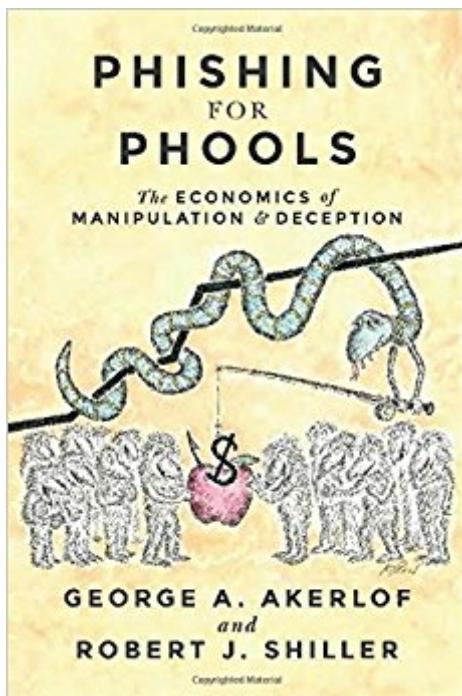


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# Phishing For Phools: The Economics Of Manipulation And Deception



## Synopsis

Ever since Adam Smith, the central teaching of economics has been that free markets provide us with material well-being, as if by an invisible hand. In *Phishing for Phools*, Nobel Prize-winning economists George Akerlof and Robert Shiller deliver a fundamental challenge to this insight, arguing that markets harm as well as help us. As long as there is profit to be made, sellers will systematically exploit our psychological weaknesses and our ignorance through manipulation and deception. Rather than being essentially benign and always creating the greater good, markets are inherently filled with tricks and traps and will "phish" us as "phools." *Phishing for Phools* therefore strikes a radically new direction in economics, based on the intuitive idea that markets both give and take away. Akerlof and Shiller bring this idea to life through dozens of stories that show how phishing affects everyone, in almost every walk of life. We spend our money up to the limit, and then worry about how to pay the next month's bills. The financial system soars, then crashes. We are attracted, more than we know, by advertising. Our political system is distorted by money. We pay too much for gym memberships, cars, houses, and credit cards. Drug companies ingeniously market pharmaceuticals that do us little good, and sometimes are downright dangerous. *Phishing for Phools* explores the central role of manipulation and deception in fascinating detail in each of these areas and many more. It thereby explains a paradox: why, at a time when we are better off than ever before in history, all too many of us are leading lives of quiet desperation. At the same time, the book tells stories of individuals who have stood against economic trickery—and how it can be reduced through greater knowledge, reform, and regulation.

## Book Information

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George A. Akerlof, Co-Winner of the 2001 Nobel Prize in Economics Robert J. Shiller, Co-Winner of the 2013 Nobel Prize in Economics Winner of the 2016 Gold Medal in Economics, Axiom Business Book Awards One of Foreign Affairs' Best Economic, Social, and Environmental (Economics) Books of 2016 Selected for Bloomberg View's "The Writing that Shaped Economic Thinking in 2016" One of The Times Literary Supplement's Books of the Year 2016, chosen by Paul Collier Honorable Mention for the 2016 PROSE Award in Economics, Association of American Publishers One of The Independent's Best Economics Books 2015 One of LinkedIn's Best Business Books of 2015 One of BusinessInsider.com's Best Business Books of 2015 One of Legal Theory Bookworm's Books of the Year 2015 Longlisted for the Financial Times and McKinsey Business Book of the Year 2015 "[Akerlof and Shiller] want to go far beyond behavioral economics, at least in its current form. They offer a much more general, and quite damning, account of why free markets and competition cause serious problems. . . . They are intellectual renegades. . . . Akerlof and Shiller make a convincing argument that phishing occurs because of the operation of the invisible hand, not in spite of it. . . . [This] extraordinary book tells us something true, and profoundly important, about the operation of the invisible hand."--Cass Sunstein, New York Review of Books "No question, Phishing for Phools is a radical book. It may also be a radically important one."--Fortune "Entertaining, readable and provocative."--John Lanchester, London Review of Books "I highly recommend this, even for those who might disagree with the authors' outlook. Their case studies are illuminating, and their insights on the way markets work are fascinating. When you consider the sorry state of the personal finances of the median working age family in the United States today, it's hard to disagree with their central thesis that our current system isn't working properly."--John Reeves, The Motley Fool, USA Today "A needed call for skeptical economics and financial mindfulness."--Nature "Using compelling examples of flawed decision making from advertising, health care and personal finances, the authors identify our rational weak spots and arm readers with the ability to resist manipulation."--Scientific American Mind "As you would expect, it's a very clearly written book with tons of examples. And it makes a simple and powerful point about the fragility of the normative, welfare economics conclusions economists tend to draw."--Diane Coyle, The Enlightened Economist "Akerlof and Shiller present convincing evidence of how tobacco, pharmaceutical, and liquor companies and politicians weasel a chapter of their own into our life

