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"Dynamic rational inattention: inertia and delay in decision-making"

Abstract

We solve a general class of dynamic rational-inattention problems in which an agent repeatedly acquires costly information about an evolving state and chooses actions. Information takes the form of an arbitrary signal chosen by the agent in each period. Optimal behavior resembles that in a dynamic logit model. The distribution of actions at each decision node depends on the expected payoffs (not including information costs) and on an endogenous heuristic rule that does not depend on the realized history of states. We apply the general solution to the study of (i) inertia in actions leading to lagged adjustments to changes in the state; (ii) the tradeoff between accuracy and delay in decision-making; and (iii) the sunk cost fallacy.