Testimony before the Joint Economic Committee of U.S. Congress on "Avoiding a Lost Generation: How to Minimize the Impact of the Great Recession on Young Workers"

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Chair Maloney, Vice Chairman Schumer, Ranking Members Brady and Brownback, and members of the Committee, it is an honor to be with you today. The labor market in the United States is recovering from the most severe recession since World War II. Today we meet to discuss how this recession may affect the long-term outlook of a particularly vulnerable group in the labor market, labor market entrants and young workers.

In my testimony I will summarize the available evidence on the short and long term effects of entering the labor market in a recession on young workers' employment and earnings. I will also indicate which labor market entrants are most affected by such initial bad luck, and will summarize potential explanations of these effects. Finally, I will briefly offer some implications for policy from these findings.

The available evidence suggests that the consequences from entering the labor market in a recession are severe in both the short and the long run.[1] In the short run, labor market entrants and young workers suffer from larger increases in unemployment and layoffs than the average worker. Yet, even in the long-run young workers – who enter with no prior employment history and are presumably most flexible – can suffer from initial bad luck for a long period of time.[2]

[1] Several recent papers analyze the long-term effects of entering the labor market in a recession (e.g., Oreopoulos, von Wachter, and Heisz 2008, Oyer 2008, Kondo 2008a, Kahn 2010). A separate literature has examined the differential contemporaneous effect of recessions for young workers (e.g., Clark and Summers 1981, Blanchflower and Oswald 1994), and the general effect of career instability at labor market entrance (e.g., Gardecki and Neumark 1998).
[2] The following paragraphs summarize findings from Oreopoulos, von Wachter, and Heisz (2008).

Entering the labor market in a large recession such as the current one can lead to reduced earnings for up to 10 to 15 years. During this period younger workers are also exposed to higher incidence of non-employment and job and earnings instability. The evidence suggests that these adverse effects are driven by labor market conditions in years immediately following entry into the labor market. As a result, a quick improvement in labor market conditions can speed up the recovery process, but it can not eliminate significant long term effects from entering the labor market in a recession.[3]

Existing evidence suggests that part of the decline in earnings arises because young workers entering the labor market in a recession take jobs at worse employers than they otherwise would have had. This process is often referred to as cyclical downgrading.[4] For the average labor market entrant, this initial effect fades over time, partly as workers search for better jobs, partly as they manage to move up the job ladder at their existing employers. However, our findings suggest that the recovery process can take a long time and that it can involve continued mobility between occupations, sectors, employers or regions. As a result, some individuals never recover from the initial shock, as they settle down, buy a house, and start family life.[5]

These effects differ by education group.[6] In the short run, lower educated workers experience larger increases in unemployment than more educated labor market entrants. However, in the long run less educated individuals tend to recover faster. In fact, it is workers in the middle of the education distribution who can suffer close to permanent earnings consequences from entering the labor market in a recession; those individuals at the bottom and the top of the education distribution recover more quickly from a bad initial start.[7] Thus, more education in itself does not yield full insulation against shocks occurring in the aggregate labor market. Yet, more education is certainly beneficial as it still raises overall mean earnings and employment stability.

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[3] For an elaboration, see the sensitivity analysis and the supplementary appendix of Oreopoulos et al. (2008).
[4] E.g., Reynolds (1951), Reeder (1955), Okun (1973), McLaughlin and Bils (2001).
[5] For a more extensive discussion see Oreopoulos et al. (2008).
[6] Oreopoulos, von Wachter, and Heisz (2008), Kondo (2008a), Genda, Kondo and Ohta (2010).
[7] A similar hump-shaped pattern in the cost of economic shocks is found for displaced workers in von Wachter and Handwerker (2009).

Entering the labor market in a recession also has impacts on individuals' beliefs and other lifetime outcomes. The evidence suggests unlucky cohorts of labor market entrants tend to believe in a higher degree of income redistribution; at the same time they tend to mistrust public institutions.[8] Similarly, available evidence suggests prolonged unemployment affects the age of marriage and family formation.[9] Thus, a bad initial start can have significant and lasting effect on both career prospects and lifetime outlook of affected individuals.

