



Episode 820: Speculators Aren't Evil, and Neither Is Cinnabon: Common Fallacies Refuted

Guest: Don Boudreaux

WOODS: Gene Epstein is a big, big Don Boudreaux fan. He sent me an email not long ago saying – because he's book review editor and economics editor at *Barron's*, of course, and a frequent guest of this show, and he said, This Boudreaux guy just keeps sending me excellent, outstanding reviews of oftentimes terrible economics books, and I think his reviews might be food for thought and interesting conversation fodder for your show. So I looked at them, and I thought yes, that is an absolute definite.

So there are four titles that I'd like to hit on in lightning-round fashion here. The first one, published by Princeton University Press, is called *Phishing for Phools*. Tell me who the authors of this book are, why they matter, and what the thesis is.

BOUDREAUX: The two authors are Robert Shiller and George Akerlof. Akerlof and Shiller each is a Nobel prize-winning economist, and that's the Shiller, by the way, of the famous Case-Shiller housing index. So they're both very prominent economists, having won the Nobel prize, and very celebrated of course in the economics profession.

And their notion boils down to that people acting in private markets on their own are so inept or so given into temptation to satisfy their short-run desires that entrepreneurs – and that's why they call them "phools" – that entrepreneurs will "phish" for them and get them to do all sorts of things they otherwise wouldn't do: get them to buy Cinnabons. That's an example that they give in their book, that if you walk through a mall or an airport, that Cinnabon very cleverly positions itself so that the wonderful smell of baking cinnamon buns waft out at the public, and the public can't resist. They'll just immediately go to the Cinnabon and buy one, even though they really don't want them, because it's going to make them fat.

So it's a very, very dismal notion of ordinary people. It's a very elitest notion, to put it differently, of ordinary people. Akerlof and Shiller know what ordinary people want; ordinary people don't really know what they want, and so Akerlof and Shiller cant very strongly that the state should be involved in nudging or forcing people to behave differently than people behave on their own.

WOODS: So people who make ridiculous on-the-spot decisions that could damage their health will make excellent, wise decisions when it comes to choosing political figures?

BOUDREAUX: Yeah. I mean, this is always the big gap in these sorts of arguments.

WOODS: Yeah, it's the same people.

BOUDREAUX: It's the same people, yeah. And let's face it, Tom. As you know, of course people make mistakes. We all make mistakes. We're human beings. But the likelihood of making a mistake when your own skin and your own money are on the line is much smaller than when you're choosing in a way that has no immediate impact on you. So when you go into a polling place and you yank a lever for one candidate versus another, that's a very disjointed decision from your everyday life. But when you buy that Cinnabon, you pay your own money, and you presumably are aware of the caloric consequences of that. But yeah, none of these paternalists really try to even grapple with the point that you raised: that how can people who are so irresponsible in their daily lives when their own money and skin are on the line, why do they suddenly become responsible and trustworthy when they're making decisions for other people?

WOODS: I want to make sure I understand their thesis correctly. Are they saying that people – It seems like there are two possibilities. People are too foolish to make decisions that pertain to their health and well being, just in general. They're just too foolish to do it. Or they're so easily sucked in to marketing schemes and the wafting odor of a Cinnabon that that takes over their ordinarily robust rational faculties. So normally they would have good sense, but marketing just overtakes them, and if we could just sit them down and speak to them rationally they wouldn't make that decision.

BOUDREAUX: I think it's more the latter. I think they would say that, to be fair to them.

WOODS: Okay, so then how do they know? How do they know? Because I know perfectly well – I know all the health issues related to a Cinnabon, and I probably have two of them a year. And I know that I shouldn't be having them, but yet sometimes you just do something for the fun of it, you know? You just do something for the plain old fun of it. And I'll say, Yeah, maybe I'll be on this Earth for ten fewer seconds, but, man, the 50 seconds it takes me to eat this thing more than make up for that. Why can't – Why is that not a rational decision on my part?

