

**EPISODE 615**

[INTRODUCTION]

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**FT:** This episode originally aired on August 29<sup>th</sup>, 2016.

Welcome to So Money everyone. I'm your host, Farnoosh Torabi. Thank you very much for joining me today. It's a good day. It's a very good day. Today's guest is one of my favorite authors on the planet. He has given me so much invaluable insight throughout the years as I have been working on the field of personal finance, trying to untangle the reasons why we do the silly things we do with money.

Dan Ariely, he's our special guest today. The author of several New York Times bestsellers. You've probably come across them, they still sell them. They sell like hotcakes in the airports and that's the best place to be if you've got a book. His books include Predictably Irrational: The Upside of Irrationality and the Honest Truth about Dishonesty.

I actually tapped Dan for his expertise recently from my Oprah column about how we can combat all the money myths that we have circling in our heads and how we can save better and Dan and I were two of the keynote speakers recently at the Northern California Financial Planners Association gathering. I missed him there though, he spoke before I did. I arrived later and we missed each other but it was still an honor. Selected to speak at the same event that he was at. It felt pretty cool about that.

A little more about Dan, he is a founding member of the Center for Advanced Hindsight and a chief behavioral economist with the new savings app called Qapital with a Q. He's a multiple TED time talker, his speeches have been viewed millions of times and he's also the James B. Duke professor of psychology and behavioral economics.

With Dan we learn the pros and cons to technology and the digital age we live in when it comes to personal finance. The ways we can change our irrational tendencies when it comes to

savings and investing, how to avoid expensive cravings and how to feel more grateful for what we have. Here we go, here's Dan Ariely. Enjoy.

[INTERVIEW]

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**FT:** Dan Ariely, welcome to the show. So great to have you.

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**DA:** A pleasure to be here.

[0:02:36.8]

**FT:** What I love most about your work Dan is not just the research but the solutions that you give us to try to, in very practical ways, combat our irrationality. But given the pressures today of income, inequality, rising cost, there's a lot of lack of education, how optimistic are you that we can really turn things around and become more physically responsible as a society? Do you find that there is resistance? Do you find that there are just some circumstances that makes it really difficult to practice some of your solutions?

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**DA:** So first of all, thanks for having me and I think absolutely the answer is yes, but I don't get depressed by it. So one of the things that we've realized in social science over the many, many recent years is that the environment matters and it matters more than we think. So we usually think of people as agents of decisions and it's all about us and we decided and we act and so on, but the reality is that the environment has a lot to do with it. Imagine I came to your office every morning and I layered your desk with donuts, every morning, fresh and wonderful.

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**FT:** Thank you very much, that would be delicious.

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**DA:** And let's say I do it for a whole year, what do you think will be the effect on your waistline by the end of the year and your health in general, right? So look, if we did this experiment and I expose you to a lot of donuts every day, I'm not saying you'll be tempted every day to eat a little bit but there'll be many, many days that you'll be tempted and the consequence will be short term pleasure and long term perhaps health issue.

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**FT:** Depression.

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**DA:** So the thing is that if I expose you to donuts or whatever it is, you'll very likely to fail but I don't have to expose you to donuts. So once we get people to be exposed to temptation, texting and driving, overeating, under saving, not exercising, the temptation is so strong and the companies that produce temptations improve all the time.

Again, not to say anything bad about donuts but Dunkin Donuts is just getting better and better at tempting us. That is their mission in life and Facebook is getting better and better in getting us to check Facebook more often and life is really about companies around us, almost all of them want to tempt us. They want to tempt us to use our time, money, attention in a way that works for them right now. So we fail often, so that's the depressing side. The good side is that we can create new tools.

So in the same way that we don't have to expose ourselves to donuts, right? We could do other things like we can create a phone that would not let us text while driving right? We haven't done it yet but it's possible. Actually it's not too complex to figure out that there's algorithms know that you're driving and disable all kinds of things. Yes it's less fun but also less dangerous. So I'm a big believer in creating tools that help us overcome some of our weaknesses.

