Speaker: Matthias Weber (University of St. Gallen)

Date: Monday, May 3, 2021

Intertemporal Prospect Theory

Abstract:

Prospect Theory is the most prominent contender of expected utility theory to describe decisions under risk. In atemporal contexts, prospect theory is well understood. In intertemporal contexts, however, it is not clear how prospect theory should be applied (in particular, whether probabilities should be weighted within time periods or whether the probabilities of present values should be weighted). It is also unclear what parametric specifications of probability-weighting and value functions should be used. Considering that many decisions in economics, finance and health are of intertemporal nature, this is surprising. Using data from a pre-registered experiment on a representative sample, we find that an application of prospect theory weighting probabilities of present values predicts decisions best. Estimated probability weighting functions are very similar to those typically estimated in atemporal settings while value functions are almost linear with a loss aversion coefficient close to one.