The Heritage Foundation
LEADERSHIP FOR AMERICA
214 Massachusetts Avenue, NE • Washington DC 20002 • (202) 546-4400 • heritage.org

CONGRESSIONAL TESTIMONY

Avoiding a Lost Generation: How to Minimize the Impact of the Great Recession on Young Workers

Testimony before
Joint Economic Committee
United States Congress

May 26th, 2010

James Sherk
Senior Policy Analyst in Labor Economics
The Heritage Foundation

My name is James Sherk. I am a Senior Policy Analyst in Labor Economics at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The current recession has harmed Americans in almost all walks of life. It has particularly hit America's youth, for whom joblessness has increased far more than for the population as a whole. This has serious long-term consequences for today's youth future employment and earnings and will affect many of them throughout their working lives.

Unfortunately, there are no simple policy solutions to this problem. Congress has spent billions on job and job-training programs for youth. Evaluations of these programs consistently find that they accomplish little. Evaluations of European youth employment programs have come to the same pessimistic conclusion. Congress should be realistic about the utility of youth employment programs as a policy response.

The best way to improve the job market for youth is to improve the job market overall. The job prospects of less skilled workers improve substantially when labor demand improves. Measures to promote entrepreneurship, business investment, and overall job creation are the best ways to help America's youth find work.

One policy that would specifically improve youth employment would be lowering the minimum wage. The recent minimum wage increase has priced many unskilled teens out of the labor market – depriving them of the opportunity to gain important on-the-job training that would make them more valuable employees. Temporarily reducing the minimum wage to $5.15 an hour would spur hiring of unskilled youth.

The consequences of this recession for youth today pale in comparison to what they will face in the future. The taxes necessary to pay the debts accumulated today will impose a crippling burden on future workers. Today's youth face the prospect of becoming a debt-paying generation who spend their working lives paying off the debt incurred by their parents and grandparents – truly a lost generation.

Difficult Youth Job Prospects

Unemployment has risen across all demographic groups in the recession, and especially for youth. In December 2007 the seasonally adjusted unemployment rate for workers between the ages of 16 and 24 stood at 11.8 percent. By April 2010 it had risen 7.8 percentage points to 19.6 percent: roughly 60 percent greater than the increase in overall unemployment. The figures are worse for teenagers: 25.4 percent of teenagers who want jobs cannot find them.

Disproportionately high youth joblessness is not surprising in a recession. Youth unemployment usually rises more than overall unemployment during economic downturns.[1]

Recessions hit younger workers harder because they have relatively few skills and less experience, making them less productive employees. Employers looking to cut back on their workforces target lower-skilled workers first, both because they contribute less to the enterprises' success and because they are easier to replace when the economy picks up.

New entrants to the labor force face an added difficulty: hiring has dropped sharply in this recession.[2] Many businesses responded to the economic uncertainty by freezing planned expansions. Layoffs also rose substantially as companies struggled to stay afloat but they have now returned to pre-recessionary levels. Hiring has not.[3] This disproportionately hurts young workers looking for work after finishing their education – there are fewer new jobs for them to find.

Long Term Consequences

High youth unemployment has serious long-term consequences. Workers who start their careers during a recession have less bargaining power to ask for higher wages. Studies show that such wage differences persist throughout their careers.[4]

Workers who begin their careers in a recession are also more likely to wind up in jobs they are less suited for; they take the best job they can find. Unfortunately this permanently affects their careers. A study of college graduates before, during, and after the 1981-82 recession – the last recession as deep as the current downturn – found that workers who graduated in the recession had lower earnings 15 years later and were less likely to work in desirable occupations.[5]

Other studies point to the same conclusion. Higher minimum wages disproportionately reduce teenage employment. An examination of teenagers in states that raised their minimum wages above the federal rate found they earned lower wages

---

[1] M. Elsby, B. Hobjin, and A. Sahin, 2010 "The Labor Market in the Great Recession" Brookings Papers on Economic Activity, Table 1 at http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2010_spring_bpea_papers/spring2010_elsby.pdf

[2] James Sherk, "The Cause of High Unemployment: Still Due to Dwindling Job Creation," Heritage Foundation Backgrounder #2392, March 24, 2010 at http://www.heritage.org/Research/Reports/2010/03/The-Cause-of-High-Unemployment-Still-Due-to-Dwindling-Job-Creation

[3] *Ibid*.

