

On the Empirical Plausibility of Theories of Risk Aversion

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Expected utility theory, prospect theory, and other theories of behavior under risk typically model risk-avoiding behavior with nonlinear transformations of payoffs and/or probabilities. Use of nonlinear transformations of payoffs introduces issues associated with calibration of the implications of small-stakes risk-avoiding behavior for the implied behavior towards large-stakes risks. Previous papers have explored theoretical arguments about concavity calibration by using assumptions about patterns of small-stakes risk aversion. This paper reports experiments designed to shed light on the empirical validity of these assumptions and thereby on the empirical relevance of the concavity calibration literature.