

Psychology and Personal Finance

Money and Happiness

Overview

- What makes us happy?
- Do we really know what makes us happy?
- How to be happier
- Money and Happiness

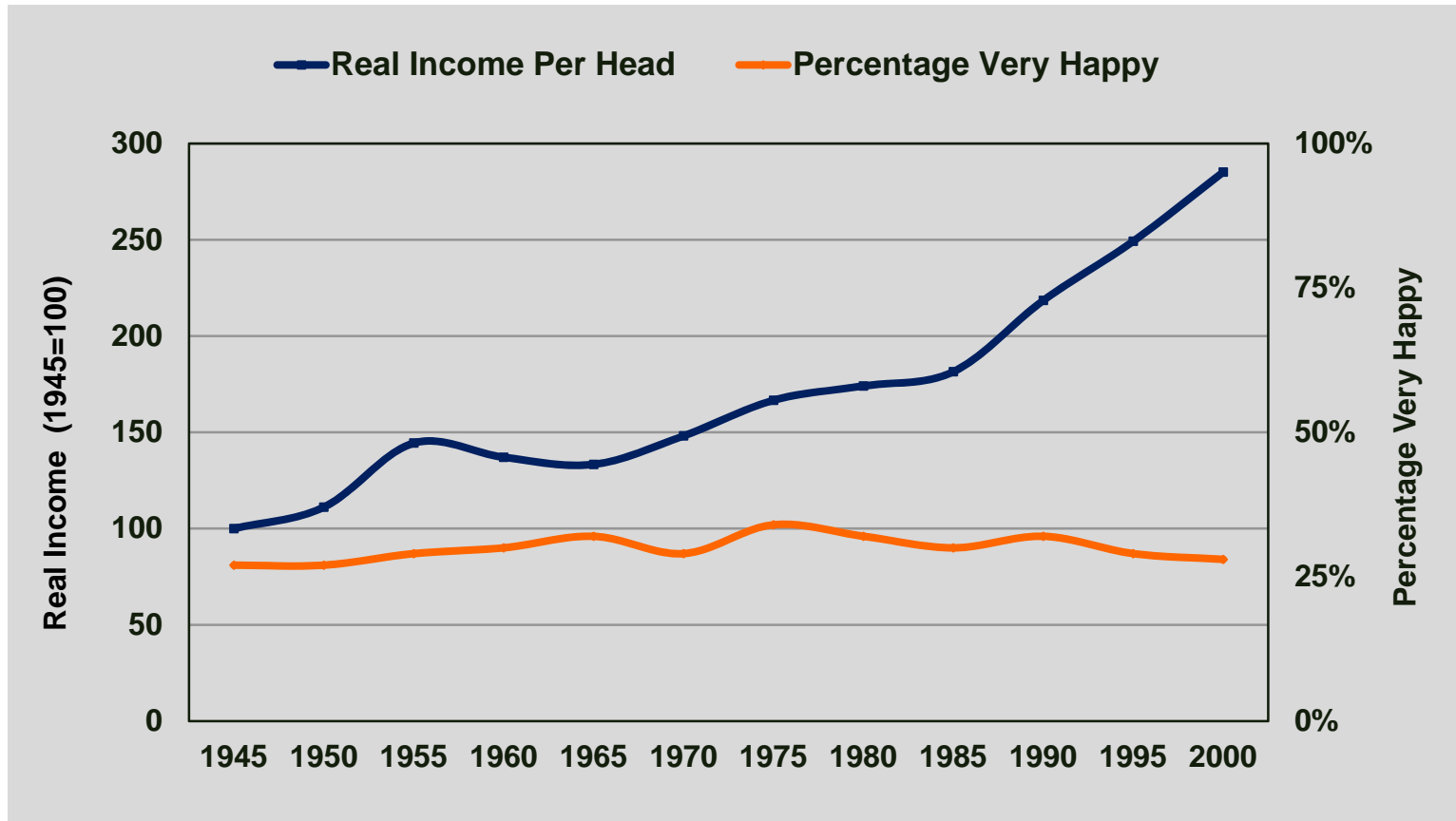
What Makes Us Happy?

