

XXXXXX SLIDE 1 XXXXXX

Economics and Identity

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Stamp Lecture

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SLIDE 2 XXXXXXXX

Thanks to Rachel Kranton

This lecture is based on a long-term research program with Rachel Kranton on the implications of identity for economic behavior.

I am especially grateful to Rachel for extending to me the invitation to join this project.

In the spring of 1996 Rachel wrote me a letter which said that my previous paper, on Social Distance, in *Econometrica*, had missed the concept of *identity*.

She also said that concerns regarding identity were a serious omission from economic theory.

Initially I was not pleased to receive this letter, which said that my previous paper was all wrong.

I also thought that Rachel was in error.

**I thought that identity was just an aspect of people's tastes.
As a result, I also thought that standard utility theory already took full account of it.**

But after we talked it over for a great deal of time we discovered that *identity* really does have a meaning.

We decided also that it is a major factor missing from current economics.

Rachel and I have now written four lengthy papers on this subject, and now we are trying to summarize it in a book.

Those four papers are:

Economics and Identity: QJE.

Schooling and Identity: JEL.

Organizations and Identity: JEP.

Macroeconomics and Identity: AER.

And this lecture is a summary of where we have gotten to date on that book.

**There are a very large number of people who do not like what we do.
They think that we are violating the rules.**

Some questions may come up during about this and I think that I have answers to these questions that always come up.

I actually think that it is the other way around.

**I think everyone else is failing to understand what the rules should be.
They may citing the rules of economics.
But the rules of economics violate the more general rules of science.**

So this is my strategy on this.

When I was a child I used to read a series of books called the Freddy Books.

They were about a talking pig who lived in Upstate New York.

There are some 30 books in the series, all about some different adventure of Freddy.

He is a detective, he is a politician, he goes to Florida and to Mars, he flies a balloon, etc.

My aim with Rachel here is to write such a series.

Not the Freddy series, but the Identity series.

Even though people initially find identity discordant, it is my hope that with persistence, over a very long period of time, that people will get used to the idea, and instead of identity being something you should not consider, it will gradually become part of the accepted landscape.

Remember that the Rock and Roll of the 1950's and 1960's is now considered the Golden Oldies.

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SLIDE 3 XXXXXXXX

With that prefatory note let me begin.

Economics is about Incentives.

The standard view of economics is that it is about *incentives*.

For example, this is the main theoretical theme of *Freakonomics*.

By training its sights on *price incentives*, standard economics is *price theory*.

But that takes us to the central question of this lecture.

Are there types of *motivation* that are not described in current price theory or that are not described in current economics?

This lecture will describe what I believe is a significant source of *missing motivation* in economics.

Of course there may be other sources of missing motivation, but Rachel and I think that this is a particularly important one.

We ask the question whether there is a systematic way to think about and to characterize this missing motivation.

Our goal is to analyze it by tools that are very similar to what we use for price theory.

Sociologists have described that missing motivation as concerned with identity.

These motivations are all but absent in current price theory and in current economics.

Yet it has serious impact on many of the most important economic problems.

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SLIDE 4 XXXXXXXX

Standard Method of Economics

Standard economics is based on the maximization of objective functions.

Typically, consumers maximize utility functions.
Firms maximize profit functions.

This may be a good way of doing economics.

The description of what people are maximizing gives a way to classify how firms and consumers both behave.

It classifies their motivations.

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SLIDE 5 XXXXXXXX

III. The Missing Motivation: Norms

But economists' characterization of these motivations is now very narrow.

This was pointed out at the beginning of the Twentieth Century by Vilfredo Pareto.

Pareto said that economists missed important aspects of motivation.

According to Pareto people typically have opinions as to how they *should*, or how they *should not*, behave.

They also have views on how *others should*, or *should not*, behave.

Their views about how they and others should behave depends also upon who people think they are.

Sociologists would say that it depends upon their *identity*.

This means that they lose utility insofar as they, or others, fail to live up to these beliefs regarding what people should or should not do.

Such notions are central to motivation in modern sociology.

But they are absent from economists' representations of utility.

People's views of how they, and others, should or should not behave, are called *norms*.

These views may be held with great conviction.

But they are usually not moral or ethical views.

For example, I should not deliver this lecture while wearing shorts.

It is useful to understand why sociologists have considered norms to be central to motivation.

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SLIDE 6 XXXXXXXX

Ideals

Sociology has a further concept that gives an easy and natural way to add those norms to the utility function.

