

Impact of the Federal Sequester on the SBA and Small Businesses

*A Report Prepared by the Democrats of the
House Committee on Small Business*

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INTRODUCTION

Since the most recent recession ended in June 2009, the economy has started to expand, albeit at a modest pace. Private sector employment has grown for 35 consecutive months, averaging 175,000 new jobs per month. Gross Domestic Product (GDP) grew for 13 consecutive quarters, showing signs of resilience as the economy tried to regain momentum. Together, these signs are promising and show significant improvements from the depths of the recession and financial crisis in 2008 and 2009.

Part of the reason for this recovery has been the contributions of small businesses. They play a critical role in our economy, creating 65 percent of net new jobs in the past 17 years, paying 43 percent of U.S. private payroll, and representing 99.7 percent of all employer firms. These impacts are especially critical during the period after a downturn when the economy is searching for renewed momentum.

According to ADP, it has been the smallest firms that have shown the greatest resilience during the last four years.¹ In fact, small firms with less than 500 employees have added 2,952,000 jobs

Firm Size	Jobs Added Since June 2009
1-499	2,953,000
500+	1,376,000

since June 2009, while larger firms with more than 500 employees have added just 1,376,000 jobs. While contributions from firms of all sizes are necessary to move the economy forward, it is clear that small firms have been adding jobs at a rate of more than twice that of their larger counterparts. This was punctuated in January, when small businesses added 194,000 new jobs and the largest corporations reduced employment by 2,000. Such an occurrence shows the vital importance of small businesses to the ongoing economic recovery.

Because small firms are such key drivers of this growth, it is crucial that they always have access to the resources and tools they need to start-up and expand. This includes access to capital, competing for federal contracts, and ensuring that entrepreneurs can secure training and technical assistance at no or very low cost. Such services are available through the Small Business Administration (SBA) and are part of our nation's commitment to entrepreneurship.

¹ Data from ADP National Employment Report Historical Data, January 2013.

The sequester, set to take effect March 1, 2013, has the potential to undermine this commitment by reducing SBA funding across-the-board. As a result, lending, contracts, and training for small businesses will be diminished and the economy will lose a key stimulus for growth and job creation. To this point, it is estimated sequestration itself will reduce GDP growth in 2013 by approximately 0.6 points.² Similarly, the sequester will also reduce employment by 700,000 jobs, thereby increasing the unemployment rate by a quarter of percent.³ During the current period of economic recovery, our nation simply cannot afford to take a step back. By not taking steps to avoid this sequester, we are risking doing just that. To this end, the following report assesses the sequester's impact on the SBA and examines its effect on small businesses and job creation.

AGENCY OVERVIEW

In 1953, Congress passed the Small Business Act (P.L. 83-163), which authorized the SBA. As specified in the Act, the SBA's mission is to promote the interests of small businesses and to enhance competition in the private marketplace by providing aid, counsel, assistance, and protection to small businesses.

To carry out this mission, the SBA's operating budget for FY 2013 is approximately \$1.1 billion. This funding supports every aspect of the administration, from business loan making to assisting veteran-owned businesses. Should sequestration go into effect, the SBA will lose nearly \$60 million. As shown in the table below, such a broad across-the-board cut will result in reductions to small business services, loss of lending authority, reduced oversight of private-sector lending partners, and many other areas that help our nation's small firms succeed.

² Due to the sequester, the Congressional Budget Office and Macroeconomic Advisors forecast that GDP would be reduced by 0.6 percent in 2013.

³ Due to the sequester, Macroeconomic Advisors forecasts job losses of 700,000 by the end of 2014.

