



You are cordially invited to

UCLouvain Economics Seminar

On Thursday November 16, 2017, from 12:45 to 14:00
Doyen 22, Place des Doyens, 1

Paul Heidhues
(University of Dusseldorf)

Will give a presentation on

Unrealistic Expectations and Misguided Learning

Abstract:

We explore the learning process and behavior of an individual with unrealistically high expectations ("overconfidence") when outcomes also depend on an external fundamental that affects the optimal action. Moving beyond existing results in the literature, we show that the agent's beliefs regarding the fundamental converge under weak conditions. Furthermore, we identify a broad class of situations in which "learning" about the fundamental is self-defeating: it leads the individual systematically away from the correct belief and toward lower performance. Due to his overconfidence, the agent - even if initially correct - becomes too pessimistic about the fundamental. As he adjusts his behavior in response, he lowers outcomes and hence becomes even more pessimistic about the fundamental, perpetuating the misdirected learning. The greater is the loss from choosing a suboptimal action, the further the agent's action ends up from optimal. We partially characterize environments in which self-defeating learning occurs, and show that the decisionmaker learns to take the optimal action if and only if a specific non-identifiability condition is satisfied. In contrast to an overconfident agent, an underconfident agent's misdirected learning is self-limiting and therefore not very harmful. We argue that the decision situations in question are common in economic settings, including delegation, organizational, effort, and public-policy choices.

(Joint paper with Botond Koszegi (Central European University) and Philipp Strack (UC Berkeley))

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