BOUDREAUX: That's why I say these people are elitist. Of course it's a rational decision on your part, or we have to presume it's a rational decision. You may later come to – You may later say it's a mistake. Again, we've all made mistakes. But a lot of times – Many of the examples that they give of what they regard to be foolish behavior are examples that I assume are people making perfection rational decisions. There's no reason to believe – As you say, how do they know? There's no reason to believe these people don't know that it might take ten seconds off their life, but the pleasure they get, the satisfaction they get from the enjoyment of Cinnabon from time to time, from smoking a cigarette, from hang gliding – whatever it might be – outweighs in their minds the added risks.

Here's another problem with this whole line of research. These scholars are oblivious to not only subjectivism, the fact that you can't get into someone else's head and

understand how they analyze various tradeoffs, but they don't understand that people differ in their tastes. They seem to not understand that people differ in their tastes and preferences. There is not one correct level of risk that all of humanity should incur or be exposed to. It varies from person to person. One of the great joys and benefits of a free market is that it allows each of us to choose our own levels of risk versus reward, and Akerlof and Shiller would go a long way toward shutting that down, because they believe that there's one correct way or a much narrower range of what's right, and they know it, and poor ordinary people don't know it, and so they're here to help ordinary people.

WOODS: The example you give of Sunkist oranges. Is that actually taken out of the book? They say that the use of the name "Sunkist" will mislead people into buying too many oranges?

BOUDREAUX: I had to read it several times just to make sure I was reading it correctly, that it wasn't meant to be a parody. But they actually used the example of the name Sunkist as a devious marketing — those are my words. I don't have the book in front of me now — but a marketing ploy to fool people into thinking that these oranges are better than they really are, to fool people into thinking that they've been kissed by the sun. I mean, their opinion about the intelligence of ordinary people is really quite low.

WOODS: I don't know anybody who's ever said to me, "Hold on a minute; I've got to have this orange, because I know it was kissed by the sun." I've never heard that. In the same way, there was a great video made in Harlem recently where an investigative reporter went around to ask black resident of Harlem if they had driver's licenses and government-issued IDs, because it's also claimed, well, in the same way that people are too dumb to figure out that an orange is an orange is an orange, black people are kind of too slow to be able to get driver's licenses.

So he actually went on the street and asked them, "Do you have an ID?" And they said, "Yeah." "Well, if you needed to get one, would you know where?" And they guy said, "Yeah, 125th Street, the DMV." And then he said, "Do you know anybody who doesn't have an ID?" And he said, "Of course not. How could you function without an ID." He said, "Do you realize there are white people across the country who think you're too inept to get a driver's license?" And he said, "Well, those people are ignorant." And they all just say — And then the claim was they're too dumb to use the Internet to get a license, and one woman said, "I use my smartphone as a hotspot. What's wrong with you people?" So this is all part of the same, you know, gosh, people are just too stupid, and we need to be in charge of them.

Now, one good response to them I always thought was, when people like John Kenneth Galbraith would say that marketing just tricks people into buying things and feeding wants they don't really have would be: if that were true, why would firms engage in the expensive market research to figure out people's true demands if all they needed to do was come up with a clever name like Sunkist or an aromatic product like a Cinnabon?

BOUDREAUX: That's a great point, yeah. And you're right; firms spend a lot of money doing marketing research, which belies the premise of Galbraith and of Akerlof and

Shiller. Akerlof and Shiller – I'm glad you mentioned Galbraith. Akerlof and Shiller are really just an early 21st century updated version put in updated language of that old Galbraithian theme. So Akerlof and Shiller depend a lot, use a lot of behavioral economics findings, which of course Galbraith didn't use, because behavioral economics hadn't yet been invented. But it's the same idea. It's the same pretentious notion that professors, particularly those at Ivy League colleges, can better run the lives of ordinary people than those ordinary people can.

WOODS: Let's jump over now to Jeff Madrick's book, *Seven Bad Ideas: How Mainstream Economists Have Damaged America and the World*. If he didn't use the subtitle and it was just *Seven Bad Ideas*, it wouldn't surprise me Jeff Madrick wrote that book, because I have never read a good idea from that guy. So talk about this one.

