Small Business: Access to Capital and Job Creation

Robert Jay Dilger
Senior Specialist in American National Government

Oscar R. Gonzales
Analyst in American National Government

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Summary

The Small Business Administration's (SBA) authorization is due to expire on April 30, 2010. The SBA administers several programs to support small businesses, including loan guarantees to assist small businesses gain access to capital. This report addresses a core issue facing Congress during the SBA's reauthorization process: what, if any, additional action should the federal government take to enhance small business access to capital?

Historically, small businesses (firms with less than 500 employees) have experienced greater job loss during economic recessions than larger businesses. Conversely, small businesses have led job creation during recent economic recoveries. As a result, many federal policymakers look to small businesses to lead the nation's recovery from its current economic difficulties. Some, including the chairs of the House and Senate Committees on Small Business and President Obama, have argued that current economic conditions make it imperative that the SBA be provided additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small business economic growth and job creation.

This report examines the pros and cons of federal intervention in the marketplace to enhance small business access to capital. It assesses recent federal credit market interventions, including the creation of the Troubled Asset Relief Program (TARP) and Term Asset-Backed Securities Loan Facility (TALF); modifications to the SBA's loan guarantee programs and other small business provisions under the American Recovery and Reinvestment Act of 2009 (ARRA); empirical evidence concerning small business lending and borrowing, including the number and amount of small business loans guaranteed by the SBA; the efficacy of the SBA's programs designed to enhance small business access to capital; and two bills introduced in the 111th Congress, H.R. 3854, the Small Business Financing and Investment Act of 2009, and S. 2869, the Small Business Job Creation and Access to Capital Act of 2009, which are designed to enhance small business access to capital.

This report also discusses P.L. 111-118, the Department of Defense Appropriations Act, 2010, enacted on December 19, 2009, which provided $125 million to extend modifications to the SBA's loan guarantee programs under the ARRA through February 28, 2010 and P.L. 111-144, the Temporary Extension Act of 2010, enacted on March 2, 2010, which provided $60 million to extend those modifications through March 28, 2010. It also discusses H.R. 2847, the Jobs for Main Street Act of 2009, which would provide $325 million to extend those modifications through September 30, 2010, and President Obama's State of the Union proposals—the "Small Business Jobs and Wages Tax Cut" to encourage small business job creation and wage increases and a $30 billion set-aside of TARP funds to encourage community banks to provide small business loans.

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Small Business Access to Capital

The Small Business Administration (SBA) administers several programs to support small businesses, including loan guarantees to lenders to encourage them to provide loans to small businesses "that might not otherwise obtain financing on reasonable terms and conditions."[1] Historically, one of the justifications presented for funding the SBA's loan guarantee programs has been that small businesses can be at a disadvantage, compared with other businesses, when trying to obtain access to sufficient capital and credit.[2] As an economist explained:

> Growing firms need resources, but many small firms may have a hard time obtaining loans because they are young and have little credit history. Lenders may also be reluctant to lend to small firms with innovative products because it might be difficult to collect enough reliable information to correctly estimate the risk for such products. If it's true that the lending process leaves worthy projects unfunded, some suggest that it would be good to fix this "market failure" with government programs aimed at improving small businesses' access to credit.[3]

Congressional interest in small business access to capital has increased in recent years because, as discussed in the following section, lending institutions have tightened small business lending standards, largely in reaction to rising loan default rates and increased numbers of noncurrent (past due) loans during the economic downturn. In addition, disruptions in business credit markets during 2008 and early 2009 reduced lenders' liquidity, making it more difficult for lenders to supply loans to small business. The credit market disruptions' adverse impact on lending were particularly evident early in 2009, and remain a congressional concern.

Access to Capital and Job Creation

Small business has led job formation during previous economic recoveries.[4] The tightening of lending standards and disruption of business credit markets in 2008 and early 2009 has led to increased concern in Congress that small businesses might be prevented from accessing sufficient capital to enable them to take on that role during the current recovery. As the SBA indicated in its FY2010 congressional budget justification report:

> Over the last decade, small businesses across this country have been responsible for the majority of new private sector jobs, leaving little doubt that they are a vital engine for the nation's economic growth. However, with the United States facing the most severe economic

[1] U.S. Small Business Administration, *Fiscal Year 2010 Congressional Budget Justification* (Washington, DC: GPO, 2009), p. 30.

[2] Proponents of providing federal funding for the SBA's loan guarantee programs also argue that small business can promote competitive markets. See, P.L. 83-163, § 2(a), as amended; and 15 U.S.C. § 631a.

[3] Veronique de Rugy, *Why the Small Business Administration's Loan Programs Should Be Abolished*, American Enterprise Institute for Public Policy Research, AEI Working Paper #126, April 13, 2006, http://www.aei.org/docLib/20060414_wp126.pdf. Also, see U.S. Government Accountability Office, *Small Business Administration: 7(a) Loan Program Needs Additional Performance Measures*, GAO-08-226T, November 1, 2007, pp. 3, 9-11, http://www.gao.gov/new.items/d08226t.pdf.

[4] U.S. Small Business Administration, Office of Advocacy, *Small Business Economic Indicators for 2003*, August 2004, p. 3, http://www.sba.gov/advo/stats/sbei03.pdf; and Brian Headd, "Small Businesses Most Likely to Lead Economic Recovery," *The Small Business Advocate*, vol. 28, no. 6 (July 2009), pp. 1, 2, http://www.sba.gov/advo/july_09.pdf.

crisis in more than 70 years, small businesses are confronted with a frozen lending market and limited access to the capital they need to survive and grow at this critical time.[5]

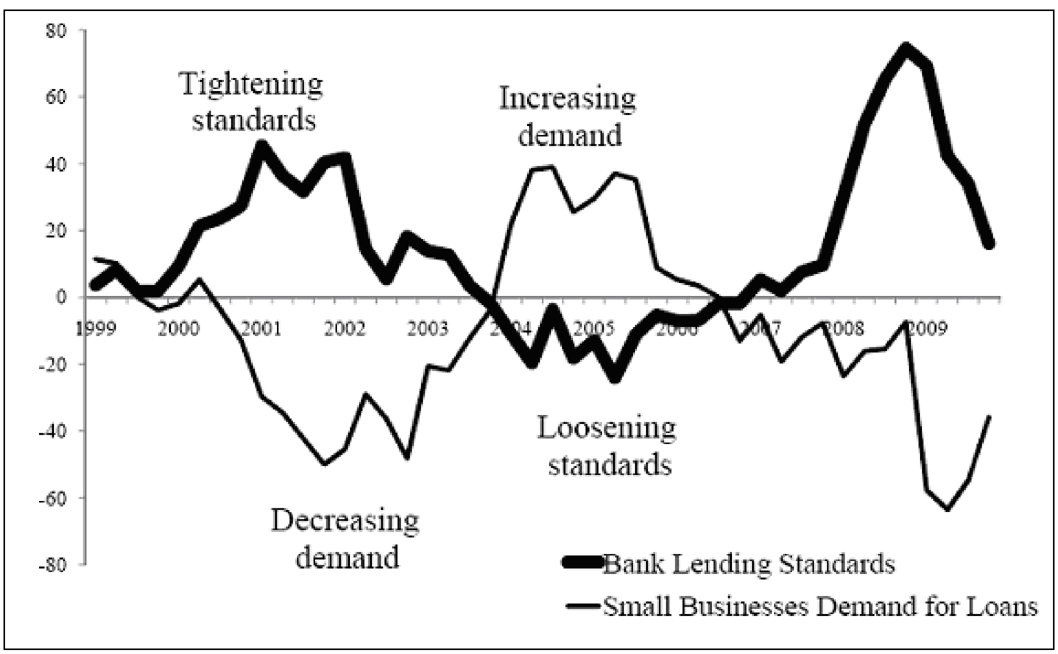
The Supply and Demand for Small Business Loans

Each quarter, the Federal Reserve Board surveys senior loan officers concerning their bank's lending practices. The survey includes a question concerning their bank's credit standards for small business loans: "Over the past three months, how have your bank's credit standards for approving applications for C&I [commercial and industrial] loans or credit lines—other than those to be used to finance mergers and acquisitions—for small firms (annual sales of less than $50 million) changed?" The senior loan officers are asked to indicate if their bank's credit standards have "Tightened considerably," "Tightened somewhat," "Remained basically unchanged," "Eased somewhat," or "Eased considerably." Subtracting the percentage of respondents reporting "Eased somewhat" and "Eased considerably" from the percentage of respondents reporting "Tightened considerably" and "Tightened somewhat" provides an indication of the market's supply of small business loans.

As shown in **Figure 1**, senior loan officers reported that they tightened small business loan credit standards during the early part of this decade, loosened those credit standards mid-decade, and tightened them in 2008 and 2009.

Figure 1. Small Business Lending Environment, 1999-2009

(senior loan officers' survey responses)



Source: Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," Washington, DC, http://www.federalreserve.gov/boarddocs/SnLoanSurvey/, cited in Brian Headd, "Forum Seeks Solutions To

[5] U.S. Small Business Administration, *Fiscal Year 2010 Congressional Budget Justification* (Washington, DC: GPO, 2009), p. 1.

Thaw Frozen Small Business Credit," *The Small Business Advocate*, vol. 28, no. 10 (December 2009), p. 3, http://www.sba.gov/advo/dec09.pdf.

The survey also includes a question concerning the demand for small business loans: "Apart from normal seasonal variation, how has demand for C&I loans changed over the past three months for small firms (annual sales of less than $50 million)?" Senior loan officers are asked to indicate if demand was "Substantially stronger," "Moderately stronger," "About the same," "Moderately weaker," or "Substantially weaker." Subtracting the percentage of respondents reporting "Moderately weaker" and "Substantially weaker" from the percentage of respondents reporting "Substantially stronger" and "Moderately stronger" provides an indication of the market's demand for small business loans.

