Violations of Expected Utility: The Common Ratio and Common Consequence Effects
ECON 1820 Spring 2015
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The Common Ratio Effect

- Which would you choose?

The Common Ratio Effect

- Which would you choose?

• Many people choose C1 and D2

The Common Ratio Effect

- Claim:
  - C1 and D1 consistent with EU (63%)
  - C2 and D2 consistent with EU (5%)
  - C1 and D2 inconsistent with EU (27%)
  - C1 and D2 inconsistent with EU (5%)
- Significant violations of EU
  - These violations are not random
Common Consequence Effect

100% $16 vs 89% $16

– Which would you choose?

1% $0

Common Consequence Effect

$0 vs $0

– Which would you choose?

11% $16 vs 10% $18

Common Consequence Effect

A1 100% $16 vs 89% $16

A2 10% $18

Common Consequence Effect

B1 $0 vs $0

B2 $0

• Claim:
  – A1 and B1 consistent with EU (9%)
  – A2 and B2 consistent with EU (64%)
  – A1 and B2 inconsistent with EU (27%)
  – A1 and B2 inconsistent with EU (0%)
• Significant violations of EU
  – These violations are not random

And the winner is....

• Stewart Sharpe
• Randomly Selected Question: A
• You Chose A2

• Many people choose A1 and B2
And the winner is....

- Stewart Sharpe
- Randomly Selected Question: A
- You Chose A2

What do these violations mean?

Class Exercise

What do these violations mean?

- Often interpreted as a 'preference for certainty'
- But what about E?