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How the Financial Sector Could Fight The Increasing Generational Divide (1)

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Abstract

How can the financial system support young people's social and economic development? Is the financing of startups the only way to combat the growing generational divide in Europe? This paper, using the Generational Divide Index, focusses on four domains: *Financing*, *Income*, *Wealth* and *Family Welfare*—to demonstrate why financial regulation should intervene during a young person's life to combat emerging intergenerational inequalities. The aim of this paper is to examine the extent to which the *Credit, Wealth* and *Family Welfare* domains affect the generational divide—referring, in particular, to the new Generational Divide Index (GDI 2.0) indicators—which have been recently modified with a new set of sub-indicators in the domains of *Financing, Income*, and *Wealth*.

Keywords: income, wealth, household, family welfare, generational divide

Some of the results that are discussed in this paper have been presented to the round table "**Building the Future: Human Development, Sustainability and Resilience"—held in Rome,** on 16 December 2017, **at the** ROME INVESTMENT FORUM 2017: Financing Long-Term Europe. I thank Jan Kermer for proofreading.

1. Introduction

It is not easy to estimate the impact and measure the intensity of unsustainable growth of young generations, since the recent recession is the product of multifarious factors. Amongst other things, we should consider lower job protection and a less job-specific experience. The still present imbalances stemming from European integration and sectorial impact of the recent financial crisis has led to a less favorable climate for youth development. Much of southern Europe remains mired by unacceptably high rates of youth unemployment that have left indelible scars on young people, both psychologically and economically, posing economic problems for future generations and threatening the European economies' competitiveness.

The *Bruno Visentini Foundation* (hereinafter abbreviated as BVF) explores the youth problem through the prism of the 'generational divide'—which is a term referring to the accumulated delay that young people of a single European country face in reaching certain personal and professional development 'life goals' compared to previous generations, taking into consideration the obstacles that restrict the full attainment of social and economic maturity (Monti 2017a).

In order to measure this phenomenon, BVF has devised a composite index, called the Generational Divide Index (GDI) that is currently (GDI 2.0 version) composed of 13 relevant domains, which are the following: Unemployment, Housing, Pensions, Government Debt, Participation in Democracy, Health, Income & Wealth, Environment, Education & Culture, Access to Credit, Mobility, Legality, Innovation and Gender Equality (Monti 2017b).

The GDI results indicate a continuing decline in young people's life prospects compared to previous generations. This deterioration has been attributed to *inter alia*: rising pension liabilities per worker, increasing healthcare costs due to aging demographics, disproportionately high youth unemployment rates *vis-à-vis* the wider population, increasing government debt per person, and rising housing costs. According to Intergenerational Fairness Index (IFI), the weakest ranks are those of Greece, Italy, Romania, Cyprus and Spain, which means (save for France) a clear concentration in the Mediterranean area (Leach & Hanton 2016).

The aim of this paper is to examine the extent to which the *Credit, Wealth* and *Family Welfare* domains affect the generational divide—making reference to the revised Generational Divide Index (GDI 2.0) indicators—recently enriched with new sub-indicators in the domains of *Financing, Income, Wealth* and *Family Welfare* (Monti 2017b).

2. Methodology

In order to analyze the impact of the financial sector on the generational divide, 3 of the 13 GDI 2.0 indicators are particularly relevant: *Income, Wealth & Family Welfare* and *Financing*. The analysis begins *with Income, Wealth & Family Welfare*, which are composed of four different sub-indicators. The quantitative study is focused exclusively on the country case study: Italy. Data has been collected from 2004 until 2015 for most of the indicators, save for some that are limited to 2014 for practical purposes—in the latter case, figures have been estimated. The following figures illustrate the historical trends for the country case study.

a) *Income*: The objective is to compare the median income of young people with the general populations' median income. The population median income is divided by the median income of young people aged between 16 and 24 years old. The GDI thereby grows as the ratio increases.