BOUDREAUX: Oh, well, from top to bottom it's just a display of economic ignorance. It's a parody of left-wing, progressive misunderstandings of economics. It doesn't understand the role of prices; it doesn't understand the role of markets; it doesn't understand the role of incentives; it does not understand the role of competition; it does not understand the role of entrepreneurs. It doesn't understand the role of anything that goes on in markets. And he has an abiding, almost touching faith in government, as do Akerlof and Shiller, to correct these errors that ordinary people get themselves into in markets. So he supports minimum wages. He doesn't like free trade. It's just a parade of nonsense.

WOODS: On the other hand, there is something, at least a little bit of common ground we can find with him when he says "how mainstream economists have damaged America and the world." Well, we have our criticisms of mainstream economists. They might not be the same as his, but at least one of them is he does seem to take issue with the efficient markets hypothesis. I don't know if he uses the term.

BOUDREAUX: Yeah, no, I believe he actually does use the term, and yes, on that he's correct. It's easy – You know, you and I would certainly agree here. A lot of free market economists, particularly those who are influenced by Chicago, have not done the market cause any good service with the efficient markets hypothesis by holding out perfect markets as the ideal. They've actually damaged the cause of freedom. These types don't understand that markets are a process, that this process involves the discovery of error and the constant correction of error, but it's never perfect.

And Madrick of course is able to – not unfairly, I should say – use the mischaracterization of markets that is embodied in the efficient markets hypothesis as a way to attempt to discredit free market thinking. But of course he's discrediting something that you and I understand is discredited, a case for the market. The case for the market is not at all dependent upon the market being perfect, and to point out that reality is not perfect as the efficient markets hypotheses claim it to be is easy enough for Madrick to do. It's correct, but that's not the case of the market.

And while you and I would agree with Madrick on that point, he doesn't take that disagreement to where it should go. His solution to the absence of efficient markets is to turn more power over to the state. My solution would be to turn more power over to ordinary people spending their own money in competitive markets.

WOODS: Just to make clear everybody is familiar with, because not everybody reads about stuff like efficient markets hypothesis, how would the efficient markets hypothesis deal with the claim: there is a housing bubble in the American economy? If I had said that in 2006, what would an EMH person have said back to me?

BOUDREAUX: Well, I'm not an EMH person, and I know that there are nuances among that group. I think what they would say is there is no such thing as bubbles, that people are always making wise decisions, at least in general, and that the results of these decisions at any moment in time are about the best the market can achieve. Information can change, which might expose yesterday's decisions to be in error, but at any moment in time the decisions people make are perfectly wise. People are not given to hurting behavior; people are not given at all to anything that an economist would recognize as an error, which I think is just silly.

It's one thing to note that people are not consistently irrational in the way that Akerlof and Shiller think they're irrational, but that doesn't mean that we then have to say, Okay, well, then everyone at every moment in time is always perfectly rational and never prone to error. The correct answer is somewhere in between.

And the efficient markets hypothesis, again, it gives unnecessary but good ammunition to enemies of the market, such as Jeff Madrick, who, by holding that hypothesis out as the groundwork upon which the case of markets are built, he's able to show the falsity of it. And therefore, he thinks, he's undone the case for the market, which he hasn't done, because the better case for the market, from Mises, from Hayek, from Milton Friedman when Milton Friedman did more of his popular work, Armin Alchian, from all the good economists, it's not based upon any sort of assumption of super-efficiency in markets and Mr. Spock-like rationality on the part of ordinary people. It's based upon decentralization and entrepreneurial discovery of and correction of error over time.

WOODS: And so if there were bubble conditions, the thought is that these would, given that people will figure this out, they'll all get incorporated into prices — Prices basically reflect real conditions, and if they don't there are correction mechanisms to make them reflect real conditions, so we wouldn't be in a bubble situation. But you're right; that turns people into — It gives people the thought that, Well, if markets aren't absolutely perfect, then there's no merit in them. They must just be a wild casino fluctuating wildly with no rational basis.

