

**XXXXXXXXX SLIDE 1 XXXXXXXXXXXXXXXXXXXX Consortium for  
Argentine Economic Association**

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**Phishing for Phools**

**XXXXXXXXX BOOK SLIDE XXXXXXXXXXXXXXX**

**Thank you for coming to this talk.**

**I am going to base this talk on a book I published a few  
years ago with Robert Shiller.**

**It's called *Phishing for Phools*.**

**XXXXXXXXX PREFATORY NOTES XXXXXXXX**

**The first and most fundamental motivation of this book is to challenge the view of the public and of economists that whatever markets do is right.**

**Of course all of us would take into account income distribution and such things as pollution.**

**Such belief that is seldom discussed has a further problem that is seldom discussed.**

**There is also another very serious downside.**

**The book explores the notion that markets are the playing field for deception and manipulation.**

**Because they spawn what we call phishing for phools.**

**All economists know this.**

**But that leads to the second very general motivation.**

**The rule of what can—and what cannot—be published in economics leaves holes.**

**There are some perfectly valid and important things to say, but there is no way to say them that would be acceptable in any journal.**

**For example, quite a few economists thought that there could be something like the financial crisis of 2008.**

**But economists could not figure out a way to express these views in the form of a paper that would serve as sufficient warning.**

**I believe that Phishing for Phools is one of those holes in economics.**

**Because we all know it, it cannot be published.**

**But then because it cannot be published in journal form it gets ignored.**

**And because it was ignored we had the financial crisis, whose legacy, even now, in times of Covid, has been the central event in the economic history of our times.**

**With the rise of the new nationalism, we continue to see its aftermath.**

**But then the book also has a subtext which gradually becomes increasingly important as it proceeds.**

**That subtext concerns a principle way in which we think, and that results in our being phished for phools.**

**I will come to that later.**

**XXXXXXXXXXXXXXXX Danny's Observation XXXXX**

**With these prefatory notes, let me begin with the theory.**

**The book is based on conversations with the psychologist, Danny Kahneman, some 30 years ago.**

**In a conversation then, Danny told me that the basis for psychology was that we humans are machines.**

**We are machines that are prone to error.**

**The job of the psychologist is to ferret out that error.**

**In contrast, he said, the basic, fundamental notion of economics is equilibrium.**

**That equilibrium means that if there is a profit left on the table, someone will take up that opportunity for profit.**

**We see that every time we go to the grocery store.**

**People sequentially choose what they think is the shortest line; and in equilibrium the lines are almost the same length.**

**XXXXXXXXXXXXX Proposition XXXXX**

**How to put together Danny's insight into economics?**

**Danny's insight says that free markets will not just provide what we really want.**

**That is only the case if we human machines are making the right choices.**

**But free markets will also provide us wrong choices;  
they will do so as long as there is a profit to be made.**

**Let me restate:**

**The principle means that if we have some weakness or other, in the equilibrium, that weakness will be taken up, if there is a profit to be made.**

**That means that among business persons looking around and deciding where to spend their investment dollars, some will look to see if there are unusual profits from our weaknesses.**

**If they see such an opportunity for profit, that will be what they choose.**

**As a result, economies will have a phishing equilibrium.**

**That is an equilibrium in which every chance for profit more than the ordinary will be taken up.**

**And that includes our willingness to make the wrong choices.**

**XXXXXXXXXXXXXXXXX Example 1: Cinnabon® XXXXX**

**Let me give two examples.**

**The first Example is: Cinnabon®**

**The motto is: Life needs Frosting.**

**XXXXXXXXXX Cinnabon Picture XXXXXXXXXXXX**

**Most Americans take it for granted that there just happens to be such an outlet right where we are waiting for our delayed flight, or at the shopping mall.**

**All those outlets and all that cinnamon, which undermines our diets, are a natural result of a free-market equilibrium.**

**XXXXXXXXXX Example 2: Capuchin Monkeys XXXXXXXX  
(PICTURE)**

**The second example comes from a metaphor, invented by Bob.**

**Keith Chen, Venkat Lakshminarayanan and Laurie Santos taught capuchin monkeys how to use money to trade.**

**The monkeys developed an appreciation of price; they saved; and did other transactions.**

**But, let's go beyond those experiments.**

**XXXXXXX THOUGHT EXPERIMENT XXXXXX**

**Let's do a thought experiment.**

**Suppose we opened the monkeys up to trading with humans quite generally.**

**We would give a large population of capuchins substantial incomes and let them be customers of for-profit businesses run by humans, without regulatory safe-guard.**

