The Recession Generation

Those entering the workforce now will likely make less and save more—not just in the short term but for the rest of their lives.

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We all know the type of person who came of age in the Great Depression. They are the grandmothers and grandfathers who can't use a tea bag too many times, yet are enjoying comfortable retirements in warm climates. And we know what the children of the 1950s are all about. They are the optimistic boomers who embodied an age of continual upward mobility and possibility. They have often spent more than they earned, because for them it has been a truism that times can only get better. It's no accident that the psychology of entire generations is shaped by the milieu in which they grew up; economic research tells us that our lifelong behaviors are determined in large part by the seismic events—good or bad—of our youth. So, given that we have just experienced the worst economic period in 70 years, it's no surprise that people have begun to wonder what sort of consumers, investors, and citizens will be bred by the Great Recession. Will there be, in effect, a "Generation Recession" of young people whose behaviors will be permanently shaped by the downturn?

Some optimists—pointing to a recent spate of positive economic data, including increases in car sales, upticks in factory production, and a robust stock market, say no: the downturn simply hasn't been bad enough, for long enough, to create the next Depression generation. Yet there is powerful evidence that belies this argument; a National Bureau of Economic Research (NBER) paper released this past September looking at data from 1972 to 2006 shows that even one really tough year experienced in early adulthood is enough to fundamentally change people's core values and behaviors. Meanwhile, there's an entire body of research to show that recession babies not only invest more conservatively, they tend to make less money, choose safer jobs, and believe in wealth redistribution and more government intervention. Yet paradoxically, they are also more cynical about public institutions and, arguably, about life, embracing the European notion that success is more about luck than effort. To the extent that they grapple with unemployment, they are more likely to be more depressed and disconnected from their communities. Politically, they can skew either left or right, depending on the cultural zeitgeist and the leaders who seize the moment. Economic downturns, after all, not only created the New Deal, but also the Third Reich.

We have now technically emerged from recession. But there's a broad feeling that Americans' psyches and behaviors will be somehow permanently altered by the crisis. There's now a booming cottage industry among consultants and investment managers to describe and capitalize on "the New Normal," which will likely be the opposite of the hypercapitalist market culture of the past 25 years. That moment was perhaps most eloquently captured by former Clinton labor secretary Robert Reich in his 2007 book, *Supercapitalism*, and it's fitting that he is now working on a book titled *Aftershock*. "Every time we've had a major downturn, there have been predictions that Americans will permanently change their ways and embrace frugality," says Reich, now a professor at the University of California, Berkeley. "Since World War II, it hasn't happened." Yet Reich and many other respected academics, economists, and investors—from George

Soros to Pimco's Bill Gross to Goldman Sachs's chief economist Jim O'Neill—say that it will happen this time, not only because of the megashock of the financial crisis, but also because the global landscape has simply shifted in such a way that the American consumer will no longer be the single dominant force in the world, even if the U.S. economy continues to recover. Rather, the key emerging markets (read: China, India, Brazil, and others) will continue to emerge and become more powerful; the dollar will continue to weaken; American labor will continue to face more and more competition from abroad; and, thanks to a new era of big government, reregulation, and (possibly) protectionism, money flows will stay tight. Throw in the probable rise in inflation and you've got an inevitably slower-growth future in which Americans will also have to come to grips with average unemployment levels that will likely stay much higher than they've been in decades.

Unemployment and the specter of instability it creates will really shape the behavior of Generation Recession. A weaker dollar will make all Americans feel poorer by raising the cost of goods, but the young generation graduating and going to work now may actually end up poorer in real terms. Unemployment among 20- to 24-year-olds in the U.S. is more than 15 percent, compared with the nationwide average of 10 percent, and statistics show that for every percentage point in higher unemployment, new graduates take a 6 percent pay cut—an effect that lasts for decades. Skills loss could be a huge issue, too, especially because the average duration of unemployment has increased. Although wages in the U.S. have been relatively flat since the 1970s, Generation Recession may be the first in 30 years to see theirs actually fall.

The behavioral shifts resulting from the New Normal have, of course, already begun. The personal savings rate has more than quadrupled from its 2008 low to the current rate of 4.5 percent. Research done by AlixPartners found that Americans don't want to stop there, but hope to save 15 percent of their income going forward (they won't be able to, but the desire itself speaks volumes about their sense of insecurity about the future—particularly since the number has continued to rise even as the economy has improved). Half of those surveyed by AlixPartners have stopped investing in the markets altogether, and the majority say they won't put money into stocks for another three years; 43 percent don't expect the economy to ever recover to pre-recession levels.

The disconnect between these sorts of poll results and the recently improving economic data underscores another megatrend that Generation Recession will have to deal with: the growing divide between the fortunes of big American firms and the average American worker. Markets may be up, yet unemployment, while slightly down, is still at its highest level in decades, and even the most bullish economists believe it will stay higher than average for years to come. Large U.S. firms are well into the black, in part because of the labor-cost savings they've enjoyed from IT improvements and offshoring to cut expensive U.S. jobs, yet the small- and medium-size firms that generate the majority of new jobs at home have been hurt most by the financial crisis as their lines of credit have dried up. "We are in a very unique period, in which we're seeing the biggest disconnection between financial capitalism and the real economy since modern economies began in the 19th century," says Nobel laureate and Columbia economics professor Edmund Phelps, who runs the university's Center on Capitalism and Society. "That's not to say that banks don't fund some useful projects like wind farms or whatever, but increasingly they're existing in a virtual sphere in which they are more interested in funding each other, and developing complex securities, than in funding real businesses."

