The psychology of opportunity costs: Emotions and cost effectiveness in public policy decision making

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A fundamental premise in economics is that of opportunity costs. Using resources for one thing is always done at the expense of not using those resources for something else. An opportunity cost is the foregone benefit of options not chosen. When the unlimited wants of individuals or society face limited resources, some wants must go unsatisfied. In order to ensure that the best options are chosen, policymakers must carefully consider the opportunity costs of different policy options (i.e., the foregone benefits of options not chosen). Although it seems natural for anyone wanting to maximize welfare to consider opportunity costs when making choices, they are often neglected in practice.

The phenomenon of opportunity cost neglect primarily arises as individuals tend to be selective in their use of information, focusing on attributes that are salient at the point of decision-making. Since they are implicit by nature, opportunity costs may be underestimated when making choices. The implications of opportunity cost neglect for public policy are substantial, including misallocating public resources and an artificially high demand for public spending. In this text, I summarize the key findings from a series of studies exploring the psychological reasons for when and why people ignore and underestimate opportunity costs in public policy. In other words, when and why people (deliberately) ignore information and become *Homo ignorans* rather than *Homo economicus* when making trade-off decisions regarding scarce public resources.

A behavioral experiment conducted with a diverse sample of the Swedish adult population (n = 809) and an international sample of health care prioritization experts (n = 148) showed a robust effect consistent with opportunity cost neglect in public policy. Participants who acted in the role of policymakers were between six and ten percentage points less likely to invest in a public health program when reminded of opportunity costs (money that could fund other health programs). The results also show that opportunity cost neglect is stronger in the domain of public policy than in private consumption. This is because opportunity costs related to common public resources are likely to be less salient as individuals themselves do not feel connected to the actual spending of this money. Moreover, people will not experience the opportunity costs of public spending since politicians rarely explain what they do not spend public recourses on. Rather, they focus on what they do spend resources on, thus further increasing opportunity cost neglect in public policy.

At a general level, opportunity costs neglect undoubtedly has far-reaching consequences for public policy. Ignoring the sacrifices associated with public spending such as public health programs make them more attractive, thus artificially increasing the demand for public spending. Opportunity costs neglect may also explain why governments typically fail to keep expenditures below the limits set in their budgets, since this phenomenon causes members of the public to demand a higher level of public spending than they are willing to pay for. Moreover, opportunity cost neglect in public policy will almost by definition create inefficiencies, meaning that resources are not allocated in a way that maximizes social welfare. Taken to the extreme in a health context, this means that people will suffer and that lives will be lost as money is not always be channeled toward the most effective use.

A straightforward solution in the case of opportunity cost neglect is obviously to make public opportunity costs more noticeable to people by explicitly highlighting what is not funded due to public spending. However, from the perspective of politicians, reminding people of opportunity costs seems like a sure path to not getting re-elected. In this respect, a stronger mandate for economic evaluations such as cost-benefit analysis (CBA) and cost-effectiveness analysis (CEA) could be important since their role is to explicate necessary tradeoffs in public policy. Although there has been an increase in the use of economic evaluation among guideline-producing agencies over time, the use of economic evaluations in actual decisions at the local level is still rare, and it appears as if there is deep-rooted skepticism regarding this approach. This, in my view, is unfortunate because the use of economic evaluations in public policy should not only be motivated on economic grounds, but also on cognitive grounds. In this text, I argue that economic evaluations such as CBA and CEA should be understood as a way of ensuring a better prioritization by highlighting important social facts that might otherwise be neglected. I also argue that cost-benefit thinking and cost-effectiveness analysis should be seen as a method for counteracting problems associated with selective attention. The existence of opportunity cost neglect in public policy is thus a clear empirical example that strongly strengthens this argument.