ELSEVIER

Available online at www.sciencedirect.com

ScienceDirect

Journal of Macroeconomics 30 (2008) 1347–1369

Journal of MACROECONOMICS

www.elsevier.com/locate/jmacro

Overconfidence and consumption over the life cycle

Frank Caliendo [a], Kevin X.D. Huang [b,*]

[a] Department of Economics, Colorado State University, Fort Collins, CO 805523, USA
[b] Department of Economics, Vanderbilt University, VU Station B 351819, 2301 Vanderbilt Place, Nashville, TN 37235-1819, USA

Received 28 March 2007; accepted 11 October 2007
Available online 24 October 2007

Abstract

Overconfidence is a widely documented phenomenon. In this paper, we study the implications of consumer overconfidence in a life-cycle consumption/saving model. Our main analytical result is a necessary and sufficient condition under which any degree of overconfidence concerning the mean return on savings can produce a hump in the work-life consumption profile. This condition is almost always met in the data. We show by simulations that overconfidence concerning the variance of the return can have little effect on the long-run average behavior of consumption over the life cycle, and that our basic conclusion is fairly robust with various realistic modifications to the baseline model. We interpret the general applicability of our analytical framework and discuss our numerical results in the light of aggregate consumption data.
© 2007 Elsevier Inc. All rights reserved.

JEL classification: D91; E21

Keywords: Overconfidence; Consumption; Life cycle; Time inconsistency; Hump shape; Elasticity of intertemporal substitution

> The chance of gain is by every man more or less overvalued, and the chance of loss is by most men undervalued.
> The over-weening conceit which the greater part of men have of their own abilities, is an ancient evil remarked by philosophers and moralists of all ages.
>
> – Adam Smith

* Corresponding author. Tel.: +1 615 936 7271; fax: +1 615 343 8495.
E-mail address: kevin.huang@vanderbilt.edu (K.X.D. Huang).

0164-0704/$ - see front matter © 2007 Elsevier Inc. All rights reserved.
doi:10.1016/j.jmacro.2007.10.001

1. Introduction

Humans can be overconfident in self-perceptions and overrate themselves on many positive personal traits. If John perceives he is better-looking than his classmates, he is not alone: Motley Fool guest columnist Whitney Tilson (Tilson, 1999) reports that 86% of his Harvard classmates feel they are better-looking than their peers (who is left to be worse looking?). If John thinks he can get a better grade than his peers, he is not alone either: University of Chicago professor Richard Thaler (Thaler, 2000) writes that on the first day of his class every student expects to get an above-the-median grade (half of them are always disappointed).

Overconfidence does not just belong to those elite school students. If you think you are safer and more skillful than your fellow drivers, you are not alone: in Svenson's (1981) study of Texas car drivers, 90% of those assessed believe they have above-average skills and 82% rank themselves among the top 30% of safe drivers. Anything you think you are better at or have better luck with than others, your peers are likely to think the same way: 70% of lawyers in civil cases believe their sides will prevail; doctors consistently overestimate their abilities in detecting certain diseases; parents feel their children are smarter than others'; lottery pickers bet that tickets they choose have greater odds to win than randomly selected ones; professional athletes and military personnel may even be trained to be overconfident and overoptimistic.

The presence of overconfidence in the business world is also well known. A large body of literature documents that managers are prone to the wishful thinking that projects they have command of are bound to succeed.[1] In a survey by Cooper et al. (1988) of nearly 3000 new business owners, 81% of those sampled believe their businesses have more than a 70% chance to succeed while 33% believe they will thrive for sure. In actuality, 75% of new ventures do not even survive the first five years.

The phenomena of overconfidence and overoptimism are widespread and have long been documented in the cognitive psychology and behavior science literature based on data from interviews, surveys, experiments, and clinical studies. Perhaps what is more overwhelming than the mere existence of overconfidence itself is the fact that the degree of overconfidence is rather persistent and generally does not wane over time. In the car-driver example, Camerer (1997) notes that even after suffering serious car accidents, drivers still rate themselves as above-average, and Bob Deierlein reports in a 2001 issue of WasteAge that more experienced drivers can develop a higher degree of overconfidence in their ability to avoid accidents but can in fact have accidents more frequently.

When it comes to investing, saving, and wealth, the phenomena of overconfidence and overoptimism are even more overwhelming. As we will survey in Section 2, the presence of overconfidence is a persistent phenomenon not only in stock and bond markets, but in other types of asset classes such as real estate and retirement savings. The evidence that we have already surveyed above indicates the general existence of overoptimism or overconfidence about one's ability in doing things, including making income.[2]

[1] See Kidd and Morgan (1969), Langer (1975), Larwood and Whittaker (1977), Weinstein (1980), Bettman and Weitz (1983), March and Shapira (1987), Russo and Schoemaker (1992), and Malmendier and Tate (2003, 2005), among others.

[2] A number of studies find that in many circumstances overconfidence can benefit the overconfident individuals themselves, and sometimes even the society as a whole. See, for instance, De Long et al. (1991), Kyle and Wang (1997), Hirshleifer and Luo (2001), and Berg and Lein (2005).

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات