

Money and happiness

Classical economics
and happiness

Behavioral economics
and happiness

Adaptation spoils happiness

Principles of happiness

You need to be able to ...

- 1. Identify and explain how classical economics explains happiness**
- 2. Identify, explain and apply how behavioral economics correct deficiencies in the classical view**
- 3. Recognise the role of adaptation in reducing happiness**
- 4. Explain how various principles of happiness are related to the principles of behavioral economics and adaptation**

Classical economics and happiness

Think and discuss

What things will bring you
the most happiness
over the next 20 years?

Yes ... economists are interested in happiness

Economics studies how people make choices

Classical economics = rational choices

Behavioural economics = biased choices

Happiness economics = happy choices

Note that while Economics is sometimes called the 'dismal science', this term was actually coined by Thomas Carlyle in 1849 while advocating the re-introduction of slavery for African men in the West Indies. What a loser!

Who should be happiest? Why?

All three people are equally happy with all aspects of their lives except for their money



John
\$20,000



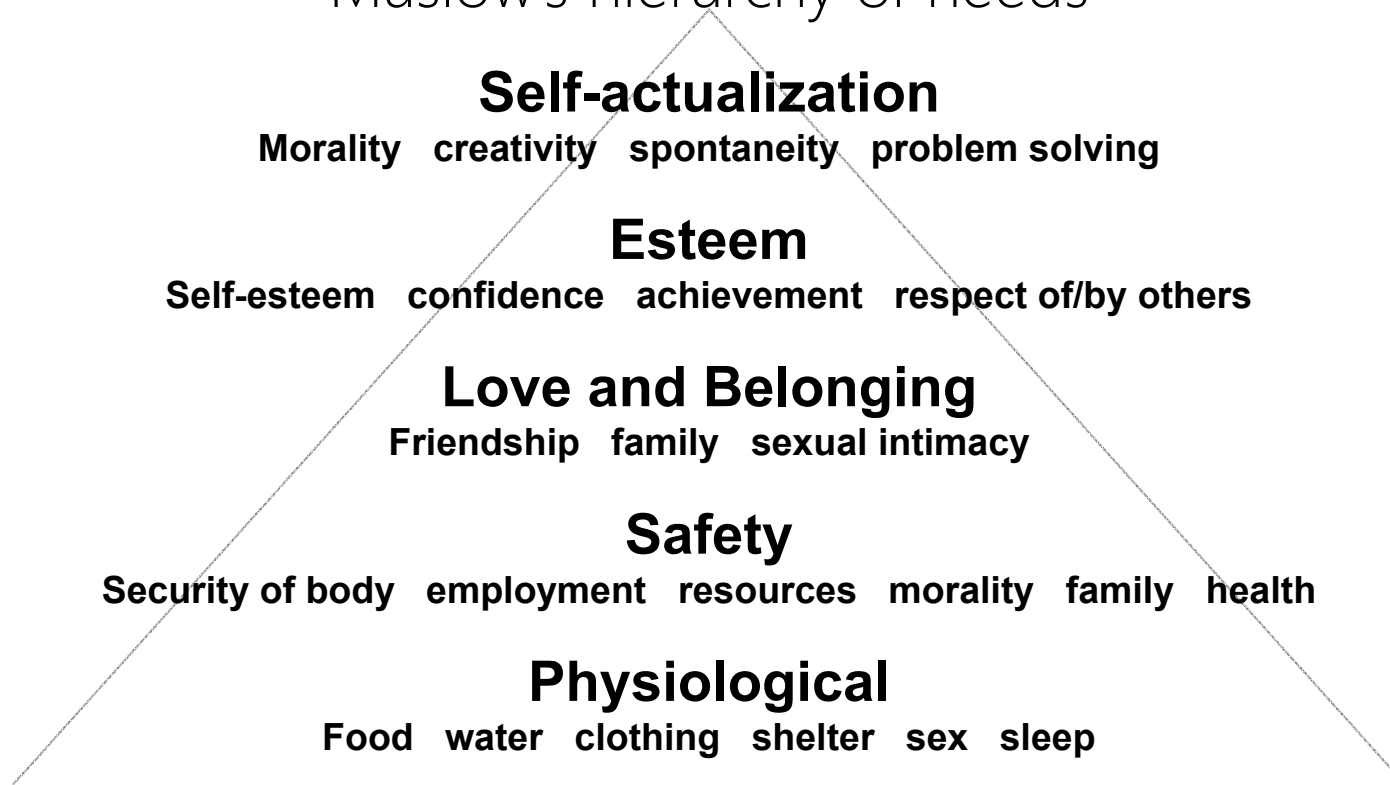
Anna
\$100,000



David
\$500,000

First some psychology ...

Maslow's hierarchy of needs

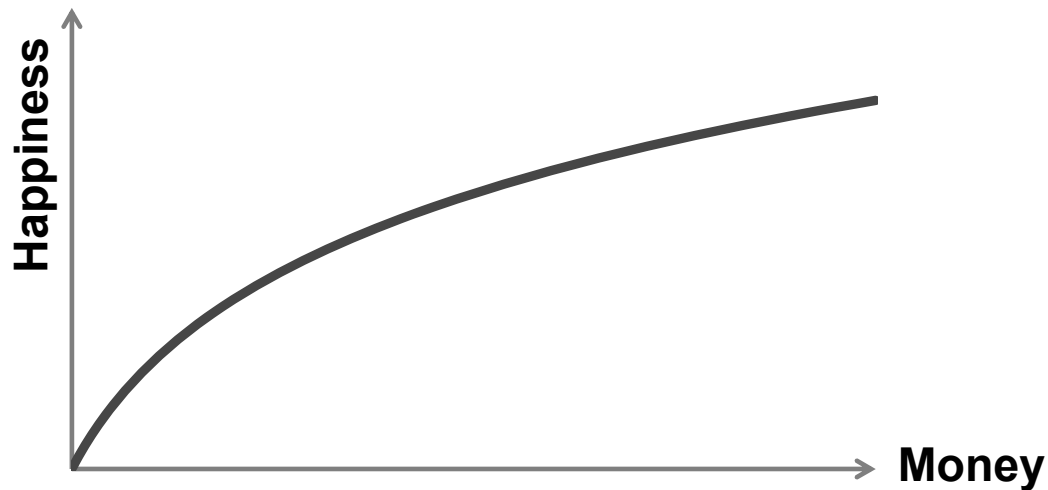


Wikipedia: [Maslow's Hierarchy of Needs](#) by Alan Maslow (1943)

