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Why the Small Business Administration's Loan Programs Should Be Abolished

Veronique de Rugy
American Enterprise Institute

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Section 1: Introduction

The promotion of small business is a cornerstone of U.S. economic policy. Policymakers constantly point to small businesses as important sources of employment and economic growth.¹ There are about 25 million small firms in the U.S., employing almost 50 percent of all workers. Hence, even when politicians find little else to agree on, there is strong bipartisan support for government intervention aimed at promoting small business.

A particular area of concern for policymakers is whether, in a free market, small businesses can access sufficient credit. The imperfections of credit markets, particularly for small businesses, are often used as the quintessential illustration of a market failure that necessitates government intervention.

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 of 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.

Encouraging lending to small businesses is one of the primary purposes of the Small Business Administration (SBA). Established as a tiny lending agency in 1953, the SBA has mushroomed into a multibillion dollar financial institution with a significant presence in the credit market. By the 1990s, the SBA had become a conglomerate agency pursuing multiple policy objectives. New programs were established to provide venture capital to growth-oriented companies, assist minority entrepreneurs, and lend management assistance to firms struggling to compete.

According to the SBA's Office of Advocacy, nearly 20 million small businesses have received assistance from one of the SBA's many programs since 1953. In particular, the SBA's flagship loan guarantee program, the 7(a) program, has grown significantly over the past decade.

This paper is devoted to a basic question: are these SBA loan guarantees desirable? Should the SBA remain in the banking, credit allocation, and subsidy business or should these activities be terminated? The paper asks whether there is in fact a market failure that justifies government intervention via the SBA. If there is a market failure, are the SBA programs well designed to address the problem? Or if there is no market failure, does the SBA help achieve policy goals important enough to justify its meddling in a well-functioning market?

This paper concludes that there seems to be no failure of the private sector to allocate loans efficiently, thus discrediting the economic justification for any government-sponsored small business lending or loan guarantee program. Absent such a clearly identified problem, the SBA's activities are simply a wasteful, politically-motivated subsidy to this sector. Moreover, even if to some extent the private sector fails to allocate loans efficiently, it remains to be proven that government intervention is a more desirable alternative.

The paper also demonstrates that even if credit were a serious problem for small firms, SBA loans wouldn't make a significant difference. Judging based on the SBA's ability to meet announced public policy goals—namely filling the gap between the demand and supply of small business loans, particularly for minority- and women-owned small firms—this work finds no evidence that the SBA loan guarantees serve any focused or rigorously defined public policy purpose at all.

Section 2: Is the SBA Loan Guaranteed Programs Justified Economically?

The SBA's 7(a) loan guarantee program rests on the dubious premise that small businesses are denied adequate credit in the free market because of a market failure.

The most frequently cited obstacle to new business formation is the inability of would-be entrepreneurs to acquire the capital necessary to start a business. The assumption underlying the SBA loan guarantee program is that creditors do not lend to small businesses because they are too risky. In a perfect market, creditors would increase their prices to adjust for the higher risk, and in equilibrium, no small businesses would be left without the loans they wanted. The argument is that capital markets are not perfect, however, and as a result, small businesses cannot always get the capital they need to get started or to expand. But when the SBA guarantees a portion of a small business loan, it takes on some of the risk. In this way, the SBA gives lenders an incentive to offer loans to individuals who would otherwise be too great a risk.

In this model, SBA loan guarantees for small businesses are justified as a way to correct financial market inefficiencies that make it difficult for small firms to access capital. But do small businesses really have a hard time accessing capital and getting loans from banks?

2.1. The Market Failure Theory

Small businesses have an acute need for capital. A study by Holtz-Eakin et al. (1994), for example, shows the importance of capital to small business success.² Using data from the 1981 and 1985 federal individual income tax returns of a group of people who received inheritances, the authors demonstrate that “liquidity constraints exert a noticeable influence on the viability of entrepreneurial enterprises.” They explain that “a \$150,000 inheritance increases the probability that an individual will continue as a sole proprietor by 1.3 percentage points, and if the enterprise survives, its receipts will increase by almost 20 percent.”

However, many economists contend that private lending institutions may fail to allocate loans efficiently, especially small business loans. One source of inefficiency might be the increasing concentration in financial markets, which theoretically may make it more difficult for small firms to access capital. Edwards (1964) shows that lenders in highly concentrated financial markets will charge higher loan prices than lenders in less concentrated market.³ Others, such as Buck et al. (1991), point out that higher prices for financial services exist in financially concentrated markets.⁴ The market power held by lenders makes it much harder for small business ventures to acquire capital, which then hinders their ability to start and survive. Because the recent trend in financial markets is towards greater concentration, we might expect to see small businesses with greater difficulties accessing capital.

In addition to market power, adverse selection and moral hazard may also make financial capital markets inefficient. In their seminal paper “Credit Rationing in Markets with Imperfect Information,” Stiglitz and Weiss (1981) explain that the asymmetry of information between lenders and borrowers—potential borrowers know their own financial situation and likelihood of repayment far better than lenders—makes credit rationing the natural equilibrium result in financial markets.

Credit rationing is defined as “whenever a borrower’s demand for credit is turned down although this borrower is willing to pay all the price and non-price elements of the loan contract.” In other words, there is rationing when credit is allocated by means other than price.

There are two types of rationing. First, rationing can occur when members of an identifiable group, such as members of a particular community or people of a particular race or gender, are more likely to be rejected for loans than members of another group. The second type of rationing occurs within a group that is homogeneous from the lender's viewpoint. Although the individuals appear similar, some get loans and others do not.

Stiglitz and Weiss note that a bank's expected return depends on the interest rate it receives on the loan and the probability of repayment, or in other words, the riskiness of the loan. Different borrowers have different probabilities of repaying their loans. If information about borrowers is difficult to acquire, then lenders have a hard time identifying borrowers who are more likely to repay them. This in turn gives rise to adverse selection and moral hazard.

Adverse selection affects the ability of markets to allocate credit by price because it removes the lower-risk borrowers from the set of potential borrowers. The mechanism is the following. High-risk borrowers are more willing to agree to a higher interest rate because they perceive that their probability of repaying the loan is lower than average. In other words, these are less creditworthy borrowers. If lenders offer an interest rate that reflects the average risk of all borrowers in the market, it will attract a large share of loan applicants from the high risk/less creditworthy pool of borrowers. Given this mix of applications, the lending rate is now too low and the bank's profit will suffer.

However, increasing the rate will not solve the problem. As lenders raise loan prices, they discourage low-risk borrowers from requesting loans, and the borrower pool becomes riskier and riskier. In addition, moral hazard comes into play. Because a higher interest rate reduces the expected return for projects, it encourages high-risk borrowers to enter the credit market and encourages all borrowers to engage in riskier projects—ones with lower probability of succeeding but higher payoffs when successful. Thus, the average default risk of a lender's portfolio increases with higher loan prices. Stiglitz and Weiss therefore suggest that lenders in markets with high-risk borrowers have an incentive to ration credit rather than offer higher loan prices.

According to this theory, under these conditions—the inability of banks to distinguish between high- and low-risk borrowers—the demand for credit may exceed the supply in equilibrium. The traditional solution to this problem is to increase the price of loans (i.e., increase the interest rate), which would decrease the demand for credit. But because of the two effects outlined above, this doesn't happen in the case of credit markets. Instead of increasing its rate, the bank will ration credit and worthy projects will be denied loans.

