An Anatomy of Ambiguity Attitudes

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Abstract

Experimental evidence in economics and psychology has shown that in decisions under uncertainty, people distinguish between situations of risk, where the probabilities of different outcomes are known, and situations of ambiguity, where the probabilities are unknown or uncertain. In particular, in the domain of gain events ("good outcomes") with modest or large likelihoods, people have been observed to dislike ambiguity. On the basis of these findings, a large literature in economics builds on ambiguity aversion to explain patterns observed in financial markets that cannot easily be explained if investors held neutral attitudes toward ambiguity. However, recent evidence suggests that ambiguity aversion may not generalize to the domain of losses, or to situations where outcomes occur with low likelihood. Methodological heterogeneity across studies that considered different domains so far precludes clear conclusions regarding the domain specificity of ambiguity attitude. We present a study that measures ambiguity attitudes in all domains in a uniform design. We discuss the implications of our results for economic modeling and policy.