**You can easily imagine that the free market system, with its taste for profits, would supply whatever the monkeys choose to buy.**

**We could expect an economic equilibrium, with concoctions appealing to strange capuchin tastes.**

**But amid this monkey cornucopia, their choices would be very different from what makes them happy.**

**We know, from Chen, Lakshminarayanan and Santos, that they love sweet Fruit Roll Up Tacos with Marshmallow Fluff.**

**Capuchins have limited ability to resist temptations.**

**We have every expectation that they would become anxious, malnourished, exhausted, addicted, quarrelsome, and sickened.**

**XXXXXXXXXXXXXXXXX Two Types of Tastes XXXXX**

**We now come to the point of this thought experiment; we shall see what it has to say about humans.**

**Our view of the monkeys has analyzed their behavior as if they have two types of what economists call “tastes.”**

**The first type of “tastes” are what the capuchins would exercise if they made the decisions that are good for them.**

**The second type of “tastes”—their Fruit-Roll-Up-Taco tastes—are those they actually exercise.**

**Humans are, no doubt, smarter than monkeys.**

**But, we can view our behavior in the same terms.**

**We can imagine us humans, like the capuchins, as also having two different types of tastes.**

**The first concept of “tastes” describes what is really good for us.**

**But, as in the case of the capuchins, that is not always the basis for all of our decisions.**

**The second concept of tastes is the tastes that determine how we really make our choices.**

**And those choices may not, in fact, be “good for us.”**

**The distinction between the two types of tastes and the example of the capuchins gives us an image: we can think about our economy as if we all have monkeys on our shoulders when we go shopping or when we make economic decisions.**

**Those monkeys on our shoulders are in the form of the weaknesses that have been exploited by marketers for ages.**

**Because of those weaknesses, many of our choices differ from what we “really want,” or, alternatively stated, they differ from what is good for us.**

**We are not generally aware of that monkey on our shoulder.**

**So, in the absence of some curbs on markets, we reach an economic equilibrium where the monkeys on the shoulder are substantially calling the shots.**

**XXXXXXXX General Equilibrium XXXXXXXX**

**This now takes us to a further proposition.**

**The modern rendition of Adam Smith’s invisible hand statement is that a competitive, free-market equilibrium is “Pareto optimal.”**

**That means that once such an economy is in equilibrium, it is impossible to improve the economic welfare of everyone.**

**For example, a change that would cause your welfare to go up, would cause my welfare, or someone else's, to go down.**

**Any interference will make *someone* worse off.**

**The theory, of course, recognizes some factors that might blemish such an equilibrium of competitive free markets, such as problems of pollution and bad distributions of income.**

**But with these qualifications, the result is believed by economists to be true.**

**But then with completely free markets, there is not only freedom to choose; there is also freedom to phish.**

**It will still be true that the equilibrium will be Pareto optimal.**

**But it will be an equilibrium that is optimal, not in terms of what we really want.**

**It will be an equilibrium that is optimal, instead, in terms of our monkey-on-our-shoulder tastes.**

**And that, for the monkeys, as for ourselves, will lead to manifold problems.**

**Standard economics has ignored this obvious difference, because most economists have thought that, for the most part, people do know what they want.**

**That means that there is nothing much to be gained from examining the differences between what we really want and what those monkeys on our shoulders are, instead, telling us.**

**But that ignores the field of psychology, which is, for the most part, about the effects of those monkeys.**

**It also ignores the fact that the competitive equilibrium will also involve people generating information that will lead us astray, insofar as it is legal and insofar as there is a profit to be made by it.**

**It ignores that markets enable phishing for phools.**

**XXXXXXXXXX Onus on Us XXXXXXXXXXXXX**

**The onus on Bob Shiller and myself in the book is then to indicate that in real life this equilibrium does affect our lives.**

**We have four areas of NOBODY COULD POSSIBLY WANTS, in which we are seriously phished for phools.**

**XXXXXXXXXXXXXXXXX The Four Areas XXXXXXX**

**Area 1 of NO-ONE-COULD-POSSIBLY-WANTS:**

**PERSONAL FINANCIAL INSECURITY.**

**A fundamental fact of economic life has never made it into the economics textbooks.**

**Most adults, even in rich countries, go to bed at night worried about how to pay the bills.**

**Economists think that it is easy for people to spend according to a budget.**

**We shall later see that it isn't.**

**NO ONE WANTS TO GO TO BED AT NIGHT WORRIED ABOUT THE BILLS.**

**Yet most people do.**

**Area 2 of NOBODY COULD POSSIBLY WANTS:**

**FINANCIAL AND MACROECONOMIC INSTABILITY.**

**Phishing for phools in financial markets is the leading cause of the financial crises that lead to the deepest recessions.**