Sociologists say that people have an *ideal* for how they *should* or *should not* behave.

Furthermore, they often conceptualize that ideal in terms of someone they know; it may be someone they do not know; or it may even be an imaginary person.

We can then bring this into standard economics by a simple device.

We just modify the utility functions that express people's motivations.

We modify the utility functions to add a loss in utility that depends on the distance of behavior from that ideal.

Religion affords many examples of norms that are described by the behavior of an ideal person, who is the founder or the prophet of the religion.

Consider Christianity's use of the Gospels.

The Gospels describe the life of Christ.

Christians believe that:

A Christian ought to take the Gospel of Christ as the model of behavior.

A Christian thinks she should be *ashamed* when she does not live up to her interpretation of the Gospels.

Other Examples:

But religion is only one of the many realms where people have such an ideal.

To appreciate the ubiquity of norms in motivation it is useful to see some further examples.

Those examples will demonstrate that people tend to be *happy* when they live up to how they think they *should be*;

And they are, correspondingly, *unhappy* when they fail to live up to those norms.

XXXXXXXXXXXX SLIDE 7 XXXXXXXXXXXXXXXXXXXX

Further Examples

Here is an example that should be especially familiar to those of you who have taught.

A teacher usually has a clear view of what it means to be a good teacher.

**If she lives up to that standard, she feels good about herself.
If she falls short she may even feel quite miserable.**

The same feelings apply to most any activity, from playing golf to being a parent.

It applies to the conduct of most jobs.

Randy Hodson, a sociologist at Ohio State, surveyed ethnographies of the US workplace.

**He found that most employees care about their *dignity at work*.
They want to conceive of what they do as useful.
And they feel a lack of dignity if they are thwarted, either by their own actions or by the actions of others.**

Those who are unable to get such satisfaction are likely to show their displeasure by acting up in some way or other.

The *Feminine Mystique* gives what may be as good a description of norms and their impact on people's lives as can be found anywhere.

Here is a brief sample of Betty Friedan's descriptions of the norms for a middle-class housewife in the early 1960's.

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XXXXXXXXXXXX SLIDE 8 XXXXXXXX

[Betty Friedan slide]

Millions of women lived their lives in the image of those pretty pictures of the American suburban housewife, kissing their husbands goodbye in front of the picture window, depositing their stationwagonsful of children at school, and smiling as they ran the new electric waxer over the spotless kitchen floor. They gloried in their role as women, and wrote proudly on the census blank: "Occupation, housewife."

**Most women agreed with those norms.
But there were dissenters, like Friedan, who disagreed.**

**They felt compelled to follow a norm with which they disagreed.
Friedan says they had “the problem without a name.”**

They were unhappy because they were failing to live up to other people’s norms for how they were supposed to behave.

We may appeal to religious texts, to work ethnographies, and, like Friedan, to women’s magazines, to see the role of norms.

**The sociologist Erving Goffman has found an example that is yet better.
He has found a natural experiment that is revealing of adherence to norms.**

He observed the behavior of children of different ages when they were brought to the local Merry-Go-Round.

Because appropriate activity differs by age, the children should have predictably different reactions.

For the toddlers, riding a wooden horse is an accomplishment.

They show their joy at fulfilling what they should do with smiles and waves as they pass by.

In contrast, for older children, there is a gap between their conception of how they should behave and riding the Merry-Go-Round.

They feel the need to distance themselves from an activity that is so age inappropriate.

They do so by riding a frog, rather than a “serious” animal like a horse.

Or they show off by standing up “dangerously” during the ride.

In some way or other, they play the clown.

A few months ago I observed this at the local Merry-Go-Round in the public park in Berkeley.

The three and four year olds waved merrily to the parent on the sidelines as they passed.

I especially watched a 13 year old who went onto the Merry-Go-Round.

He first warily sat on an ostrich; he later switched to a horse; then he went to another animal; and, finally, while the Merry-Go-Round was still turning he seems to have gotten off, as I lost sight of him.

But such behavior is not just the stuff of kids.

In surgical operations, because of their inexperience, medical students are given tasks that are ridiculously easy.

They respond in the same way as the older children at the Merry-Go-Round.

They act the clown.

These examples are then illustrative of behavior that is pervasive.

Sociology is *dense* in examples of people's views as to how they and others should behave.

They show their joy when they live up to those standards.

They show their discomfort and reactions when they fail to do so.

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SLIDE 9 XXXXXXXX

So how does this apply to economics?

