Abstract

People often fail to appreciate the extent to which the information they have differs from the information available to others. Strong psychological evidence supports the claim that people exaggerate the extent to which the information they have is available to others and there is also some though weaker evidence consistent with the fact that if they do not have certain pieces of information they act as if others did not have it either. In this paper I develop a formal model of this phenomenon. I assume that people make the mistake of information projection and after receiving a signal people overestimate the probability that this signal is also available to others including their own past selves. Similarly, having not received a signal people make the mistake of ignorance projection and underestimate the probability with which this signal is available to others. I then apply this model to problems of adverse selection, moral hazard and the formation of social attitudes.

In the context of performance evaluation I find that a supervisor's assessment of an agent's skill of processing information will be too sensitive to luck and that on average the supervisor will underestimate how skillful the agent is. This leads non-standard wage dynamics where the supervisor overreacts to a failure and might overreact to a success. It also leads to excessive turnover because the supervisor overestimates the expected gain from firing an agent whose performance he observed. Agents who anticipate the bias will have non-standard preferences over tasks and will prefer cases with more information rather than less even if success in a case with less ex-ante information would be a stronger signal of a high skill level.

In the context where a principal provides incentives for an agent to exert effort through a commitment to a stochastic monitoring rule, I find that agent's will be punished too often and rewarded too rarely. If agents anticipate this bias then information projection leads to an underprovision of effort and the social optimum, which takes into account the bias of the supervisor involves less effort than in the unbiased case as long as monitoring is costly. I also show how increasing the frequency of monitoring might lead to increasingly conservative decisions on the part of the agents and in a case where agents care about their reputation of being able to process signals to underprovison of information and hence suboptimal decisions. I show that even if explicit performance contracts are suboptimal in the unbiased case, monitoring based on ex-post liability judgements might be even less efficient if supervisors and courts are biased.

Finally, I consider the problem of attributing intentions and preferences to actors by observers and argue that even biased observer's will judge too much by the consequences of an actors choice rather than by her intentions. I show how information projection can lead to hostility and stereotyping through a misattribution of social preferences. Through a simple voting example I also show that information and ignorance projection can lead to overattribution of

non-partisan preferences of those who agree with the observer and to overattribution of partisan preferences of those who disagree with her.