THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

OFF THE NEWS

Two Cheers for Small Business

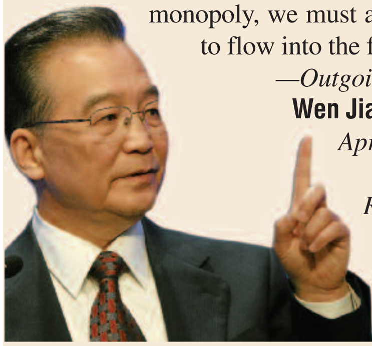
"We often read that small business is the primary driver of new jobs—this is both incorrect and overly simplistic. Sometimes those net new jobs appear in small businesses, and sometimes they appear in large businesses. In fact, recent studies show that large companies generally are more stable over time and that their employment goes down less during recessions.

One thing we know for sure is that capital expenditures and R&D spending drive productivity and innovation, which, ultimately, drive job creation across the entire economy. In the United States, the 17,000 large firms account for 80 percent of the $280 billion business R&D spending—and the top 1,000 firms alone account for 50 percent of this amount. U.S. companies also spend more than $1.4 trillion annually on capital expenditures, and the top 1,000 firms account for 50 percent of that amount. Big businesses are capable of making huge investments. A typical semiconductor plant costs $1 billion, and a typical heavy manufacturing plant costs $1 billion. These types of investments create lots of jobs. Many studies have shown that for every 1,000 workers employed by a big business' new plant, 5,000 jobs are generated outside the plant—from high-tech to low-tech positions (all to support the plant and its employees); most of these jobs appear in small businesses."

—JPMorgan Chase Chairman and CEO **Jamie Dimon,** *from his March 30, 2012, letter to shareholders.*

Crony Capitalism, Chinese Style

"Let me be frank. Our banks earn profit too easily. Why? Because a small number of large banks have a monopoly. To break the monopoly, we must allow private capital to flow into the finance sector."



—Outgoing Chinese Premier **Wen Jiabao** *in an interview April 3, 2012, on state-run China National Radio, on his regrets at not pushing harder for reforms.*

Man to Watch

German central bank hardliners both in and out of office have been ecstatic with the appointment of Ludger Schuknecht as adviser to finance minister Wolfgang Schäuble. Schuknecht is said to be the only close adviser to the finance minister with an economics background. "Everyone else is a lawyer," a colleague said, adding Schuknecht knows the dangers of eurobonds. He prepares the minister for all financial meetings and continually emphasizes that there are no magic, pain-free solutions to the eurozone debt problems.

Ludger Schuknecht

What's Next for Interest Rates

"Consider the remarkable path of yields on ten-year U.S. Treasury notes from 1950 to March, 2012 (see graph)—the long period of first rising, then falling, interest rates.

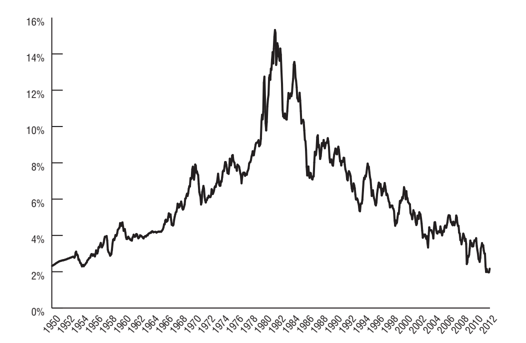
First, look at the amazing symmetry! The chart begins in the first quarter of 1950, and ends 62 years later, with interest rates at the same level: about 2.25 percent. At the beginning and the end, the Federal Reserve was and is, respectively, manipulating bond prices to keep long-term interest rates low. In 1950, this manipulation had been going on since World War II. Naturally, we wonder how long it can go on now. The Treasury Department did and does greatly appreciate this help in keeping down its financing costs.

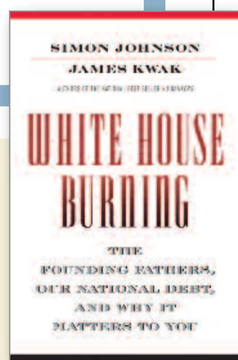
In the years in between, the chart makes an interest rate mountain. Ten-year Treasury rates peaked at over 15 percent in 1981—a level unbelievable in 1950 and again unbelievable now, but the reality in the aftermath of the runaway inflation of the 1970s. It was the death-knell of the savings and loan industry and of the postwar American mortgage finance system. From 1950 to 1981, there was a painful, secular bear market in bonds for three decades. Then came a secular bull market in bonds for three decades. The near mirror-image of the secular bear and bull decades is truly remarkable.

After this symmetrical rise and fall, how do we go about anticipating what is coming next?

—*Alex J. Pollock,*
"Fearful Symmetry: Six Decades of Treasury Yields,"
The American*,*
April 4, 2012.

Ten-Year Treasury Note Rate, 1950 to March 2012





Demystifying Debt

Does the United States face the prospect of a European-style debt crisis? Rich and proud eurozone countries are now repeatedly humbled by financial markets—the result of having borrowed too much and for too long. Simon Johnson and James Kwak, in their new book, *White House Burning* (Pantheon), review the history of public debt in the United States, demystifying the jargon and unpackaging the numbers. They explain how the United States has faced six debt shocks so far—and how the first five were managed so as to avoid crisis. The sixth debt shock, since 2000 and more intensely since 2008, is the most serious and likely hardest to escape.

But escape we will, according to the authors. Financial disaster in 2008 blew a huge hole in federal government revenue, but this can be restored. And, quite contrary to the conventional wisdom, they argue that social insurance programs (mostly Social Security and Medicare) can and should be protected. The United States can bring spending under control while also strengthening revenue. Johnson and Kwak provide a menu of options; you may not agree with their precise recommendation, but you need to read the menu to understand the choices that are really available.

Political gridlock is an obvious problem—but it also provides an opportune escape hatch. Don't extend the Bush era tax cuts, put the national debt on a more sustainable path, and keep long-term interest rates down, they suggest.