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Comment on "The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulation"

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Older and younger individuals are more likely to pay higher prices for financial products than individuals in their middle years. Sumit Agarwal, John Driscoll, Xavier Gabaix, and David Laibson document this fact in several consumer finance markets, including markets for mortgages, credit cards, and auto loans. The age-related pattern holds after controlling for other features of the credit contracts and for borrowers’ other demographic, financial, and risk characteristics, suggesting that older and younger individuals could have paid less than they did. I follow the authors in labeling this phenomenon a “mistake,” although determining this with certainty would require knowledge of the full range of each borrower’s options, which is lacking.

The authors assemble evidence from the medical, psychological, and economic literatures that suggests that older individuals make mistakes because of declining cognitive ability, whereas younger individuals appear to make mistakes because of inexperience. Although both groups are more prone than middle-aged individuals to make mistakes, the paper focuses primarily on the financial decisionmaking of older individuals.

The authors explore a range of possible regulatory responses, including doing nothing, requiring a financial “driver’s license” to invest in non-standard products, strengthening the fiduciary duties of financial salespeople, and requiring explicit regulatory approval of financial products. The authors decline to take a stand on which interventions, if any, are desirable.

The empirical work in this paper is clear and convincing, and the authors place their findings in a broad and rich context. However, many of the possible regulatory responses may prove politically unpalatable: the political system seems reluctant to impose restrictions on the behavior of older individuals, even when such restrictions may be warranted. I describe below two situations in which both younger and older individuals are more likely to make mistakes, yet regulations are considerably more comprehensive for younger than for older individuals.

Driving. Teenage drivers and older drivers are both more likely than other drivers to be involved in car crashes (Liu, Utter, and Chen 2007). As drivers age, the advantage of their greater experience is eventually outweighed by physical factors such as degradation of reflexes, vision, and hearing, and decreases in strength, mobility, and ability to process information (Islam and Mannering 2006). In addition, because of their relative frailty, older drivers are more likely to be injured or killed in a crash: drivers 65 or older have almost three times the odds of drivers 24 or younger of being seriously injured in an auto accident (Liu and others 2007).
The top panel of figure 1 shows driver deaths by age, scaled by billions of miles driven by members of the age group. The age-related pattern is dramatic: on average, 34 drivers aged 16 and 17, 5 drivers in their forties, and 96 drivers age 85 or older were killed per billion miles driven over the 1999–2003 period.
The bottom panel of the figure shows nonmotorist (such as pedestrian) deaths by driver age, again scaled by billions of miles driven. This figure isolates the age-related pattern due to driver error rather than the relative frailty of older drivers. The pattern is still apparent but is less dramatic: on average 7 nonmotorists were killed by drivers aged 16 and 17, about 2 were killed by drivers in their forties, and 5 were killed by drivers aged 85 or older.

Figure 1 suggests that the argument for age-based regulation of driving is compelling. And indeed, states are highly involved in regulating teenage driving. Almost all have adopted a form of “graduated licensing,” which includes some combination of a learner’s period during which parents may have to certify a certain amount of supervised driving, and an intermediate period during which night driving and teenage passengers may be prohibited or limited (Insurance Institute for Highway Safety 2009a).

States regulate older drivers, however, with a substantially lighter touch. Twenty-four states place no restrictions on older drivers, and in Tennessee, licenses issued to drivers 65 years or older never expire (Insurance Institute for Highway Safety 2009b). Four states and the District of Columbia forbid licensing administrators to treat people differently solely on the basis of advanced age, and only New Hampshire and Illinois require road tests for older drivers.

CREDIT CARDS. As the paper documents, both younger and older individuals appear to pay higher credit card interest rates and fees than those in between. Policymakers and consumer groups have also raised concerns about the use of credit cards by students and the elderly, but only the concerns about the former have been translated into law.¹

Legislation enacted in 2009 imposes broad changes on the credit card industry. The Credit Card Accountability, Responsibility, and Disclosure Act has no provisions specific to the elderly, but it does place significant restrictions on the access of young borrowers to credit cards. An applicant under the age of 21 may open a credit card account only with a co-signer age 21 or older, unless the applicant submits evidence of independent means to repay. Issuers are not allowed to send unsolicited prescreened credit offers to individuals under the age of 21, and they may not increase the credit lines of accounts with a co-signer without the co-signer’s permission.

POLICY IMPLICATIONS. The above two examples suggest that policymakers and the public are comfortable protecting young individuals from their

¹. See General Accounting Office (2001) for an overview of the issues surrounding students and credit cards, and García (2007) for an example of concern about older households’ credit card debt.
inexperience, but are less comfortable protecting older individuals from their declining mental or physical abilities. Thus, popular support may be low for many of the regulatory responses outlined in this paper.

Perhaps support would be higher if the costs of the financial mistakes that older people make were more apparent. This paper cannot make that case, because the costs of the mistakes the authors identify are not particularly large. For example, they show that older borrowers pay perhaps $5 to $20 more in credit card rates and fees than middle-aged borrowers. In the most costly example of the 10 that the authors document, older borrowers may pay around $250 more on their home equity lines annually than middle-aged borrowers.

In contrast, mistakes that older households make in managing and investing their retirement savings may have significant quality-of-life consequences. As the authors note, more research is needed about the consequences of these and other mistakes for policymakers to formulate appropriate regulatory responses. However, research alone may not be enough. For example, the costs of driving by the elderly are large and well measured, but the policy response does not seem commensurate.

REFERENCES FOR THE PENCE COMMENT

GENERAL DISCUSSION Linda Goldberg said she accepted the idea that experience rises with age while cognitive abilities decline, and she found the evidence for a U-shape of costs persuasive. She was not yet