[With a new language comes a new solution]

The new language

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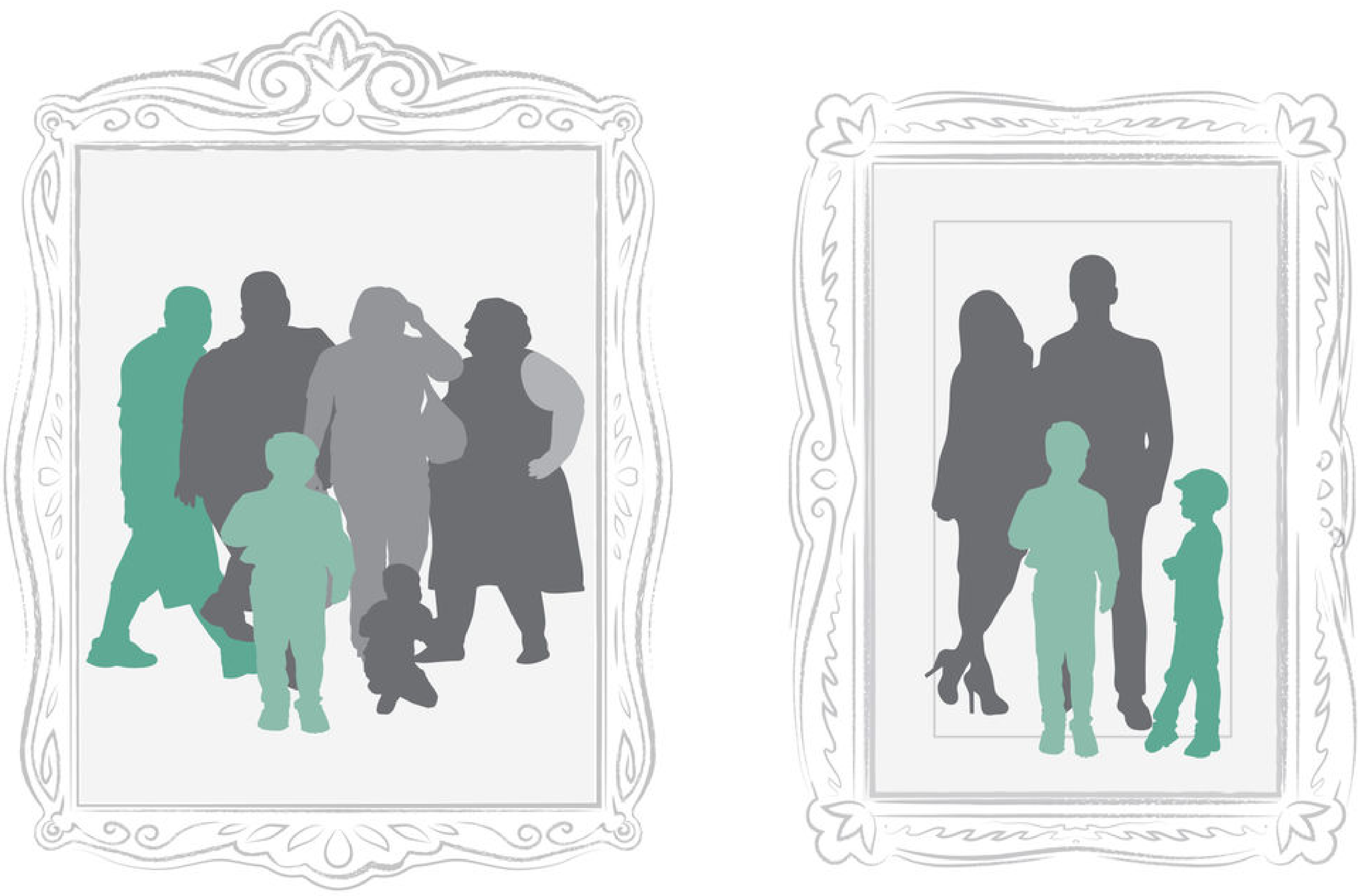
Financial well-being is not a new concept, but it may well be a new term for some. It emerges from two streams of literature. The first is the philosophical and economic conversation about utility, happiness and subjective well-being. The second is the financial literature which frequently locates financial well-being as the ultimate goal of financial education and financial literacy interventions[1]. But when used in the financial literature, the term does not have an explicit or consistent definition, nor is there a standard way to measure it. To be able to get a better grasp of the concept, we need to turn to the philosophical literature.

