Course Outline

• Part I: Big picture concepts and tools

• Part II: Deeper theory of consumer/producer choice

• Part III: Market failure (chs 12-18)
  – Ch 12 (+ part of 13) – game theory and oligopoly
  – Externalities, chs 14-15
  – Information (ch 18)
  – Behavioral economics
Reasons for market failure

• Insufficient competition

• Externalities

• Asymmetric info

• Bad choices
Believe it or not, people sometimes make mistakes 😊

• Consumers don’t always max $U$

• Firms don’t always max $PI$
Behavioral Economics

- Is the study of ways in which **standard economic** assumptions are systematically invalid, and implications

- Which assumptions? That people, on avg:
  1. Form accurate beliefs (probabilities) under uncertainty
  2. Take optimal actions, given their preferences/beliefs/constraints
  3. Are purely self-interested *(it’s good that this assumption is wrong!)*
Neoclassical/standard econ assumes choices look like this
Information econ like this
And behavioral econ, like this:

• I.e., that errors are sometimes **systematic** and therefore **predictable**
Our minds play tricks on us...

Segment A = Segment B
Müller-Lyer Pulsating Star
by Gianni A. Sarcone

Though the star seems to pulsate, the **blue** and **black** segments of the radial structure are always the **same length**!
You Had One Job @youhadonejob1 · 10m
These are perfectly round circles that don't overlap each other. #sor
OK, this is awesome. Stare at the red dot on the woman's nose for 30 seconds, then look at an empty wall while blinking quickly...

reddit.com/r/blackmagicfu ...
Some say...

- BE is about:
  - 1) bounded rationality
  - 2) bounded self-control
  - 3) bounded self-interest

- (Standard E assumes these are all unbounded (unlimited)!)
Historically, economists did not assume choices were always rational

• “How many people ruin themselves by laying out money on trinkets of frivolous utility? …

• All their pockets are stuffed with little conveniences…

• of which the whole utility is certainly not worth the fatigue of bearing the burden.”

• -Adam Smith, 1759 (!)
Then economic theory got totally rational

- Mathematical revolution in 1930s/40s (Hicks, Samuelson – former physicist)
- Seemed (was? Is?) more scientific, precise
- Natural baseline assumption for mathematical models: people make optimal choices
- Pretty good starting point
But then we overdid it

• Forgot that it was a simplification and started to think that this was a theoretical principle!

• “The aesthetic in the field became that if the agents in Model A are smarter than the agents in Model B, then Model A is better than Model B…

• The IQ of Homo Economicus became bounded only by the IQ of the smartest economic theorist!”

• (Thaler, JEP, 2000)
Why did model of rational choice become so dominant?

• 1. Econ argument #1: There’s only 1 way to be rational, unlimited ways to be irrational

• 2. Econ arg #2: Evolution + markets: irrational types ‘competed out’ so economically irrelevant

• 3. Sociology of the field: Nash equ to model agents as rational (given rest of field assumes rationality, optimal for new PhD to also do this)

• 4. Psychology of the field: Bias! (economists got too attached to what they were used to)
Took some smart and gutsy guys to change this

- 3 biggest names: 2 psychologists, Kahneman and Tversky; 1 economist, Thaler (*Undoing Project*, Lewis, 2017 (??))
- Got hot, especially post 2008 financial crisis
- E.g. “How Did Economists Get It So Wrong?”, Krugman (“mistaking beauty for truth”)
Behavioral Economics

Insights from psychology about individual behavior – examples of which include limited rationality, low self-control, or a taste for fairness – predict several important types of observed market outcomes that fully-rational economic models do not.

Responses

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<th>Strongly Agree</th>
<th>Agree</th>
<th>Uncertain</th>
<th>Disagree</th>
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Responses weighted by each expert's confidence

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Source: IGM Economic Experts Panel
www.igmchicago.org/igm-economic-experts-panel

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10 New Economic Expert IGM Panel

For the past two years, our expert panel is informing the public about the extent to which economists agree or disagree on important policy issues. This week, we are delighted to announce that we are expanding the IGM Economic Experts Panel to add ten new distinguished economic experts, these new panelists bring a wealth of qualifications to speak on matters of the highest importance, and their names will be familiar to economists and the media.

