

General Discussion: Labor Market Fluidity and Economic Performance

Chair: Peter Blair Henry

Mr. Feldstein: Thank you. This is a very good paper very much in the Davis/Haltiwanger tradition. It raises the question whether there are government policies that reduce fluidity and therefore have the adverse effects that they refer to—and they give one answer to that, which I found very interesting, and that is the increased fraction of jobs that require licensing. Over the last few decades, from fewer than 10 percent of all jobs, to more recently nearly 30 percent, and indeed by some measures closer to 40 percent. I think it would be a good thing for economists to study how important each of these licensing requirements is and whether they are justified on a cost-benefit basis or whether their damage to macroeconomic fluidity and to productivity outweighs whatever it is that caused this dramatic increase in licensing over the last several decades.

Mr. Romer: I thought this was an insightful paper. The discussion of the facts and possible causes and of the advantages and disadvantages was very interesting. But I wasn't at all persuaded by the OLS estimate of the effects on employment. So the core is the IV estimates—and I have two concerns about them.

The first is the magnitude of the difference between OLS and IV. John and Steve give two reasons that OLS might be biased: one is

a story about of how OLS might be biased up, and the other is a measurement or story where OLS is biased down. When they do the estimation, the OLS estimates are about a quarter the size of the IV estimates. So, I think that means that to believe that the IV estimates aren't biased, I have to believe that the positive bias in OLS isn't there and that the measurement error conditional on the covariates is very, very large. I would love to see a calculation of what the magnitudes would have to be for that to hold and whether they're plausible, but my initial reaction is that I'm pretty skeptical.

The other concern I had about the IV estimates is the instruments. The core instrument is the fraction of young people in a labor market conditional on the covariates. For that to be a valid instrument, what we need is for the only way that the fraction of young workers in a labor market affects employment is through fluidity. But we can think of lots of reasons why it would affect employment. Fluidity would be on the list, but so would lots of other things. Concretely, the particular story Steve and John tell is that having a lot of young workers means that there are lots of badly matched people out there and potential good hires, so that firms create a lot of jobs. But that means it isn't an instrument for fluidity; it's an instrument for job creation. If you tell me that job creation is good for employment, I'm on board with it—that's wonderful, but that's not telling me that fluidity is good. That's saying that something that gives firms an incentive to create a lot of jobs is good for employment. I think that is what they are picking up in their estimates—or potentially other things going on with their instruments—but I don't think they're picking up fluidity.

Ms. Groshen: We have seen a decline in labor share outputs in recent decades that has been pretty strong and also part of what John and Steve talk about, rising number of large firms in certain industries, concentration in those industries, we have seen an increase in wage volatility, all these combined. One indication of this is decline in workers' bargaining power in the U.S. within firms. So, why wouldn't we think that the decline in reallocation maybe reflects higher employer confidence and security, allowing them to use other means of adjustment to demand shocks rather than those that are

associated with worker flows and changing wages, avoiding the tougher measures that might improve productivity more.

Mr. Hubbard: Very interesting paper. Like Richard Rogerson, I would have started with thinking that productivity would have been the first order issue. Thinking about policy related to employment calls to mind regulatory issues of the sort Marty Feldstein raised and also fiscal policy, particularly the way we treat older workers for tax purposes, disability and so on. My question for you is the following: Do your results have any implication, whether it is your fluidity hypothesis or this broader view that Ned Phelps calls dynamism, for aggregate demand policies generally or monetary policy in particular? I'm hard-pressed to take for the Federal Reserve an implication from your work other than as a cautionary tale; I see little reason to expect that Fed policy would affect fluidity or dynamism.

Mr. Haltiwanger: I want to thank Richard in particular for superb comments and obviously lots of good questions and comments from him and others. Good news is that there are so many questions that I'll avoid some of the harder ones. So, let me start, because it came up in the last question, but also Richard raised it—let's talk a little bit about productivity. There is strong evidence that a large share of productivity growth in the United States is associated with moving resources away from less-productive to more-productive businesses. That is, reallocation plays an important role in innovation and growth. Related to this, Richard noted that one puzzling aspect of our evidence at first glance is there has been a decline in the pace of job reallocation at least back to the 1980s but we know that there was a surge of productivity in the late '80s and through the 1990s. The obvious question is how are we to reconcile this evidence? Here is where you kind of need to look under the hood a little bit in the nature of job reallocation and the decline in business dynamism. The structure of that change has changed pretty dramatically over the last couple decades. In the 1980s and 1990s, a large fraction of the decline in reallocation, and also this decline in entrepreneurship that dates back to these years, was concentrated in sectors like the retail trade and the service sectors. These were sectors in which, particularly in retail trade, there was a shift away from Mom & Pop to