Do These Things Make Us Happy?



Wealth?

Income and Happiness



Sources: Layard (2005); Easterlin (2001)

Do These Things Make Us Happy?

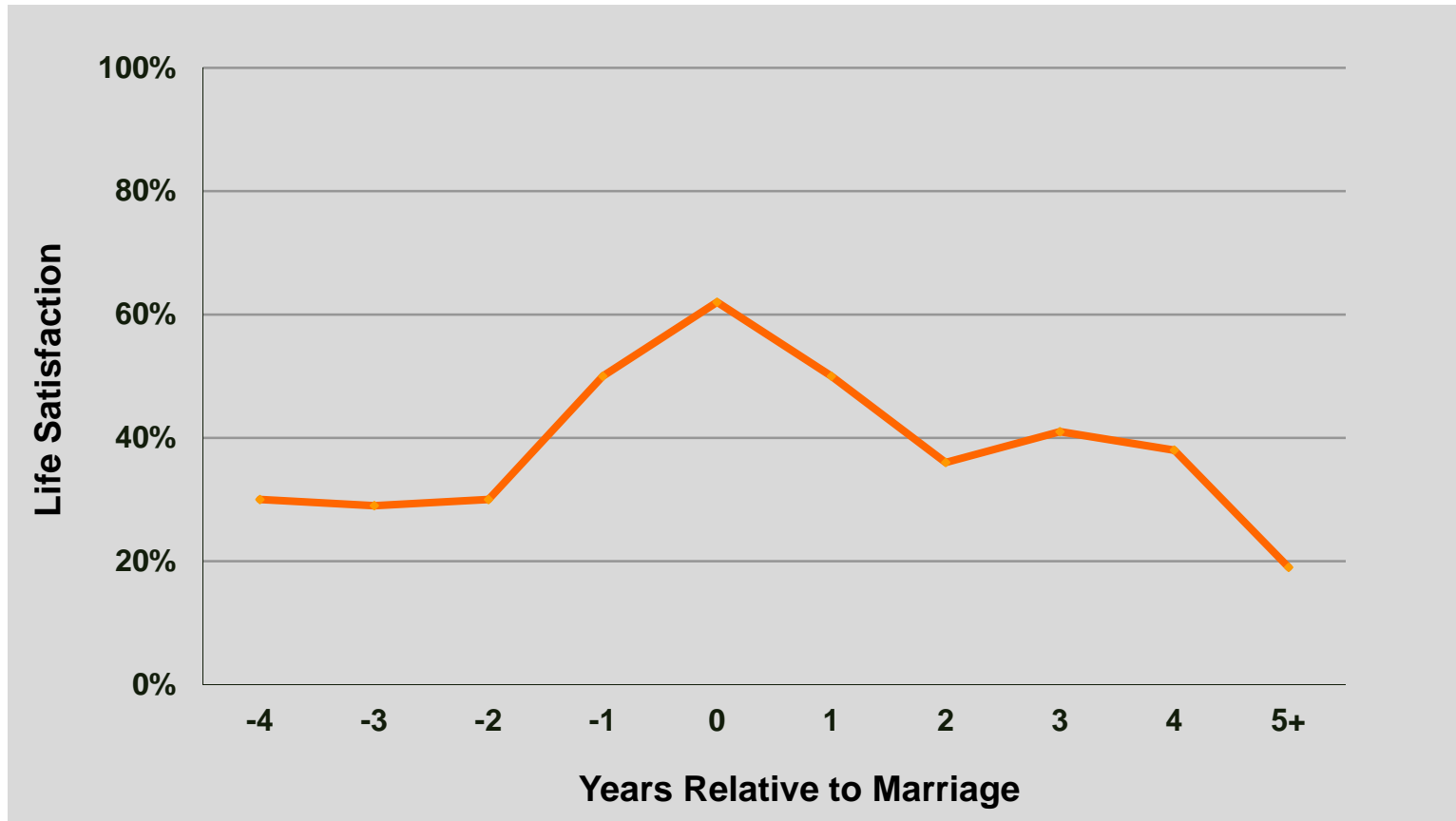


Wealth?



