Do little engines really do big things?

In “Are Small Businesses the Big- dig things?” (The Regional
economist, Federal Reserve Bank
of Saint Louis, April 2011, http://
www.stlouisfed.org/publications/
re/articles/?id=2087), Kevin L.
Kliesen and Julia S. Maués examine
the data behind a claim that is rou-
inely asserted by politicians of ev-
ery persuasion, namely, that “small
businesses” (however they may be
defined) are the job creation engines
of the U.S. economy, responsible
for generating a disproportionately
large share of new jobs relative to
larger firms.

The article traces the claim to its
root. In 1979, David Birch, who was
then a professor at the Massachu-
setts Institute of Technology, wrote
that firms with 20 or fewer employ-
ees accounted for two-thirds of new
jobs created during the early 1970s,
and firms with 100 or fewer employ-
ees accounted for 82 percent of new
jobs. Correspondingly, large firms
(those with 500 or more employees)
accounted for only a small share (15
percent) of new jobs. Birch’s find-
ings were subsequently refined by
him and revised by others, but the
idea that small businesses account
for most of the country’s job growth
was soon ingrained as fact in the na-
tion’s political discourse.

It is well known that the failure
rate of small businesses is notably
high. It takes time for businesses
that do not survive to be born and
live, then to fail and die. During
that time, the business increases
the number of jobs, but only in the
short run. Later, as it fails, the busi-
ness decreases the number of jobs.
Think of the large number of small
businesses that come into existence
each year, some of them destined to
fail and be forgotten, others able to
turn a profit and continue in opera-
tion—with a few in the latter group
eventually outgrowing the “small
business” category—and it’s easy to
see why, as a whole, small businesses
account for such a large portion of
new jobs.

However, looking at job creation
statistics tells only half the story.
True, small businesses, as they come
into being and begin to grow, ac-
count for an attention-getting share
of job creation. It is also true that as
some of them struggle and fail, they
also account for a large share of job
destruction. The authors note that “a
common confusion between net and
gross job creation” occurs when the
focus is placed only on the number
of jobs created by small businesses
and no attention is paid to the
number of jobs destroyed as some
small businesses become smaller or
cease operations entirely. The no-
table hundreds of thousands of new
jobs are transformed into dozens of
thousands when job losses are sub-
tracted from gross job gains to yield
net job gains. When the focus of
research is shifted to net job gains,
it can be seen that large firms cre-
ate the most jobs. One illustration of
this in the article is a table of data
from the BLS Business Employment
Dynamics program (www.bls.gov/
bed/) showing that firms with 500
or more employees had the largest
number of net job gains over the

Why Greek sovereign
debt matters to us

Because the financial crisis in
Greece could lead to political and
civil unrest within the country and
has caused concerns about the sta-
bility of the euro and its impact on
the world economy, Greek finan-
cial troubles are of international
importance.

In “Demystifying Sovereign Debt
in Greece: Why It Matters to Us”
(EconSouth, Federal Reserve Bank
of Atlanta, second quarter 2010,
http://www.frbatlanta.org/docu-
mements/pubs/econsouth/10q2_
greece.pdf), economic analyst An-
drew Flowers explains the Greek
money crisis, its potential repercus-
sions on both the euro nations
and the global economy, and what
lessons it holds for other countries
dealing with large budget deficits.

Flowers notes that while Greece
has led the pack among euro coun-
tries in terms of running large bud-
get deficits and carrying a high debt-
to-GDP (gross domestic product)
ratio, Greece is not alone in its fiscal
problems. Several other European
countries, including Italy, Ireland,
Spain, and Portugal, are also deal-
 ing with large deficits.

The severity of Greece’s fiscal cri-
sis was revealed in October 2009 by
the newly appointed Greek finance
minister. Investors began to lose
certainty in the country’s sovereign
debt, resulting in widening bond
and credit default swap spreads. By
December of the same year, the gov-
ernment proposed the first of several
austerity measures to help lower the
budget deficit; these measures were
met with investor skepticism and
objections from protestors. “The po-
itical and financial drama in Greece
has since oscillated between greater
protests and renewed, bolder auster-
ity plans,” explains Flowers.

Flowers notes that some analysts
worry that the Greek crisis could
also affect other European countries, especially if a large European financial institution were to fail. In addition, the effects of the crisis could spread outside of Europe. Flowers points to troubling signs of strain in the interbank lending market, which could feed through to businesses and consumers around the world.

Concerns over potential spillover effects to other fiscally troubled countries in the euro area prompted a pan-European response to the crisis. In May 2010, the European Commission unveiled a rescue package totaling $957 billion for troubled European governments. However, euro-area countries must still enact tough budget and labor reforms to successfully stabilize their economies, says Flowers.

There are several lessons to be learned by governments all over the world battling large financial deficits. Yet, as Flowers concludes, “time will tell how Greece and its European partners will regain stability and the confidence of investors. For other countries, the Greek fiscal crisis has been a sobering reminder of how precarious government finances are in this postrecession world.”