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## Delay and deservingness after winning the lottery

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## **Delay and Deservingness after Winning the Lottery**

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## Abstract

Economics rests upon a set of presumptions about how human beings are affected by income. Yet causal evidence is scant. This paper reports a longitudinal study of randomly selected lottery winners. Remarkably, we show that it takes almost three years before they enjoy their money. We develop a model of dissonance and deservingness. We argue that, despite the tradition of economics, human beings may weight differently the different kinds of income that accrue to them. If so, it is not sufficient to describe utility by a function  $u(y)$ , and it is not true that ‘a dollar is a dollar’.

Delay and Deservingness after Winning the Lottery  
Andrew J Oswald  
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*“One of the main things for me was whether I deserved it, deserved to win”.*  
— A recent US state lottery winner (quoted in Smith 2002)

*“When we won, we looked at each other, me and Karen, and thought why us?”* Mr Ryan said candidly after his win. *“Because to be honest, I’m not the most deserving person”.*  
— Quoted in The Independent newspaper in the UK (Independent 1996)

## 1. Introduction

Economists are deeply interested in income and its consequences for human beings. One of the fundamental ideas in the discipline is that, because it allows individuals to buy extra goods, greater financial resources bring higher utility. The tradition in economics has been to assume that a dollar is a dollar is a dollar -- in other words that income from one source is the same as that from another<sup>1</sup>.

We provide longitudinal evidence that sheds doubt on this way of thinking. We study lottery windfalls. After laying out the data, the paper turns to an analytical model. Our conceptual approach, which is motivated partly by the quotes at the beginning of the paper, builds upon the possibility that lottery winners may not immediately feel that they *deserve* their win. We are conscious that such terminology is unfamiliar in, and perhaps even antithetical to, standard economics. This paper uses the specific empirical example to draw wider implications.

The paper can be seen as a contribution to the incorporation of emotions into economics (Elster 1998). Cognitive dissonance (Akerlof and Dickens 1982) later plays a particular role.

## 2. Lotteries as a Natural Experiment in Exogenous Income Windfalls

Real-life lotteries provide the economist with a quasi-laboratory setting in which individuals receive much bigger sums than can be distributed in a conventional social-

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<sup>1</sup> The tradition is, of course, to assume that people maximize  $v(x)$  st.  $y=px$ , so that utility can be written as a function of income  $u(y)$  with given prices  $p$  suppressed from the notation, and  $x$  a vector of goods. Then  $y$  is a kind of sufficient statistic for utility or well-being.

science laboratory experiment. The first part of the paper is straightforwardly empirical. Using data from a German panel, it examines how an approximately exogenous windfall of cash affects people's well-being<sup>2</sup>.

Strikingly, for the first two years after a windfall, we cannot find any statistically significant effect on our sample of winners. The reasons we take seriously what is, in a sense, a non-result, and do not view it merely as a consequence of measurement error, are threefold:

- (i) the data set is particularly suitable for the task, and is, to the best of our knowledge, the world's largest source of longitudinal data on lottery winners;
- (ii) the paper's point estimates themselves are close to zero;
- (iii) there are precedents for the non-finding in the literature (both the results of Brickman et al 1978 and the newer work of Kuhn et al 2008 conclude that lottery winners are not happier).

Nevertheless, we find that lottery wins are not forever neutral. Eventually, by the third year after a win, the data reveal large effects.

The design is the following.

First, we use a random sample of individuals. These are nationally representative data (for Germany). We follow people for some years, and observe them before and after a windfall.

Second, by studying lottery winners, we argue that it is reasonable to treat windfall money as approximately exogenous. More exactly, we compare those with substantial lottery wins to people who receive tiny wins. This design allows us to come close to the ideal kind of test -- one that no social-science funder would authorize -- which would be a giant experiment where some subjects were randomly allocated large sums of cash.

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<sup>2</sup> We do not study health, but Lindahl (2005) and Apouey and Clark (2008) attempt to do so.

Third, the lottery prizes are not small: they range in size up to the equivalent of one million US dollars. These are paid as lump sums.

Fourth, although our sample size on substantial winners is inevitably not enormous (at approximately 200 observations), the data set spans a long enough period to allow us to check the key findings in each of two subsamples of time. This replication works surprisingly strongly. We find, robustly, a delayed effect of a windfall upon reported levels of contentment.

The second part of the paper suggests a model in which lottery wins lead to cognitive dissonance. Initially, people do not feel they deserve the money as fully as they deserve their actual earned income. Over time they adapt, and eventually come to enjoy their lottery income. The model is highly stylized, but it captures the essential idea. It builds upon and is inspired by the (non-mathematical) theorizing of the psychologist Norman Feather, in sources such as Feather (1999), Feather et al (2001), and Feather and Johnstone (2001), and the work of economists such as Akerlof and Dickens (1982) and Konow (2000). Fong and Luttmer (2007) is one of the few recent papers by economists to touch empirically upon the idea of deservingness<sup>3</sup>.

The paper's evidence also disposes of one much-repeated idea. It is the view that lottery wins initially make people very happy but that this happiness erodes away over the ensuing years as winners habituate to the money. Our data suggest the reverse. There is initially no impact<sup>4</sup> and then eventually a large one.