Utility theory

More money allows you to satisfy more needs

But each dollar gives less happiness than last one

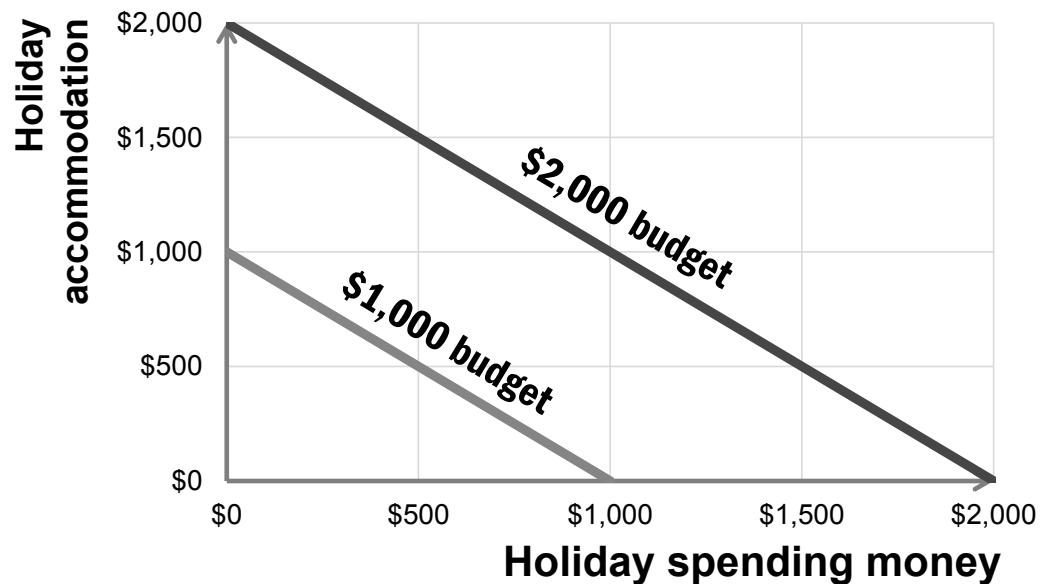


Budget constraints

More money opens up options

Some options are good and some are bad

Money + good choices can increase happiness



2 optimisation games

There are two ways to optimise your expenses

1. Utility maximisation

Keep the same level of total expenses then ...

**Re-allocate funds between different expense categories
to maximise utility or happiness**

OR

2. Expense minimisation

Keep the same level of total utility or happiness then ...

**Re-allocate funds between different expense categories
to minimise total expenses**

Recap

We all have a hierarchy of needs that we seek to satisfy

Money helps to satisfy some of those needs

Utility theory indicates more money increases happiness

... but each dollar isn't as good as the last one

Money also opens up options

