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Comparative Risk Aversion and the Prevention Puzzle

ABSTRACT

The prevention puzzle is twin puzzles that refer to the difficulty of showing the intuitive result that greater risk aversion should lead to more prevention, and the deficiency in providing guidance on how to foster prevention despite its policy importance. This paper offers plausible solutions to the prevention puzzle using a canonical model of self-protection in the expected utility framework. Holding prudence the same across different individuals who exhibit constant absolute prudence, greater risk aversion is shown to induce higher levels of self-protection when the probability of loss is less than 1/2 if individuals are less prudent than a reference individual who acts like a risk-neutral individual. Similar results hold for individuals who exhibit decreasing absolute prudence and are poorer than the reference individual. A policy implication is that a lump-sum subsidy can be granted to the poor to promote prevention if they exhibit decreasing absolute prudence and the probability of loss is less than 1/2.

Prof. Keith K.P. WONG
Professor
The University of Hong Kong

Date: 7 July 2026, Tuesday

Time: 2:30pm - 4:00pm

Venue: SEK210

Language: English

BIOGRAPHY

Professor Keith K.P. WONG received his Ph.D. in Finance from the University of British Columbia in 1993. He also holds a B.Soc.Sc. in Economics from the Chinese University of Hong Kong and a M.A. in Economics from the University of Western Ontario. After teaching at the Hong Kong University of Science and Technology for three years, Keith joined the School of Economics and Finance at The University of Hong Kong in 1996, and was promoted to Professor of Finance in 2006. In March 2012, Keith took up the School's Directorship.

Keith's research is mainly theoretical and can be divided into three areas: corporate finance, risk management, and real options. Beginning with his Ph.D. dissertation, Keith's research on corporate finance focuses on integrating financial contract theory with industrial organization theories. Since 1998, Keith has done research on risk management that examines the issues of how risk-averse firms should hedge their exposure to various sources of uncertainty (e.g., exchange rate risk, price risk, and liquidity risk) in general, and the optimality of using options as a hedging instrument in particular. Firms' preferences towards risk, regret, and ambiguity, as well as state-dependent preferences are studied.

Keith started his research on real options in 2004 with the paper entitled "The Effect of Uncertainty on Investment Timing in a Real Options Model," published in the Journal of Economic Dynamics and Control. This paper points out that the investment-uncertainty relationship is necessarily U-shaped unless the underlying uncertainty is purely idiosyncratic in nature, as is commonly considered in the extant literature. He also studies a firm's capital structure and capital budgeting decisions using the real options approach.

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