Table 1. Agency-wide Impact of Sequestration

Agency Program	Budgetary Reductions	Small Business Resources Lost Due to Sequester
Budget		
Total	\$ 1,115,381,000	\$ 59,115,193
Loan Subsidy	\$ 335,680,000	\$ 17,791,040
Personnel		
Administration & Business Lending	2181	116
Disaster Lending & Servicing	1021	54
Inspector General	120	6
Risk Management		
Lender Reviews	200	11
8(a) Contracting Review	7610	403
Business Lending		
Loans Made	52,174	2,765
Gross loan volume	\$ 29,271,397,500	\$ 1,551,384,068
Surety Bonds		
Bonds Issued	8,850	469
Contracts Supported	\$ 3,700,000,000	\$ 196,100,000
Veterans Business Development		
Veterans assisted	112,000	5,936

The administration will also lose \$17.7 million in business lending subsidy, which at current lending rates will prevent lending after late August. Risk management is a vital part of the SBA's ability to prevent waste, fraud, and abuse of lending and contracting programs. Sequestration will reduce examinations of private-sector lenders, as well as of 8(a) firms. Any fraudulent conduct not uncovered due to a reduction in oversight may cost taxpayers millions of dollars.

As announced by President Obama in his State of the Union address, upwards of 34,000 veterans will begin returning home from Afghanistan over the next year. Some of these veterans will choose to open a new small business and seek assistance from the SBA's Office of Veteran Business Development. The administration anticipated its funding could assist 112,000 veterans, but a sequestration will likely reduce that figure by at least 5,936.

Taken together, these reductions will make it more difficult for would-be entrepreneurs to start a business and for existing businesses to obtain the resources they need to expand.

SMALL BUSINESS FINANCING

The SBA administers an array of financing programs that are intended to bridge the gap in the conventional markets that small businesses encounter in trying to secure access to affordable capital. In the 7(a) and 504 programs, entrepreneurs are provided with greater access to capital through the extension of federal guarantees on long-term loans. These loans can be used as working capital, or to buy inventory, equipment, and real estate. In the Microloan program, entrepreneurs receive SBA-subsidized small dollar loans in conjunction with basic managerial and technical assistance to better assist owners in operating their business.

The common thread in the SBA's lending programs is that the SBA relies on private-sector intermediaries to deliver credit to small firms. The agency does not directly provide capital to small businesses, but instead shares the risk of loss with banks and investors, thereby enabling these lenders to provide small businesses with greater access to capital than they could otherwise obtain in the conventional market.

As of February 1, 2013, the SBA has approved 16,846 loans totaling \$9.751 billion.⁴ At the current lending rate, the SBA is projected to make over 52,000 loans supporting \$29.3 billion in financing, thereby extending the maximum amount of SBA-guaranteed credit authorized under the lending caps.

By providing small businesses with nearly \$30 billion annually,⁵ the SBA plays a significant role in the labor market. As shown in table 1, SBA capital access programs will likely create or retain nearly 400,000⁶ small business jobs in FY 2013. For comparison, the US economy only created 253,000 jobs across all business sectors over the past two months. Clearly, any reduction in access to SBA-guaranteed capital will have real world impacts on job creation.

Table 2. Projected FY 2013 SBA Lending and Job Creation

Program	Projected number of small business loans in FY2013	Projected lending volume (in \$) in FY2013	Jobs created or retained due to SBA lending in FY2013
7(a) Term Loans	42,657	\$ 16,038,375,000	213,845
504/CDC	7,881	\$ 13,215,022,500	176,200
Microloan	1,636	\$ 18,000,000	240
Total	52,174	\$ 29,271,397,500	390,285

⁴ Includes full amount of 504/CDC mortgages.

⁵ The SBA supported \$31.7 billion in FY2011 and \$31.9 billion in FY2012.

⁶ \$75,000 in capital helps small businesses create or retain one job.

If the sequester occurs, SBA lending will be substantially curtailed. While the cuts will result in an approximate 5.3⁷ percent reduction on an annualized basis, they would be closer to a 9 percent decrease when considered over the seven month period starting on March 1, 2013, when they are scheduled to take effect.⁸ The result will be thousands of businesses unable to secure the capital they need to survive and grow. In turn, cash-strapped businesses will have to cut jobs or postpone adding new employees.