Now think about the world of money. Some time ago, whatever a hundred years ago or 50 years ago, we had cash and cash is simple and also we had a rather simple life. People have defined benefit plans, we didn't live that long, donuts were not as good, we didn't have all the variety of all the things that modern life has, which is wonderful but also tempting. As life progressed, life became more complex. All of a sudden, we figuring out the mortgage is difficult.

By the way, here's an interesting story. As long as mortgages had only one dimension, what's the interest rate? It was very easy to figure out that 3.75% is a worse interest rate than 3.5%. But then they went ahead and they added points to the mortgage process. So now you can pay an amount of money upfront and that reduces your interest rate and now people get confused because the computation is much more difficult. So think about what it means that people get confused and choose the wrong mortgages or the ones that actually don't pay, don't charge them more.

The moment you move from one dimension to two dimensions and think about the economic environment right now. We have of course mortgages and student loans and car payments and credit card payments. We have retirement savings, we have emergency savings. We need to save for our kid's college, all of these is becoming incredibly difficult. Also because of the American tax system, we don't really know how much we get paid until April the following year. So we have created a system that is very, very complex.

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**FT:** Have you noticed though, just to ask I am curious because you're comparing society today to say, society in the 50's. Were we better at making decisions in the 50's because our environment was more simple?

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**DA:** That's right. So it's not that we were better, just life was pointed out to make a simple decision. Just imagine a world in which you only have interest rate and a world in which you have interest that then points. When you just have interest rate, you can't make the same

mistakes. They're not available. Imagine a world in which you have a phone that keeps on beeping all the time while you're driving and you're really curious about what it says versus living in a world in which you don't have a phone. It's not that human being became more stupid. I know that as I get older, it's kind of a nice –

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**FT:** It's an easy excuse, right.

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**DA:** That's, "Oh when I was young." But the reality is that life is becoming more complex but here's the good news, when you think about money, money has moved from being physical to digital and while debt is creating some complexities, I also think that's also the opportunity for how to do things. So imagine you and I sat together and we said, "Look, we understand a lot about the psychology of money. We understand about the limitations, we understand about saving, we understand about budgeting. How would we create an electronic wallet that would help people understand the opportunity cost of money?"

Every time you go into Starbucks and you buy a cup of coffee, you give up something in the process, right? Something gives, what? It's very hard to figure out. Can we create an electronic wallet or an electronic tool that would help people understand that? So yes, electronic money and life complexity has become harder. It's harder to save, life is more tempting and people make more mistakes.

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**FT:** But yeah...

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**DA:** We could do better.

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**FT:** But Dan, one of the more famous studies around cash which I've read because I'm a nerd is that when you use cash, it's actually better than using a credit card in the sense that there is a pain associated with giving out your money, your actual cash. So when in the digital era when everything is now your electronic wallet, is that something that is going to hurt us?

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**DA:** Yeah, so I think this is great point, kind of a great way to think about it. This notion of pain of paying that you mentioned is the idea that when we go to a nice restaurant and we pay with cash, at the end we feel a ting. There's a little bit of annoyance. But if we pay with a credit card, we don't feel the same thing. Actually, debit card is a little less, credit card is a little less if we do something like Apple pay, we don't even think about this.

Somebody just swipes something next to our phone and the pain of paying is all about saliency. It's all about thinking about money at the time when we are paying. So yes, you're right. It's so far the electronic tools that we've created from cash to credit cards to Apple and Android pay, those have made the pain of paying lower and our temptation to spend higher but we don't have to do it this way.

Let's just use our creativity for a few minutes. Imagine you and I were designing together an electronic wallet that tries to get you to think about the pain of paying. They try to get you to think about where the money is coming from. How would you design it? So to start with, you would want people to think about money before they order not after they get the dinner, right?