To give the public a broad sense of their views on important policy issues, each expert has re-voted on 16 statements that our panelists previously addressed. We chose these statements, which cover a wide range of important policy questions, because the original panelists’ responses were analyzed and published in a paper comparing the views of economic experts with those of the American public.

You can read more about this initiative here. The paper, along with the American Economic Association annual conference video, can be found here.

The new panelists’ responses to these statements can be seen on their individual voting histories, and the new experts are:

- Abhishek Banerjee (MIT)
- Markus K. Brunnermeier (Princeton)
- Liran Einav (Stanford)
- Amy Finkelstein (MIT)
- Oliver Hart (Harvard)
- Hilary Hoynes (Berkeley)
A quick intro to selected concepts from behavioral econ....
Last 5 roulette spins landed on red. Is the next spin:

A. More likely red than black
B. More likely black than red
C. Equally likely red, black
The gambler’s fallacy

• Tendency to expect reversals in 50-50 events. E.g. think probability of red after black > 0.5
  • (true probability=0.5)

• More generally: tendency to expect random numbers to ‘even out’ in small samples. E.g.:
  • if 1st child boy, mild surprise when 2nd also boy
  • If recent lotto #s 9’s, avoid choosing 9’s this week
  • If stocks up yesterday (and mkt
Jake is a 50% shooter over his basketball career. He makes his first 3 shots of game. Is he

A. <50% likely to make his next shot
B. About 50% likely to make his next shot
C. >50% likely to make next shot
The hot hand in basketball: On the misperception of random sequences

Thomas Gilovich, Robert Vallone, Amos Tversky

Abstract

We investigate the origin and the validity of common beliefs regarding "the hot hand" and "streak shooting" in the game of basketball. Basketball players and fans alike tend to believe that a player's chance of hitting a shot are greater following a hit than following a miss on the previous shot. However, detailed analyses of the shooting records of the Philadelphia 76ers provided no evidence for a positive correlation between the outcomes of successive shots. The same conclusions emerged from free-throw records of the Boston Celtics, and from a controlled shooting experiment with the men and women of Cornell's varsity teams. The outcomes of previous shots influenced Cornell players' predictions but not their performance. The belief in the hot hand and the "detection" of streaks in random sequences is attributed to a general misconception of chance according to which even short random sequences are thought to be highly representative of their generating process.
<table>
<thead>
<tr>
<th>Player</th>
<th>P(hit/3 misses)</th>
<th>P(hit/2 misses)</th>
<th>(P(\text{hit}/1 \text{ miss}))</th>
<th>P(hit)</th>
<th>P(hit/1 hit)</th>
<th>P(hit/2 hits)</th>
<th>P(hit/3 hits)</th>
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<td>.52</td>
<td>.51</td>
<td>.50</td>
<td>.46</td>
<td>-.039</td>
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**Note.** Since the first shot of each game cannot be conditioned, the parenthetical values in columns 4 and 6 do not sum to the parenthetical value in column 5. The number of shots upon which each probability is based is given in parentheses.

* \(p < .05\).
** \(p < .01\).
Overinference

- Tendency to over-identify patterns
- 1 example: the **hot hand bias** (over-identify changes in ability or state of something)
  - E.g.: to say Jake is ‘hot’ and should keep shooting (even if now guarded more closely) based on making a few in a row
- Wait, is this the opposite of gambler’s fallacy?
- GF occurs when probabilities are known to be stable (like roulette outcome)
- HHB when probabilities can change
Suppose there’s a rare disease, occurs in 0.1% of population

- Test for it: get positive or negative result

- Result always positive when person has disease

- Test result also positive 10% of time when person does not have disease

- You get positive test result.

- How likely is it that you actually have the disease? (write guess)
How likely is it that you actually have the disease?

A. Over 50%
B. 25-50%
C. 10-25%
D. 1-10%
E. <1%
Correct answer is < 1%!

• ‘Base rate’ of 99.9% means in population of 1,000: 999 don’t have disease
• But 10% get false positives (99.9 false positives)
• Only 1 true positive
• When people guess an answer (well) over 1%, this is base-rate neglect:
  • Tendency to ignore strong ‘base’ (general) rates and overreact to ‘noisy’ new information
• Explains hot-hand bias... or firing CEO w good track record and 1 bad year
Suppose I randomly draw names from this class of 33. How many do I have to draw to have > 50% chance of drawing 1 person’s name at least twice?