Table 3. Reduction in SBA Lending and Jobs Lost Due to Sequester

Program	Reduction in lending volume (in \$) caused by sequester	Projected number of small business loans lost to the sequester	Jobs lost due to sequester
7(a) Term Loans	\$ 850,033,875	2,261	11,334
504/CDC	\$ 700,396,193	418	9,339
Microloan	\$ 954,000	87	13
Total	\$ 1,551,384,068	2,765	20,685

Over \$1.5 billion in SBA-guaranteed lending will be lost due to the sequester. Under current loan demand, the SBA will exhaust its reduced lending capacity by late summer. As a result, more than 2,765⁹ small businesses may be denied an SBA loan. These businesses would have created or retained 20,685 jobs.

For over 50 years, the SBA has been a leader in assisting small businesses access capital when lending markets tighten. In the three years following the economic collapse of 2009, the SBA has facilitated lending to 176,000 small businesses totaling \$87 billion and helped create or retain 840,000 jobs. With the economy showing signs of an accelerated recovery and the CBO anticipating strong economic growth in 2014, reducing access to capital now will hinder our ability to put Americans back to work, curb the deficit, and revitalize the economy.

SMALL BUSINESS PROCUREMENT

The primary purpose of the SBA’s Government Contracting and Business Development is to help small businesses increase their access to the federal marketplace. Through federal contracts, small businesses are able to increase their capabilities and capacity thereby improving their competitiveness. The programs that are operated out of the SBA include the following: 7(j); 8(a); HUBZone; Prime Contracting; Subcontracting; and Business Matchmaking.

⁷ Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, February 2013.
⁸ Testimony of Daniel I. Werfel, Controller, Office of Management and Budget, before the Senate Appropriations Committee, February 14, 2013.
⁹ Based on the average-sized 7(a), 504/CDC, and Microloan through February 1, 2013.

With over 20,000 businesses assisted in FY 2012 and over 100,000 eligible for services, these programs impact the ability of small businesses to compete in the federal marketplace. However, with cuts resulting from sequestration, SBA will have \$5.5 million less in funding to provide training and assistance to small businesses (see Table 4 below).

Table 4. Effect of Sequestration on Small Business Procurement Programs

Program	FY 2012 Budget	Reduction Due to Sequester
7(j)	\$3,270,000	\$163,500
8(a)	\$61,758,000	\$3,087,900
HUBZone	\$12,165,000	\$608,250
Prime Contracting	\$24,273,000	\$1,213,650
Matchmaking	\$3,736,000	\$186,800
Subcontracting	\$4,790,000	\$239,500
Total		\$5,499,600

Due to this \$5.5 million reduction, more than 1,000 small businesses will go without the support they need to access the federal procurement marketplace (see Table 5 below). Without this support, many firms will face challenges in securing contracts, causing them to shed employees and reduce operations. This will impair economic growth, particularly in regions with high proportions of government contractors.

Table 5. Impact on Small Businesses

Program	Reduction Due to Sequester	Cost Per Business Assisted	Businesses Left Without Assistance
7(j)	\$163,500	\$921	178
8(a)	\$3,087,900	\$7,266	425
HUBZone	\$608,250	\$1,232	494
Total			1,096

In order to ensure that small businesses receive their fair share of federal contracting opportunities, the Small Business Act sets forth a government-wide 23 percent goal of federal contracts that should be awarded to small businesses. Additionally, the Act sets goals for certain subcategories of businesses: 5 percent for both small disadvantaged businesses and women-owned businesses; and 3 percent for HUBZone and service-disabled veteran-owned businesses.

However, the sequester will reduce every agency's discretionary budget, where contracts are most often funded, resulting in small businesses losing a significant amount of contracting dollars. These businesses will be particularly affected as sequestration will impact them more in the last two quarters of the fiscal year. In FY 2012, 63 percent of small business contracting dollars were awarded from March to September. The impact will be even greater as agencies prorate the cuts over only seven months instead of the entire year. This will effectively require civilian agencies to reduce accounts by 9 percent, while the Department of Defense must make cuts equal to 13 percent from March to September instead of the 5 percent and 8 percent cuts, respectively, over the entire fiscal year.¹⁰ Using the FY 2012 contracting numbers during the same period, Tables 5 and 6 illustrate how many actions and contracting dollars will be lost due to the automatic cuts.

