Nobel laureate is attacking age-old economic rules (he's also Mr. Janet Yellen)

By Tim Kiladze

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It's been a frustrating fall for George Akerlof. Imagine spending five years writing a book. Now imagine your writing partner is fellow Nobel Prize-winning economist Robert Shiller—whose brain power, in combination with your own, is off the charts—and consider what that does to reader expectations. Then imagine that, despite the high hopes, some critics deride the work as rather...simple.

Yes, the reviews of *Phishing for Phools*, the baby Akerlof and Shiller gave birth to in September, have been divided, with many economics wonks decrying the book's thesis as less than earth-shattering. In it, the two academics argue markets aren't perfect and that capitalist competition breeds "pressures for less than scrupulous behaviour."

Two of their examples: Cinnabon sets up shop in airports and train stations because the chain knows customers in a rush are going to be less discerning about inhaling an 880-calorie dessert. Food companies vigorously try to load their products with the optimal mix of sugar, salt and fat to make them addictive—or, as the industry puts it, "alluring." The authors refer to these behaviours as "phishing," and they argue the practice is pervasive in capitalism. We think we have free choice, and we think we're rational consumers, but our minds are constantly being messed with, which often influences us in the worst ways.

That businesses might deceive us, particularly through advertising, isn't an epiphany. As a review in *The Economist* put it: "Readers are merely left with the impression that there are lots of nasty people about."

Such criticism would be hard for anyone in academia to swallow, since this is a world where people's livelihoods are determined by the power of their ideas. But it is especially so for Akerlof, perhaps, because of that Nobel—and because he happens to be married to Federal Reserve chair Janet Yellen,[1] whom he thanked for "extraordinarily helpful discussions" in the notes for his 2001 Nobel speech. No one in the First Family of Economics is supposed to create run-of-the-mill work.

On the phone from Washington, where he is a professor at Georgetown University, Akerlof talks the way you'd expect a bright economics professor to talk. His mind moves all over the map, so sound bites aren't his forte. "I'm rather inarticulate," he confesses. Not in print, though. And that might be the most frustrating thing of all for Akerlof—that critics are missing the point of *Phishing*. "It may appear that the idea is tremendously simple," he says. But within the world of economics, his and Shiller's argument is actually radical, challenging "the whole notion that whatever markets do is going to be right, and that we should not interfere with them."

To many Canadians, that probably doesn't sound all that profound; we watched unfettered capitalism contribute to the 2008 financial crisis in the United States and Europe. But south of the border, it's a completely different ballgame. Many Republicans—particularly

[1] Akerlof met Yellen at a Fed luncheon in 1977. She'd been lured there from Harvard; he was on a temporary research assignment. They got married less than a year later. Their son, Robert, is an economics professor.

Tea Party supporters—preach the power of unbridled markets, and the entire economics field is taught using principles penned 240 years ago. Any undergraduate student studying economics begins with Adam Smith's 1776 book, *An Inquiry into the Nature and Causes of the Wealth of Nations* (or at least a small chunk of it). Smith argues the market is guided by an "invisible hand": So long as everyone pursues their own self-interest, broad society will be better off.[2]

Many *Phishing* critics "don't understand that the central ideology in the United States…is the fundamental view of Adam Smith," Akerlof argues. The belief that markets work perfectly on their own and that no one but a fool would interfere "drives huge amounts of policy."[3]

The authors not only argue the invisible hand is foo-foo, they also stress capitalism actively incentivizes people to act irrationally. (Why would you buy a Cinnabon if you'll have to spend hours working off the calories?) This directly contradicts the historical model, which assumes we constantly make rational choices.

The argument that capitalism has flaws is not new; Karl Marx believed the system would lead to a revolt. Akerlof and Shiller differentiate themselves by stressing they're not anti-capitalist; they are pro-market, because they've seen society flourish through it. But they do believe that capitalism needs some help—it needs rules and "heroes" who hold the system in check, such as a strong securities regulator with boatloads of funding and people who independently test Volkswagen's diesel engines. Theirs is "the grown-ups theory of how the economy really works," says Akerlof.

The belief that our brains can be manipulated, leading to irrational thoughts, is just starting to generate a following. Behavioural economics is a burgeoning field that examines the ways in which humans can be influenced, and it is making an impact through books such as Daniel Kahneman's *Thinking, Fast and Slow*.

One small example of the studies in this field: If you walk past a restaurant and someone is sitting in the front window, you're more likely to step inside—even though you have absolutely no idea whether the food's any good. In *Phishing*, the authors argue the old song *How Much Is That Doggie in the Window?*—which Akerlof starts singing over the phone—conveys this very idea; pet shops used to showcase cute animals to lure people in.

But as persuasive as these studies are, they've barely caught on in economic circles; the behavioural field is often relegated to university psychology departments. That's partly why Akerlof and Shiller are speaking so broadly, so as not to be treated as "others" by their economics peers. "We have a much more general way of thinking of behavioural economics," says Akerlof. "If you have some kind of weakness and somebody can make a profit on that weakness, then that service is going to be there."

For anyone who says that's too basic, consider that capitalism itself is centred on the very simple belief that some "invisible hand" will make everything okay. If it worked for Adam Smith, why can't it work for two Nobel laureates?

[2] Despite the fact that it is the single idea most often associated with Smith, the term "invisible hand" appears just once in *Wealth of Nations*, a tome that runs to roughly 900 pages.

[3] This has long fascinated Akerlof—his Nobel win was based largely on his 1970 work on information gaps in imperfect markets.