A. < 8  
B. 8-12  
C. 13-16  
D. 17-20  
E. >20
Correct answer = 6!
Today's #GoodRead: 'The Birthday Paradox' is a perfect illustration of how people often misunderstand probability. This article fully explains it, and also includes a clip of Johnny Carson unsuccessfully trying to explain it on "The Tonight Show" in 1980.

It's My Birthday Too, Yeah
The classic math puzzle Johnny Carson grappled with on the air 32 years ago.
opinionator.blogs.nytimes.com

6:32 AM - 21 Aug 2018

28 Retweets 84 Likes

Lee Jones @leehjones - Aug 21
Repeating to @RunItOnce
Amen. And once you've wrapped your head around the birthday problem, see if you can solve the Monty Hall problem without cheating.
Fooled by randomness

• Biases above driven by deeper underlying force:

• “It is likely that unlikely things will happen”

• (like that roulette will come up red 5 times in a row... or Jake makes 3 shots... or one of you getting drawn multiple times by Excel....

• Or you’ll have a bad day sometimes due to bad luck... don’t be too hard on yourself... or good day due to good luck... don’t get too full of yourself 😊)
How many total students were enrolled at Bowdoin in the year 2016?

• Write down guess..

• Then write a lower number and a higher number such that you think there is 95% probability the true value falls in the range
1,806. Does this fall in your range?

A. Yes
B. No
Bowdoin College / Total enrollment

1,806
2016

People also search for

Colby College: 1,815 (2011)
Bates College: 1,792 (2015)
Middlebury College: 2,526 (2014)

People also ask

How big is Bowdoin College?
How much does it cost to go to Bowdoin?
How many students are at Williams?
How many students does Bates College have?

Answers to Frequently Asked Questions - Bowdoin College
https://www.bowdoin.edu/ir/data/faqs.shtml
Aug 21, 2017 - How many students are enrolled at Bowdoin (In Residence, Fall 2016) 1,806. How many men? 902 (49.9%)
Overconfidence

- 2 major types: 1) Overconfidence in judgment/knowledge = overprecision
- “Don’t believe everything you think!”
- You were overconfident, on avg, if you wrote down intervals that were too precise...
- Meaning less than 95% contained true value
- Causes all kinds of bad choices... e.g. ‘planning fallacy’ – overconfidence in plans going smoothly
- Firms overconfident in risky investments...
- Consumers underestimate need for savings...
Are you a better driver than the typical person in this class? (don’t answer if you don’t know how to drive)

A. better
B. worse
C. same
Overconfidence type 2: over-optimism

• Caused by motivated reasoning – fancy term for wishful thinking (more or less)

• Both types of overconfidence seem to apply to entrepreneurs. Kahneman:
  • Pr(small new biz fails w/in 5 yrs) = 65%
  • 33% of new biz owners say Pr(failure)=0%!
  • But the 2 types of overconfidence are distinct
  • (“I’m good for nothing...” = example of __ ?)
A Quick Puzzle to Test Your Problem Solving

By DAVID LEONHARDT and YOU JULY 2, 2015

A short game sheds light on government policy, corporate America and why no one likes to be wrong. RELATED ARTICLE

Here's how it works:
We've chosen a rule that some sequences of three numbers obey — and some do not. Your job is to guess what the rule is.

We'll start by telling you that the sequence 2, 4, 8 obeys the rule:

[Boxes with numbers 2, 4, 8 highlighted]

Obeys the rule

Now it's your turn. Enter a number sequence in the boxes below, and we'll tell you whether it satisfies the rule or not. You can test as many sequences as you want.

