On the emergence of identity economics: a review

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Abstract

The emerging sub-field of identity economics has gained a recognizable increase in interest since the publishing of the seminal work of Akerlof and Kranton (2000). One must acknowledge that there have been significant antecedents of their work within psychology. According to our review of the related literature, the application of social identity theory from social psychology to economics seems as a theoretically well-founded logical step; however, the actual integration of the concept of identity into the analysis of economic choice has resulted in a rather fragmented literature. In this paper, we reviewed the seminal theoretical works, and the most representative empirical papers on possible applicability of the identity economics approach. We claim that after recognition of alternative approaches like considering identity as relations, rather than categories, the field will gain a more significant role in economic analysis.

Keywords: identity economics, social identity theory, social environment, decision making

Why identity economics?

Economists' approaches to decision-making are often criticized for decontextualizing the decision-making process, while representing economic agents as simplified beings with a single aim of utility maximization. The emerging subfield of identity economics attempts to remedy the shortcomings of the current mainstream economics approaches. According to this line of research, humans are social beings who base their choices not only on monetary incentives, but also on their social identities. From this perspective, individuals and economic transactions are embedded into social context, where the desire to build, to maintain or to avoid certain identities in relation to others can also serve as a motivating factor for individuals. In this short paper, we review the seminal theoretical works that have led to the emergence of the field, followed by an introduction of selected empirical studies from various areas of application. By compiling this review, we aim to provide a foundation for future research in identity economics.

Theoretical foundations

Social identity theory and identity economics

Identity economics is an emerging sub-field of economics that is not associated with a singular, standardized and agreed upon theoretical and empirical framework. Due to this characteristic, psychologist, sociologist and economist researchers over the past 40-50 years have developed their models and theories along separate paths, sometimes creating divergent interpretations regarding their focus on identity functions (Charness & Chen, 2020). However, several more established and cited models have emerged, two of which are social identity theory by Tajfel and Turner (1979; 1986) and the identity economics framework by Akerlof and Kranton (2000; 2010) which are discussed in this literature review along with papers that build on these works,

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as both of them have been instrumental in creating the groundwork that a significant number of identity economics related papers cite and incorporate.

The concept of social identity, as examined in the following line of research, is defined as an individual's sense of self in relation to social group memberships, as perceived by that individual (Charness & Chen, 2020). The studies of human identity and its behavioral implications started in the psychology sphere, where a noteworthy model called social identity theory was developed by Tajfel & Turner (1979; 1986). According to the model, a person's social identity is an important variable that is responsible for one's motivations of grouping other individuals and themselves into social categories and consequently for discriminating behavior between the thusly established groups. Individuals categorize others and themselves into social groups via inherent human instincts, which categorization is then utilized to gain positive feeling and identification from those group memberships. On the other hand, this also goes for discrimination towards outgroups, as viewing them negatively reinforces the positive feeling from belonging to the ingroup.

The social identity theory utilizes the minimal group paradigm, where the ingroup and outgroup is distinguished only by an irrelevant classification. However, that classification difference is found to influence reward distribution between outgroup and ingroup members; in other words, there is a positive ingroup bias even for unrelated social group memberships (Tajfel et al., 1971). An integral component of social identity theory, the self-categorization theory, (Turner, 1985) describes how priming individuals for certain environmental cues causes specific social categories to become salient, which causes the individuals' behaviors to change towards the social norms associated with the newly salient category. Utilizing priming, it is therefore possible to create the conditions needed to observe behavior changes related to social categorization and its inherent biases towards group memberships. Integrating the social identity theory and the self-categorization theory led to the broader concept of the social identity approach, which denotes the utilization of the underlying concepts into a significant number of fields of research, cited most popularly in psychology, business and management, with economics also being on the list (Brown, 2019).

Identity economics, as developed by Akerlof and Kranton (2000), approaches the topic by criticizing the rational choice and expected utility theories stating that they do not adequately represent how individuals make economic decisions, and to remedy this they created a new utility function. In their system, individuals are a part of society which influences what is considered the appropriate decision by a certain individual. Individuals value goods that are related to their social identities, while reject goods that are unsupported by their social norms as these goods provide positive and negative utility, respectively. Additionally, identity economics is applicable to the economics of organizations alongside individuals. It is stated that a positive effect exists between effort put in work and the remuneration provided for it, which has implications for what is the optimal amount of work for a given amount of remuneration. This is also applicable for education, where social identity associated with studying and the institution determines how much positive or negative utility is generated. In the job market, the model explains the effect of gender segregation on which jobs are seen as socially accepted for each gender (Akerlof and Kranton, 2010).

