The Power of Love: Emotional Support and Financial Hardship

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Motivation

- Financial hardship is both **prevalent** and **persistent** in the United States:

  ▶ Four in 10 adults have difficulty handling an unexpected expense of $400 (Federal Reserve Board, 2020).

  ▶ Some have frequent trouble with money and their children face similar prospects (Athreya, Mustre-del-Río, and Sánchez, 2019; Kreiner, Leth-Petersen, and Willerslev-Olsen, 2020).

- Why some households are financially fragile while many others are not is still <u>not fully understood</u>.

- I explore a novel determinant of household financial fragility — **emotional support from family and friends**.

Motivation (Cont.)

- It has long been recognized that family and friends play a critical risk-sharing role:

  - ▶ **Practical help** & **financial assistance**: during periods of sickness, they provide informal care and help with paying medical bills (e.g., Arno, Levine, and Memmott, 1999; Kaiser Family Foundation, 2016).

  - ▶ **Informational support**: in the event of job displacement, they offer job search advice and information about employment opportunities (e.g., Topa, 2001).

- It remains largely unknown, however, what role the **psychological** dimension of networks of family and friends plays when households face potential adverse shocks.

Motivation (Cont.)

- To weather these shocks, it is important that households not only effectively use financial instruments, but also **plan ahead** (e.g., Ameriks, Caplin, and Leahy, 2003).

  - ▶ Formulating a financial plan is a daunting task for many household because of their limited financial knowledge (e.g., Campbell, 2006; Lusardi and Mitchell, 2014; Campbell, 2016).

  - ▶ Carrying out a plan as straightforward as setting up a rainy-day fund can be equally challenging, psychologically.

- Key insight: emotional support from family and friends can overcome psychological barriers that impede the execution of financial plans, which in turn improves financial preparedness and lowers the propensity toward financial hardship.

Preview

- **Baseline**: individuals who lack emotional support from family and friends are more likely to experience financial hardship.

- **Heterogeneity**: this pattern is stronger for women, as well as for those prone to anxiety and depression.

- **Pathway**: individuals who lack emotional support are less likely to take precautions to mitigate potential adverse shocks.
    - ▶ A belief-based channel: the lack of emotional support may induce individuals to hold overly pessimistic beliefs about the effectiveness of their effort.

Contribution

1. The literature that studies the determinants of household financial distress (e.g., job displacement, medical costs, credit market environment, educational attainment, cognitive abilities, and noncognitive skills).

    - This paper: proposes emotional support from family and friends as a novel determinant and underscores the psychology of financial distress.

2. The literature that studies the effects of interactions through social networks on financial behavior (e.g., active trading, retirement savings, home ownership, mortgage refinancings and defaults, household debt, and consumer bankruptcy).

    - This paper: highlights the **psychological** (rather than informational) aspect of social interactions in shaping household financial outcomes.

Roadmap

1. Data & measurement

2. Baseline regressions

3. Potential concerns

4. Underlying mechanisms

Data

- The National Longitudinal Survey of Youth 1979 Child and Young Adult cohort (NLSY79 CYA): 2008−2018.

  ▶ A panel of biological children of the female respondents in the NLSY79, which itself is a nationally representative panel survey of 12,686 individuals aged between 14 and 22 in 1979.

- The Health and Retirement Study (HRS): 2004−2016.

  ▶ A longitudinal study that surveys a nationally representative sample of individuals over the age of 50.

- Unique feature: respondents report the level of emotional support from family and friends.

  ▶ Both of these surveys collect information on financial hardship and a wide array of demographic and economic characteristics.

Measuring Emotional Support

- I use the following four questions in the NLSY79 CYA:

  1. How much do you feel loved and cared for by your **relatives**?

  2. How much can you open up to your **relatives** if you need to talk about your worries?

  3. How much do you feel loved and cared for by your **friends**?

  4. How much can you open up to your **friends** if you need to talk about your worries?

- For each question, a respondent's rating ranges from 1 to 5, where 1 means "not at all" and 5 means "a great deal."

- Sum all four ratings and convert to percentile ranks.

Measuring Emotional Support (Cont.)

- In the HRS sample, emotional support is measured along four dimensions: (i) from **spouse**; (ii) from **children**; (iii) from **other immediate family members**; and (iv) from **friends**.

- Respondents are asked:
    1. how much they can open up to each source about worries;
    2. how much each source really understands the way they feel.

- For each question, a respondent's rating ranges from 0 to 3, where 0 means "not at all" and 3 means "a lot."

- Sum all eight ratings and convert to percentile ranks.

Financial Hardship Indicators

1. Payment difficulties:
   - NLSY79 CYA: if the household had either "quite a bit" or "a great deal" of difficulty paying bills over the past 12 months.
   - HRS: if it is either "very difficult" or "completely difficult" for the household to meet monthly bill payments.

2. Cutting necessities:
   - NLSY79 CYA: if the household has to put off buying necessities (e.g., food, clothing, medical care, and housing) either "frequently" or "all the time."
   - HRS: if the respondent ate less than they should over the past year because there was insufficient money to buy food or ended up taking less medication than was prescribed over the past two years due to cost.

Regression Specification

- I run OLS (s.e. clustered at the household level):

$$y_{it} = \beta \cdot \text{Emotional support}_{it} + \gamma' \mathbf{X}_{it} + \delta_t + \varepsilon_{it}$$

- y: financial hardship indicators.

- $\mathbf{X}$: gender, race, age, educational attainment, marital status, health status, time and risk preferences, cognitive ability, and noncognitive skills of the respondent; family income; and home ownership.