### 3. Empirics

The paper's analysis of satisfaction after a lottery pay-out is based on a comparison of small and large winners using data from the German Socio-Economic Panel. For the social scientist interested in understanding the consequences of money for people's lives, lotteries have a number of well-known advantages. Conditional on playing,

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<sup>3</sup> A search on the American Economic Review, Economic Journal, and Quarterly Journal of Economics finds no papers with 'deservingness' or 'deservedness' in the title, abstract or keywords. The same is true of a search on Psychological Science and Psychological Review.

<sup>4</sup> It might well be plausible to expect an initial elation effect, in the first week of hearing the news, but we are unable to examine that in our annual data.



winning is serendipitous. The assignment of winners to big or small amounts is also random, and the causal effect of a large lottery win among lottery players can be established by comparing outcomes across the two groups.<sup>5</sup>

We follow the general identification strategy employed in papers such as Imbens et al. (2001) -- although those authors did not have access to longitudinal data on winners.

Information on lottery wins was collected in the German Socio-Economic Panel for the first time in the 2000 survey, and is now available up to, and including, 2007. Using this type of data rather than, say, a follow-up survey of winners has a number of advantages. The main one, apart from representativeness, is that the panel information can be used to construct a time-window for each household. In our case, we will look at measurements of winners both before the actual win and up to three years after. In this way, we can uncover any slow-acting and dynamic effects of winning, and distinguish between 1-period (immediate), 2-period (medium term) and 3-period (longer term) effects. Identifying the time path of these effects is key to our later ideas on deservingness and income.

A disadvantage of studying lottery winnings in a representative-household survey is that the sample of winners is fairly small. Although it is estimated that around 1/3 of the German population play regularly in the lottery, winning is of course much less common. This problem is compounded by the fact that only “significant” prizes are recorded in the German Socio-Economic Panel. Moreover, the definition of what it means to be significant has shifted over time. The initial cut-off imposed by the questionnaire design was 5000 DM in 2000 and 2001. It was then converted to 2500

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<sup>5</sup> Although causality remains debatable and debated, a large literature has established in micro data a positive correlation between people’s happiness and income (for a large range of countries). Frijters et al (2004) is arguably one of the papers to come closest to a causal test. Detailed results are given in sources such as Blanchflower and Oswald (2004), Clark et al (2008a), Di Tella et al (2001), Frey and Stutzer (2002), Luttmer (2005), Shields and Wheatley Price (2005), Stevenson and Wolfers (2008), Van Praag and Ferrer-i-Carbonell (2004) and Winkelmann and Winkelmann (1998). Kahneman et al (2006), however, is doubtful of the existence of any large causal effect of money on human well-being; the paper argues that mood is only marginally affected by income. Clark et al (2008b), Diener (1999), Easterlin (2003) and Oswald (1997) review the evidence. Our paper also has a potential overlap with the stigma from benefit income as studied by Haisken-New (2008).

Euros between 2002 and 2004, and lowered to 500 Euros from 2005 onwards. Most lottery wins fall below these thresholds and are therefore not recorded at all.

As a consequence, in the German Panel there are, in total, 271 observations on persons in a winning household. This number is reduced to 198 observations once (i) minors and young persons (under the age of 25) at home are excluded, as are (ii) those who do not provide valid financial satisfaction responses before and immediately after the time of win. The available information is thus limited, even in the absence of further aggravating factors such as potential misreporting.

However, the benefits of analyzing lottery wins from a truly dynamic perspective with longitudinal data seem to outweigh these disadvantages, even though the uncertainty associated with any estimate will not be negligible.

Tables 1 and 2 set out the main patterns in the raw data.

In our final sample of 198 winners, the minimum amount (after converting DM amounts into Euros, and adjusting for inflation, with base year 2000) is 446 Euros, and the maximum amount is 681,202 Euros. We wish to make comparisons of outcomes within the sample of players. Our working presumption is that a small win will not materially affect an individual when he or she is interviewed in the next sweep of the panel. Hence we divide the data. In order to define substantial winners compared to small winners, in a way that avoids the charge that our chosen split was deliberately picked to obtain particular results, we simply split the sample of all winners in the middle. Therefore, all amounts below the median of 3633 Euros are referred to as ‘small wins’. Our experiments -- available upon request -- suggest that the exact choice of split does not alter the paper’s fundamental findings.

The average win in this group was 1668 Euros. The average win in the group of larger winners was 31,539 Euros. We treat the former as a kind of control group and thus measure the effects of a substantial win.

Because the German panel is not a survey of expenditure or consumption, we focus on income as the main variable of interest.

We study people at each of four time points. To get as close as possible to how windfalls affect people's feelings about income and their financial situation, we do not concentrate upon 'happiness' data or an equivalent broad measure. Instead, we focus more narrowly. Our data are on overall *satisfaction-with-the-household's-income* on a zero to ten scale. For simplicity, we sometimes later refer to this as a person's *financial satisfaction*.