Also shown in **Figure 1**, senior loan officers reported that the demand for small business loans declined during the early part of this decade, increased mid-decade, and declined in 2008 and 2009.

The combination of decreased supply and demand for small business loans in 2008 and 2009 resulted in the total amount of small business debt outstanding to decline as well. Since peaking at $780.9 billion in the second quarter of 2008, small business total debt outstanding declined to $760.5 billion in the third quarter of 2009.[6]

Table 1 provides selected financial statistics for the SBA from FY2000 to FY2010. It provides an overview of the extent of the SBA's various programs designed to enhance small business access to capital. The first two columns report the amount and number of non-disaster small business loans guaranteed by the SBA from FY2000 to FY2009 and an estimate for FY2010. The figures for FY2000 through FY2009 reflect loans that were actually made and are less than the amount and number of loans approved by the SBA. Each year, about 15% of the loans approved by the SBA are subsequently cancelled, typically by the borrower.

The third column reports the volume of the SBA's surety bond guarantees from FY2000 to FY2009 and an estimate for FY2010. A surety bond is a three-party instrument between a surety (someone who agrees to be responsible for the debt or obligation of another), a contractor and a project owner. The agreement binds the contractor to comply with the terms and conditions of a contract. If the contractor is unable to successfully perform the contract, the surety assumes the contractor's responsibilities and ensures that the project is completed. It is designed to reduce the risk of contracting with small businesses that may not have the credit history or prior experience of larger businesses. The SBA does not issue surety bonds. Instead, it provides and manages surety bond guarantees for qualified small and emerging businesses through its Surety Bond Guarantee (SBG) Program. The SBA reimburses a participating surety (within specified limits) for the losses incurred as a result of a contractor's default on a bond.[7]

The fourth column reports the volume of the SBA's secondary market guarantees, which are discussed later in this report. The final column reports the SBA's end-of-year outstanding principal balance of loans for FY2000-FY2009 that have not been charged off as of the end of the fiscal year. It provides a measure of the SBA's scope of lending.

[6] Federal Deposit Insurance Corporation, "Statistics on Depository Institutions," http://www2.fdic.gov/SDI/main.asp.

[7] U.S. Small Business Administration, "Bonding Program," http://www.sba.gov/financialassistance/borrowers/surety/.

Table 1. Selected Small Business Administration Financial Statistics, FY2000-FY2010

($ in millions)

Fiscal Year	Small Business Loans Guarantee		Surety Bond Guarantee Volume	Secondary Market Guarantees	Unpaid Principal Balance
	Amount	Number			
2010 est.	$15,480	48,250	$1,000	$12,000	$91,536
2009	12,752	45,548	430	2,381	90,451
2008	18,168	78,916	531	4,138	88,244
2007	20,525	108,152	547	3,678	84,523
2006	19,954	105,680	508	3,633	78,117
2005	19,661	102,893	484	10,000	71,495
2004	21,308	83,611	595	3,572	64,362
2003	15,358	71,973	594	-	59,181
2002	15,281	53,585	1,672	-	56,219
2001	14,019	50,278	261	-	53,116
2000	13,180	NA	1,672	-	52,227

Source: U.S. Small Business Administration, *FY 2002 Budget Request and Performance Plan* (Washington, DC: GPO, 2001), pp. 14, 28, 31, 34; U.S. Small Business Administration, *SBA Budget Request and Performance Plan: FY 2003 Congressional Submission* (Washington, DC: GPO, 2002), pp. 17, 57, 58, 62; U.S. Small Business Administration, *FY 2004 Budget Request and Performance Plan* (Washington, DC: GPO, 2003), pp. 3, 4, 113; U.S. Small Business Administration, *FY 2005 Congressional Performance Budget Request* (Washington, DC: GPO, 2004), pp. 9, 15, 20, 82; U.S. Small Business Administration, *Congressional Submission Fiscal Year 2006* (Washington, DC: GPO, 2005), pp. 13, 19, 25; U.S. Small Business Administration, *FY 2007 Budget Request and Performance Plan* (Washington, DC: GPO, 2006), pp. 14, 20, 23, 51, 63; U.S. Small Business Administration, *Congressional Submission Fiscal Year 2008* (Washington, DC: GPO, 2007), pp. 17, 23, 26; 49, 52, 53, 55; U.S. Small Business Administration, *Fiscal Year 2009 Congressional Submission and Fiscal Year 2007 Annual Performance Report* (Washington, DC: GPO, 2008), pp. 17, 25, 28, 127, 128; U.S. Small Business Administration, *Fiscal Year 2010 Congressional Budget Justification* (Washington, DC: GPO, 2009), pp. 11, 17, 21, 34, 38, 43; U.S. Small Business Administration, "Recovery Act Changes to SBA Loan Programs Sparked Major Mid-Year Turn-Around in Volume," Press Release, Washington, DC, October 1, 2009; U.S. Small Business Administration, *Number of Approved Loans by Program, FY 2009*, Washington, DC, http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_bud_lperf_approvalcount.pdf; U.S. Small Business Administration, *Unpaid Principal Balance By Program*, Washington, DC, http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_bud_lperf_upbreport.pdf; U.S. Small Business Administration, *Agency Financial Report, 2009 Fiscal Year*, (Washington, DC: GPO, 2009), p. 68; and U.S. Small Business Administration, *Fiscal Year 2011 Congressional Budget Justification and FY 2009 Annual Performance Report* (Washington, DC: GPO, 2010) pp. 19, 36, 39, 41, 48, http://www.sba.gov/idc/groups/public/documents/sba_homepage/fy_2011_cbj_09_apr.pdf.

Notes: The number of loans funded for FY2009 was estimated using the historical average of 85% of the number of loans approved in FY2009. The SBA also provides disaster loans: $8.8 billion in FY2006, $1.6 billion in FY2007, $861 million in FY2008, and $725 million in FY2009. See U.S. Small Business Administration, *Congressional Submission Fiscal Year 2008* (Washington, DC: GPO, 2007), p. 23; and U.S. Small Business Administration, *Fiscal Year 2009 Congressional Submission and Fiscal Year 2007 Annual Performance Report* (Washington, DC: GPO, 2008), p. 25. FY2009 disaster loan data provided to the author by the U.S. Small Business Administration, Office of Legislative Affairs.

As indicated in **Table 1**, the amount and number of non-disaster small business loans guaranteed by the SBA declined in FY2008 and FY2009. In FY2007, the SBA guaranteed 108,152 small business loans worth more than $20.5 billion. In FY2008, the SBA guaranteed 78,916 small business loans worth about $18.2 billion. In FY2009, it guaranteed an estimated 45,548 small business loans worth approximately $12.8 billion.

In 2009, the amount of small business loans guaranteed by the SBA declined sharply early in the year, followed by modest increases during the second and third quarters, and surpassed pre-recession levels in the fourth quarter as small business owners took advantage of SBA loan subsidies that were about to end. For example, during 2008, the SBA guaranteed about $348 million in small business loans per week. During the first seven weeks of 2009, the SBA guaranteed about $165 million in small business loans per week. The amount of small business loans guaranteed by the SBA increased modestly during the second and third quarters, averaging about $275 million per week, increased to $1.1 billion in the third week of November as borrowers hurried to take advantage of temporary SBA loan subsidies that were exhausted on November 23, 2009, and then fell below pre-recession levels.[8]

The decline in the amount and number of small business loans guaranteed by the SBA during 2008 and 2009 were, at least in part, due to three interrelated factors. First, many lending institutions experienced significant economic difficulties during the recession. In 2007, before the recession, three lending institutions failed. In 2008, 26 failed. During 2009, 140 lending institutions failed.[9] Included in the list of failed lending institutions in 2009 was CIT Group, Inc., the nation's largest lender to small businesses. It failed on November 1, 2009.[10] Over the course of the year, 702 (of 8,012) banks, with $403 billion in assets, were on the Federal Deposit Insurance Corporation's (FDIC) watch list for heightened risk of failure.[11]

Deterioration in the quality of loans and securities in the portfolios of financial institutions, combined with rapidly rising loan defaults, also took a toll on the industry's earnings in 2008 and 2009. In 2007, FDIC-insured lending institutions had $101.6 billion in net profits. In 2008, they lost $12.9 billion, including a $37.8 billion loss in the fourth quarter, which more than erased $24.9 billion in profits during the previous three quarters. In 2009, FDIC-insured lending institutions had a net profit of $4.2 billion.[12] In terms of individual lending institutions, more than one in four (29.5%) reported a net loss for the year.[13] When lending institutions anticipate difficulty in making a profit, are losing money, or have diminished expectations of future profits, they tend to become more risk averse and the supply of business loans, including small business loans, tends to decline.

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8 U.S. Small Business Administration, "Recovery Act Changes to SBA Loan Programs Sparked Major Mid-Year Turn-Around in Volume," October 1, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-67.pdf; Nancy Waitz, "U.S. stimulus funds run out for lower SBA loan fees," *Reuters News*, November 24, 2009, http://www.reuters.com/article/companyNewsAndPR/idUSN2431964620091125; and Senator Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12910.

9 Federal Deposit Insurance Corporation, "Failed Bank List," http://www.fdic.gov/bank/individual/failed/banklist.html. For further analysis, see CRS Report RL32542, *The Condition of the Banking Industry*, by Walter W. Eubanks.

10 Patrice Hill, "Lender to small business bankrupt," *The Washington Post*, November 2, 2009, pp. A1, A10.

11 Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Fourth Quarter 2009, Table 1-A. Selected Indicators, FDIC-Insured Institutions," http://www2.fdic.gov/qbp/2009dec/all1a.html.

12 Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Quarterly Net Income," http://www2.fdic.gov/qbp/2009dec/chart1.htm.

