## Violations of Expected Utility: The Common Ratio and Common Consequence Effects

ECON 1820 Spring 2015 Mark Dean

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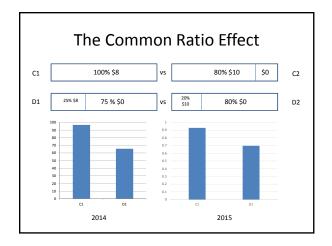
# The Common Ratio Effect

80% \$10

\$0

- Which would you choose?

100% \$8



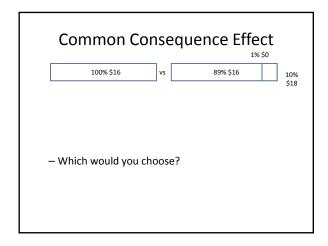
### The Common Ratio Effect

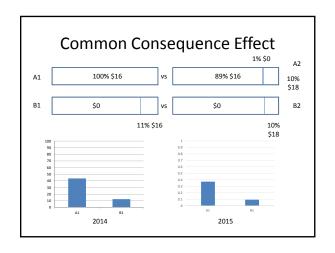
25% \$8 75 % \$0 vs 20% 510 80% \$0

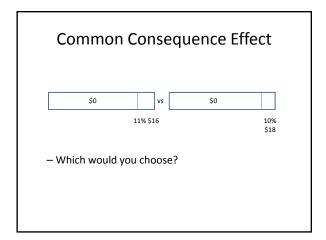
- Which would you choose?

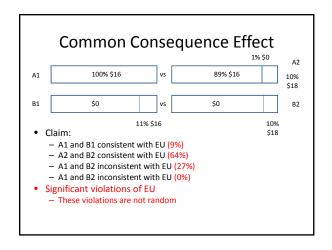
# The Common Ratio Effect

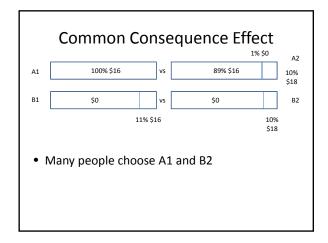
- Claim:
  - C1 and D1 consistent with EU (63%)
  - C2 and D2 consistent with EU (5%)
  - C1 and D2 inconsistent with EU (27%)
  - C1 and D2 inconsistent with EU (5%)
     Significant violations of EU
- These violations are not random











# And the winner is.... • Stewart Sharpe • Randomly Selected Question: A • You Chose A2

### And the winner is....

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



### What do these violations mean? 100% \$8 80% \$10 \$0 C2 25% \$8 75 % \$0 80% \$0 D2 \$0 E2 95% \$8 76% \$10 \$0 - Often interpreted as a 'preference for certainty' - But what about E?