Wal-Mart. For this period, the evidence suggests that this decline in entrepreneurship and dynamism, if anything was not productivity detracting but productivity enhancing. The business model that the large national chains use is quite different and more productive than the Mom & Pops. But since around 2000, we have seen a shift in the nature of the decline in entrepreneurship in key sectors for innovation and productivity growth such as the high-tech sector. Interestingly, the high-tech sector exhibited an increase in the pace of reallocation and entrepreneurship through 2000. Since the early 2000s, that sector has been one of the sectors with the largest declines in both entrepreneurship and reallocation. This is a sector where the evidence suggests that innovation and productivity growth is closely linked to creative destruction and the role of young businesses. So to respond to Richard's question, I think we can broadly say that the decline in reallocation prior to 2000 is associated with a change in the business model that are productivity enhancing while the changes since 2000 are in sectors where the decline in entrepreneurship and reallocation is likely associated with a decline in productivity.

A related point on Richard's comments is while we have seen a long-term decline in job reallocation, which I just described as a changing structure, we actually have not seen quite the same long-term decline in worker flows. So worker reallocation, if you look at our first chart, only really started to decline in 2000 as well. Churn was growing during the 1990s rather than declining. I think that both of those factors suggest whether we are talking productivity or our employment hypothesis, we should especially expect these effects to be present in the post-2000 period. Richard also talked about us putting asterisks on our results in terms of our explanation for the decline in employment rates and I'm OK with putting asterisks on this aspect of our results. We view our work in this area as a useful starting point. We were struck by two related empirical patterns that pushed us in the direction to write this paper. One is, in terms of the decline in employment rates, we know it's especially the less-skilled and young workers, where we see especially large declines. Once we started to go look at this decline in worker reallocation rates we were struck that there were especially large declines in the less-educated and young workers. So it was partly that, that pushed us in this

direction empirically. In terms of underlying theory, there are certainly antecedents in the theoretical literature as to why you might expect employment rates and fluidity to be connected and Steve and Richard both talked about this literature. We also agree with Richard and with many of the other commentators that there are many interesting research questions that our paper raises. For example, we think that studying the role of licensing is a superb idea and we would like to do that. We also are sympathetic to some of the concerns Richard and others raise. For example, Richard argued that we need to be careful using elasticities that we estimate from spatial variation and necessarily just applying them to the aggregate. We are sympathetic to that concern, that there are general equilibrium effects—most of us in this room say that we are macroeconomists, so we agree we should worry about general equilibrium effects. Having said that, I think that the effects that we identified suggest, again along the line of Richard's comments, that our hypothesis for the decline in employment rates should be on the list of possible explanations.

I will also respond to his other comments briefly. He suggested that a good exercise would be to estimate the model through 2007 and then project the effects post-2007. We actually do some robustness analysis along those lines, in one of our many Appendix tables, and we actually find results that are largely supportive of what we report in the main paper. I also very much liked his last comment. It's not something we made a lot of progress on, but I think very much rings true. This is what I'll call the resilience point. Fluidity enables us to move resources from less-productive to more-productive uses. Fluidity enables moving jobs away from less-productive to more-productive businesses. It enables workers to be able to move from not-so-good matches to better matches. So it plays a very important role in the ability of the economy to adjust to shocks. This implies that in an economy with reduced fluidity that if there is a big shock then the economy will be take longer to adjust because of the decline in resilience. One might view this is what happened in Europe following the early 1980s recession and perhaps because of the same difficulties in terms of low fluidity. The hysteresis effects from that period may be related to what is going on in the U.S. today. On a related point, this connection between fluidity and resilience makes the difficulty of

distinguishing between the secular and cyclical dynamics that much harder. You can't just do a simple decomposition between secular and cyclical dynamics.

We also got pushed very hard on our IV strategy. We are sympathetic that again, we view our results as a useful start. A couple of points. One is if you look carefully in our specifications, we have lots of controls in our specifications to deal with a lot of the issues you might think of as concerns. We actually think our OLS estimates, even though smaller, imply large and statistically significant effects. We are also sympathetic that finding good instruments for this type of macroeconomic analysis is typically difficult. We did consider a range of instruments. Steve did not have a chance to talk about an alternative set of instruments that don't have to do with using demographics but rather are a form of Bartik instruments. Those latter instruments use national variation in the reallocation rates excluding the own state and the legacy industry mix of the state. We find our results are robust to using these alternative instruments. So we are sympathetic to David Romer's concern that there may be many mechanisms related to why the aging of the population has an influence on employment rates. But even here it is important to emphasize we are focusing on within group variation in employment rate. That is, we are not using the aging of the population as a way to account for the overall decline in employment rates from composition effects. Instead, we are using the aging of the population to account for within age group changes in employment rates, which is a more subtle relationship.

