Financial Skills Decline With Age

Aging athletes can wistfully point the time when their aches and pains overwhelmed the advantages of experience they’d accumulated over the years. It turns out that something similar happens with financial skills, according to a paper to be presented Thursday afternoon at the Brookings Institution.

Economists Sumit Agarwal, John Driscoll, Xavier Gabaix and David Laibson looked at the interest rates that borrowers of different ages paid on credit-card debt, home-equity loans, lines of credit, and other types of debt. They found a U-shape to the data, with people paying gradually lower interest rates and fewer fees as they aged until they reached their 50s, when the rates and fees they paid began to climb. (The economists controlled for differences other than age among the different borrowers.) (Read a related article.)

The reason: Young, inexperienced borrowers are likely to pay high rates and fees, but as they gain financial experience, the rates and fees they pay fall. But at some point (when they are 53 years old, on average, according to the research) borrowers’ cognitive ability begins to decline, and rates and fees climb.

The economists say their results suggest that regulators should examine ways to help the elderly, in particular, avoid financial errors that can result from lost cognitive ability. Because returning to work can be difficult for them, their ability to bounce back from mistakes is limited, the economists point out. Moreover, “young adults may make financial mistakes, but they rarely have severe cognitive impairments. Being a foolish 20-year-old credit card user probably bears little comparison to the financial dangers posed by dementia.”