In the typical textbook example people have utility for apples and bananas.

And the typical demand curve is said to be derived as people choose the best combination at each price and each level of income of the apples and bananas that they will buy.

Economists have been very clever in altering the utility function to take into account many social considerations.

But they have not altered it in a way that takes into account *identity*.

What that entails is for people to have a view of *who they are*, like the examples of the Christian, of the teacher, and of the children at the Merry-Go-Round.

And corresponding to *who they are* they have an ideal for behavior.

They lose utility insofar as they do not live up to that ideal.

They may also have an ideal for how *others* behave.

And then they lose utility insofar as those others do not behave that way.

And then people often seek to restore their identity.

That is especially interesting because many of these reactions, such as dueling and making foreign wars, are very perverse.

It is useful to make a habit of adding the considerations that I have just described to people's utility functions.

It is easy and straightforward.

There is an easy and simple protocol to adding identity to standard economics.

What is that protocol?

In any situation *characterize* how the decision maker conceives of herself.

As I said before, a sociologist would say that this is her identity.

Sociologists have a name for it: they call it her *social category*.

Corresponding to this identity, ask what is her ideal for how she should behave.

We denote that ideal as e^* . e^* depends upon how she conceives of herself. It depends upon her *social category*.

This ideal, to remind you, is $e^*(c)$. It depends on her social category, c .

We use the letter e , because in many of these problems *ideal effort* is a key variable.

Then ask how unhappy she will be insofar as her actual behavior, which we denote as e , departs from this ideal.

Add this to the utility function.

She has the standard economic utility, which depends on standard economic variables.

And she has an additional argument to her utility function, which depends upon the distance between her ideal behavior and her actual behavior.

It depends upon the distance between e^* and e .

Knowing this will give you a prediction how she will behave.

There is an innovation here.

This is central to sociology.

But I am not sure that we see it at all in economics.

The innovation here, which every sociologist takes as second nature, is that the utility function is not fixed.

The ideal, which is e^* , depends on the person's social category.

That is the moving part here that makes this theory different from standard economics.

In addition:

In addition, according to the protocol, in many problems people not only care that *they* are living up to their own identity, but their identity is affected by *other* people's actions.

And then they may be motivated to act on this in turn. For many problems this should also be entered into the utility function.

I think that you will be surprised at how important concerns about identity are for your own happiness and also for most of the decisions that you make.

Also many, but not all, of the counter-intuitive statements of economics are wrong because economists simply have the wrong model.

It turns out that this method of analysis explains a great deal of people's motivation.

It is the stuff that the gossip columns and *People* magazine is made of.

And it explains the motives of everyone from school children to the most ruthless dictators.

XXXXXXX (pause—but no slide)

I know that all of the economists in the audience have three thoughts.

The first is that all of this gives up the parsimony of standard economics.

The second question is whether identity is, or is not, observable.

The third question concerns the endogeneity of identity.

Let's defer these questions to the end of the lecture, but I think that I have good answers to them.

I definitely want to answer those questions.

I also want to see your reaction to them.

But I do want to emphasize one point here.

No matter what, if people are motivated by these identity considerations, and if there is some feedback between them and economic decisions, it is wrong to assume them away.

To get the right economics the utility function must reflect people's true motivation.

We simply do not have a choice.

To assume that the utility function is different from what it really is, is lamp-post economics.

According to the joke, it is looking for the coin under the lamp-post where it is easy to look, but not where the coin really is.

Whether you like what I am going to do or not, I claim that we have no choice.

If identity really does inform people's decisions then we *must* model it.

That means we must add it to the utility function.

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Outline: remainder of the lecture

That informs the outline of the remainder of the lecture.

I am first going to give you six examples where the addition of considerations of identity does substantively affect the economics in six significant areas.

The economics of minority poverty.

The economics of schooling.

The economics of organizations.

The economics of gender in the workplace.

The economics of gender in then household.

and

Macroeconomics.

Then I will describe four *functionally* different ways in which it changes economics.

These are the reasons why leaving identity out of standard economics makes a difference.

There I will also give you some more examples.

But I am sure that I will run out of time.

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Economics of Impoverished Minorities

The worst problem to my mind in the United States is the social conditions of African-Americans.

Progress was made in the Civil Rights Movement.

But remarkable inequality remains.

At current rates of imprisonment, the probability that an African-American male spends some time in *prison* is somewhere between 30 and 40 percent.

Prison is not jail.

The average male who enters prison at some time in his life will spend on average 5 years there.

