THE IMPLICATIONS OF ALZHEIMER’S RISK FOR HOUSEHOLD FINANCIAL DECISION-MAKING

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Summary
Alzheimer’s disease and other dementias cause progressive declines in cognition that lead to a complete loss of functional capacities, and this may pose enormous financial risk to all members of a household. First, financial mismanagement is itself costly; second, Alzheimer’s and other dementias eventually require expensive long-term care. The financial risks highlight the potential benefit of preparing for the loss of functional capacities, which raises the question: how do households respond to early signs of cognitive impairment and official diagnoses of Alzheimer’s or dementia? In this paper we focus on the impact of self-reported difficulties with money and memory disease diagnoses on the choice of household financial decision-maker.

Using a nationally representative longitudinal survey of older Americans, we employ survival analysis methods to examine if and when financial responsibility is transferred from husband to wife (or vice versa) when his (or her) cognition declines. We find that as the husband’s cognition declines, the management of finances is eventually turned over to the wife. However, the switch often does not occur until well after husbands report difficulties handling money. This suggests that couples are exposed for some time to the financial decisions of a cognitively impaired husband, who may already be aware of his difficulties. This finding is consistent with medical research which shows that problems handling money are an early sign of dementia.

To understand the variation in the timing of this switch, we create an economic model of the value of information about future cognitive impairment. There is surprisingly little consensus among medical professionals—let alone patients and loved ones—about the value of early detection of Alzheimer’s. On one hand, a diagnosis may only introduce emotional trauma. On the other hand, the diagnosis allows couples to alter their plans and prepare for the future. Our model highlights both the emotional cost of new information and financial benefit of using that information to re-optimize for the future. Based on our model we hypothesize that, holding emotional costs constant, the net benefit from re-optimization depends on the level of individual oversight needed to manage existing financial assets.

Households who rely on defined-benefit income, such as fixed-income pensions and Social Security, need only a modest amount of oversight of day-to-day finances relative to those who actively manage their wealth, such as 401(k) accounts. Protecting household finances against mismanagement may involve establishing trusts, assigning power-of-attorney, or otherwise transferring financial responsibility to the wife.

In fact, couples who actively manage their retirement accounts transfer responsibility more quickly after the emergence of money difficulties and at higher levels of cognition. A diagnosis increases the hazard of switching the financial respondent by over 250% for couples who control their retirement accounts relative to those who passively receive retirement income. These results hold even after controlling for wife’s cognition, education, wealth, and stock ownership. This is consistent with our model of the value of information: households with the most to gain financially from preparation are most responsive to information about cognitive decline.