13 Federal Deposit Insurance Corporation, "Quarterly Banking Profile: Fourth Quarter 2009, Table 1-A. Selected Indicators, FDIC-Insured Institutions," http://www2.fdic.gov/qbp/2009dec/all1a.html. For further analysis, see CRS Report RL32542, *The Condition of the Banking Industry*, by Walter W. Eubanks.

Second, the secondary market for small business loans, as with other secondary markets, began to contract in October 2008, reached its nadir in January 2009, and then began a relatively prolonged recovery. In a secondary market, loans are pooled together and packaged as securities for sale to investors. This practice makes more capital available by allowing lending institutions to remove existing loans from their balance sheets, freeing them to make new loans.[14] When secondary credit markets constrict, lenders tend to become both less willing and less able to supply small business loans. For example, the secondary market volume for SBA 7(a) loans averaged $328 million a month from January 2008 through September 2008, and then fell each succeeding month, declining to under $100 million in January 2009.[15] The SBA estimates that about half of the lenders that make SBA guaranteed loans resell them to obtain additional capital to make additional loans.

Third, many small businesses experienced severe economic difficulties during the recession. The SBA estimated that about 60% of the jobs lost in 2008 through the second quarter of 2009 were lost in small firms.[16] Monthly business surveys conducted by Automatic Data Processing, Inc.(ADP) suggest that about 81% of the 7.5 million jobs lost during the recession (from December 2007 through September 2009) were in firms with less than 500 employees.[17] When business is slow, or when expectations of business sales growth is diminished, business owners (and entrepreneurs considering starting a new small business) tend to become more risk averse and the demand for small business loans tends to decline.

As will be shown in the discussion that follows, Congress has addressed all three of these factors. For example, Congress authorized the U.S. Department of the Treasury to assist banks and other lending institutions by purchasing or insuring up to $700 billion of troubled assets, targeting real estate-related loans and securities that have lost value, are difficult to price and sell to others in secondary markets, and, therefore, constrain the financial institution's profits and ability to lend.[18] It authorized interventions in secondary credit markets in an attempt to increase lending. It also approved ARRA (P.L. 111-5), which was anticipated to provide $787 billion in increased spending and tax reductions to stimulate the economy, including an additional $730 million for SBA programs and several tax provisions designed to benefit small business. [19] In January 2010, the Congressional Budget Office (CBO) estimated that ARRA would cost $862 billion, primarily

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[14] U.S. Small Business Administration, Office of Advocacy, *An Exploration of a Secondary Market for Small Business Loans*, April 2003, p. 1, http://www.sba.gov/advo/research/rs227.pdf.

[15] U.S. Small Business Administration, "Six-Month Recovery Act Report Card," August 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/six-mnth_recov_act_rep_08_2009.pdf.

[16] Brian Headd, U.S. Small Business Administration, Office of Advocacy, "An Analysis of Small Business and Jobs," March 2010, p. 14, http://www.sba.gov/advo/research/rs359tot.pdf.

[17] Automatic Data Processing, Inc. (ADP), "National Employment Report, December 2007," Roseland, N.J., p. 2, http://www.adpemploymentreport.com/pdf/FINAL_Report_DEC_07.pdf; and ADP, "National Employment Report, September 2009," Roseland, N.J., p. 2, http://www.adpemploymentreport.com/PDF/FINAL_Report_September_09.pdf.

[18] U.S. Congress, House Committee on Financial Services, *Oversight Concerns Regarding Treasury Department Conduct of The Troubled Assets Relief Program*, 110th Cong., 2nd sess., December 10, 2008 (Washington: GPO, 2009), pp. 15, 16, 23, 27, 46, 51, 59, 63, 75, 76, 79, 91, 137, 211, 213; and "David Cho, "Treasury Kicks Off Toxic-Asset Program: After Long Delay, Plan Is Scaled Back," *The Washington Post*, October 1, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/09/30/AR2009093003874.html.

[19] For further analysis, see CRS Report R40241, *Small Business Provisions in the American Recovery and Reinvestment Act of 2009*, by N. Eric Weiss and Oscar R. Gonzales.

due to unanticipated outlays for food stamps, unemployment compensation, and the Build America Bond program.[20]

The Federal Response in 2008 and Early 2009

The Troubled Asset Relief Program

In an effort to spur the economy and assist businesses of all sizes, Congress adopted the Emergency Economic Stabilization Act of 2008, which became law on October 3, 2008 (P.L. 110-343). The act created the Troubled Asset Relief Program (TARP), which authorizes the U. S. Department of the Treasury to purchase or insure up to $700 billion in troubled assets from banks and other financial institutions. The law's intent is "to restore liquidity and stability to the financial system of the United States."[21] The definition of troubled assets, defined as illiquid, difficult-to-value real estate related assets in the original proposal circulated by the George W. Bush Administration, was expanded to include any asset the Department of Treasury, in consultation with the Federal Reserve, believes would contribute to financial instability.[22] As of January 31, 2010, the Department of the Treasury had committed $545 billion for various purposes, including $205 billion to purchase stock in 707 banks. The largest bank stock purchases were $40 billion for American International Group, Inc. preferred stock; $25 billion for Wells Fargo & Company preferred stock; $25 billion for Citigroup, Inc. common stock; $20 billion for Citigroup, Inc. preferred stock; and $20 billion for Bank of America Corporation preferred stock. TARP has also provided General Motors, Chrysler, and their respective financing arms $76 billion in loans and equity investments.[23]

On March 16, 2009, President Barack Obama announced that the Department of the Treasury would use TARP funds to purchase up to $15 billion of SBA-guaranteed loans. The purchases were intended to "immediately unfreeze the secondary market for SBA loans and increase the liquidity of community banks."[24] The plan was deferred after it met resistance from lenders. Some lenders objected to TARP's requirement that participating lenders comply with executive compensation limits and issue warrants to the federal government. Smaller, community banks

[20] U.S. Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2010 to 2020 (Washington, DC: GPO, January 2010), p. 95, http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf. Note: The Build America Bond program pays state and local governments 35% of their interest costs on taxable government bonds issued in 2009 and 2010 to finance capital spending. Participation in the program exceeded expectations. For further analysis, see CRS Report R40523, *Tax Credit Bonds: Overview and Analysis*, by Steven Maguire.

[21] P.L. 110-343.

[22] For further analysis, see CRS Report RL34730, *Troubled Asset Relief Program: Legislation and Treasury Implementation*, by Baird Webel and Edward V. Murphy.

[23] U.S. Department of the Treasury, *Troubled Assets Relief Program Monthly 105(a) Report – December 2009*, January 11, 2010, pp. 5, 6, 25-29, http://www.financialstability.gov/docs/105CongressionalReports/December%20105(a)_final_1-11-10.pdf; and U.S. Department of the Treasury, *Troubled Assets Relief Program Monthly 105(a) Report – January 2010*, February 16, 2010, pp. 4, 9, http://www.financialstability.gov/docs/105CongressionalReports/January%20105(a)_2-16-10.pdf. Note: TARP made three separate investments in Citigroup totaling $49 billion. As of January 6, 2010, 64 lending institutions had repaid their TARP funding.

[24] The White House, "Remarks by the President to Small Business Owners, Community Leaders, and Members of Congress," March 16, 2009, http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-small-business-owners/.

objected to the program's paperwork requirements, such as the provision of a small-business lending plan and quarterly reports.[25]

The Term Asset-Backed Securities Loan Facility

On November 25, 2008, the Federal Reserve Bank of New York, utilizing authority provided under section 13(3) of the Federal Reserve Act, announced that it would create the Term Asset-Backed Securities Loan Facility (TALF) to "support economic activity by facilitating renewed issuance of consumer and business ABS [asset-backed securities]."[26] TALF, which became operative on March 3, 2009, is designed to help market participants meet the credit needs of households and small businesses by lending up to $200 billion to eligible owners of certain AAA-rated ABS backed by newly and recently originated auto loans, credit card loans, student loans, and SBA-guaranteed small business loans.[27] In August 2009, the Department of the Treasury and the Federal Reserve Bank of New York announced the extension of TALF for newly issued ABS and legacy commercial mortgage-backed securities (CMBS) through March 31, 2010. In addition, TALF will make loans against newly issued CMBS through June 30, 2010.[28]

The initial TALF subscription took place on March 19, 2009, and there have been 18 monthly ABS and CMBS subscriptions as of January 31, 2010. A total of approximately $61.65 billion of TALF-eligible legacy and new ABS and CMBS issuance has been lent against.[29]

Federal Guarantees

In an effort to promote financial stability and, as a result, access to capital for businesses of all sizes, the federal government has used TARP, TALF, and the FDIC to expand its role as a guarantor of financial institution's assets and transactions. For example, Congress temporarily raised the maximum guaranteed value of FDIC-insured accounts from $100,000 to $250,000 per account (P.L. 110-343, P.L. 111-22), and the FDIC also established the Debt Guarantee Program (DGP), which guarantees the debt lending institutions issue to raise funds that they use to lend to customers.[30] To reassure anxious investors, Treasury has guaranteed that money market funds would not fall below $1.00 per share, and Treasury, the FDIC, and the Federal Reserve Board jointly negotiated to secure $300 billion in assets belonging to Citigroup and Bank of America.

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[25] Emily Flitter, "Fix for SBA Snagged by Tarp's Exec Comp Limits," *American Banker*, vol. 174, no. 61 (March 31, 2009), p. 1.

[26] Federal Reserve Bank of New York, "Creation of the Term Asset-Backed Securities Loan Facility (TALF)," press release, November 25, 2008, http://www.federalreserve.gov/newsevents/press/monetary/20081125a.htm.

