

Model Uncertainty and International Differences in Risk Aversion

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Abstract

Existing empirical studies have generally found both remarkably high levels of risk aversion and substantial variation in the level of risk aversion across developed countries, for which there has been no clear explanation. To explain both findings, this study reinterprets the risk-aversion parameter as expressing a consumer's fears about model misspecification. We show that high levels of risk aversion are consistent with a plausible amount of model uncertainty for some developed countries. Further, we argue that the variation across countries results from heterogeneity in consumer concerns about model misspecification.

Keywords: Risk aversion; Model misspecification; Detection error probability; Long-run risks

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