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## Introduction

ANN HOPKINS WAS HIRED in Price Waterhouse's Office of Government Services in 1978. By all accounts, she was hard-working and diligent. She retrieved from the discard pile a State Department request for proposals and masterminded it into a contract worth approximately \$25 million.<sup>1</sup> It was the largest consulting contract Price Waterhouse had ever secured, and her clients at the State Department raved about her work. In 1982 she was put up for partner, the lone woman among eighty-eight candidates.<sup>2</sup> But the promotion did not go through.

What was deemed wrong with her performance? Colleagues complained about her deportment and the way she treated her staff. In their written comments on her promotion, the senior partners observed: "Needs a course in charm school," "macho," and "overcompensated for being a woman." Her boss, who supported her, told her that if she wanted to make partner she should "walk more femininely, talk more femininely, dress more femininely, wear makeup and jewelry, and have her hair styled."<sup>3</sup>

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Hopkins sued, on the grounds of sex discrimination under Title VII of the Civil Rights Act. After a series of appeals, the case reached the U.S. Supreme Court in 1988. There, the majority held that the firm had applied a double standard. The court wrote that “an employer who objects to aggressiveness in women but whose positions require this trait places women in an intolerable and impermissible catch 22: out of a job if they behave aggressively, and out of a job if they do not.”<sup>4</sup>

*Price Waterhouse v. Hopkins* is an illustration of identity economics at work. The partners were applying contemporary norms for behavior: *men* were supposed to behave one way, *women* another. We could interpret these views as reflecting basic tastes or preferences—they just liked working with women who talked and walked “more femininely.” But these are not basic tastes such as “I like bananas” and “You like oranges,” which are the foundations of the economic theory of trade. Rather, these tastes depend on the social setting and who is interacting with whom. The tastes derive from *norms*, which we define as the social rules regarding how people *should* behave in different situations. These rules are sometimes explicit, sometimes implicit, largely internalized, and often deeply held. And the “preferences” or “tastes” that derive from these norms are frequently the subject of dispute, so much so that—as in *Hopkins*—they may even be adjudicated in court.

This book introduces identity and related norms into economics. The discipline of economics no longer confines itself to questions about consumption and income: economists today also consider a wide variety of noneconomic motives. But identity economics brings in something new. In every social context, people have a notion of who they are, which is associated with beliefs about how they and others are supposed to behave. These notions, as we will see, play important roles in how economies work.

We begin with the *Hopkins* case because the type of identity involved—that of gender—is so obvious. Even as toddlers, children learn that boys and girls should act differently. But gender, and equally obviously race, are just the clearest manifestations of identity and norms. In this book we study norms in many different contexts—in workplaces, homes, and schools.

To see the salience of identity in economic life, let's take another example from a source where it might be least expected. On Wall Street, reputedly, the name of the game is making money. Charles Ellis's history of Goldman Sachs shows that, paradoxically, the partnership's success in making money comes from subordinating that goal, at least in the short run.<sup>5</sup> Rather, the company's financial success has stemmed from an ideal remarkably like that of the U.S. Air Force: "Service before Self." Employees believe, above all, that they are to serve the firm. As a managing director recently told us: "At Goldman we run to the fire." Goldman Sachs's Business Principles, fourteen of them, were composed in the 1970s by the firm's co-chairman, John Whitehead, who feared that the firm might lose its core values as it grew. The first Principle is "Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow." The principles also mandate dedication to teamwork, innovation, and strict adherence to rules and standards. The final principle is "Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives."<sup>6</sup> Like the military and other civilian companies we examine later in the book, Goldman Sachs is an example of identity economics in action. The employees do not act according to basic tastes: by accepting Whitehead's principles, they identify with the firm and uphold its ideals in both their professional and their personal lives. The creed is: "Absolute loyalty to the firm and to the partnership."<sup>7</sup>

### *Origins of Identity Economics*

Our work on identity and economics began in 1995, when we were both, by coincidence, based in Washington, DC. We had been together at Berkeley—George as a professor, Rachel as a graduate student. George then went to the Brookings Institution while his wife was serving on the Federal Reserve Board. Rachel was at the University of Maryland.