Advocates of SBA loan guarantees argue that to the extent that small firms are credit-rationed, government interventions may be justified because of the deadweight losses associated with not funding all worthy projects.

2.2. The Not-So-Rationed Credit Market

The main conclusion in Stiglitz and Weiss (1981) is that, due to the asymmetry in information between lenders and borrowers, the free market equilibrium in the financial markets leaves some deserving loan applicants without needed funding. This leads Stiglitz and Weiss, and others, to argue for government intervention. Indeed, the rationale behind SBA loan guarantees is that small firms have difficulty accessing capital markets.

However, in recent years, a growing body of research has challenged the widely-held belief that credit rationing makes it difficult for small businesses to obtain capital. A series of

papers by de Meza and Webb questions the theoretical underpinnings of the Stiglitz and Weiss model. De Meza and Webb (1987) show that if entrepreneurs differ in intrinsic ability, not just in project risk as Stiglitz and Weiss assume, then the equilibrium result is overinvestment; i.e., too many projects are funded.⁵ Supporting this model, Cressy (1996) finds that once human capital variables are controlled for there is no evidence of credit rationing.⁶ De Meza and Webb (1999) emphasize that in their alternative model, even if there is a positive relationship between an individual's wealth and his probability of starting a business, there may be excessive lending.⁷ De Meza and Webb (2000) show that even credit rationing, the classic symptom of underinvestment, is consistent with their model of excessive lending.⁸ De Meza (2002) adds that the tendency of would-be entrepreneurs to be overly optimistic about their chances for success also contributes to the problem.⁹ The firm conclusion of their work is that government intervention is not necessary and may actually be detrimental to entrepreneurship.

In addition to these theoretical arguments, it is also interesting to observe that the National Federation of Independent Business (NFIB), the largest small business advocacy group, does not lobby Congress to promote the SBA loan guarantee programs. In fact, facilitating access to capital markets is nowhere in their 22-page agenda.¹⁰ This is consistent with the fact that historically, support for the SBA came from members of Congress rather than small business owners.¹¹ More importantly, an increasing number of empirical studies show that small businesses do not face significant credit constraints and that the private market seems to be operating efficiently.

For instance, the Federal Reserve Board's Report to Congress on the Availability of Credit to Small Businesses (2002) explains that the demand for small business financing closely tracked the pattern of debt growth from 1997 to 2002, which suggests a correlation between the demand and supply of financing.¹² The report notes that credit terms and standards at banks for small businesses were generally favorable from 1997 to 2000. Although conditions deteriorated substantially in 2001 and the beginning of 2002, small businesses did not appear to have found financing conditions onerous during that period, nor did they suddenly have more difficulty accessing credit.¹³

The Census Bureau's 1992 Characteristics of Business Owners survey shows that low sales are a much more important factor in small business failures than a lack of access to financing (Table 1). Of all the unsuccessful businesses in the survey, 71.7 percent of owners blamed "inadequate cash flow or low sales" while only 8.2 percent said a "lack of access to business loans/credit" led to the end of the business. Minority- and women-owned businesses showed the same trend, although the percentage of owners citing lack of credit as a problem tended to be higher.

By examining the connection between wealth and business formation rates, Hurst and Lusardi (2004) debunk the traditional liquidity constraint argument that households are unable to borrow to finance their entrepreneurial projects.¹⁴ They explain that because small business ownership is a risky venture, households with higher tolerance for risk should be more likely to become business owners, all else equal. High-wealth households display a higher propensity to take risk, yet data from the Panel Study of Income Dynamics shows that wealthier people do not have a higher probability to start a business. In fact, Hurst and Lusardi demonstrate that except for the very wealthy, there is no relationship between household wealth and the probability of starting a business.¹⁵

This is not to say, however, that all potential entrepreneurs have unlimited access to affordable credit. Rather, it means that even if some people wanting to start small businesses are

currently liquidity-constrained, these constraints “are not empirically important in deterring small business formation in the United States.”¹⁶ In other words, the evidence suggests that being poor does not hinder one’s ability to start a business.

Research by Levenson and Willard (2000) supports this finding.¹⁷ They argue that to measure credit rationing, it is necessary to count not only firms that are denied credit, but also firms that are discouraged from applying for credit because they fear denial. Using data from the 1988 National Survey of Small Business Finance, they estimate that only 2.14 percent of small businesses did not obtain the funding for which they applied in 1987-88, and 4.22 percent of firms were discouraged from applying. Thus, only 6.36 percent of firms were credit-rationed in 1987-88. They emphasize that this is an upper bound estimate since they cannot distinguish between non-creditworthy firms, which were appropriately denied credit, and creditworthy firms, which were legitimately credit-constrained.

Hurst and Lusardi note that micro data surveys of business ownership show that most business owners start with very little capital, so perhaps it should not be surprising that wealth does not matter for starting a business. Yet, their work shows that even when the up-front costs of starting a business are large, wealth does not seem to matter. Contrary to the theory of Stiglitz and Weiss (1981), existing lending markets appear to work well at funneling resources to would-be entrepreneurs.

A more refined version of the capital access argument is that only women- and minority-owned businesses have difficulties accessing credit and thus only they are the ones who require preferential treatment. Controlling for many other factors, the economics literature finds that minority-owned small businesses are indeed more likely to be denied credit than white-owned small businesses but women, on the other hand, do not face significantly higher loan denial probabilities.

For instance, empirical work by Cavalluzzo and Cavalluzzo (1998) demonstrates that white men and women can expect similar treatment in credit markets.¹⁸ Furthermore, their results suggest that there are even some advantages for female-owned firms located in concentrated banking markets. The leader of Women Impacting Public Policy, a women’s business advocacy group, confirms that women are extremely successful in accessing credit. She points out that nearly half of all privately-held businesses are owned by women, and they are growing twice as fast as other companies.¹⁹

On the other hand, Cavalluzzo and Cavalluzzo find that minorities fare worse than whites. Cavalluzzo et al. (2002) confirm this finding with a larger sample of more recent data.²⁰ Bates (1991) adds that new black business owners receive smaller loans than new white business owners with identical education, age, and equity capital traits.²¹ Blanchflower et al. (2003) show that “black-owned small businesses are about twice as likely to be denied credit even after controlling for differences in creditworthiness and other factors.”²² Cavalluzzo and Wolken (2005) control specifically for differences in personal wealth and still find a higher denial rate for black business owners.²³ Bostic and Lampani (1999) show that adding controls for local geography reduces the black-white difference, but does not eliminate it.²⁴ Given this evidence, there might be a case to be made for correcting inefficiencies in the financial market for minority-owned, but not women-owned, small firms through government-sponsored business loans or other preferential treatments.

Yet, more recent findings suggest that this conclusion might not be as simple as it seems. An SBA-sponsored study by Mitchell and Pearce (2005) underlines that while minority small business owners have more difficulty accessing credit than white owners, the credit constraints

vary across different loan and lender types.²⁵ In other words, discrimination may be confined to only some segments of the loan market. Furthermore, difficulty accessing bank loans does not imply no access to loans at all. Mitchell and Pearce find that while minority firm owners are less likely to have bank loans of any kind, they have easy access to transaction loans from non-banks.

