

I. Prospect Theory

Prospect Theory

- Kahneman and Tversky, *Econometrica* 1979
- Two elements, value function and weighting function
- Elements replace utility function and probabilities in expected utility theory which has dominated economic thought

Prospect Theory Value Function

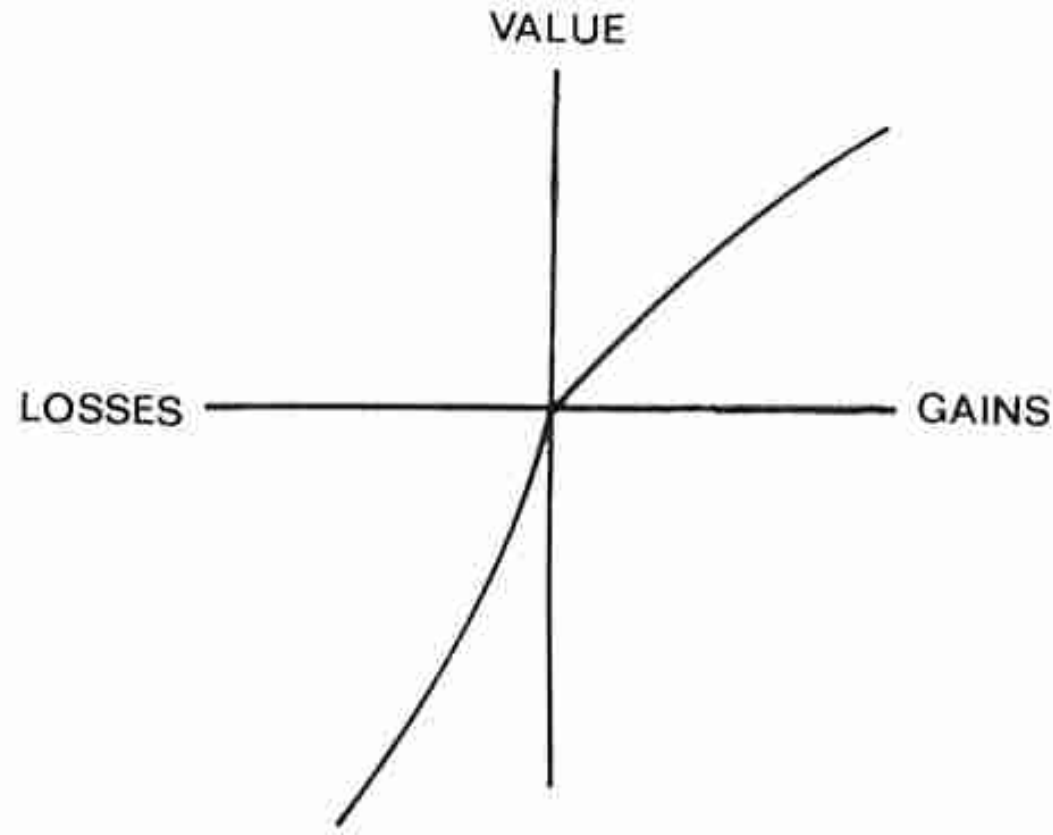


FIGURE 3.—A hypothetical value function.

Prospect Theory Weighting Function

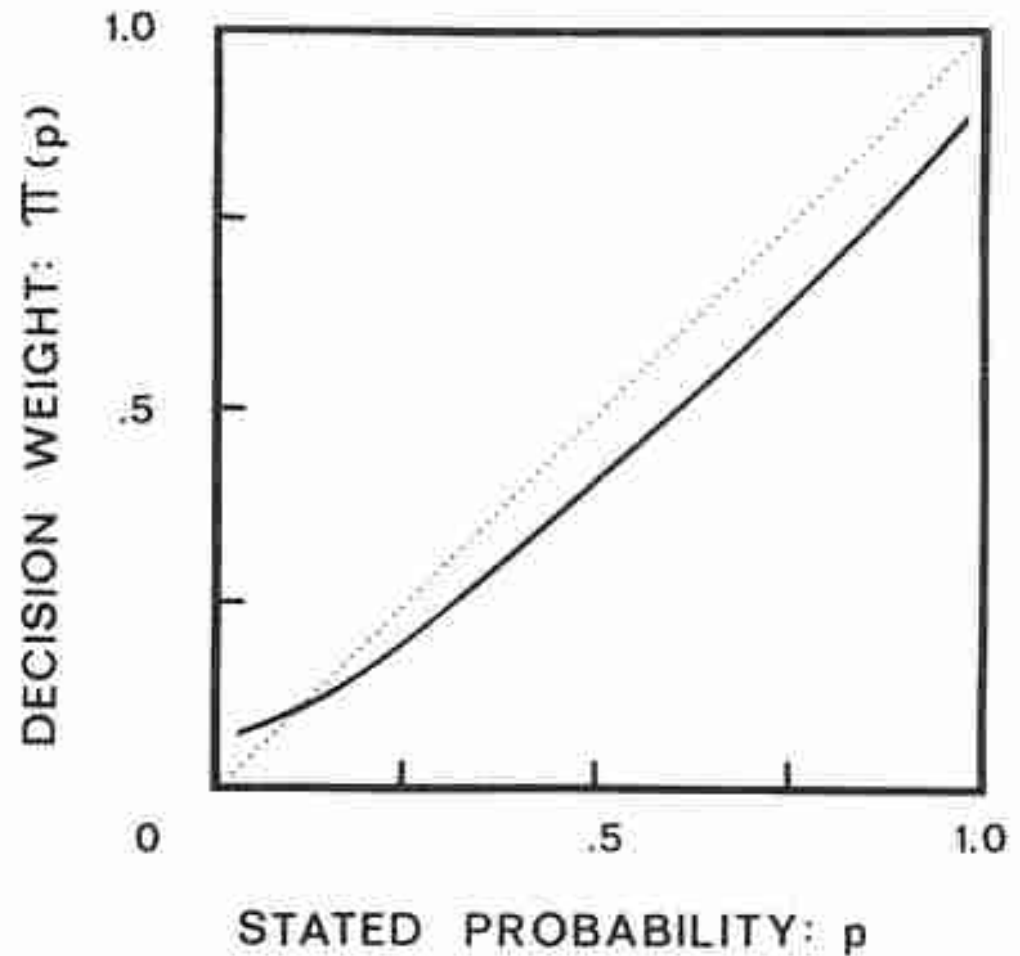


FIGURE 4.—A hypothetical weighting function.