[27] Federal Reserve Bank of New York, "Term Asset-Backed Securities Loan Facility: Terms and Conditions," http://www.newyorkfed.org/markets/talf_terms.html; and Federal Reserve Bank of New York, "New York Fed releases revised TALF Master Loan and Security Agreement and appendices," press release, http://www.federalreserve.gov/newsevents/press/monetary/20090303a.htm.

[28] U.S. Department of the Treasury, *Troubled Assets Relief Program Monthly 105(a) Report – January 2010*, February 16, 2010, p. 11, http://www.financialstability.gov/docs/105CongressionalReports/January%20105(a)_2-16-10.pdf.

[29] Ibid.

[30] P.L. 110-343 increased the deposit insurance limit to $250,000 until December 31, 2009. P.L. 111-22 made the increase in deposit insurance effective until December 31, 2013. For further analysis, see CRS Report R40843, *Bank Failures and the Federal Deposit Insurance Corporation*, by Darryl E. Getter.

Altogether, at the height of the recession in mid-2009, the federal government was guaranteeing or insuring more than $4.5 trillion in the face value of financial assets.[31]

The American Recovery and Reinvestment Act of 2009

ARRA's SBA Funding Provisions

In an effort to help small businesses during the economic downturn Congress approved, and, on February 17, 2009, President Obama signed into law, the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5). ARRA temporarily increased funding and modified several SBA loan guarantee programs to make them more attractive to small business owners. Specifically, over a two-year period, or until funding is exhausted, ARRA

- provides an additional $630 million for SBA loans and loan guarantees divided into two categories: $375 million is set aside for reimbursements, loan subsidies and loan modifications related to certain loans, and $255 million for loans of $35,000 or less in a new small business stabilization program, later named the America's Recovery Capital (ARC) Loan program;
- provides an additional $69 million for SBA salaries and expenses, including $24 million for microloan technical assistance, and $20 million to improve lender oversight;
- provides an additional $6 million for SBA direct loan subsidies for the microloan program;
- provides an additional $15 million for the SBA's surety bond program and increases the amount of the maximum bond;
- eliminates (or reduces as much as possible) fees in the SBA's 7(a) and 504/CDC (Certified Development Company) business loan programs and for lender oversight;[32]
- allows the SBA to guarantee certain loans that, in part, refinance existing business loans;
- authorizes the SBA to guarantee pools of first lien 504/CDC loans sold to third party investors;
- increases the funds ("leverage") available to SBA-licensed Small Business Investment Companies (SBICs);
- requires SBICs to invest at least 50% of their venture capital in low-income areas as defined by the New Market Venture Capital program; and
- requires SBICs to make 25% of their investments in "smaller" companies.[33]

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[31] Congressional Oversight Panel, "Guarantees and Contingent Payments in TARP and Related Programs," Washington, DC, November 6, 2009, pp. 2-3, http://cop.senate.gov/documents/cop-110609-report.pdf.

[32] The SBA guarantees certain loans made to American small businesses by commercial lenders. It is named after Section 7(a) of the Small Business Act of 1953 (P.L. 83-163, as amended). The 504/CDC loan program is named after Section 504 of the Small Business Investment Act of 1958 (P.L. 85-669), as amended, which authorized the program

For comparative purposes, in FY2008, the SBA had $786 million in non-disaster loan new budget authority, so ARRA nearly doubled the amount of funding for FY2009.

The SBA estimated that ARRA funding would support $8.7 billion in 7(a) loans, $3.6 billion in 504/CDC loans, $336 million in ARC loans, and $46 million in loans to microlenders. ARRA's funding for the 7(a) program was exhausted on November 23, 2009. In addition, ARRA's funding for the 504/CDC program was exhausted in late-December 2009. ARRA's funding for ARC and microlenders is expected to last until mid-2010.[34]

P.L. 111-118, the Department of Defense Appropriations Act, 2010, enacted on December 19, 2009, provided $125 million to extend ARRA's "fee reductions and eliminations" for the SBA's 7(a) and 504/CDC programs and 90% loan guarantee limit for the SBA's 7(a) program through February 28, 2010. P.L. 111-144, the Temporary Extension Act of 2010, enacted on March 2, 2010, provided $60 million to extend those modifications through March 28, 2010. In addition, H.R. 2847, the Jobs for Main Street Act of 2009, approved by the House on December 16, 2009, would provide $325 million to extend the fee reductions and 90% loan guarantee limit through September 30, 2010. It is awaiting action in the Senate.

ARRA's Business Tax Provisions

ARRA also includes 11 tax provisions that have the potential to benefit small businesses in a broad range of industries. The first five provisions listed are targeted at small businesses whereas the others are available to businesses of all sizes:

- Extends the five-year carryback of net operating losses, which allows businesses with $15 million or less in average annual gross receipts in the past three years to carry back net operating losses from 2008 for up to five years instead of two years;
- Extends through 2009 the enhanced expensing allowance, which allows businesses to deduct up to $250,000 of the cost of eligible assets placed in service in 2009, within certain limits;[35]
- Increases the exclusion of the gain on the sale of small business stock to 75% (instead of 50%) of any gain realized on the sale of eligible small business stock acquired between February 18, 2009, and December 31, 2010;
- Reduces the recognition period from 10 years to seven years for corporate tax on sale of appreciated assets in 2009 or 2010 by S corporations that once were organized as C corporations;

(...continued)

[33] For further analysis, see CRS Report R40241, *Small Business Provisions in the American Recovery and Reinvestment Act of 2009*, by N. Eric Weiss and Oscar R. Gonzales; and CRS Report R40728, *Small Business Tax Benefits and the American Recovery and Reinvestment Act of 2009*, by Gary Guenther.

[34] Catherine Clifford, "Stimulus cash runs out for small business loans," *CNNMoney.com*, November 23, 2009; and U.S. Small Business Administration, *Recovery Act Program Performance Report, November 2009*, http://www.sba.gov/idc/groups/public/documents/sba_homepage/recov_perform_reports_11_2009.pdf.

[35] While there is no size limit on the firms that can benefit from the allowance, its design effectively confines its use to smaller business firms.

- Allows individuals who had an adjusted gross income in 2008 of less than $500,000 and can prove that over half their income came from a small business to base their estimated tax payments for 2009 on 90% of their tax liability for 2008;
- Temporarily extends the work opportunity credit, which permits businesses of all sizes to claim the credit for unemployed veterans and disconnected youth in 2009 and 2010;
- Allows businesses of all sizes that buy back or exchange their own debt at a discounted price in 2009 and 2010 to defer their discharge-of-indebtedness income;
- Provides a credit to businesses of all sizes against employment tax payments for employer COBRA subsidies;
- Allows businesses of all sizes that could claim a bonus depreciation allowance in 2009 to claim instead as refundable credit a portion of their unused research and Alternative Minimum Tax (AMT) credits from tax years before 2006; and
- Increases the AMT exemption amount for joint filers to $70,950 and for single filers to $46,700 in 2009 and extends through 2009 a rule that allows individuals to use non-refundable personal credits to the full extent possible against the AMT and regular income tax.[36]

According to the Joint Committee on Taxation, the five tax provisions targeted at small businesses are expected to reduce small business taxes by $5.7 billion in FY2009. The six other tax provisions that could benefit many small businesses are expected to reduce business taxes by $52.0 billion in FY2009.[37]

ARRA's Credit Market Provisions

ARRA directs the SBA to work with the Federal Reserve and Department of the Treasury to open up the secondary credit market for small businesses. It authorizes the SBA to use emergency rulemaking authority to issue regulations by March 19, 2009, to make below market interest rate direct loans to SBA-designated "Systemically Important Secondary Market (SISM) Broker-Dealers." These broker-dealers would use the loan funds to purchase SBA-guaranteed loans from commercial lenders, assemble them into pools, and sell them to investors in the secondary loan market. ARRA also directs the SBA to create a secondary market guarantee authority for the SBA's 504/CDC program. The 504/CDC program provides small businesses credit for the purchase of real estate and other fixed assets. Financing under the program includes three components: (1) a first mortgage or lien, which is made by a private commercial lender for 50% of the total project and does not come with a government guarantee; (2) a second mortgage or lien, which is made by a CDC for 40% of the total project and guaranteed fully by the SBA; and (3) borrower equity for the remaining 10% of the total project.

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[36] For further analysis, see CRS Report R40728, *Small Business Tax Benefits and the American Recovery and Reinvestment Act of 2009*, by Gary Guenther.

[37] U.S. Congress, Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the Conference Agreement for H.R. 1, the "American Recovery and Reinvestment Act of 2009,"* JCX-19-09, February 12, 2009 (Washington, DC).

The SBA experienced unanticipated delays in implementing these programs due to "limited staff resources and the need to sort out other issues related to these programs, including contracting and Recovery Act recipient reporting requirements."[38] The SBA issued regulations for making below market interest rate direct loans to SBA-designated SISM broker-dealers on November 19, 2009.[39]

The SBA published regulations to create a secondary market guarantee program for the "first mortgage" portion of small business financing made through the 504/CDC program on October 28, 2009:

> Under the new program, portions of eligible 504 first mortgages pooled by originators or broker dealers could be sold with an SBA guarantee to third-party investors in the secondary market. Lenders will retain at least 15 percent of each individual loan, pool originators will assume 5 percent of the risk, and the SBA will guarantee the remaining 80 percent. To be eligible to be included in a pool, the first mortgage must be associated with a 504 loan disbursed on or after Feb. 17, 2009. The program will be in place until Feb. 16, 2011, or until $3 billion in new pools are created, whichever occurs first.[40]

TARP, TALF, and ARRA's Impact

Following the federal government's interventions in business credit markets and ARRA's enactment, the weekly number and amount of small business loans guaranteed by the SBA began to increase. For example, when ARRA was enacted on February 17, 2009, the SBA was averaging about $165 million in small business loan guarantees per week. That amount rose to about $275 million per week during the second and third quarters of 2009. In addition, after ARRA, the percentage of lending institutions tightening small business credit standards began to fall and the decline in demand for business loans began to moderate (see **Figure 1**). Although the Federal Reserve Board's quarterly surveys of senior loan officers continued to indicate a relatively tight credit market for small business, the trends of easing credit standards and increased demand for small business loans during the latter half of 2009 were viewed by the SBA as a sign that the "credit crunch may have eased somewhat" and that the market for small business loans may be "poised for a healthier lending environment."[41]

Disagreement Over Next Steps

The Obama Administration has argued that TARP, TALF, and ARRA's additional funding for the SBA's loan guarantee programs have helped to improve the small business lending environment,

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[38] U.S. Government Accountability Office, *Recovery Act: Project Selection and Starts Are Influenced by Certain Federal Requirements and Other Factors*, GAO-10-383, February 10, 2010, p. 23, http://www.gao.gov/new.items/d10383.pdf.