Define financial satisfaction in time period  $t_0$  as the satisfaction reported before the lottery win took place. For a lottery win that is reported in year  $t_1$ , the direct 1-period impact on satisfaction is therefore based on an examination of the difference of satisfaction in  $t$  minus satisfaction in  $t_0$ . For part of the sample of winners, we also observe financial satisfaction in  $t_2$  and in  $t_3$ . Therefore, we can also define a medium term impact, satisfaction in  $t_2$  minus satisfaction in  $t_0$ , and a longer term impact, satisfaction in  $t_3$  minus satisfaction in  $t_0$ .

We perform the analysis in two ways – both as a simple t-test viewing a substantial lottery win as a treatment when compared to small wins as a control group, and by estimating regression equations with other factors such as education held constant. Each leads to the same broad conclusions.

Table 3 reports the findings. The upper left panel shows the 1-period results for the full sample. Model (1) provides results without an adjustment for further controls; Model (2) includes those controls, which include a range of the usual socio-economic characteristics. To guard against possible endogeneity (e.g., large winners might adjust their employment status in response to the win: see Imbens et al 2001) these socio-economic characteristics are measured prior to winning. Since here a large windfall is a random event, and thus orthogonal to other personal characteristics, conditional on playing we would not expect the inclusion of these variables to lead to major changes in the point estimates. We would, however, expect an increase in efficiency -- since the variance of the unexplained regression component is reduced.

Table 3 reveals that in the first year a lottery win has no effect. From column (1), the average financial satisfaction of large lottery winners is paradoxically actually slightly below -- by -0.112 points on a ten point scale -- that of small winners.

This holds true even of our single largest observed winner (if we extract that person as a particular data point). *Strikingly, that person receives the equivalent of 1 million US dollars but reports a fall, in time t1, in financial satisfaction (ie. satisfaction with the household's income).*

Based on a t-statistic of 0.4, we conclude from the first block of data in Table 3 that there is no evidence that receiving a big lottery pay-out increases a person's satisfaction in the short run. The point estimate turns positive when controls are included, but it remains small and insignificant, both economically and statistically. Moving to columns (3) and (4), we see the 2-period results, i.e. the change in financial satisfaction of large winners between t0 and t2, relative to the change for small winners. The sample size drops from 188 to 145 observations, because a fraction of the sample is not observed for two periods following the win, either because the win occurred in 2006, or because the person dropped out of the survey. But the substantive conclusions remain the same. There is surprisingly little difference in a person's reported financial satisfaction for the two groups, and thus even in time t2 there is no discernible effect of winning a large amount. This is, on average, 18 months after the lottery win, because t1 measures people on average 6 months after they initially won.

However, this changes when we turn to a longer lag.

Columns (5) and (6) of Table 3 provide the 3-period results. In contrast to the case for earlier periods, there is now an effect, and it is large. The point estimates exceed one, indicating that predicted financial satisfaction of large winners is now more than one point higher, on average, on a 0-10 scale, than it would have been in the case of a small win only. The t-statistics are 2.5 (in the model without controls) and 3.0 (in the model with controls) respectively, so that the null hypothesis of no effect in period t3 can be rejected.

#### 4. Checks and Counter-Arguments

There remains some possibility that these results are spurious, and are due to the small samples on which they are based. We were concerned about that. To check for robustness, therefore, we split the sample into two parts, across time, and repeated the analysis for each of two subsamples. The first span of data is for the period 1999-2002, and the second is for the period 2003-2006.

These principal robustness checks are shown in the lower panels of Table 3 and produce encouraging conclusions. Remarkably, the key pattern is replicated in each of the two subsamples. In both instances, there is no effect in  $t_1$  and  $t_2$ , but there is a large effect in  $t_3$ . It is approximately 2 financial-satisfaction points in each subsample.

To summarize, the effect of a large lottery win on financial satisfaction is much more delayed than an economist would have expected.<sup>6</sup> It takes between two and three years until a substantial positive effect materializes. Given the findings, we checked the data set to make certain that lottery wins were being translated into higher reported incomes, and they were (results available upon request). Yet those financial gains do not spill over into people's answers on how they feel.

Some further, if indirect, corroboration comes from the work of Gardner and Oswald (2007) and Apouey and Clark (2008). They find no immediate effect of lottery wins on mental health in Great Britain, but can detect an effect some years later. Because of the rather different nature of the dependent variable, and the much smaller lottery prizes in these investigators' British data, we do not wish to emphasize those results too strongly. But they are consistent with the tenor of our findings.

It does not seem easy to interpret these findings through the lens of conventional economic theory. Income has risen exogenously here, in an unpredicted way, and yet satisfaction if anything declines in the first period after a win. A plausible account for

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<sup>6</sup> The standard model of life-cycle behavior, with the interest rate equal to the rate of time preference, predicts that utility would jump up in a once-and-for-all way, and then run flat at that higher level.

weak results in t1 and t2 could be created from the assumption of large amounts of measurement error in the data; but that account breaks down with the well-determined t3 results (found, importantly, in both subsamples).

As a benchmark, Table 4 shows -- although by definition the quality of causality is less clearly established -- that the effects of wage income show up immediately in the person's feelings of satisfaction.

