This Time is Different...*

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Abstract

Systematic deviations from ostensibly rational beliefs appear in many economic, financial, and business contexts. This paper introduces a steady-state competitive equilibrium model where firms' knowledge of the market aggregates does not determine their beliefs about their own abilities. Firms maximize expected profit and hold beliefs that are calibrated with available statistical information. Yet firms believe that market statistics, while accurately describe what happens to others, do not apply to them, that when it comes to their own projects, 'this time is different.' In particular, firms and outside observers agree that market participants are, on average, over-optimistic. They also correctly anticipate a market equilibrium with over-entry and high failure rates relative to the objective distribution of productivity. Implications for corporate finance patterns are explored.

Contact me for a copy of the paper.

*I benefitted from discussions with Luciano Pomatto and comments of seminar participants at Georgetown, Bar Ilan, Technion, Yale, the Cleveland Fed, and Ohio State.

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