Enter your first sequence here:

[Input fields for numbers]

Check

I don't want to play; just tell me the answer.
Confirmation bias

- Tendency to look for confirmation of what you already believe...
- To interpret ambiguous info in belief-confirming way...
- To ignore contradictory info, and be too credulous of belief-supporting info)
- Contributes to persistence of over-optimism, overprecision, other biases
- Economic implications (brand loyalty, beliefs on economic growth, inflation, etc) – and political...
Heads down if your last name starts with M-Z
You need a book for class. Costs $20 at bookstore on campus, $15 downtown at store. Do you

A. Walk downtown to save $5
B. Buy on campus
Ok heads up. Respond to next
*only* if last name M-Z
You need a new laptop and can either buy on campus or walk downtown to store. It costs $1005 on campus and $1000 downtown. Do you

A. Walk downtown to save $5
B. Buy on campus
Heads down if your last name starts with M-Z
What’s in the middle?

A. A
B. B
C. C
D. Something else
If M-z: What’s in the middle?

A. Something else
B. 12
C. 13
D. 14
ABC
ZBA4
**Framing** effects: how info is presented, especially what it’s compared to, affects perceptions, choices

- $5 savings seems like a lot compared to $20
- $5 seems like nothing compared to $1000
- But benefit of walk downtown, cost is same
- Look out for this in ads!
- Standard econ: framing shouldn’t matter
Two important framing effects:

- **status quo bias** and **default bias**
- (Bias toward sticking w status quo, default) (!)

- E.g.: When people are automatically enrolled in retirement savings (as default), they stay in
- When people have to sign up, they don’t bother

- Yes default is a signal of what one *should* do but people seem to respond excessively to it
Heads down if your last name starts with M-Z
For those with last names A-L:
How much would you pay, at most, to use social media next month (Instagram, snap-chat, whatever)? (If you don’t pay, you can’t use it)

A. $10  
B. $20  
C. $30  
D. $40  
E. $50  
F. $51-$100  
G. >$100
Ok, heads up last names M-Z, only you answer this:
What is the least that you would accept to give up social media for the next month (Instagram, snap-chat, whatever)?

A. $10
B. $20
C. $30
D. $40
E. $50
F. $51-$100
G. >$100
“I hate losing even more than I want to win”

• -Billy Beane (Moneyball guy)
• **Loss aversion:** losses are more painful than gains are good
• *Not* same as diminishing MU!! (tho confusing)
• Helps explain why, e.g., price differences typically framed as discounts not surcharges
• (surcharges would be *big* turn-off...)
• Why WTP (for gain) sometimes (much) less than WTS (to avoid loss)
• Another implication of loss aversion is...
The endowment effect

- Tendency to (perceive that you) value something more after gaining ownership of it
- Arguably applies to social media example
- Economic effects:
  - failure to sell assets when one should (hanging on to house or refusing to lower price, stocks etc)
  - Extreme form: hoarding (refusal to get rid of junk)
- Note: can be useful (“love the one you’re with”!)
- But like many of these, problems come when you ‘overdo it’
Our market:

- What do you think happened?
- Probably could have been some TS generated, so...
- Market failure!
- Why? (your thoughts?)
- Different preferences/tastes?
- Behavioral:
- Information:
- Strategic/market power:
- ‘Transaction costs’ (‘frictions’) =
- Other factors? (social?)
- Note other key factor (externalities) causing mkt failure (not relevant)!
What time do you want to go to sleep Wednesday night?

A. Before 11
B. 11-12
C. 12-1
D. 1-2
E. After 2am
What time do you think you’ll actually go to sleep Wednesday night?

A. Before 11
B. 11-12
C. 12-1
D. 1-2
E. After 2am
What time did you go to sleep last night?

A. Before 11
B. 11-12
C. 12-1
D. 1-2
E. After 2am
Present bias
(hyperbolic discounting)

• Bias towards acting in favor of payoff **now**

• This is not the same as simply being impatient

• Present bias means you act in **time inconsistent** way – make plans, or have hopes for plans (e.g. sleep time), then break them

• B/c ‘present’ is always changing. Framing effect
Have you ever made a New Year’s resolution?

A. Yes
B. No
Did you keep it?

A. Yes
B. No

41%
59%
Sometimes called hyperbolic discounting. A two-stage experiment provides a classic illustration: In the first stage, people are offered the choice between a hundred dollars today or a hundred and ten dollars tomorrow; in the second stage, they choose between a hundred dollars a month from now or a hundred and ten dollars a month and a day from now. In substance, the two choices are identical: wait an extra day, get an extra ten bucks. Yet, in the first stage many people choose to take the smaller sum immediately, whereas in the second they prefer to wait one more day and get the extra ten bucks. In other words, hyperbolic discounters are able to make the rational choice when they’re thinking about the future, but, as the present gets closer, short-term considerations overwhelm their long-term goals. A similar phenomenon is at work in an experiment run by a group including the economist George
Implications

- Excess spending and insufficient saving
- Poor health choices, other impulsive choices
- Procrastination
- Lots and lots of other stuff
Burger King Brings Back 15-Cent Chicken Nuggets In Price War With McDonald’s

By Laura Northrup  January 12, 2015
So, people might eat too many nuggets due to...