Indeed, it is important to realize that bank loans only represent one of many ways to acquire credit. The Federal Reserve's 1998 Survey of Small Business Finance, which had a nationally representative sample of approximately 3,500 firms with fewer than 500 employees, illustrates this point.

Table 2 shows the percentage of all small firms, and small minority- and women-owned firms specifically, that used credit, and what type of credit they used. "Traditional credit" is defined as lines of credit, mortgages, and vehicle, equipment, leasing, and other loans. "Non-traditional" sources of finance include loans from the owner and business or personal credit cards, while "non-financial institution" sources of finance include loans from family and friends, the government, or other businesses. For sole proprietorships, "loans from owner" are not included because they are considered equity, not debt.

More than 80 percent of small businesses surveyed used some kind of credit. Over half used traditional sources of credit. Approximately 71 percent used non-traditional sources of financing, of which personal credit cards were the most prevalent. About 38 percent of small businesses had debt outstanding with commercial banks, which account for 57 percent of the total outstanding debt for all small firms. A firm's likelihood of using credit increased with firm size. This was true for most credit types and sources, but not for personal credit cards. The smallest firms may rely more heavily on personal credit cards because they are not able to access more traditional forms of financing, but more information on owner characteristics is necessary before drawing that conclusion.²⁶

The survey also showed that small minority- and women-owned businesses differed from small businesses in general. Compared to all small businesses, a lower percentage of small minority- and women-owned firms used any kind of credit (77 percent and 78 percent, as compared to 83 percent). Among firms that used credit, minority- and women-owned small firms were less likely to use commercial banks and business credit cards, and more likely to use personal credit cards and non-financial institutions, such as family and friends. Women-owned firms were more similar to minority-owned firms than small businesses in general. A notable difference, however, is that women-owned firms were much more likely than minority-owned firms to use non-traditional sources of credit. These results may suggest that women and minorities have difficulty accessing credit, but again, more information is necessary.

More information about small business financing comes from a 2005 U.S. Chamber of Commerce survey of 1,080 small business owners.²⁷ The findings suggest that some of the differences in the credit used by women and minorities may reflect differences in the types of businesses they start. While about a third of all small business owners in the survey reported start-up costs of \$5,000 or less, nearly half of both women and blacks were in that category. By a margin of 2 to 1, women were more likely than men to be in the service sector, which has lower start-up and ongoing financing needs. Men-owned firms were more likely to be in industries that require more capital, such as manufacturing and construction. In addition, 75 percent of black-owned businesses had less than \$100,000 in revenues, compared to about 40 percent or less for whites, Hispanics, and Asians.

According to the Chamber of Commerce survey, by far the greatest source of initial and ongoing funding was personal savings—81 percent of respondents used savings for initial costs,

60 percent for ongoing costs. Only about 3 percent of respondents reported using SBA loans for start-up funds. Older, larger firms were more likely to use SBA loans, and women and minorities were not more likely to use the loans. The results for ongoing expenses were very similar. Minorities and women were more likely to use credit cards for initial and ongoing funding, while men were more likely to use bank loans.

In line with the evidence cited earlier, when the small business owners were asked about problems they faced, availability of credit was the next-to-last most important problem. Only 25 percent of those surveyed chose that answer.

When considering all the different types of credit available, it is hard to argue that small businesses, whether women-owned or minority-owned, have real difficulty accessing credit. More generally, there is no compelling reason in the literature or in the data to suggest that new businesses would not be created without the SBA.

2.3. Market Responses to Information Problems

According to some proponents of the credit rationing theory, government intervention is necessary to overcome the problem of not funding all worthy projects in the economy. However, it seems that a better solution to the alleged lack of information or high cost of information in financial markets would be a mechanism to reduce this cost, rather than one involving government becoming a supplier of capital. For one thing, why would the SBA be more capable of acquiring information than private lenders?

Interestingly, financial markets have been very effective at developing private solutions to information problems, especially in recent years. Banks have long relied on close relationships with clients to gain information, and more recently, innovations in information and communications technology, as well as improvements in credit evaluation methods, have also made it easier for lenders to gather information about potential borrowers.²⁸

Lending relationships are one of the mechanisms that have emerged to address the information problem in capital markets, particularly for smaller banks. Kane and Malkiel (1965) develop a theoretical model that describes the possibility of credit rationing but also the power of relationships to overcome rationing.²⁹ Borrowers with a longer history with the bank, larger accounts, and greater expected account growth are less likely to be rationed. When evaluating long-time clients, banks will consider not only their immediate creditworthiness, but also the potential lost profits from damaging a good relationship.

Lending relationships are also about gaining information. Repeated interactions with a client over time and for different purposes give the lender information about the client's creditworthiness, either specific financial information or "soft information" about his personal character. Greater information lowers the cost of lending and thus increases the availability of credit. For instance, after having a positive experience with a small business, the bank might expect future loans to be less risky and will therefore be more likely to lend again to the business. Or, a bank may be able to learn more about a client's financial situation if he already has a checking account at the bank. The information from this prior relationship will also lower the bank's cost of lending. In this way, lending relationships are a market method for resolving the information problems that lead to credit rationing.

A number of empirical studies have shown the importance of relationship lending. Using data from the National Survey of Small Business Finance, Petersen and Rajan (1994) find that lending relationships increase the availability of credit to small firms, and have a small effect on

the price of credit.³⁰ Berger and Udell (1995) also use data from the National Survey of Small Business Finance. They find that, for bank lines of credit, small firms with longer banking relationships borrow at lower rates and are less likely to pledge collateral than other small firms. This result suggests that over time, banks learn more about their clients and then use that information as they make loans.³¹ Research by Cole (1998) uses richer and more recent data and finds similar evidence for the importance of relationship lending. Lenders are more likely to extend credit to borrowers with whom they have a pre-existing relationship, but, in contrast to the other studies, the length of the relationship does not matter.³²

Another way to help overcome the information asymmetry in lending is credit scoring, which is more often used by larger banks.³³ Credit scoring involves taking information from a credit applicant and using statistical methods to generate a numeric score that predicts his/her propensity to default or become delinquent. The data collected about applicants may include monthly income, outstanding debt, financial assets, and length of time at current job, previous loan record, and home ownership. The scoring method is based on the assumption that current applicants will behave like past applicants with similar characteristics. Credit scoring makes credit evaluation quicker, cheaper, more objective, and more consistent. It greatly reduces the cost of information-gathering, and by improving a bank's ability to predict default, it can significantly improve the efficiency of lending.

Credit scoring has been widely used for a long time in consumer lending, especially credit cards, and mortgage lending, but its use in business lending is a more recent development. It was first used in small business lending in the early to mid-1990s.

In theory, credit scoring could increase small business lending as it lowers the cost of evaluation, lowers borrowing costs, and enables long-distance borrowing, which creates greater competition. It also provides a way to evaluate new firms, which are difficult to assess by traditional methods because they don't have a history, and small businesses in particular, which often do not have certified audited financial statements or publicly-traded equity or debt.

Credit scoring could also increase the availability of loans for small businesses by drawing large banks into the market. Small-business lending has traditionally been the domain of smaller banks, which are better able to build the personal relationships with small business owners that overcome informational difficulties, but the informational advantages of credit scoring may encourage large banks to become more involved in small business lending.