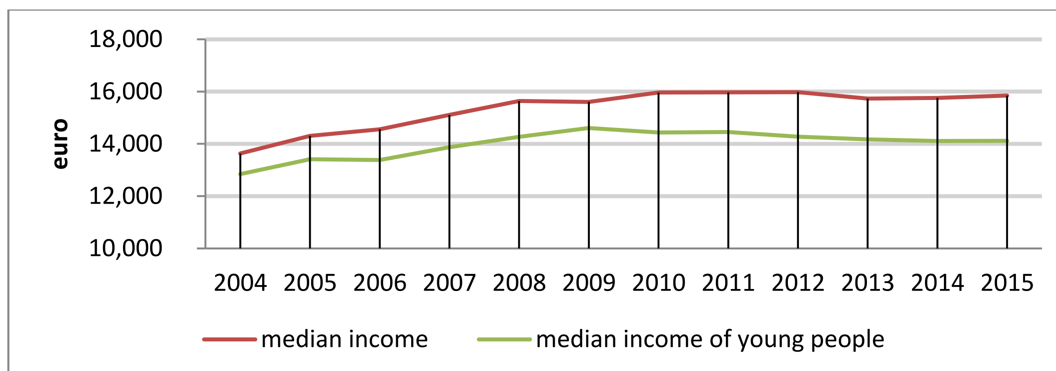

Fig. 1. Median income of young people and of the general population

Source: Bank of Italy data elaborated by Fondazione Bruno Visentini

b) *Wealth:* The objective is to compare the median wealth of young families with respect to the median wealth of families. Wealth measures the value of all the assets of worth owned by a person. Wealth is determined by taking the total market value of all physical (property) and intangible assets (i.e. shares) owned, and then subtracting all debts. Essentially, wealth is the accumulation of resources (Investopedia 2016). Recent studies paint a negative picture for young Europeans. A report by the London School of Economics has shown that the median total wealth for UK households aged 55-64 had grown to £425,000, but for those aged 25-34, it has fallen to £60,000—representing a £365,000 gap between generations 30 years apart, and with the gap still widening. (Hill et al. 2015) This indicator measures the ratio between the annual median wealth of families (expressed in euro) and the annual median wealth of families with the head of the household under the age of 34.

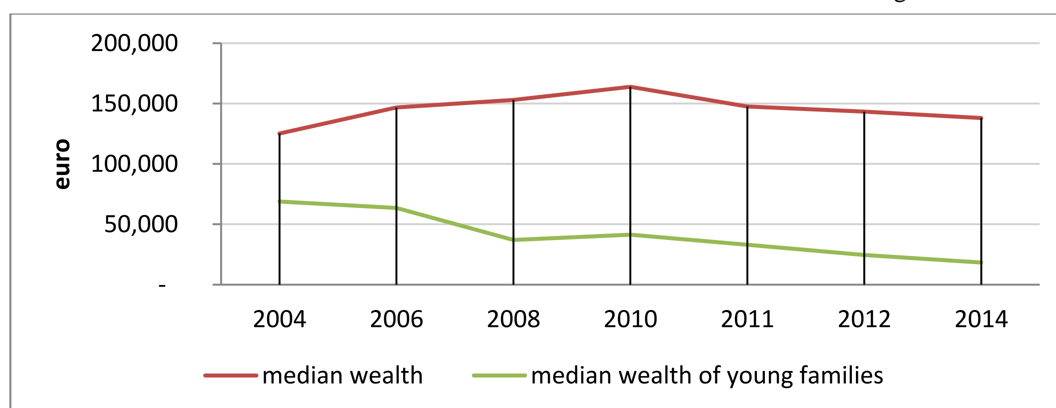

Fig. 2. Annual median wealth of Italian families (expressed in euro) and the annual median wealth of under 34 families

Source Bank of Italy data elaborated by Fondazione Bruno Visentini

c) *Family investments in bonds and mutual funds*: This indicator corresponds to the percentage of young families possessing bonds or mutual funds. A bond is a fixed income investment in which an investor loans money to an entity (typically corporate or governmental) which borrows the funds for a defined period of time at a variable interest rate (Hayes, 2017). A mutual fund is an investment vehicle made up of a pool of monies collected from many investors for the purpose of investing in securities such as stocks, bonds, and other assets (Investopedia, 2018). A family is deemed young if the head of the family is aged under 34. As the indicator increases, the intergenerational divide gets smaller.

