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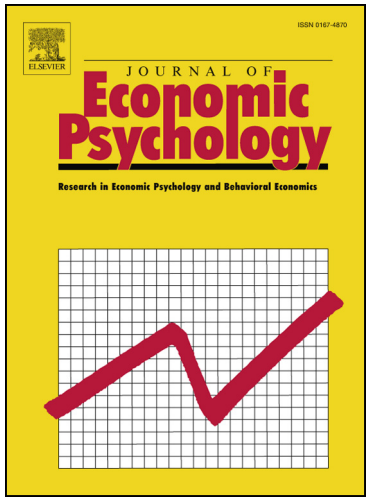

Exponential-Growth Bias and Overconfidence

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Exponential-Growth Bias and Overconfidence[a]

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Abstract

There is increasing evidence that people underestimate the magnitude of compounding interest. However, if people were aware of their inability to make such calculations they should demand services to ameliorate the consequences of such deficiencies. In a laboratory experiment, we find that people exhibit substantial exponential-growth bias but, more importantly, that they are overconfident in their ability to answer questions that involve exponential growth. They also exhibit overconfidence in their ability to use a spreadsheet to answer these questions. This evidence explains why a market solution to exponential-growth bias has not been forthcoming. Biased individuals have suboptimally low demand for tools and services that could improve their financial decisions.

Keywords: exponential-growth bias, overconfidence, financial literacy, overestimation, overprecision
JEL: D03, D14, D18

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