stories, abusing the mutual storytelling--with all its signs and wonders--that is elemental to our humanity."--Peter Lewis, Barnes & Noble Review"With accessible language and everyday examples, Shiller and Akerlof are taking on the powerful belief that aside from a few blemishes (like widening income inequality) only fools advocate interfering with the free market."--Chris Farrell, Minneapolis Star Tribune"The book's central message is certainly thought-provoking."--The Economist"Phishing for Phools forswears technical language, making this book accessible not only to economists but to consumers and policymakers. It should make everyone rethink the unfettered free-market model."--Brenda Jubin, Investing.com"It's a very clearly written book with tons of examples. And it makes a simple and powerful point about the fragility of the normative, welfare economics conclusions economists tend to draw."--Enlightened Economist"Its critique of conventional economics is more powerful and comprehensive--and more paternalistic--than that of Animal Spirits."--Carlos Lozada, Washington Post"[Akerlof's and Shiller's] insight is a powerful one."--Economist.com's Buttonwood blog"Akerlof and Shiller show that unregulated free markets systematically make people worse off by providing the unscrupulous with opportunities to take advantage of the unwary."--Adam Bouyamoun, The National"[Phishing for Phools] serves the important purpose of holding up a mirror to economics, a subject that prides itself on (supposedly) being the most sophisticated of all the social sciences. Economics may look sophisticated on paper, but it is often completely out of touch when it comes to reality."--Victoria Bateman, Times Higher Education"The book offers powerful support for a skeptical view of free markets, but it's also a helpful guide for consumers to avoid getting ripped off in the course of making important purchases."--Chris Matthews, Fortune"An interesting and entertaining new book by George Akerlof and Robert Shiller looks at the role of trickery in market economies. Phishing for Phools explains that sellers are often out to deceive you, and shows that this isn't an occasional glitch in the market system so much as an intrinsic and pervasive trait. . . . Phishing for Phools aims to help readers understand their psychological weaknesses, so that the phishermen can be phended off more effectively."--Clive Crook, Bloomberg View"Where Akerlof and Shiller break new ground is the sweeping application of the idea of the 'phishing equilibrium' to finance. . . . The style of Phishing for Phools will be familiar to fans of Shiller's work: light on jargon and pacy enough not to outstay its welcome. The authors tell some engaging tales."--Robin Harding, Financial Times"[A] surprisingly readable yet highly original book . . . the evidence and explanations marshaled by Akerlof and Shiller are compelling and they have profound political implications . . . an enlightening read by two expert economists. It should be required reading for policy makers and for consumers (which is to say, all of us. . . . [An] important, sobering book."--Oliver Kamm, The Times"Narratives