- Present bias: want utility now, discount health costs later
- Over-optimism: health effects won’t be bad
- Framing in ads etc: nuggets look so good
- (Other thoughts?)
Solutions

• Train ourselves to be less biased?
• Kahneman says this is very tough
• Tetlock ([Superforecasters](https://www.amazon.com/Superforecasting-Intelligence-Prediction-Contributions/dp/0374229736)) and others more optimistic
• Another approach: don’t try to improve conscious decision-making.
• Improve habits (make optimal choices automatic/unconscious)
• E.g. develop habit of eating healthy - can make junk food unappealing
Solutions ctd

• **Commitment devices** to restrict own choices (to avoid biased choice)

• E.g.:
  • Do your work somewhere with no wifi and leave phone at home
  • Leave your credit card at home when you go to bar
  • Buying house with big mortgage
  • Many others...
"Kids Can Eat Free if Parents Don’t Use Their Phones at This Restaurant"
fatherly.com/news/kids-can-...

#PriceDiscrimination via a
#CommitmentDevice - brilliant!

Good marketing & good for social welfare, hopefully will catch on...

ht @MargRev. fyi @joshgans @mdoepke @parentsymagazine?
Solutions ctd

- **Libertarian paternalism** public policy:
  - preserve free choice (‘lib’ part)...
  - framing options to **nudge** people in ‘right’ direction (paternalism part)
  - [https://www.youtube.com/watch?v=jsy1E3ckxIM](https://www.youtube.com/watch?v=jsy1E3ckxIM)
  - E.g. move veggies to front of buffet line
  - Make ‘organ donor’ the default (while preserving right to opt out)
Solutions ctd

• Market forces/competition?

• Akerlof and Shiller (Phishing for Phools):
INTRODUCTION

Expect to Be Manipulated: Phishing Equilibrium

The psychologists have taught us over the course of more than a century—in voices ranging in style and content from Sigmund Freud to Daniel Kahneman—that people frequently make decisions that are not in their best interest. Put bluntly, they do not do what is really good for them; they do not choose what they really want. Such bad decisions make it possible for them to be phished for phools. This truth is so basic that it is critical to the first story of the Bible, where the serpent beguiles innocent Eve to make a phoolish decision that she will instantly, and forever, regret.¹

The fundamental concept of economics is quite different: it is the notion of market equilibrium.² For our explanation, we adapt the example of the checkout lane at the supermarket.² When we arrive at the checkout at the supermarket, it usually takes at least a moment to decide which line to choose. This decision entails some difficulty because the lines are—as an equilibrium—of almost the same length. This equilibrium occurs for the simple and natural reason that the arrivals at checkout are sequentially choosing the shortest line.

The principle of equilibrium, which we see in the checkout lanes, applies to the economy much more generally. As businesspeople choose what line of business to undertake—as well as where they expand, or contract, their existing business—they (like customers approaching checkout) pick off the best opportunities. This too creates an equilibrium. Any opportunities for unusual profits are quickly taken off the table, leading to a situation where such opportunities are hard to find. This principle, with the concept of equilibrium it entails, lies at the heart of economics.
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The principle also applies to phishing for phools. That means that if we have some weakness or other—some way in which we can be phished for phools for more than the usual profit—in the phishing equilibrium someone will take advantage of it. Among all those business persons figuratively arriving at the checkout counter, looking around, and deciding where to spend their investment dollars, some will look to see if there are unusual profits from phishing us for phools. And if they see such an opportunity for profits, that will (again figuratively) be the "checkout lane" they choose.

And economies will have a phishing equilibrium in which every chance for profit more than the ordinary will be taken up. To practice our understanding, we will now turn to three "finger exercises" in the application of the concept of phishing equilibria.

**Finger Exercise One: Cinnabon®**

Consider an example of what we are driving at. Back in 1985, father
some curds on markets, we reach an economic equilibrium where the monkeys on the shoulder are substantially calling the shots.

