

ECONOMIC FINDING

Dynamism Diminished: The Role of Housing Markets and Credit Conditions

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The share of workers employed by young firms fell by nearly half between 1987 and 2014. Young firms' finances are often dependent on housing prices, which fluctuate greatly, and young firms hire a relatively larger share of young and less-educated workers. The great housing bust after 2006 largely drove an historic collapse in the young-firm share of employment.

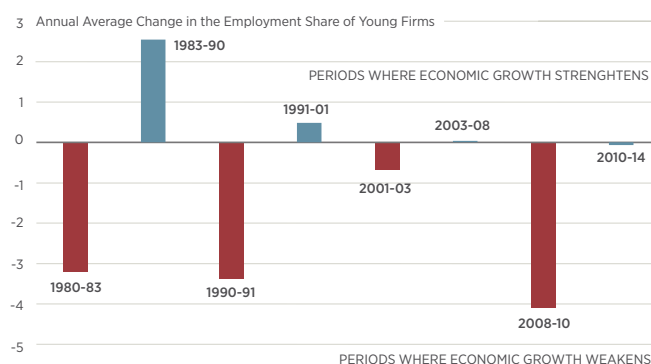
The Great Recession of 2007-09 raised several issues about the relationship of housing markets to economic activity. One issue concerns the impact of housing prices on the development of new and young firms. Another involves how housing market ups and downs affect local economies. Employment at young US firms (less than 60 months since first paid employee) has declined steadily since 1987, when it stood at 17.9 percent, plunging to just 9.1 percent in 2014.

While their activity is consistently marked by strong cyclical fluctuations, young firms experienced an especially sharp contraction during the Great Recession and a slow recovery afterwards. What is the role of housing market conditions—boom or bust—in shaping the fortunes of young firms? What is the role of credit markets? How are labor markets affected? This new research finds that the great housing bust after 2006 largely drove an historic collapse in the employment shares of young firms.

Housing cycles do not affect all MSAs equally, and the authors use this insight to isolate locally exogenous shifts in housing prices. They then estimate and quantify the effects of housing price swings on young firms and local economies. The authors conclude that the great housing bust after 2006 largely drove the historic collapse in the young firm share of employment during the Great Recession. The pullback in bank lending to younger firms played a secondary role.

The authors' rich dataset spans a long time period, which is especially useful when estimating the impact of bank lending on young firms. Banks are not all the same. They serve different markets, have different lending practices when it comes to small and young

Figure 1 • The Employment Share of Young Firms is Highly Cyclical



Notes: Each bar shows the annual average log change in the share of private sector employees at young firms during the indicated cycle episode, deviated about the sample mean log change of minus 2.2 log points per year. Blue bars denote aggregate expansion episodes, and red bars denote aggregate contraction episodes. All annual changes are from one mid-March payroll period to the next. For each cycle episode, the reported interval represents the average annual log change from March of the initial to March of the ending year. For example, 1980-81, 1981-82 and 1982-83. See working paper for an exact description of the calculations.

businesses, and are hit differently by financial crises and national business cycles. While almost all national banks retrenched their lending practices in response to the financial crisis of 2007-09, some were in better shape than others and better able to weather the storm and participate in the nascent recovery.

MSAs served by national banks that were particularly hard hit by the crisis had bigger drops in loan volume, and this reduction in credit redounded in their lending to young businesses. Indeed, the authors find that young firms suffer more than the average small business when banks scale back lending to small firms. Similarly, the authors find that the negative effects of falling housing prices are felt more strongly by young rather than small businesses.

This research also offers insights into implications for the employees of those businesses. That young firms tend to hire younger employees is perhaps unsurprising, but the authors also find that young firms tend to hire less-

educated workers, as shown in Table 1. As an example, in 2010 young firms employed 10 percent of female workers who did not finish high school but only 7 percent of female workers with a college degree. As a result, the fortunes of young firms have an outsized impact on younger and less-

educated workers. Thus, the housing bust and financial crisis hurt younger and less-educated workers through their particular effects on the fortunes of young firms in addition to their broader effects on the overall level of economic activity.

Figure 2 • Share of Employment at Young Firms by Demographic Characteristics

Worker Age and Gender	Men				Women			
	2000	2008	2010	2015	2000	2008	2010	2015
19-24	13.9	11.9	10.3	10.0	13.3	12.8	11.2	10.8
25-44	12.3	10.3	8.7	8.5	11.6	10.3	8.7	8.5
45-54	9.5	8.2	6.7	6.5	10.0	8.7	7.1	6.9
55-64	8.8	7.6	5.9	5.6	9.7	8.1	6.4	6.2
All	11.6	9.6	8.0	7.7	11.3	9.9	8.3	8.0

Education and Gender	Men				Women			
	2000	2008	2010	2015	2000	2008	2010	2015
< High School	12.7	11.4	9.3	8.8	13.1	12.1	10.1	9.4
High School	10.8	9.2	7.6	7.4	10.8	9.6	7.9	7.8
Some College	10.7	9.0	7.4	7.1	10.8	9.2	7.6	7.4
Undergrad +	11.3	8.6	7.1	6.7	10.6	8.6	7.1	6.8
All	11.2	9.3	7.6	7.4	11.0	9.5	7.8	7.6