- Household wealth is controlled for in the HRS sample.

- δ_t: year FE, absorbing all sources of variation over the years.

Baseline: the NLSY79 CYA Sample

	Payment difficulties	Cutting necessities
	(1)	(2)
Emotional support	-0.070^{***}	-0.065^{***}
	(0.008)	(0.008)
Controls	Yes	Yes
Observations	23,917	23,917
Adj. R^2	0.054	0.057

- A one standard deviation reduction in emotional support:
    - ▶ $\Rightarrow$ a 2.0 (1.9) pp increase in the probability of a household having great difficulty in paying bills (cutting necessities);
    - ▶ representing an increase of 21% (19%);
    - ▶ a one s.d. $\Downarrow$ in family income $\Rightarrow$ an increase of 18% (23%).

Baseline: the HRS Sample

	Payment difficulties	Cutting necessities
	(1)	(2)
Emotional support	−0.029***	−0.036***
	(0.008)	(0.009)
Controls	Yes	Yes
Observations	26,173	26,173
Adj. R^2	0.109	0.130

- A one standard deviation reduction in emotional support:

  - ▶ ⇒ a 0.8 (1.0) pp rise in the probability of a household having great difficulty in paying bills (cutting necessities);

  - ▶ representing a decline of 8% (7%).

Potential Concerns

- Omitted variable bias: there may be unobserved characteristics that affect both emotional support and the likelihood of financial hardship.

- Comparisons between siblings: difference out confounding factors that are fixed within the family the siblings grew up in (e.g., parental education and parenting style).

  ▶ Individuals with weaker emotional support in adulthood than their siblings are more likely to experience financial hardship.

- Within-individual analysis: eliminates time-invariant confounding individual heterogeneity (e.g., childhood experience and social skill).

  ▶ As emotional support dwindles, individuals are more likely to experience financial hardship.

- Reverse causality: e.g., individuals in better financial situations may spend more time with family and friends and therefore enjoy stronger emotional support from them.

- Investigate the impact of an event that results in arguably exogenous variation in emotional support — loss of parents.

  ▶ After their parents' death, individuals are more likely to experience financial hardship, controlling for any changes in household economic characteristics including family income and household wealth.

  ▶ This finding is almost entirely driven by loss of mother, who tends to have a stronger emotional bond with her adult child than the father does (e.g., Lye, 1996).

Non-Emotional Support?

- Financial assistance?

  ▶ Estimates of the effect of emotional support on financial hardship in both samples remain largely the same among households that receive little to no financial assistance.

- Practical help (e.g., informal child and elderly care)?

  ▶ Estimates are almost identical in magnitude to those in the baseline regressions among (i) single individuals in the NLSY79 CYA sample; and (ii) individuals with no work-limiting conditions in the HRS sample.

- Informational support (e.g., financial advice)?

  ▶ No differential effect by narrow-mindedness.

Emotional Support?

- Since women tend to suffer more emotional distress than men (e.g., Mirowsky and Ross, 1995), one would expect a stronger effect of emotional support on financial hardship for women.

  - ▶ NLSY79 CYA: the magnitude of the effect for women is more than double that for men.

  - ▶ HRS: the effect is almost entirely concentrated among women.

- I then focus on neuroticism, a personality trait of emotional instability characterizing a tendency toward negative feelings such as anxiety and depression (Goldberg, 1993).

  - ▶ The effect is stronger for individuals with higher levels of neuroticism in both samples.

Pathway

- I start by exploring whether emotional support improves financial preparedness.

  - ▶ Motivated by the importance of planning ahead for household financial well-being (e.g., Ameriks, Caplin, and Leahy, 2003).

- To capture financial preparedness:

  - ▶ NLSY79 CYA: whether the household sets aside emergency funds that would cover expenses for three months in case of sickness, job loss, economic downturn, or other emergencies.

  - ▶ HRS: how much the respondent thinks about retirement.

- Individuals who lack emotional support are less likely to set aside emergency savings as well as to plan for retirement.

Pathway (Cont.)

- It is instructive to conceptualize the execution of a financial plan as a choice of effort (Kuhnen and Melzer, 2018).

  ▶ While it is costly to exert effort today, in not doing so, one is more likely to experience financial hardship in the future.

- Two channels through which a lack of emotional support can discourage effort provision:

  1. Preference-based: the lack of emotional support may make individuals less patient, which reduces the attractiveness of avoiding financial hardship in present value terms.

  2. Belief-based: the lack of emotional support may induce individuals to hold overly pessimistic beliefs about the effectiveness of their effort.

Pathway (Cont.)

- Testing the preference-based channel (**X**):

  ▶ One would expect a stronger effect for impatient individuals.

  ▶ In neither sample is there a statistically significant heterogeneous effect for patient versus impatient individuals.

- Testing the belief-based channel ($\checkmark$):

  ▶ One would expect a stronger effect for individuals who hold more pessimistic beliefs about the returns to their effort.

  ▶ I perform a heterogeneity analysis by self-efficacy, or belief in one's capacity to execute behaviors and accomplish tasks (Bandura, 1977).

  ▶ The effect of emotional support on financial hardship is stronger for individuals with lower levels of self-efficacy.

Conclusion

- Individuals who lack emotional support from family and friends are more likely to experience financial hardship.

- The evidence suggests a belief-based channel through which a lack of emotional support psychologically discourages taking precautionary actions to mitigate potential adverse shocks.

- This paper underscores the importance of the psychological dimension of social networks in shaping household financial outcomes.