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Economics of Identity

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I.

Why do people get tattoos, and how do they choose the place and type of tattoo? Why do an ever-growing number of people subject themselves to plastic surgery in order to look like some ideal? Why do some powerful organizations prescribe uniforms, and have a code of conduct and honor that strictly define what is acceptable and unacceptable behavior for their members? Why do students primarily seek to be accepted by their colleagues from the group they consider important? Why are some jokes just a skillful pun for the people of one cultural model, and a grave insult for people from a different cultural context, causing a strong reaction? Why are some professions considered to be exclusively male, and some exclusively female? Why does money fail to provide sufficient motivation for action in many situations? All of these examples, as well as many others not listed, have to do with people's understanding of who they are. In other words, identity-related. Identity has finally become an integral part of economic science, to which George A. Akerlof and Rachel E. Kranton have particularly contributed their work.

In addition to other contributions in economics, American economist and Nobel laureate, Akerlof is also known as a consistent advocate for the introduction of new elements into the economic models. In his work, as well as in joint work with other authors, he suggests that it is necessary to include trust and mistrust in the economic analysis (i.e. a sense of fairness and the like) as a supplement to the simplified image of the selfish and perfectly rational homo economicus from economic textbooks. Akerlof and Robert J. Shiller believe that many complex phenomena in the economy and society cannot be explained satisfactorily if people are seen only as beings who have an economic motivation (i.e. responding only to economic incentives), and that rationally they aspire to achieving their goals (George A. Akerlof and Robert J. Shiller 2009). Real life provides ample evidence for the thesis that such economic model is not a satisfactory description of human behavior. In addition to economic motives, people also have non-economic motives, and do not always behave rationally when trying to achieve their interests in real life. For example, adherence for fairness means that people are not guided by profit-maximizing criterion when making decisions, but choose those outcomes that seem fair to them instead. Also, people often make such moves which do not bring any economic benefit, and even make decisions that may be fatal for them. Given this behavior, economic theory must also take into account these facts, not neglecting them in the construction of economic models.

In order for economic science to include, and analytically explain such "irrational" behavior, it is necessary to adapt existing analytical apparatus. The book in

question is definitely a step in that direction. In the book *Economics of Identity* the standard economic model applied in the analysis of behavior is extended by the introduction of a new element - identity. The economics of identity has been stimulated by the article "Economics and Identity", published by Akerlof and Kranton, in which they formally introduced the concept of identity (Akerlof and Rachel E. Kranton 2000). In this article, the objective of the authors was to demonstrate how identity can be successfully integrated in the standard economic analysis.

By using game theory they have shown how identity can affect the interaction among individuals, and have then applied the basic idea to different situations. The "Economics and Identity" article was followed by additional studies, and the theory has evolved in different directions (i.e. it was followed by the application of economics of identity in the analysis of some complex economic problems). This book outlines key findings of this very interesting and stimulating research, and the several fundamental papers written by the authors of the book.

II.

Before focusing on the details of the book itself, we would like to recall a few important observations presented by Amartya Sen in his analysis of identity (Amartya Sen 2007). He noted that it is hard to come to a satisfactory acceptance and treatment of identity in the social sciences, although it is clear to the analysts that identity is very important for understanding the numerous social processes. Sen pointed to the existence of two types of reductionism that can be observed by a careful study of the social and economic literature. He called the first "neglect of identity". Specifically, one group of authors works with the assumption that people do not have any sense of identity with anyone else except themselves. This approach, according to Sen's opinion, is dominating in economic theory. Economic models are built on the assumption that people do not pay attention to anything beyond themselves when choosing their goals and priorities, and have no sense of identity with anyone else. Sen called the second type of reductionism "single bond". It is an approach in which identity is not neglected, but it is assumed that any person has only one identity, and that it belongs only to a single collective. Sense of identity with others can have a strong influence on one's behavior, especially on the behavior within a group. The time has come, believes Sen, to dethrone the hypothesis of "neglect of identity" from the position it occupies not only within economic theory, but also in the legal, political and social theories. Viewed in this context, Sen believes that the work of Akerlof and Kranton, as well as other analysts, is a step in the right direction.

Akerlof and Kranton maintain that economics of identity reinstates human passions (i.e. "living people") and social institutions to economic science. Simply put, identity is to be included in the economic models in order to analyze how it affects motives and behavior. It is a common standpoint of economic theory that the tastes and preferences are proper to the individual. Akerlof and Kranton expand this idea, and include it in their analysis of identity and norms derived from the social environment. This procedure introduces social context in the analysis of behavior (i.e. the individual is not viewed in isolation but as a part of a social environment). In their model utility functions include individualistic tastes, as well as norms. They

especially emphasize that individuals also acquire some preferences as members of their communities. Preferences therefore vary according to social context, for example, individual understanding of fairness depends on the social context.

