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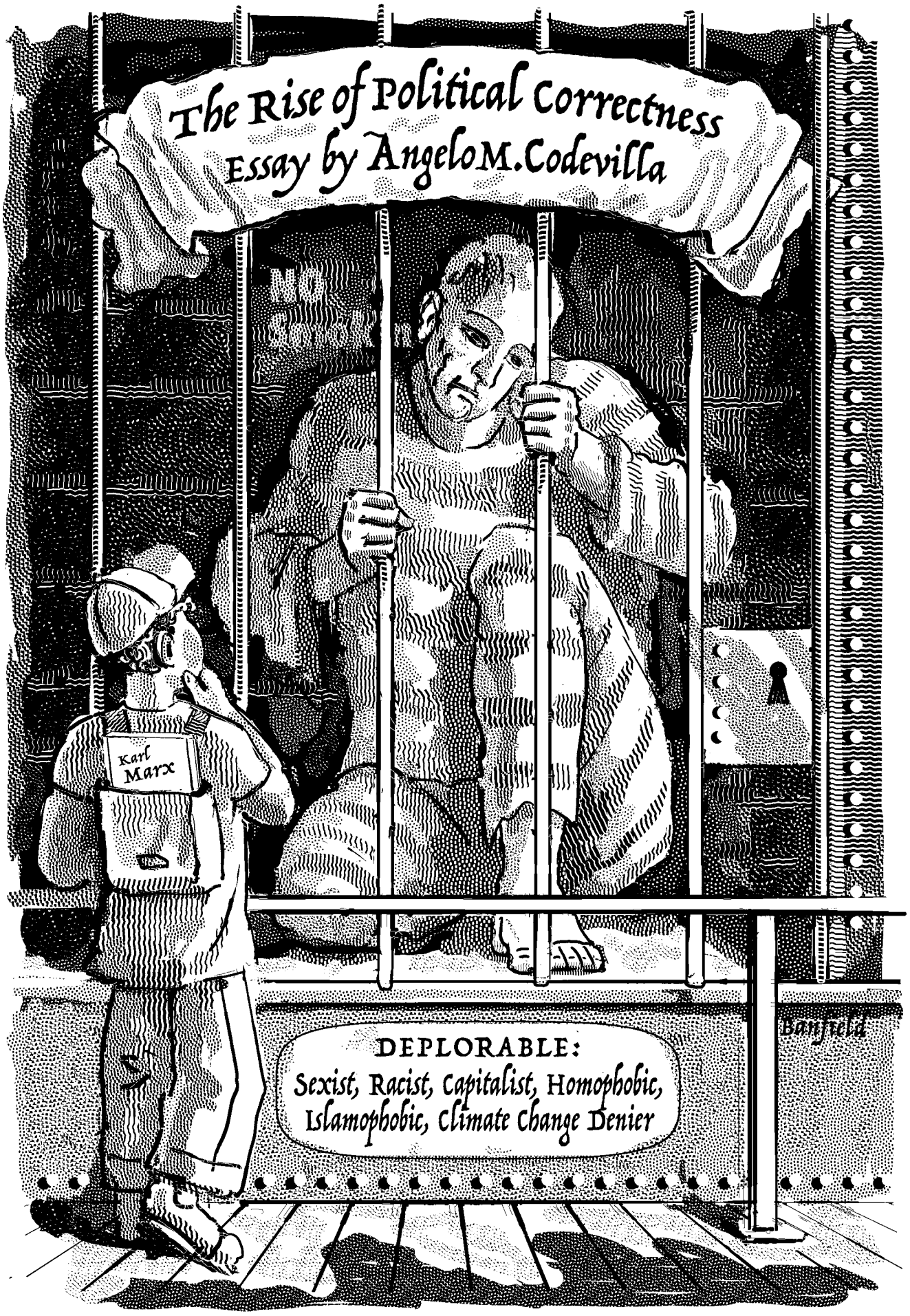

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Book Review by George L. Priest