Table 5 moves to life-satisfaction data. Encouragingly, the same broad pattern -- in the top row of the table there is an initial fall in life satisfaction but then by t3 it is approximately 0.3 points higher than t0 -- can be seen, although the standard errors are large. For that reason, it is natural to concentrate on the financial satisfaction data.

As one further check, we examined whether the findings are robust to the use of a consistent sample -- one in which the individuals do not change through time<sup>7</sup>. We find that they are (the overall sample, being balanced, is then necessarily smaller). Results are available upon request.

Alternatively, might it be that the phenomenon is a result of people using a technical definition of income -- as answering implicitly: "no, my satisfaction with income is not higher, because although I have received a large windfall I do not count that as household income"? First, for the average citizen, technical sophistication in the distinction between income and wealth windfalls lacks the ring of plausibility, and we know from the income reports that surveyed individuals do record the money as greater income. Second, such an interpretation would not predict the near-3-year delay followed by the observed large rise in satisfaction. Instead, if the effect happens merely because people count as income only the interest on lottery windfalls, then the effect would show up as soon as it arrives in their bank accounts, namely, immediately in our annual data. Third, the qualitative pattern through time is seen also in the life-satisfaction responses, which would not be predicted by a windfalls-are-not-income account.

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<sup>7</sup> We are grateful to Alan Krueger for this suggestion.

Finally, one could reason in the following way A possible explanation for the lag is that a lottery win disrupts identity ("Who am I? What do I value? Who are my friends?") and it takes time to develop a new one. In the first few years, having money is inconsistent with person's normal way of living, and it takes some years to learn to be a person who has money. So it may not be that lottery money is less valuable than salary money; rather, winnings may do what salary money does to make us feel good, but it may have the 'additional' effect of making us feel bad in different ways. However, the difficulty with this line of argument here is that it seems likely to apply to the winning of millions rather than, as typically in our data set, the winning of thousands. Receiving 30,000 Euros may be an important event to a person but not in itself identity-changing.<sup>8</sup>

### 5. Deservingness and Lottery Wins: A Model of Cognitive Behaviour

We now try to make sense of this pattern<sup>9</sup>. It is not possible to establish unambiguously why the individuals in our sample take so long to gain satisfaction from their windfall. Nevertheless, this section proposes a utility-maximizing model of a lottery winner.

Assume that the lottery win has just been announced. Let  $u(.)$  be a concave utility function defined over total income. Income comes in two forms: a fixed salary  $y$  and a flow of income  $i$  taken from the lottery win. An endogenous salary can be introduced into the model without altering the main points.

The win is a given sum of money,  $L$ , that is announced at time 0. The individual decides at each point in time how much of the cash to use per annum -- that is, how

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<sup>8</sup> We thank Dan Gilbert for valuable suggestions on this.

<sup>9</sup> Two possibilities are that (i) people take some years to purchase goods with their lottery winnings or (ii) it takes time to appreciate money just as it does to appreciate fine wine. However, neither of these is predicted by standard economic theory, and neither seems plausible. A third, a 'lucky charm' theory, is that winners feel good because they interpret the financial luck as a sign of a generic change in their chances in future random events; but, contrary to our data, this theory would predict a flat-rate effect, independently of the windfall size. A fourth, which is close in spirit to the changed-identity theory discussed earlier, is a disruption theory: winning shakes up people's lives in an uncomfortable way. But this would predict a fast drop at time  $t_1$  rather than a higher utility level per se later on. Moreover, again, most of our wins are too small for this account to seem truly persuasive.

large the drawings  $i$  should be in each period -- from the entire stock of lottery winnings  $L$ ; she can, for example, consume it all early on, or wait and spend money later. Time is continuous and runs from 0 to  $T$ .

Earned income is seen by the person as money which she intrinsically deserves. Lottery income, by contrast, is not viewed in the same way. The individual does not think immediately that she is fully 'deserving' of the money. In her mind, she marks down the utility value of the flow of lottery income by a coefficient  $D$ , which lies between zero and unity. Intuitively, until the individual comes to terms with the win, this is a kind of psychic 'tax'. If  $D$  is 0.5, for example, the person is indifferent between salary income of \$1 and lottery income of \$2.

This gap can be thought of as a form of cognitive dissonance. Through time, however, the individual can persuade herself that she is deserving of the lottery money. This -- the erosion of the dissonance -- happens slowly. It requires effort  $e$ . The cost of effort is a convex function  $c(e)$ . By investing psychological resources, she can gradually build up the deservingness level,  $D$ , in her own mind. But doing so causes mental strain along the way. This is a kind of reverse-adaptation theory.

In terms of the earlier data, we will think of  $u(\cdot)$  as proxying the satisfaction from income. Overall satisfaction or well-being, correspondingly, is instead given each period by  $u(\cdot) - c(e)$ .

Discounting does not alter the nature of the optimization, so for simplicity is omitted. A discount rate  $r$  can easily be introduced into the model.

