OPPORTUNITY COST NEGLECT IN THE POOR

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ABSTRACT

- Several authors suggest opportunity costs—the value of foregone alternatives—should be more salient for the poor.
- Frederick et al. (2009) find that people are less likely to buy a product when reminded of opportunity costs, implying that they do not spontaneously consider them.
- Across 5 experiments, we find that the poor are influenced by reminders of opportunity costs as much as the rich, suggesting no difference in the salience of opportunity costs.

INTRODUCTION

Are the poor more likely to spontaneously consider opportunity costs in their financial decisions? Several authors suggest so, because scarcity should promote trade-off thinking (Mullainathan & Shafir, 2013; Shah et al., 2015; Spiller, 2011). This would mean that reminding of opportunity costs should affect the poor less strongly than the rich. We test this proposition in 5 Experiments using Frederick et al.'s (2009) paradigm and a variation.

METHOD

All experiments used a scenario describing an attractive product. In experiments 1–4, half of participants were reminded of opportunity costs by changing the “not buying” option:

> *Imagine that on your most recent visit to the video store you come across a special sale on a new DVD. [...] It is available at a special sale price of $14.99. What would you do in this situation?*
> *- Buy this entertaining video*
> *- Not buy this entertaining video* **[Keep the $14.99 for other purchases]**

In Experiment 5, half of participants were asked to list alternative uses of the money before making their decision. After making a decision, participants were asked about demographics and subjective wealth. Effective income was calculated as $\frac{\text{yearly household income}}{\sqrt{\text{household size}}}$.

RESULTS

Across the 5 experiments, we find no evidence for a negative interaction effect between condition and effective income, nor between condition and subjective wealth. In all experiments except Experiment 3 willingness-to-buy was significantly lower in the opportunity costs condition.

