

Trauma, Depression, and Financial Risk Aversion: Evidence from a National Study

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Objective

This paper examines the long-term effects of depression and trauma on financial risk aversion of older adults and the association of these factors with the financial well-being of households using a panel comprised of 6-waves of the Health and Retirement Study dataset spanning the 2002- 2014 period.

Significance

Living with depression has been found to be a complex chronic illness and has been associated with other physical impairments (Frederick et al., 2007). This study examines the long-term consequences of depression on financial risk aversion and financial resource constraints of households. Previous studies have examined the effects of depression on several health-related risk factors (Alexopoulos, 2005; Trinh et al., 2011), however very little research is available on the effects of depression on financial risk tolerance and financial well-being of households.

Method

Using the 2002-2014 waves of the HRS data, empirical analyses were conducted to examine the association between depression and trauma on financial risk tolerance and financial well-being of households after controlling for factors found significant in previous studies (Xiao, Chen, & Chen, 2014; Mottola, 2013). Our empirical model is explained below:

Dependent Variables

Financial Risk tolerance is measured using the income gamble scales available in the HRS that is based on the scale developed by Barsky et al. (1997).

Financial Assets The financial assets variable is the total of all the financial assets owned by the households.

Independent Variables

The key independent variables for this study are measures of depression (CESD-scale) and whether the respondents suffered trauma (binary variable). Other control variables included in this study comprised of the socioeconomic and demographic variables found significant in previous literature.

The empirical model for this study is summarized below:

$$Y_i = f(D, T, A)$$

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Where,
Y1= Financial risk tolerance; Y2=Financial assets D=Depression scale (CESD)
T=Trauma
A=other control variables.

Since both variables are categorical variables, we have used probit models for our analysis after controlling for yearly fixed effects.

Results

Based on the positive association between depression and health risk, we would expect a positive association between depression and risk aversion. We also expect a negative association between depression and financial assets of households.

Conclusion/Relevance

This fills the gap in literature by studying the association between depression and trauma and financial asset holdings of households. The findings of this study will inform policymakers on the importance of depression on financially constrained households.

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