So as you enter the restaurant, I would have some geo fencing, and I will let you know, "Hey, by the way, here is your budget for dining out this month and here is where you are and if you're going to spend more than that, the money has to come from somewhere. Where is it coming from, right? Tell me where it's coming from." And then maybe during the ordering process, I would get you to reconsider alternatives, right?

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**FT:** Right.

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**DA:** So here's by the way a beautiful experiment that Dilip Soman did in India and it's not digital but you can think about how it could be digital. So he went to a place in India where migrant workers show up to work and these are people who come to work very hard physical labor and send money to their families. But everywhere where men gather to work, temptation also appears, all kinds of things.

So what happened is people on Friday get an envelope with money and they spend too much of it and send too little money home. So Dilip tried two things, he compared what happens when you give people an envelope to what happen when you give people four separate envelopes with the same amount of money but you just pack it in four different envelopes and you seal them. What happened?

People send more money home and when do they stop? When they have to open a new envelope. So what happened is the moment you open an envelope, you just use it but then you get to what we call the decision point. The moment you start an envelope, you just use it but if you get to the end of the envelope, you stop for a second and you ask yourself, "Do I really want to open a new envelope?" And many times people say "no", and then life gets better.

But in another condition, a more interesting one, he gave them the same four envelopes but he wrote the name of their kids on each of the envelope. Now, you could say this is a little cruel but this is a representation of the opportunity cost. All of a sudden he said, "You know what? I want you to think about where this money is coming from," and by thinking about where this money is coming from, people were spending less money. Now this is with envelopes, we could do a much better approach with an electronic wallet.

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**FT:** Right.

[0:13:58.2]

**DA:** Okay, so you're right that everywhere that the industry has gone is to make us spend with greater ease, with less pain of paying and think less about the future and more about the present but I am still hoping that somebody will create a better electronic wallet.

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**FT:** So you're working right now with Qapital, you're the chief behavioral economist, it's a FinTech app, how is that app maybe offering some of these behavioral solutions?

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**DA:** Yeah, so Qapital actually is a combination of all kinds of solutions bundled into one with the idea that some things are difficult and let's help people with those things. For example, one of the things that happened is that people look at their balance at their checking account balance and that is used as a guide to how much money we have to spend. But the problem is, that we have a very uneven flow of income and outcome.

So think for example about two people, person A and person B. They both get paid \$5,000 as a salary and they both have a rent or mortgage, let's say a mortgage of \$2,000. Both of them get paid on the last day of the month but person A gets the mortgage payment on the first of the month and person B gets the mortgage deducted on the 20<sup>th</sup> of the month. What happens?

Person A gets the money in the mortgage comes out and they see they have \$3,000 in their checking account. That basically helps them think about how to budget themselves. Person B gets \$5,000 nothing comes out for the first 20 days, they look at their checking balance and they say, "Oh my goodness, I have lots of money."

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**FT:** Right.



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**DA:** Now, it's not that these people could not sit with a piece of paper and say, "I really don't have that money." But when you look at that number you're not thinking about all of your expenses but that's the easy case, right? Think about what happened with by yearly expenses like insurance. Some states, people pay insurance twice a year. Every month, money goes into your account and some of it needs to go to pay this bill. You don't want to get the bill all of a sudden.

So Qapital basically tries or one of the first things that they are trying to do is to basically say, "Let's help people automatically take money out of your checking account to all of those buckets." So when your salary comes in, we virtually take money for all the bills and all the expenses and emergency savings to sort out how your financial life really looks like. So instead of one number that represents lots of things, we help you by doing separate numbers.

On top of that, we said that opportunity cost is very hard. So every time you buy something you are giving up something else. A few years ago, we went to a Toyota dealership and we asked people, these are people who are about to buy a car and you asked them, "Look if you buy this car, what would you not be able to do?" And people had no answer. Why? Because they never thought about it.

So then we pushed them. We said, "Look something has to give" and the most common answer we got was, "If I buy Toyota, I can buy a Honda." So people were substituting in the same time frame in the same category but they should have said something like, "I'm giving three weeks of vacation over the next five years and a hundred lattes and 70 books, and whatever it is."

