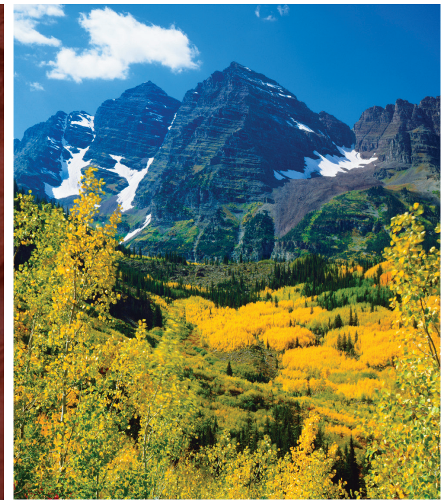
THE Rocky Mountain ECONOMIST:
Economic information for Colorado, New Mexico and Wyoming



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New Establishments and a Slow Return to Pre-Recession Employment Levels

by Alison Felix, Economist and Denver Branch Executive, and Sam Chapman, Assistant Economist

After almost five years of post-recession recovery, U.S. employment in May 2014 surpassed its previous peak. This return to pre-recession levels took longer than in previous recoveries, indicating employment gains have been slow to materialize since the end of the 2007-09 recession. New establishments, either a new location of an existing firm or an entirely new business, have traditionally been the largest contributors to overall net employment changes, and therefore any change in the rate at which new establishments are created will affect job creation. This issue of *The Rocky Mountain Economist* examines the decline in new establishment births during the recent recession and recovery and how this change has weighed on overall net job creation.

Dissecting Employment Growth in the Mountain States

Overall employment growth is a combination of two factors: job creation and job destruction. Therefore, employment growth can rise as the job-creation rate increases, the job-destruction rate decreases or a combination of both. Annual data releases from the U.S. Census Bureau, called the Business Dynamic Statistics (BDS), provide a source to dissect these two effects at the state level and to examine these components by the size and age of establishments.[1]

Apart from cyclical variations due to recessions and recoveries, a fairly consistent trend has persisted over the past three decades, with steady increases in both the levels

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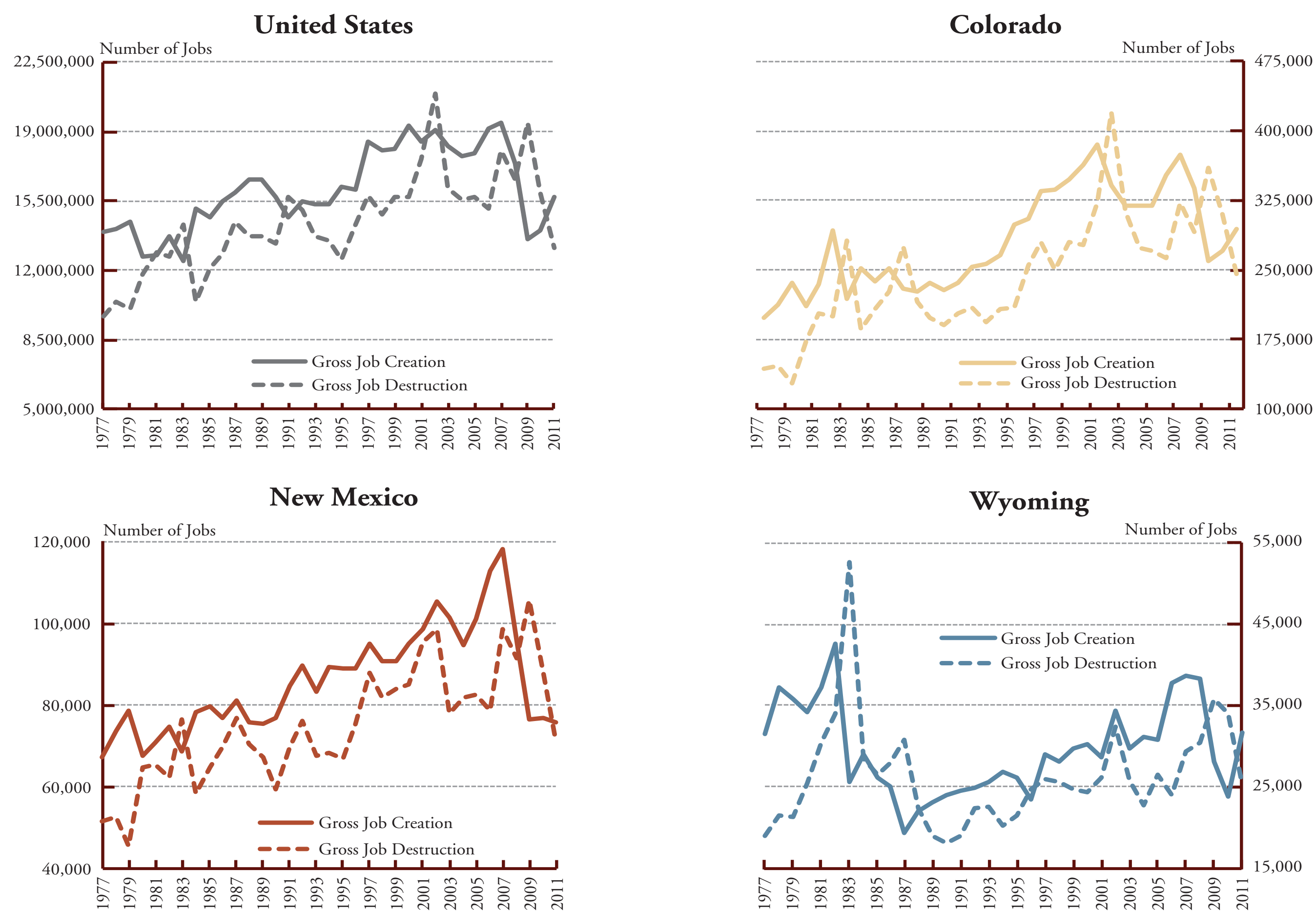
of job creation and job destruction. This reflects a growing population and workforce. As long as gross job creation remains above gross job destruction, employment levels will rise. However, during recessions, job creation typically falls to a level below job destruction, resulting in an overall decline in employment.

During the 2007-09 recession, employment levels fell sharply in the United States and the Mountain States due to both a large decrease in job creation and a large increase in job destruction (Chart 1). A similar pattern occurred during the recessions beginning in 1981 and 2001 although there were some notable differences at the national level and across the Mountain States. Across the United States and most of the Mountain States, the decrease in job creation during the 2007-09 recession was much larger than previous recessions. During the recessions prior to 2007, the increase in job destruction accounted for most of the decline in employment levels while the decrease in job creation played a smaller role.

Colorado and Wyoming also experienced sharp increases in job destruction during the recessions of 1981 and 2001. During the dot-com bust of the early 2000s,

Chart 1

Gross Job Creation and Gross Job Destruction



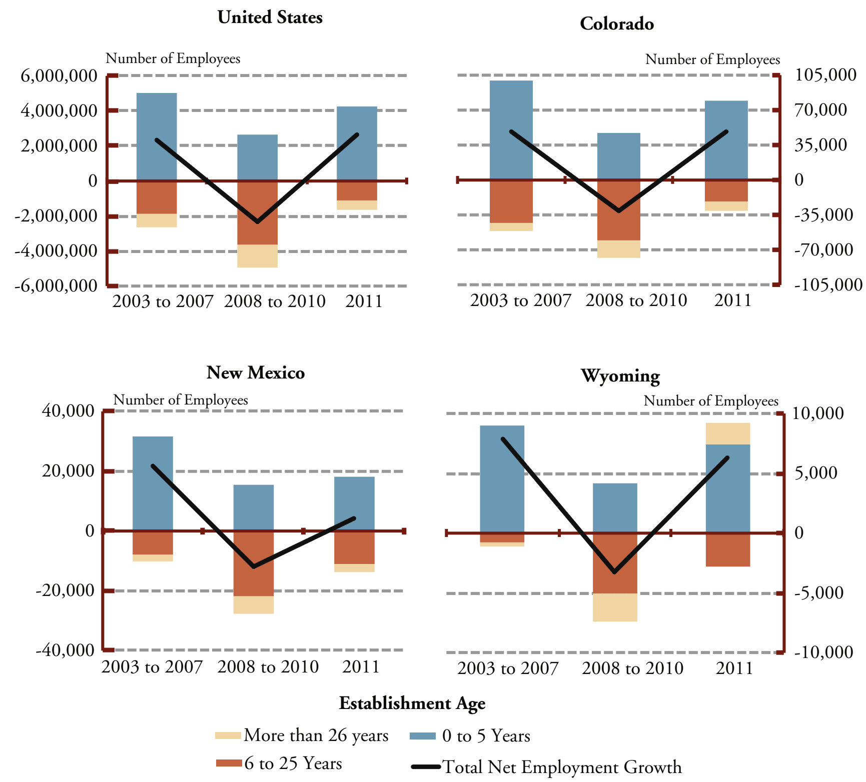
Source: U.S. Census Bureau's BDS.

Colorado's economy was hit much harder than the nation as a whole. In particular, job destruction increased at a faster pace following the 2001 recession in Colorado than during the 2007-09 recession. However, the decline in job creation was much more severe during the 2007-09 recession in Colorado because the recent national recession affected almost every industry in the state.

Wyoming's economy was especially hard hit during the 1981 recession and the years after. Chart 1 shows that after a sharp decline in job creation beginning in 1981, job creation levels in the state didn't approach prior peaks until the late 2000s. Job destruction rates also increased sharply during the 1981 recession but returned more quickly to normal levels following the recession. The severity of the 1981 recession in Wyoming was largely due to heavy reliance on a struggling international energy market.

Chart 2

Average Annual Net Employment Growth by Establishment Age



Source: U.S. Census Bureau's BDS.

Employment Growth by Establishment Age

To examine one potential explanation for the sharp decrease in gross job creation during the 2007-09 recession, employment growth can be dissected by the age of an establishment. Since publication of BDS data started in 1976, establishment data have suggested that young establishments, those open five years or less, are typically the only establishment age group that contributes positively to net job growth. For example, a new retail store (either an additional location of an existing concept or an entirely new concept) will have to hire many employees to run the establishment. After the initial hiring, the net change in employment will most likely be small unless the establishment closes or expands into a larger retail space. Of course, many older establishments add employees, but on net, older establishments over time have reduced staffing levels.

Chart 2 illustrates the importance of young establishments for employment growth, and shows the average annual net employment growth by establishment age during the years prior to the 2007-09 recession, during that recession and in 2011, the most recent available year of data. In all three periods, young establishments (represented by the blue bars) added jobs on net, while older establishments on net decreased employment. The black line shows the total change in net employment for all establishments. As the 2007-09 recession took hold, the United States and Mountain States experienced a significant drop in average net employment and net job losses from 2008 to 2010.

Net job gains rebounded to positive levels in 2011 in the United States and the Mountain States, with net job gains in the U.S. and Colorado exceeding pre-recession annual averages.

During the 2007-09 recession, establishments of every age were negatively affected by either slower net job growth or larger job losses. Young establishments experienced a sharp decline in net employment growth from 2008 to 2010. Although net job gains remained positive during these years for young establishments, the number of gains dropped by about half in the United States, Colorado, New Mexico and Wyoming. Net job creation also fell sharply among older establishments between 2008 and 2010, with job losses more than doubling for establishments more than 5 years old.

By 2011, net employment gains had improved across all establishment ages. However, net job growth for young establishments still remained well below pre-recession annual averages for the United States and the Mountain States. In contrast, at the national level, net employment growth exceeded pre-recession averages for older establishments. Among older establishments, improvement varied across the Mountain States, but net employment growth in all three states improved significantly.

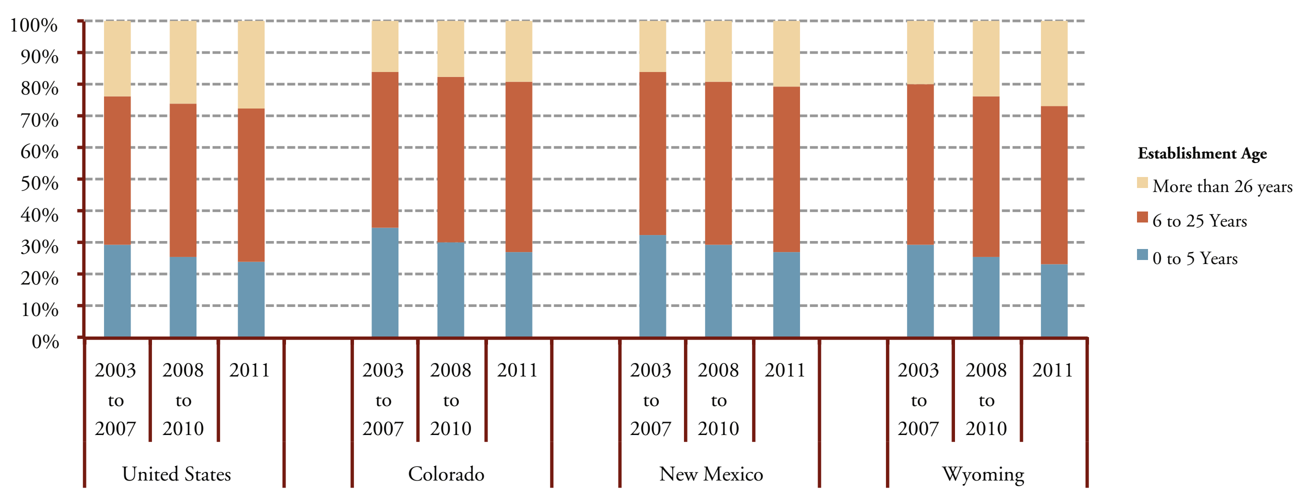
The 2007-09 Recession's Toll on Young Establishments

Although young establishments have traditionally been a key contributor to net job growth, older establishments continue to employ the majority of U.S. and Mountain States workers. In the years prior to the recent recession, young establishments employed 29 percent of workers nationally, while establishments aged 6 to 25 years and those older than 26 years employed 47 percent and 24 percent, respectively. However, since the recession started, the share of employment in young establishments has decreased (Chart 3). From 2003 to 2011, the share of employment in young establishments fell from 29 percent to 24 percent in the United States, from 35 percent to 27 percent in Colorado, from 33 percent to 27 percent in New Mexico and from 29 percent to 23 percent in Wyoming.

