

## Florida's Labor Market Flexibility: A Good Sign in Difficult Times

Market flexibility has been demonstrated to be a critical element of growing economies. Researchers have found that national and state economies with more flexible markets consistently provide higher standards of living for their citizens than those with less flexible markets. This issue of Economic Commentary looks at some recent research on labor market flexibility among the states. Florida fares extremely well by these measures and highly flexible labor markets may help to buffer the current economic downdraft.

Market flexibility refers to the ease with which resources (such as workers, natural resources, capital, etc.) are allocated and re-allocated towards their highest-valued uses. That is, the ease with which resources move from lower to higher value-added activities.

All economies, to varying degrees, experience on-going shifts in consumer wants and needs, new technologies, new ways of providing goods and services, new competitors, new products, and entrepreneurial creativity. As a result new firms, industries and sectors may emerge and existing ones may expand while, at the same time, other firms, industries, and sectors will be in decline. Economies with flexible markets adapt more rapidly and more completely to this process of 'creative destruction.' Resources are used with greater effectiveness and efficiency, flowing towards expanding activities where they create and receive higher value and away from declining activities where they create and receive lower value.

**Figure 1: Labor Market Flexibility. Average Excess Job Reallocation Rates (in percent), 1989 - 2003**



Source: Paul W. Bauer and Yoonsoo Lee, "Regional Variation in Job Creation and Destruction." Federal Reserve Bank of Cleveland, Economic Commentary September 15, 2007.

<http://www.clevelandfed.org/research/Commentary/2007/091507.cfm>

Job creation and job destruction are hallmarks of flexible labor markets. Entrepreneurs and businesses that cannot shed jobs when conditions warrant may be less willing to form new firms or to expand existing ones and create jobs in the first place.

Economists at the Federal Reserve Bank of Cleveland, among others, have been researching labor market flexibility at the state level. Their insightful and interesting findings and the implications for Florida's economy are summarized below.

Figure 1 depicts the overall snapshot of labor market flexibility for each state. Excess job reallocation measures the sum of the job creation and job destruction rates, minus the absolute value of the net change in employment. The average rate for 1989 - 2003 is presented in the Figure.

For example, in 2003 Florida's job creation rate was about 22% and its job destruction rate was roughly 17%. In total, 49% of jobs

**Figure 2: Relative Job Creation Rate, 1989 - 2003**



Source: Source: Paul W. Bauer and Yoonsoo Lee, "Regional Variation in Job Creation and Destruction." Federal Reserve Bank of Cleveland, Economic Commentary September 15, 2007.

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were reallocated, which was 44% in "excess" of what would have been necessary to obtain the net employment change of about 5%. According to this measure, Florida, along with states in the South and West Coast, had a high degree of labor market flexibility. Florida and these other states have also been among the fastest growing ones.

Figure 2 focuses on job creation. Each state's actual average job creation rate is presented along with a 'hypothetical' rate - i.e., the rate of job creation if each industry in the respective state had created jobs at the national rate for that industry.

