Loss aversion

Loss aversion refers to the tendency to prefer avoiding a loss rather than acquiring an equivalent gain. This leads to **risk aversion**, which is when people prefer avoiding losses to making gains when they evaluate an outcome comprising similar gains and losses.[1] Another way of stating this idea is that the pain of losing is psychologically about twice as powerful as the pleasure of gaining.[2] Amos Tversky and Daniel Kahneman developed a successful behavioral model, called prospect theory, using the principles of loss aversion, to explain how people assess uncertainty.[3] Essentially, they found that people react more strongly to possible losses than to potential gains.

Loss aversion explains a phenomenon called the endowment effect, which is a tendency for people to place a higher value on something they have purchased or already own than an identical or similar thing that they don't own. This may explain why we are inclined to "throw good money after bad" – as the saying goes and what economists refer to as the *sunk costs fallacy* – so we won't waste what we've already spent. We stick with our plan and hope for a gain, even though that may lead to a bigger loss in the long run.[4]

Next: Sunk costs

[1] Kahneman, D. & Tversky, A. (1992). "Advances in prospect theory: Cumulative representation of uncertainty". Journal of Risk and Uncertainty. 5 (4): 297–323. doi:10.1007/BF00122574
[2] https://www.behavioraleconomics.com/mini-encyclopedia-of-be/loss-aversion/.
[3] https://www.scientificamerican.com/article/what-is-loss-aversion/.
[4] http://www.beinghuman.org/article/loss-aversion.

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