

# Phishing for Phools

George A. Akerlof

ABCDE Conference

June 15, 2015

# Prefatory Notes

- Robert Shiller.
- Why a popular book?
  - Over-acceptance of view that markets are invariably beneficial.
  - Holes in acceptable economics.

# Danny's Observation

- **Psychology:**  
Humans as fallible machines.
- **Economics:**  
Equilibrium.
- **Supermarket equilibrium:**  
Lines equalized in length.

# Proposition

- Free markets provide only what we really want:  
If human machines are making the right choices.
- Free markets provide wrong choices:  
If there is a profit to be made.
- If we have some weakness or other, in the equilibrium, that weakness will be taken up as long as profit can be made.

# Example 1: Cinnabon®

- Example 1: Cinnabon®  
Life Needs Frosting®.  
Pheromones.



# Example Two: Health Clubs

## Example 2: Health Clubs

Wrong choice of contract.

Hard to cancel.

# Example Three: Capuchin Monkeys

- Thought experiment:  
Opened the monkeys up to trading with humans.
- Fruit Roll Up Tacos with Marshmallow Fluff.



# Two types of tastes

- What is good for them.
- What they choose.
- Monkeys on our shoulders.

# General Equilibrium

- Pareto optimality.
- Freedom to choose *and* freedom to phish.
- Equilibrium is optimal:  
In terms of monkey-on-our-shoulder tastes.

# Phish and Phool

- Phish:

Influence us to do what they want, but that is not good for ourselves.

- Phool:

Someone who is phished.

# Onus on Us

- **Four areas of:**

**NOBODY-COULD-  
POSSIBLY-WANTS.**

# The Four Areas

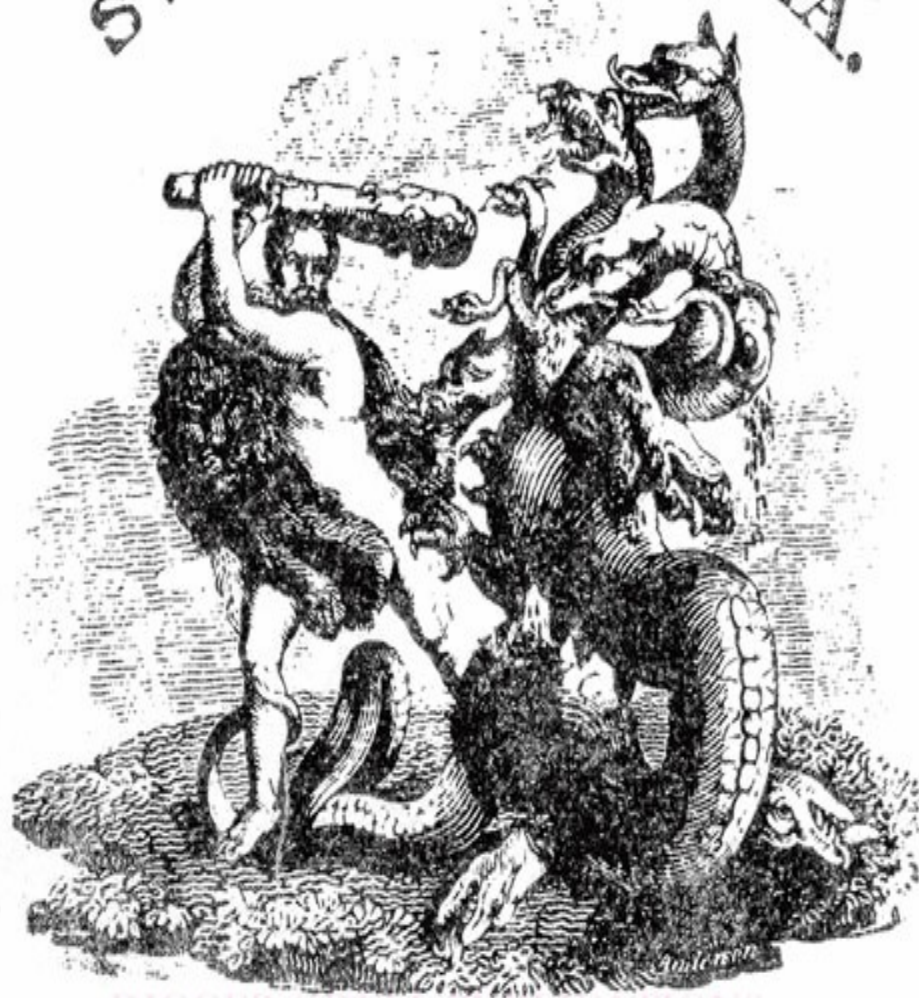
- PERSONAL FINANCIAL INSECURITY.
- FINANCIAL AND MACROECONOMIC INSTABILITY.
- ILL HEALTH.
- BAD GOVERNMENT.