Marriage?

Marriage and Happiness



Sources: Kahneman et al (2004)

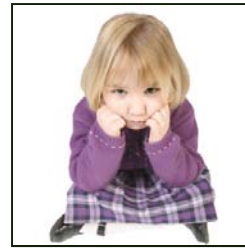
Do These Things Make Us Happy?



Wealth?

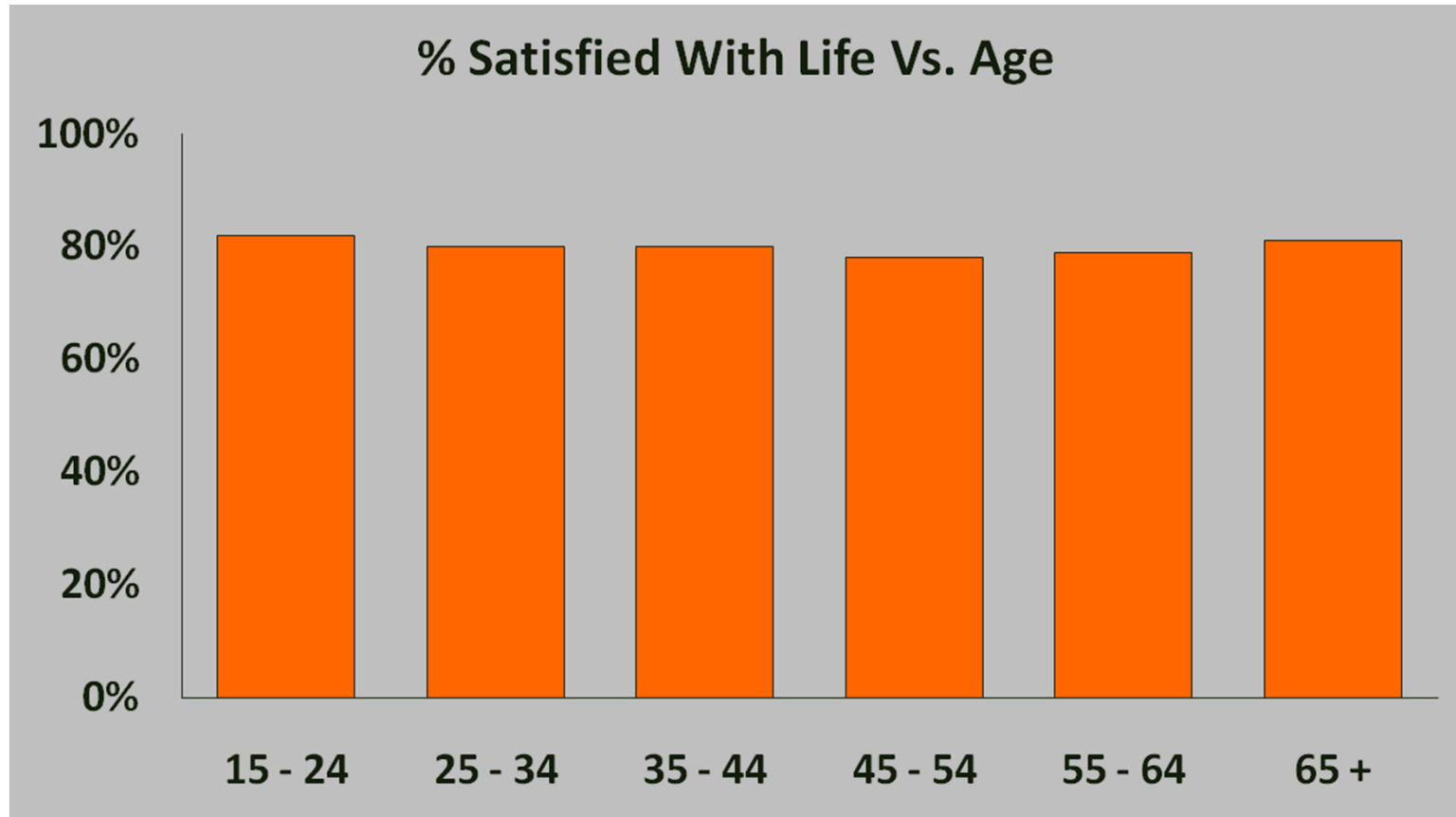


Marriage?



