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Psychological construal of economic behavior

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Abstract

According to construal level theory (CLT) [Trope, Y., & Liberman, N. (2003). Temporal construal. *Physical Review, 110*, 403–421], psychological representation of information depends on "psychological distance", that is, on whether the relevant information refers to the near or distant psychological space. While CLT was originally developed to account for intertemporal choice, Trope and Liberman proposed that it could account for other dimensions of psychological distance such as social distance. We follow up on Trope and Liberman's proposal and demonstrate how CLT accounts for a wide range of economic behaviors such as predicting the choices of others, advice giving, saving for retirement, and the failure to annuitize assets at retirement. By explaining how CLT can account for these various economic behaviors and suggesting novel predictions, we hope to stimulate researchers to investigate further the role of psychological distance in economic behavior.

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1. Introduction

Economic models have traditionally assumed that individuals have consistent preferences that follow the principle of expected utility maximization. Over the past few decades, however, a large body of behavioral research has shown that these assumptions do not always fit actual human behavior. Hundreds of experiments have shown that economic behavior deviates from full rationality and is subject to various biases. To account for these findings, alternative models were developed, of which perhaps the most prominent is prospect theory (Kahneman & Tversky, 1979; Tversky & Kahneman, 1992). Prospect theory explains well-documented choice preferences that standard economic models could not explain, by relying on psychological principles such as loss aversion (losses loom larger than gains) and reference dependence.

The contribution of traditional economic models that attempt to create a comprehensive, logical, and precise model of economic behavior is unquestioned. These models are especially successful in explaining market level outcomes, because biases in individual behavior often do not affect the aggregate level of markets, due to market forces. However, individual level decisions may be interesting in their own right while sometimes individual biases are discernable in the aggregate market level. To explain or predict behavior and outcomes in these instances, the psychological and social motivations that underlie some economic behavior must be taken into account.

Recently, Trope and Liberman (2003) introduced Construal Level Theory (henceforth CLT), a theory that explains judgment and choice with reference to the psychological representation of the decision elements. While CLT has primarily been advanced to explain intertemporal choice, it has also has been suggested as an account for other economic behaviors such as affective valuation of potential outcomes, gambling preferences, and predictions of other people's choices. In this review we summarize some of the literature on CLT and explore its implications for several economic behaviors.

We present the theoretical principles of CLT and the empirical support it has received, review relevant behavioral findings, propose how CLT may account for additional behaviors (not previously addressed by CLT), and suggest ways in which the principles of CLT may be implemented in future research. In so doing, we hope to expose additional researchers to CLT and to stimulate new research that will use CLT to explain behaviors not well accommodated by existing theories.

2. Construal level theory: Temporal distance

We begin with a brief description of the behavioral and economic literature on intertemporal choice and then describe the theoretical principles of CLT and the way it explains current findings in intertemporal choice.

2.1. Intertemporal choice

People prefer immediate gratification, often at the cost of long-term benefits. For a simple example, when offered a choice between:

A. Receive \$20 now OR B. Receive \$50 in one year, most people prefer option A (Green, Fristoe, & Myerson, 1994).