The labor market policy response to COVID-19 must leverage the power of age

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Labour markets around the world are experiencing an unprecedented crisis. Current government policies, both already in place and in preparation, are designed to support the hardest-hit workers and jobs. Their success is predicated on the assumption that the crisis will be short-lived. The world economy, however, is already experiencing clear needs for employment reallocation, towards activities that are either risky, essential or in growing demand. We propose a new policy framework to resolve the trade-off between protecting the most valuable match-specific capital and restoring the desired pace of healthy reallocation, the twin goals that we argued for in a previous Vox column. Our scheme leverages worker age. Younger workers face vastly lower health risks from COVID-19 and are naturally more mobile in labour markets. Middle-aged workers are at slightly higher health risk and possess the highest level of firm-specific human capital, taking into account the time left to use it. Older workers face extremely high health risk and have less time to recover any type of investment. We propose to tailor furlough subsidies, wage subsidies and unemployment insurance to worker age, to optimize the reallocation of employment in terms of both safety and productivity.

In our previous column, we argued that saving aggregate matching capital is a priority during the current COVID-19 crisis, and that government policy is called for to address a fundamental inefficiency of market equilibrium, the lack of commitment by firms and workers to reunite. But we also emphasized that the urgency of these measures should not interfere with the necessary and desirable reallocation of employment from impacted to essential sectors, some of which also present health risks to workers. More generally, reallocation is a massive ongoing phenomenon at the heart of market economies, and a major engine of productivity growth and welfare. While the news lament the astronomical number of newly unemployed workers, these still amount to just a few months of churning at normal pace. Reallocation is particularly pronounced in the US, where in an average month of 2019 close to four million employed workers switched jobs (Fujita, Moscarini and Postel-Vinay (2019)), even more left the labour force, 1.7 million lost their jobs and became unemployed, and about as many made the opposite transition (Bureau of Labor Statistics, Research series from the Current Population Survey). That is, in recent times every month about one in sixteen workers employed in the US separated from their jobs for one reason or another. While each of these flows tracks the business cycle, their sum is relatively acyclical, as more separations in recessions are compensated by more hires, despite a decline in the hiring rate. In Europe, transitions rates are notoriously lower, but still millions of people make some transition each month in an average-sized country. Many government policies implemented in the last two months in Europe and the US, mostly as blanket insurance to workers and businesses, are conducive to the goal of preserving matching capital, much less so to reallocation. In this column, we propose practical ways to improve upon emergency measures and address also reallocation.

Our proposal builds on the following observation: matching capital, worker reallocation, and COVID-19 health risk all have distinct, albeit different, age profiles. These correlations can be exploited to vastly improve upon current labour market policies, whether already implemented
(see our previous column) or being planned (such as, for example, The Paycheck Security Act currently sponsored by U.S. Sens. Sanders, Warner, Jones, and Blumenthal).

For health risk by age, a rough but useful statistic is mortality, the number of deaths per 100,000 residents. Deaths are harder to discount than cases and, if anything, missed COVID deaths would affect older groups and reinforce the argument. The US (CDC), UK (ONS) and Italy (ISS), some of the hardest-hit countries, report minuscule death rates for people aged below 35 (zero deaths to date among Italians aged 10-19), comparable with mortality from the flu, and astounding mortality and fatality rates for older classes, with an age profile that rises strongly after age 45. Health risks for younger workers do exist, but pale in comparison to other hazards that these people face in life, whether work-related or not. In addition to death, health risks are also very significant for members of the working-age population above 45, coinciding with the prevalence of comorbidities, which are associated to over 90% of hospitalizations and deaths. Moreover, by absorbing valuable hospital resources for weeks at end, older workers exert a negative externality on the much larger number of people who need health care for all sorts of reasons. Therefore, protecting older workers from COVID-19 is a public health priority.

In the economics literature, we observe similarly striking and robust age profiles that are relevant for the main trade-off between saving matching capital and reallocation. It is firmly established that younger workers are much more likely to either lose their job and become unemployed or to switch jobs. The turnover profile of workers is strongly declining in age until age 35 or so, and then mildly declines and stabilizes (see Rubinstein and Weiss (2006) for a survey of the available evidence). Job-to-job transitions, in particular, are an order of magnitude more likely among young workers. Job shopping occurs early and explains about half of wage growth in the first ten to fifteen years of a worker’s career (Bagger et al. (2014)). Therefore, the fuels for employment reallocation and for the build-up of “matching capital” are young workers, especially their job-to-job transitions.