Mr. Gurria: Just to say I would not place an asterisk. I think this is pretty substantial, consistent with our own findings about what are the most important features of a good labor market. We think decline and churning in reallocation is a recent feature and that it also of course affects productivity increases or the possibility of increase in productivity particularly when we are looking at knowledge-based or more knowledge-based economy and the importance of services and moving forward. We think that because the decline in churning was amplified by crisis but we saw a long time before the crisis, we do have some evidence, that it is something I think may have happened

in other countries, not just the United States. For example, the reconfiguration of the supply chains in the retail sector—that is something that happened throughout, not just the United States. It took a little longer in some countries, but one would imagine the trend would be along the same lines. It is also very important because young firms are the ones that are providing new jobs. It is not whether they are SMEs—actually all SMEs are destroying jobs in many cases and size of company is not important—it's really new companies, start-ups, and again that seems to cut across countries; we have some evidence about that. The importance of job creation and for that reallocation and for that some kind of churn is important and of course on the policy side the question of looking at the level of rigidity in the labor market is crucial, rigidity in the product markets and there is something else that has to do with labor policies and social policies and that is there are going to winners and losers in this reallocation and the question of taking care of the losers, allowing them to be able to reinsert, it needs a special deliberate policy focus, is not going to happen by itself otherwise we will add to the armies of long-term unemployed. Yes, the crisis was of the less skilled, young and male and this will exacerbate if policy is not focused on. The other thing of course is the dualism in labor markets is being exacerbated by this phenomenon so by all means I would not put an asterisk on it. I would place a very important mark on these as part of the issue, certainly not the only issue, about how we are where we are today and what we need to do policy wise, but I think this is a very meaningful contribution, thank you.

Mr. Spriggs: I want to pick up on Angel Gurriá's last comment. It strikes me for purposes of this conference your paper is constructed for the following reasons: if we have this secular decline in new firm formation and we think about the world as risky, assessing what are the costs if we slow down the economy versus what are the benefits is a useful framework. It strikes me that you are pointed to way-higher costs if economic growth slows because obviously if we slow down we are going to have fewer new firms, they won't develop in a slower economy. You show a broad-based effect on workers, while it is true in your data it is disproportionately younger workers and less-educated men who take the brunt, but you show across the board a

decline in reallocation of workers. If there is a lot of churning, you could imagine the cost of having higher unemployment means that it may be broadly shared or maybe one or two pockets, but you can say the cost is not really long endured, because there are just transient. This is saying no, that actually we are going to impose a pretty broad-based, high cost of being unemployed, and it isn't as if one can simply avoid the costs of unemployment by being better. For all your education groups, the reallocation to new jobs is becoming a more difficult problem to overcome. So it strikes me your paper is really important for understanding how to balance the cost of slowing economic growth. The cost of slowing down, it strikes me from your paper, are exceedingly high and will get higher because of a secular decline in new firm formation and the slowing in the reallocation of workers. I think it gets to Richard's point before we go off assuming your paper is a manifesto for business-friendly policies. I don't think we can leap to using your paper as evidence that we need more supply-side interventions. I think his asterisk on that is very important. But from a macro perspective, since the Fed does not get to control the "business-friendly" things, whatever they are, from a macro perspective, Richard's point is really key.

Finally, just as an aside, I would say licensing may not be bad at all. A large share of the licensing is because that we have had a very high shift toward healthcare, which is highly licensed. Workers in that industry have great mobility because of licensing. Workers in manufacturing find themselves in a very different position, when they lose their jobs trying to defend their credentials and experience the lack of uniform credentialing makes it very hard. We have lots of churning going on inside the healthcare industry between hospital-based care and outpatient facilities and actually it means it's easy to reallocate registered nurses and other practitioners because they have that license within the industry. It's very difficult for workers across industries, but within the industry it's actually helpful.

Mr. Haltiwanger: I very much liked the comments about the role of young businesses and again let me reiterate the changing nature of decline in young businesses. I already talked about retail trade versus the high tech. The other thing we know about young businesses is

that they are very important for net job creation in the United States but in a complex manner. What happens to most start-ups in the United States? They fail. Conditional on not failing, what happens to most of them? They don't grow. But there is a relatively small fraction that takes off and contributes substantially to job growth. The high growth firms are connected to the creative destruction in innovation that we think are important. We note that in the post-2000s period, we saw evidence that the role of young businesses' contribution to growth diminished. In particular, we saw evidence that high growth young firms contributed less to job creation in this period. This decline in high growth firms was especially dramatic for the high-tech sector. For my last response, I want to return to a comment that Erica Groshen made and is related to some of the subsequent comments. It is important to remember that there is little value in the churning of jobs and workers for its own sake. The churning has value to the extent it represents improved allocation of resources. So it is possible this reduced churning of jobs and workers reflects a change in the business model like that we discussed for retail trade that does not adversely impact productivity growth. As we have noted, there is some evidence that this fits the evidence for the 1980s and 1990s. But since 2000, there has been a decline in reallocation that appears to have had an adverse impact on the economy in multiple ways.

