

## **Type and Context**

Convocation Remarks, June 2014

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Graduates of the class of 2014, I feel deeply honored speak to you today, continuing the University's long-standing tradition of having a faculty member address you at Convocation, as we celebrate your significant accomplishment. On behalf of the faculty, I extend my heartiest congratulations to you. I also congratulate your friends and families, without whose support this achievement would not have been possible, and who feel inestimably proud of you today.

I must tell you that I have felt incredibly nervous ever since I was asked to give these remarks. It isn't a fear of drawing a blank up here at the podium that has really flustered me. After all, I know that if that were to happen I would have given you as a graduation present a terrific story to tell at dinner parties for decades to come, about how the speaker at your convocation just stood there, totally silent for several minutes. while the President, Provost and Trustees sat there horrified.

No, the main reason I have been nervous is that I could not figure out what words of mine, bearing somewhat on my research, could possibly apply to you severally, coming as you do from a wide variety of fields and majors, and about to embark on an equally

diverse set of future activities. What is it that you have in common: the budding biologist, the young classicist, the future policy analyst or lawyer or entrepreneur?

I believe you are united by the fact that during your time here we have tried to inculcate in each of you a certain orientation towards knowledge - a particular habit of mind if you will - marked by a relentless skepticism; by a reliance on evidence and rigor, and by delight in informed argument.

Our environment here at the U of C is not for everyone. Not every young person would like being in a place where their every assumption is challenged, where cogent argument rather than appeals to authority carry the day. Not all would take advantage of all that this special University has to offer.

Every year the admissions office sifts among thousands of applications, looking for those students who are the right types: those who would - as you did - throw themselves wholeheartedly into the intellectual life of our community. Admissions has lots of information to aid them in their search for these kinds of people. They see transcripts. They know grades and test scores. And yet - unfortunately - they can never correctly identify every applicant's type.

Now it's true that in the year that you applied they got things perfectly right, but ... in general... - in every other year - they make mistakes.

Some students will be admitted who are the wrong type. Those straight A's in high school? They were mainly because of her attentive parents and not because of her own thirst for knowledge. When she comes here, and can do whatever she wants on Friday night, free of parental supervision, maybe the very last thing she will do is actually read Augustine's *Confessions* all the way through. And other applicants, who are very much the type who would have flourished here, get rejection notices because we did not know that those B's were because their teachers didn't inspire them in high school.

Even with good data about, it is difficult for Admissions to distinguish applicants' *types* from the fact that features of the particular situations in which they live - their *contexts* - might have given rise to the specific behavior we see.

This problem arises in a large number of situations, and has been theme in much of my research. A few years ago, my colleague Erik Hurst and I did some work trying to adjudicate between the relative importance of type versus context in the case of racial and ethnic differences in spending.

We were trying to understand a really curious fact. If you take a nationally representative sample, you will find that compared to whites with the same level of income, blacks and Latinos - and especially young black and Latino men - systematically

spend a larger fraction of their incomes on visible goods - things like cars, clothing, jewelry and personal care. Why is this?

One possibility, maybe the first one you might think of, is that perhaps blacks and Latinos on one hand, and whites on the other, are different *types* of consumers, with fundamentally different preferences over goods. Maybe blacks and Latinos simply like nicer cars and jewelry than do whites with similar incomes.

Alternatively, perhaps there is something different about the contexts faced by blacks and Latinos relative to whites which accounts for these spending differences.

Here's a thought experiment. Let's imagine two men of different races, but otherwise exactly the same. In particular, let's suppose that they have *exactly* the same preferences over goods, and *exactly* the same level of incomes. Now, it is an undeniable, if unfortunate, feature of life that many people interacting with one of these hypothetical men - a potential dating partner deciding whether to give him her number, the maitre d of a crowded restaurant deciding where to seat him, a potential client wondering whether to give him business - will base their treatment of him partly on what they believe his income to be.

I say “believe his income to be” because none of these people actually *knows* the man’s income. They only have *estimates* - educated guesses - about what his income might be.

Statistics tells us something about how these estimates are likely to be formed, and the results line up neatly with common sense.

- If one knows nothing about a person except the group that they are from, the guess that is most likely to be made about their income is that it is equal to the average income of the group.

Here is what this means: The estimates people will have about the incomes of our two hypothetical men will be quite different, even though their incomes are, in fact, exactly the same. The man from a racial group with lower average income will face situations where people knowing only his race will estimate his income to be lower – maybe even sharply lower – than their estimate of the income of the man from a racial group with higher average income.