And of course as you say, there's nothing to that either, and that tends to make people think government is all-wise. And yet government would be at least as subject to these problems; certainly more, because they're not even dealing with their own property. They're not disposing of their own property.

So how do we respond now? This will take us into yet another one of these books, because there are two books that deal with the same problem about the financial crisis, the recent financial crisis — well, not so recent anymore, but 2008. The claim is this goes to show that markets don't work and that people are irrational. And I mean, I happen to have a pretty strong opinion on that, but I'm curious to hear how you answer that.

BOUDREAUX: Well, I do believe that bubbles can exist. I, frankly, like my colleague Larry White's explanation of at least a major part of what led up to the 2008 financial crisis. The Fed was overly exuberant with the money supply. People in markets, of course, they make their decisions based upon prices, and prices are determined by the supply of money. And if the supply of money gets out of whack, if the supply of money is being inflated, as it was, then people are misled by these rising prices. They don't realize that these rising prices are the result of excess numbers of dollars; they interpret these rising prices as reflecting real underlying economic changes. But at some point, because it is inflationary, the inflation bubble bursts.

And that's a very, very thumbnail sketch of a complicated historical episode, the financial crisis, but I believe it was caused — I believe a main culprit, if not the only culprit, but a main culprit was inflationary policy by the Greenspan Fed following the 2001 dot-com bubble burst. And so it's not irrational at all on the part of people to read prices. People are not geniuses. We're not omniscient. The Fed was able to fool people in a perfectly understandable way for a number of years into believing that real underlying economic conditions were changing, when in fact it was changing the value of money. And when that fact became revealed, then the house of cards fell. But it wasn't at all an indictment of free markets; it's an indictment of government monopoly control over the supply of money.

WOODS: I read an interesting paper by a Professor Lucas Engelhardt at Kent State University where he was arguing also that entrepreneurial quality suffers under massive central bank intervention, because he says it's not enough to say that the intervention of the Fed and the artificially low interest rates makes entrepreneurs into fools; it's more than that. It makes fools into entrepreneurs. So the type of person who enters the market under those conditions is not the same kind of person in terms of risk balancing and decision making that we would normally see in an unhampered market.

BOUDREAUX: That's a great point. That is a great point. To the extent that the price system gets out of whack because of monetary manipulation, the economic calculation becomes much more difficult, and you get mistakes on both sides. You get people making what would otherwise have been good decisions, those decisions appear at least immediately to be mistakes. And you have people making what would otherwise be exposed as bad decisions, you have those bad decisions being hidden and masked and protected from being exposed by the monetary manipulation itself. And so yeah, I like that point a lot. I hadn't quite heard it put in that way, but that's a great point.

WOODS: Yeah. Yeah, I always thought that was interesting. And plus, it's very rare that one of our points can be summarized in a bumper sticker, so when we get one I hold onto that thing like grim death. Now, we've sort of floated into the next book, *Debtors' Prison: The Politics of Austerity Versus Possibility* by I guess Robert Kuttner.

BOUDREAUX: Yes.

WOODS: And he talks about the financial crisis. But what I like is your discussion of the way he treats speculators, who are viewed as being the cause of problems. Like for

example, Greece was really damaged by speculators. Is it really speculators who damaged Greece?

BOUDREAUX: (laughing) No. No, Kuttner has the most hackneyed, potted view of speculators. He has the same view of speculator as Hugo Chavez and Maduro have. It's just an excuse. Of course Greece's problems arise – They are real, underlying problems. They're caused by government mismanagement of the economy. And what the so-called speculators do when they recognize, as any decently informed person would do, that the economy of Greece is being run into the dirt by its government, then investors sell Greek assets short, as anyone would do, because they're going to fall in value.