The person thus maximizes lifetime utility subject to, first, a lottery-win budget constraint and, second, a differential equation constraint on the rate of change of deservingness  $D$ . The problem in full is: in each period choose psychological effort,  $e$ , and the amount of lottery winnings drawn down,  $i$ , to solve

$$\text{Maximize } \int_0^T [u(y + iD) - c(e)] dt \quad \text{Lifetime utility}$$



subject to four constraints:

$$\int_0^T i dt \leq L \quad \text{Lottery-win budget constraint}$$

$$\dot{D} = e - \delta D \quad \text{Adjustment-of-deservingness equation}$$

$$0 \leq D \leq 1 \quad \text{Bounded deservingness}$$

$$0 \leq e \leq \bar{e} \quad \text{Bounded effort}$$

where deservingness  $D$  lies in the unit interval,  $e$  lies between zero and  $\bar{e}$ , the time rate of change of a variable is marked by a dot, and  $D$  depreciates at rate  $\delta$ . It is not necessary for the analysis that the rate of depreciation be strictly positive, and we return to this issue at a later point.

A value of  $D=1$  corresponds to full deservingness. In this case, the person treats wage income and lottery income as identically valuable inside their utility function. By assumption, the deservingness parameter  $D$  cannot exceed unity, nor go negative. Effort  $e$  is assumed to lie in a closed interval, and also, by assumption, cannot go negative.

Form the Hamiltonian

$$H = u(y + iD) - c(e) + \lambda[L - i] + \psi(e - \delta D)$$

where  $\lambda$  is a multiplier that is constant (ie, independent of time) and  $\psi$  is a multiplier that is dependent on time.  $\lambda$  here is independent of  $t$  because it corresponds to an integral constraint. In the model, the value of  $\lambda$  is closely linked to the marginal utility of income, whereas  $\psi$  is the shadow price of deservingness.

The necessary conditions for an optimum, from Pontryagin's Maximum Principle, are:

$$H_i = u'(y + iD)D - \lambda = 0 \quad (1)$$

$$H_e = -c'(e) + \psi \leq 0 \quad (2)$$

$$\dot{\psi} = -H_D = -u'(y + iD)i + \psi\delta \quad (3)$$

$$\dot{D} = e - \delta D \quad (4)$$

$$D(T)\psi(T) = 0. \quad (5)$$

When (2) holds as a strict equality, these characterize an optimal interior solution. In some circumstances, bang-bang solutions (with variables set at corners) may be the optimal outcome.

Equation 1 requires that the (deservingness-adjusted) marginal utility of income be the same in each time period. With  $D=1$ , the condition collapses to the conventional form found in optimal lifetime consumption models. Equation 2 determines the instantaneous value of the shadow price of deservingness, which is given by the marginal cost of psychological effort, namely, the first derivative of  $c(e)$ . Equation 3 is the equation of motion of deservingness's shadow price,  $\psi$ . Equation 4 reproduces the dynamics of how deservingness builds up over time. Equation 5 is a transversality condition.

Figure 1 describes a typical outcome. Over time, a rational individual invests -- perhaps only subconsciously -- in building up his or her sense of deservingness. When that deservingness level hits a value  $D^*$ , a steady state ensues.

It seems natural to assume that deservingness  $D$  begins, in time  $t=0$  when the individual learns of the lottery win, close to zero. The model requires some assumption of this type about the initial value  $D(0)$ .

From equation 1, the derivative of utility with respect to income is in each period

$$u'(y+iD) = \frac{\lambda}{D} \quad (6)$$

where the multiplier  $\lambda$  is a constant. This can be thought of as the deservingness-scaled marginal utility of income. The expression means that as deservingness  $D$  rises so the right hand side of (6) declines and hence the value of  $u'(\cdot)$  must itself decline. The value of  $D$  cannot literally be zero at the starting point,  $t=0$ , if (6) is to hold as a well-behaved interior optimum.

Equation (6) is simple but powerful. Because  $u(\cdot)$  is strictly concave,  $y+iD$  must move inversely with  $D$ . Thus total effective income  $y+iD$  rises through time as  $D$  increases. Hence the income-driven part of the utility function,  $u(\cdot)$ , is also increasing over time. This establishes that as deservingness  $D$  increases it must be the case that the utility from income goes up.

Within this framework, as depicted in Figure 1, *the characteristic of all but pathological cases is thus that utility starts close to, or lower than, the original pre-lottery level.*

This is for three reasons. First, the individual sets high effort  $e$  to try to bring up her sense of deservingness  $D$ . That is a source of mental strain and acts, *ceteris paribus*, to pull down the person's utility from the level prevailing just before the announcement of the lottery win (when the person had had no need to put in effort to rationalize their own income, which was only from salary). Second, the optimizing individual does start to draw upon lottery income, because now recognizes that she will be richer over her lifetime, so that it is rational for her to bring forward new spending. But now the consequence of every dollar spent is a smaller utility gain than from an equivalent dollar of salary income; this is because each lottery dollar is downgraded by parameter  $D$ . Third, in turn, this downgrading makes it less desirable in the early periods to consume from the lottery winnings  $L$ . Other things constant, it

is preferable to wait a few periods, to allow the deservingness level to rise, and thus to allow the money eventually to be more fully enjoyed.

