Ambiguity Aversion, Loss Aversion, and Risk Aversion

Stefan Trautmann

Erasmus Universiteit Rotterdam

Abstract: Two studies investigate the relation between ambiguity attitude and loss and risk attitudes. In study 1 (with F. Vieider and P. Wakker) preference reversals between choice and WTP elicitation are found that can be explained by a state-dependent reference point (Sugden 2003, JET) and loss aversion in WTP. Our model predicts that irrespective of ambiguity attitude in choice, WTP for an ambiguous prospect will always be lower than WTP for a risky prospect. This is confirmed by the data. In study 2 (with M. Kocher) subjects can select into a first-price sealed-bid auction for a risky or an ambiguous prospect. The markets for the risky prospect are much larger than the markets for the ambiguous prospect, but the transaction prices are equal. We find that ambiguity attitude and risk attitude are positively correlated, and selection therefore leads to smaller markets with relatively risk tolerant bidders for the ambiguous prospect.