Medical Xpress

Debunking aging myths in financial decisions

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Growing older leaves many with a gloomy prognosis, namely that cognitive aging will slow the mind and the ability to make decisions. However, when it comes to making financial decisions, many baby boomers would be pleased to know that experience, knowledge, and expertise can compensate for the challenges that age-related deterioration present in finance, according to new research from Columbia Business School.The study, "Sound Credit Scores and Financial Decisions Despite Cognitive Aging" recently published in the journal, *Proceedings of the National Academy of Sciences* (*PNAS*), found evidence that "crystallized intelligence," which is gained through experience and accumulated knowledge, can be more important that "fluid intelligence," the ability to think logically and process new information.

"Our research shows that cognitive decline is real, but does not spell doom for making financial choices," says Eric Johnson, the Norman Eig Professor of Business at Columbia Business School and co-author of the study. "An alternative route to making sound financial decisions comes from experience—and that improves with age."

According to the United States Census Bureau projections, the number of Americans 65 and older will more than double by the year 2050. Policy changes (e.g. defined contribution retirement plans such as 401Ks) puts more complex decisions in the hands of individuals, and those 65 and older may find these financial decisions increasingly challenging. The research suggests guidelines for future policymakers to help those 65 and older with these complex financial decisions.

"With the proliferation of self-directed benefit plans and the demise of traditional pensions, those who have accumulated wealth over their lifetime face even greater challenges and more responsibility when managing their finances than the older population of previous generations," said Elke Weber, the Jerome A. Chazen Professor of International Business at Columbia Business School and co-author of the study. "One way to improve financial decisions across lifespan is to reduce the reliance on fluid intelligence by limiting decision options, or allowing decision makers to sort options."

The Research

The study is co-authored by Ye Li of UC Riverside School of Business Administration, Jie Gao, A. Zeynep Enkavi, and Lisa Zaval of Columbia University.

In a four-part, web-based study, researchers assessed the cognitive ability and economic preferences of 478 US residents between the ages of 18 and 86. The web-based study included a battery of cognitive, decision-making, and demographic measures.

Researchers then leveraged a unique data set combining measures of cognitive ability and knowledge with credit scores, a measure of credit-worthiness that reflects sustained ability for sound financial decision-making. This dataset allowed researchers to explore whether knowledge and expertise accumulated from past decisions could offset age-related declines in cognitive ability.

"It can be misleading to only assess the effect of age on decision quality," said Johnson. "Policymakers and future researchers should also examine the distinct roles of decreasing cognitive abilities and increasing (but eventually plateauing) domain-specific knowledge and expertise when developing tools for the aging population."

The researchers believe that age-specific decision aids and interventions that build on conduits to good decisions will not only produce better outcomes for older individuals, but reduce potentially large costs to society.

More information: phys.org/news/2014-12-financia … adults-lifetime.html

Provided by Columbia Business School