Finally, age correlates positively with tenure on the job, which in turn correlates positively with earnings (see Altonji and Williams (2005) for a review of the literature). Whether the latter is due to the accumulation of firm-specific human capital on the job, or to selection of good surviving matches, is a long-standing, major research questions. In either interpretation of this stylized fact, however, longer-tenured workers have more firm-specific human capital, so our efforts to preserve it from the COVID-19 shock should be focused on them.

There is a third interpretation, that seniority premia exist for pure incentive reasons: firms backload compensation and reward seniority to motivate new hires to work hard and/or not to jump ship (Burdett and Coles (2003)). In this case, worker age, tenure, and pay would be unrelated to their human capital. But the empirical evidence in Fujita and Moscarini (2017) shows that firms are more likely to recall previously long-tenured workers after a jobless spell, and recalled workers are more likely to remain at the company thereafter than new hires. We cannot rule out that even these phenomena are part of a grand incentive scheme, as it was probably the case in 1970s car manufacturing, when long tenured workers were the first to be temporary laid off when a shift closed, and also received support from union funds. Still, this requires a formidable amount of commitment by the firm. Furthermore, incentive contracts would prevent precisely the high turnover of younger, less senior employees that we observe in the data. Therefore, we are fairly confident that tenure and pay correlate with firm-specific human capital and productivity, and society has more to lose from failing to protect older job matches. Accordingly, younger workers are much more mobile, and matches are mostly
shorter-lived and less valuable. The COVID-19 shock is very large, affecting productive and resilient matches, but is (hopefully) also temporary.

One exception to the importance of job tenure arises from job-to-job transitions. The theory of market equilibrium with on the job search (Postel-Vinay and Robin (2002)) emphasizes that voluntary worker transitions signal a strong selection, so a new hire poached from other companies can be immediately very productive in the new job, and this is why the worker switched jobs in the first place. Indeed, a simple regression of log earnings on age (or experience) and job tenure returns positive estimates on both, but larger on the former. For this reason, age, albeit still imperfect, is a more reasonable and easily observable criterion to evaluate the social value of a match than tenure alone. An even more refined criterion, reconciling both, may be work experience, including years of post-secondary education. A simple way to measure work experience is the contribution history to public pension systems, such as Social Security. So, we should aim to preserve the jobs of more experienced workers and let the less experienced workers fill the gaps that open up.

The current crisis demands a special type of reallocation. Local authorities in different countries utilize their own classifications of types of businesses, industries and occupations, to gradually re-open local economies. While these classifications are best suited to the reality of each local economy, we adopt here, for illustration, a unified framework, based on the best available data.

Following Kaplan et al. (2020), we classify sectors as either S(ocial), if demand depends on social interaction which is risky during the pandemic, or C (regular Consumption) otherwise. Examples are live entertainment (S) and agriculture (C). This distinction determines the differential demand impact of the crisis. Three-digit occupations are classified as Essential (E) and non-essential, as set by each local authority, for example by each US state following the Federal Government guidelines. Many authorities define “Essential” in terms of industry, rather than occupation. Three-digit occupations are further classified into Flexible (F) or Rigid (R), depending on whether they can be performed in telecommuting mode or not. The latter classification is based on Dingel and Neiman (2020). All Essential occupations are, by inspection, Rigid. So we have six groups: E-S (e.g., police), E-C (construction), R-S (some retail), R-C (engineers), F-S (teachers) and F-C (lawyers), where the last four are understood to be non-essential.

This classification takes into account the social aspect of an economic activity on the demand side. On the supply side, there are also social and health risk considerations for the workers to be on the job. For example, meat processing workers, often in the news lately, are a R-C occupation, but are still dangerous, because the workers, not the customers, must operate in close physical proximity. Mongey et al. (2020) offer a coarser classification along these lines, using the American Time Use Survey. We’ll say that some occupations are Hazardous (H) or not. Many essential sectors are Hazardous, but some (e.g., agriculture) are not. So, we have in total 12 groups. Another important criterion, that local authorities appear to be neglecting, and that can be measured from the ATUS, is commuting time, but we will ignore it too, for the sake of simplicity.

Policy must facilitate reallocation of employment, especially young workers, to Essential sectors and related occupations, and to R-S-H occupations that are only temporarily affected (many retail workers). The natural source are workers in Non-Essential R-S-H occupations, such as leisure and hospitality, which cannot be performed remotely and are Hazardous to both
workers and customers, and where demand is more likely to be directly and persistently affected. F-S occupations, such as teachers, may be more subject to temporary disruptions during lockdowns, and job protection there may be more valuable. R-C occupations, such as ground maintenance, and F-C, such as IT specialists, should receive no special support, unless they are R-C-H, such as food retail, which should be encouraged to hire young workers.

