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## Federal Direct Loans to Small Businesses

By Anne Kim, Ryan McConaghy, and Tess Stovall

**S**mall businesses have become yet another casualty of the credit crunch caused by the ongoing financial crisis. By the end of 2008, more than half of the nation's small businesses looking for credit were unable to obtain a loan. This credit freeze will force many businesses to shut their doors, while others will be unable to expand. In either case, it means a loss of American jobs. Congress should supplement current efforts to thaw the credit market for small businesses by temporarily establishing a direct lending program within the Small Business Administration. This program could provide loans to small businesses that can't otherwise find credit, thereby potentially saving or creating tens of thousands of American jobs.

### THE PROBLEM

#### Small businesses are suffocating from the credit crunch

Small businesses have been hit hard by the current economic downturn—as many as one in four small business owners fear that their businesses will not weather the storm.<sup>1</sup> Compounding the woes of small businesses, including those that are otherwise healthy, is the lack of access to credit.

#### **Banks are shutting down lending to small businesses.**

During the fourth quarter of 2008, 70% of banks reported tightening their lending standards for small firms.<sup>2</sup> As a consequence, fewer than half of the small businesses that tried to get a loan in the fourth quarter of 2008 were able to get one.<sup>3</sup> And of the small businesses that tried to obtain a new line of credit, only three in ten succeeded in doing so.<sup>4</sup> The credit crisis is hitting small businesses across the board, including those that have been current in their payments and have no ties to high-risk sectors of the economy such as housing.<sup>5</sup>

## **The small business credit crunch is exacerbating job losses.**

From November 2007 to November 2008, more than one quarter of small businesses reported a decline in the number of jobs at their companies,<sup>6</sup> and in December 2008, only one in eight small businesses said they planned to hire new employees in the next twelve months—a 48% drop since August 2008.<sup>7</sup> In addition, the number of small businesses filing for bankruptcy rose 54% from 2007 to 2008.<sup>8</sup>

## **Current federal small business lending programs aren't keeping up.**

The 7(a) loan program is the Small Business Administration's largest and most used lending program. Under this program, the Small Business Administration (SBA) provides a guaranty of up to 85% for loans provided by private lenders to small businesses.<sup>9</sup> But because 7(a) loans are offered through private-sector banks, which are reeling from the current crisis, small businesses may not be able to get the relief they need. From the first quarter of 2008 to the first quarter of 2009, the number of loans approved by the 7(a) program dropped 57%.<sup>10</sup> Moreover, the SBA is expected to guarantee only about \$10 billion in loans this year, down from its historic norm of \$20 billion per year.<sup>11</sup>

## **THE SOLUTION**

### **Federal direct lending to small businesses**

To help ease the credit crisis for small businesses, Congress should temporarily establish a two-year, \$10 billion direct lending program through the Small Business Administration. This effort would offer low-interest loans to otherwise healthy businesses that are having trouble obtaining the credit they need for necessary operating expenses or expansion.

### **Could deliver timely relief to small businesses.**

The proposed direct lending program would be modeled after the SBA's 7(a) loan program, but instead of commercial lenders administering the loans, the SBA would directly lend to small businesses. Like the 7(a) program, the maximum loan amount available would be \$1.5 million with a maximum repayment period of 25 years.<sup>12</sup> Moreover, the SBA could establish a program relatively quickly, if it expands the infrastructure for direct lending now in place for smaller-scale, limited-purpose lending programs such as its Economic Injury Disaster Loan Program.

### **Would complement new efforts to unfreeze small business credit.**

The Obama Administration has announced several important steps for expanding the availability of private-sector lending to small businesses, including a

waiver of guaranty fees under the SBA's 7(a) program, an expansion of the federal guaranty under the 7(a) program to 90 percent, and the purchase of up to \$15 billion in securities backed by SBA loans.<sup>13</sup> The proposed direct lending program would supplement these efforts and help small businesses access financing as the credit markets thaw and return to a normal lending environment.

### **Would be a cost-effective investment in job creation.**

Small businesses are a critical engine of American job growth. Small businesses make up more than 97% of all businesses in America<sup>14</sup> and employ more than half of the American private sector workforce.<sup>15</sup> Small businesses also produce about half of the nation's annual private-sector gross domestic product, and, on average, are responsible for two-thirds of the net new private sector jobs created each year.<sup>16</sup> Helping otherwise healthy small businesses survive the downturn could save countless American jobs and position the nation for a robust recovery. Moreover, given the 7(a) program's default rate of only 7%,<sup>17</sup> the taxpayer investment in this initiative is highly likely to be repaid.

## **■ CRITIQUES AND RESPONSES**

### ***There would be abuse of the program.***

The SBA 7(a) program is widely used by many small businesses and commercial lenders, and there are mechanisms already in place to verify applications and enforce the proper use of the loans. The SBA already has experience processing and administering a high volume of applications through the Disaster Loan Program, and the proposed lending program would be no different. Small businesses are engines of growth and recovery, and we should not spare any tool available to help them remain viable in the face of current conditions.

### ***It would push out private sector lending.***

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. This solution would provide a new service under an existing government agency and based on an existing program. It does not call for the creation of a new, permanent institution. The proposed direct lending program would only be in place until the economy turns around, and then the private banks and lenders would be able to resume lending to small businesses at a steady pace.

## APPENDIX

### Details of a direct lending program for small businesses

This effort would largely be modeled after the eligibility and loan requirements of the SBA's 7(a) loan program and could make use of the SBA's existing administrative infrastructure, such as that associated with the Disaster Loan Program.

<b>Maximum loan amount:</b>	\$1.5 million
<b>Maximum interest rate:</b>	Prime Plus 4.75%
<b>Maximum length of repayment period:</b>	25 years
<b>Total length of program:</b>	Two years, \$5 billion per year
<b>Eligibility:</b>	Otherwise healthy small businesses with good credit that are currently unable to obtain loans elsewhere
<b>Use of funds:</b>	To assist in the operation, acquisition or expansion of an existing business

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#### THE AUTHORS

Anne Kim is the Director of the Third Way Economic Program and can be reached at [akim@thirdway.org](mailto:akim@thirdway.org). Ryan McConaghy is Deputy Director of the Third Way Economic Program and can be reached at [rmcconaghy@thirdway.org](mailto:rmcconaghy@thirdway.org). Tess Stovall is a Policy Advisor at Third Way and can be reached at [tstovall@thirdway.org](mailto:tstovall@thirdway.org).

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## ■ ENDNOTES

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