

Diamond (2013) Self-regulation (McCullough and Willoughby, 2009) involves resisting temptations and impulsive behaviors to control attention, thoughts, actions, and emotions. We utilized two psychological theory self-control models to explain how poverty decreases self-control. Self-regulation may deplete self-control, according to the Resource Model. Avoiding one temptation raises the chances of refusing another. Process Model denies internal depletable resources. Self-control fails owing to motivational changes and reward-focused attention. Cognition may hinder self-control. Economic constraints and the huge sacrifices required to satisfy requirements like shopping and leisure time reduce poor people's self-control. Thus, managing fundamental necessities may reduce self-control. Cognition, attention, and working memory impact self-control. Baumeister et al. (1994) imply that focusing on others may decrease self-control. Mann and Ward (2007) suggest limited attentional resources make people prioritize present demands over distant ones. Self-regulation is violated. Narrower attention and greater working memory may help self-regulation when demanding requirements entail control and restriction.

Despite this evidence, they suggest that stimulation or activity may modify self-control. Short-term remedies may not help chronic or occasional poverty. Thus, studying poverty's immediate effects, such bad moods and stress, and how attention and working memory influence self-control may help solve this issue.

Finally, poor mood and stress impact executive functioning directly and indirectly. This study examined three scientifically documented executive functions. Executive functions impact economic decision-making, according to research.

INTUITION/DELIBERATION AS A DETERMINANT OF ECONOMIC DECISION-MAKING

Economic decision-making is also affected by intuition/deliberation. The Dual Process notion describes two distinct thinking styles: intuition and deliberation (Evans, 2003; Kahneman, 2003, 2011). According to Kahneman (2011), intuitive thinking is fast, implicit, and heuristic, whereas deliberate thinking is systematic and rational.

Reasoning through a situation does not guarantee correct behavior (Starcke and Brand, 2012; Epstein et al., 1996; Kahneman, 2003). Stress affects innate decision-making. Heuristics are quick and inexpensive. Pressure may strengthen the framing effect heuristic, which describes how presents impact judgments. Stress inhibits judgment. Cui et al. (2015) found that

emotional and stress-related working memory strain affects judgment. Stress impacts decision-making intuition/deliberation in a stress-induced deliberation-to-intuition paradigm. Stress and impulsive decision-making were moderate to strong in a Fields et al. (2014) meta-analysis. Masicampo and Baumeister (2008) revealed that stressed persons prefer automated over managed methods.

(2009) investigated self-regulation and decision-making. Authors say self-regulation simplifies and naturalizes decision-making.

Evans (2010) found that deliberation requires working memory while intuition does not. Mathematical ability, temperament, working memory, and self-control affect deliberative thinking, according to Travers et al. (2016). Intuitive thinking is unaffected.

Poor individuals make choices with many economic and social factors. Poor judgment, impulsivity, and intuition characterize these choices. Refusing temptation lowers self-control, which leads to poor judgments (Shah et al., 2012). Thus, intuition/deliberation may affect poverty-induced executive function-economic decision-making.

POVERTY AND ECONOMIC DECISION-MAKING

Behavioral economics and psychology studies provide various economic decision-making assessments. This research focuses on three key factors: Time discounting, risk-taking for reward, and risk-taking for loss. Financial literacy is important to appropriately examine these qualities' economic aspects. Financial literacy helps us determine whether economic preferences are (1) a cognitive mechanism of poverty or (2) a consequence of financial literacy and the ability to employ mathematical abilities during fundamental economic events.

Time-Discounting

Intertemporal choice, temporal discounting, delay discounting, and delay of gratification entail evaluating trade-offs between costs and rewards at various periods. Shows self-control. Brown et al. (2015) discusses time-discounting variables. Higher-income, financially secure, and longer-lived people prefer bigger delayed rewards, according to the research. Carvalho et al. (2016b) showed that waiting for a larger payout increases self-control and financial stability. Psychological characteristics of poverty, not financial position, determine reward choice, according to Liu et al. (2012). They say the destitute seek a lower immediate payoff due to financial restrictions, danger, and impulsivity. To briefly equalize with affluent individuals, Hoel et al. (2016) propose choosing fast advantages.