At the Department of Defense, small businesses stand to lose more than 79,000 contracts or \$5.3 billion. Among those that will be most affected will be small disadvantaged businesses (SDB), 8(a) firms, Service-Disabled Veteran-Owned Small Businesses (SDVOSB), and Women-Owned Small Businesses (WOSB). SDBs will lose nearly \$2 billion in contract opportunities, while SDVOSBs will be unable to compete for more than \$650 million in contracts that would have been awarded had the sequester not gone into effect.

Table 6. Impact of Sequester on Small Business Contracts at the Department of Defense

DoD Contracting	Small Business Contracts Lost Due to Sequester	
	Number	Dollar Amount
Total Defense	79,167	\$ 5,338,810,315
SDB Defense	16,516	\$ 1,993,876,385
8(a) Defense	5,986	\$ 1,022,885,692
SDVOSB Defense	4,605	\$ 652,315,653
WOSB Defense	15,123	\$ 891,086,363
HUBZone Defense	4,178	\$ 588,849,018

¹⁰ Testimony of Daniel I. Werfel, Controller, *supra* note 8.

For non-defense civilian agencies, the cuts to small business contracts will also be significant (see Table 7 below). Due to the sequester, small businesses will lose out on nearly 44,000 contracts or \$2.2 billion. For those businesses that work with agencies such as NASA, the Department of Health and Human Services, and the Department of Transportation, among others, the sequestration will mean a loss of contracting opportunities.

Table 7. Impact of Sequester on Small Business Contracts at Civilian Agencies

Civilian Agency Contracting	Small Business Contracts Lost Due to Sequester	
	Number	Dollar Amount
Total Civilian	43,728	\$ 2,228,492,606
SDB Civilian	7,369	\$ 828,408,075
8(a) Civilian	2,519	\$ 377,116,718
SDVOSB Civilian	2,970	\$ 406,501,294
WOSB Civilian	7,733	\$ 450,168,559
HUBZone Civilian	1,679	\$ 144,535,146

This loss in contracting actions and dollars will have a tremendous impact on the ability of small businesses to not only create jobs but also to retain the employees they already have. Unlike larger firms, the loss or award of one contract can mean the difference between building their capacity and capabilities and closing their doors. Ultimately, the over \$7 billion loss in contracting dollars could mean a forfeiture of more than 100,000 employees. This could multiply as the loss of contracts trickles down to the thousands of subcontractors and suppliers who would no longer have orders to fill. Since the economy has only just started to recover and the unemployment rate is beginning its decline, cuts of this size would only negate the progress the economy has made and further limit the ability of small businesses to access the federal marketplace.

ENTREPRENEURIAL DEVELOPMENT

Since 1953, the SBA has provided technical assistance and counseling to small businesses and would-be entrepreneurs. Today, these programs span a range of initiatives, including the Small Business Development Center (SBDC), the Women's Business Center (WBC), and the SCORE programs. Providing free or low-cost assistance for business plan development, raising capital, international trade, regulatory compliance, and marketing, these entities provide tools and resources to small businesses across the country.

In FY 2012, the SBA provided nearly \$160 million to about 14,000 resource partners, including more than 900 Small Business Development Centers, 108 Women's Business Centers, and 364 chapters of the mentoring program SCORE. According to the SBA, more than 1 million aspiring entrepreneurs and small business owners receive training from an SBA-supported resource partner each year. Additional resources include those provided through the Microloan Technical Assistance, Native American Outreach, and Veterans Business Development programs. Together, through all of these initiatives, new firms are given the tools to start-up, while existing concerns are provided with the technical know-how to become more successful.