[4] George Baker, Michael Gibbs & Bengt Holmstrom, 1994. "The Internal Economics of the Firm: Evidence from Personnel Data," *The Quarterly Journal of Economics*, MIT Press, vol. 109(4), pages 881-919, November

[5] Lisa Kahn, 2010, "The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy," *Labour Economics*, Volume 17, Issue 2, Pages 303-316

and held fewer jobs up to a decade later.[6] Youth pay a lasting price for forgone experience.

The long-term effects of recessions on youth are not entirely negative. Poor employment prospects spur some students to go to college who would not have otherwise done so. Each percentage point increase in the unemployment rate increases the youth probability of completing college by approximately one percent.[7] However the benefits of this additional schooling do not outweigh the costs on future employment prospects.

Youth Employment Programs Ineffective

Congress should resist the urge to respond to the recession by expanding youth employment or training programs. These programs are well intentioned. Unfortunately evaluations show that they accomplish little.

Evaluation studies that randomly assign some workers to "treatment" groups that receive job training or employment subsidies and put other workers in "control" groups that do not provide the strongest statistical evidence on whether programs work or not. Program evaluations show that such measures sometimes raise adult earnings and help adult workers find jobs. However, program evaluations almost universally conclude that U.S. youth employment programs accomplish little.

The youth programs in the National Supported Work Demonstration, the Job Training and Partnership Act, and the JOBSTART program all failed to increase in youth employment or earnings. In some cases the estimated effects were actually negative – youth were worse off with the training than without it.[8]

The best known American youth employment and training program is Job Corps. Job Corps also provides little long-term benefit to the youth it serves. Four years after Job Corps youth who went through the program earn average wages of just $0.22 an hour more than their peers who did not. By year five even these modest gains have disappeared. Job Corps only improves job finding in the short term. In the long term Job Corps participants have no greater likelihood of working than youth who did not attend. Some data sources even show Job Corps slightly hurts long-term chances of holding a job.[9] At a cost to taxpayers of over $16,000 a participant and $1 billion a year, Job Corps has been a costly failure.

---

[6] David Neumark and Olena Nizalova, 2007. "Minimum Wage Effects in the Longer Run," Journal of Human Resources, University of Wisconsin Press, vol. 42(2)

[7] Lisa Kahn, 2010, "The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy," *Labour Economics*, Volume 17, Issue 2, Pages 303-316

[8] James Heckman, Robert Lalonde, and Jeffrey Smith, 1999. "The economics and econometrics of active labor market programs," Handbook of Labor Economics, in: O. Ashenfelter & D. Card (ed.), Handbook of Labor Economics, edition 1, volume 3, chapter 31, page 2056.

[9] Peter Schochet, John Burghardt, and Sheena McConnell, 2008. "Does Job Corps Work? Impact Findings from the National Job Corps Study," American Economic Review, American Economic Association, vol. 98(5), pages 1864-86, December

The billions that Congress has spent on youth employment programs have done little to help those youth succeed later in life. As Nobel laureate James Heckman summarized the research, "we believe that neither the experimental nor non-experimental literatures provide much evidence that employment and training programs improve US youths' labor market prospects."[10]

The European experience provides little more encouragement. Europe has had higher unemployment – and especially youth unemployment – than the United States for most of the past 30 years. Measures to reduce youth unemployment have thus been a particular concern for European policymakers. Evaluations of these programs find them similarly ineffective: public training, wage subsidies, and direct government job creation all fail to improve European youth labor market prospects.[11]

The Swedish experience provides a particularly important lesson for Congress. In the early 1990s Sweden went through a severe downturn and unemployment among 20-24 year olds increased from 3 percent to 18 percent in just three years. The Swedish government responded by creating new large scale programs to help youth find jobs. The youth practice (*ungdomspraktik*) program provided employment subsidies for unemployed youth where the government paid part of the cost of their wages. Sweden also created large new job training programs to improve unemployed youths' skills. Hundreds of thousands of Swedish youth utilized these programs in the early 1990s.