This division between capital and labor and the permanently high unemployment that it seems to encourage not only depresses wages, it depresses people; a large body of research shows they tend to withdraw from their communities and societies after being laid off (their spooked neighbors, encouraged to work ever harder, do too). Parental unemployment has huge negative consequences for children, making them more likely to fall behind in school, repeat grades, and exhibit anxiety disorders. During the Great Depression, such negative social consequences were partly buffered by a stronger civil society—attendance at churches, clubs, and community centers was greater than now. The worry today, say Reich, Soros, and political scientists such as Harvard's Robert Putnam, is that fearful, vulnerable people will become more easy prey for ugly class politics, being drawn, as Reich puts it, to "populist demagogues on either side of the political spectrum." Certainly during this recession there has been sniping at the usual targets of free trade and immigration. Many experts worry about the current trade and currency squabbles between the U.S. and China, which could easily spiral into the sort of protectionism that exacerbated the Great Depression. There could also be future political wars along demographic lines, as boomers worried about health care and Social Security fight for a shrinking slice of the public pie with younger people demanding more money for education and job training.

The situation could get even uglier if, as many predict, a depressed post-crisis landscape forces Americans to let go of the mythology of upward mobility. As Brookings fellows Isabel Sawhill and Ron Haskins point out in their new book, *Creating an Opportunity Society*, this myth hasn't been true for some time: by international standards, intergenerational social mobility in the U.S. has been falling since the 1970s, and is lower than in countries such as Britain, Sweden, and Denmark. As everyone from de Tocqueville to the producers of *MTV Cribs* has observed, Americans generally have a high tolerance for inequality. Yet that tolerance may wane as we enter a new age in which young graduates can't expect to do better than their parents—and one in which Wall Street is perceived as being able to continue business as usual while Main Street struggles. "Americans are OK with inequality," says Reich, who believes we are at a tipping point, "as long as they feel the system isn't rigged."

Unfortunately that feeling seems to be associated not only with this past year's massive bailouts and halfhearted efforts to regulate finance, but with recession itself. The NBER study examining the attitudes of people ages 18 to 25 who began their adulthood in economic downturns from 1972 onward found that they all tend to believe that success in life depends more on luck than on effort, and they have less trust in public institutions. This is an unfortunate attitude to breed in a generation that will undoubtedly have to live in an age of bigger governments working with more powerful international public institutions to forestall future financial and environmental disasters. It also has real-world economic implications. As Paola Giuliano, a professor at UCLA's Anderson School of Management and one of the authors of the study, notes, "People who buy into the idea of luck over effort tend to work less hard, and that lowers productivity, which of course can lower economic growth." Indeed, this may go some way toward explaining the often mysterious growth edge that "can-do" Americans have long enjoyed over "yes, but" Europeans, who tend to mock such Type A behavior. Whether Americans will eventually follow them is an interesting question: the Conference Board recently released numbers showing that U.S. job satisfaction is at its lowest level in two decades.

All this said, there are some glimmers of hope in the New Normal. For starters, a weakening dollar and huge productivity gains made in the past year could end up being a salvation for U.S. manufacturing. McKinsey estimates the U.S. could create 1 million jobs if the dollar depreciated by just 10 percent. Indeed, Global Insight chief economist Nariman Behravesh believes that American exports will rise by 11 percent a year between 2010 and 2013, compared with just 7 percent in Germany. Smart investors like Warren Buffett have bought into the vision: his $26 billion bet on the Burlington Northern Santa Fe rail line is clearly a gamble that in the New Normal more American workers will be holding wrenches and loading cargo (from solar panels to bags of grain) onto trains, à la the post-Depression generation, rather than fiddling with BlackBerrys.

And, if the current trend lines continue, Generation Recession may mirror Generation Depression in more profound ways. For example, more talented graduates may choose public service over the private sector, not least because then, as now, that's where the jobs will be. Happiness research shows that fewer choices tend to be more satisfying than endless ones. Just as our tea-bag-saving grandparents seemed to do fine with less, so might the children of this downturn. A number of consultancies, like BCG, have released studies showing that post-crisis, consumers are putting a greater value on time spent with family and friends than on money (a good thing when there's little of the latter around).

There's also a glimmer of possibility that hard times might make us nicer to each other. Kathleen Vohs, a consumer psychologist at the University of Minnesota, has shown that simply thinking about money made subjects less sensitive to pain, and less likely to help each other or want to connect with strangers. Perhaps rather than stepping over each other, 1980s style, on the climb to the top, we will stop to lend a hand. Certainly, we'll be more wary of falling down the ladder of life, and thus more empathetic, than our predecessors were. Generation Depression never stopped saving, and couldn't have conceived of buying into interest-only mortgages or flat-screen televisions on credit. It's likely that the generation coming of age today will also realize that things that seem too good to be true—from jobs that come with free lattes and signing bonuses to subprime derivatives—probably are.

With Jerry Guo in New York

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