

## Baby-Boomers and the Romanian Financial System<sup>1</sup>

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**Abstract:** This paper analyses the possible contribution of the over-represented “decree” generation of the 1960’s and 1970’s to the development of the Romanian financial system. Contrary to most other studies on the subject, the focus of this paper is on the financial impact this generation can have before reaching retirement age. Consequently, the analysis is centered on the interaction between the members of this generation and the local financial institutions in the next two decades. It is suggested that the time frame used for this study is better suited for the strategic analysis requirements of financial institutions. It is argued that this generation is maturing professionally and moving towards reaching its financial peak in terms of individual earnings. Therefore, one of the main conclusions of the paper is that financial institutions should adjust their strategies in order to benefit from a significant opportunity.

**Keywords:** financial institutions; financial markets; demographic change; financial assets, retirement.

**JEL Classification:** J11, D14, D53

### 1. The Romanian baby boomers

Romania experienced an atypical baby boom starting with the late 1960s. Therefore, the term baby boomer is not used in this paper with reference to a post-war generation, like it would be the case in other countries, but to an over-dimensioned generation that was born in Romania after 1967 (to put things into an international perspective, this roughly coincides with the period when the first cohort of US baby boomers reached the age of 20, as presented by Bergantino [1998]). The paper focuses on the *decree* generation which was born in Romania after the Decree 770 of October 1966 was issued, which imposed a ban on abortion. This ban was particularly effective on the shorter term, leading to a significant increase in births in the first few years after it was imposed. Therefore, from a demographic point of view, the most important effects of the ban can be seen (Fig. 1) at the cohort born between 1967-1971 (particularly due to the very high increase in birth rate in 1967 and 1968), which will reach the age of 50 between the years 2017-2021.

Locally, this cohort is known as *Decretei*, the Romanian term for “children of the decree”. This particular generation, due to its disproportionate size, had to face various problems in time. Firstly, the educational system, at all levels, was not prepared for such a

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high number of students, then there were problems when they had to enter the labor market and even, as Trebici (1991, p. 81-89) describes, in the “matrimonial market”. In a complete analysis, the psychological effects of the fact that many of the children from this generation were unwanted by their families should also be taken into account.

From Fig. 1 it can be seen that the cohort aged 40-44 in 2011 is about 60% larger than the previous one and is followed by two other cohorts (35-39 and 30-34 years) that, although of smaller size, are also significantly larger than the average. We consider this to be a demographic tidal wave, a large and also potentially dangerous ridge in the population that undulates throughout time.

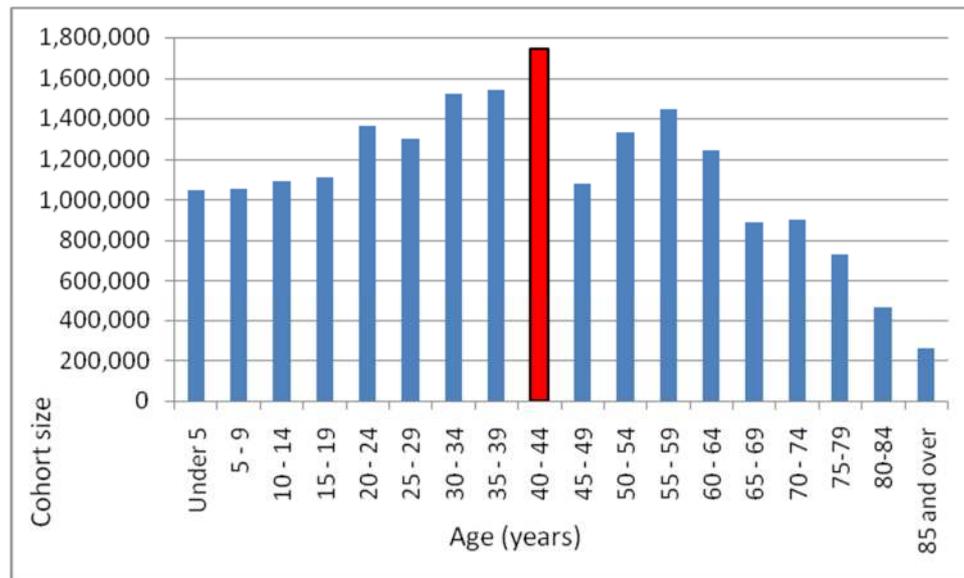


Fig. 1 The population of Romania – age distribution at the 2011 Census, based on official data (Institutul Național de Statistică, 2013).

## 2. Conceptual and theoretical context

Much of the current literature that refers to baby boomers focuses on their impact on the pension system (Shoven & Schieber, 1997; Lee & Skinner, 1999, Dobre et al, 2012, Şeitan et al, 2012) or on the financial markets (Shoven & Schieber, 1997; Brooks, 2000; Poterba, 2004) **when (after) they retire**. While some authors suggest that the problem of population ageing and its impact on the pension system should not be regarded as catastrophic (Brooks, 2006; Rotariu, 2009), others are less optimistic (Abel, 2001; Siegel, 1998). In any situation, the danger of a self-fulfilling crisis, as described by Lupu (2012), should be taken into account. Leaving that aside, what happens to this generation and the impact it will have on the economy while it is still economically active, therefore **before it retires**, is a question that received much less attention.