The evidence bears out the theory and suggests that credit scoring has in fact increased the availability of credit to small firms. For instance, Feldman (1997) observed that in FY1996, as small business credit scoring was gaining popularity, larger banks increased their amount of small business lending relative both to other business lending and to FY1995, when small business credit scoring was less common.³⁴

These results are corroborated in several studies that use information gathered in a 1998 phone survey of the 200 largest U.S. banking organizations, conducted by the Federal Reserve Bank of Atlanta. For instance, Frame, Srinivasan, and Woosley (2001) find that 63 percent of respondents used credit scoring for small business lending. Controlling for a variety of bank characteristics, they "find that credit scoring is associated with an 8.4 percent increase in the portfolio share of small-business loans, or \$4 billion per institution."³⁵ Research by Berger, Frame, and Miller (2005) suggests that small business credit scoring is associated with increased small business lending, higher loan prices, and greater average loan risk. Their interpretation of these findings is that credit scoring increases credit availability primarily for relatively risky borrowers who will pay relatively more for loans.³⁶

Instead of an aggregate look at the effect of credit scoring at the banking organization level, Frame, Padhi, and Woosley (2004) take a micro look at its effect at the Census tract level. They find that lower- and upper-income areas benefit equally from credit scoring. In addition, credit scoring increases the probability that a large bank will lend in a given low- or moderate-income Census tract. In their sample, the total effect of credit scoring technology was an increase of \$2.2 billion in small business lending in 1997.³⁷

Both lending relationships and credit scoring have developed without government intervention. They are just two examples of how financial markets have found their own ways to overcome the information problems faced by lenders when dealing with small businesses.

Section 3: Is the SBA Doing What It Says It Does?

The economic justification for any government-sponsored lending or loan guarantee program must rest on a well-established failure of the private sector to allocate loans efficiently. Absent such a private sector deficiency, the SBA's activities would simply be a wasteful, politically-motivated subsidy to this sector of the economy. As demonstrated in the previous section, the private sector does not seem to suffer from such deficiencies, which suggests that there is no economic justification for SBA loans.

Yet many argue that some public policy objectives require the sacrifice of marketplace efficiency. It is an accepted feature of modern American government that some public interests or social policy gains can outweigh economic losses and hence are worth selected override of our free-market values. In the case of the SBA, its lending programs could fulfill specific public policy objectives that the marketplace on its own would not otherwise serve or would supply at suboptimal levels. But does it?

In describing its role in the economy, the SBA proclaims that small is beautiful: "Small business is where the innovations take place. Swifter, more flexible and often more daring than big businesses, small firms produce the items that line the shelves of America's museums, shops, and homes. They keep intact the heritage of ingenuity and enterprise and they help keep the 'American Dream' within the reach of millions of Americans. Every step of the way, SBA is there to help them." From this belief, it naturally follows that we need more small businesses around and should implement policies that will increase the number of small businesses. Glorifying small businesses also leads to the idea that small business owners deserve assistance because they are morally admirable and more deserving than big business owners. They create more jobs and economic growth than larger firms while facing what some consider to be unfair competition from big business. Along the same lines, the SBA points to racial and gender disparities as a justification for assistance to disadvantaged groups in particular.

SBA can thus be judged based on its ability to meet these public policy goals—namely, to fill the gap between supply and demand of small business loans, particularly for women- and minority-owned small businesses. To measure the SBA's results, I will concentrate on the SBA's flagship loan guarantee program, the 7(a) program. I will analyze the flow of SBA credits to evaluate who receives them and whether the SBA is meeting its stated policy objectives to promote new startups, to encourage female and minority business owners, and to help small businesses become big ones.

A close examination demonstrates that neither stated SBA policies nor its actual lending patterns provide evidence that SBA loan guarantees serve any focused or rigorously defined public policy purpose at all. Even if we assume, for the sake of argument, that there is a

significant market failure that prevents small businesses from receiving adequate credit, the SBA's loan programs are not an effective way to combat the problem. Furthermore, the program may do more harm than good as it creates an unlevel playing field. Finally, these programs are costly to taxpayers and may impose even more costs in the future. In FY 2007, Congress allowed the SBA to guarantee up to \$28 billion in loans to small business, and its total portfolio of outstanding loans is approaching \$70 billion, which might have to be paid off by taxpayers.³⁸

3.1. Background

There are about 25 million small businesses in the United States. According to the SBA's Office of Advocacy, nearly 20 million small businesses have received assistance from one of the SBA's many programs since 1953. In particular, the SBA's flagship loan guarantee program, the 7(a) program, has grown significantly over the past decade. Graph 1 shows that the number of 7(a) loans guaranteed by the SBA went from less than 20,000 in 1990 to over 95,000 in 2005. As Craig, Jackson, and Thomson (2005) point out, "These lending numbers are remarkable when one considers that SBA loan guarantees are aimed at that segment of small business borrowers that presumably would not otherwise have access to credit."³⁹

The SBA does not make direct loans to small businesses; rather, the 7(a) program provides security for commercial lenders by providing them with a guarantee for a percentage of a small business loan, typically ranging from 75 to 85 percent. The program specifies loan guarantee amounts, total loan size, allowable interest rates to be charged for the loan, and relevant fees, but the funds for the loans come directly from the participating lenders.

3.2. SBA Lending Profile

Analyzing the flow of SBA credit will help identify how well the SBA is serving its stated objectives, such as promoting new startups, helping small business compete with big business, and stimulating high tech investment, economic growth, and job creation.

Seven main conclusions can be drawn from the data. One, no more than 1 percent of small businesses receive SBA loans each year. This makes it hard to argue, as the SBA does, that it is helping solve a credit rationing problem and that without SBA loans small businesses would have a hard time accessing credit. The private sector finances most loans and hence, the SBA is largely irrelevant in the capital market.

Two, 75 percent of SBA 7(a) loans go to helping a very small fraction of small businesses in mainstream service, retail, and wholesale sectors. Even in those sectors most likely to receive SBA loans, each year only about 1 percent of all small firms actually do.

Three, the SBA is helping a minuscule fraction of small businesses in each sector compete against other small businesses in the same market. In the 25 sectors receiving the largest share of SBA 7(a) loan guarantees, less than 0.5 percent of the small businesses received the guarantees.

Four, there is no shortage of firms or new startups or services in America. Looking at the data, there is no compelling reason to suggest that new businesses would not be started without the SBA's 7(a) loan program.

Five, in 2004, 29 percent of 7(a) loan guarantees went to minority business owners but SBA distributed loans to only 3 percent of all minority-owned firms. The same trend is true for women-owned firms.

Six, markets are functioning well in the sectors that account for 75 percent of SBA lending. There are an overwhelming number of firms, a large amount of competition, and no empirical evidence that the market is being underserved in these areas.

Seven, most of the restaurants, car repair shops, grocery stores, dry-cleaning stores, and daycares that compete with SBA borrowers paid the market rate to meet their credit needs. By giving a credit market advantage to some small businesses, the SBA ends up harming the competing small businesses.

In short, it appears that no unique policy objectives are served by extending subsidized credit to less than 1 percent of the firms that supply basic economic services.