While in principle reallocation is desirable, it will be easier along paths of least resistance. Therefore, identifying large average workers flows between sectors and occupations in normal times will help to direct policies. If the reallocation between any pair of sectors or occupations is desirable, but very low in normal times, the distance in skill requirements might be too large and thus policies might be less effective in that specific direction.

We propose three main policy tools to direct employment reallocation: furlough subsidies to employers, to keep older workers on payroll during temporary lockdowns mandated by authorities for public health reasons; wage subsidies to younger workers in the socially desirable, but riskier, activities; and unemployment insurance add-ons for older workers who were working in activities that are likely to be persistently affected. These three tools should be deployed across sectors and occupations depending on where these fall in our classification. The definition of “older” should also be nuanced into three categories: young (below 35, high mobility, low health risk), middle age (35-44, low mobility, high human capital, long horizon to use it, moderate health risk) and old (45 and up, low mobility, high human capital, shorter horizon to use it, high health risk). Young workers should be targeted with “pull” instruments, such as wage subsidies and scarce support off the job; middle age workers should be the main target of European-style furlough subsidies, to keep them on payroll during lockdowns; and older workers should receive generous Unemployment Insurance, to stay out of the labor force if displaced from, or at health risk on, their job. Older workers, can, however, still work regularly in many Flexible and Non-Hazardous occupations. One limitation to this scheme is possible infection at home from young workers, who tend to be asymptomatic, to their older family members. Conclusive evidence of asymptomatic transmission and of widespread within-family transmission is still lacking. Supporting the incomes of young workers can only facilitate their ability to live independently.

A critical issue is implementation. The first UI intervention in the US encountered enormous bottlenecks at the state level, which should hopefully be resolved soon. European countries already have systems in place to subsidize furloughs and wages. The US Treasury can selectively forgive payments of Payroll and Medicare taxes, and the withdrawal of Federal income taxes that can be diverted from the employer directly to the worker paycheck, whether on furlough or at work. To this end, an interesting component of the Paycheck Security Act proposal is to leverage the infrastructure of payroll-processing companies. Payroll taxes are regressive, so their holiday also attains a redistribution goal. The Social Security administration has a complete record of workers contribution histories, hence experience, to supplement age.

We leave the specific sectorial configuration to local authorities. In this column, we lay out the general principle, along with concrete examples of occupations and age classes. The hardest determination is whether a S(ocially affected) sector suffered a temporary or persistent decline. Are people going back to dine in restaurants and fly around, until the health crisis is resolved? Current estimates put that goal-post at 8-24 months from now, depending on the discovery of effective and safe vaccines and antivirals or herd immunity. There is a chance neither will happen, and COVID-19 will become another seasonal pandemic, like the flu. At any rate,
keeping on life support, through furlough subsidies, sectors and occupations that are likely to suffer demand declines for many quarters is not socially desirable.

Real-time surveys of the state of the labour market can provide market-sourced information. Several of these surveys (Bick and Blandin (2020), Coibion et al. (2020)) are designed to measure job losses and unemployment, without waiting for the BLS monthly cycle. More relevant for our policy framework is the perceived persistence of the crisis, by job and worker characteristics. The National Tracking Poll #200495, conducted in the US between April 28-29 by Morning Consult, offers a first look from the worker side. Two thirds of interviewed workers directly affected by the crisis had not been contacted by their employers about returning to work. Worryingly, the share is much larger (79%) for the 35-44 age category, which is the one we argue is most worth protecting from separation, and lower for workers aged 18-34 (59%) and 45-65 (69%). So it appears that the market outcome is not going in the desirable direction. But, when asked if they expect to be recalled, about 70% answered yes in the middle and older classes, as opposed to 60% in the younger one 18-34, in line with the evidence in Fujita and Moscarini (2017) in normal times, although the difference across age classes now may be more modest. As we expected from normal churning, younger workers are already on the move: 18% of the younger, and 14% and 6% for the middle and older categories, reported having already found a new form of work. Finally, reported confidence in own skills and resources necessary for a successful career change is markedly higher among young workers. We conclude that our proposal would leverage both market and biological forces already at play, and direct them in the socially desirable directions.

REFERENCES.