The cost of operating these entrepreneurial development programs (see Table 8 below) includes more than \$110 million for the SBDC program, which delivers small business training and counseling through a national network of 63 lead centers and 900 locations. In 2011, SBDCs assisted more 210,000 small businesses, including 108,000 start-ups and 102,000 existing firms; more than 13,600 new businesses were started with SBDC assistance. As a result, SBDCs generated more than \$182 million in state revenues and \$234 million in federal revenues, meaning that for every dollar spent on SBDCs, \$1.62 in state revenues and \$2.09 in federal dollars were generated.¹¹

Table 8. Current Status of SBA's Entrepreneurial Development Program^{12,13}

Program	FY 2012 Spending	Number of Locations	Small Businesses Assisted
Small Business Development Center Grants Program	\$112,500,000	900	210,000
Microloan Technical Assistance Program	\$20,000,000	181	3,999
Women's Business Center Grants Program	\$14,000,000	108	138,923
SCORE (Service Corps of Retired Executives)	\$7,000,000	364	356,837
Veterans Business Development Program	\$2,500,000	16	137,011
Native American Outreach Program	\$1,250,000	na	3,116
Total	\$157,250,000	1,569	849,886

While other programs lack the breadth of the SBDC network, they provided significant contributions as well. The Microloan Technical Assistance supported nearly 4,000 businesses and when combined with financing, sustained 13,271 jobs. The WBC program assisted more than 135,000 business owners and helped launch more than 500 new firms. SCORE provided counseling to over 350,000 entrepreneurs, while Veterans initiatives provided entrepreneurial training to almost 140,000 veterans.

Unfortunately, if the sequester occurs, these small business resources will be substantially curtailed. While the cuts will result in an approximate 5 percent reduction on an annualized basis, they would be closer to a 9 percent reduction when considered over the seven month period starting on March 1, 2013 when they are scheduled to take effect.¹⁴ The result is a sharp reduction in the number of locations that serve small businesses. Closed would be 45 SBDCs, 9 micro intermediaries, 5 Women's Business Centers, 18 SCORE Chapters, and 1 Veterans Business Outreach Center (see Table 9 below). In total, there would be 78 fewer entities for small businesses to seek free or low-cost expert assistance through.

¹¹ Association of Small Business Development Centers, *SBDC Economic Impact*.

¹² U.S. Small Business Administration, *FY 2013 Congressional Budget Justification and FY 2011 Annual Performance Report*, February 2012.

¹³ Congressional Research Service, *Small Business Management and Technical Assistance Training Programs*, July 25, 2012.

¹⁴ Testimony of Daniel I. Werfel, Controller, *supra* note 8.

Table 9. Projected Impact of Sequestration on SBA Entrepreneurial Development Programs¹⁵

Program	Number of Locations Closed	Potential Small Businesses Unable to Assist
Small Business Development Center Grants Program	45	10,500
Microloan Technical Assistance Program	9	200
Women's Business Center Grants Program	5	6,946
SCORE (Service Corps of Retired Executives)	18	17,842
Veterans Business Development Program	1	6,851
Native American Outreach Program	na	156
Total	78	42,494

This reduction in capacity will affect small businesses seeking training and technical assistance. Across these programs, nearly 42,500 small businesses and almost 7,000 veteran entrepreneurs, some returning from Afghanistan, would be unable to receive the help they need. Growing businesses, many of which depend on the support provided through these entities, will either have to go without assistance or look to other higher cost consulting services.

Reducing these cost-efficient services will both decrease the success of small businesses and their ability to create new jobs. Based on data from ASBDC, each SBDC on average creates or helps retain 145 jobs annually.¹⁶ Assuming a similar impact across all locations, the loss of 78 centers would translate into a decrease of 11,310 jobs annually. Depending on the community, such losses could be significant and difficult to replace, especially given the low-cost per job, either created or retained, of operating these SBA programs. Given this, steps should be taken to avoid the sequestration of funding for these cost-efficient entrepreneurial development initiatives.

TRADE ASSISTANCE

The Small Business Administration (SBA) provides direct export financing assistance as well as indirect promotion services for small businesses. The primary mechanism for the agency's trade promotion activities stems from the SBA Office of International Trade (OIT). SBA's OIT assists with four stages of export promotion including: 1) identifying small businesses interested in export promotion; 2) preparing small businesses to export successfully; 3) connecting small businesses to export opportunities; and 4) supporting small businesses once they find export opportunities.

¹⁵ Analysis prepared by the staff of the House Small Business Committee.