How much did these programs help Swedish youth? Those who went through these programs had lower earnings and a smaller probability of holding a job a year later than those who did not. By the second year the situation improved – program participants had no better or worse wages or job prospects than non-participants.[12]

Program evaluations consistently find that government funded youth employment measures do little to improve the labor market outcomes of disadvantaged youth. Congress should carefully examine any proposed expansions of youth employment programs to ensure they do not waste taxpayer funds.

Strong Labor Market the Best Solution

The best way for Congress to improve the job prospects of America's youth is to focus on improving overall unemployment. Recent economic research confirms President Kennedy's argument that "A rising tide lifts all boats" – the employment prospects of young workers are strongly pro-cyclical. Unemployment among less skilled workers rises much faster than the overall unemployment rate in recessions. When the economy recovers, however, unemployment among less skilled workers recovers at a faster rate as

---

[10] James Heckman, Robert Lalonde, and Jeffrey Smith, 1999. "The economics and econometrics of active labor market programs," Handbook of Labor Economics, in: O. Ashenfelter & D. Card (ed.), Handbook of Labor Economics, edition 1, volume 3, chapter 31, page 2068.

[11] Paul Martin and David Grubb, 2001. "What works and for whom: A review of OECD countries experiences with active labour market policies", *Swedish Economic Policy Review*, Vol. 8 pp. 9 - 56.

[12] Laura Larsson, 2003. "Evaluation of Swedish Youth Labour Market Programs." *The Journal* of. *Human Resources*. Vol. 38, No. 4., pp. 891-927.

well.[13] During the economic boom of the late 1990s the employment prospects of most groups of low-skilled workers – including youth – improved substantially.

Congress should focus on policies that will encourage entrepreneurship, investment, and wealth creation. This will spur employers to create jobs as they take advantage of these opportunities, increasing the demand for labor and giving them more reason to hire less skilled workers.

Congress has no silver bullet policies that will improve the labor market overnight. However, Congress can take several concrete steps to encourage private sector investment and job creation:

- **Eliminate Costly Regulations.** Many government regulations raise business costs while providing little benefit. For example, Section 404 of the Sarbanes–Oxley Act requires publicly traded firms to have an annual external audit of their financial controls. This regulation provides little benefit to shareholders, but it costs an average 0.5 percent of revenues ($1.5 million a year) for small- to medium-sized companies. Nationally, Section 404 costs the economy $35 billion a year.[14] Eliminating such regulations would reduce business operating costs, raise profits, and spur new investment.

- **Domestic Energy Development.** Federal law and regulations heavily restrict domestic energy production. Congress could ease these restrictions and spur energy investment. Congress should consider permitting environmentally responsible oil and natural gas production in the Alaska National Wildlife Refuge, permitting oil shale development, and streamlining the licensing of nuclear power plants and the awarding of construction permits on federal lands. The Heritage Foundation has estimated that increasing domestic oil production by 2 million barrels a day would create 270,000 jobs.[15]

- **Suspend the Davis–Bacon Act (DBA).** Congress can better leverage the funds it spends by suspending an antiquated labor law. The DBA requires federal construction contractors to pay "prevailing wage" rates that average 22 percent above market rates. Under DBA, the government hires four construction workers for the price of five. Suspending DBA would allow the government to build more for the same amount of money, employing 160,000 additional workers in the process.[16]

---

[13] James Hines, Hilary Hoynes and Alan Krueger. 2001. "Another Look at Whether a Rising Tide Lifts All Boats." In A. Krueger and R. Solow eds. *The Roaring Nineties: Can Full Employment Be Sustained?* New York: Russell Sage Foundation

[14] Jiamin Wang, "Sarbanes-Oxley Section 404 Places Disproportionate Burden on Smaller Public Companies," Heritage Foundation Center for Data Analysis, August 2008, at *http://www.heritage.org/CDA/upload/SOX-CDA-edited-3.pdf*

[15] David Kreutzer, "The Economic Case for Drilling Oil Reserves," Heritage Foundation *WebMemo* No. 2093, October 1, 2008, at *http://www.heritage.org/Research/EnergyandEnvironment/wm2093.cfm*

[16] James Sherk "Davis-Bacon Suspension Would Fund 160,000 New Construction Jobs," Heritage Foundation WebMemo #2782, January 27th, 2010 at

Measures like these – which spur investment and economic growth – would do more to help low-skilled workers succeed than new youth programs.

