Dimensions of Change in Cleveland's Economy

by Randall W. Eberts

In the past two decades, Cleveland has shared in the plight of many heavily industrialized cites in the northern United States. Unable to match the attractions of climate and business environment of the Sunbelt, these metropolitan areas have experienced a slow but steady movement of population and employment opportunities away from the North and into the South and Southwest. In most cases, the shift in activity is a response to fundamental social and economic changes in the United States and not to specific conditions in particular metropolitan areas. Nonetheless, this trend has placed cities such as Cleveland in an uneasy period of transition. Once a great success story in the industrialization of this country, Cleveland is now grappling with declining population, an employment growth rate that is below the national average, and a shift away from manufacturing to other types of employment. The Cleveland of tomorrow will be dramatically different from the Cleveland of two decades ago.

When assessing the vitality of the local economy, there is a tendency to concentrate on one or two dimensions of employment change. The closing of existing businesses, for instance, is usually associated with decline, and the opening of new ones is associated with growth. No one can dispute that the formation of new businesses stimulates an economy. But economic health does not preclude the closing of plants. In fact, recent studies show that the fastest growing regions are associated with the highest rate of business failures. Thus, one sign of a community's vitality is the absolute number of formations of new businesses and closings of existing ones. To dwell on a single dimension of the dynamic process of regional change, therefore, may misrepresent the forces that continue to transform a local economy.

Instead of concentrating on net change of employment, as many studies have done, we compared employment activity in four basic components of change. These four components are (1) the formation of new businesses; (2) the expansion of existing businesses; (3) the contraction of existing businesses; and (4) the closing of existing businesses. Recently released data from the Small Business Administration record the four components of employment change for individual firms and make such an analysis possible? A comprehensive understanding of these dynamics can help answer important questions that arise when shaping local development policies.

Business Activity in Cleveland

The level of activity within a local economy can be viewed in two ways, both of which are considered here. One is to consider the number of establishments that exhibited no change in employment; the other is to examine the number of businesses that reported a change in employment. Since businesses may behave differently over various portions of a business cycle, we compared their performance over an entire cycle. To do this, we chose two time periods—1976–78 and 1980–82. The 1976–78 period marks a recovery, while the 1980–82 period spans two recessions (as defined by the National Bureau of Economic Research). Charting the performance of businesses over both periods helps to distinguish businesses that are susceptible to downturns from those that are resistant to them. It also helps to separate structural, or permanent, changes from cyclical changes. Although many of the cyclical effects are outside local control, the structural effects are certainly within local control.

1. In this article Cleveland refers to the Cleveland standard metropolitan statistical area (SMSA).
2. For a description of these data, see Eberts, “Components of Employment Change in Cleveland.”

This article summarizes the results found in Randall W. Eberts, “Components of Employment Change in Cleveland,” Review, vol. 2, no. 1 (November 1984), pp. 3–12.

Federal Reserve Bank of Cleveland

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This article summarizes the results found in Randall W. Eberts, "Components of Employment Change in Cleveland," Review, vol. 2, no. 1 (November 1984), pp. 3-12. The author is assistant professor of economics, University of Oregon, and a visiting scholar, Federal Reserve Bank of Cleveland.
In both the 1976–78 and 1980–82 periods, nearly half of the businesses in the Cleveland SMSA reported having the same number of employees (within a 2 percent margin) in each year. More businesses remained stable in the recessions than in the recovery. Nationally, nearly 60 percent of the businesses reported no change in employment between 1978 and 1980. Tabulating the amount of employment change within Cleveland reveals that its economy may be considered more dynamic than one might think. Cleveland has 35 percent of the businesses in existence in both years registered a net employment change of more than 2 percent of their 1976 employment.

In Cleveland's economy, the contribution of small businesses to the components of employment change—openings, closings, expansions, and contractions—is shown in Table 1. The 1980 fig-

Table 1 Employment Change in Cleveland's Economy

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Openings</th>
<th>Closings</th>
<th>Expansions</th>
<th>Contractions</th>
<th>Net</th>
<th>Openings</th>
<th>Closings</th>
<th>Expansions</th>
<th>Contractions</th>
<th>Net</th>
</tr>
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<td>11.6</td>
<td>11.6</td>
<td>9.7</td>
<td>+1.9</td>
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<td>11.6</td>
<td>11.6</td>
<td>9.7</td>
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<td>16.5</td>
<td>1.8</td>
<td>1.86</td>
<td>+1.86</td>
<td>21.3</td>
<td>16.5</td>
<td>1.8</td>
<td>1.86</td>
<td>+1.86</td>
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<tr>
<td>Transportation</td>
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<td>5.6</td>
<td>1.1</td>
<td>3.5</td>
<td>+1.6</td>
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<td>1.1</td>
<td>3.5</td>
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</tr>
<tr>
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<td>13.8</td>
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<td>+1.7</td>
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<tr>
<td>Manufacturing</td>
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<td>16.8</td>
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<td>5.7</td>
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<td>3.5</td>
<td>+1.6</td>
</tr>
</tbody>
</table>

Components of Change

The components of employment change—openings, closings, expansions, and contractions—are shown in the first row for each sector. The second row for each sector represents the percentage change in employment from each component. The more recent period presented a slightly different picture. From 1980 to 1982, openings and expansions included employment by 19.1 percent, while closings and contractions reduced employment by 18.1 percent. The combination resulted in a net decline in employment by 4.6 percent.

Comparison of the four components of change over the business cycle provides a somewhat surprising assessment of the machinary of change. The percentage of employment loss because of closings remained at 12 percent over the entire business cycle. Con- tractions and expansions were also very similar, with slightly more layoffs and slightly fewer hirings during the recessions than during the recovery. The striking differ- ence between the two periods is in the composition and shares of employment change in each category originating from small businesses.

The Role of Small Firms

Small businesses recently have been heralded as the primary sources of jobs in the U.S. economy. Birch (1979) estimates that the contribution of small businesses to job creation is as high as 78 percent of net new jobs.3 There is a widely held belief that the small-business sector is a powerful force for technological innovation and entrepreneurial ingenuity that can stimulate the economic recovery of severely depressed regions. In addition, small businesses are believed to be more devoted to the structure of the local economy than are branch plants; they are less likely to abandon a region when economic condi-
tions turn sour or even when in a recession. The interesting exception to this behavior is the two sectors that expanded during both periods—paper, chemicals, petroleum, and related products. Financial and other services exhibited more openings than closings and more expansions than contractions in both periods. Thus, service shows a strong residuum throughout the entire business cycle. Since the formation of new establishments is one of the primary forces that alter the composi-
tion of the economy, it is interesting to see how employment has changed within the largest sector—manufacturing. Within manufactur-
ing, textiles, apparel, furniture, paper, chemicals, petroleum, and primary metals consistently have lost more employees because of closings of establishments than they have gained from new openings. Rubber, transportation equipment, and instruments, on the other hand, have consistently gained more employees because of openings than they have lost because of closings. Thus, the business process—opening new plants to move the economy away from the more traditional manufactur-
ing activities into more high-tech- nology endeavors.

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