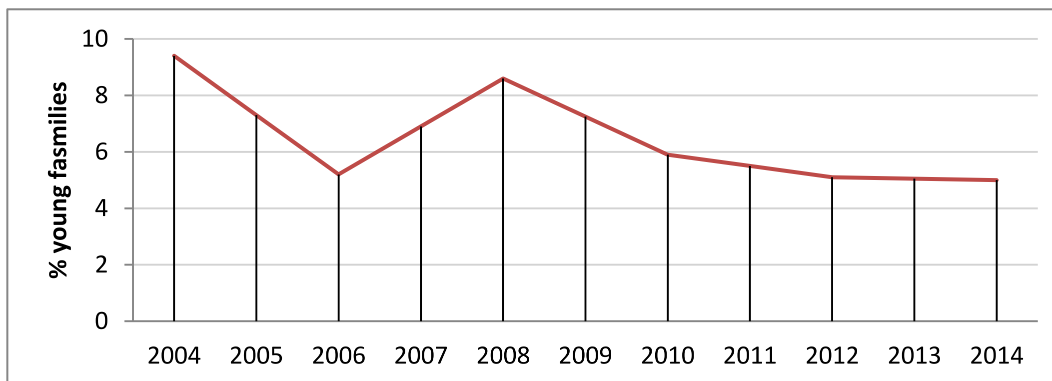

Fig. 3. Percentage of Italian young families possessing bonds or mutual funds

Source Bank of Italy data elaborated by Fondazione Bruno Visentini

d) *Integrated pensions*: The objective is to assess to what extent young families benefit from integrated pensions. This indicator is measured by the percentage of young families who possess integrated pensions. As the indicator increases, the intergenerational divide gets smaller.

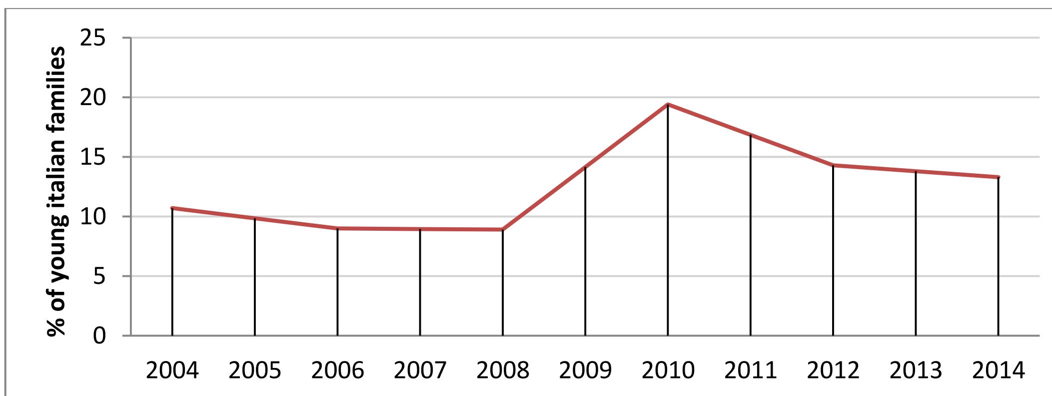

Fig. 4. Percentage of householders (under35) having complementary private pensions in Italy

Source: Bank of Italy data elaborated by Fondazione Bruno Visentini

For the second domain, *Financing*, the following three sub-indicators have been adopted:

e) *Credit*. The objective is to assess the borrowing capacity of Italian young people, defined as the amount of money available that an individual can borrow, which is dependent on the individuals financial situation. As a result of the 2008 financial crisis, borrowing has become harder in many European countries. Banks have become more risk-averse—recent banking regulations (i.e. Basel III) have reduced the appetite for lenders to borrow to, in particular, young people. Many mortgage lenders now require significantly higher deposits from home purchasers, with 20 per cent being a typical requirement (Dolphin 2012).

This reduced borrowing capacity has had knock-on effects for the wider economy. A recent report by the British Labour party found that the key drivers for falls in homeownership in England derived from *inter alia* long-term falls in relative incomes and diminished borrowing power of young people (see Redfern 2016). Such an improvement could occur through an easing of credit constraints for first time buyers through easing the prudential regulation.

In the UK, steps have been taken to improve the borrowing capacity of young people through mortgage initiatives such as the "Help to buy" scheme. As the name implies, under this initiative, people are granted favourable borrowing conditions on their first home. Although the measure does not directly target young people, as most first-time buyers are predominantly younger people, they are the cohort that is most likely to benefit. This indicator is measured as the ratio between the borrowing capacity of over-65s and under-34 age groups. The intergenerational divide grows as the indicator increases.

