

Risk Aversion and Incentive Effects

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A menu of paired lottery choices is structured so that the crossover point to the high-risk lottery can be used to infer the degree of risk aversion. With "normal" laboratory payoffs of several dollars, most subjects are risk averse and few are risk loving. Scaling up all payoffs by factors of twenty, fifty, and ninety makes little difference when the high payoffs are hypothetical. In contrast, subjects become sharply more risk averse when the high payoffs are actually paid in cash. A hybrid "power/expo" utility function with increasing relative and decreasing absolute risk aversion nicely replicates the data patterns over this range of payoffs from several dollars to several hundred dollars.

Keywords: lottery choice, risk aversion, incentive effects, hypothetical payoffs.

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