

**Identify and explain three consequences of loss aversion for foreign policy. Next, using an example, pick one consequence and explain how loss aversion affects foreign policy at the domestic level. Do the same (using a different consequence and example), to explain how loss aversion can shape the decision-making of leaders.**

## 1 On Loss Aversion

Loss aversion, while a simple phenomenon, plays an important role in the decision-making of regular individuals and state policy-makers alike. Understanding loss aversion is therefore critical to properly understand foreign policy decision making. At its core, loss aversion simply refers to the idea that losses loom greater than gains. Specifically, people will place greater significance on losses than they do on gains, even when the losses and gains are equal in magnitude. To demonstrate this, consider the effects on losing \$25 as opposed to gaining \$25. While gaining \$25 will certainly make a rational actor happy and losing \$25 will make them unhappy, loss aversion argues that the unhappiness experienced by losing \$25 is greater than the happiness derived from gaining \$25, despite the monetary value being equivalent. Contemporary literature on the topic indicates that actors tend to be more loss-averse than they are gain-seeking, and that framing topics in terms of losses may trigger loss-averse tendencies, which leads to interesting behavior.

This paper argues that there are three consequences of loss aversion on foreign policy: (1) increased difficulty of negotiation between two states (due to loss aversion and the endowment effect), (2) engagement in risky behavior to avoid losses, and (3) tendencies to focus on "preventive issues" (issues that seek to avoid losses from the status quo) rather than "promotive" issues (issues that seek to better the status quo).

## 2 Foreign Policy Implications

### 2.1 Negotiation Problems

The effects of loss aversion in foreign policy can be seen through the negotiation problems it creates for states. Because loss aversion dictates that losses will be felt greater than gains, each state in a negotiation will incorrectly believe that they are giving up more than they are gaining, despite the negotiation being equitable. This may also be seen through the lens of the endowment effect - an extension of loss-aversion. The endowment effect simply states that actors will place greater weight on forsaking things they already own than they will on obtaining new items. In this way, actors are more loss averse than gains-seeking in the status quo. This can be seen during the Camp David Peace Accords between the United States, Israel, and Egypt. While there were equitable negotiation agreements that occurred between just Israel and Egypt, these agreements seemed unfair to both parties and rejected them accordingly. This is because each party viewed their losses and gains through loss aversion and accordingly felt they were giving up more than they gained. For this reason, a settlement only occurred when the United States offered both Israel and Egypt significant amounts of foreign aid and benefits. The aid and benefits offered by the US compensated for the losses perceived by each party and eventually led to a settlement. In this way, loss aversion has consequences for foreign policy complicating an already difficult state-negotiation process.

### 2.2 Risky Behavior

Loss aversion may also lead states to take risky behavior with respect to foreign policy decisions. Because decision-makers are loss-averse, they are likely to attempt to avoid losses through potentially risky means. If a decision-maker therefore (1) sees the status quo as a loss or (2) expects a loss to occur in the future, they may take a gamble that a completely rational actor may not, if they perceive that gamble as potentially being able to solve the loss. Examples of such gambles can be seen frequently in foreign policy through conflict. Jervis provides an excellent example of this with Saddam Hussein's attack on Kuwait. Specifically, the argument provided explains the attack not in terms of gains-seeking, but as loss aversion. Because his attack violated Kuwaiti sovereignty and was likely to be met with international backlash, Hussein knew this would be a risky decision. Left to the status quo, though, Saddam Hussein saw definite losses to his power

and influence occurring. This led to the risky decision to invade Kuwait being a mechanism of loss-aversion rather than gain-seeking.

## 2.3 Promoting Preventive Issues

Loss Aversion also encourages decision-makers to act upon preventive issues rather than promotive ones. Because the incentive structure for many decision-makers is based largely upon re-election, which is contingent upon public opinion, public support is an important aspect of decision-making. Because loss-aversion weighs avoiding losses more than seeking gains, public opinion seems to be inherently higher for tackling preventive issues rather than promotive ones. This stands logically. By definition, preventive issues seek to prevent status quo losses, while promotive issues seek to maximize future gains. If the former is thought to be more important as a function of loss-aversion, politicians that focus on preventive issues will likely be held in higher regard. Indeed, literature on the subject finds that in the vast majority of cases, public support was higher for military action on preventive issues when compared to promotive ones.

## 3 Case Studies

### 3.1 Brexit, Loss Aversion, & Risk Taking

One important case study exploring the effects of loss aversion on foreign policy at the domestic level can be seen through Brexit. Specifically, the loss-framing of EU membership that was done by decision-makers in Britain triggered loss-aversion in British voters during the Brexit referendum. This is an example of how loss aversion can incite risky behavior.

The "Vote Leave" movement was Britain's premier Brexit campaign, led by Boris Johnson and other notable members of the British parliament. While the "Vote Leave" campaign employed many different campaigning strategies, most focused on using loss aversion. Because a major aspect of the campaign focused on the losses British citizens were suffering in the status quo through economic and social policy restrictions of EU membership, the status quo was successfully loss-framed. As a result, British citizens were averse to the losses present in the status quo and saw the Brexit referendum as a means of avoiding the loss. It may have been clear to many pro-Brexit voters that leaving the EU was a risky decision with a multitude of potential downsides. As result of their loss-aversion, however, they were more risk-acceptant and accordingly accepted a greater gamble. Here, the foreign policy of EU membership was affected domestically through the Brexit referendum by loss-aversion created through "Vote Leave."

### 3.2 (Re)Negotiating the Iranian Nuclear Deal

Loss aversion also shapes the decision-making of leaders. A contemporary example of this can be seen with Iranian president Rouhani and the Iranian nuclear deal. Since Trump's withdrawal from the Joint Comprehensive Plan of Action (JCPOA), Iran has cut in half the amount of time it needs to build a functional nuclear weapon and has recently taken steps to withdraw from the Iranian nuclear deal. Under the Biden administration, talks about the re-institution of the JCPOA have increased significantly.

Loss aversion that has shaped President Rouhani's decision-making, however, will likely tip the scale of nuclear deal re-negotiations in favor of Iran. This is because renormalization has occurred for Rouhani, and he may now see denuclearization attempts as a loss to the status quo. When the original JCPOA was signed, Iran's nuclear program was significantly behind its current state and the deal was somewhat equitable. Now that Iran's nuclear program is more established and Rouhani sees nuclearization as the status quo, a denuclearization agreement with the same terms as the JCPOA would be seen as unfair. Rouhani's decision-making at the negotiating table will be skewed as a result of loss-aversion and the endowment effect of the status quo, closing his win-set and making even equitable offers seem unfair. In this manner, loss aversion has shaped Rouhani's decision-making with respect to the Iranian nuclear deal.