That is really a terrible thing.

2/3 of African-American births are out of wedlock.

The fraction of African-American males of prime age 25 to 34, who are not employed is close to 40 percent.

For high school drop outs, according to Derek Neal, it is 60 percent.

Such nonemployment, out-of-wedlock birth, and incarceration are so high that they require an explanation that goes beyond illegal racial discrimination.

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SLIDE 12 XXXXXXXX

Oppositional Culture

For that we turn to identity.

Historically, there has been a different code for how blacks and whites should behave in America.

Such a code was especially clear in the US South.
Some of it was even formalized in the law.

The code told blacks and whites how they *should* behave.

It also specified punishments for transgressions.

When Rosa Park refused to give up her bus seat for a white, she was arrested and fined.

When Richard Wright was given an optometry job deemed only appropriate for whites, the other employees threatened him and forced him to quit.

Emmett Till was lynched.

Such actions are now illegal.

And Americans now think that it was morally wrong.

Yet, in the words of Glenn Loury, white Americans, even when well-intentioned, still think of a white American as “us” and a black American as “them.”

Such difference between “us” and “them” is the origin of an oppositional identity.

The psychological effects on those who are treated so differently and supposed to *know their place* as one of “them” are very powerful.

“They” are likely to adopt a view of themselves in opposition to the “we” of the dominant culture.

Such opposition comes from a basic human emotion.

If *they* thumb their noses at *us*, *we* want to thumb *our* noses at them.

This rejection is self-affirming.

But it also comes at an economic cost.

With this identity, it is difficult to adopt the behaviors expected in a white dominated workplace.

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Standard Theory

This is the leading theory among African-American scholars for the continuance of African-American poverty.

Here is a list of some of those scholars:

Elijah Anderson, James Baldwin, Kenneth Clark, W. E. B. Du Bois, Franklin Frazier, Ulf Hannerz, John Ogbu, Lee Rainwater, and William Julius Wilson.

Such opposition and the motivation behind it are evident every hour of the day and night.

You can just tune in to rap music.

Kabir Sen, who is the son of a former LSE professor, has made an invention. He is writing and performing *peaceful* rap, rather than violent rap.

Oppositional culture can be easily be represented by simple changes to a standard economic model.

Those who accept the dominant culture are *insiders*.

They have a high level of effort that they think they should put in.

That is e* for insiders.

On the contrary those who feel that they cannot accept the dominant culture, are *outsiders*.

They have a different level of effort that they think they should put in.

There is a different e* for outsiders.

Of course, effort is a general word describing a whole panoply of different behaviors.

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Economic Policy

If oppositional culture does exist, as the sociologists say, how should it affect policy?

I will talk about what I know, which is the US, and I will let you extrapolate what I have to say about America regarding its possible relevance to your own country.

First of all, every non-Black American should understand how every African-American feels.

If you read the book by Stephan and Abigail Thernstrom on black and white in America you know that there are a lot of people, even presumably the leading historians on the subject, who do not get it.

That should be a beginning.

There are also ways, at least gradually, to make America a place in which everyone feels welcome.

But that takes public money and public resources.

A significant number of studies have shown that African-American children are very sensitive to the quality of their education.

They respond much more than white children to small class size. (Krueger and Whitmore).

They also respond much more than white children to excellent teachers. (Ronald Ferguson).

There are miracle schools.

These schools--even in the most violent neighborhoods--have produced excellent educational outcomes.

The Comer Schools in New Haven and the Central Park East Secondary Schools in New York have shown that by taking a sensitive approach to students' problems they can obtain very good outcomes.

At the elementary level Comer achieved excellent test results.

CPESS achieved rates of high school graduation and college continuance that would have looked good in the richest suburbs.

All of these miracle schools have done well because they have led the students to a positive ideal for how they *should behave* in school.

I will illustrate with a brief anecdote.

When James Comer took over as advisor to the Baldwin school in New Haven, Connecticut the place was a mess.

It was impossible to get the students to sit down for an effective class.

His program taught administrators, teachers, parents and students that there was an *appropriate* way to behave in that school.

In terms of our model, there is an e^* for how one should behave in that school.

It was Comer's goal to affect that e^* .

Comer knew that his program had become a success at the beginning of its fifth year when he saw a new student begin a fist fight, and then, as Comer watched, one of the continuing students intervened:

He said: "We do not do that in this school."

But that is exactly the point: that the cure to this problem is to give students a view regarding *what we do and what we do not do in this school*.