**The Alleged Optimality of a Free-Market Equilibrium**

There is a perhaps surprising result that, indisputably, lies at the very heart of economics. Back in 1776, the father of the field, Adam Smith, in *The Wealth of Nations*, wrote that, with free markets, as if “by an invisible hand ... [each person] pursuing his own interest” also promotes the general good.16

It took a bit more than a century for Smith’s statement to be precisely understood. According to the modern version, commonly taught even in introductory economics, a competitive free-market equilibrium is “Pareto optimal.”17 That means that once such an economy is in equilibrium, it is impossible to improve the economic welfare of everyone. Any interference will make someone worse off. For graduate students, this conclusion is presented as a mathematical theorem of some elegance—elevating the notion of free-market optimality into a high scientific achievement.18

The theory, of course, recognizes some factors that might blemish such an equilibrium of free markets. These factors include economic activities of one person that directly affect another (called “externalities”); they also include bad distributions of income. Thus it is common for economists to believe that, those two blemishes aside, only a fool would interfere with the workings of free markets.19 And, of course, economists have also long recognized that firms that are large in size may keep markets from being wholly competitive.

But that conclusion ignores the considerations that are central to this book. When there are completely free markets, there is not
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INTRODUCTION

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only freedom to choose; there is also freedom to phish. It will still be true, following Adam Smith, that the equilibrium will be optimal. But it will be an equilibrium that is optimal, not in terms of what we really want; but an equilibrium that is optimal, instead, in terms of our monkey-on-our-shoulder tastes. And that, for ourselves, as for the monkeys, will lead to manifold problems.

Standard economics has ignored this 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, largely, about the effects of those monkeys.

As exceptions, behavioral economists, especially for the past forty years, have been studying the relationship between psychology and
How often do you think people in general get ‘phooled’ by businesses? (manipulated into making decision not truly in their own best interest)

A. Pretty rarely
B. Occasionally but not often
C. Somewhat often
D. Pretty often
• An important perspective

• Still certainly a subject of debate

• One critical response-
A Phool and His Money

By ALEX TABARROK

Review of PHISHING FOR PHOOLS: The Economics of Manipulation and Deception, by George A. Akerlof and Robert Shiller

Princeton University Press, 2015

Cinnabon pastries are hard to resist. Advertising can be deceptive. Humans sometimes act in foolish ways. If these statements strike you as anodyne then there is no need to read George Akerlof and Robert Shiller’s new book Phishing for Elves, a disappointing foray into behavioral economics from two recent Nobel Prize winners. If these statements strike you as novel then I recommend instead Ariely’s Predictably Irrational, Sunstein and Thaler’s Nudge, Kahneman’s Thinking, Fast and Slow or Daniel Gilbert’s Stumbling on Happiness, to name just a few classics in
field.

*Phishing for Phools* might have had a bigger impact had it been written 20 years ago but today its examples seem tired. Do we really need another book telling us how supermarkets “phish” us by putting staples like eggs and milk at the back of the store and the impulse purchases like candy and magazines at the front? Aside from being overused, does this example even mean what the authors think it means?

Akerlof and Shiller write as if we need milk and eggs but are then broken down by the supermarket’s obstacle course of temptation so that we exit the store in a dazed and dejected fugue loaded with baskets of stuff that we don’t really know why we bought. Maybe that is what a trip to the supermarket is like for them. But for me a trip to Trader Joe’s that doesn’t result in an unexpected purchase is a disappointment. Shopping for milk and eggs is a chore. I shop for novelty and enjoy trying out new items like *Indian Peaberry* coffee, *Jamaican ginger beer* and *Sardinian Brigante cheese*. I deliberatively avoid the store with the lowest prices and the consistent stock and instead head for the place with the jazz band on the weekend. Judging by the crowds, I don’t think I am alone in valuing the shopping experience nor do I think that all such customers are phools.

Throughout *Phishing for Phools* there is little attempt to discuss alternative interpretations, perspectives or tradeoffs. Consider the chapter on the Food and Drug Administration. It begins rather predictably with *The Jungle*, Upton Sinclair’s 1906 exposé that finally triggered the Food and Drug Administration (FDA)
None of this is to suggest that credit isn’t abused but only that you will have to look elsewhere than *Phishing for Phools* for a balanced treatment of the question or for a discussion of how the worst forms of credit abuse might be curtailed without imposing significant costs on those who do use credit conscientiously.