WHAT IS WELL-BEING?

Consider the pictures of these two families: Which of these families would you judge to be more representative of 'well-being'?



When people around the world were shown pictures like these, they gave very different responses as to which group they perceived were 'better off'. In wealthier, more Western parts of the world, answers favoured the thinner, more compact group. In poorer, less Westernised parts of the world, fatter, more expansive groups signalled greater wealth, and as such this would be deemed as the family which is 'better off'[2].

We throw around the word 'well-being', but do we actually know what it means? If we can agree that well-being might be a real concept and we might be able to agree on what that is, would we agree that it is important? And, if it is, what would be our reasoning? Is employee well-being better because it makes workers more productive for their employers? Is financial well-being valuable because it gives financial services companies better customers? Surely the concept means more than that.

Grappling with the concept of well-being has a long history in human thought. It is a history that goes all the way back to the Greeks – back to questions of what constitutes happiness and what constitutes a good life. It traces its way through the thought of all the major philosophers and encompasses that nebulous term 'utility' economists so often use.

Well-being as a concept is not easy to define, and it is not easy to compare, either between people or through time. Aristotle thought happiness was the reason we did everything else. It was that thing which we couldn't reduce any further. We pursue happiness or well-being for itself and it's why we pursue everything else.

Happiness isn't an ephemeral feeling or a passing impression. It is something that marks a full life, well lived.

And whether we look at the concept of happiness, or utility, or well-being, those observations have remained rather enduring. Well-being isn't something we pursue for another reason – to make money for our employer or a bank. It's the ultimate objective of everything we do.

> **We throw around the word 'well-being', but do we actually know what it means?**

What the philosophers say

Three basic perspectives have emerged out of the long and varied philosophical debates that inform our views about what well-being[3] is:

1. There is the hedonic approach where we simply look at our current 'happiness' or feelings of pleasure and pain.
2. There is the evaluative approach which looks at how we see our lives as a whole, often referred to as 'life satisfaction'.
3. There is the eudemonic approach which looks at the 'meaning' we ascribe to our lives.

The most commonly used of these approaches is the 'life satisfaction' approach. An important aspect of 'life satisfaction' is that it encompasses the full life. It isn't merely about a point in time; it's about the full journey. Ideas around maximising utility over a person's life embody this type of concept.

In addition to questions around what is well-being, there are also important questions about what makes us well. Increasingly, studies are also trying to understand what factors drive well-being. When I ask you whether you are happy or satisfied with your life, what aspects of your life matter in terms of your answer?

Surprisingly, despite all the variation between individuals and even for the same individual through time, there are many consistencies emerging in the literature. Some of the strongest consensus exists around aspects of life such as family, health and security, as well as living a life consistent with your values and having options or choices[4].

What role does money play in well-being?

Terms like 'financial well-being' or 'employee well-being' have to be placed within the broader concept of 'well-being'. And so, to understand what 'financial well-being' is, we have to understand what role money plays in an individual's overall 'well-being'.

In studies examining well-being, which typically use the term 'subjective well-being', some find that happiness increases with income, while others find it doesn't. The reason for this seems to be that, for most people, money itself doesn't make them feel more 'well', but what it can do for them does. In other words, for most people, money is valuable as a means to well-being, not an end in itself.

For instance, Richard Wilkinson and Kate Pickett's book *The Spirit Level: Why Equality is Better for Everyone* argues that an increasing income only improves well-being up to a certain level and then inequality in incomes becomes more important. This is because at low levels of income, increases in income can buy significant improvements in the parts of life we value. More money can buy more nutritional food, or access to better schools, or a nicer family home, all of which contribute to well-being.

At higher levels of income, Pickett and Wilkinson argue that these effects start to fade away. Money has helped people to achieve a happy and healthy family, but additional amounts make a very small difference. This fits in fairly neatly with the findings on what affects national well-being. GDP per capita plays a role because it will drive the access to basic goods and services – such as sanitation and nutritional food. But the other key factors for nations are measures of social capital, such as social support, trust and generosity[5].

What this literature illustrates is that money affects our well-being through how it impacts on the aspects of our lives that we value – like our family, our homes, our security, our options and so on. For instance, if money problems make us feel out of control of our lives, this can have a big impact on our well-being.