That is a problem that is not going to be solved solely by a curriculum, but by teaching students, teachers, administrators and parents, one by one, the ideals of what it means to be a good student.

That is possible.

But it is possible only if we make a special commitment to the high quality teachers needed to accomplish this task.

The inner city schools need the best of our teachers.

They also need the lowest teaching loads.

Current US education policy, which is No Child Left Behind, is only an empty slogan, without the *real* resources to back it up.

If the leading sociologists are right.

If they are right that racial identity, really, is the important factor in Black/White differences, then it would be a mistake for economics not to incorporate it into economic analysis.

This is a first indication of an area where the understanding that we obtain from economic analysis can be enriched by adding considerations of identity.

In this view it is not just initial conditions of low education and low endowments, but also e^* that is responsible for the continuation of African-American poverty in the US.

This variable is central to sociological studies, but it has been off the table for economists because it is not a part of our standard theory.

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Economics of Education

I have, not entirely inadvertently, then begun to cover the very next topic of the talk, which is the economics of education.

Race is very important, but it is just one aspect of the economics of education.

In my reading of the literature, the most basic question in the economics of education has been: how much education do people get?

That is called the demand for education, or the demand for schooling.

Economists also ask what are the returns from an extra year of education?

**I take what I know on this from Alan Krueger and David Card.
In my opinion they have shown that those returns are quite high.**

A third question regarding the economics of education is: what effect do different programs have on academic achievement?

I very much like the work in the economics of education.

But Rachel and I found that education practitioners have very different questions.

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Literature on Education

Educational practitioners and scholars want to describe what makes a school work and what causes it to fail.

Typically they write school histories and ethnographies.

I want to give you three snippets regarding US schools and show how they relate to identity.

First, Rachel and I were surprised at the emphasis in histories of US schooling on immigrants in the late 19th Century.

The school teachers of this time felt it was their mission to Americanize *their* students. They would even tell them how to dress and whether or not they needed a hair cut.

The students found this insulting.

Some of them put up with it.

Many of them simply dropped out.

Whether rightly or wrongly the school teachers of this generation felt that it was their mission to change their students' identities.

The historians have emphasized this behavior in the 19th Century schools because education scholars claim that US public schools have evolved into the exact opposite.

The second theme from this literature is then that the current US high school has evolved into “shopping mall high.” (Powell, Farrar, and Cohen)

It is not because it physically resembles a shopping mall, but rather because the attitude of the school is the attitude of the shopping mall.

At the shopping mall, the shops give you what you want.

In contrast, according to the book *Shopping Mall High*, the purpose of the school should be to change *who the students are*.

That is what the old teachers did in their caring but insulting way.

Those teachers had a view of who their students should be.

They worked to impose it.

But Shopping Mall High just caters to the pre-existing demands of the students.

**If you want a good education you can get it.
That is the honors track.**

But if you want to get no education at all, the schools have programs for that.

Most of all, the schools are scared stiff of insulting their students and telling them what they think they *should* or *should not* be doing.

[Here is an anecdote from a recent *New York Times*.

A current prominent Supreme Court Case concerns whether a student who was punished for posting a 14 foot banner saying Bong hits 4 Jesus is entitled to \$3000 in damages. The banner was placed across from the school in an Olympic parade in Juneau Alaska.

Justice Roberts felt that such practice of freedom of speech might interfere with teachers who wanted to teach Shakespeare.]

In this view the problem with US education is that it is not doing its duty.

It is failing to impart the proper identity to its students.

Then, there is a third theme in the sociology and history of education.

This is associated with the late great sociologist, James Coleman.

Coleman said that schools are *little societies*.

These little societies have norms and identities of their own.

These norms are not the norms of the adults who presumably run the schools.

They are the norms of the students who go to them.

He entitled his book on this *Adolescent Society*.

The norms are set by “the leading crowd.”

There is a recent paper by John and Michael Bishop. They have taken the Coleman method one step further.

I quote their view:

XXXXXXXXX SLIDE 17 XXXXXXXXXXXXXXXX

Students form groups with strong independent sub-cultures in order to produce and consume excludable jointly produced services. These services include friendship, emotional support, socializing, gossip, parties, competitions between schools, prestige from belonging to a high status clique. They set norms for academic engagement, pressure teachers to “go easy” and punish group members who violate peer norms.

The Bishops took surveys in which they asked students about the leading crowd, and the extent to which they felt that they needed to conform because of the bullying.