Working memory and time-discounting debates continue. Working memory improves temporal discounting, according to Shamosh et al. (2008) and Basile and Toplak (2015). Steinberg et al. (2009) found no relationship. Self-control has comparable challenges. Waegeman et al. (2014) discovered that seeking a bigger, delayed reward promotes self-control. Basile and Toplak's (2015) time-discounting and self-control research confirms this. Carvalho et al. (2016a) claim that spending habits before and after payday stay the same despite limited resources and poor economic judgments. Liquidity restrictions may explain self-control disparities. Kidd et al. (2013) found that stable conditions encourage people to wait for a higher payout. Michaelson et al. (2013) discovered that trustworthy individuals wait longer for rewards. Temporal discounting and deliberate or impulsive decision-making research is more reliable. Frederick (2005) says deliberate decision-makers are patient and seek bigger rewards. This affects women more. Delayed incentives reduced the relationship. Deliberative decision-making decreases heuristics and cognitive biases, improves cognitive

performance, and prefers greater, delayed rewards (Travers et al., 2016). Stanovich (2010) discovered that intuition/deliberation independently predicts decision-making success. Poor impulse controllers prefer smaller, early rewards, according to Mishra and Lalumière (2016). According to Wittmann and Paulus (2009), rash financial choices fail.

Poverty raises cognitive strain, impairs executive functioning, and impacts time-discounting, according to study. Poverty-stricken individuals prioritize short-term joys above long-term profits. Risk preference matters because economic decision-making involves more than time-discounting.

Risk Preference in Economic Decision-Making

Poverty affects health, sexuality, crime, drug usage, and gambling. Economic choices? Are poor individuals more willing to accept a lower payment or lose a larger benefit? Finally, does money loss count?

Andersen et al. (2008) argue individuals instinctively shun financial risk. Haushofer and Fehr (2014) add that reward certainty may minimize severe liquidity restrictions, so impoverished individuals avoid financial incentive risks. Finally, Carvalho et al. (2016a) found no changes in reward-related risk-taking among disadvantaged groups before and after payday. They believe long-term financial stability encourages financial risk-taking.

Cognitive strain from negative emotions may raise reward risk aversion. Stress affects risk-taking less. Shah et al. (2012) show stress may cause riskier financial decisions. Starcke and Brand (2012) say acute and chronic stress drives risk-taking with possible rewards and losses. According to another research, acute stress encourages risk-taking after a loss and cautious judgments after a gain. Kandasamy et al. (2014) observed that induced chronic stress produces risk-aversion, whereas Moreno (2015) found that economic decision-making risk preference is practically uncorrelated with chronic stress.

Intuition/deliberation influence risk-taking. Frederick (2005) found that cognitive reflection boosted risk-taking when the payoff was high. Males differed more. High-deliberative thinking women and men were equally risk-taking. Deliberative thinkers favored little losses. In contrast, intuitive thinkers risked losing more than succeeding. Prospect Theory fits. People consider benefits and dangers (Cueva et al., 2016). Poor individuals focus on 'here and now' benefits and strive to avoid future loss, even if this may backfire and make matters worse. Stress might support this. Mather and Lighthall (2012) argue acute stress stimulates previously rewarded behaviour. Under pressure, people may overvalue past hardships. Men risk more than women.

Thus, poverty, cognitive load, and intuitive decision-making cause the poor to take more risk when profit is possible and less risk when loss is possible. Haushofer and Fehr (2014) suggest that impoverished people's motivation risk aversion varies from their intrinsic risk-taking. Guaranteed wages help the impoverished cope with recurrent disasters. Poor individuals may risk financial loss. Mather and Lighthall (2012) say stressed individuals avoid bad situations. Financial literacy influences economic decisions.

Financial Literacy

Basic economic calculations, interest, real and nominal product values, risk allocation, and more are tough for people. Lusardi and Mitchell (2011) and French and McKillop (2016) examined the financial management and numeracy skills of disadvantaged debtors. Bad financial management generates wealth inequality. Math doesn't affect money. Thus,

competent financial management, part of financial literacy, helps people borrow less and avoid excessive interest rates, lowering debt.

Studies show that financial literacy influences economic decision-making. Financial demands and loan defaults were connected by Gathergood (2012). Financially savvy persons preferred greater, delayed benefits, according to Meier and Sprenger (2013).

Conclusion, cognitive load impairs the poverty-financial decision-making relationship. Economic decision-making needs self-control and intuition/deliberation.

Data supports assertions that

(1) individuals living in poverty are inclined toward smaller, earlier rewards due to higher cognitive load, lower self-control (higher impulsivity), and a tendency to utilize intuitive decision-making processes;

(2) These characteristics are associated with a reluctance to take risks for a reward;

(3) The same characteristics are related to a willingness to take risks associated with losses;

(4) Conversely, people who favor larger, delayed rewards are more willing to take risks associated with rewards and are more cautious in regards to potential loss; they also have higher self-control and/or more deliberative thinking style. These findings allow us to propose a complex conceptual model, which reflects the consequences of poverty on economic decision-making via a cognitive mechanism that rationalizes these relationships.