If horizon time  $T$  goes to infinity, the model's solution converges to a steady state path, and that solution is characterized by

$$u'(y + i^* D^*) i^* = c'(e^*) \delta \quad (7)$$

$$e^* = \delta D^*. \quad (8)$$

The individual continues to put in psychological effort to maintain her sense of deservingness, but only at level  $e^*$  necessary to cover the level of depreciation.

Two special and simple cases are the following.

A: When  $u(\cdot)$  is linear, it is optimal to build up  $D$  as slowly as possible, and to consume all the  $L$  lottery win in the final few periods, or whenever  $D$  first reaches the value of unity. The reason is that there is no gain from consuming in any particular period, so it pays to wait as long as feasible.

B: When  $c(\cdot)$  is zero as well, there is a so-called bang-bang solution. It is optimal straight away to set effort  $e$  to its maximum level,  $\bar{e}$ . The individual adjusts psychologically as quickly as possible, while leaving the lottery winnings intact. Then, when  $D$  hits unity, the consumption of lottery winnings can begin.

One issue is how the per-period lottery-drawings  $i$  are set in each period as the level of deservingness  $D$  rises through time. Here the structure of equation 1 means that what matters is the conventional degree of relative risk aversion of the  $u(\cdot)$  utility function.

This follows easily from differentiating throughout the inter-temporal optimality requirement, equation 1:

$$D^2u''(.)di + iDu''(.)dD + u'(.)dD = 0 \quad (9)$$

which, after rearrangement, and multiplication throughout by  $D/i$ , gives the expression:

$$\frac{di}{dD} \frac{D}{i} = -[1 + \frac{u'(.)}{u''(.)} \frac{1}{Di}] \quad (10)$$

Or simply

$$\frac{di}{dD} \frac{D}{i} = \frac{1}{\eta} - 1 \quad (11)$$

where  $\eta$  is the degree of relative risk aversion.

Therefore, in the useful benchmark case where  $\eta$  is equal to unity, it follows that if deservingness increases through time the variables  $i$  and  $D$  rise together in exact proportion. Then, as  $\eta$  lies above (or below) unity, lottery income is drawn on less (or more) through time.

## 6. Conclusions

When we began this work, we expected to find that people like winning the lottery and that such wins quickly improve the quality of people's lives. This is what most economists, and economics textbooks, would predict. But the facts do not support such a conclusion.

Instead, these longitudinal data, which have the advantage of following randomly selected people before they win the lottery and for some years afterwards, reveal a strikingly delayed effect. Even for a measure of financial satisfaction -- chosen here because it is so naturally the domain of lottery winnings -- we cannot discern any

impact upon people for a full 2 years<sup>10</sup>. Then, a large effect becomes visible. By the third year, a person's satisfaction with their household's income is markedly higher if they earlier had a substantial win on the lottery. The control group in this calculation is effectively those with small wins. The effect is highly robust in subsamples.<sup>11</sup>

The paper's evidence also disposes of one commonly heard idea -- the view that lottery wins can initially make people happy but that such an effect on well-being quickly erodes as individuals adapt hedonically to a new standard of living. There is much folk-lore on this, and Brickman et al (1978) proposes the same idea, but it is not consistent with these data.

Building upon the psychological literature on deservingness<sup>12</sup>, we have suggested a formal model that is consistent with the facts observed in our data. In the model, people suffer from cognitive dissonance when they win. Initially, they do not feel they deserve the windfall, and this reduces the marginal utility of their lottery income. They slowly invest in psychological effort to persuade themselves of their deservingness, and the utility from income then rises through time. They come to enjoy the money. In the model, we have attempted to distinguish between the satisfaction from income  $u(.)$  and overall satisfaction or utility  $u(.) - c(e)$ . The model is placed second in the paper because it is an attempt ex post to make sense of the patterns found empirically.

Interestingly, in the German language, there is a single verb "verdienen" which means both "to earn" (as a payment for work) and "to deserve". The main hypothesis of this

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<sup>10</sup> It is worth noting that 2 years is how long it takes humans to adapt to other hedonic shocks, such as bereavement and divorce (Clark et al 2008a). In this paper, we study what might be thought of as a form of 'negative adaptation'.

<sup>11</sup> As explained in the paper, this effect cannot be because winners draw a subtle definitional distinction between windfall wealth and income. If as a lottery winner I put 100,000 dollars into the bank, at an interest rate of 5%, then I get 5000 dollars per annum straight away, namely, in the first year. After three years, I am still receiving 5000 dollars a year in interest (or marginally more if, contrary to the spirit of the life-cycle model, I have compounded it all). Therefore it is not true that investing the windfall sum will only slowly lead to an up-rating of my income, and correspondingly not true that the patterns in our data can be explained by such an account.

<sup>12</sup> We have found little published empirical research on deservingness and lottery wins, although Callan et al (2006) touches upon the issue.

paper -- that some forms of income are perceived as more deserved than others -- is thus in a sense anticipated in the culture and vocabulary.

Whatever the correct theoretical interpretation, and further inquiry will be necessary, the paper has shown that lottery income and wage income are not identical in their consequences. Despite the traditions of economics, human beings may weight differently the different kinds of income that accrue to them. If so, it is not sufficient to describe utility by a function  $u(y)$ , and it is not true that ‘a dollar is a dollar’.

