10.5 Limits of the Expected Utility Model

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Allais Paradox

Price	A	B	C	D
0	0	.01	.89	.9
1	1	.89	.11	0
5	0	.1	0	.1

$EU_A = U(1)$

$EU_B = .01U(0) + .89U(1) + .1U(5)$

$EU_A > EU_B \rightarrow U(1) > .01U(0) + .89U(1) + .1U(5)$

$EU_C = .89U(0) + .11U(1)$

$EU_D = .9U(0) + .1U(5)$

↳ Can't both be true

$EU_D > EU_C \rightarrow .9U(0) + .1U(5) > .89U(0) + .11U(1)$

Both A+B, .89 prob of 1

Both C+D, .89 prob of 0

Ellsberg Paradox

- Ambiguity Aversion

Endowment Effect

- Cornell experiment
  - ↳ John List