[39] U.S. Government Accountability Office, *Status of the Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*, GAO-10-298R, January 19, 2010, pp. 6, 7, http://www.gao.gov/new.items/d10298r.pdf.

[40] U.S. Small Business Administration, SBA *Creates Secondary Market Guarantee Program for 504 First Mortgage Loan Pools*, October 28, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-76.pdf.

[41] Brian Headd, "Forum Seeks Solutions To Thaw Frozen Small Business Credit," *The Small Business Advocate*, vol. 28, no. 10 (December 2009), pp. 3, http://www.sba.gov/advo/dec09.pdf.

but additional federal action is warranted to provide small business the access to capital necessary for increased levels of job creation.[42] For example, it has proposed increasing loan guarantee limits for the SBA's 7(a), 504/CDC loan, and microloan programs and providing small business greater access to credit by utilizing the Treasury Department's Community Development Financial Institutions (CDFI) fund and remaining TARP funds.[43]

As discussed in the following section, Congress is also considering bills that include provisions to improve small business access to capital. If enacted, these bills would increase loan guarantee limits for the SBA's 7(a) and 504/CDC programs, but in ways different than those proposed by the Administration and extend ARRA's funding for SBA programs. One of the bills would also establish a temporary SBA direct lending program, which would continue in operation or restart should specified adverse economic conditions persist; streamline the SBA's loan application process; and create new lending guarantee programs targeted at specific industries.

The SBA's critics argue, as a general principle, that increasing funding for the SBA's loan guarantee programs is ill-advised. In their view, the SBA has a relatively limited impact on small business economic prospects. They argue that, in a typical year, no more than 1% of small businesses receive a SBA-guaranteed loan, and those loans account for less than 3% of the total amount loaned to small businesses.[44] They assert that "these numbers show that the private banking system finances most loans and that the SBA is therefore largely irrelevant in the capital market."[45] As further evidence, they point to an October 2009 survey of owners of small businesses employing five or fewer employees by Discover Financial Services. The survey found that 90% of respondents reported that they have never applied for an SBA loan. When presented with a list of several reasons why not, 48% said that they did not need an SBA loan, 15% said they are unfamiliar with the SBA's programs, 14% said they received funding from another source, 9% said it takes too much time, 9% said they would rather use their personal assets, and 6% said they have some other reason or are not sure.[46] They also point to surveys of small business firms conducted by the National Federation of Independent Business (NFIB), which indicate that small business owners have consistently placed financing issues near the bottom of their most pressing concerns.[47] Instead of increasing federal funding for the SBA, they advocate

[42] U.S. Small Business Administration, *Recovery Act Changes to SBA Loan Programs Sparked Major Mid-Year Turn-Around in Volume*, October 1, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-67.pdf; and U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf.

[43] The White House, "Remarks by the President on Job Creation and Economic Growth," December 8, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth.

[44] Raymond J. Keating, "Keating: Obama's policies will hurt, not help," *Long Island Business News, The Debate Room*, October 30, 2009, http://libn.com/thedebateroom/2009/10/30/keating-obama%e2%80%99s-policies-will-hurt-not-help/.

[45] U.S. Congress, Senate Committee on Homeland Security and Governmental Affairs, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, *The Effectiveness of the Small Business Administration*, 109th Cong., 2nd sess., April 6, 2006, S.Hrg. 109-492 (Washington: GPO, 2006), p. 92.

[46] Discover Financial Services, "Discover® Small Business WatchSM: Small Business Economic Outlook Remains Cautious," Riverwoods, IL, October 26, 2009, http://investorrelations.discoverfinancial.com/phoenix.zhtml?c=204177&p=irol-newsArticle&ID=1346088&highlight=.

[47] Bruce D. Phillips and Holly Wade, *Small Business Problems and Priorities* (Washington, DC: NFIB Research Foundation, June 2008), p. 5, http://www.nfib.com/Portals/0/ProblemsAndPriorities08.pdf. Note: The survey was conducted from mid-January to March of 2008 across a randomly drawn sample of the NFIB's 20,000 members. Useable questionnaires were returned by 3,530 small business owners, a 17.7% response rate.

small business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small business economic growth and job creation.[48]

Still others share the view of the ranking minority member on the House Committee on Small Business, who stated at a congressional hearing on small business access to capital, held on October 14, 2009, that he supported additional federal support for SBA programs, but tempered expectations concerning the impact of such support. He argued that other programs have a greater impact on small business economic prospects:

> With 25 million small businesses in this country, improving the capital access program of the SBA will not cure the credit and capital access ills through which the economy is suffering. We must recognize that overly restrictive regulatory policies must be corrected in order to swing the pendulum back to an appropriate middle ground for the country's capital and credit markets.
>
> Congress also must not adopt policies that sap confidence of small business owners to invest in the growth of their enterprises. Imposition of additional costs, whether it is through cap and trade legislation or increased taxes to reform health care, will reduce confidence in small businesses to take the economic risks needed to grow their enterprises. If Congress takes an approach that improves access to capital in SBA programs on one hand, and then takes away through increasing operating costs of small businesses on the other, Congress will not have accomplished anything.[49]

Current Administration Proposals and Congressional Bills

Obama Administration Proposals

On October 21, 2009, President Obama announced that the Administration's efforts (through ARRA and TARP) to improve small business access to capital had "made a real difference for small businesses across America" noting that "the Recovery Act has supported over 33,000 loans to small businesses that have already helped save or create nearly tens of thousands of jobs—nearly $13 billion in new lending.... And more than 1,200 banks and credit unions that had stopped issuing SBA loans when the financial crisis hit are lending again today."[50] He also asserted that because there is "still too little credit flowing to our small businesses" and there are "still too many entrepreneurs who can't get the loans they need to open up their doors and start hiring" new steps were needed "to support more lending to America's small businesses."[51] The

[48] Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," Washington, DC, October 21, 2009, http://www.nfib.com/newsroom/newsroom-item/cmsid/50080/; and NFIB, "Government Spending," Washington, DC, http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49051/.

[49] Representative Sam Graves, *Opening Statement for Hearing on Increasing Access to Capital for Small Business*, October 15, 2009, http://republicans.smbiz.house.gov/News/DocumentSingle.aspx?DocumentID=150611.

[50] The White House, "Remarks by the President On Small Business Initiatives," October 21, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-small-business-initiatives-landover-md.

[51] Ibid.

President announced that "The first thing we need to do is increase the maximum size of various SBA loans."[52]

SBA Capital Access Programs

On October 21, 2009, President Obama called for legislation that would increase the loan limits for the SBA's 7(a) and 504/CDC loan guarantee programs. The 7(a) loan limits would be increased from $2 million to $5 million to "help more small business owners and franchisees grow" and the SBA's 504/CDC loan limits would be increased from $2 million to $5 million for standard borrowers (supporting a total project of $12.5 million) and from $4 million to $5.5 million for manufacturers (supporting a total project of $13.75 million).[53] The Administration argued that these increases would "allow small businesses to undertake larger projects."[54] In addition, the Administration recommended that the SBA's microloan loan limit be increased from $35,000 to $50,000.[55]

On February 1, 2010, the Administration included these recommendations, and an increase in the maximum outstanding loan amount for lenders in their first year of participation in the SBA's Microloan program from $750,000 to $1 million and from $3.5 million to $5 million in the subsequent years, in its Small Business Administration FY2011 budget request to Congress.[56]

On February 5, 2010, the Administration proposed a temporary increase in the cap on SBA Express loans from $350,000 to $1 million to "expand the program's ability to help a broad range of small businesses through a streamlined approval process" and allow the refinancing of owner-occupied commercial real estate loans under the SBA's 504/CDC program for "businesses with a loan maturing in the next year who are current on all loan payments."[57] Both proposals would be financed through fees and would not require additional appropriations.

Utilizing the Community Development Financial Institutions Fund

President Obama announced on October 21, 2009, that his Administration would make "more credit available to the smaller banks and community financial institutions that [small] businesses depend on" by using the Community Development Financial Institutions (CDFI) fund to provide low-cost capital loans, subsidized by the Treasury Department at below-market rates (an initial interest rate of 3% for up to five years and then increasing to 9% to encourage timely repayment),

[52] Ibid.

[53] Ibid; and U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, October 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf.

[54] U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, October 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf.

[55] Ibid.

[56] U.S. Office of Management and Budget, *The Budget of the United States Government, Fiscal Year 2011: The Appendix* (Washington, DC: GPO, 2010), p. 1200, http://www.whitehouse.gov/omb/budget/fy2011/assets/sba.pdf.

[57] The White House, "President Obama Outlines Latest in a Series of New Small Business Proposals," February 5, 2010, http://www.whitehouse.gov/the-press-office/president-obama-outlines-latest-a-series-new-small-business-proposals.

for community banks with under $1 billion in assets.[58] Banks that choose to participate in the program will be required to submit a small business lending plan that explains "how the capital will allow them to increase lending to small businesses."[59] Participants will also be required to submit quarterly reports detailing their small business lending activities.

