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Reversing the question: Does happiness affect consumption and savings behavior? ☆

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ABSTRACT

This paper attempts to answer an interesting but empirically challenging question: Do changes in well-being (life satisfaction or happiness) lead to changes in consumption and savings behavior? The paper uses regional sunshine as an instrument for personal happiness using the Dutch Household Survey from the Netherlands. Sunshine improves happiness significantly. Instrumenting happiness with sunshine, happier people are found to save more, spend less, and have a lower marginal propensity to consume. Happier people take more time for making decisions and have more control over expenditures; they expect a longer life and (accordingly) seem more concerned about the future than the present; they also expect less inflation in the future.

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1. Introduction

"Success is not the key to happiness. Happiness is the key to success. If you love what you are doing, you will be successful." Albert Schweitzer (1875–1965) 1952 Nobel Peace Prize Winner.

Given their background as moral philosophers, classical economists were interested in affect and the emotions which govern human nature (Smith, 1759). This interest maintained its pace for many years, until the marginal revolution. The aim of developing a formal theory based on mechanical laws resulted in the adoption of a concept of utility which excluded emotions and affect. Modern mainstream economics is characterized by rational decision makers maximizing a given utility function under constraints, where utility is simply a labeling that represents a weak ordering of commodity bundles. In conventional micro- and macro-economics, emotions are regularly treated as a factor which can be neglected (in the context

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of ideal markets or rational decision making). On the other hand, recent contributions from neurological and psychological studies have provided strong support for the idea that emotions, and in particular happiness, play a key role in decision-making (Gilbert, 2007).

Differences in emotions and moral perceptions can account for parts or all of the discrepancy found between willingness to accept and willingness to pay (Biel, Johansson-Stenman, & Nilsson, 2011). Emotions are also found to be an important driving factor in investment behavior (Van Winden, Krawczyk, & Hopfensitz, 2011). A link between emotions and consumption has also been established in psychology. For example, Cryder, Lerner, Gross, and Dahl (2008) showed that sad people tend to spend more. Stillman, Fincham, Vohs, Lambert, and Phillips (2012) find that higher levels of spirituality correspond to a decreased desire to consume material goods in a conspicuous manner.

To date, economists have mainly focused on the effects of macroeconomic variables, economic preferences, and personal characteristics on subjective well-being. For instance, Shim, Serido, and Tang (2012) find an impact of saving and future-oriented financial behaviors on young adults' well-being. As such, financial capability has significant and substantial effects on psychological health (Taylor, Jenkins, & Sacker, 2011). On the other hand, luxury consumption can lead to declines in personal happiness (Winkelmann, 2012). Mitrut and Wolff (2011) show that received public and private transfers can predict life satisfaction.

Even though there has been a vast literature on the determinants of happiness, the reverse effect has so far received scant attention (Kahneman & Krueger, 2006). Recent work by economists and psychologists on subjective well-being suggests that there may very well be reverse causality. Charles Kenny (1999) was one of the first scholars to deal with reverse causation. Using time series evidence from happiness polls in ten wealthy countries, he finds no support for a causal link from growth to happiness, weak support for reverse causation, and further (weak) support for links between national equality and happiness and leisure time and happiness. Lyubomirsky, King, and Diener (2005) provide evidence that happiness is related to better health, labor, and social outcomes. Ifcher and Zarghamee (2011) conduct a random-assignment experiment to investigate whether positive affect impacts time preference and find that, compared to neutral affect, mild positive affect significantly reduces time preference over money. Their finding has implications for the effect of happiness on time preference and the role of emotions in economic decision making, in general. Freeman (1978) shows that job satisfaction is a major determinant of labor market mobility because it reflects aspects of the work-place which are not captured by standard objective variables. Mastekaasa (1992) and Frey and Stutzer (2006) verify that well-being at one point in time is positively related to subsequent probability of marrying. Guven (2011) presents a causal effect of happiness on social capital. In addition, Carte (2011) finds that positive emotions can be effective at inspiring environmentally responsible behaviors. Psychological experiments suggest that the behavior of happier people tends to be different from that of people who are less happy, but the direction of causality remains unclear. For example, are people with higher levels of consumption happier, or does happiness lead to greater consumption? Does smoking cause depression, or are depressed people more likely to smoke? Similar questions can be posed in a number of areas, including the relationships between health, social capital, productivity, and happiness.

This paper attempts to answer an interesting but empirically challenging question: Do changes in self-reported well-being (life satisfaction or happiness)[1] lead to changes in consumption and savings behavior? To date, it has been well-established in the literature that emotions (happiness in particular) and consumption are significantly correlated with each other (Cryder et al., 2008; Richins, 1997; Rucker & Petty, 2004). Therefore the stated objective is to establish causality rather than a simple correlation, which is always a difficult task given the usual endogeneity related problems applied researcher face. In terms of causality, the best approach would be to find an exogenous shock which influence economic behavior only through its impact on self-reported well-being. The paper uses weather changes, unexpected part of daily sunshine changes in particular, as an example of such an exogenous shock.

In this framework, a major concern will be the validity of the instrument and the unexpected sunshine satisfies those conditions to be a strong and valid instrument. Another concern could be that individuals may migrate to the sunnier regions. If this is the case, sunshine will not be exogenous to happiness. However, in the Netherlands most people do not migrate much during their lives. Indeed, the probability of living in a region, say "South Holland," conditional on living in the same region in the previous period is nearly 99%. See the robustness section for a detailed discussion on this issue.

The paper uses data from the Dutch Household Survey (DHS) which is a panel of 4500 individuals available for the period 1993–2006. The survey provides self-reported measures of well-being, such as responses about how happy and satisfied individual respondents are with their lives, as well as detailed information about consumption and savings behavior. The DHS also provides information on the exact date when the respondents answered the "happiness" question in the survey together with the province of residence for each respondent. Using these information together with daily weather data (gathered through weather stations in each province), the paper calculates the amount of sunshine experienced during a particular day in a specific province. In this framework, happiness is a function of weather experiences not only today but during the last 10 days. Since expected part of sunshine will be correlated with individual characteristics, the unexpected part of the sunshine changes will be used as an instrument for happiness.

[1] Life satisfaction and happiness are used interchangeably in this paper, and it is assumed that these two self-declared mental states are approximations of experienced utility (as opposed to decision-utility, which is unobservable, see Kahneman, Wakker, & Sarin (1997)). However, de facto, these measures are highly correlated. For instance, the correlation between self-declared life satisfaction and self-declared happiness, both measured on a 1–10 scale, is 0.7 in the European Social Survey (waves 2002, 2004 and 2006; see Clark & Senik (2010)).

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