In similar situations different people make different decisions, meaning that they act differently to the same incentives. For an explanation of this behavior it is also necessary to include identity in the analysis (i.e. the perception of who people are, what is expected of them, and what they will lose if they violate the norms that should be respected). What one's motivation will be, and how one will behave, depends on what one wants to be. What people are concerned about, and how much they really care about something, depends also on their identity. Human behavior largely depends on who people think they are. Experimental studies of behavior have indicated that people behave differently when they are just "reminded" of their identities (e.g. racial, ethnic, gender, social). The motive arising from the identity may, in some cases, be so strong that people are ready to even die for it. Pursuant to the economics of identity, what makes people happy largely consists of living in harmony with the idea which individuals have built about who they are, and what they should do. In other words, using the language of microeconomics, the individual increases his utility if he behaves in accordance with his ideals - identity. Akerlof and Kranton talk about identity utility, specifically as a gain when the actions of the individual are in harmony with his ideals and norms, and a loss if they are not.

The authors emphasize that identity may be chosen (of course, some identities are given and unalterable), and given that it is fundamental to behavior, it may represent the most significant "economic decision" that people make. When they talk about the choice of identity, Akerlof and Kranton do not mean only the conscious choice. They have in mind the fact that individuals are trying to fit into a particular group, for example, a migrant may choose whether to assimilate or not. Thus, the available choice of identity is restricted in many cases.

The standard economic model, the authors note, does not take socialization into account. This book assumes that individuals shape society, but also that they themselves are shaped by society. Identities and norms are derived from the social environment. The norms are clear when people have an ideal of who they should be, and how they should act. In this concept, individuals internalize norms, and adhere to them because they consider it appropriate.

The common view in economics is different, where the individual complies with the norms because he expects to be punished in case of violation. The economics of identity assumes that people who comply with the norms do so because they believe in them. Identity could be simply described as a set of social rules that the individual has internalized, and is the basis in which he forms his personality. Compliance with, or violation of the rules (e.g. in school, firm, work group, family), is a way to communicate something to others about oneself. In an article published in 2000, the authors note that identity introduces a new type of externality. Actions of a person may have meaning for other people, and can cause reactions in them (Akerlof and Kranton 2000).

III.

Akerlof and Kranton provide an overview of key works in which economics of identity were applied in different contexts (e.g. military, business, designing incentives in the work group, education, gender segregation, racial discrimination). They believe that identity is of the utmost importance when it comes to understanding how organizations operate, which in turn eventually influences the efficiency of the entire economy. To illustrate this, we shall single out just a few observations. If an organization wants to operate successfully it should not rely solely on financial incentives. In order to explain this observation it is necessary to include the identity in the analysis. First of all, it should be noted that employees do not have financial motives only. The identity of the individual in this context comes down to whether he considers himself an “insider” or “outsider”. Insiders are those who fit in, the adapted ones, those who identify themselves with the company. The insider’s ideal is to provide maximum effort and work not only for his own benefit, but also for the benefit of the company. In contrast, the outsider has only his own benefit in mind, without paying attention to the company. If he considers himself an insider, the employee will have the same goals as other members of the group, and will be motivated to get them implemented. More precisely, if he considers himself an insider the employee will perform his best at work, as he will feel good in this case. Pledging full force at his workplace, the insider maximizes his identity utility. The outsider will shirk (such employee does not share the same goals with the company in which he works), and will seek appropriate financial compensation as an incentive to put his best effort forward.

An outsider would reduce his identity utility in his work performance requiring a raise of his salary in order to make him put his best effort forward, and neutralize the negative impact of his performance on the identity utility. In short, if the employee identifies himself with the company, he will need a small cash incentive to maximize his work performance. Therefore, it is rational for the firm (it is in its best interest) to decide on the measures and activities that will contribute in transforming outsiders into insiders. It is also important to note that an insider would experience decrease of his salary as something unjust, and therefore he would act accordingly. Likewise, it has been determined that employees identify themselves with the work group to which they belong, and not necessarily with the company as a whole. In this context, insiders are those who identify themselves with the group, while outsiders consider themselves a foreign body. In addition, it is observed that in order for an organization to be successful, it is necessary for the employees to perform those tasks with which they are personally identified.