President Obama also announced on October 21, 2009, that the Treasury Department would create an initiative to provide even lower-cost capital loans (an initial interest rate of 2% for up to eight years and then increasing to 9% to encourage timely repayment) to certified CDFIs that document that more than 60% of their small business lending and other economic development activities target low-income communities or underserved populations.[60] In addition, he announced that the Treasury Department would work with community banks and the small business community to finalize program terms "to best support small business lending" and that Treasury Secretary Timothy Geithner and SBA Administrator Karen Mills would convene a conference "to bring together regulators, Congressional leaders, lenders and small businesses to discuss additional efforts that can be taken to improve the availability of credit to small businesses."[61] The conference was held on November 18, 2009.[62]

Small Business Tax Incentives and Utilizing TARP Funds

On December 8, 2009, President Obama proposed several tax reduction measures designed to assist small business, including the elimination of capital gains taxes on new equity investments in small businesses for one year (these are 75%-excluded now), a new short-term tax credit to encourage small businesses to hire and retain employees in 2010, and an extension of ARRA's provision to allow businesses to deduct up to $250,000 in capital investments to 2010.[63]

He also announced, without providing details, that, in addition to his CDFI initiative, he was directing "my Treasury Secretary to continue mobilizing the remaining TARP funds to facilitate lending to small businesses."[64]

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[58] U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, October 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf; and The White House, "Remarks by the President On Small Business Initiatives," October 21, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-small-business-initiatives-landover-md. Note: The CDFI Fund was created to promote economic revitalization and community development through investment in and assistance to CDFIs. It was established by the Riegle Community Development and Regulatory Improvement Act of 1994. Its FY2009 budget was $107 million. See CDFI, "About the CDFI Fund," http://www.cdfifund.gov/who_we_are/about_us.asp.

[59] U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, October 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf.

[60] Ibid.

[61] Ibid.

[62] U.S. Small Business Administration, *Treasury, SBA Host Small Business Financing Forum*, November 18, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-80.pdf; and David Lawder, "Geithner: Tight small business credit hurts recovery," *The Washington Post*, November 18, 2009.

[63] The White House, "Remarks by the President on Job Creation and Economic Growth," December 8, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth.

[64] Ibid. Note: several congressional proposals concerning the use of TARP funds for small businesses preceded President Obama's announcement. For example, on March 30, 2009, Senators Mary Landrieu and Olympia Snowe wrote to Treasury Secretary Tim Geithner asking him "to consider a program that would allow the federal government to use TARP funds to guarantee lines of credit for qualifying small businesses" and, on October 15, 2009, Senator (continued...)

In his State of the Union Address on January 27, 2010, President Obama renewed his call for small business tax incentives, proposing a tax credit for "over one million small businesses who hire workers or raise wages," the elimination of "all capital gains taxes on small business investment," and "a tax incentive for all large businesses and all small businesses to invest in new plants and equipment."[65]

The Administration's proposed $33 billion Small Business Jobs and Wages Tax Credit would provide businesses of all sizes a $5,000 tax credit against their payroll taxes for every net new employee hired in 2010 who earns at least $7,000. Business start-ups would be eligible for half of the tax credit. Businesses would also receive a bonus 6.2% tax credit on aggregate wages in excess of inflation for reimbursement of the Social Security payroll taxes they pay on those payroll increases. The wage bonus would be calculated off the firm's Social Security payroll tax base. As a result, firms would not receive a tax credit for increasing wages for employees making more than Social Security's current taxable maximum of $106,800. The maximum tax credit would be limited to $500,000 per business to target the incentives to small business. To address concerns that businesses may "seek to game the system, by, for example, replacing full-time employees with part-time employees," the proposal would limit "the maximum jobs tax credit amount to 25% of the increase in a firm's Social Security payroll wage base" and "prevent businesses from renaming themselves or merging in order to claim the credit."[66] Employers would have the option of receiving the tax credit on a quarterly estimated basis to "get money in the hands of employers earlier in the year" and to "provide an early incentive to hire."[67]

President Obama also proposed during his State of the Union Address to "take $30 billion of the money Wall Street banks have repaid [to TARP] and use it to help community banks give small businesses the credit they need to stay afloat."[68] The Administration released a "potential design" for the program on February 2, 2010. Under the proposal, banks with less than $1 billion in assets would be eligible to borrow up to 5% of their risk-weighted assets from the fund, and banks with $1 billion to $10 billion in assets would be eligible to borrow up to 3% of their risk-weighted assets from the fund. The banks would be charged a 5% dividend on the loan, but they could receive a 1% point decrease in their dividend rate for every 2.5% increase in incremental business lending they achieve over a two-year period, down to a minimum dividend rate of 1%. After five years, the dividend rate would be increased to encourage timely repayment.[69]

(...continued)

Mark Warner proposed combining resources from TARP, the Federal Reserve, and community-based banks to create a $50 billion pool of money that could be used to lend to small businesses. See U.S. Senate Committee on Small Business and Entrepreneurship, "Landrieu, Snowe call on Geithner to Stabilize Small Business Credit Lines," press release, March 30, 2009; and Senator Mark Warner, "A plan to expand help for small businesses," press release, October 15, 2009.

[65] The White House, "Remarks by the President in State of the Union Address," January 27, 2010, http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address.

[66] The White House, "President Obama to Propose New Small Business Jobs and Wages Tax Cut, Fact Sheet," January 28, 2010, http://www.whitehouse.gov/the-press-office/president-obama-propose-new-small-business-jobs-and-wages-tax-cut.

[67] Ibid.

[68] The White House, "Remarks by the President in State of the Union Address," January 27, 2010, http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address.

[69] The White House, "Administration Announces New $30 Billion Small Business Lending Fund," February 2, 2010, http://www.whitehouse.gov/sites/default/files/FACT_SHEET_Small_Business_Lending_Fund.pdf; and Damian Paletta, "White House Plans to Lend $30 billion to Small Banks," *The Wall Street Journal*, January 27, 2010. Note: (continued...)

As mentioned previously, the Administration proposed in March 2009 to encourage community banks lending to small businesses by purchasing up to $15 billion of SBA-guaranteed loans with TARP funds. The proposal was designed to "unfreeze" the SBA-secondary loan market and increase community banks' liquidity.[70] That proposal was deferred after it met resistance from lenders. Some lenders objected to TARP's requirement that participating lenders comply with executive compensation limits and issue warrants to the federal government. Smaller, community banks objected to the program's paperwork requirements, such as the provision of a small-business lending plan and quarterly reports.[71] To address these concerns, the Obama Administration proposes to transfer $30 billion in TARP funds, through legislation, to a new program that would be distinct from TARP. As a result, banks would not face TARP restrictions, such as those placing limitations on executive pay. Also, by "rebranding" the program, banks would not face the stigma of taking TARP money.[72]

Congressional Bills

H.R. 3854, the Small Business Financing and Investment Act of 2009, was introduced in the House by Representative Kurt Schrader on October 20, 2009. It combined language from eight bills and was referred to the House Committee on Small Business, which reported it, by voice vote, on October 21, 2009.[73] The House passed it, 389-32, on October 29, 2009. S. 2869, the Small Business Job Creation and Access to Capital Act of 2009, introduced by Senator Mary Landrieu, was reported out of the Senate Committee on Small Business and Entrepreneurship on December 17, 2009. Both bills would increase loan limits for the SBA's 7(a) and 504/CDC loan guarantee programs, but in different amounts, and contain provisions designed to increase small business's access to capital.

Increases in the SBA's Loan Guarantee Limits

H.R. 3854 would increase the SBA's loan guarantee limits for 7(a) loans from $2 million to $3 million. It would also increase the SBA's loan guarantee limits for 504/CDC loans from $2

(...continued)

Risk-weighted assets are a bank's assets weighted according to credit risk. Some assets, such as debentures, are assigned a higher risk than others, such as cash or government securities/bonds.

[70] The White House, "Remarks by the President to Small Business Owners, Community Leaders, and Members of Congress," March 16, 2009, http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-small-business-owners/.

[71] Emily Flitter, "Fix for SBA Snagged by Tarp's Exec Comp Limits," *American Banker*, vol. 174, no. 61 (March 31, 2009), p. 1.

[72] Damian Paletta, "White House Plans to Lend $30 billion to Small Banks," *The Wall Street Journal*, January 27, 2010; Ylan Q. Mui and David Cho, "Small Business Leery of Obama's jobs plan," *The Washington Post*, January 29, 2010, p. A14; and The White House, "President Obama to Outline New Small Business Lending Fund," February 2, 2010, http://www.whitehouse.gov/the-press-office/president-obama-outline-new-small-business-lending-fund.