Also, your money needs to serve you throughout your life, and your financial well-being then needs to be assessed over your life as a whole. Similarly, our financial well-being is about the 'full journey' and also the pitfalls we manage to avoid.

And now – back to financial well-being

Now that we've established that money does play a role in happiness – albeit an indirect one – it raises the question of what financial well-being would be. In the context of 'subjective well-being', we would have to look at whether or not a person or household's finances were contributing positively or negatively to their overall well-being.

The subjective assessment of financial well-being moves beyond an assessment of how money makes us feel to a place where we are carrying out a subjective assessment of our circumstances in entirety. The Consumer Financial Protection Bureau (CFPB) describes financial well-being as a continuum – ranging from severe financial stress to being highly satisfied with one's financial situation – that is not strictly related to income level. For example, a low-income earner, though unable to access many assets and investments, may still feel a high level of financial well-being. Financial well-being therefore also encompasses an ability on the part of the individual to achieve a state of financial well-being within the constraints of the resources that they currently have available to them.

We can then say that financial well-being can be defined as 'a state of being wherein a person can fully meet current and on-going obligations within their constraints, through an effective level of financial capability; where they can feel secure in their financial future and where they have choices available that improve their quality of life[6].'

What is financial well-being?

A state of being in which an individual:

- FULLY **MEETS** CURRENT AND ON-GOING **OBLIGATIONS**
- HAS AN EFFECTIVE LEVEL OF **FINANCIAL CAPABILITY**
- IS **SECURE** IN THEIR **FINANCIAL FUTURE**
- HAS **CHOICES** AVAILABLE THAT IMPROVE QUALITY OF LIFE

What role does the financial expert play here?

As well-being is an inherently subjective concept, this makes it messy, biased and inconsistent. But it is important because it speaks to what individuals value. Where an expert can play a vital role is in two key areas:

1. Setting the floor

The first is around setting a floor for a household's income. In Benefits Barometer 2014, we talked about how the State sets the social floor for the nation as a whole, while financial products provide individuals with the ability to raise this floor in relation to their own income.

Below certain threshold levels of income, income is a very important determinant of well-being. So, it is important to not fall below these levels. And although people can recover from large falls in relative income, they do experience short-term discomfort. In addition, the possibility of a fall – especially in an unequal society – can have negative effects. Placing a floor that strikes the right balance between short-term and long-term outcomes can support well-being.

The concept of floors plays an interesting role in the writings of the American moral and political philosopher John Rawls. Rawls looked extensively at issues of social justice and how it can be achieved in a society where different things matter to different people. He argued that everyone in a society should get an equal share of basic rights – these are typically political rights such as freedom of speech, freedom of association and so on. Thereafter, economic and social 'goods' should be distributed to ensure the best possible outcome for the least well-off in the society.

This does not rule out inequality, but it does moderate it. Imagine a village where everyone has the same income. Everyone in that village will be better off if they give up some of their income to make sure that the doctor in the village has a car and can get to them quickly when they are sick – so long as that loss in income doesn't put their day-to-day survival at risk.

So, there is an argument that there are certain types of protection that are useful for all of us. And as we highlighted in Fine-tuning the employee benefits system, it's important to relieve the consequences of risk in a society for the overall well-being – and economic improvement – of that society. These types of protection are often achieved through various types of long-term savings and insurance products.

On the other hand, people are adaptable. So, full protection against all forms of disaster is not necessarily the best way to do things either. In theory, experts should be able to provide individuals with guidance as to which protections best suit an individual's unique circumstances. In practice, when financial service provision becomes conflicted, this trade-off discussion may not be forthcoming.

> **Placing a floor for a household's income that strikes the right balance between short-term and long-term outcomes can support well-being.**

Poverty is a lack of choices

2. Creating more options

The second area where expert assessments can play a role in improving subjective well-being is around increasing the options available to an individual. One of the aspects of well-being with considerable consensus as to its value is keeping options open.

A great supporter of the value of options is Nobel prizewinner Amartya Sen. In his book *Development as Freedom*, he introduced the concepts of 'entitlements' and 'capabilities'. Entitlements are the resources we have access to and capabilities are the things we are able to do. For instance, I may have enough money to send my daughter to a private school but if there isn't a decent road between my village and the school, I don't actually have the capability to do it.