Something Smells Phishy

Phishing for Phools: The Economics of Manipulation and Deception, by George A. Akerlof and Robert J. Shiller. Princeton University Press, 288 pages, $24.95 (cloth), $16.95 (paper)

The Conjurer, *drawing after the painting by Hieronymus Bosch, c.1505*

Modern economics is based on the proposition that consumers know what goods and services they're buying, and buy only the ones they believe will provide benefits exceeding their costs. It follows that relying on private transactions is advantageous to the society. Forcing people to buy or sell at prices other than the ones they agree upon mutually and voluntarily leaves some people stuck with goods, services, or money they don't want, and others unable to acquire things they *do* want on terms they're willing to meet. Government interventions to this effect not only reduce freedom, therefore, but welfare and efficiency: the information conveyed by market prices about resources' optimal uses is distorted or ignored.

In *Phishing for Phools*, George Akerlof and Robert Shiller reject this theory, calling for a new economic analysis that takes into account deception and misperception, which they believe to be rampant in market economies. Akerlof and Shiller are both Nobel laureates, the former for work on the economics of information, the latter for scholarship on the housing market. Schiller repeatedly predicted the fall in U.S. housing prices, though some years before the housing market began to plummet in 2007. (Full disclosure: Schiller is a colleague and neighbor of mine.)

The authors of this book, intended for a popular audience, define "phishing" as the perpetuation of "a fraud on the internet in order to glean personal information from individuals," though they apply the term more broadly to include getting consumers to do things in the interest of the "phisherman," rather than in the interest of the target consumers, the "phools." Thus, their analysis and examples extend far beyond the internet. They argue that modern economics should be reoriented to recognize a phishing equilibrium, not the welfare-maximizing equilibrium of the current view.

This issue is important for clear thinking and wise governance. If substantial misrepresentation distorts consumer choices, then conclusions about market equilibrium and the maximization of consumer welfare become far less tenable. A defense of the market that rests on the premise that consumers know what they're buying won't work if, in fact, consumers *don't* know what they're buying, or are purchasing products and services they don't need. Akerlof and Shiller insist repeatedly that the market is rigged to induce consumers to buy what sellers want to sell, against the consumers' long-term interest.

The authors present many examples of this perverse behavior. A favorite of theirs—often invoked in the book—is Cinnabon, which sells sugar-coated pastries in many airports and shopping malls. The authors, who apparently disapprove of sugary pastries, describe Cinnabon as placing outlets "in the track of people who would be vulnerable to that smell and to the story of the best cinnamon roll." *Phishing for Phools*'s other disapproving examples include: health clubs for which a monthly entry membership is more expensive than paying singly by use; cake mixes whose directions recommend adding an egg, even though the egg is not necessary; high-interest borrowing; advertising in general; and credit

cards. Akerlof and Shiller also regard special occasions—such as Christmas, weddings, funerals, and births—as events that lead to "rip-offs" of consumers.

They go to extreme lengths to establish that consumers are being deceived. Shiller, for example, tested different flavors of cat food—"turkey, tuna, duck, and lamb"—and found that, to him, the tastes weren't that different. Few of us would want to replicate that study. And its empirical validity is undermined by the fact that Shiller is not a cat.

"[C]ompetitive markets by their very nature spawn deception and trickery," the authors contend. Well. All of us recognize that there are efforts to deceive. We have laws criminally punishing fraud and other serious deceptions. Courts can void contracts entered into as a result of misrepresentation. The Federal Trade Commission (FTC) was established to prohibit "unfair and deceptive trade practices." Akerlof and Shiller mention none of these legal protections. They do cite a Uniform Commercial Code provision requiring "fair dealing," a provision so vague it has had no practical effect.

And, of course, consumers are and should be wary on their own. Comparison shopping—especially now on the internet—is an effective deterrent against deception.

The authors claim that there are two types of phools, psychological and informational: respectively, those too emotional to make sensible choices and those victimized by information "intentionally crafted to mislead." Their theory rests heavily on the work of Robert Cialdini, a social psychologist who has developed a typology of phools' leading characteristics. They want to reciprocate gifts and favors, to be nice to people they like, to obey authority, to follow others in deciding how to share, for their own decisions to be internally consistent, and to avoid taking losses.