3.2.1. The SBA versus the Market as a Whole

How many firms is the SBA helping relative to the entire market? If there were a true need for government intervention, we would expect to see the SBA guaranteeing a large share of the total number of loans to small businesses. Yet, SBA loans are only a tiny fraction of all small business lending. The SBA estimates that in FY2004 there were approximately 24.7 million small businesses. According to the SBA's FY2004 Performance and Accountability Report, 1.6 million start-up and existing small businesses received financial, technical, and/or procurement assistance from the SBA.⁴⁰ Of that total, 102,000 received financial assistance, which includes the 7(a) Loan Program, the 504 Loan Program, the Microloan Program, and other programs. That same year, banks made 15.26 million small business loans (defined as loans of less than \$1 million; there were 14.45 million loans under \$250,000 and 13.58 million loans under \$100,000). In other words, SBA loans represented less than 1 percent of all small business loans issued in 2004.⁴¹

Most SBA loans are 7(a) loans. In FY2004, SBA guaranteed 81,133 7(a) loans, or approximately 1 loan for every 300 small businesses. According to a survey by the U.S. Chamber of Commerce, even in some of the industry sectors most likely to receive 7(a) loans, no more than 3 percent of start-up small businesses received SBA loans.⁴² This means that 97 percent of the survey respondents in these sectors managed to start their businesses without any financial help from the SBA.

SBA-guaranteed 7(a) loans are also a small fraction of the total amount of small business lending. The value of SBA-guaranteed 7(a) loans in FY 2004 was \$12.7 billion. That number is dwarfed by the \$522.3 billion in total small business loans (defined as loans of less than \$1 million; loans under \$250,000 totaled \$228.4 billion, and loans under \$100,000 totaled \$125.3 billion).⁴³

These numbers show that the private banking system finances most loans and that the SBA is therefore largely irrelevant in the capital market. Moreover, the data suggests that rather than serving the public good, the 7(a) program inflicts unfair competition on the 99 percent of small businesses who have to finance their business activities through commercial loans.

This economic harm could arguably be justified if the relatively few firms aided by SBA-guaranteed credit each year made a much greater contribution to economic growth, or if the guaranteed loans otherwise produced benefits to outweigh their costs. As the subsequent analysis will show, however, this is not the case. It therefore seems that the SBA ends up harming the vast majority of small businesses.

3.2.2. Where do SBA Loans Flow?⁴⁴

Table 3 shows the number and amount of 7(a) loans by industry in FY2002.⁴⁵ The overwhelming bulk of SBA of 7(a) loans—75%—flows to a small fraction of firms in the service, retail, and wholesale sectors. Overall, only 1 in 500 small businesses received a 7(a) loan guarantee in FY2002.

Taking a closer look at the data is useful. Table 4 uses more refined industry classifications to show the 25 business sectors that received the most SBA loans. Several characteristics stand out:

First, every sector was mainly comprised of small business firms, ranging from about 40,000 in the case of beer, wine, and liquor stores (96 percent of all establishments in that sector) to over 860,000 in the category “services to buildings and dwellings” (over 99 percent of all establishments in that sector).

Furthermore, in most of these sectors, the relatively few larger firms did not pose a serious threat to competition. In 17 of the 25 business sectors receiving the most 7(a) loan guarantees, the 8-firm market concentration ratio was 20 percent or less. Conversely, the most concentrated business sectors received less than a third of the loans that the least concentrated sectors received (Table 5). Clearly, the bulk of subsidized SBA loan guarantees are not being used to help small business compete against big business.

Instead, the SBA is helping a minuscule fraction of small businesses in each sector compete against other small businesses in the same market. In the top 25 sectors, less than 0.5 percent of the small businesses received 7(a) loan guarantees (Table 4). Most of the restaurants, car repair shops, grocery stores, dry-cleaning stores, and daycares that compete with SBA borrowers paid the market rate to meet their credit needs. By giving a credit market advantage to some small businesses, the SBA ends up harming the competing small businesses.

These top 25 sectors do not seem to warrant special attention from the SBA. They do not exhibit any of the classic symptoms of market imperfections; instead, they are characterized by numerous firms, strong innovation, and robust competition. Nor do they play a particularly important role in the economy. A relatively small number of new or bigger gas stations, liquor stores, or dentist offices will have little effect on national prosperity.

Table 6 breaks down 7(a) loan guarantees by specific business categories. The category that received the largest share of 7(a)-guaranteed loans in 2002 was bars, restaurants, and liquor stores. This sector received 4,185 loans, some \$1 billion or 8.4 percent of all 7(a) guaranteed loans. But the recipients of these loans were only 1.3 percent of all small businesses in this category. Over 300,000 other small firms were competing to serve the same market.

This trend is not unique. While there were over 73,000 bars, only 351 received SBA 7(a) loan guarantees in 2002. It means that a disproportionate share—99.5 percent—of all bars did not need and did not receive SBA loans. Because they had to compete with 351 bars that did receive help from the government, they were at a competitive disadvantage.

For another example, 5.7 percent of SBA 7(a) loans went to a variety of professional offices, including doctors, dentists, and accountants, but of all offices, only a tiny fraction—0.2 percent—received loans, meaning that 99.8 percent of offices functioned without government help. Similarly, out of more than 25,000 laundromats, only 317 received SBA 7(a) loan guarantees in 2002.

In a sampling of other service industries, the SBA served just 0.1 percent of all small businesses. Less than 1 percent each of florists, clothing stores, shoe stores, sporting goods stores, book stores and newsstands, and music stores received SBA 7(a) loan guarantees in 2002.

Of the more than 100,000 used car dealers classified as small businesses, only 205 received SBA loans.

It is difficult to make the case that valuable policy objectives are being served by extending subsidized credit to such a tiny fraction of small businesses when millions of small businesses make it without subsidized credit. They compete in an open, dynamic marketplace that satisfies the needs and wants of consumers across all business sectors, from dentists to dry cleaning. As David Stockman, former director of the Office of Management and Budget (OMB), testified before Congress in 1985, “In this context, SBA’s few thousand loans make only one consistent difference: millions of taxpaying small businesses face unneeded and uneconomic competition from bureaucratic clients who can’t compete profitably, or at all, on a level playing field.”⁴⁶

The limited number of loan recipients would be more defensible if the SBA’s assistance brought greater dynamism to the market. Table 7 shows, however, that 7(a) loan guarantees have little effect on business turnover. For instance, between 1998 and 2002, over 900,000 new small businesses appeared in the 25 business sectors that received the most SBA 7(a) loans. This number is over half as large as the number of small businesses in 1998. The gross turnover rate, which combines business starts with closures, is an incredible 98 percent. The high turnover indicates vigorous competition and a robust rate of small business entry in those 25 industries.

The role of the SBA in this process was minimal. Compared to the more than 1.8 million small businesses in these sectors in 1998, the 27,000 that received 7(a) loan guarantees in 2002 are insignificant. The dynamic entry and exit of nearly 1.7 million small businesses was driven primarily by free market forces.

Despite the SBA’s emphasis on start-ups, its efforts are largely irrelevant in promoting competition. For example, nearly 60,000 new car repair and maintenance shops opened between 1998 and 2002, which equals 41 percent of the number in 1998. The SBA guarantees approximately 2,500 loans per year in this business sector. Even if all of those loans went to start-ups, it clearly affects only a small fraction of new businesses. Even in the restaurant market, the SBA’s largest lending category, the number of loan guarantees is far smaller than the number of start-ups.

