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The science of spending (money can sometimes buy happiness)

Michael Kitces | Pinnacle Advisory Group | 18 February 2015

Historically, practitioners have tended to focus more on strategies about how clients can earn or accumulate more money, grow and protect those assets, and (perhaps) figure out HOW MUCH can be spent – but not necessarily looked at and given suggestions to clients about HOW that money should be spent.

Yet, contrary to the conventional wisdom that “money can’t buy happiness”, a recent new book entitled "Happy Money" by researchers Elizabeth Dunn and Michael Norton suggests that there may be far more opportunity than we realise to derive greater happiness by changing the ways we spend our money. How we spend – on ourselves, and others – really does impact the enjoyment and emotional well-being we derive.

In fact, the research suggests that sometimes, the best things we can do to improve our happiness may lie in NOT trying to maximize our wealth, but instead focusing on experiential purchases (rather than "stuff" that appreciates in value), spending money to buy time, and even spending money to support family and relatives instead of ourselves (which may not be cost-effective, but can be remarkably happiness-effective).

So, hopefully, this review of some of the "Happy Money" research will give you ideas about how you can have these spending-happiness conversations with your own clients... and, perhaps, even reconsider some of the ways you do and don't spend money for yourself in the coming year.

FIVE PRINCIPLES OF "HAPPY MONEY" BY DUNN AND NORTON

In their book “Happy Money: The Science of Happier Spending”, authors and researchers Elizabeth Dunn and Michael Norton delve into the research linking money and happiness.

While the famous saying is that "money can’t buy happiness", Dunn and Norton reveal that the truth is more nuanced. More money doesn't always lead to more happiness (although there is research that suggests in the US, increases in household income up to about $75,000 are associated with greater emotional well-being). However, HOW you choose to spend your money can in fact have an impact – sometimes quite significant – on happiness and overall life satisfaction.

Accordingly, Dunn and Norton explore the research about what kinds of spending decisions can have a positive impact on happiness, finding five key ways that money really can “buy” happiness:

1. Buy experiences, not stuff

2. Make it a treat
3. Buy time
4. Buy now, enjoy later
5. Spend on others

1. Buy experiences, not stuff

When people are asked prospectively whether they'd rather spend a significant sum of money on material goods or on an experience, most answer that they would rather buy the "thing" than the experience. The stuff we buy is tangible, it lasts, and we can enjoy/use it over and over again. The experiences we purchase are fleeting moments, and then gone for good.

Yet, when researches approach the question from the opposite side – asking people whether, thinking back on the past, if they would rather give up the memories associated with a material purchase, or the memories associated with an experiential purchase, people were far less willing to trade in memories of the experience than the material object.

In essence, what the research shows is that while we think the material good will last longer, after the fact, we realise the nostalgic memories of the experiences are more satisfying. As it turns out, the joy of the material good fades as we attenuate to having it, and we start to notice other objects to compare to that are even better (leading us to regret our purchase and/or to want the bigger/better/next thing). By contrast, memories of the experience continue to be remembered fondly long thereafter, and it's difficult to regret the experiential purchase because there's nothing similar to compare it to.

The significance of this distinction is critical. It means, given the opportunity to spend money, choosing to purchase a vacation, engage in an event, or have some other experience, can lead to far more happiness than purchasing the new big-screen TV, the nicer car, or the bigger house. And, notably, the research suggests that the length of the experience is less critical than just having the experience (one study found that four-day vacationers were as happy as 14-day vacationers). And, overall, the studies suggest that the best experiential purchases involve a social connection to make it a shared experience.

2. Make it a treat

As noted earlier, a significant challenge to material goods, when we do buy them, is that we get used to them and then the purchase no longer feels special. More generally, the mere fact that something is always available seems to make us less likely to indulge or take advantage of it. Just think of the area where you live, and the last time you took advantage of the sights that visiting tourists go out of their way to see? The distinction is that what's always abundant and available to you is a "treat" for the tourist – something they haven't seen before, won't have a chance to see again for a long time, and therefore have a limited-time-opportunity to enjoy. Which, as it turns out, is directly related to us enjoying it more!

Accordingly, Dunn and Norton suggest that an effective strategy for making spending more enjoyable is to vary what you purchase, giving yourself the opportunity to experience something anew as a fresh treat. A regular Frappuccino may become dull and boring, but a standard daily visit to Starbucks for normal coffee, with an occasional Frappuccino mixed once a week, is a treat.

Notably, our urge to enjoy the experience of a treat is the same reason that businesses often give "limited time offers", and, in fact, research has even shown that we actually enjoy television more when it's interrupted by commercials (although we don't think we will), because the return of the regularly scheduled program then becomes a small treat and breaks up what otherwise becomes diminishing enjoyment of sustained watching.

Notably, this also means that while a gift card might be a "sensible and practical" gift, giving a person something they probably wouldn't buy for themselves really is more likely to create happiness, because it invokes the experience of a treat for the person... something he/she may not have otherwise purchased at all. In addition, the research also suggests that the treat doesn't have to be large to be enjoyable; in reality, we seem to enjoy a larger number of smaller pleasures, than fewer big treats.

3. Buy now, consume later

Continuing the theme that we attenuate to our material goods and derive less enjoyment from them over time, and similarly need to mix things up and create a "treat" for ourselves from time to time, the research also suggests that the anticipation of paying up front but waiting to enjoy something can make it even more enjoyable.

In essence, waiting creates an uncertainty that can intensify the emotional experience. On the down side, if the event we're waiting for is negative, the waiting just creates anxiety (e.g., waiting for the results of a potentially-dangerous medical diagnosis). But when the good or experience coming at the end is positive to begin with, the anticipation just amplifies the positive feelings.

