BUILDING WEALTH FOR GENERATION Z: HOW POLICY CAN HELP NEW LABOR MARKET ENTRANTS

ISSUE BRIEF BY **SUZANNE KAHN** | JANUARY 2021

INTRODUCTION

Since March, a steady stream of news stories has lamented the fate of the class of 2020, forced to enter the job market during the worst economic downturn since the Great Depression (Alter 2020; Pinsker 2020). Within a month of stay-at-home orders going into place in states across the country, 32 percent of all workers between 16 and 19, and 26 percent of those between 20 and 24, were unemployed. A quarter of young people between 16 and 24 were still unemployed in May as stay-at-home orders began to lift. By August, youth unemployment was still twice that of older adults (Inanc 2020).

For insight and precedent, much coverage about the unlucky class of 2020 has turned to the class of 2009—which only 11 years ago graduated into what was previously the worst downturn since the Great Depression. Unfortunately, the class of 2009's story mostly serves as a warning. The young people who entered the job market during the Great Recession are still experiencing its scarring effects. According to a report from the St. Louis Fed, as of 2016, people born in the 1980s had wealth levels 34 percent below what they would have had absent the Great Recession (Emmons et al. 2018).

The second major economic crisis in 11 years has demonstrated how holes in our social safety net harm new labor market entrants and young people—hindering their access to unemployment benefits and excluding them from COVID relief (Alter 2020). This is a significant problem, and patching existing safety net programs alone will not go far enough to fix it.

In the last year, we have seen renewed calls for jobs guarantees and paid family leave, but we also need to develop policies—for example, changes to the Social Security formula or subsidized employment—that help protect those entering the labor market during a recession from the long-term effects of that misfortune.

The social insurance system is meant to protect people from economic consequences of unpredictable life events beyond our control, like injury and illness. We also cannot control the external economic factors that shape our individual futures. Our existing social insurance system recognizes this: Unemployment Insurance (UI), for example, is designed to protect workers in the labor market from macroeconomic shifts.

But UI benefits exclude many young people and are not designed to address the long-term consequences particular to entering the labor market in a recession—such as weaker attachment to the labor market and wage losses that last over 20 years, significantly affecting young people's ability to build wealth.

A properly designed social insurance program could reduce the long-term effects of recessions on new labor market entrants, increase these workers' long-term attachment to the labor market overall, and stimulate the economy. This brief offers some suggestions for how this might work. Because the young people who suffer most from entering the labor market during a recession are young people of color and those with the least education, the proposals outlined here could also help address racial and educational disparities.

THE CHALLENGE

That the Great Recession was particularly harmful to young people and new labor market entrants was clear from fairly early on in the recovery. In 2010, the unemployment rate for recent high school graduates was 32.7 percent and only lowered to 31.1 percent by 2012 (Wething et aI. 2012). Policymakers did not ignore this crisis. Their response was to increasingly focus workforce training programs on young people while also encouraging young people to get postsecondary degrees with the aid of federal student loans (White House Council for Community Solutions 2012). This strategy left a generation carrying significant student debt when the COVID-19 economic crisis hit and ignored structural issues that individual training simply could not address.

Since the Great Recession, a wealth of research has provided us with a better understanding of what those structural issues are. Economist Lisa Kahn (no relation) found that for every percentage increase in the unemployment rate, college graduates entering the labor market see a wage loss of 3 to 4 percent a year. Eighteen years after graduation, the effect remained but had narrowed to roughly 2.5 percent. Kahn predicts that this adds up to a loss of close to $80,000 per year over the first 20 years of a person's career (Kahn 2006). A separate study found that a 3 to 4 point increase in the unemployment rate can lower initial pay about 10 to 15 percent below what those who start their career in a strong economy receive. After 10 years, the study estimated a cumulative earnings loss of about 5 percent for college graduates and up to 11 percent for high school graduates (Schwandt and von Wachter 2019).[1]

[1] The effects of graduating in a recession have been documented across countries including Canada and Spain.

There are multiple reasons for these depressed wages. First, entry-level wages are simply lower in a recession and, if the recession drags on, these already-low wages grow slowly. Yet, these early years are important for establishing a base; for the average individual, 70 percent of overall wage growth happens in the first decade of work. Second, those who enter the labor market during a recession generally end up at smaller, lower-paying firms that are worse matches for their skill sets. They have to switch jobs more often to make up for initial losses, and it takes years for wages to recover from this initial hit. Finally, studies have also shown that members of recession cohorts that enter the job market after graduating high school not only have lower wages than luckier cohorts but have low employment rates long after the recession ends (Nevisky 2006; Pinsker 2020).

While more education decreases the impact of graduating in a recession, there are also stark differences in impact based on race (Nevisky 2006). In 2007, the unemployment rate for white college graduates was 5.3 percent, but for Black college graduates it was 8.5 percent. During the Great Recession, the unemployment rate went up for both Black and white college graduates, but while for white graduates the rate never went above 9.4, for Black graduates it spiked all the way to 21.9 percent in 2010. (For Latinx graduates the unemployment rate went just above 15 percent at its height).