... so money + good choices can increase happiness

Q1: Optimisation game

- 1. Consider your expense for last week. How could you reallocate your expenses in order to increase total happiness without increasing total expenses?**
- 2. Consider your expenses for last week. How could you reallocate your expenses to decrease total expenses without changing your level of happiness?**

No answer provided

Behavioral economics and happiness

Who do you think is happiest now?

How does the new information change things ...



John



Anna



David

| | | | |
|-----------|----------|-----------|-------------|
| Now | \$20,000 | \$100,000 | \$500,000 |
| Last year | \$10,000 | \$100,000 | \$1,000,000 |

The problem with utility theory

It assumes we are rational

We are biased by comparisons to a 'status-quo'

Past experiences peer group expectations

How much we have is less important than ...

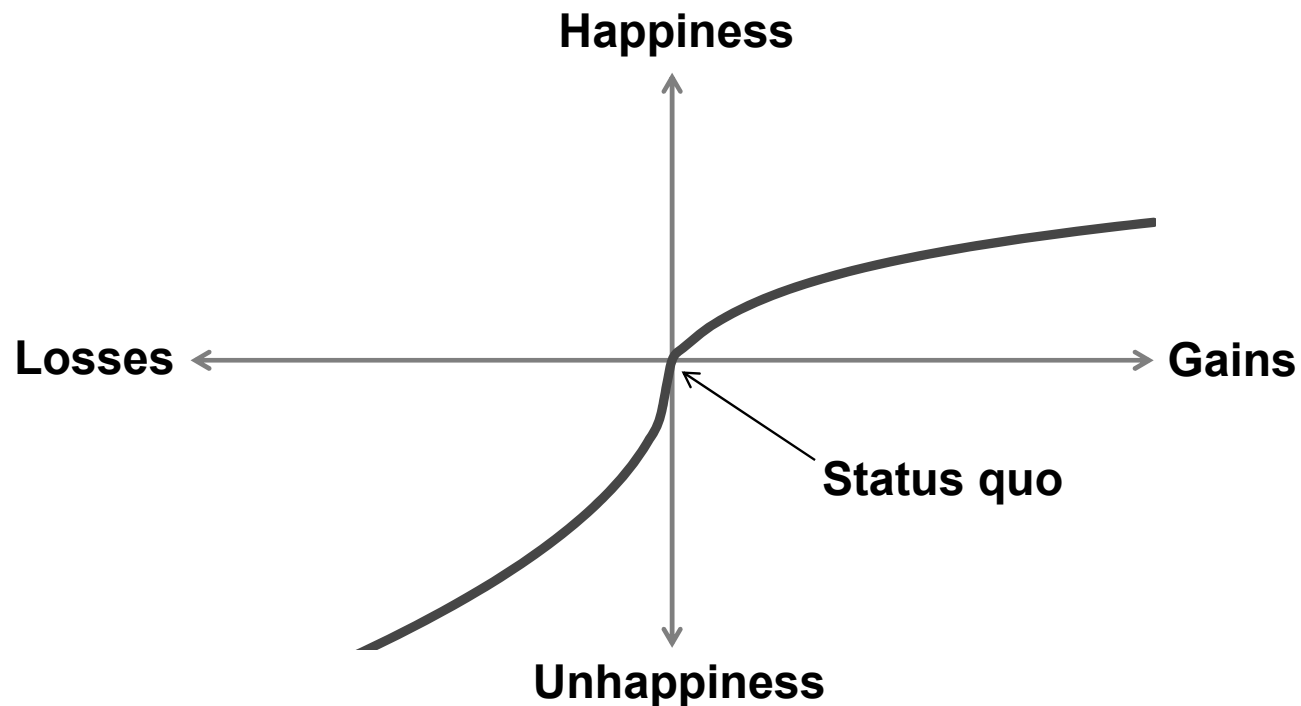
... perceived gains and losses against the status-quo