This study is at best only a start on the concept of deservingness-adjusted dollars. However, we believe the idea may have applications in many settings in social science. Money may not be as homogeneous, and psychologically fungible, as the discipline of economics<sup>13</sup> has presumed.

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<sup>13</sup> With a small number of honorable exceptions, such as Thaler (1990).

**Table 1: Descriptive Data**

	Small winners		Substantial winners	
	mean	s.e.	mean	s.e.
Financial Satisfaction (with household income)	6.64	0.21	6.81	0.20
Household Income	46632.1	4275.1	39674.6	1955.7
Household Size	2.64	0.11	2.99	0.11
Years of Schooling	12.16	0.26	11.77	0.25
Employed (Yes=1)	0.81	0.04	0.63	0.05
Unemployed (Yes=1)	0.01	0.01	0.06	0.02
Male (Yes=1)	0.53	0.05	0.50	0.05
Age	47.3	1.2	49.9	1.5
German (Yes=1)	0.94	0.02	0.90	0.03
Married (Yes=1)	0.69	0.05	0.73	0.04
Single (Yes=1)	0.18	0.04	0.11	0.03
Size of lottery win	1668.1	96.4	31539.5	9584.4
Observations	101		103	



**Table 2: Amounts Won (in real Euros)**

Year	# of households	# of persons	Av. Amount	Minimum	Maximum
2000	7	12	9244.8	3000.0	30000.0
2001	9	17	6558.4	2455.8	17190.6
2002	10	16	103665.7	2476.7	681201.6
2003	13	25	14028.0	2396.9	95877.3
2004	6	13	5481.0	2544.8	9425.1
2005	27	42	13060.8	462.1	184842.9
2006	23	42	4833.2	454.1	42234.3
2007	22	37	9796.4	446.0	89206.1

**Table 3: Longitudinal Changes in the Financial Satisfaction of Lottery Winners**  
(Comparing Before and After a Win in year t1)

	Difference t1-t0		Difference t2-t0		Difference t3-t0	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Full sample</i>						
Substantial lottery win	-0.112	0.068	0.066	0.067	1.148	1.429
	(0.35)	(0.19)	(0.20)	(0.21)	(2.44)	(2.73)
Equation controls	No	Yes	No	Yes	No	Yes
N	188	188	145	145	94	94
<i>1999-2002 subsample</i>						
Substantial lottery win	-0.060	0.001	0.017	0.215	1.341	1.897
	(0.10)	(0.00)	(0.03)	(0.46)	(2.25)	(3.21)
Equation controls	No	Yes	No	Yes	No	Yes
N	65	65	61	61	55	55
<i>2003-2006 subsample</i>						
Substantial lottery win	0.104	0.202	0.441	0.283	1.563	2.055
	(0.24)	(0.43)	(0.91)	(0.61)	(1.89)	(2.28)
Equation controls	No	Yes	No	Yes	No	Yes
N	123	123	84	84	39	39

Source: German Socio-Economic Panel 1999-2007.

Notes:

t-statistics in parentheses, adjusted for clustering at the household level.

The dependent variable is in life-satisfaction points, on a scale from zero to ten.

The omitted, comparison group is those with a small win.

t-0 signifies the year before the win. t-3 signifies the third year after the lottery win.

Equation controls include Employment, Household size, Male, Age, Age squared, German, Married, Never Married (excluded category: Separated, divorced or widowed), Years of education, Logarithmic household income, and Health satisfaction in t0.

The exact question in the German Panel, which forms the dependent variable, is: “How satisfied are you today with ... your household’s income, on a zero to ten scale, where zero stands for totally dissatisfied and ten stands for totally satisfied.”

**Table 4: The Immediate Impact of Wage Income on Financial Satisfaction**


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Dependent variable: Change in Satisfaction t-1 to t				
The independent variables are:				
Change in log net earnings from...				
<hr/>				
t-1 to t	0.386	0.372	0.378	0.345
	(7.47)	(7.19)	(5.74)	(5.18)
t-2 to t-1			0.116	0.092
			(1.60)	(1.24)
t-3 to t-2			0.042	0.020
			(0.07)	(0.03)
Controls	No	Yes	No	Yes
Observations	9574	9574	7872	7872

---

Source: German Socio-Economic Panel 2004-2007.

Notes:

t-statistics in parentheses. The dependent variable is the change in financial satisfaction between 2006 and 2007 among those receiving a wage income.

Equation controls include Employment, Household size, Male, Age, Age squared, German, Married, Never Married (excluded category: Separated, divorced or widowed), Years of education, and Health satisfaction in t.