They trace the very sad story of a poor young child in middle school who wanted to be what he called “straight” rather than be a part of the leading crowd. This poor young boy was simply shunned by all of his erstwhile friends.

And the Bishops have especially given a picture of the roles of the leading crowd, and how they have very large effect on the norms of the school.

They paint a picture that the leading crowds are so powerful that they trump the norms that the teachers and the school would like to set.

The leading crowd controls because those who belong think that *others* should behave according to its norms.

They get utility by enforcing those norms on anyone those who do not obey them.

The Bishops find that there is a great deal of bullying and teasing in US middle schools and high schools.

Those who do not like the norms set by the leading crowd have a difficult choice.

They can choose to be unpopular on the one hand, or to join them on the other hand.

Of course much of the time they do not even have a choice. They simply look or act different from how the leading crowd thinks they should be.

There are two terrible things about the norms of the leading crowd.

The first is that they involve a great deal of bullying.

Those who do not behave as the leading crowd thinks they should in the typical American school face a very difficult life.

The direct suffering caused by bullying should be sufficient reason to make its eradication a priority in all schools.

But, its effects go beyond that.

And that is the second terrible thing about these norms.

They determine the ideal type of who students *should be*.

It changes the ideal type as all of the students have to come to terms with how to deal with the bullies.

The message of this literature is that the economics of schooling, what makes a good school and what makes a bad school, comes from the identities that schools manage to impart to their students.

It matters who those in the leading crowd think they should be.

The implications of this literature is that good schooling is schooling that imposes on the school population the proper notion of *who one should be* in this school.

That, as I said earlier, is the exact opposite of *Shopping Mall High*.

Once again we see that the standard economic theory leaves out something essential.

Of course this question regarding how well people fit in, and what it means to fit in, are essential to answering the three key questions of economics.

Let's go back to the three major issues in the economics of education.

We see that identity then affects all three of them.

It affects the drop out rate.

It affects the quality of the education.

And it is extremely important in the respective success or failure of different school interventions or experiments.

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This takes us to the third area, which is the:

The Economics of Organizations

Most economic activity takes place within organizations.

So what makes organizations work?

The standard economic theory of organizations says that they will work if people in different jobs are given the right economic incentives.

But a careful reading of the economics also gives an opposite interpretation.

In this view, no matter what the incentives of an organization, its employees will find a way to use them to their own advantage rather than for their original purpose.

Let me motivate this by an example from *Freakonomics*, where Steve Levitt found that Chicago school teachers responded to the financial incentives by *directly filling in* their students' answer books.

There is one way, and perhaps only one way, around such *gaming of incentives*.

In organizations that work, employees identify with their organization.

Or, perhaps more narrowly, they identify with their task within the organization.

In this case the workers identify as *insiders*.

In terms of the model.

They have one value of e^* if they are *insiders*.

They have another value of e^* if they are *outsiders*.

If they are insiders, they *want* to do their jobs.

This very much reduces the conflict of interest between the organization and its employees.

The key result of our paper on Organizations is that if people identify with the organization, or with their job in it, then the optimal variation in pay is much less than if people do not identify with it.

That, in our view, is what allows organizations to work.

They work then when people who are given a job identify with it.

Why is that what makes organizations work?

Because in our interpretation, the standard economic theory of organizations mainly shows that variable compensation policy *does not* work.

(We think that this also accords with the views of leading contract theorists such as Canice Prendergast and Bob Gibbons.)

It does not work because people, like the Chicago School teachers, will always find a way to game any system, with which they do not identify.

Once again we have seen that a key variable that has been left out of the analysis is e^* , and key motivation that is left out is how people feel bad when their effort e has not lived up to e^* .

In bad organizations, employees are *outsiders*, e^* is low, and people do what they can get away with.

In good organizations, employees are *insiders*, e^* is high, and people want to do what their jobs say they should do.

I can illustrate with the example from the very beginning of the lecture.

When I teach a class that goes over well I feel good about it.

When I give a bad one, I am ashamed.

I am not doing it for the pay.

I am doing it because of my ideal that I *should be* a good teacher.

I think that is how I *should* behave.

American Universities are said to work very well.

All of us have very strong identifications of being good teachers and also good researchers.

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We know that this addition to the theory must be relevant because it has:

Policy Implications

The policy implications of such identification are relevant to every organization from schools to businesses to the US Army.

In terms of economists' traditional concerns regarding pay, if workers identify with their organization then they do not need much variable compensation to meet the *Incentive Compatibility* constraint.