We over-react to losses

We over-react to the prospect of future losses even more

Prospect theory

Gains and losses versus 'status-quo' are what matter



Kahneman, D. and Tversky, A. (1979), "Prospect theory: An analysis of decision under risk", *Econometrica*, 47, 263-291 ... Nobel Prize (2002)

Which creates more happiness? Why?

Win \$100

Win \$50
... followed a week later by
Win \$50

Which creates more unhappiness? Why?

\$100 Fine

\$50 Fine
... followed a week later by
\$50 Fine

Some implications ...

- 1. More is not necessarily better**
- 2. What matters is gains and losses against status quo**
- 3. We choose status quo and this 'frames' comparisons**
- 4. Split up good experiences**
- 5. Combine bad experiences ... don't drag them out**
- 6. Avoid unfavourable comparisons**
- 7. Be aware of irrationality with the prospect of losses**

Recap

We think we are rational so more is better

We actually make judgements based on comparisons

Perceived gains and losses matter most

We have a irrational psychological aversion to losses

The aversion is particularly strong with the ‘prospect of future losses’

Q2: Behavioral economics

- 1. How can you use Prospect Theory to increase the enjoyment from your next holiday?**
- 2. You have just dented your parent's car on the way back from a university exam you definitely failed. Use behavioural economics to identify a communication strategy.**
- 3. Use the concept of behavioral economics to identify the optimal 'gift strategy' for your 'significant other'.**

No answer provided

Adaptation spoils happiness

Adaptation is a spoiler

Our adaptability is the key to the success of our species

It also makes happiness illusive

We adapt to good things in our lives

Our home, car, food, people, devices, experiences ...

They become part of the status quo

And then no longer trigger gains and losses

We are all hamsters ... but only some realise it

Quote

I've got it all, but I feel so deprived
I go up, I come down and I'm emptier inside
Tell me what is this thing that I feel like I'm missing
And why can't I let it go.

There's gotta be more to life
Than chasing down every temporary high to satisfy me
Cause the more that I'm...
Trippin' out thinkin' there must be more to life
Well it's life, but I'm sure... There's gotta be more.

Lyrics from 'More to Life' by Stacie Orrico

Quote from a king written 3,000 years ago

"Meaningless! Meaningless!", says the Teacher.

"Utterly meaningless! Everything is meaningless."

What do people gain from all their labors at which they toil under the sun? ...

... The eye never has enough of seeing, nor the ear its fill of hearing.

What has been will be again, what has been done will be done again;
there is nothing new under the sun ...

... I denied myself nothing my eyes desired; I refused my heart no pleasure.
My heart took delight in all my labor, and this was the reward for all my toil.
Yet when I surveyed all that my hands had done and what I had toiled to
achieve, everything was meaningless, a chasing after the wind;
nothing was gained under the sun.

King Solomon – King of Ancient Israel (circa 970 to 931 BC)

Excerpts from the Book of Ecclesiastes chapters 1 and 2 from the Bible

What influences the rate of adaptation?