Reduce the Minimum Wage to Spur Youth Employment

Congress has one straightforward and effective policy measure it can take to specifically target youth employment. Congress could suspend the recent minimum wage increase.

Businesses do not hire workers whose labor produces less than the cost of hiring them. Most economic studies unsurprisingly find that increasing the minimum wage reduces employment among low-skilled workers – it prices them out of work.[17] Although individual studies give different estimates, the typical results suggest that in normal economic times a 10 percent increase in the minimum wage reduces employment among heavily affected groups of workers by roughly 2 percent.[18]

The minimum wage disproportionately harms youth employment because many younger workers lack the productivity to command higher wages. About half of minimum wage workers are between the ages of 16 and 24.[19]

Businesses are especially sensitive to higher costs now; few businesses have the profits to pay higher wages out of. So they have responded to this minimum wage hike by reducing their overall payroll costs as much as possible. That has meant hundreds of thousands of fewer jobs for youth and has contributed to the overall increase in youth unemployment.

Putting these youth out of work causes lasting pain because the main value of a minimum wage job is as on-the-job training, not the low wage it pays. Few workers start at the minimum wage and stay there for decades. Rather, most workers take minimum-wage jobs as entry-level positions.[20] Minimum-wage jobs teach unskilled youth valuable job skills, such as how to interact with customers and co-workers or accept direction from

---

http://www.heritage.org/Research/Reports/2010/01/Davis-Bacon-Suspension-Would-Fund-160000-New-Construction-Jobs

[17] David Neumark and William Wascher, 2007 "Minimum Wages and Employment," *Foundations and Trends in Microeconomics*, vol. 3, no. 1+2, pp 1-182.

[18] See for example David Neumark, Mark Schweitzer, and William Wascher, "The Effects of Minimum Wages throughout the Wage Distribution," *The Journal of Human Resources*, Spring 2004, pp. 425-450; Stephen Bazen and Velayoudom Marimoutou, "Looking for a Needle in a Haystack? A Re-Examination of the Time Series Relationship between Teenage Employment and Minimum Wages in the United States," *Oxford Bulletin of Economics and Statistics*, Vol. 64, Supplement (2002), pp. 699-725.

[19] Department of Labor, Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers: 2009," March 1st, 2010 at http://www.bls.gov/cps/minwage2009.pdf

[20] David Macpherson and William Even, "Wage Growth among Minimum Wage Workers," Employment Policies Institute, June 2004, p. 3, at *www.epionline.org/studies/macpherson_06-2004.pdf*

a boss. Once workers have gained these skills, they become more productive and earn higher wages. Two-thirds of minimum wage workers earn a raise within a year.[21]

The minimum wage increase from $5.15 to $7.25 an hour has sawed off the bottom rung of many unskilled workers career ladders – higher minimum wages measurably hurt workers' job prospects up to a decade later.[22]

Congress could put these youth back to work by returning the minimum wage to $5.15 an hour until youth unemployment falls below 12 percent. This would spur employers to hire unskilled workers, creating hundreds of thousands of jobs without costing taxpayers a dime. It would provide youth with valuable on-the-job training and experience that will help them earn raises in the future.

Temporarily reducing the minimum wage would mean less pay for some minimum wage workers. However, relatively few of these workers rely on minimum wage jobs to support themselves – almost two-thirds of minimum wage workers work part-time.[23] The benefits of jobs and job training for hundreds of thousand of young workers outweigh these costs.

Debt-Paying Generation

The current recession and joblessness will do lasting harm to the careers of today's youth. However, it does not threaten to turn America's youth into a lost generation. Youth unemployment rose nearly as high as today in the 1981-82 recession but that did not consign the baby boomers to permanent poverty.