So the second thing that Qapital is trying to do is to help people understand the tradeoffs. So there's some things you might say you want. You want a bicycle, you want a summer vacation, you want to change your car in five years and money is just sitting in your checking account. It doesn't have a color. It doesn't have a goal, it's just money but by putting the money into different buckets for people in terms of what they want to achieve, we help people realize what they want.

Now, I have to say I like computer gadgets. I enjoy the process of buying computer gadgets. From time to time I'm disappointed with what I got, but the excitement of trying something new is still nice but how do I want to indulge in computer gadgets. Do I want to just look at it and every time say, "Oh that's great. Let me try it." Or do I want to basically say, "I got this, let me get it in three months." Or, "I want this but do I want it more than something else?" So Qapital is trying to get all of those activities for people to basically add some pause to think about the thread that we are actually making but doing them.

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**FT:** And how is it working? Have you been measuring the results?

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**DA:** Yes. So Qapital have been going on for a while. It started really small with just a few people that were invited. Now it's becoming bigger and people love the automation of the process because look, dealing with money and thinking about money is just mostly unpleasant. We want some help. If we enjoyed it, we would start every morning with an Excel spreadsheet with how much money we have and what we want to do and how to allocate the money.

So the automation is helping people a lot and then basically thinking about money as we're not using this term in Qapital but I like the term as colored. As having a color, it has a goal, it has a category. It helps people align spending with how they want to spend. I'm very happy if let's say that you and I talked about your financial spending. It could be at the end of the day I would say, "You know what? I don't think you're spending enough on coffee." Or, "I don't think you're spending enough on vacation."

Helping people make decisions about money is not always about spending less. It's about spending better right? We have decisions between now and later and we have decisions between now and now. You can say, "Let me go once a week in expensive restaurant or twice a week to a cheaper restaurant." Or, "Bring a bottle of wine from home."

Whatever it is, the goal is to help people do things better but we really have to help people because we have to give people the sense of where is this money coming from, what would you not be able to do? The tradeoffs that are hidden, how do we make them slightly more visible and thoughtful?

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**FT:** I like that. Don't spend less necessarily, it's about spending better. With regards to automation Dan, what's the downside to that? My feeling is that, and I think you have written about this is that on the one hand, automation is a fabulous solution, take the 401(k) for example, if that didn't exist so many of us would have zero dollars in retirement. But ideally, you still want to have some relationship with that money because what happens is when we automate, we just set it and forget it.

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**DA:** That's right.

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**FT:** And so how do we reconcile automation with still having a connection to our money so that we still have that important emotional feeling towards it that we actually end up caring instead of forgetting about it.

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**DA:** Yeah, so I think it's an interesting balance between doing something like counting calories right? Counting calories of how much you eat is so annoying and so time consuming that the vast majority of people just give up, right? And when they give up, it's not as if they start eating well. When we give up, we eat badly and I think the same thing applies to money. Thinking about money and accounting and how much money we have and what's the tradeoffs and so on is just a little but too much for the joy of life.

If every time you thought about a cup of coffee, you would say, “Okay, what am I giving up in the future? Let me make a list of that,” life would be very annoying. So the goal is to make some decisions that help us down the line and we come maybe once a year and revise those big decisions. So it’s not that we’re completely out of control but we can set up a plan for ourselves.

So if you go to a gym, it’s a really good thing to make 10 appointments with the trainer and say, “Okay, I have figured out what to do in the next five weeks and then I’ll figure out the next step.” With money, you think about something like budget for restaurants. You pick a budget for a restaurant, you figure what it is and you just use this for a while maybe six months, maybe a year? At the end of the year you say, “Okay, was this too much, was this too little?”