Another possible defense of the small number of 7(a) loan recipients is that the loans focus on new firms on the cutting edge of technology, firms venturing into fields so new that banks have trouble evaluating their potential. But Table 8 counters this proposition. Each of the 12 high-tech industry sectors is characterized by strong small business job growth from 1998 to 2002, with the number of jobs rising by nearly 29 percent—compared to about 9 percent small business job growth in the overall U.S. economy. And for the most part, they achieved this spectacular growth without the help of the SBA: each year, only about 3,300, or 1.1 percent, of these high-tech businesses received 7(a) loan guarantees.

For example, the telecommunications industry created over 65,000 new small business jobs from 1998 to 2002, a growth rate of nearly 60 percent, yet fewer than 2 percent of telecommunications establishments received 7(a) loan guarantees each year. Almost 160,000 new small business jobs were created in the computer systems design and related services sector, a 32 percent increase from 1998. Only about 1.2 percent of small businesses in this sector received 7(a) loan guarantees each year. As was the case for the wholesale, retail, and service industries described earlier, the high-tech sector has no trouble meeting the vast majority of its funding needs with private financing.

Of course one should not be surprised that bureaucratic lending is not needed to foster new business formation. The attractions of profits and independent entrepreneurship are far more powerful and determinative. In fact, the marketplace miracles of small business and high-tech growth have almost nothing to do with the bureaucratic myths about the value of SBA lending.

3.2.3. Is the SBA Catering to Women and Minorities?

According to the SBA, women and minorities face special competitive challenges, so its programs devote particular attention to them. Women and minorities receive a significant share of 7(a) loan guarantees. Table 9 shows that the percentage of 7(a) loan guarantees going to minority business owners has increased steadily from less than 13 percent in 1990 to almost 29 percent in 2004. This figure is especially striking given that, in the most recent statistics, minority-owned businesses accounted for just 18 percent of all firms.⁴⁷ But when the Chamber of Commerce reports that among all minority small business owners, 3.2 percent used SBA loans for start-up and slightly less than 3 percent used SBA loans for ongoing expenses, it is hard to argue that the SBA makes a big difference for minorities.

The share of 7(a) loan guarantees going to women increased from 13 percent in 1990 to a plateau of about 21 percent in recent years. Unlike minorities, however, this share is less than the 28 percent of all businesses owned by women. But here too, the Chamber of Commerce reports that, of all women-owned small business owners, only about 3 percent used SBA loans. Hence, SBA makes almost no difference for women either. Only a tiny fraction of women and minority business owners use SBA loans and, except for Hispanics, they use SBA loans at about the same rate as men and white business owners.

3.2.4. How Do We Know?

All of the evidence presented above points in one direction: the SBA's 7(a) loan guarantee program is not having a significant positive effect on the market. But you would never know this from the SBA's evaluations of its programs. The SBA does not publish or even try to measure the gains, whether economic or social, of its programs. In fact, the SBA's only measure of success amounts to stating how many loans have been guaranteed in a given year and how much it has spent on small businesses, rather than measuring the return on its efforts.

Measuring the performance of SBA loans should include their effect on economic growth. It is possible, for instance, that even though a large share of SBA borrowers default on their loans, thus costing taxpayers money, the economic growth triggered by the other borrowers compensates for the losses. In addition, the OMB doesn't publish the details of its actuarial analysis of the proper level for the SBA loan fees. We are left in the dark about the performance and economic impact of SBA loans.

3.3. What is the Value of the SBA's Loan Programs?

In his 1985 Congressional testimony, David Stockman wrote of the 7(a) loan program, "SBA conducts a \$3-4 billion annual lending program which indiscriminately sprays a faint mist of subsidized credit into the weakest and most prosaic nooks and crannies of the nation's \$4 trillion economy. In the process it serves no rigorously defined public policy purpose objective."

Twenty years later, it seems that very little has changed. Now, the SBA runs a \$28 billion loan program and we have a \$12.8 trillion economy. However, SBA credit volumes are still inconsequential in the market as a whole since they reach such a tiny fraction of small firms. Most SBA loans still go to helping small businesses in service, retail, and wholesale sectors, but even in these industry sectors most likely to receive 7(a) loans, no more than 1 percent of small businesses receive the loans in any given year. Similarly, the evidence suggests that the SBA's loan guarantees are not targeted to helping small businesses compete with big businesses. For the most part, the SBA helps a very small fraction of small businesses compete with unsubsidized firms in naturally competitive healthy markets.

But why does this matter? The SBA may not be having a large effect in a macroeconomic sense, but it does have some impact in a microeconomic sense. The U.S. economy may not be better off because of SBA loan guarantees, but the individual recipients are certainly helped. In fact, advocates of the SBA's lending programs remind us that few of the beneficiaries will become tremendous success stories like FedEx; most will stay small. The problems with this scenario are twofold: one, anecdotes about the program's success are not enough to make the case that it creates value because the costs to taxpayers may still far exceed these benefits; and two, the program creates an unlevel playing field that in some cases ends up hurting other small businesses.

3.3.1. The Cost to Taxpayers

Congress determines the total amount of loans the SBA is able to guarantee. In its FY2007 budget request, SBA asked to be allowed to guarantee \$28 billion in loans, of which \$17.5 billion would be for 7(a) loans.⁴⁸ A loan guarantee only requires funding if the borrower defaults on the loan. Until recently, the SBA covered default costs with a combination of fees and taxpayer dollars. The OMB was responsible for a "subsidy rate" calculation that would determine the share of funds paid by taxpayers and that would set the level of fees assessed to borrowers and lenders for each 7(a) loan. In 2005, Congress agreed with the Bush administration's plan to eliminate the subsidy for the 7(a) loan program. Instead of paying off loan defaults with taxpayer dollars, users of the 7(a) loans would be required to pay sufficient fees to cover all costs.⁴⁹ Thus, in the FY2007 budget, no money was appropriated for 7(a) loan guarantees.

The difficulty is this: Over the years, there has been much dissension on how to calculate the subsidy rate effectively—whether this rate is zero or not. Until recently, studies of the loan program showed a profound inability to establish a subsidy rate that would cover projected loan defaults or to establish the proper level of fees to make the rate zero. For instance, in 2001, the Government Accountability Office (GAO) released a report showing that the SBA's approach of averaging historical data was causing large overestimates in subsidies.⁵⁰ However, the report mentioned that SBA was currently working on an econometric model to address the problem.

In FY2003, the SBA began using the new econometric model, and it seems to have worked well so far. In 2004, the GAO analyzed the new model and concluded that it was reasonable.⁵¹ The GAO did suggest that the SBA: 1) update the model over time, 2) decide whether it might be appropriate to include additional variables in the model, and 3) release how exactly they constructed the model so that the model could be examined in more detail by outside sources. According to the SBA's 2005 annual report, the most recent reestimates of expected 7(a) losses were the "smallest in the program's history." They attributed this improved

accuracy to the stability of the ongoing loan performance as well as the consistency of the credit subsidy model.⁵²

Whether the accuracy of the model can continue, however, is still an open—and crucially important—question. Neither the OMB nor the SBA publishes estimates of the size of the subsidy or its economic impact, but according to an estimate from the Congressional Budget Office, in FY2003 the subsidy was on track to be more than \$1 billion over ten years.⁵³ Since then, the SBA has raised its loan fees, yet actual outlays to the SBA have exceeded its estimated funding needs, suggesting that fees are still too low and there remains a subsidy.