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*Identity Economics* began with a letter from Rachel to George telling him that his most recent paper was wrong.<sup>8</sup> He had ignored identity, she wrote, and this concept was also critically missing from economics more generally. We decided to meet. Quite possibly, we thought, identity was already captured in the economics of the time; perhaps it was already included in what we call *tastes*.

We talked for months. We discussed the research of sociologists, anthropologists, psychologists, political scientists, historians, and literary critics. We discussed the focus on identity: how people think they and others should behave; how society teaches them how to behave; and how people are motivated by these views, sometimes to the point of being willing to die for them. We worked to distill many ideas and nuances, to develop a basic definition of identity that could be easily incorporated into economics. And we saw that including identity would have implications for fields as disparate as macroeconomics and the economics of education.<sup>9</sup>

This book builds an economics where tastes vary with social context. Identity and norms bring something new to the representation of tastes. Garden-variety tastes for oranges and bananas—to continue with the earlier example—are commonly viewed as being characteristic of the individual. In contrast, identities and norms derive from the social setting. The incorporation of identity and norms then yields a theory of decision making where social context matters.

This vision of tastes is important because norms are powerful sources of motivation. Norms affect fine-grain decisions of the moment—decisions as trivial as which T-shirt we wear to go jogging. Norms drive life-changing decisions as well: on matters as important as whether to quit school, whether and whom to marry, whether to work, save, invest, retire, and fight wars. We will see throughout the book that identities and norms are easy to observe. Anthropologists and sociologists are professional observers of norms. But norms and identities are also easy to see in day-to-day life. We have already seen two examples: Goldman Sachs, with its fourteen principles, and Price Waterhouse, with the partners' descriptions of Hopkins. People express their

views in the ways they describe themselves and others. As the Supreme Court put it in the *Hopkins* decision, “It takes no special training to discern sex stereotyping in a description of an aggressive female employee as requiring ‘a course at charm school.’ Nor does it require expertise in psychology to know that, if an employee’s flawed ‘interpersonal skills’ can be corrected by a soft-hued suit or a new shade of lipstick, perhaps it is the employee’s sex, and not her interpersonal skills, that has drawn the criticism.”<sup>10</sup>

Until now, economists have had neither the language nor the analytical apparatus to use such evidence or to describe such norms and motivations. Of course, many economists have suggested related nonmonetary reasons for people’s actions, such as morality, altruism, and concern for status. This book provides both a vocabulary and a unifying analytical framework to study such motives.

### *Ideas Have Consequences*

Economics—for better or for worse—pervades how policy makers, the public, and the press talk and think. Modern economics follows Adam Smith’s attempt in the eighteenth century to turn moral philosophy into a social science designed to create a good society. Smith enlisted all human passions and social institutions in this effort. In the nineteenth century, economists began to build mathematical models of how the economy worked, using a stick figure of a rationally optimizing human with only economic motivations. As economics evolved into the twentieth century, the models grew more sophisticated, but *Homo economicus* lagged behind. This began to change when Gary Becker developed ways to represent a variety of realistic tastes, such as for discrimination, children, and altruism.<sup>11</sup> Fairly recently, behavioral economics has introduced cognitive bias and other psychological findings. *Identity Economics*, in its turn, brings in social context—with a new economic man and woman who resemble real people in real situations.<sup>12</sup>

What does this increased humanity buy us? We get a more reliable model, which makes economics a more useful tool for im-

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proving institutions and society. This richer, socially framed conception of individual decision making should help economists working at various levels to construct sturdier accounts of the economy. Social scientists in other disciplines should find identity economics useful because it connects economic models with their own work, enabling the development of richer accounts of social processes. And policy analysts and business strategists will benefit from identity economics because it offers ways of more accurately predicting the consequences of public policies and business practices.

“Ideas have consequences” was a theme at Milton Friedman’s ninetieth birthday celebration at the White House in 2002.<sup>13</sup> As John Maynard Keynes wrote two generations earlier: “Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.”<sup>14</sup> Identity economics restores human passions and social institutions into economics. Whether economics includes or excludes identity, then, also has its consequences.