**Every time it *is* different: the stories are different; the entrepreneurs are different; their offerings are different.**

**But, also, every time it is the same.**

**There are the phishermen; there are the phools.**

**And when the built-up stock of undiscovered phishes (named “the bezzle” by John Kenneth Galbraith) gets discovered, asset prices crash.**

**In the crisis of 2008, the investment managers who had purchased the overrated securities COULD NOT HAVE POSSIBLY WANTED THEM.**

**Area 3 of NOBODY COULD POSSIBLY WANTS: ILL HEALTH.**

**Here we discuss how the pharmaceuticals in the United States do their phishing and how the phood industry (with a ph) fills us with sugar, salt and fat.**

**Think of the opioid problem in the United States, where there were more than 48,000 suicides for 2018.**

**NO ONE WANTS BAD MEDICINE.**

**About 69 percent of American adults are overweight.**

**More than that 40 percent of American adults are obese.**

**Yet NO ONE WANTS TO BE OBESE.**

**And there is tobacco, which according to the US Center for Disease Control is responsible for 20 percent of deaths.**

**Area 4 of NOBODY COULD POSSIBLY WANTS is BAD GOVERNMENT.**

**Just as free markets work at least tolerably well under ideal conditions, so does democracy.**

**And politics is vulnerable to the simplest phish, whereby politicians silently gather money from the Interests, and use that money to show that they are “just one of the folks.”**

**A chapter of the book describes a campaign by Charles Grassley, of Iowa, who gathered a multimillion-dollar war chest, and showered the state with TV ads, where he is just “one of us,” back home, riding his tractor lawnmower in concentric ellipses.**

**(ALMOST) NO ONE WANTS A DEMOCRACY WHERE ELECTIONS ARE BOUGHT IN THIS WAY.**

**XXXXXXXXX SUSI ORMAN XXXXXXXXXXX**

**Suze (pronounced “Susie”) Orman: The picture.**

**Let me now give you the taste of one chapter.**

**Probably most of you do not know Suze Orman, who is a popular US TV figure.**

**She gives very loud and shrill financial advice.**

**Her audience seems to adore her and lap up every word.**

**When I asked an IMF economist friend of mine about her, he had the predictable reaction.**

**He had watched her for only ten seconds.**

**He could not stand her mommy-knows-best voice.**

**And he found her investment advice simplistic.**

**XXXXXXXXXX SUZE ORMAN XXXXXXXXXXXXX**

**But it does not explain why Orman's audiences lap her up.**

**Orman's most popular book is *The 9 Steps to Financial Freedom: Practical and Spiritual Steps So You Can Stop Worrying*.**

**Let's contrast what she tells us there with the portrait given of consumer spending in the economics textbooks.**

**According to economics textbooks, we decide on our demand for the proverbial apples and oranges by choosing the bundle of apples and oranges that maximizes our happiness subject to our budget constraint.**

**But Suze Orman's financial advice books tell us that consumers do not follow such a textbook protocol in their purchases.**

**How could consumers do anything other than what the textbooks describe?**

**Orman tells us that people have emotional hang-ups with regard to money, and with regard to spending it.**

**They are not honest with themselves.**

**And, as a consequence, they do not engage in rational budgeting.**

**How could she know?**

**She is a financial adviser, and she has a test.**

**She asks her advisees to add up their expenditures, and those expenditures all but invariably fall short of what a documented accounting, from the records, later turns up.**

**Figuratively, relative to the proverbial trip to the grocery store to buy apples and oranges, it's as if her advisees spend too much in the fruit section.**

**By the time they reach dairy products, there is nothing left over for eggs and milk.**

**In real life, such budgetary failure translates into having nothing left over for savings.**

**This failure to deal cognitively and emotionally with money, says Orman, leads to those unpaid bills.**

**It is her mission to keep those bills down, so that her readers and her clients will no longer *worry* at night.**

**That is the role of mommy, and also why those audiences excuse that mommy-knows-best voice.**

**It is worth noting, more than parenthetically, that *worries*, as noted in Orman's subtitle, are central concerns of the financial advice books, but you do not find them in books on economics.**

