

SALIENCE AND SKEWNESS PREFERENCES

Markus Dertwinkel-Kalt

Frankfurt School of Finance &
Management

Mats Köster

Düsseldorf Institute for Competition
Economics (DICE)

Abstract

Whether people seek or avoid risks on gambling, insurance, asset, or labor markets crucially depends on the skewness of the underlying probability distribution. In fact, people typically seek positively skewed risks and avoid negatively skewed risks. We show that salience theory of choice under risk can explain this preference for positive skewness, because unlikely, but outstanding payoffs attract attention. In contrast to alternative models, however, salience theory predicts that choices under risk not only depend on the *absolute* skewness of the available options, but also on how skewed these options appear to be *relative* to each other. We exploit this fact to derive novel, experimentally testable predictions that are unique to the salience model and that we find support for in two laboratory experiments. We thereby argue that skewness preferences—typically attributed to cumulative prospect theory—are more naturally accommodated by salience theory. (JEL: D81)

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E-mail: m.dertwinkel-kalt@fs.de. (Dertwinkel-Kalt); koester@dice.hhu.de. (Köster)