Akerlof and Shiller have both made enormous contributions to economics but one will find in this book little of the analytical rigor or attention to evidence that earned them their laurels. Instead, in what to me was the book’s nadir, one finds this test of “the theory of shrouded attributes”:

“[Bob] had been persuaded by the TV advertisements to purchase gourmet cat food for his cat Lightning. In the ads the cats go to their food bowls so perky and happy. But does gourmet cat food really taste good? Bob tasted it. The advertised flavors that sound attractive to humans—turkey, tuna, duck and lamb—did not seem to be there at all.” (p. 167)

An ordinary economist might suggest that rather than tasting the cat food himself, Bob could have simply watched his cat to see which food she was most eager to eat. But that would be to assume that Lightning’s choices reflected her genuine preferences. Thus, Bob was being entirely consistent in substituting his own tastes for those of his cat and choosing accordingly. The reader may ponder which method the cat would have preferred.

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Another limitation to firms “phishing” consumers...

- Demonstrated in the **ultimatum game**:
- 2 players. ‘Pot’ of EC = 4 = X
- 1 player is “proposer”
- Other player is “responder”
- Proposer makes offer between 0 and 4 to “responder”
- If responder accepts: responder gets offer, proposer gets remainder of ‘pot’ (4 – offer)
- If responder rejects: both get 0
- (‘ultimatum’ offer = take it or leave it)
- Let’s play?
Suppose you were responder in this game and got offer of 1 (with total = 4).

Do you:

A. Accept
B. Reject
Suppose you got offer of 0.1. Would you accept?

A. Accept
B. reject
The ultimatum game

- Standard econ prediction:
  - Offer 1 (or smallest amount > 0), keep ...
- Reality: most common offer = 50%
- Offers ≤ 30% usually rejected
- Why?
- Preferences for others?
- But then one shouldn’t reject positive offers!
- More importantly: preferences for fairness
- [https://www.youtube.com/watch?v=dqxQ3E1bubl](https://www.youtube.com/watch?v=dqxQ3E1bubl) (4:30)
Consumers (often) expect firms to act in fair way

• Standard econ: if demand increases, then $P^*$ increases, TS increases
• And monopolists charge profit-maxing price
• In reality: this is (sometimes) called price gouging, extortion
And some firms think it’s in their own best interest...

• To consider the welfare of consumers, workers, other ‘stakeholders’

• A global corporate social responsibility (CSR) movement?
• http://freakonomics.com/podcast/corporate-social-responsibility/
CONSCIOUS CAPITALISM
Liberating the Heroic Spirit of Business

JOHN MACKEY
Co-CEO, Whole Foods Market
Welcome to Conscious Capitalism

“We believe that business is good because it creates value, it is ethical because it improves the quality of life.”
What are B Corps?

We must be the change we seek in the world. All business ought to be conducted as if people and place mattered. Through their products, practices, and profits, businesses should aspire to harm and benefit all.
Vote Every Day. Vote B Corp.

You cast your vote every day with the choices you make—what you buy, where you work and who you do business with. You have the power to make your voice heard beyond the ballot box. Every day is election day.

CAST YOUR VOTE
Certified B Corporations are a new kind of business that balances purpose and profit. They are legally required to consider the impact of their decisions on their workers, customers, suppliers, community, and the environment. Together, they are driving a global movement of people using business as a force for good.
Abstract

Society's demands for individual and corporate social responsibility as alternative responses to market and distributive failures are becoming increasingly prominent. We draw on recent developments in the psychology and economics of prosocial behaviour to shed light on this trend and the underlying mix of motivations. We then link individual concerns to corporate social responsibility, contrasting three possible understandings of the term: firms' adoption of a more long-term perspective, the delegated exercise of prosocial behaviour on behalf of stakeholders, and insider-initiated corporate philanthropy. We discuss the benefits, costs and limits of socially responsible behaviour as a means to further societal goals.

INTRODUCTION
• “The disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition is the great and most universal cause of the corruption of our moral sentiments.”

• –ADAM SMITH
Other limits to markets?