in this impressive book tell how to avoid being tricked by means of better enforcement and being told of pending scams. . . . [O]ne of the few titles dealing with fraud in the marketplace."--Library Journal"The authors provide is a . . . unifying theory for all kinds of trickery, an economic explanation for why deception is so rampant. It takes many of our scattered findings about humanity's blind spots--both psychological weakness and a lack of perfect information--and weaves them into a comprehensive framework that has the potential to be devastating for free market fundamentalists."--Victoria Finkle, *Washington Monthly*"Its central idea is an important one and merits more attention."--Emran Mian, *Prospect*"Phishing for Phools is packed with examples--including subprime mortgages, pharmaceuticals, political campaigns, gym memberships, credit cards, cars and cranberry juice labels--of the pervasiveness of deception and manipulation in our economy and the price it exacts on individuals and the society at large."--Glenn C. Altschuler, *Tulsa World*"This interesting book is written by economists mainly for economists, but it includes many entertaining stories about business behavior (and some disturbing ones), told in lively and accessible prose."--Foreign Affairs"The book is easy to read and relate; and more importantly will make you start thinking of the number of times you have been phished. The list would be endless!"--Madan Sabnavis, *BusinessWorld*"This unusual book offers a simple but challenging corrective to the assumptions made by most mainstream economists. . . . Probably not every reader will agree with every interpretation or argument--but every reader will find something that enlightens and stimulates."--James Ledbetter, *Yale Alumni Magazine*"This book was enjoyable to read, and the expertise and knowledge of the authors are abundantly evident."--William Holcomb, *PsycCRITIQUES*"Bob and George urge us to slap Adam Smith's invisible hand when it steals from everybody's cookie jar. They ask us to ponder those situations, economic or political, that provide particularly tempting opportunities to phish for phools. . . . Penetrating insights rendered in accessible prose."--Marlene Lang May, *Commonweal*"The book is the result of deep thinking and presented in an entertaining and easy-to-grasp manner."--Leonhard K. Lades, *Journal of Bioeconomics*"George Akerlof and Robert Shiller, two of the biggest names in economics for the past half century, take aim at the widespread assumption that free markets tend to produce the best outcomes."--Adam Creighton, *The Australian*

"In an entertaining and lively account, Akerlof and Shiller show that while the pursuit of profits may lead to products that enrich our lives, it may also lead to manipulation and deception. Much of recent innovation has led to products that make cheating the public easier. The implications are complex and profound."--Joseph E. Stiglitz, Nobel Laureate in Economics"Phishing for Phools is an

intellectual tour de force. It may change your image of the invisible hand into an invisible phoot, always looking to trip you up. Read it for phun; read it for wisdom."--Alan S. Blinder, author of *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*"A phabulous book! This is economics after the behavioral revolution at its best."--Samuel Bowles, Santa Fe Institute"Kerlof and Shiller provide a phenomenal guide to the pitfalls of the phree market. This redemptive revision of economic theory explains the built-in risks of rip-offs in a profit-maximizing world."--Nancy Folbre, professor emerita, University of Massachusetts, Amherst"As Kerlof and Shiller remind us, the same incentives that lead sellers to introduce innovations that improve quality and reduce costs also ensure that no profitable opportunity to cheat us will remain unexploited. This highly readable and insightful book will transform how we think about the role of government."--Robert H. Frank, author of *The Economic Naturalist*"Kerlof and Shiller extend the standard 'market failure' theory--which says that there is a potential role for government intervention when markets fail--by showing that markets fail not only because of the familiar reasons of externalities and unfair income distribution, but also because of the pervasive phenomenon of 'phishing for phools' (profit-seeking through manipulation and deception). They point the way to a new paradigm freed from the constraints of market failure theory, able to illuminate 'control by capital' (partly through phishing) and to prescribe for 'control of capital' (partly by techniques for limiting phishing suggested here)."--Robert H. Wade, London School of Economics"This insightful book exposes a fundamental contradiction in the market system. Consumers and policymakers beware: profit-seeking businesses foster efficiency and innovation, but have strong incentives to manipulate you and sophisticated new data tools allow them to do so in personalized ways."--Laura D'Andrea Tyson, University of California, Berkeley"This fun but serious book tells how the standard story about free markets often gets it wrong. Indeed, Kerlof and Shiller suggest that we should drop the view of markets as generally benign institutions. The argument is laid out with the help of fascinating anecdotes, the language is conversational, and the book is easy to read. It is addressed to a broad audience, but economists will enjoy it too."--Dani Rodrik, author of *The Globalization Paradox*"Phishing for Phools is a coherent and highly plausible explanation of why markets--although usually beneficial--can lead to undesirable outcomes. The book takes an intriguing approach and gives many interesting examples."--Diane Coyle, author of *GDP: A Brief but Affectionate History*

We are all, to a greater or lesser extent, "phools" being "phished" almost all the time unless we are especially mindful about our purchases. The trouble is that the US economy is driven 70% we are

told, by consumer spending. How much of this is essential spending, how much responsible purchasing, how much contributes to our sense of well being vs. some impulse or vanity or merely the result of some slick or persuasive advertising? It is hard in our culture to avoid being "phooled" and let's face it, who is doing the "phishing" much of the time but us directly in selling stuff or indirectly in working for companies that sell stuff or promote the stuff. Would this be a better world if less stuff was "phished" with less waste, less junk in the landfills, less energy used to create the stuff etc., etc. Good book for being more thoughtful and selective about our purchasing decisions.