Advances in identity economics

Other subfields, combined with identity economics, can advance understanding and fill in gaps of knowledge. Complications in stratification economics were addressed through identity economics which arose from how individuals can have multiple identities. In this case, two types of social identities are distinguished: categorical and relational identities, which are both self-constructed and socially constructed. These social identities are ranked by individuals based on social contexts they are in (Davis, 2014). While most reviewed research involves categorical identities, Garai (2017) discusses an alternative strain of social identity research based on relational identities. In his work, the external environment is in focus, shifted from the internal environment, where individuals are interconnected through their relationships to each other and their social groups. These relationships are defined by interactions and the saliency of social identities in these interactions, as opposed to categorical classifications of defining attributes.

Review of empirical studies of different fields

An example of the economics application of the self-categorization theory and social identity is seen in a study that looks at Asian and Black ethnic category norms on time and risk preferences by utilizing priming targeted to make the racial background salient causes Asians to make more patient choices, and Blacks to become more risk averse in stock market participation (Benjamin et al., 2010). Additionally, when priming a group of Asian American women for racial identity, which is associated with quantitative skills expertise, they performed better at a math test than when they were primed for gender identity, in which case they are not associated with the corresponding skills (Shih et al., 1999).

Group conflicts can happen both in an organizational setting and between different social groups based on social identities and their conflict generating tendencies. Social identity theory, as applied to organizational settings, relates to how employees' social group memberships are impacted based on how employees perceive their own and others' social prestige. It was found that management accountants' prestige, that is derived from their perceived social identities as employed by an organization, has an effect on their potential conflicts with their managers. In this case, a higher perceived prestige lowered the potential conflicts within an organization, as the accountants felt more respected and taken seriously (Hiller, 2014).

In the context of conflict in a non-organizational setting, two groups, who are primed with different identities, can introduce outgroup conflict between them, while strengthening ingroup unity and effort. Sen (2007) explores how cultural or historical differences, in salient identity, can cause conflict between outgroups. While an individual might possess multiple identities, some of which they share with other individuals, not all identities are salient at once; this can exclude otherwise shared identities with others, causing differences as opposed to shared values to be the defining factors between them. This selective saliency of identities has the potential to generate conflict between groups who would otherwise peacefully coexist. A study, based on the identity-based conflict literature, found that conflict arises between groups in a real identity-based context, but not necessarily in a minimal group setting. In the experiment, two groups were separated based on racial characteristics in a competitive lottery game, involving Caucasians and Asians respectively, which when revealed to the group members caused a stronger ingroup unity and lesser free-riding effect within the groups, particularly in female participants. Meanwhile, in a minimal group setting where only a color indicator was the known difference between the groups, the effect was not observable (Chowdhury et al., 2016).

Social identity can be used to uncover the underlying motivations for individuals starting an activity and who have a desire of being productive. In a study utilizing interviews, it was found that individuals aged 50 or older want to be perceived by themselves and others as productive members of society, who are capable of autonomy and self-realization, instead of being relegated into the less prestigious social category of pensioners (Soto-Simeone & Kautonen, 2020). The individual's perceived position in the social group membership system also determines what earnings are viewed as remunerative. Using national survey data in India, a study found that an individual's position within the Indian caste system has an influence on what earnings are seen as remunerative when looking at what self-employed jobs different caste members would find acceptable doing, which depends on their social status derived from their position in the caste system. Individuals with a higher position would require higher returns on self-employment, while lower ranked individuals would perceive lower remuneration as acceptable, while also perceiving the earnings gap as smaller than the actual earnings gap based on data (Goel & Deshpande, 2020).

From the political identity side, a financial risk-taking variance is found based on whether an individual identifies as a liberal or a conservative. Manipulating participants' self-efficacy, defined as their belief in their ability to perform actions as situations demand, it is shown that conservatives have increased financial risk-taking preference as self-efficacy increased, while the effect is not observed for liberals. This effect is attributed to conservatives possessing more social dominance orientation, while for liberals it is not an important part of their social identity (Han et al., 2019).

In terms of investments, a study uses the social identity theory to investigate how social information is used by crowdfunding investors. As it is found through an experiment designed to task the participant to invest into one of two crowdfunded companies, social identity theory can explain how investors might forgo the profit-maximizing option based on social group membership. When the investors are primed for a certain identity shared by one of the crowdfunding companies, the social information available about the company becomes more attractive to the investors, who then become more willing to invest into that option even if that means foregoing the financially more lucrative option due to the shared values and identity causing strengthened commitment. This effect is also observed when negative social information is shared, in which case there is a defensive investment taking place by the investors sharing the identity with the company (Kuselias, 2020).