## **XXXXX STATISTICAL PORTRAIT XXXXXXX**

**We can paint a statistical portrait which shows that this is a serious concern.**

## **XXXXXX STORY IN TEXTBOOKS XXXXXXX**

**This poses a problem.**

**This Suze (Susie) Orman view of the world suggests that people are spending too much and they are worried as a result.**

**That leads to the question why?**

**And this takes us to the second general message from Phishing for Phools.**

**Current behavioral economics is based on economics and on psychology.**

**But there is another emerging branch of economics.**

**This is based on sociology, rather than on psychology.**

**Why should sociology make a difference?**

**As we have already seen, the textbooks tell us that we should describe our behavior in the grocery store as maximizing our utility subject to a budget constraint.**

**That's what determines our demand for apples and for oranges.**

**According to the textbooks, that's the story we are telling ourselves.**

**The textbooks also indicate that we should use a similar story to derive most of economics.**

**Perhaps surprisingly, such derivation fails to describe much of real life.**

**The question arises what is the mistake in the model?**

**A basic mistake is that our economic models rain in on people our assumptions regarding what they care about, and then, correspondingly, how they behave.**

**People may be very purposeful, as economists presume.**

**That means we are maximizing something.**

**XXXXXXXXXX THINK THROUGH STORIES XXXXXXX**

**But how people behave is determined by how they think.**

**And a good way to picture how people think, and what determines how people behave, is that in every moment of our lives we are living out some story.**

**The decisions that we make depend upon the stories that are our focus when we make those decisions.**

**While the first part of the book refers to conventional behavioral economics regarding why people may be phooled, the second part of the book emphasizes this much more general point.**

**That point is that we are phooled because we are always telling ourselves stories.**

**That corresponds to the core of both sociology and cultural anthropology.**

**That core is ethnographies that uncover those stories that people are telling themselves.**

**It also reflects what advertisers do.**

**Their mission is to graft onto the story that we are already telling ourselves, another story that will get us to buy their product.**

**In order to make our economics right, we need to base motivation on these stories that people are telling themselves.**

**XXXXXXXXXX UBIQUITY OF STORIES XXXXX**

**Before I go further let me give an indication for the ubiquity of stories in any capitalist economy.**

**You see it on any commercial street, in any town.**

**The shop windows induce you to tell yourself a story that gets you to come in and buy.**

**In the US, in the old days, on shopping streets in suburban areas, there used to be pet stores that placed puppies in the window.**

**And there is an old song.**

**Patti Page, the singer, is coming down the street.**

She sees such a puppy, and she sings.

[I hope you don't mind if I sing.]

“How much is that doggie in the window?

The one with the waggley tail.

How much is that doggie in the window? (arf, arf)

I do hope that doggie's for sale.”

Some people know that first verse.

But very few know what comes next.

It says:

**XXXXXXXXX SECOND VERSE XXXXXXXXXXXX**

I must take a trip to California,

And leave my poor sweetheart alone.

If he has a dog he won't be lonesome,

And the doggie will have a good home.

I don't know if it is intentional, but this song has a beautiful ambiguity that exactly mirrors Phishing for Phools.

**On the one hand, the girl's purchase may be marvelously considerate.**

**Her relationship with her boyfriend may be perfect.**

**Every time the doggie wags its tail, the boyfriend will be reminded of their beautiful romance.**

**On the other hand, the relationship may be a disaster.**

**The girl may be scatterbrained.**

**Every time the doggie needs to be walked, the boyfriend will have to take care of it.**

**And he will also be reminded of the failed relationship.**

**Life in a capitalist economy is therefore not just an opportunity to get what you want.**

**It is also about the creation and spread of stories that influence you to come in and buy.**

**Those stories are to get you to buy: irrespective of whether the purchase is good for you, or not.**

**The rest of my talk will be four stories that indicate their central role in economics and politics.**

**XXXXXXXXX The Euro XXXXXXXXXXXXX**

**How did the Europeans get themselves into the Euro?**

**There is a wonderful, book by Ashok Mody.**

**Its title is: EuroTragedy.**

**There was a story that the Europeans' desire for unity would allow them to easily overcome the problems of a fixed exchange rate across most of Europe.**

**Prime Minister Helmut Kohl had told a similar story in Germany in the late 1980's/early 1990's regarding the currency union of East and West Germany at a one-to-one ration between East Marks and Deutsche Marks.**

**And then Kohl became a leading supporter of the Euro.**

**The integration of the East and West Germany economies had been difficult enough.**

**But with the Euro, no single language would ease migration, as had occurred between the two Germany's.**

**Nor, unlike the transfers from West to East Germany, there would be no similar transfers from richer countries to poorer countries within the Euro Zone.**

**Economists' analysis that a single currency would prevent needed exchange-rate adjustments went unheeded.**

**The story of the benefits from the Euro gained traction.**

**Mody tells how the myth of the benefits of the Euro, escaped like a virus from official meetings.**

**Part of that story was magical thinking: that the problems of a fixed exchange rate would be magically solved with the wave of a desire-for-unity-wand.**

**This story itself has played a crucial role in the economic state of Europe today.**

Let me give you another example in which a story made a huge difference.