Accordingly, this is why we look forward to Friday (a work day but one where we're anticipating the weekend to follow) more than Sunday (the weekend but a day where we're anticipating the work day to follow), and why it's better to rip the band-aid off than peel it off slowly. The anticipation of what follows can be more significant than what's actually happening in the moment. In fact, it turns out that one of the key underpinnings of suicide is not the amount of negative thoughts and feelings, but the lack of anticipating anything positive to follow.

Ironically, this suggests that the layby plans that were popular decades ago (where you made payments for an item over time that was held aside on layby but not actually delivered until payments were complete) may well lead to greater enjoyment of the purchase than today's credit-card-driven world where we get the item immediately upon purchase and get around to paying for it later.

The bottom line – it may feel free to buy something and get it immediately, but the anticipation of buying it now and waiting to get it can actually make you even happier with the result. This may be especially true for experiential purchases, where the experience itself may be relatively brief, but the anticipatory build-up extends the period of enjoyment and excitement for far longer (and is also why we seem to derive more enjoyment from the all-expenses-paid [up front] vacation that allows us to just enjoy the moment while we're there).

4. Buy time

Spending money on experiences and buying treats may both lead to greater happiness, along with the simple opportunity to be with family and friends, or volunteer to help others, but it's all a moot point if there's no time to do so in the first place. Yet Dunn and Norton note that in practice, people often sacrifice incredible amounts of time just to save a little money without thinking about the ramifications.

Conversely, this means that by sometimes spending a bit more, we could potentially free up a lot more time, and have an opportunity to become a lot happier. Whether it's spending money on a housekeeper to free up time from housecleaning chores, spending a bit more to get a direct flight instead of one with a layover, or just paying a little more for gasoline instead of driving 15 minutes out of the way to save a few cents, there are a lot of ways that spending just a little more can buy a lot of time. And the result isn't trivial. One study found that going from no commute to a 22-minute commute would require a one third increase in income to offset the decrease in happiness from lost time.

Notably, though, Dunn and Norton do point out some paradoxical research finding that while we can derive more happiness by spending money to free up time – a rather literal application of the idea that "time is money" -obsessing about the time we have available can actually make it feel more scarce and make us less happy. This may explain why it is that technically, the average person in the US spends four hours more per week engaging in leisure than they did 50 years ago, yet we've never felt busier and more time-stressed as a society.

Accordingly, the point here is not to obsess about time and time management, but simply to recognise that where there's an easy opportunity to go the extra step of spending a little more in dollars to get back a little more time, it's generally going to be a net positive for our happiness potential. Similarly, this also suggests why it can be so valuable to simplify one's financial life – complexity demands time to manage it, and if greater material affluence leads to diminished time affluence, the net result may not be positive.

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5. Spend on others

While much of the focus on how "money can buy happiness" is about spending on ourselves, it turns out that one of the most effective ways we can put money to use to create happiness is spend it on others and give it away.

In fact, the research finds that "prosocial spending" (money spent on/for others) is actually far more correlated to happiness than how much we spend on ourselves (even though the bulk of our spending is still on ourselves). In one global study, the fact that someone had donated to charity in the past month was as much of a happiness boost as doubling household income!

Similarly, the enjoyment we derive from prosocial spending may go a long way to explaining why so many people spend significantly to support family members (even if it may encourage them to remain dependent on that largesse); in fact, one study found that those who provide support to their relatives report better overall health.

More generally, Dunn and Norton's summary of the research suggests that the more we feel our altruism is a result of our active choice, the more we feel connected to the subject of our giving, and the more we feel our giving has an impact, the more we want to give and the greater the happiness we derive.

IMPLICATIONS FOR SPENDING ADVICE WITH CLIENTS

Although advisers typically focus more on how much can be earned, saved, and spent, than helping clients set spending policies about how those funds are consumed, the research that Dunn and Norton present suggests that advisers could play a far greater role in guiding clients on actual spending issues. The "counter-intuitive" benefit of spending on experiences that create lasting memories and not on objects that last even as the enjoyment doesn't, structuring spending behavior to create "treats", and bucking the instant-gratification trend by focusing on strategies to "buy now and consume later", do not come naturally to most. Which means a little adviser coaching could go a long way towards having a material impact on clients and their happiness.

Conversely, the Happy Money research also suggests planners should be cognisant of the fact that sometimes spending decisions that maximise happiness will NOT look optimal from the perspective of just maximising wealth. Consuming money for experiential purchases could mean not investing in things that save or increase long-term wealth. Making layaway-style purchases may explicitly ignore the time value of money. Buying time could have a material happiness increase but a significantly adverse financial impact, if it means taking a job that pays 20% less in exchange for getting rid of a 30-minute commute. Clients who spend "too" altruistically - even to the point of their own financial impairment - may simply be prioritising the happiness they derive by spending on others over improving their own financial future that might not actually make them happier down the road anyway.

Of course, for some, the greatest impact of the Happy Money research may be introspective look at our own spending behaviors, the decisions we make, and whether some spending choices could be altered to increase our own happiness. For those who are business owners, the research also has significant implications regarding ways to better keep employees happy, from providing occasional treats, to considering bonuses that pay for experiences (not just paying "more money"), and simply recognising the significant value of rewarding employees with time.

The bottom line, though, is that the traditional saying that "money can't buy happiness" may not be so accurate after all. Although greater financial affluence doesn't always lead to greater happiness, the problem may not be that money can't buy more happiness, but simply that those with more money aren't necessarily making the most effective decisions about how to spend their money to get that happiness benefit.

So, if you're curious about how to leverage spending decisions for happiness – either your own, or the clients you counsel – I do highly recommend checking out Dunn and Norton's "Happy Money: The Science of Happier Spending" for some great ideas and insights!

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