(There may be a need for high pay to meet the Participation Constraint).

The idea that CEO's need enormous pay incentives is simply wrong.

A CEO who does not deeply care about his ship should not be the captain of it.

In fact a CEO who gets highly variable pay and that is what she cares about is very dangerous, because she will game the system to increase her pay.

The other general conclusion is that people who have jobs have a duty to do their jobs. They are fiduciaries.

We should be researching legal arrangements that are less specific than current law in punishment of specific misdeeds.

Instead, the basic crime of office should be the failure to meet its responsibilities.

Since such fulfillment of fiduciary duty to office should be the fundamental motive of the office holder, then an efficient law should make that also the fundamental crime for nonfulfillment of the office.

US law, as currently written, usually punishes white collar crime for the violation of some technicality rather than for the real crime, which is gross neglect of what fiduciary responsibility.

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This takes us to the fourth area where the omission of identity from economics makes a substantive difference.

This is the economics of:

Gender and the Work Place

Economists have studied gender quite extensively.

The usual (Becker-Mincer) economic model of gender explains the division of labor between men and women by specialization.

Men then specialize in market production.

Women specialize in home production.

That was considered a natural division of labor since, because of pregnancy, women have a comparative advantage in home production.

But identity gives another picture.

In that picture there are some *tasks* that are labeled *for men*.

There are other *tasks* that are labeled *for women*.

Men lose identity if they work in women's tasks.

They also lose identity if they associate with women who work in men's tasks.

They will try to restore their lost identity by punishing women who do.

Also, women lose identity if they work in men's tasks.

Interestingly, women also often punish *other women* who cross gender lines.

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Economic Policy

Where does this affect economic policy?

Economists wrote about the welfare of women before the women's movement.

The University of Chicago and Columbia were especially good. Relative to the times they were remarkably advanced.

But they also did fail to appreciate the basic problem.

The Women's Movement made it clear for the first time that most *tasks* should not be considered to be more appropriate for one gender than for another.

Even today some of the most enlightened lawyers fail to see the real nature of most sexual harassment.

The standard view of *sexual* harassment is that it has *sexual* connotations.

Of course this is an important form of gender discrimination.

But the major form of sexual harassment is different.

Let me give an example from Irene Padavic, who is a sociologist at the University of Florida.

Padavic took a job as a participant observer as a coal handler at a large utility.

The men there saw this as a man's job, not a woman's job.

They needed to restore their threatened identity.

On one occasion they picked her up, treated her as if she were a sack of coal, and pretended to put her on the coal conveyer belt.
They were joking of course.

There is now a legal movement in the US that sees such behaviour as the basis of sexual harassment.

It fights gender discrimination on the basis that harassment occurs because tasks have been inappropriately gendered.

Harassment is the penumbra of activities that concern treatment of women as different from men.

They are especially hard to police because they often take the form of jokes, that are occurring because men are trying to assert their identity.

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The Economics of the Household

I have briefly described gender at work.

But it is also true that in the household many tasks are considered feminine.

Others are considered masculine.

Arlie Hochschild interviewed many San Francisco Bay area couples about work in the household.

She reported her findings in a book called *The Second Shift*.

Being enlightened Californians, of course, they split the work 50/50.

One of my favourite couples was Evan and Nancy Holt.

They also split the work 50/50.

Nancy took care of the house above the basement.

Evan took care of the basement, which included his tool chest.

They also evenly split the duties with respect to the biological life of the family.

Evan walked and fed the dog.

Nancy took care of the baby.

Statistical regressions show that such division of household duties are a national pattern.

When the husband does all of the outside work in the household, the wife does 90% of the housework.

From that we would expect that when the wife does all of the outside work in the household that the man would do 90 % of the work.

On the average, according to our estimation, he does 1/3 the work.

Also within the home for the most part women do women's work.
Men do men's work.

There are nice studies of this by sociologists.

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[I will skip Macroeconomics, which is the last of the six areas where identity matters.]

Macroeconomics

That takes us to the last of the six areas where identity matters.

I will go over the paper on this very briefly.

Macroeconomists have obtained a large number of rather surprising results over the last 50 years, which basically say that Keynesian policies do not work if people are fully rational.

They have shown many different neutrality results such as those from rational expectations and natural rate theory.

But none of these results have taken into account that people have views regarding how they and others *should* or *should not* behave.

Once one has taken such views into account we easily get the standard Keynesian economics that is taught in most intermediate macro textbooks, but which has been rejected in most graduate textbooks and most graduate teaching of economics.