1. Novelty

... we have not experienced the event before

2. Surprise

... we didn't expect the event to happen the way it did

3. Uncertainty

... we are not sure how to interpret the event

4. Variability

... the experience keeps changing over time

Why they slow adaptation

Novelty Surprise Uncertainty Variability

Make events harder to understand

Force us to pay attention

Increase cognition levels

So we are more likely to evaluate a gain or loss

Q3: Adaptation

1. Score the following things from 1 to 5 based on Novelty, Surprise, Uncertainty and Variability

| | | Novelty | Surprise | Uncertain | Variable | Total |
|---|---|---------|----------|-----------|----------|-------|
| A | Your car | | | | | |
| B | Eating lunch by yourself | | | | | |
| C | Meeting a friend for lunch | | | | | |
| D | Going to favourite restaurant with friend | | | | | |
| E | Going to new restaurant with friend | | | | | |

2. Think of a significant relationship in your life.

- In what ways have you adapted to that person so that the positive things about them no longer trigger any perceived 'gains'?
- In what ways can you the principles of novelty, surprise, uncertainty and variability to improve the relationship?

No answer provided

Principles of happiness

1. Invest in relationships

Each interaction is unique ... making it difficult to adapt
... forcing higher cognition ... triggering gains and losses

Diener, E. and Seligman, E.P. (2002), "Very happy people", *Psychological Science*, 13(3), 81-84.

2. Invest in experiences rather than things

We adapt quickly to intransient physical things
Experiences require higher cognition
... and are more likely to trigger gains and losses

3. Help others rather than yourself

Dunn, E.W., Aknin, L. and Norton, M.I. (2008)
"Spending money on others promotes happiness"
Science, 319, 1687-1688.

4. Buy regular small pleasures not big ones

Prospect theory predicts
that separating gains will
elicit a greater perceived gain

Nelson, L.D. and Meyvis, T. (2008), "Interrupted consumption: Adaptation and the disruption of hedonic experience"
Journal of Marketing Research, 45, 654-664.

5. Enjoy 'free' anticipation

The person who buys a good gets X units of pleasure

The person who anticipates then buys it gets $X + Y$ units of pleasure

6. Happiness is in the details

Day to day life experience
have biggest impact
on happiness

Avoid seeking happiness
in abstract long-term plans
as they tend to be
light on detail

Kahneman, D., Krueger, A.B., Schkade, D.A., Schwarz, N.
and Stone, A.A. (2004),
"A survey method for characterizing daily life experience:
The day reconstruction method",
Science, 306(5702), 1776-1780.

7. Practise contentment and thankfulness

'Counting blessings' slows down the rate of adaptation while also eliciting a perceived gain.

8. Avoid unfavourable comparisons

Prospect theory predicts that choosing an unfavourable 'status quo' will trigger off an unnecessary and adverse sense of loss.

9. If you pursue happiness you won't find it

We are most happy when
we are 'lost' in a task and
lose sense of time

We consistently overestimate
the happiness derived from leisure

Kahneman, D., Krueger, A.B., Schkade, D.A., Schwarz, N. and Stone, A.A. (2004), "A survey method for characterizing daily life experience: The day reconstruction method", *Science*, 306(5702), 1776-1780.

Recap

- 1. Invest in relationships**
- 2. Invest in experiences rather than things**
- 3. Help others rather than yourself**
- 4. Buy regular small pleasures not big ones**
- 5. Enjoy free anticipation**
- 6. Happiness is in the details**
- 7. Practise thankfulness**
- 8. Avoid unfavourable comparisons**
- 9. If you pursue happiness you won't find it**

Q4: Principles of happiness

Review your answers to the optimisation game earlier ...

- 1. Consider your expenses for last week. How could you reallocate your expenses in order to increase total happiness without increasing total expenses?**
- 2. Consider your expenses for last week. How could you reallocate your expenses to decrease total expenses without changing your level of happiness?**
- 3. Identify some goals for the short-term (1 year), medium term (1-5 years) and long-term (5+ years) that are consistent with these principles on happiness.**

You need to be able to ...

- 1. Identify and explain how classical economics explains happiness**
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- 3. Recognise the role of adaptation in reducing happiness**
- 4. Explain how various principles of happiness are related to the principles of behavioral economics and adaptation**