

## Preference Reversals and the Independence Axiom

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**Abstract:** A preference reversal occurs when a subject chooses one lottery over another but puts a higher selling price on the lottery not selected. Such behavior is generally thought to violate one or more basic assumptions, for example, transitivity, that underlie all formal preference theories that are commonly used by economists. The focus of this paper is on the random lottery-selection method of controlling for income effects preference reversal experiments with financially motivated subjects. If the independence axiom of expected utility theory is not satisfied, then the lottery choice and the selling price elicitation decisions are no longer separable as would be the case in an expected-utility analysis. As a consequence, decisions that appear to violate transitivity can result from direct violations of the independence axiom or of other axioms such as "reduction of compound lotteries."