Phishing for Phools: The Economics of Manipulation & Deception. George A. Akerlof and Robert J. Shiller. 2015. The authors, both Nobel laureates in economics, argue that the common economic model of a free market with assumed perfect conditions is woefully inadequate for formulating policy in the real world. Although free markets have contributed greatly to prosperity, they have also included many failures such as unfair distribution of income, inadequate social protections, and externalities like pollution that are mitigated by government intervention. Phishing for phools is added to this list of market failures. It is defined as manipulation and deception that are intrinsic to markets and that inexorably arise from the same profit motive that produces prosperity. In the past four decades, behavioral economics has identified many aspects of human psychology that differ greatly from the rational man of economic models and that are highly vulnerable to phishing. These include many cognitive biases and thinking in terms of narratives onto which marketers can graft other stories. For a much longer time, advertising and marketing in both business and politics have used sophisticated techniques to understand and exploit these same vulnerabilities. Numerous examples are drawn from all walks of life to show the pervasiveness of phishing for phools. For the financial crisis of 2007, the untoward actions of investment banks, rating agencies, and the trading of derivatives and credit default swaps are discussed. Rip-offs regarding cars, houses, and credit cards are revealed. Phishing in politics is said to undermine democracy, particularly because of the oversize role of money in elections and lobbying. For Pharma and phood, abuses before and after the Food and Drug Act of 1906 are discussed, including the 2006 lobbying victory that barred competitive bidding for Part-D Medicare drug coverage. Bankruptcy for profit by fraudulent bookkeeping in the savings and loan crisis of 1986-95 is described. The rise of Michael Milken's junk bond industry that enabled the excesses of leveraged buyouts by corporate raiders is reviewed. The phishing equilibrium is pervasive but not comprehensive. That is because we have individuals who step back from the profit motive and act as leaders of business and government. It is these heroes who make the free-market system work as well as it does, not

the unadulterated actions of markets. Some of these individuals work in or have founded organizations that measure and enforce standards, like the Food and Drug Administration, the National Bureau of Standards, and the Better Business Bureau. Other individuals have developed legal protections for consumers or have worked to regulate business and finance in government agencies that may be strikingly underfunded by the enemies of regulation in congress. The final section of the book discusses the competing stories of the free market. (Remember the importance of narrative in human thinking.) During the Age of Reform from 1890 to 1940, Populism, Progressivism, and the New Deal led to a new, more expansive view of the role of government. The old story is that in the post-World War II years there was a consensus that government met real needs by Social Security, Medicare, securities supervision, deposit insurance, the interstate highway system, aid to the indigent, supervision of food and drugs, environmental protection, auto safety laws, laws against mortgage-gouging, civil rights, and gender equality. The new story achieved currency in the 1980s when Ronald Regan said, “Government is not the solution to our problem; government is the problem.” This story is derived from an unsophisticated interpretation of standard economics that says free-market economies without government interference yield the best of all possible worlds. Actually, the free market is a double-edged sword that does produce great prosperity but that also produces highly significant harmful effects from which we need protection. The authors provide three examples of important old story protections and new story efforts to end or minimize them by

