

Optimal Illusion of Control and Related Perception Biases*

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Abstract

We study perception biases arising under second-best perception strategies. An agent correctly observes a parameter that is payoff-relevant in many decision problems that she encounters in her environment but is unable to retain all the information until her decision. A designer of the decision process chooses a perception strategy that determines the distribution of the perception errors. If some information loss is unavoidable due to cognition constraints, then (under additional conditions) the optimal perception strategy exhibits the illusion of control, overconfidence, and optimism.

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