Youth?

Youth and Happiness



Sources: Inglehart (1990)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?

Education and Happiness

There is no effect on happiness across countries
and only a small effect within countries

Source: Helliwell (2003)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?



Looks?

Looks and Happiness

Looks don't make us happy after taking away the hair, makeup, jewelry and nice clothing



Source: Diener, et al (1995)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?



Looks?



Gender?

Gender and Happiness

Men are more prone to alcoholism, while women to depression



Source: Layard (2005)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?



Looks?



Gender?



Religion?

Religion and Happiness

Religion does make us happy...but why?

Is it the “God” part which makes us happy, or
the “community” part?

Sources: Seligman (2001); Putnam (2000); Layard (2005)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?



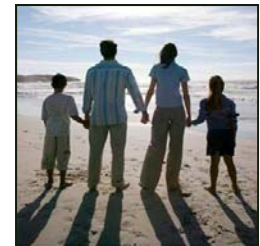
Looks?



Gender?



Religion?



Family?

Family and Happiness

People with the highest levels of happiness have strong social relationships

Sources: Seligman (2001); Putnam (2000); Layard (2005)

Do These Things Make Us Happy?



Wealth?



Marriage?



Youth?



Education?



Looks?



Gender?



Religion?



Family?

What We've Learned (So Far)

- What makes us happy?

Do We Really Know What Makes
Us Happy?

Are These People Happy?



What About Now?



Long Term vs. Short Term Happiness

- “In the moment” and “Morning after” have very different levels of happiness
- Momentary happiness and life satisfaction could be dramatically different too
- Obese people love to eat the food they do...but are not happy with their overall life

The Focusing Illusion

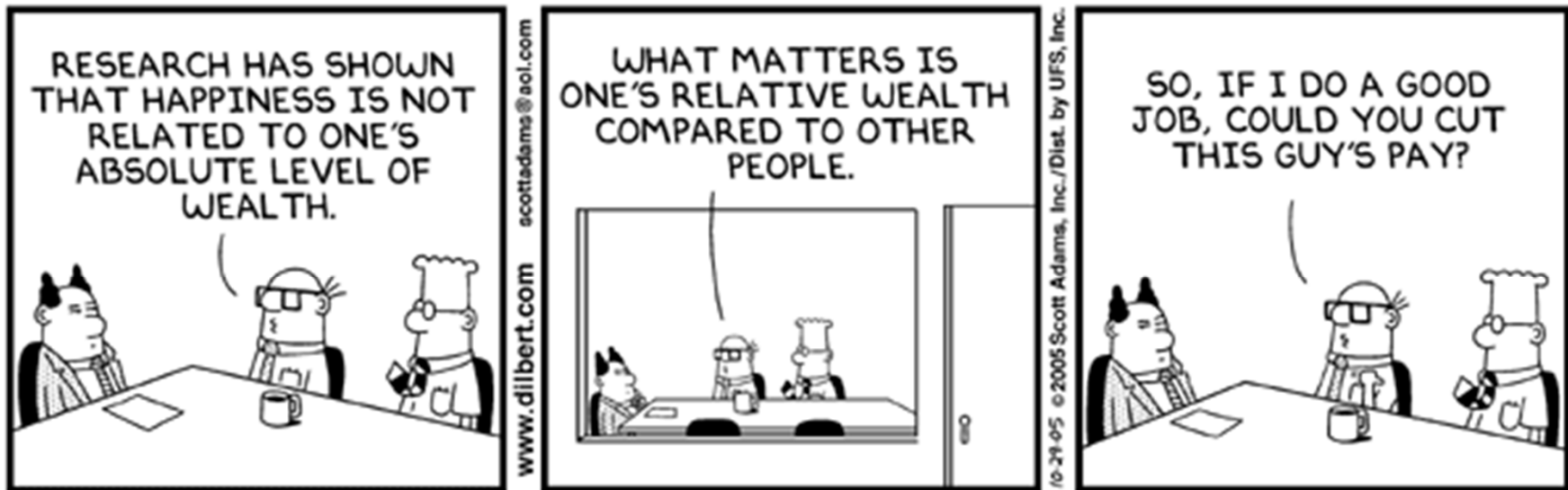
- We fail to recognize that people do not continuously think about their circumstances, whether positive or negative
- As a result, we tend to exaggerate the effect of various circumstances on well-being
- Paraplegics are not as miserable as you think and lottery winners are not as happy as you think