**Table 5**

**Longitudinal Changes in the Life Satisfaction of Lottery Winners**  
(Comparing Before and After a Win in year t1)

	<b>Difference t1-t0</b>		<b>Difference t2-t0</b>		<b>Difference t3-t0</b>	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Full sample</i>						
Substantial lottery win	-0.242	-0.225	-0.275	-0.203	0.197	0.352
	(0.96)	(0.94)	(0.89)	(0.63)	(0.45)	(0.77)
Equation controls	No	Yes	No	Yes	No	Yes
N	198	196	149	147	97	95
<i>1999-2002 subsample</i>						
Substantial lottery win	-0.280	-0.522	0.062	0.095	0.269	0.244
	(0.68)	(1.21)	(0.13)	(0.14)	(0.38)	(0.36)
Equation controls	No	Yes	No	Yes	No	Yes
N	66	66	61	61	55	55
<i>2003-2006 subsample</i>						
Substantial lottery win	-0.079	-0.044	0.032	0.194	0.300	0.639
	(0.20)	(0.13)	(0.07)	(0.47)	(0.41)	(0.59)
Equation controls	No	Yes	No	Yes	No	Yes
N	132	130	88	86	42	40

Source: German Socio-Economic Panel 1999-2007.

Notes:

t-statistics in parentheses.

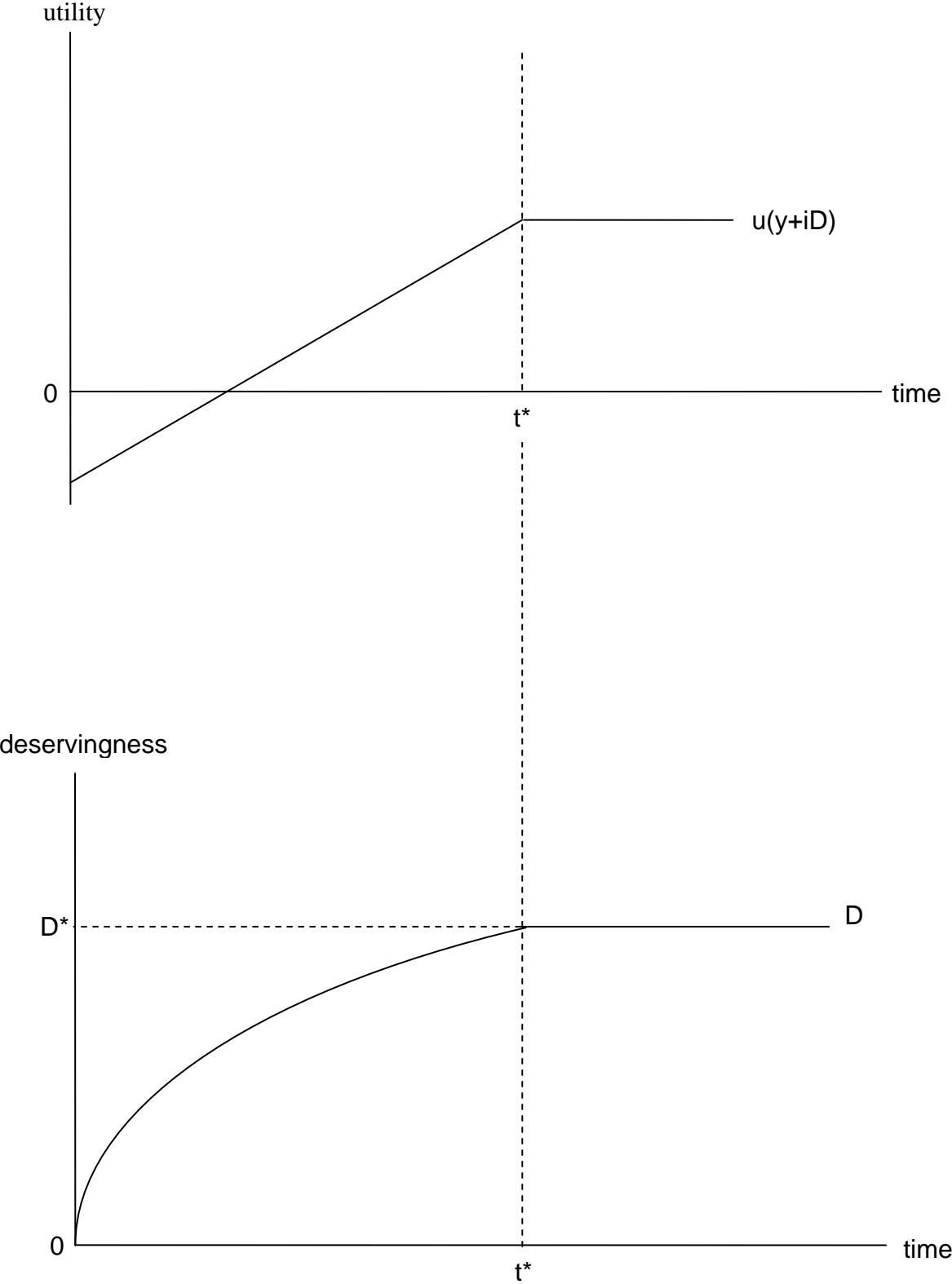
The dependent variable is in life-satisfaction points, on a scale from zero to ten.

The omitted, comparison group is those with a small win.

t-0 signifies the year before the win. t-3 signifies the third year after the lottery win.

Equation controls include Employment, Household size, Male, Age, Age squared, German, Married, Never Married (excluded category: Separated, divorced or widowed), Years of education, Logarithmic household income, and Health satisfaction in t0.

Figure 1



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