

**George Akerlof**

**Phishing for Phools**

**Workshop on Dysfunctional  
Organizations**

**February 6, 2016**

# Prefatory Notes

- **Robert Shiller.**
- **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<sup>®</sup>

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# Example Two: Health Clubs

- **Stefano DellaVigna and Ulrike Malmendier**

# 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.**

# Suze ("Susie") Orman



# Suze Orman

- **Enthusiastic Audiences: A Puzzle.**
- ***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.**

# Methodological Mistake

- **Story has been rained in from 30,000 feet.**
- **Departs from how Sue and Tim are really thinking.**
- **Need to know the narrative they are telling themselves.**
- **Consumer finance books:**
  - **Aim to correct their narrative.**



# Role of Narratives

- We think in terms of stories.
- We tell stories to each other.
- The story-teller wants to change your focus in her favor.
  - To graft her story onto your old one.

# Three Examples

- **Surgeon General's Report.**
- **Politics.**
- **New Story in the US.**

# Identity Economics

- **Who does the actor think she is?**
- **How should she, and others, behave?**
- **Lead in to whatever narrative the person is telling about her self and her context.**

**Thank You  
and Welcome.**



















































































# 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**

# Ratings 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.**

- **But the book also describes how the stories themselves are part of policy-making: perhaps the most important part.**
- **That may be the most important take-away from the book.**