

**Course**  
**on**  
**HS205: consumer Behaviour and Welfare Economics**  
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**Instructor**

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# Choice under uncertainty: Attitude towards risk:

- For making a choice among risky & uncertain alternatives, a kind of quantitative measurement is necessary
- **St. Petersburg Paradox:** It refers to the problem why rational people are unwilling to participate in a fair game/gamble. Rational people may even be unwilling to participate in a gamble at favourable odds, i.e., when money value of the game exceeds the loss of money in case he/she loses.

**Fair game:** A fair game is one where an individual faces the situation involving variable outcomes in which the expected value of the gamble is equal to the income with certainty.

**Certainty equivalent:** A certainty equivalent is the sure sum of money.

According to Daniel Bernoulli, a rational people will take decision under risky situation on the basis of expected utility rather than expected money value.

**John Von Neumann and Oskar Morgenstern** (N-M utility index)

**Attitude towards risk:**

**Risk averter/avoider:** A risk averter is a person who does not participate in a fair game.

**Risk lover/taker:** A risk lover is a person who participates in a fair gamble.

# Construction of N-M utility index: