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Where Are The Next Jobs Coming From?

Thomas F. Cooley, 02.10.10, 12:01 AM ET

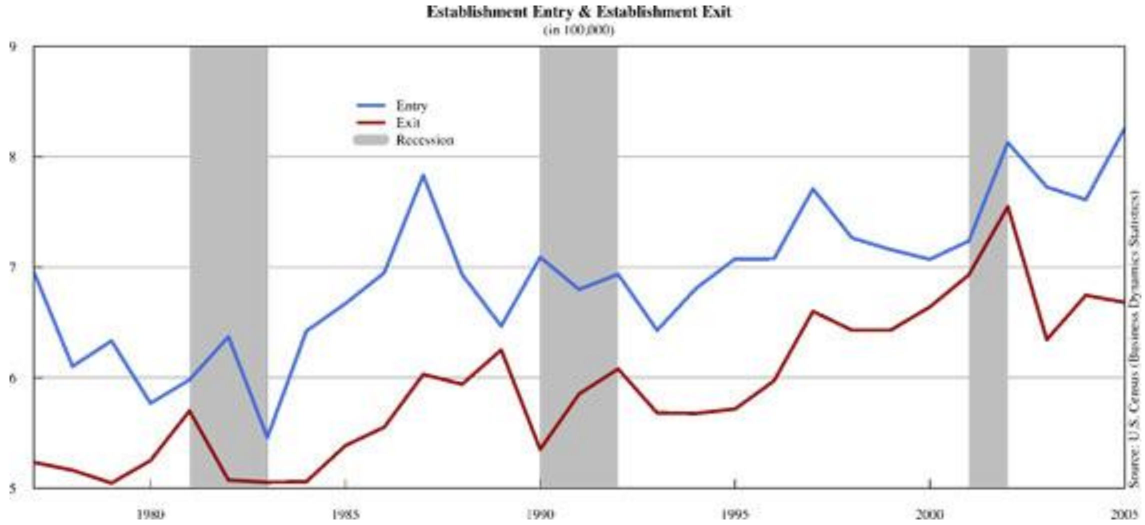
Last week Peter Rupert and I argued that the Great Recession continues in the labor market in spite of the signs of recovery elsewhere in the economy. We showed that the fraction of the working-age population that is employed continues to drop. Friday's employment report showed that net jobs continue to be lost. Many people look at the total number of jobs that have been lost in this recession and view them as gone for good or difficult to recreate. Where, they wonder, are new jobs going to come from, given that we are shipping more and more manufacturing and service jobs out of the U.S.? Will it be a jobless recovery?

Economists are quick to point out that the labor market lags the rest of the economy on the way out of a recession. This lag has become more pronounced in the last two milder recessions: Although the decline in employment was less severe than in the 1973 or 1981 recessions, the recovery took much longer. In this recession, as we illustrated last week, the drop in employment has been particularly severe. One of my favorite bloggers, David Altig, points out that the decline has been far more pronounced than in the E.U., the U.K., Japan and Canada. He also notes that those areas have experienced productivity declines, whereas we have experienced sharp productivity growth.

