

## Prepublication Version

**Klaus F. Zimmermann** recommends

“Identity Economics. How Our Identities Shape Our Work, Wages, and Well-Being”

by George A. Akerlof and Rachel E. Kranton

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*Economists explain individual behavior by market prices, total income and preferences through a utility evaluation of alternative actions. A new research agenda adds an identity variable that depends on the individual's actions, its assigned social categories and the actions of others. Social norms related to expected behavior in social groups can influence individual behavior and choices. If monetary factors are constant, any choices in conflict with identity are avoided.*

Economists are used to explaining individual behavior by market prices, total income and preferences through a utility evaluation of alternative actions. A new research agenda adds an identity variable that depends on the individual's actions, its assigned social categories and the actions of others. Choices are then based on both monetary incentives and identity issues. This way, social norms related to expected behavior in social groups can influence individual behavior and choices. It incorporates a number of noneconomic motives by stressing the impact social context has in real life. Identity as the individual's self-image gets to the center of individual choices. If monetary factors are constant, any choices in conflict with identity are avoided. The conclusions of previous economic analyses may change substantially.

While standard consumption bundles are allocated by “garden-variety tastes”, identity and norms are based on social context. The core of the new theory relies on an identity formation relationship in the spirit of Gary Becker's home production function relating the identity of an actor to all his or her own and all others' actions and the difference between individual characteristics and the norms in the assigned social categories. It now matters for identity and the utility derived from the self-image in what way individuals act contrary to or in line with the norms of the social groups they belong to. A new type of externality may also arise when individuals' utility is affected by the

departure of other actors from those social norms. It is important to note that tastes remain independent of social context and individual preferences are given. Social context drives identity formation, but individual identity is captured fully by the entire augmented utility function.

George A. Akerlof and Rachel E. Kranton have developed the concept in a series of articles since 2000 and have outlined their insights in a well-known book written for a wider audience (2010). The importance of identity was also observed in disciplines like anthropology, psychology, sociology, philosophy, or subfields of economics like culture, gender or ethnicity. Issues of measurement, determinants and the effects on economic behavior are also frequently investigated. *Identity Economics* is a theoretical analysis that encompasses the idea into traditional economic analysis and outlines its potential for a variety of real-life challenges like organizations, education, gender, race and poverty. The book illustrates that economics can be realistic and fun.

The authors "know that there is little distance between assumption and result (p. 118)" in their approach. Its value lies in the new assumptions that enable a significantly different view of reality: Loyal workers need lower incentive payments in organizations like trade unions, the military and churches. Generated by societal norms, individuals labelled male or female work in different occupations and female wages will be lower, even with similar education. "Many African Americans seem to choose courses of action that middle-class white and black Americans consider disastrous", although their rate of return to schooling is higher than for whites. In all cases, individuals seem to trade off lower wages against higher social status. More empirical studies will provide possibilities to evaluate relevance and relative weight of identity and shed more light on identity formation and the evolution of norms.

## **Literature**

Akerlof, George A. and Rachel E. Kranton (2010). *Identity Economics. How Our Identities Shape Our Work, Wages, and Well-Being*. Princeton University Press, Princeton and Oxford.