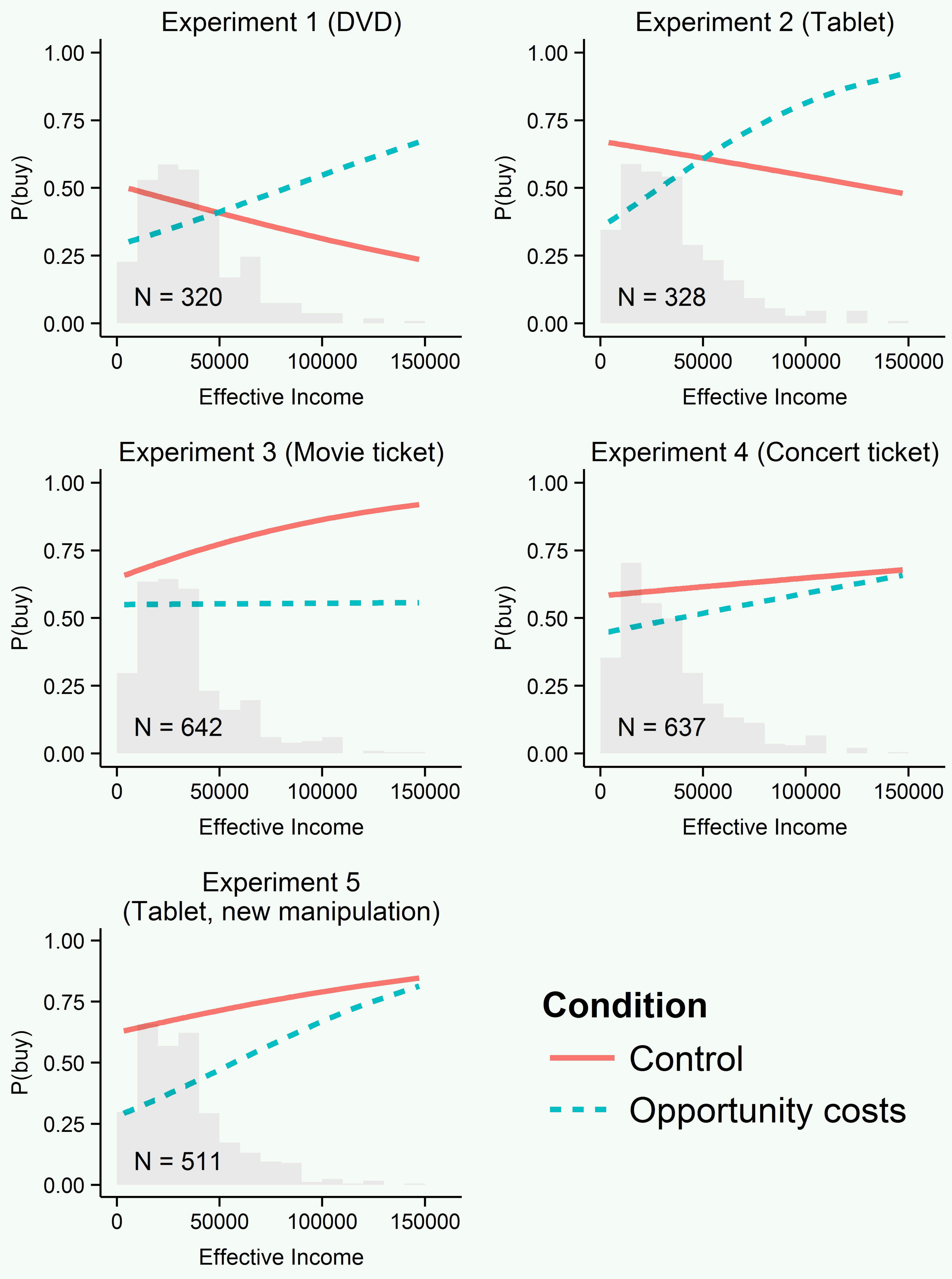

Figure 1: Estimated effect of effective income and condition on willingness-to-buy in Experiments 1–5.

META-ANALYSES

Meta-analyses on the 5 experiments find that reminding of opportunity costs strongly decreases willingness-to-buy. This effect is not moderated by effective income. Effective income had a small positive effect on buying.

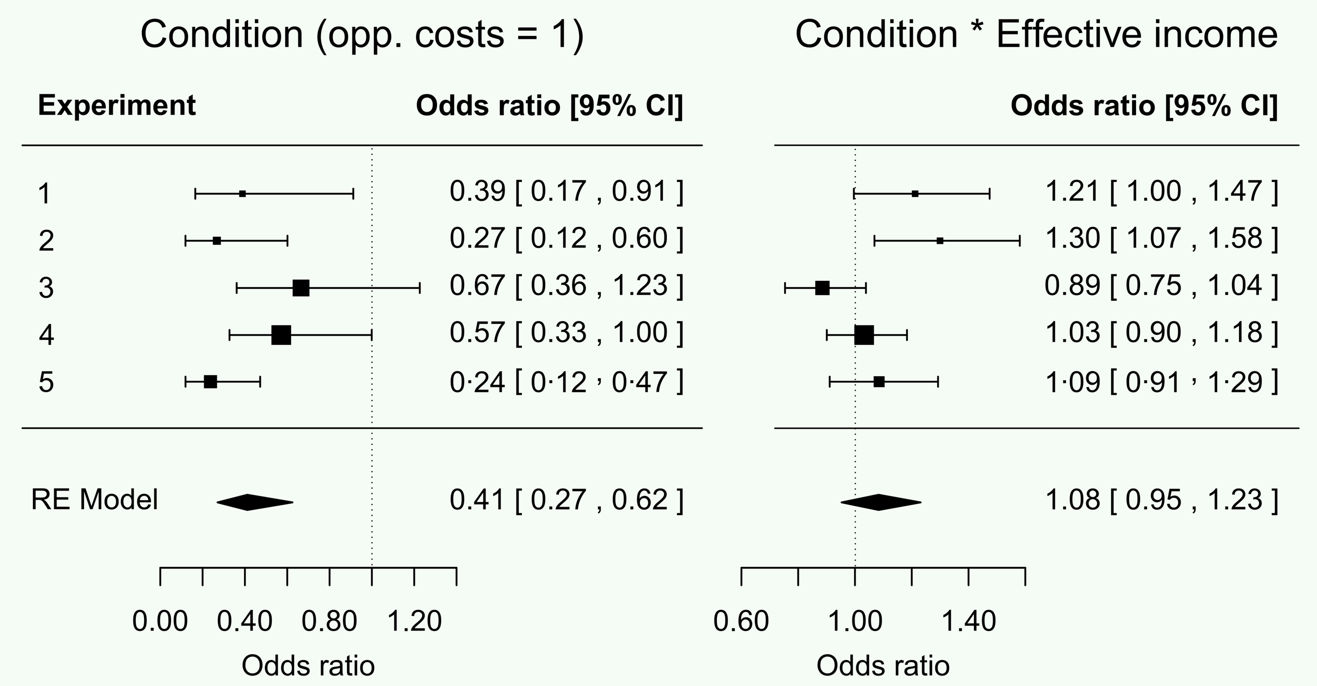

Figure 2: Forest plots for the effects of condition and condition*effective income, in logistic regressions with condition, effective income (in $10,000), and their interaction predicting willingness-to-buy.

DISCUSSION

The results are unlikely to be due to a lack of variance in income, as income was well spread and did affect buying. Although the decisions were hypothetical, Frederick et al. (2009) found high congruence between hypothetical and real choices. In sum, reminding of opportunity costs affects the poor as much as the rich, suggesting that the poor do not spontaneously consider opportunity costs. However, the consequences of opportunity cost neglect might be larger for the poor because poverty creates a narrow margin of error.

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