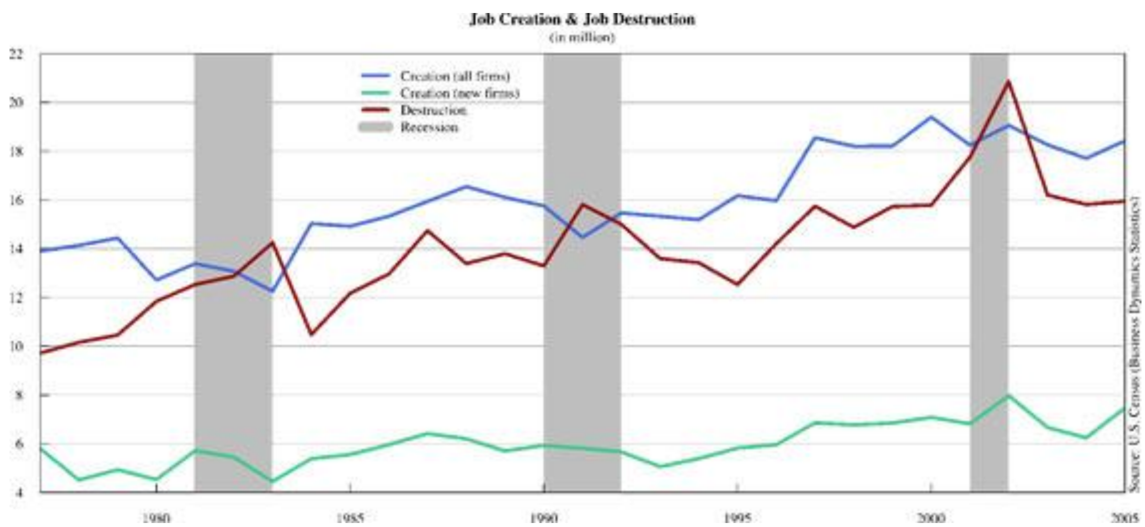
Many people have written loosely about creative destruction and the cleansing effects of recessions--meaning that the least productive workers and jobs disappear in a downturn. That is surely part of the story here. But the U.S. economy and U.S. labor markets are incredibly active, and one of the underlying reasons employment fell so sharply is that U.S. labor markets are so fluid. It is easier in the U.S. to start firms, hire workers, fire workers and enter new markets than in most other parts of the world. And the reports of 4 million jobs lost in 2009 and 7 million lost since the start of the crisis don't give you a full picture of how active the U.S. labor market really is.

To better understand the incredible dynamism of our labor market, consider a typical year: 2003. In that year, according to the Business Dynamics Statistics of the U.S. Census Bureau, 772,624 new businesses were created. At the same time 634,440 businesses closed. In that year more than 18 million new jobs were created, and of those, more than one-third--6,669,536--were created by new firms. At the same time more than 16 million jobs were "destroyed."

These numbers are huge and illustrate how adaptable the U.S. labor market is. Labor market flows are very high relative to the levels. It is one of the strengths of our economy. Figure 1 shows the pattern of firm entry and exit from 1979 to 2005.



Generally business startups are procyclical (2001 is an exception). Figure 2 shows the huge impact business creation has on employment.



Overall, business startups in the private sector account for something like 3% of total employment. This is a lot and these are all new jobs. Another database that shows the incredible flows in the labor market is called Jolts--Job Openings and Labor Turnover Survey. It tracks vacancies, hiring and separation in the labor market.

Another important feature of the market is that young firms, if they survive, have higher employment growth rates than established firms. Very young firms (one year old) have a net employment growth rate of about 15%, conditional on survival. Older firms (those that have survived for 29 years and longer) have a net employment growth rate of about 4% conditional on survival. It is also true that younger firms experience more employment loss because of exit. The pattern is one of very rapid growth for survivors but with a very high exit rate.

What all of this makes clear is that policies designed to create new jobs in the economy should be directed at encouraging new firms. What policies are those? Perhaps the most important issue for new and young businesses is financing. Access to credit markets is critical. When credit markets seized up in 2008 it was a dire period for many small and nascent firms. Lending to small business has declined a lot in 2009 but there are conflicting reports about why. Many small businesses claim it is hard to get credit but many lenders claim the demand isn't there.

The administration's policies do seem to be focused on increasing the access to financing for small firms. At the same time, however, they have created some very large sources of uncertainty that impact small businesses and those who would finance them. By pursuing a huge policy agenda without much success they have created large-scale uncertainty about health care costs, cap-and-trade policies, corporate taxes, taxes on incomes over $250,000 and estate taxes. At the same time they have been very slow to get through regulatory reforms that would provide us with a more stable financial system in the future. All of this is a huge deterrent to job creation and to the smooth functioning of our normally fluid labor market.

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