Money is part of improving our capabilities, but it isn't everything. Sen argues that the purpose of economic development is to expand the capabilities of all individuals in a society. Irrespective of what people value (whether it is nice cars or happy families) we place importance on ensuring that every individual is able to pursue what they value. Essentially, in Sen's thought, poverty is a lack of choices.

The expert's challenge
To put together a comprehensive and helpful picture of financial well-being, we need an approach that integrates both subjective and objective aspects. On the subjective side of the table, an individual is able to communicate what goals they value and wish to pursue as well as how they prioritise those goals.

On the objective side of the table, an expert can help people identify the methods most likely to allow them to achieve their goals. They can also help an individual to identify the common pitfalls they might fall into so they can put appropriate preventative measures in place.

What might this look like? An expert may identify a gap in terms of life insurance, but an individual needs to subjectively assess how important that is to them. Perhaps it is important, but so is sending their child to a better school or to university. Then, once again, an expert can help assess how someone can achieve both goals, and also help ensure that they don't sacrifice the more important goal for the sake of the less important goal.

How do we connect the dots to financial well-being?

There is an array of literature around other financial concepts that have started to identify financial well-being as the ultimate output of all interventions in this field. These concepts include financial empowerment, financial literacy, financial wellness and so on. In connecting these concepts, it is important to understand which of them can be affected by outside stakeholders and which cannot.

Financial literacy can be influenced through financial education provided by outside stakeholders – such as the employer and financial services industry. The growing frustration with financial education has been that improving literacy does not show a clear link to improving financial decision-making. For this reason, the term 'financial capability' has emerged. Financial capability shifts the focus from the input (literacy) to the output (decision-making). It looks at whether or not individuals are making good decisions. Again, financial capability can be influenced by external stakeholders, using a range of techniques from nudges to edutainment.

Another term that refers to what can be influenced by external stakeholders is 'financial wellness'. The financial wellness literature tends to focus on the aspects of finances which create stress and are most likely to impact on the variables of influence to employers.

What cannot be so easily influenced is 'financial empowerment' and 'financial well-being'. Empowerment requires engagement from the individual to get back into the driving seat. Well-being is inherently subjective and intermediated by individuals' values and personal idiosyncrasies. So the crux of a wellbeing initiative is that it must be a collaborative exercise between the individual who understands what they need, and the expert who helps the individual create that minimum floor of stability and expand their options.

What individuals control

Financial empowerment:
A person's ability to use their knowledge and skills to effectively navigate any financial decision they may face. It requires a high level of financial literacy as well as the ability to use that literacy in a financially capable way. Attaining financial empowerment necessitates a high degree of engagement from individuals.

