Inequality: The more money, the merrier? by Michael I. Norton

If you are a top hedge-fund manager taking home $40 million this year, you can afford a lifestyle with more than a little luxury. So why strive to take home $50 million next year? The question goes to the heart of one of the most-researched paradoxes in social science: why do people dedicate so much energy to trying to make more money, when having more money does not seem to make them that much happier?

First, some caveats. People who make very little money do become significantly happier when they earn more. But a large survey of people in the US showed that the impact of additional income on happiness tends to taper off around an annual salary of $75,000 - well below the threshold for inclusion in the top 1 per cent. There is no data suggesting that making more money makes people less happy - it's just that it stops making them much happier.

Nonetheless, it is abundantly clear that the very rich are forever striving to augment their wealth. Some of the reasons why are surprisingly simple.

Leapfrogging the Joneses

People might be happier with their current level of wealth - and stop trying to accumulate more - if not for the curious and apparently irresistible urge humans have to compare ourselves with others on every dimension imaginable: attractiveness, intelligence, height, weight, and crucially, financial success. As the writer H. L. Mencken said, "A wealthy man is one who earns $100 a year more than his wife's sister's husband." The happiness we derive from income is based not only on how much we have, but on how much we have relative to our peers. And the peers of a top hedge-fund manager earning $40 million a year may include fellow hedge-fund managers bringing in $100 million or more. The pain of seeing someone else make more money is a major motivator when it comes to accumulating wealth. Additionally, recent research suggests that people are concerned not only with keeping up with the Joneses, but also with leapfrogging as many as they possibly can. People are much more likely to engage in conspicuous consumption when they know that those purchases will move them ahead of as many of their peers as possible in the status hierarchy.

Interestingly, this applies at the other end of the income spectrum as well. A recent study I collaborated on shows that the group of people in the US who are most opposed to an increase in the minimum wage are those who make just above the minimum wage. Why? Because if the minimum wage increases, these people will now tie for "last place", along with all the people whom they used to feel superior to.

Money can be counted

More obviously, money has a property that many other things that matter in life do not: it can be counted. When people reflect on whether they are better off this year than last, metrics like "do I have more meaning in my life?" are too fuzzy to put a number on; "my life is 32 per cent more meaningful" is just not a calculation we are accustomed to making. Salary, on the other hand, gives us a measuring stick: "If I make more this year than last, then I am doing better in life". This also may explain why people are always buying larger houses and larger televisions.

We just don't know any better

Lastly, despite studies contradicting this notion, most people still believe that more money equals more happiness. Consider research I conducted with Elizabeth Dunn and Lara Aknin at the University of British Columbia in Vancouver, Canada. We asked people to predict how happy they would be if their annual income was anything from $5000 up to $1 million. We also asked how much money they actually earned, and how happy they were with their lives.

We found that people generally overestimated the impact of money on happiness; for example, those who reported earning $25,000 a year predicted that their happiness would double if they made $55,000. More money, much more happiness.

But when we measured the happiness of people at these two levels of income by having them rate their satisfaction with life on a scale from 1 to 10, we found that the wealthier group was only 9 per cent happier. This shouldn't be too surprising: many of us can think back to times when we earned less but were happier. (Remember the good times you had while being broke in college and you all had to chip in just to buy a pizza?)

All of that said, the richest among us are better equipped to turn money into happiness, but perhaps not in the way you would expect. Our research shows that people can gain happiness with money if they do something a bit unusual: give it away. It turns out that spending money on yourself does not make you any happier, but spending on others - from donating to charity to buying coffee for a friend - is an efficient way of turning cash into happiness. The wise hedge-fund manager would do well to take a break from giving investment advice to others, and instead take time to invest in others.

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