Self Control, Risk Aversion, and the Allais Paradox

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This paper develops a dual-self model that is compatible with modern dynamic macroeconomic theory and evidence, and calibrates it to make quantitatively accurate predictions in experiments that display a wide range of behavioral anomalies concerning risk, including the Allais paradox. To obtain a quantitative fit, we extend the simpler "nightclub" model of Fudenberg and Levine [2006] by introducing one additional choice (the choice of a "nightclub," or more generally of anticipated consumption) and one additional parameter that needs to be calibrated. We find that most of the data can be explained with subjective interest rates in the range of 1-7%, short-run relative risk aversion of about 2, and a time horizon of one day for the short-run self.

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