THE PROPOSAL OF TWO MODELS INTEGRATING POVERTY, COGNITIVE LOAD, EXECUTIVE FUNCTIONS, INTUITIVE/DELIBERATIVE STYLE OF THINKING AND ECONOMIC DECISION-MAKING

Two ideas of cognitive processes that hinder economic decision-making perpetuate poverty, according to the study. Our simple model demonstrates the most probable relationship causality. This model shows how difficult cycle breaking is. Empirical evidence is inconsistent and certain components are unknown. Thus, partial models, validity, and parameters must be developed.

Poverty demands sacrifices and temptation avoidance, affecting self-control. Depletion of mental resources and/or switching attention and motivation between activities may enhance susceptibility to impulsive acts for immediate reward. Exhausted folks make snap decisions.

Heuristic-based intuitive thinking may be better in the short run. Hedonistic intuition conserves brain resources and rewards quickly regardless of consequences. In time-discounting activities, intuitive reasoning leads individuals pick a smaller immediate reward over a greater delayed one, impacting economic choices. Poverty and its cognitive mechanisms force individuals to meet escalating needs whenever possible.

The process may generate cautious behavior for probable gain and risky behavior for minor potential loss in risk preference tasks. Poverty may make any tiny danger of loss appear disproportionately terrible, making the option of no loss seem subjectively preferable. These decisions demonstrate how psychological and economic rationality differ. Waiting makes economic sense.

Poverty may force surrender of long-term economic gains. Primal urges need settling acute problems before making long-term judgments, supporting this behavior. Poverty reduction requires economic decisions for the "here and now" and the future. Financial literacy affects economic time-discounting and risk choosing. Control its influence on economic decision-making. Economic decision-making reinforces poverty, but the model focuses on poverty-

related cognitive processes.

POTENTIAL LIMITS OF THE PRESENTED MODEL

Poverty assessment is the first obstacle to verifying the paradigm. Our method evaluates poverty differently. Dichotomization avoids subjective characteristics that are critical to the model's performance and may reduce the suggested mechanism as early as the poverty-cognitive load association.

Causation is another matter. Despite scientific confirmation of poverty's roots, statistical correlations dominate research. Thus, poverty is poorly explained by study. The analysis suggests the mechanism's causality component will verify the idea. Our theory is that poverty impairs economic decision-making. The essay discusses numerous poverty-related processes that are consequences rather than causes. Gottfredson (1997) discovered that brighter individuals earn more and have better employment. Any model simplifies and portrays real-life occurrences drawn from a complicated reality.

Previous studies may be unreliable. Cognitive load and executive functioning are significant issues. Self-control, working memory, and attention under stress or unpleasant emotions aren't well-studied (note: the whole model includes the most logical option). Test partial models to understand this interaction system.

We propose testing four alternatives:

- (1) working memory and attention as mediators of the relationship between cognitive load (negative affective and stress) and self-control;
- (2) self-control as a mediator between cognitive load and working memory with attention;
- (3) attention, working memory and self-control are at the same level, mutually covaried, and depend on cognitive load; and
- (4) attention, working memory and self-control affect each other reciprocally and depend on cognitive load.

Time-discounting and risk preference/aversion to reward or loss may further complicate economic decision-making. Choi et al. (2014) show that those with inadequate mental resources make inconsistent judgments. Measurement instruments can solve this. Another challenge is differentiating economic and psychological rationality in financial decision-making. Economic decision-making seeks maximum profit with little loss.

Thus, such alternatives are calculable. Psychological aspects influence more decisions. It's smarter to select 200€ in a month than 100€ today. It simplifies and ignores psychological decision-making. Instant food incentives are available. Thus, simplifying economic decision-making for economic profit while neglecting more sophisticated viewpoints fails to explain and appreciate observed links or likely causalities.

Gender, poverty duration, and social unit type may also be important in the overall and partial models. Controlling social settings may benefit individual studies.

Studies show this approach can determine poverty and socioeconomic position. It may fail in severe poverty.

CONCLUSION

Poverty persists. Recent research have studied poverty's psychological repercussions. Haushofer and Fehr (2014) suggest such variables may explain poverty persistence. The importance of links between varied pieces in a wider framework was overlooked until recently in narrow studies with specialized aims. Poverty affects economic decision-making

via cognitive load, executive processes, and intuitive/deliberative thinking. Testing this hypothesis may explain the poverty cycle's self-perpetuation.

This review links factors that may be used to examine an individual's economic decision-making style to cover research gaps. Poverty, cognitive load, executive functions, and economic decision-making may also explain poverty. Understanding poverty determinants may also improve poverty-reduction measures.

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