[73] The eight bills merged into H.R. 3854, the Small Business Financing and Investment Act of 2009, are H.R. 3723, the Small Business Credit Expansion and Loan Markets Stabilization Act of 2009; H.R. 3739, the Job Creation and Economic Development Through CDC Modernization Act of 2009; H.R. 3737, the Small Business Microlending Expansion Act of 2009; H.R. 3740, the Small Business Investment Company Modernization and Improvement Act of 2009; H.R. 3722, the Enhanced New Markets and Expanded Investment in Renewable Energy for Small Manufacturers Act of 2009; H.R. 3014, the Small Business Health Information Technology Financing Act; H.R. 3738, the Small Business Early Stage Investment Act of 2009; and H.R. 3743, the Small Business Disaster Readiness and Reform Act of 2009.

million to $3 million for standard borrowers, from $2 million to $4 million for projects located in a low-income community, from $4 million to $8 million for manufacturers, and for up to $10 million for projects that constitute "a major source of employment" as determined by the Administration.[74]

S. 2869, similar to the Administration's proposal, would increase the SBA's loan guarantee limits for 7(a) loans from $2 million to $5 million, for the SBA's 504/CDC loans from $2 million to $5 million for standard borrowers, and from $4 million to $5.5 million for manufacturers.[75] It would also authorize the SBA to establish an alternative size standard for the SBA's 7(a) and 504/CDC programs that uses maximum tangible net worth and average net income as an alternative to the use of industry standards to "help more small businesses meet the SBA's requirements to access SBA-backed loans."[76]

Proponents argue that increasing the SBA's loan guarantee limits may lead to greater lending to small businesses and, as a result, create jobs and enhance economic growth.[77] Critics contend that increasing the SBA's loan guarantee limits is not as important to small businesses, as a group, as are the SBA's upfront loan costs and interest rates, the condition of the local regional economy, taxes, or health care costs. They also note that increasing the loan guarantee limits may reduce the total number of loans that might be available to a larger number of small businesses if the current loan limits were retained. They also assert that increasing the SBA's loan guarantee limits may lead to higher loan defaults for the SBA. [78]

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[74] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[75] S. 2869, the Small Business Job Creation and Access to Capital Act of 2009.

[76] Ibid; and Senator Olympia Snowe, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12913. Note: S. 2869 would set, as an interim rule upon enactment, the maximum tangible net worth of the applicant to be "not more than $15 million" and the average net income after federal taxes for the two full fiscal years before the date of the application to be "not more than $5 million." For additional analysis, see CRS Report R40860, *Defining Small Business: An Historical Analysis of Contemporary Issues*, by Robert Jay Dilger.

[77] U.S. Small Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*," October 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf; U.S. Small Business Administration, *Treasury, SBA Host Small Business Financing Forum*, November 18, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-80.pdf; Senator Mary Landrieu, "Increasing Loan Limits," remarks in the Senate, *Congressional Record*, vol. 155, no. 154, October 22, 2009, p. S10696; U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, committee print, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), pp. 2, 13-20, 29, 31; Representative Chellie Pingree, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), p. H12070; Representative Nydia Velázquez, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12074, H12075; and Representative Kurt Schrader, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12075, H12076.

[78] Dyan Machan, "For Small Business, Borrowing Is Not So Dire," *The Wall Street Journal*, September 2, 2009; Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," October 21, 2009, http://www.nfib.com/newsroom/newsroom-item/cmsid/50080/; Joseph J. Schatz, "As Small-Business Programs Draw Fresh Attention, Some Questions Linger," *CQToday*, October 23, 2009; Mark Zandi, "Help Small Businesses Hire Again," *The New York Times*, November 3, 2009; and Representative Pete Sessions, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12070, H12071.

Extension of ARRA's SBA Provisions

As mentioned previously, The Department of Defense Appropriations Act, 2010, enacted on December 19, 2009, provided $125 million to extend ARRA's "fee reductions and eliminations" for the SBA's 7(a) and 504/CDC programs and 90% loan guarantee limit for the SBA's 7(a) program through February 28, 2010, and P.L. 111-144, the Temporary Extension Act of 2010, enacted on March 2, 2010, provided $60 million to extend those modifications through March 28, 2010. Also, H.R. 2847, the Jobs for Main Street Act of 2009, was approved by the House on December 16, 2009. It would provide $325 million to extend those modifications through September 30, 2010. It is awaiting action in the Senate.

In addition, H.R. 3854 would extend ARRA's SBA loan guarantee percentage increases and fee reductions through the end of FY2011. It would also extend ARC, with modifications, through the end of FY2011. Under the bill, ARC's loan guarantee limit would be increased from $35,000 to $50,000, and to $75,000 in areas of high unemployment; the SBA is directed to establish a one-page application for ARC loans and to study the program's implementation to address any impediments to lender and borrower participation in the program; and borrowers may use ARC loans to refinance existing SBA loan debt.[79] The bill would also provide 100% loan guarantees for small business concerns owned and controlled by veterans, and expand and make permanent the SBA's secondary market lending authority.[80]

S. 2869 would extend the authorization to provide 90% guarantees on 7(a) loans and eliminate fees for 7(a) and 504/CDC loans through December 31, 2010. It also would allow 504/CDC loans to be used to refinance up to $4 billion in short-term commercial real estate debt each year for two years after enactment into long-term fixed rate loans. It does not address the ARC loan program.[81]

Proponents argue that extending ARRA's SBA's fee reductions and loan guarantee percentage for the 7(a) program may lead to greater lending to small businesses and, as a result, create jobs and enhance economic growth.[82] Critics contend that the Administration's proposal to use the Treasury Department's CDFI fund to provide low-cost capital loans, subsidized at below-market rates, to community banks with under $1 billion in assets and the Treasury Department's initiative to provide low-cost capital loans to certified CDFIs that document that more than 60% of their small business lending and other economic development activities benefit low-income communities or underserved populations is a more targeted approach that will cost less and achieve similar results.[83] Others argue that extending SBA's fee reductions and loan guarantee

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[79] Note: The ARC loan program has come under some criticism, primarily for having a projected default rate in excess of 50% and for implementation issues related to the SBA's paperwork requirements. On November 16, 2009, Senator Olympia Snowe introduced legislation (S. 2777) to repeal the program and return any unobligated funds to the Treasury.

[80] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[81] S. 2869, the Small Business Job Creation and Access to Capital Act of 2009.

[82] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, committee print, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), pp. 2, 13-20, 27, 28; Representative Ron Kind, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), p. H12073; and Representative Kurt Schrader, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12075, H12076.

[83] The White House, "Remarks by the President On Small Business Initiatives," October 21, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-small-business-initiatives-landover-md; and U.S. Small (continued...)

percentage for the 7(a) program is not as important to small businesses, as a group, as are the condition of the local regional economy, taxes, or health care costs.[84]

Proposed Modifications to the SBA Microloan Program

H.R. 3854 would increase the loan limits for intermediaries participating in the SBA's microloan program from $750,000 to $1 million in the first year of the intermediary's participation in the program, and from $3.5 million to $7 million in the remaining years of their participation in the program. In addition, the SBA Administrator would be provided authority to increase the intermediary's loan limit up to $10 million, "if the Administrator determines, with respect to an intermediary, that such treatment is appropriate."[85]

H.R. 3854 would also modify intermediary eligibility requirements in an effort to increase intermediary participation in the program and modify the microloan subsidy recoupment fee exemptions to allow more small businesses to prepay their microloans without penalty.[86] It would also allow intermediaries that make loans to small businesses averaging not more than $10,000, as opposed to the current $7,500, to provide loans that "bear an interest rate that is 2 percentage points below the rate determined by the Secretary of the Treasury for obligations of the United States with a period of maturity of 5 years, adjusted to the nearest one-eighth of 1 percent."[87]

S. 2869 would increase the SBA's microloan limits for borrowers from $35,000 to $50,000 and increase the maximum loan made to microlender intermediaries after their first year in the program from $3.5 million to $5 million.[88]

Proponents argue that increasing the SBA's microloan limits for intermediaries and microloan limits for borrowers may lead to greater lending to small businesses and, as a result, create jobs and enhance economic growth.[89] Critics contend that increasing the SBA's microloan limits for intermediaries and microloan limits for borrowers is not as important to small businesses, as a group, as are the condition of the local regional economy, taxes, or health care costs.[90]

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Business Administration, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses*, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_effort_credit_sb.pdf.

[84] Dyan Machan, "For Small Business, Borrowing Is Not So Dire," *The Wall Street Journal*, September 2, 2009; Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," October 21, 2009, http://www.nfib.com/newsroom/newsroom-item/cmsid/50080/; Joseph J. Schatz, "As Small-Business Programs Draw Fresh Attention, Some Questions Linger," *CQToday*, October 23, 2009; Mark Zandi, "Help Small Businesses Hire Again," *The New York Times*, November 3, 2009; and Representative Pete Sessions, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12070, H12071.

[85] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[86] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[87] 15 U.S.C. § 636(m).

[88] S. 2869, the Small Business Job Creation and Access to Capital Act of 2009.

[89] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, committee print, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), pp. 2, 10, 13-20, 33, 34; and Senator Mary Landrieu, "Increasing Loan Limits," remarks in the Senate, *Congressional Record*, vol. 155, no. 154, October 22, 2009, p. S10696.

[90] Dyan Machan, "For Small Business, Borrowing Is Not So Dire," *The Wall Street Journal*, September 2, 2009; Susan Eckerly, "NFIB Responds to President's Small Business Lending Initiatives," October 21, 2009, http://www.nfib.com/
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SBA Direct Lending Programs

The SBA currently has authority to make direct loans to small businesses, but, with the exception of disaster loans, has not exercised that authority since 1994.[91] Prior to 1995, the SBA made direct loans through its general business loan program. It provided loans of up to $150,000 to small businesses that could demonstrate an ability to repay the loans and document that they were denied guaranteed financing from a lender, and in cities of more than 200,000 residents, from at least two lenders. Prior to 1986, the SBA made direct loans to eligible small businesses subject to the availability of funds. From 1986 through 1994, it made a more limited number of direct loans under special loan programs "targeted to the needs of particular groups or types of businesses, such as handicapped individuals and/or minority businesses."[92]

H.R. 3854 would create a new, direct lending Capital Backstop program that directs the SBA to "establish a process under which a small business concern may submit an application to the Administrator for the purpose of securing a loan under this subsection."[93] If the Administrator determines that the loan application meets "basic eligibility and credit standards," the Administrator is to make the loan available to lenders within 100 miles of the loan applicant's principal office and, subsequently, to lenders in the Preferred Lenders Program. If a lender does not agree to "originate, underwrite, close, and service the loan" the Administrator shall do so.[94]

The Capital Backstop program would become operational effective on the date of enactment to September 30, 2011, and on any date afterwards if the Bureau of Economic Analysis, or successor organization, determines that U.S. gross domestic product (GDP) has decreased for three consecutive quarters. The program would then end when the Bureau of Economic Analysis, or successor organization, determines that U.S. GDP has increased for two consecutive quarters. The program would remain operative, even if U.S. GDP had increased for two consecutive quarters, if the number of loans provided under the Capital Backstop program is at least 30% less than provided prior to the same point in the previous fiscal year.[95]

S. 2869 does not address SBA direct lending authority.

Proponents of SBA direct lending argue that the failure of several major financial firms during 2008 and the subsequent freezing of credit markets and secondary markets for securitization of loans, tightening of lending standards, and decline in economic activity resulting in historically high unemployment levels signal the need to create a SBA direct lending program.[96] They also

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newsroom/newsroom-item/cmsid/50080/; Joseph J. Schatz, "As Small-Business Programs Draw Fresh Attention, Some Questions Linger," *CQToday*, October 23, 2009; and Mark Zandi, "Help Small Businesses Hire Again," *The New York Times*, November 3, 2009.

[91] U.S. Congress, Senate Committee on Small Business, *Hearing on the Proposed Fiscal Year 1995 Budget for the Small Business Administration*, 103rd Cong., 2nd sess., February 22, 1994, S. Hrg. 103-583 (Washington: GPO, 1994), p. 20.

[92] U.S. General Accounting Office, *Small Business: Financial Condition of SBA's Business Loan Portfolio Is Improving*, GAO/RCED-92-49, December 1991, pp. 14, 15, 30-34, 57-62, http://archive.gao.gov/d31t10/145560.pdf.

[93] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[94] Ibid.

[95] Ibid.

[96] U.S. Congress, House Committee on Small Business, *Small Business Financing and Investment Act of 2009*, committee print, 111th Cong., 1st sess., October 26, 2009, H.Rept. 111-315 (Washington: GPO, 2009), pp. 2, 13-20, 26, (continued...)

contend that a direct lending program would provide "rapid access to much-needed capital without having to face the administrative delays posed by the current Small Business Administration (SBA) lending process."[97] Proponents also argue that a temporary SBA direct lending program during periods of economic difficulty is necessary because:

> In prosperous times, small businesses are able to shop around to different lenders to find the best available terms and conditions for a loan. But in times of economic downturns, those same lenders aren't as willing to lend to small businesses. More than ever during these times, it's the government's responsibility to step in to help small businesses access the loans they need to keep their businesses running and workers employed.[98]

Critics contend that the SBA's mission is to augment the private sector by guaranteeing loans, not competing with it by providing direct loans to small businesses. Although the Capital Backstop program requires the SBA to first offer the loan to the private sector, critics worry that any program with a direct lending component could be a precursor to the SBA competing directly with the private sector.[99] They also argue that these loans hold greater risk than most, otherwise the private sector would accept them. They assert that SBA defaults may increase, resulting in added expense, either to taxpayers in the form of additional appropriations or to other small business borrowers in the form of higher fees, to cover the defaults.[100] The SBA stopped offering direct loans in 1995, primarily because the subsidy rate was "10 to 15 times higher than that of our guaranty programs."[101] Also, a Government Accountability Office (GAO) study of the SBA's direct lending program in 1991 found "the default percentage for guaranteed loans was only half as great (5.3 percent) as the default percentage for direct loans (10.5 percent)."[102] Since its inception through FY2008, the SBA's default rate is 20.4% for direct (non-disaster) loans to small businesses and 5.0% for guaranteed loans.[103]

Critics also assert that providing direct loans to small businesses might invite corruption. They note that the Reconstruction Finance Corporation (RFC), the SBA's predecessor, made direct loans to business and was accused of awarding loans based on the applicant's political

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97 Dan Gerstein, "Big Stimulus For Small Business, A new direct lending program would benefit millions," *Forbes.com*, January 14, 2009; Sharon McLoone, "Landrieu: Small Business to Benefit from Economic Plan," *The Washington Post*, February 6, 2009; George Dooley, "ASTA Renews Call For SBA Direct Lending Program," American Society of Travel Agents, February 18, 2009; and Anne Kim, Ryan McConaghy, and Tess Stovall, "Federal Direct Loans to Small Businesses," *Third Way Idea Brief*, April 2009.

98 Anne Kim, Ryan McConaghy, and Tess Stovall, "Federal Direct Loans to Small Businesses," *Third Way Idea Brief*, April 2009.

99 Sue Malone, *Myth: The SBA will make direct loans under the stimulus bill*, Strategies For Small Business, March 12, 2009.

100 Representative Jeff Flake, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), p. H12070, H12072.

101 U.S. Congress, Senate Committee on Small Business, *Hearing on the Proposed Fiscal Year 1995 Budget for the Small Business Administration*, 103rd Cong., 2nd sess., February 22, 1994, S. Hrg. 103-583 (Washington: GPO, 1994), p. 20.

102 U.S. General Accounting Office, *Small Business: Financial Condition of SBA's Business Loan Portfolio Is Improving*, GAO/RCED-92-49, December 1991, p. 44, http://archive.gao.gov/d31t10/145560.pdf.

103 U.S. Small Business Administration, *FY2008 Small Business Administration Loss Report*, p. 11, http://www.sba.gov/idc/groups/public/documents/sba_program_office/cfo_2008_loss_report.pdf.

connections or personal ties with RFC loan officers.[104] Critics also argue that the SBA does not have the human, physical, and technical resources to make direct loans. H.R. 3854 requires the SBA's Administrator to "establish a group of at least 250 individuals" to implement the Capital Backstop program, provide them "the training necessary to carry out" the program's activities, and ensure that "each individual in such group with loan application evaluation and underwriting responsibilities has at least 2 years experience with respect to such responsibilities."[105] Critics assert that establishing a new office within the SBA to administer a direct lending program is not as efficient or as cost-effective as relying on the private sector to make lending decisions.

Concluding Observations

Historically, small businesses (firms with less than 500 employees), especially those in the retail and construction sectors, have experienced greater job loss during economic recessions than larger businesses. Conversely, small businesses have led job creation during recent economic recoveries.[106] As a result, many federal policymakers look to small businesses to lead the nation's recovery from its current economic difficulties. As the chair of the House Committee on Small Business stated at a 2008 congressional hearing:

> There are a lot of different takes on the current financial crisis and even more opinions on how we should dig our way out of it. But regardless of your thoughts on the matter, one thing is very clear: Small businesses will be the key to economic turnaround. Whether it is by expanding the SBA role or providing targeted tax relief, entrepreneurs must have access to all the tools they need. They have powered this country out of other recessions, and they can do it again today. While current circumstances may be different from those in the past, the blueprint for recovery remains the same: more jobs and greater economic growth. That is the formula we need, and that is the formula small businesses can provide.[107]

The question currently being debated is not whether the federal government should act, but which federal policies will most likely result in small business creating the most jobs. Some, including the chairs of the House and Senate Committees on Small Business and President Obama, have agued that current economic conditions make it imperative that the SBA be provided additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs.[108] Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform

[104] Representative Jeff Flake, "Providing for Consideration of H.R. 3854, Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12070, H12072.

[105] H.R. 3854, the Small Business Financing and Investment Act of 2009.

[106] U.S. Small Business Administration, *Small Business Economic Indicators for 2003*, August 2004, pp. 3, 4, http://www.sba.gov/advo/stats/sbei03.pdf.

[107] U.S. Congress, House Committee on Small Business, *Creating Opportunities for Small Businesses in an Economic Recovery*, 110th Cong., 2nd sess., October 28, 2008, H. Hrg. 110-116 (Washington: GPO, 2008), p. 2.

[108] Representative Nydia Velázquez, "Small Business Financing and Investment Act of 2009," House debate, *Congressional Record*, daily edition, vol. 155, no. 159 (October 29, 2009), pp. H12074, H12075; Senator Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12910; and The White House, "Remarks by the President on Job Creation and Economic Growth," December 8, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth.

of financial credit market regulation, and federal fiscal restraint as the best means to assist small business economic growth and job creation.[109]

Still others argue that congressional action on the SBA is largely symbolic because the SBA's guaranteed loan programs account for a relatively small fraction of small business lending.[110] However, it also could be argued that the SBA's loan guarantee programs purposively account for a relatively small fraction of total small business lending because the SBA's mission is to augment, not supplant, the private market for small business loans. Moreover, as TARP, TALF, and ARRA demonstrate, the authorization and oversight of the SBA's programs is just one of several ways Congress can influence the market for small business loans. According to this argument, congressional action concerning the SBA should be viewed not in isolation, but as an important part of a larger effort to enhance small business access to capital and job creation.

Author Contact Information

Robert Jay Dilger
Senior Specialist in American National Government
rdilger@crs.loc.gov, 7-3110

Oscar R. Gonzales
Analyst in American National Government
ogonzales@crs.loc.gov, 7-0764

[109] National Federation of Independent Business, "Payroll Tax Holiday," http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49039/; and NFIB, "Government Spending," http://www.nfib.com/issues-elections/issues-elections-item/cmsid/49051/.

[110] U.S. Congress, Senate Committee on Homeland Security and Governmental Affairs, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, *The Effectiveness of the Small Business Administration*, 109th Cong., 2nd sess., April 6, 2006, S. Hrg. 109-492 (Washington: GPO, 2006), p. 92; and Discover Financial Services, "Discover® Small Business WatchSM: Small Business Economic Outlook Remains Cautious," Riverwoods, IL, October 26, 2009, http://investorrelations.discoverfinancial.com/phoenix.zhtml?c=204177&p=irol-newsArticle&ID=1346088&highlight=.