The wage loss experienced early in individuals' careers has long-term effects on wealth-building. Researchers have found that while almost every generation lost wealth during the Great Recession, younger families lost more and recovered more slowly. "As of 2016, younger families' median net worth was between 27 percent and 37 percent below 2007 levels, while retirement-age families' net worth was only 9 percent lower than similarly aged families" (Emmons et al. 2018). Here too we see disproportionate effects on young Black people. Recent data shows that the average wealth for Black millennials is around $5,700 in contrast to $26,100 for white millennials and $14,690 for Latinx millennials. Notably, wealth inequality for Black and white millennials was 2.6 times greater than income inequality (Emmons et al. 2019). These gaps have particularly concerning implications for the most diverse generation in American history.

The negative impacts of entering the workforce in a recession extend beyond earnings and wealth. Researchers have now also traced health effects to this particular brand of bad luck. Due to increased stress, rates of drug and alcohol abuse, as well as suicide and mortality rates, are higher among cohorts that enter the workforce during a recession (Schwandt and von Wachter 2019).

The social insurance system can and should ease the consequences of entering the labor market in a recession. This means recognizing the full scope of these consequences. Previous efforts—such as focusing job training programs on young people in the wake of the Great Recession or the "job entrant compensation payment" Democrats proposed in the early COVID stimulus package—have not gone far enough (H.R. 6379). While including young people in federal job training programs and the UI system is important, neither of these policies begins to address the long-term wealth and earnings effects of graduating in a recession.

POLICY RECOMMENDATIONS

A social insurance system that protects people from the bad luck of entering the job market during a recession should address long-term earnings and wealth losses, as well as long-term unemployment effects. Below are three ways the social insurance system could do this.

Social Security

The Social Security system's retirement benefits are designed to offer essential support to retired Americans. Because Social Security benefits are progressive and nearly universal, the program plays an essential, but far from sufficient, role in narrowing the racial wealth gap for retired Americans. According to one study by the Center for Retirement Research at Boston College, in 2016 Black households nearing retirement had 46 percent of the retirement wealth of a white household; but when Social Security was taken out of the calculation, the gap widened significantly, and Black families had just 14 percent of the retirement wealth of white households (Miller 2020). It is far beyond the scope of this brief to discuss how Social Security could better help close the racial wealth gap, but the success it has had in this regard does suggest that, with some tinkering, it could also address generational wealth inequality.

Currently, Social Security benefits are calculated as a percentage of a person's average indexed monthly earnings (AIME) during their 35 highest-earning years. This formula could be changed to increase the percentage of the AIME a person receives based on the national unemployment rate during the first 12 to 24 months in which they worked more than a certain number of hours a week or were actively looking for a job. The formula might also account for the length of the recession encountered and could even be changed to help cohorts that face multiple recessions early in their careers.

It is worth noting that if the benefit calculation changed based on when a worker started actively looking for a job, this change to the Social Security formula would work nicely with the addition of a job market entrant benefit to the UI system. Filing for such a benefit as a young person would log the start of job searching into the Social Security system for both the purposes of receiving the immediate job market entrant UI benefit and for later calculation of Social Security benefits at retirement.

A key function of wealth is helping individuals plan for their futures, especially retirement. Changing the Social Security benefit calculation can address the wealth effects caused by the bad luck of entering the job market in a recession.

Subsidized Employment

As discussed above, economists believe that the wage losses experienced by new labor market entrants during a recession result in large part from beginning their careers in lower-paying industries and at lower-paying firms, as well as from the increased difficulty of finding positions that match unique skill sets. A subsidized employment program that encouraged firms to continue to hire new labor market entrants in a recession could counter the reduced hiring caused by a recession and help young people start their careers in positions that better match their skills and long-term aspirations.

Under such a program, if unemployment rose above a certain level, the federal government could automatically begin subsidizing private employers to hire new labor market entrants. A recent study of 40 years of subsidized employment programs by the Georgetown Center on Poverty and Inequality and the Center on Poverty and Social Policy at Columbia University found that subsidized employment programs are an effective and underutilized strategy for increasing income and labor market attachment (Collyer et al. 2019). A targeted subsidized program for new labor market entrants could thus address two of the biggest negative effects of entering the job market in a recession.

Subsidized employment is not a substitute for a public-sector jobs guarantee. Rather, subsidizing employment at private-sector employers could complement a public-sector jobs guarantee while solving a different problem. A well-designed jobs guarantee is intended to put upward pressure on wages while addressing persistent, structural racial inequality in the job market (Flynn et al. 2020). In contrast, subsidized private employment for new labor market entrants could serve as a specific tool to help broaden the scope of new labor market entrants' options in a job search and thus improve initial placement and launch strong career trajectories earlier. These private-sector jobs would only be made better by the upward pressure placed on employers by a public-sector jobs guarantee.

In addition to addressing the long-term effects of entering the labor market in a recession, a program designed to bring young people into the labor market would have immediate and automatic economic stimulus effects. Further, it could counter the instinct to push young people to return to school during a recession—an instinct that produced unsustainable levels of student debt and drove the credentialization of the workforce during the Great Recession (Margetta Morgan and Steinbaum 2018).