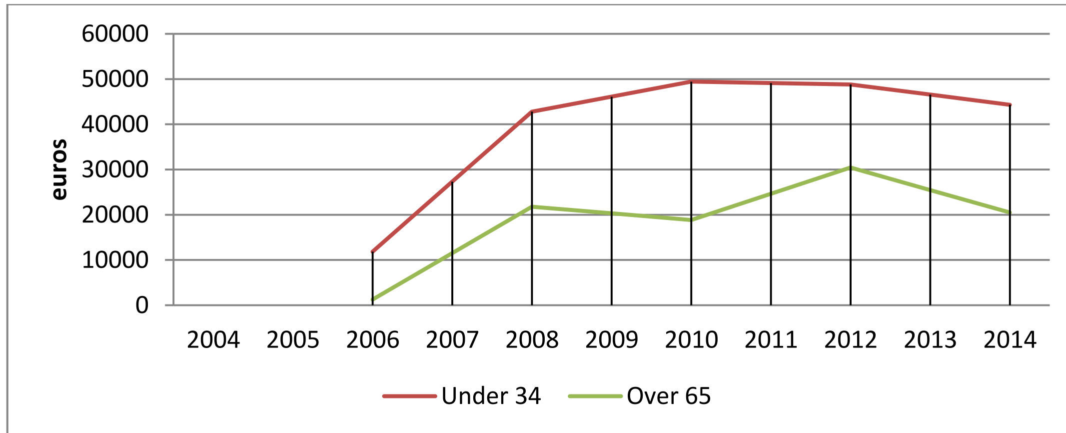

Fig. 5. Borrowing capacity

Source: Bank of Italy data elaborated by Fondazione Bruno Visentini

f) *Debt level of families*: This indicator corresponds to the debt level of families expressed as a percentage of their available income. As the indicator increases, the GDI grows. According to Consumer Finance UK, a debt-to-income ratio of up to 43% is deemed sustainable (CFPB 2017). Likewise, in the USA, to reach the requirements for a Qualified Mortgage, the DTIR (debt-to-income ratio) must not exceed 43% (Federal Reserve Bureau 2015). In Europe, it appears that the borrowing eligibility criteria are more stringent than its American and British counterparts. For example, in Italy, borrowers are normally eligible for a mortgage as long as their DTIR does not exceed 33%. In France along with Spain, the DTIR cannot exceed 35%. As Fig.6 below shows, the debt level for Italian families has reached an unsustainable footing.

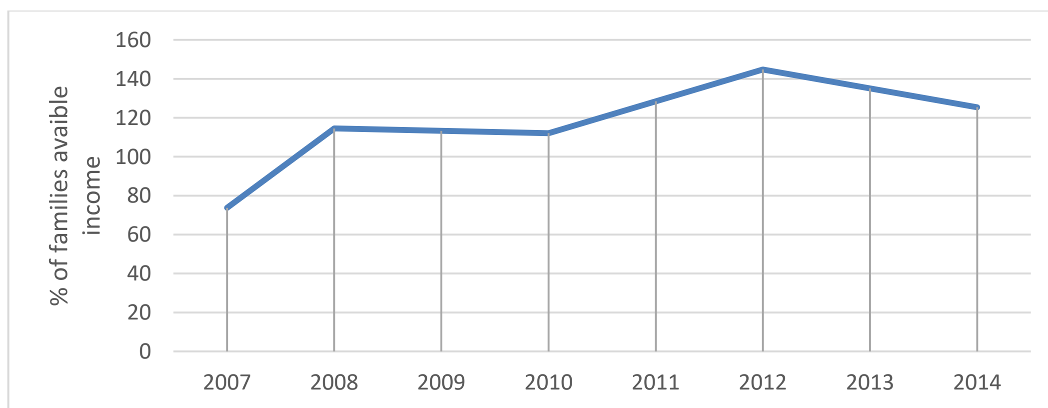

Fig. 6. Debt level of Italian families expressed as a percentage of their available income

Source: Bank of Italy data elaborated by Fondazione Bruno Visentini

g) *Insurance policies*: The objective is to evaluate to what extent the possession of insurance policies are widespread among young people. This indicator is measured as the percentage of under-34 persons possessing a life insurance policy. As the indicator increases, the intergenerational divide falls. To put it in perspective, according to Bestow, a leading American online insurance provider, up to 25% of American millennial families have taken out life insurance. Similarly, in the UK, up to 25% of millennial parents have subscribed to a life insurance policy, compared to just under 10% of Italian families (Business Insider 2017).