I don’t want people to sit every day and figure out what the restaurant budget should be like. I want you to do it once in a while and then I want you to enjoy restaurants rather than suffer every time you go to eat. So think about these balance between yes, we want control. Yes, we want to be involved but maybe it’s more like an oil change for a car where once every 3,000 miles, you stop, you fix things, you reconsider, you re-evaluate and then you continue without thinking about the engine for a while.

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**FT:** So to recap, change your environment, understand your tradeoffs, automate when you can, think about saving as spending better not less. What for you have been the biggest shift? When you have applied some of your research into your own personal life, what do you think has been the most impactful?

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**DA:** So for me, I’ll tell you the trick that I have used for myself is I created another account. I took a prepaid debit card and I basically said to myself, “I want that this card is all my fun discretionary spending.” So it includes coffee, it includes restaurants, it includes gift that I want to buy and I basically thought about it once like how much do I want it to be in this category? I kind of made a guess of what seems to be a good amount that is not too high and reasonable.

And then, I have an automatic transfer every month to this account but I have created this mental account of fund spending, I can see where I am. I can see how I'm tracking compared to what I want to and what I want to do. It's a very high order accounting because I don't break it by restaurants and gadgets and coffee but it gives me a sense of where I am now compared to what I want to spend.

I find that if I am behind, I sometimes say, "Okay that it is great." If I see something next that I really want, I go for it. If I am spending a bit too much, it helps me modulate this but as long as the money was there in my checking account, it was very hard to figure out where I am on my discretionary spending which is the only thing that I have real control over.

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**FT:** So create almost a silo for that money that it's very clear what your boundaries are.

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**DA:** Yep, you know another thing that I think is interesting to do is to figure out a bit more what makes us happy. If you think about money as a mechanism to derive happiness, which it is, it's not that you can buy everything with money but you have an amount of money and you have to decide how you want to use it to get happiness in the form of coffee and breakfast and vacation and cars and so on.

I think it's interesting to ask ourselves or to doubt ourselves whether we are really good at it and say, "Do I really understand how to use money to become happier?" And if we don't, then try some very different things. So for example, it's very easy to imagine on vacations. You say, "Well we have a family vacation. We go to Florida every year, we're perfectly happy with this. Life is good, the kids enjoy it, everybody is very happy," but is this the right approach?

There are these other things that we have never done before, we haven't tried it, not sure if it would be great or not but I am willing to admit that I can't predict very well. So for us for example, five years ago we decide to go into something called the Chautauqua Institute in New

York. It's a summer camp for kids, the kids do sailing and play and so on but it's also a summer camp for adults and the adults go for lectures.

So there's discussions on philosophy and religion and politics and science and so on. Is this a great way to spend a vacation? It was completely unclear but we tried it out and by the end of the first year, we realized it is a great way to spend a vacation. So I think also going from time to time out of our comfort zone and trying different things is incredibly important.

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**FT:** One last question, and this is a little bit of a selfish question because I am working on some articles right now around this correlation and I would love to get your take on it because I think you might have some thoughts. The correlation between being grateful and financial prosperity, in other words, when you wake up in the morning and you walk through life feeling grateful for what you have even though you may not be the wealthiest person.

You may not have all the top resources at your disposal but you appreciate the fact that you have your health and that you have a roof over your head, the simple things that there have actually been some studies on that that say that people who think like that tend to have not only a better outlook on life but a better outlook on their finances and they're more likely to go down a path of financial wellbeing versus somebody who is always comparing themselves to others. "Oh I don't have enough," etcetera. Is that just karma or is there something very scientific about that?

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**DA:** So a big part of it has to do with the key of comparing yourself. For example, we know that people who are religious in the US don't feel they need brand names to the same degree that people who are not religious and we don't know exactly the mechanism but one possibility is that they have an identity that is around religion and modesty and they are not looking for an identity around a brand of a car for example.

So they're much more likely to buy generic than branded stuff. Another thing we know is that there was a paper that came out recently that showed that when people win the lottery, their neighbors start spending more money and you can see how it happens, right? Imagine your neighbor just won the lottery.