Sources: Kahneman et al (2004); Kahneman et al (2006)

The Focusing Illusion

Would you be happier than these people if you
won the lottery?

Is It Relative Income That Matters?



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What We've Learned (So Far)

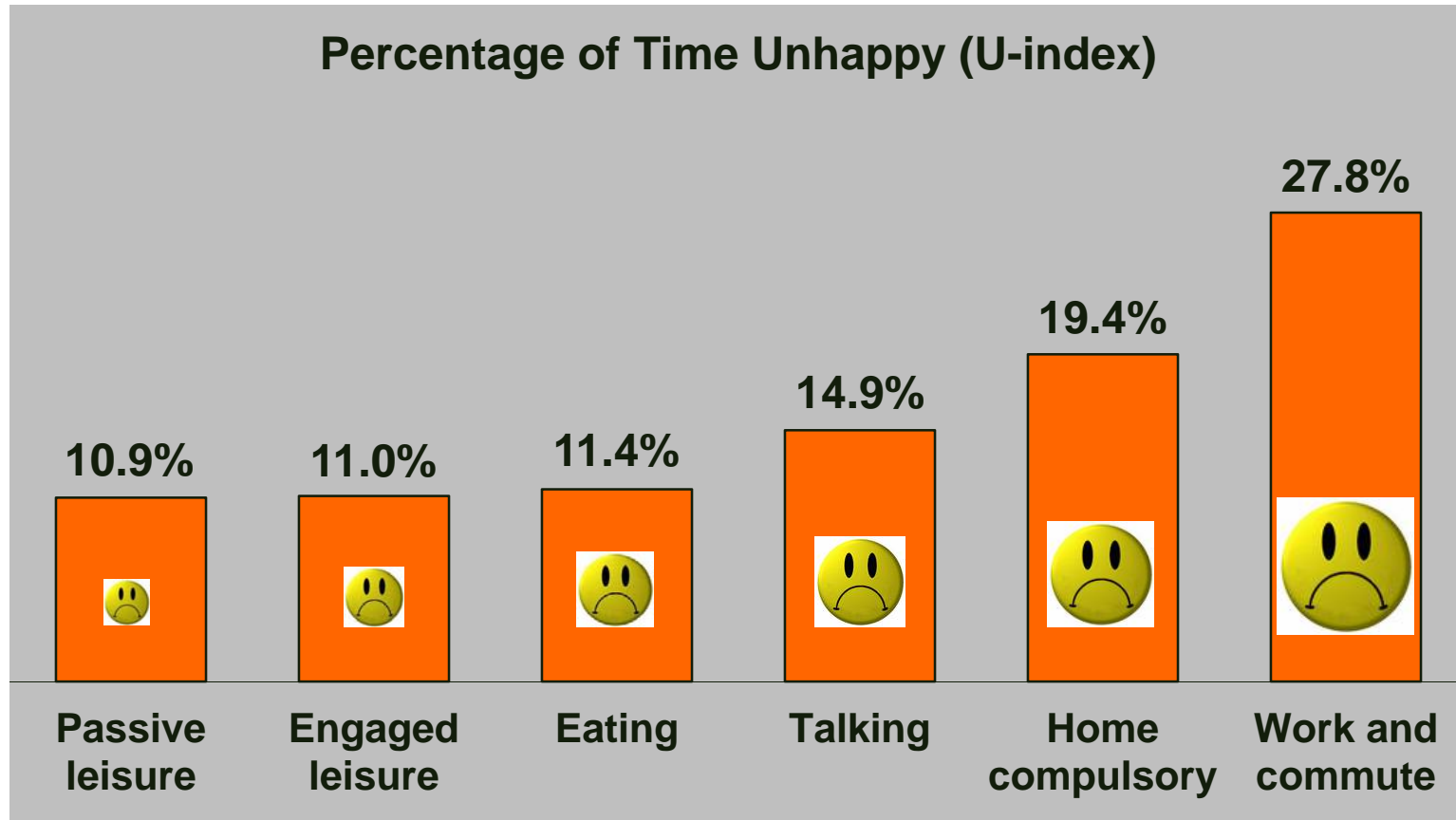
- What makes us happy?
- Do we really know what makes us happy?
 - Life satisfaction vs. experienced happiness
 - The focusing illusion
 - Relative income