And so the speculators, in the case of Greece as in the case of all historical examples of speculation, speculators merely help to reveal more quickly the underlying, real economic problems. They don't cause the economic problems. In Kuttner's book he writes as if Greece was just this unlucky victim of speculators. It could have happened to the United States; it could have happened to Sweden, but my gosh, it somehow descended upon Greece.

WOODS: Yeah, how about that?

BOUDREAUX: Yeah. They happen to descend upon countries whose governments are especially fiscally irresponsible. Isn't that a coincidence?

WOODS: All right, so it turns out that speculators, not only are they not to blame, but in fact we should cheer what they're doing, because they're bringing the reality of the situation to us sooner rather than later. And obviously the sooner we know the real story, the faster we can try to repair the damage.

BOUDREAUX: That's right. Yep.

WOODS: And yet isn't it incredible? Speculators have the worst reputation. They are like the lowest of the low. And I personally think this is a way governments manage to divert attention for their own problems onto some obvious, evil, boogeyman bad guy.

BOUDREAUX: It is. It is definitely that.

WOODS: If politicians hadn't screwed up Greece, there'd be nothing for speculators to earn money on.

BOUDREAUX: That's right.

WOODS: All right, let's talk about *Throwing Rocks at the Google Bus* by, I guess, Douglas Rushkoff. So what's the thesis of this book here?

BOUDREAUX: That's a good question. I don't know.

WOODS: (laughing) Oh, okay. I thought that was an easy one.

BOUDREAUX: No, no. So when I read the Akerlof and Shiller book, I thought to myself, You know, this may be the worst book I've ever read.

WOODS: (laughing) And uh oh, turns out...

BOUDREAUX: And then it wasn't long after I submitted that review that Gene Epstein asked me to review this book by Rushkoff, whom I'd never heard of. And so I got the book, and I started reading it, and for the life of me, Tom, I still can't tell what it's about. He's kind of a hip – this Rushkoff guy, he's kind of a hip – actually, I think he's about my age; he's mid 50s, but he has this aura about him that he's kind of this hip Brooklyn beatnik kind of person who doesn't like capitalism. It's a mishmash of just absurdities from top to bottom.

The title, *Throwing Rocks at the Google Bus*, comes from an incident that, I gather, that Google sends a bus around the Bay Area to pick up its workers to drive them to their headquarters in what I think is Mountain View in California. And people in San Francisco are upset at Google, because Google apparently is responsible for running up rental rates, housing rates in San Francisco. So angry people threw rocks at the Google bus to protest Google's role in running up rental rates in the Bay Area – which of course is absurd. Rental rates rise in the Bay Area because of all of the ridiculous housing restrictions that exist in the Bay Area, not because of Google.

But Rushkoff has the most bizarre claims. He claims at one point in the book that capitalism is the invention of medieval monarchs. During the medieval period, fairs were – exchange was local, and that was wonderful and good, and people were starting to prosper immensely from these local exchanges. And medieval monarchs wanted to get in on the action and capture all the gains for themselves, so they invented capitalism. How they invented capitalism he doesn't really explain. But they invented capitalism in order to suppress poor people, and so capitalism was invented in the medieval period. Since then it's just been a time of unrelenting misery for ordinary human beings. (laughing) It's a crazy, crazy book.

WOODS: Which is refuted simply by turning your head slightly and looking around you.

BOUDREAUX: Absolutely, yeah. One – I think I say in my review; I certainly said it – I don't know if it came out in the final printed edition, but at one point in the review, at any rate, I mention that when I finished the book I honestly was not sure if it was not meant to be a parody on a bad book. If you set out to write just a really bad – If you wanted to make fun of a ridiculous book from a leftist perspective, you could not do better than to write this book as a parody.

It doesn't cohere from page to page. He'll say one thing – examples escape me at the moment. One page he'll say one thing; next page he'll say something else that completely contradicts what he said the page earlier. It's just a bizarre mishmash of romance about economic localism, romance about the past, misunderstanding about the role of corporations. I mean, look, of course there's crony capitalism. You and I disapprove of it, as we rightly should, of course. But his complaint about corporations isn't that they are cronies; his complaint about corporations is that they exist.