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**FT:** Keeping up with the Joneses, yeah.

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**DA:** Exactly and you know they were just like us all the time and now our kids play together, they live in the same neighborhood, it's one thing if somebody is very rich living in a very far away neighborhood and they get richer and you don't even know about it but if somebody in your neighborhood all of a sudden has a remodeled kitchen and a new car, you have the urge to get that as well.

So keeping up with the Joneses is a very important thing and I think it is about this expression of the hedonic treadmill. One of the things that we find about spending is that people say to themselves, "Oh you know if I get this new car, I'll be really happy," and you get the new car and you're really happy but for a short time and after a while, the car is not that new anymore and you're just back to your old level of happiness.

You say to yourself, "Oh I am not that happy. What did I do last time that made me happy? Well, I bought a new car. Well that maybe happy, let me buy a new boat," and you buy a new boat and you are really happy for a short time and then it goes down and the hedonic treadmill is this idea that we chase things. They make us short term happy but then we are no better later on and then we need another boost of happiness.

And then we keep on spending and spending and spending while running in place. You could see how if somebody doesn't need that if you are basically happy with what you have and you're not searching for this happiness, life is actually much simpler and there's a lot of things in

life that cost a lot. A new car, we see the price of the car but when you think about buying a new car, replacing your car, you see the upfront cost of the car.

Let's say your car now cost is worth \$10,000 and there's a new car that costs \$30,000 but what is very clear is that you pay \$20,000 to sell your car and buy a new one but people don't think about upfront is that lots of other things will become more expensive. There's taxes on the car that they will become more expensive. This insurance of course will become more expensive. Repair, maybe you'll have the engine will not get defected.

But every time you have scratch, you'll feel like fixing it. It will be like scratch number 17 that you don't care about. It will be scratch number on that you want to repair. So if we have this craving mindset of looking at the neighbors, looking at other things and so on, it's very hard to stop spending.

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**FT:** Any sense on how we could feel more grateful? Do we just join a religion? Do we join a cause?

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**DA:** So you know religions have their own blessings and their own costs. The area of mindfulness is not my area of research but every time I read something about it, I am deeply impressed with how simple mindfulness and being grateful, how simple and non-time consuming some of these interventions are. So meditating for a few minutes a day ends up making a big difference.

Saying a couple of things to yourself about reassuring and thinking about what you're grateful for makes a difference. Now I have to admit, like with meditation, I try from time to time. I close my eyes and in 20 seconds my to-do list pops up and I know it's good. I know it's important but I fail on this.

[0:33:05.6]



**FT:** Me too. Me too, don't worry. You're not the only one.

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**DA:** Well, you know I still want to worry about it because I want to get to it at some point.

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**FT:** We all want to reach Nirvana, okay?

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**DA:** Yeah, just a bit more calm. But I think there are some ways to feel more grateful, to look at the full half, full seven-eighth part of the cup and not at the other one. Personally I think that for me and the people working with me at Duke, we have some projects in Africa on financial savings and health and so on and whenever you come back from Africa, it's very hard not to feel grateful at anything.

I talked over yesterday with some people over dinner about, I said, "What do you think is the most amazing product in the US?" and you know people have their own things and I said, "You know I think it's water."

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**FT:** Wow.

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**DA:** It's just unbelievable because it's safe, it's clean, it has health supplements and they are so there all the time that we don't even think about it and it's really amazing but you know that's the part of being grateful, is that you go to a place where you realize people have to walk for an hour, an hour there and then an hour back to get some water. All of a sudden, you see how

amazing things are. So hopefully, we don't need to expose ourselves to too much misery to be more grateful. We can do it without it.

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**FT:** I love that, that's great advice. Yeah just start pitching out in your community. There's tons of ways you can experience other people's adversity and things in perspective for yourself. Dan Ariely, thank you so much. This was very enlightening and we really appreciate your time. We know you're super busy so thanks for joining.

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**DA:** My pleasure, take care.

[END]