The policy implications of this are that the government should take a major role in trying to prevent the economy from falling into recessions, and also, occasionally, curbing demand when there appears to be irrational exuberance.

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I now come back to the very beginning of the lecture.

We have seen six areas where the inclusion of identity can make a very significant difference to the analysis of economic problems.

You can draw your own conclusions, but I would say that the effects of its inclusion are first-order in each of the areas that I have described.

But then the further question arises: why should it make a difference.

There are four functional reasons why it makes a difference.

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Directly Care About Identity

The first functional difference is that people engage in activities because they care *directly* about their identity.

This can even lead to self-destructive behaviour.

We all know about the terrible things done by some primitive tribes to make themselves

beautiful.

But beauty practices, including dieting that leads to anorexia, are still common.

Personally, I will never forget the agony of my wife's college room-mate after her face-lift.

A recent book claims that cosmetic surgery is a \$15 billion dollar industry in the US.

[Reference: *New York Times Book Review*, October 22, 2006. *First Chapter*, Alex Kuczynski.

“All form a part of the mosaic that makes up the \$15 billion cosmetic surgery industry in America.”]

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Identity Externalities

Identity affects economics because it introduces a new form of externality.

I will give one example that, for the United States, was a matter of war and peace.

According to the historian Ann Norton, the US Southern culture of honour before the Civil War is not just from *Gone with the Wind*.

It was reality.

She says that the difference in identity between Northerners and Southerners was the cause of the Civil War.

Two psychologists, Richard Nisbett and Dov Cohn, found vestiges of this Southern code of honour in a clever experiment at the University of Michigan.

Male students were asked to visit the researchers in an office at the end of a narrow hallway.

Along the corridor, an accomplice of the researchers would bump the student. Rather than apologizing, the accomplice called the student “asshole.”

The experimenters measured reactions to this insult.

Students from the South were more likely than those from the North [~~and also more likely~~

~~than those from the South who had not been insulted]~~ to fill in subsequent word-completion tests with aggressive words (for example, g-un rather than f-un).

They also had higher cortisol levels.

And the insulted Southerners were also more likely to fear that the experimenter had a low opinion of their masculinity.

Such culture of honour is just one of many ways in which one person's actions has an externality, whereby their action affects the identity of others.

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Manipulation of Others

A third way in which identity plays a new role in economics, people attempt to change, or to manipulate, other people's identity to goals of their own.

The most obvious example here is: *Advertising*.

Another is *Politics*.

Politics is often a battle over identity.

Fascist and populist leaders often foster racial and ethnic divisions.

Symbolic acts and transformed identities spur revolutions.

Gandhi's Salt March sparked the Indian independent movement and a new national identity.

The French Revolution changed subjects into *citizens*.

The Russian Revolution turned them into *comrades*.

This is very different from the standard economic models of politics in which people vote for different platforms based on what they thought that the different parties would give them.

In this model people also vote for the party with which they identify.

It is not a question of what your country can do for you, but what you can do for your country.

I was a minor advisor to the Kerry campaign.

In my opinion Kerry lost the last election because he focussed his appeal on the selfish motives of the voters.

His campaign was about what programs he would give to the voters.

But since programs are expensive he had nothing much to offer.

There was never an appeal to get voters to think of themselves as being on the same team as Kerry, so that they would think that they *should* vote for him.

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Time Inconsistency

Identity provides a new window on time inconsistent behaviour.

People may have different identities at different times.
They have different focuses and different interests in different situations.

Indeed they become a different person.

And as they do so their norms and ideals also change.
In the traditional view of economics, life is a game of chess, where each move anticipates what will follow.

Here instead, life is a series of only partially connected episodes.

In these episodes people have different goals, corresponding to how they conceive of themselves at the time.

The slide lists some of the transitions which get people to think of themselves as different persons.

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Conclusion

I have given you an outline of some of the ways in which the introduction of identity gives different economics and different policy conclusions.

It involves a new use of utility theory that captures many important motivations.
In any given situation just think about *who the person thinks she is*.

And then think about what her ideal must be, and how much utility she is going to lose if she does not live up to that ideal.

You may also want to think about others' reactions to how she should or should not behave.

I had thought that this analysis would be important to every area of economics except finance.

But then I was invited to give my views to a conference on finance, so I may be wrong.

I have reserved for the end some time for questions.

I would especially like to answer the basic methodological questions, which I know are disturbing most of the economists.