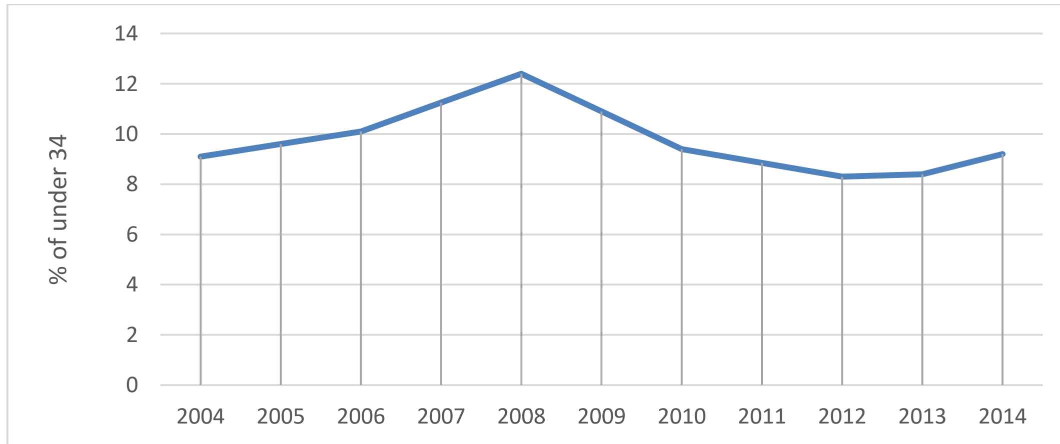

Fig. 7. Percentage of under 34 people possessing a life insurance policy in Italy

Source: Bank of Italy data elaborated by Fondazione Bruno Visentini

3. Results

In regards to the categories *Income, Wealth* and *Family Welfare*, the most negative results concern *Wealth*—in fact, this data significantly affects the whole performance of the indicator. The increasing of over-65 investments, which positively affects the whole indicator, could be relevant if we consider intergenerational solidarity between older people and their descendants. However, this is a very questionable conclusion. These long-term investments, on the one hand, might be construed as investments for prospective generations—but on the other hand, might also be considered as producing negative externalities, as arguably, these practices entrench social immobility as rich parents will transfer wealth only to their direct descendants, thereby empowering family networks. Furthermore, integrated pensions are still largely overlooked by young families. In Italy, after an increasing rate of integrated pension's ownership until 2010, in the years from 2011-2015, that number has fallen by more than 5%.