How To Be Happier

Can We Increase Our Happiness?

- The Nature View:
 - Happiness is like height: We are born with it
 - Twins: 50% Genetic, 8% Circumstantial (income, education, etc.)
- The Nurture View:
 - Although people are genetically different, we can consistently affect our happiness levels
 - 42% is a lot left unexplained – can we do something about it?

Trick # 1 – How to Spend Your Time



Source: Kahneman et al (2004)

Trick #2 – Positive Psychology

Positive psychology identifies 3 distinct routes to “happiness”

- Positive emotion and pleasure
- Engagement
- Meaning

Sources: Seligman (2002); Peterson et al (2005)

Specific Tricks That Work

- Gratitude visit
 - Write and deliver a letter of gratitude to someone who had been kind but never properly thanked
- Three good things in life
 - Write down 3 things that went well every night for 1 week and provide a causal explanation for each good thing
- Using signature strengths in a new way
 - Use 1 of top 5 “signature” strengths in a new and different way daily for 1 week

What We've Learned (So Far)

- What makes us happy?
- Do we know what makes us happy?
- How to be happier
 - How to spend your time
 - Positive psychology

Money And Happiness

Economist Advice

More is Better!

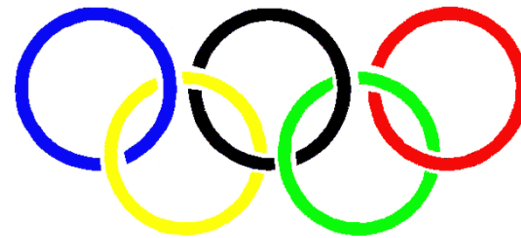


Economics vs. Hedonomics

- One analogy
 - A person that loves wooden blocks becomes bored playing with the ones he has had for a while
- How can we make him happier?
 - A solution from Economics: Acquire more blocks!
 - A solution from Hedonomics: Learn to combine the blocks in new and more satisfying ways!

Examples of Hedonomics at Work

- Changing reference points can change the hedonic experience:
 - Don't compare yourself to your MBA classmates...but your high school classmates
- Reference point can be real or counterfactual:
 - Are Olympic bronze medalists happier than silver medalists?



Source: Medvec et al (1995)

Hedonic Arbitrage

Increasing investors / consumers' hedonic experience without necessarily increasing their income, wealth, or spending



Trick # 1 – Consider Opportunity Costs

**BMW X3 and
Free Gas for 3 Years**



\$46,200

BMW X5



\$46,200

Trick # 2 – Create Multiple Accounts

- *Nest-egg* account managed by professionals and kept largely out of sight
- *Have fun* account managed by investor with low transactions costs and lots of feedback (although perhaps with limits on leverage and non-zero liability investments)

Potential Benefits of These Accounts

- Investors get to have fun (and possibly make some money)
- At the same time, they are protected from the downside of the natural desire to meddle

What We've Learned

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- Do we really know what makes us happy?
 - Life satisfaction vs. experienced happiness
 - The focusing illusion
 - Relative income
- How to be happier
 - How to spend your time
 - Positive psychology
- Money and happiness
 - Hedonomics
 - Hedonic Arbitrage

Class Exercise

Create a business model to make money by promoting happiness

Class Discussion

Should the government consider implementing policy to promote happiness as well as wealth?