The decline in the employment share at young establishments is due in part to a decrease in the rate at which new establishments enter the market, commonly

Chart 3

Employment Shares by Establishment Age



Source: U.S. Census Bureau's BDS.

referred to as establishment births. Following the onset of the 2007-09 recession, the establishment birth rate declined sharply in the United States and Mountain States (Chart 4). Chart 4 shows the number of new establishments as a percentage of total existing establishments at the time of entry. The establishment birth rate dropped by more than 3 percentage points from 2008 to 2009 in the United States, Colorado, New Mexico and Wyoming. Although establishments have started to enter the market at a faster pace since the recession ended, establishment birth rates in 2011 remained well below pre-recession levels.

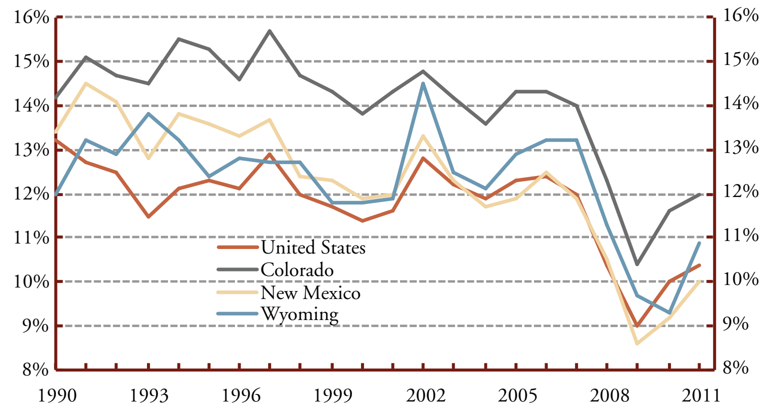
A decrease in establishment births in recent years has resulted in a historically low share of young establishments (Chart 5). By 2011, the share of young establishments had fallen to 37 percent nationally and 41 percent, 36 percent and 37 percent in Colorado, New Mexico and Wyoming, respectively. This rate has steadily been decreasing since 2007, but may rise in the coming years if new establishment births rebound.

Conclusion

Employment levels have been slow to return to peak levels following the 2007-09 recession. There have been many reasons for the slow recovery. This article highlights the effect of the decline in new establishment births on net job creation. Young establishments typically account for the majority of net job creation in the United States. During the recession, new establishments entered the market at a much slower pace. This slower entry rate has led to a sharp reduction in the creation of new jobs by young firms. Although birth rates for new establishments have started to increase, net job creation by young establishments has not returned to pre-recession levels. Overall, the rebound in job creation by young establishments has been slower than at older establishments, and this sluggishness among young establishments has contributed to a slower recovery of employment levels in the United States and the Mountain States.

Chart 4

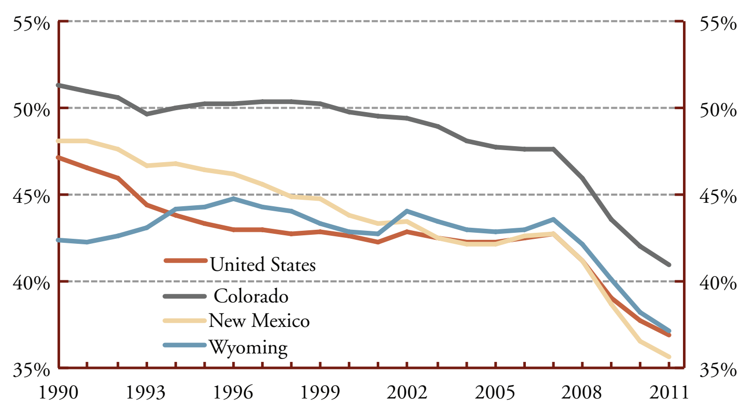
Establishment Births as a Percent of Total Existing Establishments



Source: U.S. Census Bureau's BDS.

Chart 5

Young Establishments as a Share of Total Establishments



Source: U.S. Census Bureau's BDS.

Endnote

[1] The BDS includes primarily private-sector businesses and only those that have paid employees. However, the following areas are excluded: self-employed, domestic services workers, railroad employees, agricultural production services, most government employees, employees in foreign countries and employees on ocean-borne vessels. This article will focus on establishment-level data, but the BDS also produces firm-level data. A firm can consist of one or multiple establishments, but all must be under the operational control of a single enterprise. A new establishment could be a new location of an existing firm (for example, building a new fast-food restaurant from an existing chain), whereas a new firm would be a new enterprise that does not have any existing establishments.