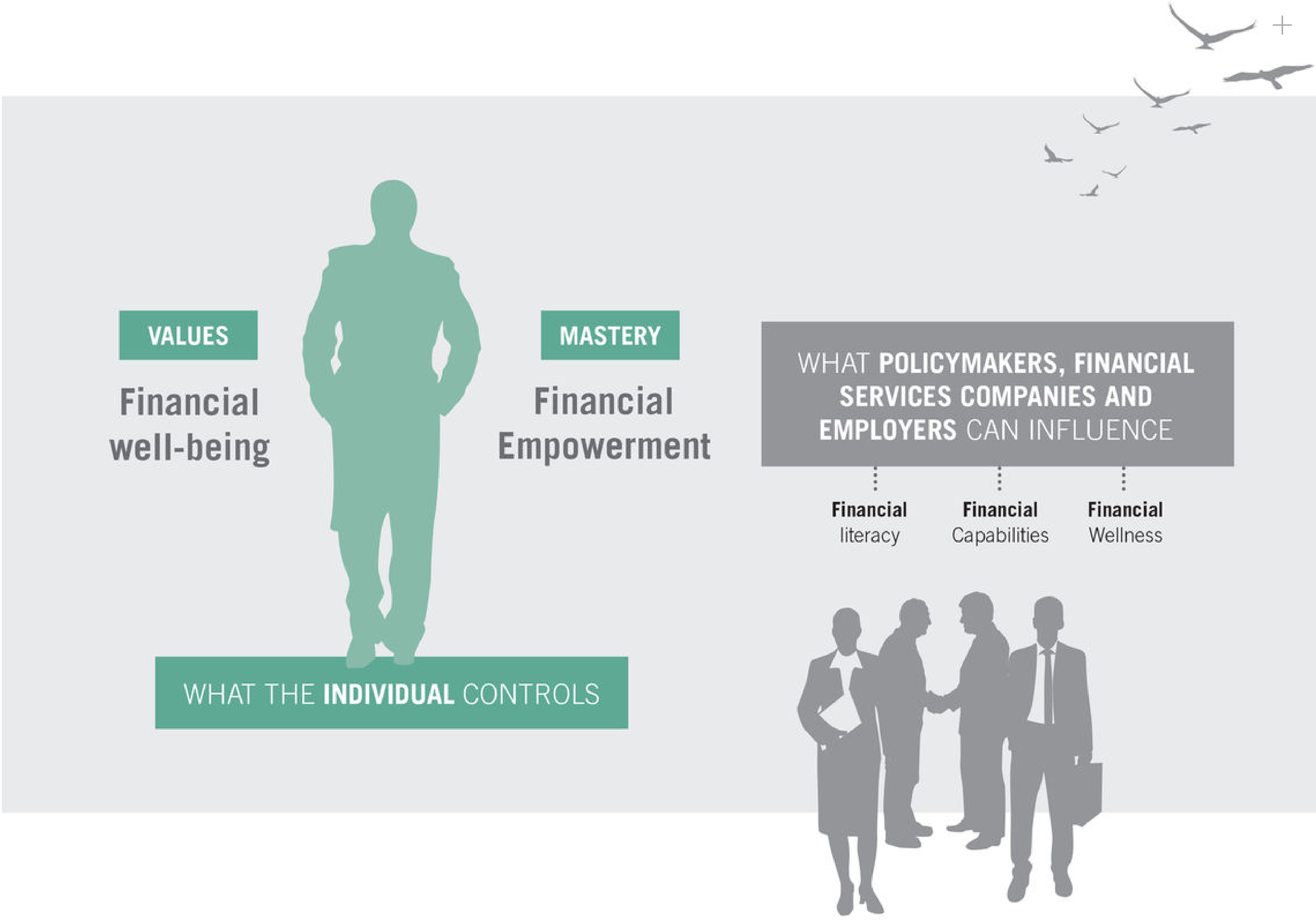
Financial well-being:
When a person deploys whatever finances financial knowledge available to them in the way which most effectively supports their life choices and overall goals.

What financial services, policymakers and employers can influence

Financial literacy
A person's knowledge and understanding of financial concepts, like compound interest and diversification, as well as their ability to apply these concepts to decisions. For instance, understanding how compound interest impacts on their borrowing.

Financial capability
The capacity to effectively manage financial resources over the life cycle and engage constructively with financial products and services. It uses as a benchmark the set of financial decisions judged to be superior in a specific context[7].

Financial wellness
A set of financial criteria judged by employers to minimise financial stress for employees.



For philosophers, well-being is part of the broader conversations on happiness and utility. For practitioners it is the purpose of all our attempts to improve people's interactions with finances.

Concluding thoughts

Two main groups have been working towards the concept of financial well-being – the philosophers and the practitioners. For philosophers, it is part of the broader conversation on happiness, utility and subjective well-being and looks at how finances serve our overall goals for life. For practitioners, it is the ultimate purpose of all our attempts to improve people's interactions with finances, but often has a fairly indistinct definition. By combining these two conversations, we can begin to see that financial well-being allows us to unlock what people really want from their money.

But the real value in the financial well-being model will become clearer in our next chapter. We have already indicated that somewhere in an individual's quest for financial viability and stability there will need to be a guiding hand of a professional. What Chapter 2 reveals, though, is that 'professional support' in this context will, by necessity, demand a very different look and feel.

References

1 Consumer Financial Protection Bureau (2015)
2 Cogan, Ballah, Sefa-Dedeh & Rothblum (1996)
3 Benjamin, Heffetz, Kimball & Szembrot (2012). Also see Helliwell, Huang & Wang (2015).
4 Benjamin, Heffetz, Kimball & Szembrot (2012)
5 Helliwell, Huang & Wang (2015)
6 Adapted from Consumer Financial Protection Bureau (2015)
7 Holzmann, Mulaj & Perotti (2013)

Article tags

FINANCIAL WELL-BEING | FINANCIAL LITERACY | FINANCIAL CAPABILITY | FINANCIAL EMPOWERMENT | FINANCIAL WELLNESS | HAPPINESS | UTILITY | FINANCIAL EXPERT | LIFE SATISFACTION | INEQUALITY