“reform” or defunding. Social Security: In the old story, for those over 65, Social Security provides more than half of unearned income for the bottom 80% and still provides 31% for the top 20%. Without it, the poverty rate for those over 65 would rise from 9% to 44%. Nevertheless, in the new story, the Bush administration, in 2004, proposed to privatize a significant portion of the program. The plan essentially gave the most vulnerable citizens government loans to be paid back with high interest rates in order to speculate in stocks and bonds. The authors thought that the plan was “to be blunt, daffy.” In addition, the Paul Ryan plan to privatize Medicare that would result in a typical person over 65 paying 68% rather than 25% of health care costs out of pocket. Securities Regulation: In the old story, securities regulation is one of the most important government functions. In the new story, these functions are to be undone by deregulation and defunding. Both of these likely contributed significantly to the financial crisis of 2007. In 2014, the SEC oversaw close to \$50 trillion of assets with a budget of 0.003 cents per dollar of asset. This is 1/400 of mutual funds budget of 1.03 cents per dollar of asset. Quite possibly, this new story defunding of regulators, with workloads and

salaries to match, contributed to the eight-year delay between notification of the SEC of suspicions about Madoff’s pyramid scheme and his arrest in 2008. Citizens United: In the old story, more than a century of campaign law aimed at limiting distortions by moneyed interests in elections. The Tillman Act of 1907 disallowed direct contributions by corporations to political campaigns. New laws in 1974 created the Federal Election Commission and limited campaign contributions and spending. McCain-Feingold of 2002 prohibited PACs, which had arisen to circumvent earlier campaign law, from mentioning candidates in advertising within thirty days of primaries and sixty days of general elections. In the new story, Citizens United, a right wing nonprofit political organization challenged McCain-Feingold in 2007 by paying to release a partisan documentary about Hillary Clinton. With new story thinking, the conservative majority of the Supreme Court denied the distinction between free speech by individuals and free speech by corporations. John Paul Stevens wrote in dissent that this defies common sense. Metaphorically, we must place some limits on those with resources to unleash huge loudspeakers that can drown out the messages of less well-endowed others. The authors conclude that it is wrong only to picture the healthy (i.e. “efficient”) working of markets because it means that modern economics fails to grapple with deception and trickery that are inherent in competitive markets. Thus phishing for phools is not just an occasional nuisance that should be considered on a case-by-case basis. It is a generality that is an inevitable and inherent part of free markets. Thus phishing for phools should be cast in an Adam Smith-style general equilibrium framework, which is the benchmark for thinking for all economists.

Free markets have generated unprecedented prosperity for individuals and societies alike. But, because the authors observe that free markets may also persuade many people to buy things that are good neither for us nor for society, they undercut Adam Smith’s notion that the individuals’ pursuit of self-interest in free, competitive markets advances the interest of society as a whole. It is this conundrum of free markets that forms the core of George Akerlof and Robert Shiller’s engaging new book, *Phishing for Phools: The Economics of Manipulation and Deception*. A “phool” is anyone who does not fully comprehend the ubiquity of “phishing,” the aggressive marketing and often, outright fraud (or example, Bernard Madoff’s Ponzi scheme) that has become the reality of today’s digital-age financial markets. As too many optimists have learned to their detriment, investing in asset markets is highly complex and fragile, and a whole ocean of phishes has set out to exploit this reality: Borrowers are lured into unsuitable mortgages; financial advisers spin narratives of riches from nowhere; and the media promote extravagant claims. Akerlof and Shiller’s view (supported by

plenty of data) is that rapidly rising prices usually reflect irrational exuberance, aided and abetted by phishing. Their main advice is that the financial authorities need to be prepared to intervene when financial turmoil turns into financial crisis. However, simply by the title, I think they are trying to tell us that we are all "phools" at one time or another, and that we need to be aware of this in making our investment decisions in our 401Ks and in other investing. This strikes me as a timely recapitulation of the wisest financial advice that has ever been given: "a phool and his/her money are soon parted."

Classic capitalist economics has a glaring omission: If people can turn a profit by scamming more easily than through honest work, then they will scam. And we have plenty of psychological blind spots that render us vulnerable to scammers. Most economists erroneously downplay these truths, and miss the richness of the "phishing equilibrium" that can help explain puzzling aspects of politics, the Great Recession, Bernie Madoff, and more. Written entertainingly and intelligently, Phishing for Phools discusses pharmaceuticals, advertising, real estate, street hustles, dope dealers, and more, to reveal the systematic ways in which we're persuaded to overpay. This is the most enjoyable book I've ever read about the dismal science (and arguably the most informative). It should be required reading for every high school senior and every college freshman.

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