Akerlof and Shiller's examples do not convince. Is Cinnabon a fraud, or do many travelers and shoppers sincerely enjoy a pastry for the flight or in the shopping mall? For centuries, people have debated the meaning of Eve and the serpent, but this book is the first to blame her temptation on the free market economy. It may be cheaper for many to pay health clubs by the visit, rather than to buy a monthly pass, but the pass means the marginal outlay to go to the gym is zero. This form of advance planning probably increases the number of visits, to the benefit of the consumer. The makers of cake mixes don't sell eggs, so derive no benefit from recommending an ingredient that enhances their product's consistency. The authors do not address these considerations.

Other particulars in their indictment are weakened by the failure to consider obvious counterarguments. They criticize credit cards, for example, because of the sometimes high interest rates consumers pay if they don't pay their balance on time. But do the authors live their lives entirely on cash, foregoing the advantages of reduced risk and enhanced flexibility?

Many complaints in *Phishing for Phools* address small-scale transactions. Some deceptions or misrepresentations are, surely, too trivial to justify invoking formal laws prohibiting fraud, or the time and attention of a regulatory agency. To my knowledge, the FTC has not investigated the sugar level in Cinnabon pastries.

But the authors make larger claims. They condemn advertising generally, for example. It "enhance[s] the sale of [products]…even if those sales reduce customers' well-being." Their central example is an ad from the 1960s showing a man with a black eye-patch wearing a Hathaway shirt. I remember the ad, but have never bought a Hathaway shirt. Akerlof and Shiller treat all advertising alike. Clearly, it isn't. There are products that are consumed and easily replaced if unacceptable, such as a shirt or soap. There are also more durable products, such as automobiles or large home appliances, where consumer research and comparison shopping play a larger role in purchasing decisions.

The authors also treat the savings-and-loan crisis of the 1980s and the financial crisis of 2008 as examples of phishing. They assign the lion's share of the blame for these financial crises to the rating agencies—Standard & Poor's, and the like—for failing to recognize the financial danger of the securitization of unsound mortgage loans. They don't, however, consider Peter Wallison's recent book, *Hidden in Plain Sight* (2015) about government policies promoting home ownership through easy credit—a big reason, he argues, for the housing market bubble and collapse. Akerlof and Shiller criticize proportionately high closing costs on mortgages requiring low down payments—10% or less—failing to see that the real problem is the governmentally induced low down payment itself.

Phishing for Phools asserts much more than it proves. Were the executives at AIG really phools for believing the ratings agencies' favorable reports on the financial obligations they incurred—and were they more alike than different from Cinnabon customers? Does Cialdini's list of "phoolish" character traits—reciprocity, being nice, obeying authority, prizing internal consistency, avoiding losses—really harm rather than help maintain a civilized society?

Regrettably, the authors don't offer a true theory of consumer misperception or its effects on the market. Nor do they attempt to measure the extent of market misperception, leaving the reader unable to gauge this problem's severity. In general, they recommend more government regulation—especially of the financial sector—but also severely criticize a number of regulatory decisions, in particular Food and Drug Administration (FDA) rulings. But do Akerlof and Shiller really want the FDA to approve new drugs, including life-saving ones, even more slowly? And how can we reason from FDA's failures to placing *more* trust and authority in other regulatory agencies? Is it fair to blame addictions—alcohol, drugs, smoking, gambling—on phishing, and ultimately on the market economy? Those addictions are hardly unique to nations that rely on markets. If anything, they are more prevalent in countries that suppress markets, such as in Russia.

So *Phishing for Phools* has not made a convincing case that misperception and deception require a new analysis of the economics of markets. Deception undeniably exists, and has a new venue on the internet, but logic and experience argue that individual monitoring, allowing consumer choice in the market, is the most important, most effective, and least risky preventive.

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