Do little engines really do big things?

In "Are Small Businesses the Biggest Producers of Jobs?" (*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 routinely asserted by politicians of every 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 Massachusetts Institute of Technology, wrote that firms with 20 or fewer employees accounted for two-thirds of new jobs created during the early 1970s, and firms with 100 or fewer employees 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 findings 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 nation'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 business 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 operation—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, account 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 notable hundreds of thousands of new jobs are transformed into dozens of thousands when job losses are subtracted 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 create 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 1992–2010 period.

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 stability of the euro and its impact on the world economy, Greek financial 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/documents/pubs/econsouth/10q2_greece.pdf**), economic analyst Andrew Flowers explains the Greek money crisis, its potential repercussions 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 countries in terms of running large budget 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 dealing with large deficits.

The severity of Greece's fiscal crisis was revealed in October 2009 by the newly appointed Greek finance minister. Investors began to lose confidence in the country's sovereign debt, resulting in widening bond and credit default swap spreads. By December of the same year, the government 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 political and financial drama in Greece has since oscillated between greater protests and renewed, bolder austerity 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." □