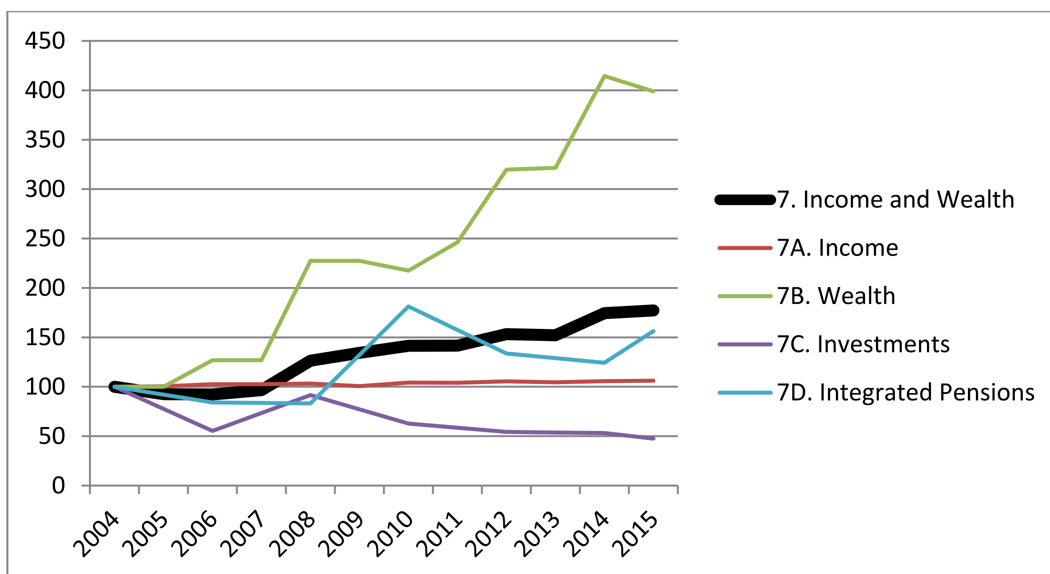

Fig. 8. GDI index of Income, Wealth and Family Welfare for Italy

Source: Fondazione Bruno Visentini GDI 2.0

Concerning the second domain, the data illustrates a marked deterioration in the *Credit* indicator i.e. the borrowing capacity. This indicator is not only influenced by the labour market for young generations, but also by the increasing general debt level. Young people are more likely to be employed on "*fixed-term,*" (UK) or "*contratto tempo determinato*" (Italy) contracts, and as a result, they have less job security than older generations. This might partially explain why the GDI for *Wealth* has widened so considerably. Focussing on *Financing*, the worst sub-indicators are *Credit* and *Debt Level* (see fig. 10). As alluded to before, integrated pension plans subscribed by under-35s remain marginal.

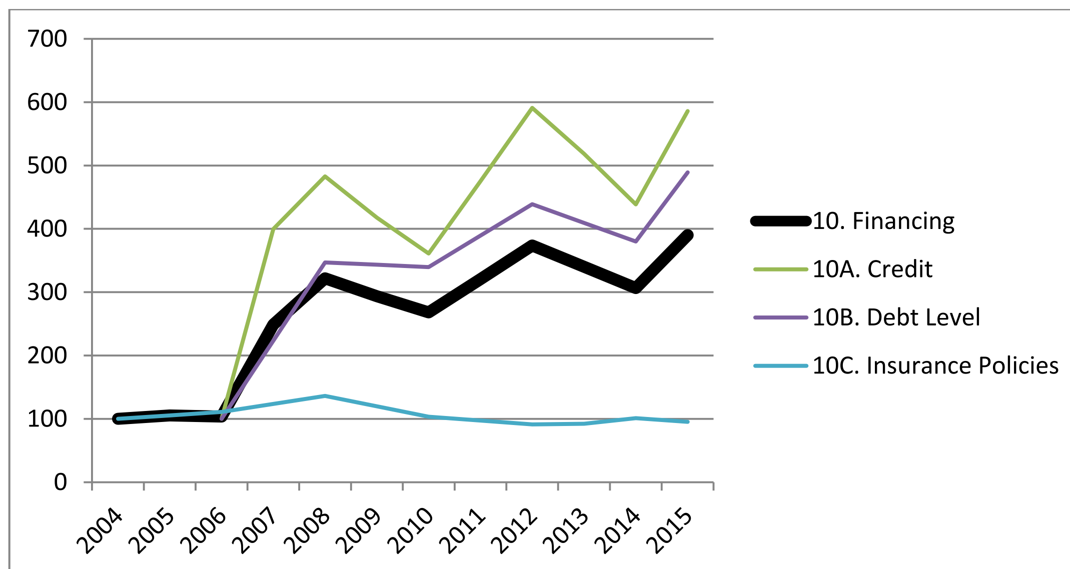

Fig. 10. GDI index of financing for Italy

Source: Fondazione Bruno Visentini GDI 2.0

4. Conclusion

As far as the country case study of Italy is concerned, the deteriorating trends for *Income* and *Wealth* can be explained by the relatively low salaries and unstable unemployment arrangements for young adults (between 29 and 34 years old) vis-à-vis older generations. This phenomenon is not the cause of generational divide, but one of its effects. Therefore, any solutions should be tied to systemic, organic and multidimensional governmental policies—such as reforms to educational practices, which are garnered towards new, emerging jobs and targeted industrial policies. However, banks and assurance sectors could play a decisive role—by incentivising family investment and complementary private pension targets, promoting new and specific forms of integrated pension plans for young people and long-term investments in favor of descendants.

In short, the new GDI indicators of *Income*, *Wealth* and *Family Welfare* demonstrate, as far as the Italian case is concerned, a lack of relevant incentives to promote complementary pensions for under-35 households.

Therefore, banks and assurance companies should promote long-term investment for over-65 households in favour of their descendants. In order to avoid a simple transfer of wealth to direct descendants, this measure should be balanced by instruments of mutualisation.

Acknowledgements

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