XXXXXXXXX Bread and Bullets XXXXXXXXXXXX

This story is from a paper by Dennis Snower and myself, entitled *Bread and Bullets*.

It begins with a joke, from pre-1990 Russia.

*A man walks into a grocery store with a notebook.*

*"Do you have sausage?"*

*"No."*

*He makes a note.*

*"Bread?"*

*"No."*

*He makes another note.*

*"20 years ago, they would have shot you for making notes like that," says a woman waiting in line.*

*"No bullets either," he writes.*

**The joke illustrates the Soviet system at every scale.**

**Our article demonstrates the role of the Soviet story.**

**According to that story, the Soviet plan for force-fed industrialization would create a new paradise on earth.**

**This story legitimated extreme cruelty against anyone accused of resisting the plan.**

**But even worse.**

**Ruthless men like Stalin, falsely accused their opponents of resistance to the Plan.**

**And then they used the sanctions legitimated by the Soviet story to eliminate those opponents.**

**Let's turn to another story.**

**This time, we economists did not do so well.**

## **XXXXXXXXXX Financial Derivatives XXXXXXXXXXXX**

**According to standard economic theory, in the absence of externalities, the equilibrium of a free market, competitive economy will be Pareto optimal.**

**In the 1990's financial derivatives of many different complicated types were introduced.**

**They grew wildly.**

**But economists offered minimal warnings.**

**Economists told the story that the new securities would be benign.**

**The new securities would help people hedge against risk.**

**Based on this reasoning, the US Commodities Futures Modernization Act of 2000 greatly restricted the regulation of financial derivatives.**

**The story behind this deregulation failed to see that financial markets serve two functions.**

**They match savers with investors.**

**That's good.**

**But financial markets can also be a gambling casino.**

**That poses problems for the uninformed.**

**The securities can dupe people into taking risks they had never intended.**

**And then those people go bust.**

**The leverage taken out with derivatives have made world financial markets more fragile.**

**The description of how this happened is then the subject of three chapters in Phishing for Phools.**

**But every time they buy or sell a security they also know that they have to think about why that person on the other side of the market is selling or buying that security.**

**And they should be careful.**

**This is a central part of how financial markets work.**

**But it is often forgotten.**

**I know for myself that I have forgotten this principal in several important transactions I have made that I do not want to confess publicly.**

**This is just a part of life.**

**In the words of Jane Austen's Mr. Bennet: "For what do we live, but to make sport for our neighbors, and laugh at them in our turn?"**

**XXXXXX Global Warming XXXXXX**

**Let me give you another story.**

**About global warming.**

**The first inconvenient truth of global warming is the physical problem of climate change itself.**

**But there is a second inconvenient truth.**

**That is the story the public tells itself.**

**At the extreme, in the United States, that story says global warming is a hoax.**

**Yet more prevalent is failure to perceive the urgency of counteracting it.**

**Year after year after year slips by and the threat gets ever worse.**

**XXXXXX Summary and Conclusion XXXXXX**

**The book, Phishing for Phools, then gives us two major points.**

**The Pareto Optimality of competitive free markets is not the Pareto optimality of our what's-good-for-you tastes, it's the Pareto optimality of our monkey-on-the-shoulder tastes.**

**That means that if you have some weakness from which someone can make a profit, that someone, somewhere will find it profitable to set up a business to take advantage of your weakness.**

**That's what happens in a phishing equilibrium.**

**Phishing for Phools gives example after example after example of this principle.**

**Phishing of Phools also teaches us that the world's problems are not just the fundamental, physical problems like global warming itself.**

**They also include the stories that people tell themselves that get us into physical problems.**

**Such stories also keep us from dealing with those problems effectively when they arise.**

**Those stories and how they arise should be a part of our economics itself.**

**As illustrations of the role of those stories, we saw the Euro, Stalinist Russia, financial derivatives, global warming, and the doggie.**

**Counteracting stories that lead to bad outcomes needs to be a major function of economic policy in every country at every level, worldwide.**

**Of course that is also a major job for economists.**