This paper is based on the hypothesis that the following 10-15 years represent the professional peak period for this generation. This also implies that this period will also be the one with the highest individual earnings. This hypothesis derives from the fact that most sources indicate the age of around 50 as the peak age in terms of professional achievement and earnings. The relationship between age and income has been previously discussed in the literature. Kreps (1977), for instance, observes that earnings peak around the age of 45-54, with a slight decrease in the last decade of work life. Kreps also refers to the differences in earnings between men and women in relation to age. For the particular case of Romania we do not have detailed information regarding this relationship but, according to NIS (2012), the

age bracket with the highest individual earnings was that of 55-64 years in Romania in 2010. This would place the period with the highest individual earnings for our cohort between the years 2026-2037. While estimating this period, we should also take into account the possibility of delayed retirement, both due to individual choice or to a rather probable more general expansion of working age, which might push forward both retirement age and the age of peaking in terms of individual earnings.

Some studies discussed the effect of cohort size on earnings. Welch (1979) indicates, based on US baby boom data, that especially at the beginning of the career, large cohorts have a depressant effect on earnings. For Europe, Brunello (2010) and Moffat and Roth (2013) find that the negative effects of cohort size on earnings increase with the level of education. These findings would imply that when our target generation will reach its peak in terms of earnings, the average would be lower than that of a smaller cohort.

Even considering the previously mentioned aspects, it appears to be quite clear that the life progression of this cohort has the potential to influence the local financial markets because of its disproportionate size and particular needs. Using life cycle analysis, we can expect certain changes in the saving and investment behavior, and generally in the demand for various types of financial products and services. An impact on the structure of financial markets can be expected, because significant percentages of the population will reach a stage in their lives when they tend to accumulate financial wealth (instead of borrowing, for example). Pension funds, for instance, may be favored while consumer and real estate credit may be negatively influenced.

The particularities of this generation should be taken into account. Ducatti Flister (2013) for example, indicates a lower education level for this cohort than from cohorts outside the Decree time frame (it should be noted, however, that Pop-Eleches (2006) indicated opposite effects for the cohort of 1967). Individuals from this generation are *used* to face particular problems, not experienced by those from previous generations. They faced particular conditions in their early family environment, during their schooling and employment (Trebici, 1991). Based on the results of a recent study (Dóczy, 2010) focused on those born between 1965-1967, it might be extrapolated that women from our cohort earn less than those born before, the chances of unemployment were higher for both men and women. The study also pointed to a higher proportion of handicapped individuals.

Bergantino (1998) looked at the relationship between the age distribution of the population and housing, stock and bond prices, in the US. His motivation for the study was much similar to the one of this paper: he noted that in US, the dramatic rise in housing prices in the 1970s and 1980s and the dramatic rise in stock prices in the late 1980s coincided with the entrance of the baby boomers in life stages typically associated with high demand for those assets (Bergantino, 1998, p. 9). In this paper we hypothesize that the real estate boom of the 2000s in Romania was, to a large extent, associated with the maturity of this country's baby boom generation and in the future years we could expect an associated boom in stock prices or other financial assets. At the relationship between the baby boom and the stock market boom also looked Lim and Weil (2003) and Geanakoplos et al. (2004).

### **3. Influences on the financial system**

The very small cohort of individuals aged 45-49 in 2011 is followed by the largest cohort, of those aged 40-44 at that time. We hypothesize that this demographic tidal wave will bring significant changes in the amplitude of demand for financial services and products.

Due to the position on the individual life cycle which allows for a higher percentage of income to be saved or invested, among the possible effects we can expect baby boomers to have on the financial system we can briefly mention the following:

- Increase in the demand for financial assets (stocks, bonds, bank deposits);

- Rise in financial assets prices, due to the increased demand;
- Lowering the rate of return of financial assets, due to the rise in prices;
- Higher securities trading volumes, due to the increase in demand;
- Downward pressure on interest rates, due to the increase in supply of individual savings and decrease in demand for loans;
- Increased interest in innovative and diversified financial products and services;
- Increased interest in pension funds;
- Lower interest in housing loans, since smaller cohorts reach the life cycle stage when acquiring a house is necessary;
- Lower interest in consumer loans;
- Increased interest in international financial assets (to protect from a possible meltdown when baby boomers reach retirement age).

For a better understanding of the impact of baby boomers on the Romanian financial markets it would also be beneficial to conduct future research to clarify the stage of development of the local financial markets. This would help understand if Romania is moving from an initial bank phase in the financial system evolution towards a market or securities phase (as discussed in Davis [2006]). Such clarifications might shed more light on the parameters of the environment in which local financial institutions compete and would also be useful from a regulatory point of view.

#### **4. Strategic implications for the financial institutions**

Among the strategic priorities of financial institutions, just as would be the case for any other organization, we believe that a forward looking attitude should exist, which would allow the adjustment of activities according to changes in the market. Concerning the subject of this paper, such a forward looking attitude would imply a careful analysis of demographic changes and their implications. After all, the discussed demographic changes are highly foreseeable.

As mentioned at the beginning of the paper, the baby boom was delayed in Romania (also, it had fundamentally different causes). This means that the experience of peaking baby boomers from other countries can be incorporated in the strategies of financial institutions in Romania. A careful study of the way baby boomers impacted the financial system of the US or other countries that had such generations born after World War II, can be of real help in evaluating whether the hypotheses presented in this paper are of significant importance.

Another important factor to be considered in possible future analyses is the position of the local economy relative to the economic cycle, since this will influence the individual behavior. Such a behavioral influence would be based on psychological reasons and on availability of financial resources, both motives having durable effects. For example, if the current crisis will continue and become chronic, it will obviously have negative effects on the financial system, but its long lasting psychological impact should be taken into account irrespective of the position on the economic cycle at a later date.

To conclude, we should recall that recently, The Nielsen Company (2012) named the US baby boomers “Marketing’s most valuable generation”. In the light of what can be considered a significant industry opportunity it probably is the time for the Romanian financial system to consider the local baby boomers it’s “most valuable generation” and make the necessary adjustments.

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