Table 10 compares the beginning of the year budget requests for SBA outlays and the OMB's revised figures for what the SBA actually received. The difference between requested and actual SBA outlays is primarily attributable to credit subsidy re-estimates (changes in the lifetime estimated cost of outstanding loans) and supplemental funding. For example, the SBA recorded net upward credit re-estimates of \$713 million in FY2003 and \$3.3 billion in FY2004. In those years, supplemental funds were \$0 and \$30 million, respectively. The actual loan foreclosure and defaults are reflected in the credit re-estimate. The figures show that from FY2002 to FY2006, actual outlays exceeded estimated outlays by more than \$6 billion.

As William Shear, the GAO's Director of Financial Markets and Community Investment, testified before Congress, the zero subsidy rate is an accounting concept rather than an economic one.⁵⁴ The economic reality will always turn out to be quite different than the *a priori* claim of zero subsidies. For one thing, as Senator Tom Coburn noted in the same Congressional hearing, the administrative costs of the SBA for the 7(a) loans are substantial. Shouldn't these be paid by the borrowers too?⁵⁵

What's more, if the economy suddenly takes a turn for the worse, for instance, and small businesses become much more likely to default on their loans, will the SBA be prepared to cover the increased costs? Or will taxpayers have to bail out the SBA? In addition, the SBA's Office of Inspector General has repeatedly warned that the SBA needs to improve its oversight of lenders to minimize the risk of default, waste, and fraud.⁵⁶ As long as the SBA guarantees such a high percentage of the loan amount, banks have very little incentive to thoroughly evaluate loan applicants. Can the model accurately predict the costs of loans made by minimally-supervised lenders?

The threat of high default costs is very real. The default rate for the SBA's loan programs is higher than in the private sector. Glennon and Nigro (2005), for instance, look at a sample of seven-year maturity SBA 7(a) loans disbursed from 1983 to 1998.⁵⁷ They analyze the riskiness of SBA loans by measuring the cumulative default probabilities. Using the same methods that Moody's and Standard & Poor's use to evaluate corporate bonds, they find that SBA loans rate between Moody's B and Ba ratings and between Standard & Poor's BB and B ratings. This is the upper end of speculative grade; i.e., "SBA loans are concentrated in the relatively more risky segment of the loan market." However, they note that earlier research shows that, at the end of 1997, nearly half of the rated assets of commercial banks were comparably risky.

They then measure the default rate. Approximately two-thirds of the loans in their sample went to existing firms and one-third to start-ups, with a vast majority to firms with 25 employees or less. They find that default rates vary by industry sector and by firm size. Across all the different categories, the default rate is generally around 15 percent. This number is higher than the GAO's 2003 estimate that the default rate on 7(a) preferred lender loans had averaged about 14 percent in recent years.⁵⁸

Glennon and Nigro then refine their data and measure the default by cohort. They look at loans by year of disbursement, which controls for “the impact of changes in program guidelines, the aging (or seasoning) of the loans, and the censoring of observations in 1998 [i.e., the data stops in 1998, and not all of the loans have reached maturity by that time]”.

They find that the average annual default rate, which adjusts for the shorter exposure time of the censored loans, declines after 1987, reaching a low of 2.6 percent, and then rises after 1993, reaching a high of 4.6 percent in 1995. The cumulative default rate for the non-censored cohorts falls over time, from almost 30 percent for the 1983 cohort to less than 20 percent for the 1991 cohort. The censored cohorts show that the risk of default is time-dependent: the rate of default increases over the first few years after disbursements, then declines as the loan matures further.

According to the SBA’s own data, for its 2005 cohort of 7(a) loan guarantees, the cumulative default rate was 7.4 percent, and it is 7.21 for the 2006 cohort so far. This is outstandingly high compared to the private sector. For all business loans (“commercial and industrial” or “C&I” loans) from all FDIC-insured banks, the annual net charge-off rate—i.e. the share of loans that the lender no longer expects to be repaid—is very low, typically less than 1.5 percent.⁵⁹ But this includes both small and large businesses. Default rates for small businesses alone are expected to be significantly higher because of their riskier nature.

The FDIC does not collect data on default rates for small businesses specifically, so it is difficult to compare SBA-guaranteed loans to small business loans in general. A rough comparison is the charge-off rate for credit cards, since credit cards tend to be used for higher-risk borrowing. If small business owners get turned down for traditional bank loans, they might turn to non-traditional credit sources, like credit card borrowing. Charge-off rates for credit card lenders are a lot higher, but still lower than SBA loan default rates. For instance, in 2005, the annual net charge-off rate for credit card lenders was 4.64 percent, while the default rate for SBA-guaranteed loans disbursed in 2005 was 7.4 percent.⁶⁰

Of course, this disparity is understandable. To qualify for an SBA loan, one must first be rejected at least once by a private funding source. However, it doesn’t mean that it makes economic sense. Edwards (2004) explains that “If a small business has a sound business plan with solid prospects, it should be able to raise debt and equity capital in private markets. If a small business has shaky finances and poor prospects, it will be denied private capital, which is a good thing because such loans would be economically wasteful.”⁶¹ Yet these “shaky” small businesses are exactly whom the SBA lends to: the SBA’s mission is to lend money to those rejected by the private banking sector because they were perceived as too risky and unlikely to make money.

The implicit assumption is that bringing a small business to life that would not have existed without the SBA is worth the cost. But if that’s the case, the SBA needs to demonstrate that claim. We know that the agency doesn’t give a loan to every small business owner who applies for a loan. It rejects many applicants. Yet the SBA does not provide a model explaining how it, unlike the private sector, is capable of identifying the winners among the losers—those previously rejected. If the SBA really could pick winners, its value would be clearer. Its lending programs could be justified by its ability to identify those who would become the next Amazon.com among the small businesses rejected by commercial banks, thus allowing economic value to be created where it would not have been otherwise. Of course, even if the SBA has a way to identify future winners in a way that the private sector cannot, it would still have to make the case that these winners are worth the cost to the taxpayers.

Unfortunately, that's hardly the case. A recent report by the Office of Inspector General (IG) for the SBA details several programs and activities by the SBA that are particularly vulnerable to fraud, waste, and other inefficiencies.⁶² Posed as a series of "challenges," the report includes an assessment of the SBA's progress in improving the areas of concern. Among other concerns, the report examines the 7(a) loans and notes that the program, as well as SBA loan programs generally, requires better oversight and monitoring to improve control and reduce fraud risk. In addition, the report mentions the SBA's difficulty in identifying viable businesses.

Almost every local SBA office has its own web page with numerous "success stories." Even though some of these stories are impressive examples of entrepreneurship, most are about businesses basically managing to stay afloat, rather than maturing into fast growing businesses. Also, these are nothing more than anecdotes, which is hardly a basis for sound cost-benefit analysis.

What's more, the two main SBA success stories seem to be Outback Steakhouse and Staples.⁶³ In 1990, Outback Steakhouse received \$151,000 in working capital, with which, according to the SBA, the restaurant obtained the size it needed to go public. Of course, the rest is history, and now Outback receives about \$3.6 billion in sales. Staples received about \$1.5 million from the SBA in 1987 so that it could expand from just a single store to five stores. It went public in 1989 and now has about \$16 billion in sales.