# World without Regulation

- History leading up to Meatpacking Inspection Act of 1906 and Pure Food and Drug Act of 1906.

DIGGER ODELL PUBLICATIONS

# SWAIM'S PANACEA.



DIGGER ODELL PUBLICATIONS

Germ, Bacteria, or Fungus Destroyer

# WM RADAM'S MICROBE KILLER





# Suze ("Susie") Orman



# Suze Orman

- Enthusiastic Audiences.
- *The 9 Steps to Financial Freedom: Practical and Spiritual Steps So You Can Stop Worrying.*
- Financial advisees: do not follow rational budgeting.
- Test: expenditures do not add up.
- Real life: nothing left over for savings.

# Statistical Portrait

- Could not raise \$2,000.
- Low financial assets.
- Purchases and payday.
- Bankruptcies.

# Theoretical Puzzle

- Why are there all those sleepless nights, with worries about unpaid bills?
- Keynes: “Lives of our Grandchildren.”

# Answer to Puzzle

- **Businessmen's Goals:**
  - For you to spend your money.
- “How much is that doggie in the window?”
- **Continual temptation:**
  - Shop windows.
  - Supermarket aisles.
  - Renting/buying a house.
  - Buying a car.

# Endemic Temptation

- Goes beyond credit cards.
- The nature of capitalist markets.

# The Financial Crisis

- Phishing for phools as succinct explanation for what happened.

# Reputation Mine

- Reputation for perfect avocados.
- I can sell you a rotten one.
- I will have mined my reputation.
- I will also have phished you for a phool.





**FOR SALE**

# Rating Agencies

- Ratings agencies: for a century built up reputation.
- Job: to rate prob. of default for bonds.
- New task: rate prob. of default for derivatives.
- Possibility: for reputation mine.

# By Analogy

- Rotten avocados were rated perfect.
- Commanded high prices.
- Central-Valley-ful of growers:  
profitable business of producing rotten avocados.

# Role of Leverage

- Commercial banks, hedge funds, investment banks borrowed short term and invested in the over-rated securities.
- When truth discovered that securities were rotten:
  - Owed much more than they owned.

# The Four Questions

- How had original reputations been established?
- What made it profitable then to mine those reputations?
- Why were the buyers so naïve?
- Why was the financial system so vulnerable?

# Later Chapters

- Chapter 4. The Role of Advertising.
- Chapter 5. Cars, Houses, Credit Cards.
- Chapter 6. Lobbying.
- Chapter 7. Food and drugs.
- Chapter 8. Inventions.
- Chapter 9. Tobacco and alcohol.
- Chapter 10. Looting of S & L's.
- Chapter 11. Michael Milken and the Junk Bond Market.
- Chapter 12. Protections against phishing for phools.
- Chapter 13. Conclusion.
- Epilogue. Where this fits into economics.

# Conclusion

- **Telling stories:**
  - Basic to how we think.
- **Mental frames; scripts; narratives.**
- **Influence:**
  - **Grafts onto current stories.**

# Role in Economics

- Suze Orman example.
- Concluding chapter:

A wrong US national story regarding the unambiguous benefits of free markets has led to dysfunctional national policies.



