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Ambiguity Aversion in the Long Run: "To Disagree, We Must Also Agree"*

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Abstract

We consider an economy populated by smooth ambiguity-averse agents with complete markets of securities contingent to economic scenarios, where bankruptcy is permitted but there is a penalty for it. We show that if agents' posterior belief reductions given by their "average probabilistic beliefs" do not become homogeneous then an equilibrium does not exist. It is worth noting that our main result does not imply any convergence of ambiguity perception or even the attitudes towards it. In this way, complete markets with default and punishment allows for ambiguity aversion in the long run, and the agents can disagree on their ambiguity perception but they must agree on their expected beliefs.

Keywords: Ambiguity aversion, bankruptcy, complete markets, convergence of beliefs, punishments, smooth ambiguity model. JEL Classification: D53, D81, D84.

1 Introduction

When markets are complete, one necessary condition for existence of equilibrium, in a stochastic framework with expected utility agents, is that beliefs must be locally equivalent, *i.e.*, all agents' beliefs assign null probability over the same *finite-time* events (see Harrison and Kreps (1979)). In general, equilibrium existence in infinite horizon economies is not precluded by the lack of equivalence

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