A separate study examined the effect of social group membership on crowdlending. In the experiment the authors used simple email manipulation on lenders of the Kiva crowd-lending community. The emails encouraged lenders to join lending teams, which if successful, was observed to have a positive effect on lending activity during a one-week window after joining. Overall, joining a team increased prosocial lending, as the identity gained by being team members encouraged them to contribute to the team's standing on the leaderboards alongside the increased information sharing regarding the potential borrowers (Ai et al., 2016). In the context of donations, a similar effectiveness of group dynamic is observable, where forming teams that compete for matching funds inspires team members to not let their teams down and thus increase donations. In the experiments, participants received endowments, a proportion of which they could donate in multiple experiment configurations of separate individuals, added matching funds and in team contexts. Adding the variable of matching funds increases the size of donations, while belonging to teams has the largest effect on contributions due to the salient presence of a social group membership (Charness & Holder, 2018).

Religious identity is also possible to be primed that has an impact on economic behavior. In an experiment, priming participants for religious identity caused them to act closer to the norms associated with their salient religion. Priming Catholics resulted in decreased contribution to public goods in line with the fall in trust associated with vertically organized religions, while

Protestants increased public goods contributions due to the presence of higher unconditional contribution norms (Benjamin et al., 2016). Another study found that religious identity behavior is also applicable to Muslims in the context of financial investment. In the study, it is shown that during Ramadan there is an increased optimism regarding investor sentiment linked to the religious identity, which causes investors to increase their volume of investments, leading to higher stock prices in stocks that are predominantly traded by Muslims. This effect is due to the religious influence of solidarity and optimistic social identity which influences investor sentiment benefiting stocks for the duration of the month (Białkowski, et al., 2012).

Social group membership does not only have positive effects, as free riding is a negative phenomenon that can manifest in social groups. There is a desire by individuals to join social groups that have high social status associated with them, potentially leaving less desirable social groups behind. However, social groups are shaped by their members' exogenous behavior and attributes, which can get diluted by an influx of new members. Some individuals are only interested in gaining the positive association of being part of the high-status social groups but are unwilling to contribute the necessary norms and behavior demanded by the particular group they wish to join. As an example, a free rider joins an altruistic group to adopt the social prestige associated with the group by being vocal about it, but in effect does not contribute to donations, thus reducing the overall prestige of the group. This behavior harms the original group members. As a deterrence mechanism, high contributors can exploit endogenously determined social attributes to combat free-riding and introduce required status goods to create an entry barrier into the social group (Bernard et al., 2016).

In addition, morally right behavior can be turned to produce a negative effect, as individuals rely on their social identities to adhere to moral standards and norms, but the cues dictating what is moral can intentionally or unintentionally be distorted into selfish behavior to narratively better suit the identity of the individual (Bénabou and Tirole, 2011). Another negative effect of social group memberships is potential antisocial behavior when social comparison is present and there is inequality between individuals. A study revealed through a laboratory investment task in which participants can reduce the payoff of other participants that they are inclined to do so in certain instances. In the experiment, when social identity is unknown, the low-income individuals produce a more antisocial behavior to other low-income individuals than when the social identity among them is shared, thus known (Gangadharan et al., 2019).

Conclusions

We set out to review the main works related to identity economics, in order to provide a foundation for future studies. Based on our review of the related literature, we can conclude that the field is rather fragmented both from theoretical and empirical perspectives. In this paper, we presented the theoretical works that are most often referenced and the empirical works that are most representative of the various applicability of the identity economics approach. Although Akerlof and Kranton's (2010) seminal work stands out as the basis of many subsequent papers, one must recognize alternative approaches, as well. As mentioned above, Davis (2014) points out that social identities can be considered as either categorical or relational. Garai's (2017) work, for example, could provide a valid alternative to Akerlof and Kranton's approach, when considering identities not as categories, but as relations to others. From this perspective, our identities are not set or given, but are produced through our interactions with the other members of society. Accordingly, our economic decisions are motivated by the development, maintenance or even the avoidance of an identity dimension, in other words the identities are constantly being worked out by our interactions with others, requiring investments of resources into these social maneuvering processes. Hence, identity economics, and its recognition of this resource allocation mechanism, is predicted to play a more significant role in the future of economics research.

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