

RISK PERCEPTION AND ECONOMIC BEHAVIOR

A Simple Test of Consumption Insurance, by John H. Cochrane (University of Chicago)

Are consumers effectively insured against idiosyncratic shocks to income or wealth, either by formal institutions such as charities, private insurance, and government programs or by informal mechanisms such as gifts and "loans" from relatives, friends, and neighbors? Under full insurance, consumption growth should be cross-sectionally independent of idiosyncratic variables that are exogenous to consumers. This proposition is tested by cross-sectional regressions of consumption growth on a variety of exogenous variables. Full insurance is rejected for long illness and involuntary job loss, but not for spells of unemployment, loss of work due to strike, and an involuntary move. *Journal of Political Economy*, Vol. 99, No. 5 (October 1991), pp. 957-76. (Reprinted with permission of the *Journal of Political Economy*).

Full Insurance in the Presence of Aggregate Uncertainty, by Barbara J. Mace (University of Michigan)

This paper tests implications of full consumption insurance. The object is to determine how much mileage can be obtained from a model with complete markets, with such features as private information or liquidity constraints omitted. The implication exploited is that individual consumption responds to aggregate consumption and other right-hand-side variables such as the change in household income and change in employment status. All variables other than the change in aggregate consumption are predicted to be insignificant in explaining the change in household consumption. With observations on consumption and income for 10,695 households from the Consumer Expenditure Survey, the results are mixed. The results for one specification (exponential utility) are mostly consistent with full consumption insurance; the results for the other specification (power utility) are not. *Journal of Political Economy*, Vol. 99, No. 5 (October 1991), pp.928-56. (Reprinted with permission of the *Journal of Political Economy*).

UTILITY THEORY

Choices Involving Uncertain Probabilities, Tests of Generalized Utility Models, by Paul J. H. Schoemaker (University of Chicago)

This paper contains an analytic and empirical component. The analytic one examines how people should value information on probabilities versus payoffs according to expected utility theory. It also examines under what conditions various *generalized* utility models (such as subjective expected utility theory, prospect theory, and rank-dependent utility) entail testable predictions for preference for information. The empirical component examines people's actual information preferences and to what extent they

fit the various models. After describing two experiments and their findings, it is concluded that generalized utility models are unlikely to offer much insight into risky decision making. *Journal of Economic Behavior and Organization*, Vol. 16, No. 3 (December 1991), pp. 295-317. (Reprinted with permission of the North-Holland Publishing Company).

Loss Aversion in Riskless Choice: A Reference-Dependent Model, by Amos Tversky (Stanford University) and Daniel Kahneman (University of California, Berkeley)

Much experimental evidence indicates that choice depends on the status quo or reference level: changes of reference point often lead to reversals of preference. We present a reference-dependent theory of consumer choice, which explains such effects by a deformation of indifference curves about the reference point. The central assumption of the theory is that losses and disadvantages have greater impact on preferences than gains and advantages. Implications of loss aversion for economic behavior are considered. *The Quarterly Journal of Economics*, Vol. CVI, Issue 4 (November 1991), pp. 1039-61. (Reprinted with permission of *The Quarterly Journal of Economics*).

The Value of Information - An Axiomatic Approach, by Itzhak Gilboa and Ehud Lehrer (Northwestern University)

The following question is addressed: Given a real-valued function on the partitions of a measure space, what are necessary and sufficient conditions in order that it be the value of information function for a Bayesian decision maker? A characterization is provided, and the analysis reveals a close relationship to cooperative game theory. The tools developed for characterization can also be used to derive somewhat surprising results regarding the properties of information functions. *Journal of Mathematical Economics*, Vol. 20, No. 5 (1991), pp. 443-59. (Reprinted with permission of the North-Holland Publishing Company).

On the Optimal Design of Lotteries, by J. Quiggin

In recent years, the expected utility model of choice under risk has been generalized to cope with phenomena such as probability weighting. In the present paper, one such generalized approach, the rank-dependent expected utility model, is applied to the problem of lottery gambling. The model is used to derive an optimal prize structure for lotteries, involving a few large prizes and a large number of small prizes. Other forms of gambling, such as racetrack betting, are discussed in the light of this result. *Economica*, Vol. 58, No. 229 (February 1991), pp. 1-16. (Reprinted with permission of the *Journal of Economic Literature*).