Today's youth could nonetheless become a lost generation for a completely different reason: because the burden of paying for this spending surge and the baby boomer's retirement will fall on them.

Federal spending is projected to grow dramatically as the baby boomers retire and draw on Social Security and Medicare. By 2050 the government will spend 17.9 percent of GDP on Social Security, Medicare, and Medicaid – an 83 percent increase over current levels.[24]

Paying for these entitlements will place a heavy burden on American workers. To balance the budget without reducing spending federal taxes would have to almost double. The bottom tax rate would rise from 10 percent to 19 percent, the 25 percent tax bracket

---

[21] *Ibid*., pp. 3 and 5, Table 1. Wage figures are adjusted for inflation.

[22] David Neumark and Olena Nizalova, 2007. "Minimum Wage Effects in the Longer Run," Journal of Human Resources, University of Wisconsin Press, vol. 42(2)

[23] Department of Labor, Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers: 2009," March 1st, 2010, Table 1 at http://www.bls.gov/cps/minwage2009.pdf

26. The Budget Chart Book, the Heritage Foundation, Heritage Foundation calculations using data from the Congressional Budget Office, at http://www.heritage.org/budgetchartbook/entitlements-consume-economy

would rise to 47 percent, and the top tax rate increase to 66 percent. Business taxes would rise from 35 percent to 66 percent.[25] State and local taxes would add to this burden.

The cost of paying for today's stimulus and bailouts adds to this entitlement burden. Dr. Edward Stringham of Trinity College estimates that the 2008-2009 bailouts and stimulus packages will cost the average 22 year old $145,900 during his working life -- $280 a month.[26] That is the equivalent of requiring college graduates to buy and throw out a high end iPod every month.

Today's youth will become a debt paying generation. They will spend their adult lives working not to get ahead but to pay off the debts of their parents and Grandparents. The Congressional Budget Office projects that – absent serious reforms – the debt burden will cause the growth in real GNP per person to slow in the coming decades and then start shrinking in the 2040s.[27]

Today's youth could become the first generation in American history to have a lower standard of living than their parents. The federal spending crisis – not the recession – most threatens the future of today's youth. Congress should hesitate before adding more spending to their burden.

Conclusion

The recession has badly hurt today's youth – unemployment has risen much more for workers aged 16 to 24 than for the overall economy. This will leave many workers with worse job prospects and lower earnings throughout their working lives. Unfortunately evaluation studies show that youth employment programs do not to improve youth job prospects. Increased funding for youth jobs programs would accomplish little beyond adding to the national debt.

The best way for Congress to improve the job prospects for youth and other low-skilled workers is to pass policies promoting entrepreneurship and investment that increase business demand for new workers. To specifically boost youth employment Congress could return the minimum wage to $5.15 an hour. This would spur business to hire hundreds of thousands of young employees and provide them with important experience and skills.

Fortunately, despite its costs, this recession does not threaten to turn today's youth into a "lost generation." Unfortunately the looming federal spending crisis does. Paying for the baby boomer's retirements without cutting spending would require raising middle-

---

[25] Peter R. Orszag, Director, Congressional Budget Office, letter to Rep. Paul Ryan (R-WI), May 19, 2008 at http://www.cbo.gov/ftpdocs/92xx/doc9216/05-19-LongtermBudget_Letter-to-Ryan.pdf

[26] Dr. Edward Stringham and Gavin Romm, Trinity College "Generational Theft Calculator," using default assumptions

[27] Peter R. Orszag, Director, Congressional Budget Office, letter to Rep. Paul Ryan (R-WI), May 19, 2008 at http://www.cbo.gov/ftpdocs/92xx/doc9216/05-19-LongtermBudget_Letter-to-Ryan.pdf

class income tax rate to 47 percent. Unless Congress acts today's youth will become a debt-paying generation.

****

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2009, it had 581,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2009 income came from the following sources:

Individuals	80%
Foundations	17%
Corporations	3%

The top five corporate givers provided The Heritage Foundation with 1.6% of its 2009 income. The Heritage Foundation's books are audited annually by the national accounting firm of McGladrey & Pullen. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own and do not reflect an institutional position for The Heritage Foundation or its board of trustees.