It is interesting to observe the factors of educational efficiency (i.e. it was found that the basic ideas of economics of identity are also applicable in this context). Why are some schools successful while others are not? Akerlof and Kranton maintain that the existing economic theories of education treat schools as factories, meaning that the student compares the costs and benefits of continuing education, and the school is only obligated to teach. The economics of identity considers that this image is not a good description of what is actually happening, as surely this is not a complete description of the educational process. First of all, it should be noted

that schools not only teach skills, but they are also the institutions with social goals. Schools are not only transmitting knowledge and skills to students, but also the norms about who they are, and what they should become. Schools, among other things, teach students to comply with certain rules and to appreciate certain values. Most of them are explicit, but there are also those that are transmitted tacitly. Students are trying to fit in among their peers, specifically in a particular group that has its own norms. They have different characteristics (e.g. their athletic abilities differ, their origins differ, they differ according to the income of their parents, etc.), and according to these characteristics they select groups where they wish to belong. Of course, not all students will be successful in adapting to the selected group. Students will behave according to the rules of the group if they were internalized, that is, if they have accepted them as part of the identity.

They will increase or decrease their identity utility if the effort they invested deviates from their ideal. If students do not identify themselves with the school, and do not accept its authority (outsiders), there is no learning. Learning would, in this case, lead to a reduction in their identity-utility. This raises the central question of whether the schools should be passive, and give students what they want themselves, or if their duty is to tell the students what to do? What do the experiences of the school system in the U.S. show? Successful schools differ very much from one another. One type of such schools insists on discipline, prescribing not only how to master the curriculum, but also the smallest details of dress code and communication. On the other side there are successful schools that insist that students should think freely. Although at a first glance they are profoundly different, in the opinion of Akerlof and Kranton both types of schools do the same - they purposefully design the identity of their students and tell them how they ought to behave. The reformers of the school system have applied different strategies with more or less success, but one important finding has imposed itself; in order for the school to be successful, it is necessary for both the students and teachers to identify with the ideals of the school (i.e. with its "mission" in the society). In other words, it is necessary that all those involved in the educational process have a strong insider identity. Students need to feel belonging to the school, and feel to be a part of the group identity whose important goals are learning and advancement. It is therefore no surprise that successful schools are those showing that they actively project identities and norms of their students (i.e. those which are successful in turning outsiders into insiders). Successful schools stand out as those that have succeeded - using different strategies - in creating a strong sense of community through all participants of the educational process (i.e. the feeling that everybody is working on the same task).

IV.

Many social sciences use identity as an important, sometimes even central concept, for the understanding of a particular social phenomenon. This book demonstrates how the concept of identity can be incorporated into economic science, and what results were achieved through this implementation. Behavior designated as self-destructive ("irrational") under the standard economic model becomes understanda-

ble in the new analytical context. Akerlof and Kranton draw attention to the fact that this book is only the beginning, a sort of primer in economics of identity, and they expect that this area will develop in years to come. They also emphasize some important issues that will be placed before researchers, including where do the norms and identity come from, how do they change and evolve, what are the feedback connections between identity, economic policy and institutions? For example, Sen insists in his already mentioned book that the history and origin are not the only way in which we see ourselves and the groups to which we belong (Sen 2007). Our identity is multiple because there are a number of categories to which we belong simultaneously. In addition, the importance of a certain identity for the individual doesn't necessarily diminish the importance of others.

Akerlof and Kranton also talk about the diversity of identities. In addition, they highlight the fact that people can change identities in the course of their life, whereby the dynamics of these changes depends on the type of identity. Some identities rarely change, while others change more frequently. Change of identity will be manifested as a change in preferences. Let us also mention that some economists see economics of identity as an aspect of modern behavioral economics. Economists have long recognized that people's behavior is guided not only by a financial motive, but also many other motives. However, the point of departure for most of them was the fact that these preferences are independent of the social context. Akerlof and Kranton question this assumption, and offer a different interpretation. They emphasize the individual who is part of the social environment. Seen from this perspective, the economics of identity provides an analytical framework for theoretical and empirical study of such non-monetary motives.

What position have the economists taken regarding this idea, that is, what was the reception like? As always in economics, opinions are divided. Some economists are skeptical of the concept, and their skepticism is based on the fact that it is very difficult to model identity. Most of them still believe that the economics of identity is a step in the right direction; it is a concept that has enriched the existing arsenal of economic theory and analysis, and expanded its range in the study of several important topics. Analysts have pointed out that the economics of identity will bring benefit not only to economists but also to other social researchers, including especially sociologists.

Finally, it is worth mentioning that this very interesting and inspiring book was written without the use of complex analytical apparatus of economic theory (without mathematical apparatus), and is therefore accessible to a wide range of readers. However, the book is more complex than it may seem to the reader at a first glance. The authors also tackle some fundamental questions of economic analysis and economic methodology.

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