Since everyone wants to be treated nicely, each of our hypothetical men has an incentive to pay some cost to indicate to people - to signal, as economists say - that his income is actually higher than might be believed in the absence of any other information about him. But this incentive should be especially strong for a black or Latino man, who come from groups with relatively low average incomes.

To be convincing this signal should be on an expenditure that would be difficult for someone with low income to make. What kind of signal of high income would buying a particular thing be if anybody could buy it?

It had also better be on something that he can carry around with him. Buying a granite countertop for his master bathroom isn't a good signal because almost nobody he encounters in day-to-day life ever sees his fancy bathroom. Many of these people do see his car or his clothing though.

Maybe observed racial differences in visible spending result partially from this signalling motive, in addition to any underlying racial difference in preferences.

Analyzing data on spending across different labor markets and over many years, we find evidence strongly consistent with the predictions from a signalling account:

Blacks and Latinos spend more on visible goods the lower the average income of other blacks and Latinos in their particular labor market. Their spending does not vary at all with the average income of blacks or Latinos in other *other* markets, nor with the average income of whites anywhere.

Here's the thing; whites exhibit almost *identical* behavior. Whites spend more on visible goods the lower the average income of other whites living in their area. Average incomes among other groups, or whites living elsewhere, do not matter for white spending at all.

There is an overall, national difference in visible spending between blacks and whites simply because there are more markets where the average income of black men is low, and their incentive to signal that they are different from this low mean correspondingly high. If one accounts for the average and variance of income among other persons of the same race in a labor market, virtually all of the puzzling difference in visible spending between blacks and whites completely disappears. Racial differences in visible spending are not about *type* at all, although we might be led naturally to that erroneous conclusion.

I bring to your attention today the difficulties and inevitable errors that attend attempts to learn about people's types versus their contexts from information on their behavior because of the particular, elite sub-group that you join today by virtue of your graduation.

You are one of a very small set of people from your approximate age cohort to have been educated at a university like this one. The best evidence we have suggests that you will, *personally*, fare incredibly well by almost every measure of socioeconomic well being - health, employment prospects, job satisfaction, and wages to name a few.

But besides any effect on your own outcomes, your membership in this elite group means that you will have an influence on societal choices and policy-making wholly disproportionate to your numbers. Results from articles and books some of you write will constitute the bulk of evidence discussed when the merits or defects of alternative public policy choices are being debated. In time, you will likely enjoy easy familiarity with and access to important decision-makers. And whatever your future job - teacher, manager, activist, scientist - your ideas and decisions, based on what you believe about people's types as opposed to their contexts, will apportion opportunities, circumscribe options, and even inflict punishments on other people.

Unfortunately, various things will conspire to make it difficult for you to assess what it is about people that generates the behaviors you observe. Sometimes you will be in a position like the Admissions officer, basing your decisions on the equivalent of an SAT score which, whatever its limitations, is generated precisely for the use to which it is put.

Much more commonly, you will just see some *stuff* - perhaps even terabytes of *stuff* in this age of data - generated as people live their lives, making decisions in the face of a complicated set of considerations - contexts - that are unknown to you and that in part caused them to act as they did.

You will not have the benefit of shared experience to help you intuit what those contexts might be for these other people over whose lives you will have so much impact. The growing labor market inequality on the basis of skill that has been a focus on many scholars in my field, and about which you have heard so much, means that your earnings and employment experiences will diverge ever more dramatically from people without your training. Because of social segregation your friends and your spouse will almost certainly come from the group you now enter, and even the television programs or newspapers you consume will be radically different from people outside your group.

You will also likely not have the advantage I enjoy as a faculty member here at the University, of being surrounded every day as I teach and conduct research by colleagues and students whose whole...sole....purpose...in..life.. it sometimes feels to me, is to tell me where I am wrong, - to challenge my reasoning, or to point out some conclusion I have reached too hastily.

But despite these challenges, we all would be worse off if concerns about the errors you might occasionally make mistaking type for context or vice versa caused you to withdraw from vigorous engagement with the world. As graduates of this University, you understand that mistakes are an inevitable part of learning; that learning is, in fact, never complete; and that much of knowledge consists of the replacement of the wrong with the slightly less wrong.

Your life may differ in key ways from those affected by your decisions, but your training here - those great works of literature about other cultures and times, those unending arguments we have from one end of campus to the other - has made you uncommonly able to understand the other person's point of view or circumstance. And, although you will not be physically here, you will carry always, wherever you go, our dissatisfaction with the too-easy answer, the willingness to challenge and to question and to challenge again- the Chicago seminar spirit.

I can imagine no persons more appropriate than you to whom these difficult problems should entrusted.

You are just the right type.

Congratulations, class of 2014 and good luck.