WOODS: Yeah.

BOUDREAUX: It's coming back to me a little bit now. If I had to summarize a theme, I think what he would say the theme is is that when the Web emerged 20 or so years ago, when the Internet emerged, there was a lot of hope among people who like local face-to-face exchanges that the web would make face-to-face exchanges more possible. It would bring back the wonderful localism of the medieval era. But lo and behold, the Web has been captured by the likes of Google and other big megacorporations, and so people don't exchange face-to-face; we're engaged in all of this impersonal exchange, which makes our lives miserable and impoverishes us. And he doesn't really have any solutions that deserve the name to this alleged problem; it's just a long complaint about modern capitalism by someone who doesn't remotely understand economics at all. Tom, I will say this guy makes Jeff Madrick look like Milton Friedman.

WOODS: (laughing) All right, well, that about does it. Well, let me read one sentence that you quote from him and get your comment on it. He writes, "Industrialization was about restoring the power of those at the top by minimizing the value and price of human laborers."

BOUDREAUX: Yeah. Well, let's try to figure out what that means. So the price of human laborers presumably is wages, so if you look at the wages paid to ordinary people from the beginning of the industrial age until now, you would be hard pressed to find a single economic historian who would say that those wages have not risen. Wages of ordinary people have risen dramatically in the past 200 or so years, and risen dramatically especially in those places that have been most industrialized. So this Rushkoff character is completely ignorant of economic history. He has no understanding of economic history whatsoever. He writes about a world that, from my perspective, is purely – it's a hallucination. I don't understand the world he – It's not any world that I know.

WOODS: And you know, the rise in wages has been so dramatic that even Marxists have had to retreat into saying, Well, what Marx really meant was not that the workers would deteriorate in absolute terms; he just meant in comparison with the capitalists. Of course you can see that the workers' situation has improved; it's just that it has relatively worsened. Well, if that's all they meant, it's not nearly as revolutionary. Not everybody's going to get up and have an armed revolution over that. So even they admitted that yeah, of course wages have risen. So he doesn't even understand that there's been a debate and an evolution among Marxists themselves.

BOUDREAUX: That's right; that's right. If I recall correctly, he actually cites Marx from time to time. But he genuinely believes, if his words at least in some parts of the book are to be taken seriously – and again, he contradicts himself backwards and forwards. He seems genuinely to believe that ordinary people in the world today are about as poor as we have ever been and that all the benefits of modern industrial society go to a few big wigs, a few fat cats at the top, people who own Google. And it's a very bizarre view of the world. If you close your eyes and you say, "I want the world to be whatever I want it to be. I'm going to pretend that history is whatever I want it to be at this moment when I'm writing this page of my book. It may be something different when I get to the next page of my book," that is how that book reads. It's almost as if it was written by a madman. It's just a crazy, crazy, bad book.

WOODS: Don, if people want to follow your work, is CafeHayek.com the place to go?

BOUDREAUX: That's the place to go, yep.

WOODS: All right, CafeHayek.com. And who blogs there?

BOUDREAUX: Well, the blog formally is still myself – the two bloggers are formally myself and my former colleague, Russ Roberts, who's now at the Hoover Institution, but Russ is pretty much retired from blogging. He puts up a post maybe once every six months or so now. And so it's really just me now. But formally Russ' name is still on the blog, and from time to time he will put something up. It's just me.

WOODS: Okay, okay, very good. So CafeHayek.com, I'll link to that at TomWoods.com/820. I'm also going to link to the books we've talked about in case for some reason people are – what's the word, masochistic? They can check them out, I guess.

BOUDREAUX: Yeah. Or if they're sadistic they can send them to their friends.

WOODS: (laughing) Yeah, there you go. There's something for everybody with these books. All right, thanks a million, Don. I appreciate it.

BOUDREAUX: It's my pleasure, Tom. Thank you. Happy new year.