¹⁶ Association of Small Business Development Centers, *supra* note 11.

In FY 2011, OIT assisted 1,346 small business exporters access capital through its three export programs – Export Express, Export Working Capital, and International Trade loans – in the amount of \$924 million through 387 lenders, and supported \$1.8 billion in export sales. Its staff counseled 5,662 and trained 4,768 small businesses on export finance, while the SBA counseled small business exporters at 20 Commerce Department international buyer program events.

Additionally, the SBA trained 3,518 and counseled 3,280 lenders on SBA export loan guaranty programs. The SBA also counseled or trained 10,388 businesses on export finance at 20 U.S. Export Assistance Center (USEACs) locations nationwide in FY 2011. The Agency collaborated with the Department of Commerce Trade Information Center, Export.gov, the Trade Promotion Coordinating Committee, and Small Business Development Centers to develop small business counselor international trade certificate training at the intermediate and introductory levels.

As a result of sequestration, SBA will be unable to provide the same level of service to small exporters that it has in the past. The SBA will have to reduce lending by approximately \$46 million, leaving nearly 70 small exporters without financing (see Table 10 below). This lack of capital will prevent these small firms from reaching their potential and reduce export sales by \$90 million.

Table 10. Impact of Sequestration on SBA Trade Assistance Programs¹⁷

Program	Number of Small Business Left Without Assistance
Small Business Export Loans	67
International Trade Training	522
Total	589

In addition, SBA’s ability to provide counseling through USEACs will be curtailed. More than 500 businesses will be unable to receive such assistance due to these cuts, leaving many without technical support regarding export finance, trade and customs regulation, and foreign market operations. Without such assistance, small firms will be unable to fully achieve their goals of penetrating the global marketplace.

¹⁷ U.S. Small Business Administration, *supra* note 12.

CONCLUSION

Due to the sequester, the U.S. economy will suffer wide-ranging setbacks. An estimated 700,000 jobs will be lost and economic growth will be reduced by more than half of a percent. Secondary effects may persist, including declines in consumer spending and home prices, which would discourage investment. Taken together, the cuts set to take effect on March 1, 2013 will hinder the economy and constrain job creation.

While the impacts are far-reaching, they will be particularly significant for small businesses. As this report demonstrates, sequestration will adversely affect America's small businesses by eroding the tools and resources that so many would-be entrepreneurs utilize to start a new endeavor. While the U.S. has always prided itself on values like ingenuity, innovation, and self-reliance, reducing investment in the very initiatives that support these ideals is short-sighted.

Loans to small businesses will be reduced by \$1.5 billion, translating to a decrease of 20,000 new jobs. A further \$7.5 billion in small businesses contracts will also be lost, jeopardizing up to 100,000 employees. These outcomes, when combined with the closure of nearly 80 entrepreneurial training and counseling centers, will undermine our nation's historical commitment to small businesses.

From a cost-benefit perspective, such an outcome should be avoided. Over the long term, the SBA's annual budget of approximately \$1 billion supports more than \$30 billion in lending and nearly 600,000 jobs, assists nearly \$100 billion awards in small business contracts; and aids the start-up of more than 15,000 new companies. Clearly, the return on investment – namely stimulus, employment gains, and tax receipts – exceeds its annual budget. Shortchanging this agency and the work it does weakens our economy's ability to add new employment opportunities and gain greater momentum.

It is not just the cuts to the SBA that will destabilize small businesses. Given the sweeping nature of the sequester, other agencies that spur innovation and entrepreneurship will also be impacted. Cuts to investment in basic research at the National Institutes of Health and the National Science Foundation will impair innovation, while reductions in education spending will impede the next generation of entrepreneurs. Taken together, the climate for small businesses will rapidly become more austere.

Small businesses remain central to the U.S. economy, generating new jobs and creating pockets of growth in communities across the nation. Sequestration, if executed, will reduce their access to the tools and resources they need to expand. Doing so will hold back their ability to make these valuable contributions and potentially short-circuit the economic stimulus that so often comes as a by-product of their efforts.