Some government policies may help prevent long term earnings losses from entry in the labor market in a recession and help unlucky young individuals recover.

Generally, the evidence suggests that a faster macro economic recovery will help improve the speed of the recovery from a bad initial start. However, the adjustment of individual workers lasts well into and beyond the recovery of the overall labor market. A rising tide lifts some, but not all boats. Thus it is worth to consider cost-effective policies that directly aid recovery from starting to work in a recession.

To recover from beginning to work in a recession younger workers have to reorient their career goals. As the economy improves, changes in occupation, industry, or region will speed the recovery of earnings from a lower initial level. It is important to raise awareness among young workers that the recovery process can take a long time and may involve continued mobility. This could be done within existing infrastructure providing job search help for the unemployed, such as One-Stop Career Centers.[10] Such information could also be provided through career counselors or curricula at school, community college, and universities. In this context, young workers could also be provided with information on growing industries, occupations, or regions that is routinely generated by the Bureau of Labor Statistics or the Census Bureau.

To further aid reorientation of careers, retraining can help to provide new skills appropriate for a changed labor market situation. Support for such retraining could take several forms. Subsidies

[8] Giuliano and Spilimbergo (2009).
[9] For an overview of the literature and analysis of the long-term effects of labor market conditions on marriage and fertility, see Kondo (2008b). For additional evidence on displaced workers, see Del Bono, Weber, and Winter-Ebmer (2008).

could be given for programs involving on-the-job training, which provide work experience and direct contact with employers;[11] subsidies could be given for enrollment in Community College courses;[12] or vouchers could be provided that allow workers to choose ways to up-grade skills on the private markets – in spirit not unlike Personal Reemployment Accounts.

Finally, an important concern is that many young workers quit education in progress because they lack funds to continue to finance their training. Either parents are laid-off, or they themselves cannot find jobs to support themselves during their studies. Such a recession-induced decline in completion of education could substantially raise the cost of recessions for young labor market entrants and the economy as a whole. As a result, providing subsidies or facilitate borrowing to allowing young individuals to continue their education would be worth considering.

An advantage of some of these policies is that they can be implemented or build on within the infrastructure of existing programs. This has the benefit that some of them have already been shown to be cost-effective in existing evaluations. Moreover, they could be implemented relatively quickly.

Finally, the evidence reveals a high degree of persistence of the effect of shocks in the U.S. labor market. This persistence is likely to arise from the intrinsic working of the labor market itself. It stems, among others, from the need to accumulate job-specific skills; the time-intensive process of search for a good job match; and the presence of long-term contracting.[13] Thus, it is likely to be difficult to help unlucky young labor market entrants after the fact. The best help might be prevention. This includes efforts to prevent shocks that can cause large recessions; it also includes policies that help to prevent concentrated layoffs in the future, such as job sharing.[14]

To conclude, our best evidence suggests that strong recessions such as the current one can lead to

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[10] E.g., see Jacobson (2009).
[11] E.g., see Department of Labor (1995).
[12] E.g., see Jacobson, Lalonde, and Sullivan (2005).
[13] E.g., see, respectively Neal (1995), Parent (2000), and Pletaev and Robinson (2008); Topel and Ward (1992) and Neal (1999); and Beaudry and DiNardo (1991) and Schmieder and von Wachter (2010).
[14] See, e.g., testimonies before the U.S. Congress by Hassett (2010) and von Wachter (2010).

persistent scars for young labor market entrants. Available research shows that entering the labor market in a recession lowers earnings, raises career instability, affects individuals' believes and their family formation. These scars persist for over ten or more years, and are only partially mitigated by recovery in the aggregate labor market.

The available evidence suggests that the recovery process involves increased mobility among employers, industries, or regions. Any program aiding this adjustment process is likely to lessen the lasting effects of recessions for unlucky generations of younger workers.

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