The Micro and Macro of Managerial Beliefs

Jose Maria Barrero

discussion by Toni Whited

2020 AFA Meetings

This paper has some nice data and some facts

- Atlanta Fed/Chicago-Booth/Stanford Survey of Business Uncertainty
- Managers are not over-optimistic. They get means right.
- Managers are overconfident. They underestimate sales growth volatility.
- Managers overextrapolate. Overestimate in good times and underestimate in bad times.

And a model to understand the implications of these facts

- Equilibrium, infinite-horizon.
- Firms use labor to produce output.
- Households consume and supply labor.
- Managers have incorrect beliefs about a TFP shock.

And some interesting results

- Overextrapolation lowers firm value by 2.1%.
- This translates into a 0.5%–2.3% drop in consumer welfare in equilibrium.
- Why? Managers spend too many resources adjusting to volatile, transitory shifts in profitability.

This is the second worst kind of paper to discuss.

- The worst is a hopelessly bad paper.
- The second worst is a really good paper where it is hard to add value.

The question is really interesting.

- We just do not know that much empirically about the effects of belief frictions.
- This paper gives us quantitative results—not just qualitative.

The model is no more complicated than it needs to be

- He has data on beliefs and employment, so the model is mostly about beliefs and employment.
- The intuition is extremely transparent.

The empirical execution is impeccable.

- He is using the right weight matrix.
- The standard errors are calculated correctly.
- The identification is mostly well-explained.

The paper reads like a dissertation — not a paper

- It's a little bit all over the map.
- This is fixable and really important to fix.

The measurement error part is not clear

- The paper allows for the presence of measurement error in the survey data.
- This pleases me to no end. Structural stuff plus measurement error.
- Identifying measurement error variances in regression models is tricky.
- There is no discussion of this identification in this highly nonlinear model.
- It would be ideal to have a moment that is intuitively and directly affected.

One too many parameters is calibrated

- I usually get frustrated with papers that calibrate a bunch of parameters.
- This is largely not the case here. The calibrated parameters are on the consumption side.
- Except the quit rate.
- The higher the quit rate, the more room there is for managers to screw up employment.
- There must be some way to discipline this parameter with your data.

Emphasize the subsample heterogeneity differently

- Small firms over extrapolate more
- Public and private firms behave the same
- Inside and outside CEO firms behave the same

Agency is important because convex incentives can cause overreaction

- Terry (2015): Myopia causes over reactions
- Terry, Whited, and Zakolyukina (2019): Convex incentives have the same effect.
- This is an empirical comment.
- Do the over-extrapolators have more convex incentives.

Right now the paper really has no external validity checks.

- But the public-private similarity can be framed as such.
- It is hard to imagine that private and public firm CEOs face similarly convex incentives.
- The same with inside and outside CEOs.

Take care interpreting the counterfactuals

- The belief distortions are not micro founded.
- For the purpose of estimation, this is probably OK.
- There is a tradeoff between careful microfoundations and models that are simple enough to estimate.
- More nuanced discussion of the potential biases for the counterfactuals — upper or lower bound?

Great paper – and now for the broken record

- Nice question
- Nice analysis
- Needs a bit of attention to detail

Terry, S. J. 2015. The Macro Impact of Short-Termism. Manuscript, Boston University.

Terry, S. J., T. M. Whited, and A. A. Zakolyukina. 2019. Information versus Investment. Manuscript, University of Michigan.