Yearly Tax Credit

Another possibility for helping new labor market entrants while creating an automatic stimulus would be an automatic, specialized tax credit: If employment numbers were to dip beneath a certain level, a tax credit for new labor market entrants could be triggered. The tax credit could be structured to last 15 to 20 years (the typical length of recession wage effects on job-market entrants), tapering as recipients spend more time in the labor market and as wages rise. Structured in this way, a tax credit would get money directly to young people to stimulate the economy during the triggering recession and directly address the long-term wage loss job-market entrants experience in a recession, allowing them to build wealth at a similar rate to more-advantaged cohorts.[2]

POTENTIAL OBJECTIONS/QUESTIONS

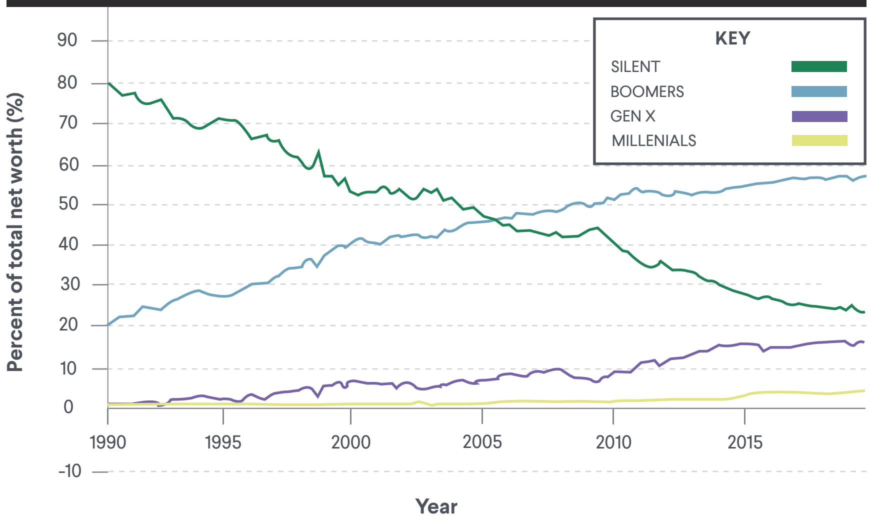
Why not just create better universal benefits?

A skeptical audience might ask why a new program should single out new labor market entrants for this sort of aid instead of focusing on making universal programs more generous, progressive, and accessible. For example, Social Security benefits at the lower end could be increased significantly; a universal public-sector jobs guarantee could address weak labor market attachment; and we could create automatically triggered, universal stimulus tax credits that decrease the higher up the income scale you go. Arguably, these proposals would help a larger group of people while also not wasting aid on those young people in unlucky cohorts who do just fine on their own.

[2] The appropriate response to the student debt crisis is reforming the system to create a free public college option while broadly cancelling existing student debt; however, an interim option that might be considered in the absence of this broad, needed structural reform would be a student debt cancellation plan that ties the amount of student debt cancelled to the economic conditions at graduation.

All of these are good ideas. More robust universal and progressive benefits are vital to creating a more equitable economy, but they will not address stark intergenerational inequities. As the chart below shows, when baby boomers were roughly the same age as millennials are today (1989/1990), they held about 21 percent of the US's total net worth. Today, millennials hold less than 5 percent of the US's total net worth (Hoffower 2019).

FIGURE 1. WEALTH BY GENERATION



Source: Federal Reserve

While millennials will catch up a bit as they age, they are starting way behind, even when accounting for their youth and the smaller number of millennials than boomers. The happenstance of when we are born affects so much of our futures, but its effects on earnings and wealth are something we can address in our existing social insurance system.

Moreover, addressing intergenerational inequality through our social insurance system can help prevent intragenerational inequality from completely reproducing itself. As baby boomers age, their wealth has already begun to be transferred to millennials; indeed, this has been dubbed "the great wealth transfer." But if this transfer proceeds on an individual level, it will recreate the inequalities embedded within boomer wealth. White families will transfer more wealth to the next generation than Black families. Socializing intergenerational wealth transfer can play a role in addressing the racial wealth gap.

Does this make sense for high school graduates entering the workforce? Shouldn't we encourage them to continue their training instead?

In 2009, the government tried to address youth unemployment by encouraging young people to go to school and earn degrees. Federal student loans helped young people do this and led to our current student debt crisis. Young people should be encouraged to continue their education as far as makes sense. The best way to do this is to create a robust, public, free college option. That said, it is also important to recognize that not everyone will attend college, and it is those with the least education who suffer the most and the longest from entering the job market in a recession. A program that left out high school graduates entering the workforce would be truly regressive.

CONCLUSION

Those who graduated into the Great Recession are still struggling to catch up; only a decade later, another generation of young people now faces the long-term consequences of entering the labor market in a recession.

It is essential that policymakers start to think about how to protect people from this particular form of bad luck. Individuals are no more able to control macroeconomic conditions than they are able to protect themselves from illness or old age. The social insurance system is meant to address exactly these sorts of problems. It's high time it did.

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