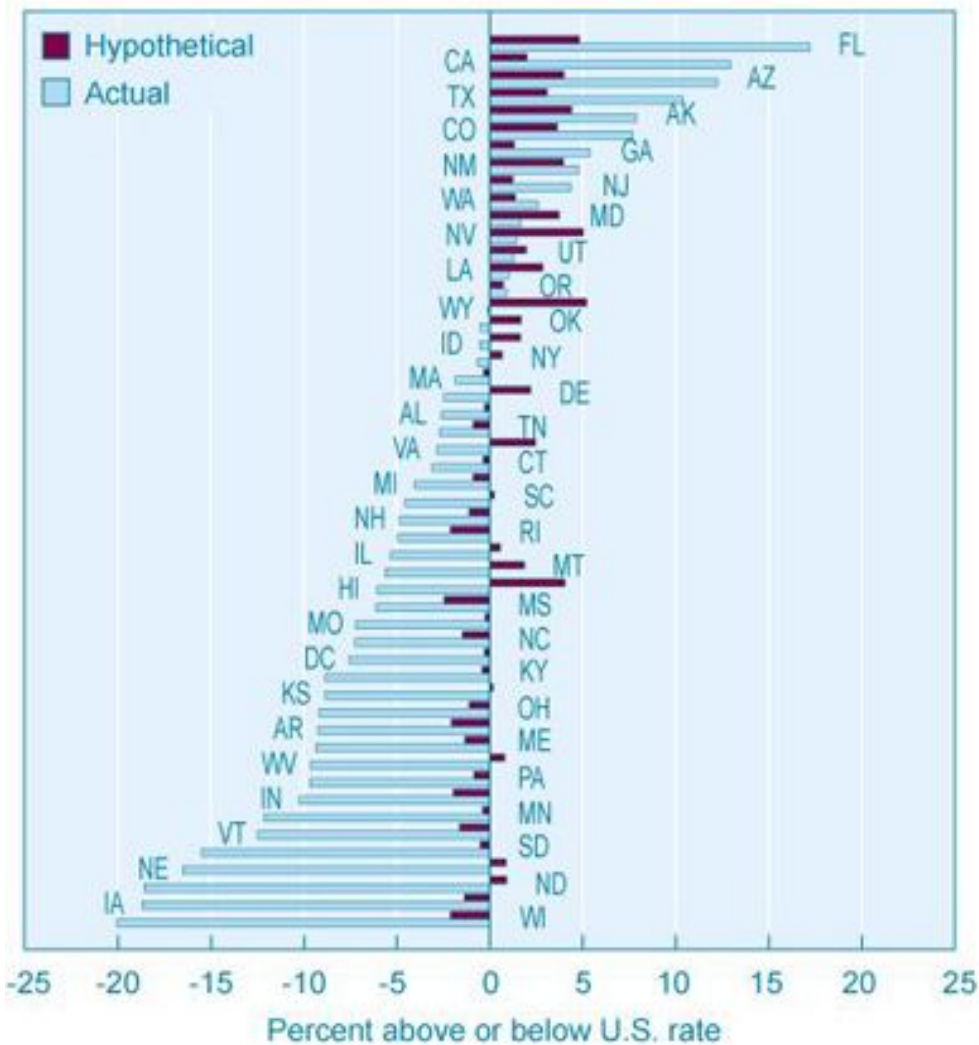
If Florida's industries had created jobs at the same rate as their national counterparts, then its total job growth would have been roughly 5% higher than the national rate. In reality, Florida's actual job creation rate was about 22% higher than the U.S. rate. The implication is that forces well beyond Florida's existing industrial composition were behind the state's robust job creation.

Figure 3 presents similarly measured data, but focuses on job destruction. If Florida's industries destroyed jobs at the same pace as their national counterparts, then job destruction in Florida would have been about 5% above the U.S. average. In actuality, Florida's job destruction rate averaged approximately 17% above the national average. Again, the implication is that changes in Florida's existing industries were not largely responsible for the state's strong job destruction rate.

Nationally, the research cited above indicates that industry composition accounts for only 30% of state differences in job creation and destruction. However, the data in Figures 2 and 3 suggest that industrial composition accounts for even a smaller fraction of job creation and destruction in Florida.

The Cleveland Fed economists also examined firm size, as a proxy for firm age, as another source of difference in job creation and destruction rates among states. The idea is that new firms tend to be initially smaller, and both create and destroy jobs at faster paces than more established and generally larger firms. The data confirm this notion. Small businesses have the highest job creation

**Figure 3: Relative Job Destruction Rate, 1989 - 2003**



Source: Source: Paul W. Bauer and Yoonsoo Lee, "Regional Variation in Job Creation and Destruction." Federal Reserve Bank of Cleveland, Economic Commentary September 15, 2007.

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as well as destruction rates, and the largest net job growth rates. This pace is especially high for firms of one to four employees.

Nationally, firm size accounts for about 25% of the variation in job creation and destruction rates across states. This figure is likely much higher for Florida, where about 75% of the state's 588,000 establishments employ 20 or fewer workers.

A considerable portion of the factors behind labor market flexibility-both nationally and in Florida-remain unexplained, even after accounting for industry composition and firm size. The Cleveland Fed economists point to three areas as potentially rich veins for future research. The first includes state economic, tax, and regulatory policies. Such policies can either encourage or inhibit the formation and expansion of businesses as well as the dissolution and downsizing of declining businesses. Labor law differences that influence the costs of terminating workers are a second area for research. Third, differences in the types of jobs found in a state may influence labor market flexibility. For example, in Florida with its sizable employment in sectors such as retail trade and services the skills necessary to move from a declining to an expanding firm or industry may be easily transferable.

Florida has a high degree of labor market flexibility, allowing for reasonably quick adjustments to ever-changing economic conditions. The state's industrial composition contributes somewhat to its labor market flexibility and the preponderance of relatively small firms in Florida likely makes a significant contribution. Also, the composition of jobs in the state may add to the labor market flexibility. Still, state economic, tax, regulatory, and labor law policies - although difficult to measure - undoubtedly contribute to Florida's labor market flexibility. Therefore, especially in light of the current economic slowdown where job destruction is advancing, it seems an ideal time for policymakers to ensure that state policies are enhancing rather than impeding labor market flexibility.

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