Those two examples regularly trumpeted by the SBA hardly make the case for the legitimacy and productivity of SBA loans. First, SBA's success stories are at least 16 years old. Does it mean that since 1990 no SBA loan has resulted in such a successful business story? But even if SBA loans resulted in one such success story every year, it is not obvious, without proper empirical evidence, that it would justify the cost to taxpayers of defaulted SBA loans. And again, it is surprising that the SBA is not concerned about measuring the return on the taxpayers' dollars that it spends.

Second, those two success stories were not funded with the SBA's flagship 7(a) loan program but with its Small Business Investment Company (SBIC) program. Established in 1958, the program was meant to be a unique tool that provides risk capital in the form of debt and equity financing to small businesses for their growth, modernization, or expansion. There are currently over 400 SBICs nationwide, with a capital base of more than \$23 billion. SBICs are privately owned and privately managed investment firms, licensed and regulated by the SBA, that use their own capital, plus funds borrowed with SBA guarantees, to make venture capital investments in small businesses.

However, this program has frequently been criticized for being inefficient and wasteful. The IG report cited above also examines concerns pertaining to the SBIC and charges that with \$12.5 billion in the form of guaranteed debt and equity interest, the program places too much risk on taxpayer funds. In other words, the return on taxpayers' dollars is negative. While the report does document progress made in addressing these challenges, it concludes that much remains to be done.

In response to an editorial in the Wall Street Journal listing major flaws with the SBIC programs, the Ranking Member on the House of Representatives Small Business Committee, Rep. Nydia Velazquez (D-NY), wrote that "four years later, under the Bush administration, there has been \$1.1 billion in losses."⁶⁴ In other words, SBA's two business stories were founded by a program that clearly has a negative return to taxpayer dollars and should be shut down.

3.3.2. SBA loan guarantees hurt other small businesses

Since the small distribution of 7(a) loans in highly competitive sectors is unlikely to greatly improve the prices and products available to consumers or significantly bolster economic growth, the primary effect of the loan guarantees is to create an unlevel playing field. Small business owners must be denied traditional credit before they are eligible for 7(a) loans. Because they, by definition, do not qualify for loans at market rates, the 7(a) loan program allows them one, to receive money that they might have never received and two, to receive funds at a lower rate than they otherwise would have. All other small businesses, however, pay the market rate that reflects the actual risk they represent.

It does not make sense that a very small fraction of small businesses that are not creditworthy—who cannot prove to lenders that they will be able to make a profit—not only have the privilege of having the taxpayers stand behind them but also compete with unsubsidized firms in naturally competitive, healthy markets. The SBA is hurting a large portion of small businesses in the name of helping very few others.

3.3.3. Lenders Are the Ones Really Benefiting from the SBA Loan Programs

Since the SBA's assistance serves only a tiny fraction of the nation's small businesses and likely has a high cost for taxpayers, one must ask who is really benefiting from the loan programs. One major beneficiary is SBA lenders. The SBA does not provide loans directly; rather, borrowers have to apply to an SBA-certified bank.

On average, the government guarantees 80 percent of each loan made in the 7(a) program. Because of this high guarantee rate, banks bear only a small fraction of the responsibility for any losses from defaults. They therefore have a strong incentive to issue more SBA loans.

The first way banks benefit from SBA programs is that by participating in the SBA's guarantee programs, banks are able to increase their lending at the same profitability as the rest of their business.

The second is that when there is a default, the bank doesn't have to pay most of the cost. Even though SBA borrowers are more risky than others, the downside risk to the bank is only 20 percent of what it would be otherwise. In other words, even though business owners applying for SBA loans are intrinsically more risky than others, the loan guarantee might make the risk for SBA lenders lower for SBA loans than for traditional loans.

In addition, through the SBA's Secondary Market Program, lenders have other ways to reduce their risk even further and also to increase their lending capability. This program allows lenders to sell the guaranteed portion of SBA-guaranteed loans to investors. By doing so, lenders can improve their liquidity and free up more capital for new loans. Lenders who sell loans must pay a small program fee to the SBA. If the loan is sold for more than 110 percent of the outstanding principal balance, half of the excess is paid to SBA.

This process of selling loans on the secondary market is known as securitization. Generally, securitization involves grouping assets—such as residential mortgages or car loans—into large pools that are sold as securities to investors. The originator of the security will often offer loss protection to enhance the credit rating of the security. Lenders benefit from the increased liquidity and asset diversity; borrowers may benefit from lower financing costs; and investors benefit from greater liquidity and lower risk than if they had invested in the loans directly.⁶⁵

To encourage a secondary market, Congress passed a law in 1994 that reduced regulatory barriers for the securitization of small business loans. Small business loans are typically not good candidates for securitization because their terms vary so much, their underwriting tends not to be standardized, and their riskiness requires such a high degree of credit enhancement that securitization becomes unprofitable. SBA-guaranteed loans do not have these problems, however, and most of the small business loans that have been securitized are SBA 7(a) guaranteed loans. From 1994 to 2001, over 40 percent of the guaranteed part of all 7(a) loans was securitized. By contrast, slightly less than 10 percent of the unguaranteed portion of 7(a) loans was securitized. The advantage of the SBA guaranteed loans is clear: between 1994 and 2001, almost \$22 billion of SBA guaranteed loans was securitized, while only about \$4 billion of conventional small business loans was securitized.⁶⁶

The best evidence of the high profitability of SBA loans for lenders can be found on the website of the National Association of Government Guaranteed Lenders (NAGGL). NAGGL is a national trade organization comprised primarily of lenders participating in the 7(a) guaranteed loan program. NAGGL members originate approximately 80 percent of all 7(a) loans.⁶⁷

On the NAGGL website, one learns that “The 7(a) loan program can do much more than improve your CRA rating. Used properly, it can increase your profitability, liquidity, and competitiveness in the increasingly hostile battle to court the small business borrowers that tend to become big time accounts.”⁶⁸ The website adds that “For lenders, the 7(a) loan program has the potential to:

1. Increase the Size of Your Portfolio—The mitigated risk provided by federal guarantees allows you to comfortably expand your customer base by servicing a wider range of small business firms by offering long-term loans.
2. Increase Liquidity—7(a) loans can be readily sold on the program’s healthy secondary market.
3. Increase Regulatory Loan Limits—Only the unguaranteed portion of an SBA loan counts against your regulatory loan limit per customer.
4. Increase competitiveness—The ability to offer terms as long as 25 years gives you a more desirable product line to offer prospective and existing customers.”⁶⁹

In addition, it has been shown that SBA loans are vulnerable to waste, fraud, and abuse by banks. For example, while most SBA lenders are regular banks overseen by the Federal Deposit Insurance Corporation (FDIC), a number of SBA lenders are non-banks. These lenders are subject only to SBA oversight, which has been proven to be weak and arbitrary. An example of this weak oversight comes from the “Preferred Lender” program. For years, some SBA lenders have had default rates of 11 percent or more. The SBA benchmark for its lenders is 9 percent, yet each year the agency renews the Preferred Lender status allowing these lenders to make government-backed loans without first having the agency vet them.⁷⁰ Evidence also demonstrates that SBA loans are often going to people who do not qualify for those loans.

In the end, this program amounts to corporate welfare for SBA-certified lenders while creating adverse consequences and increasing the risk to taxpayers.

3.3.4. The Federal Government Should Stop Its Involvement in the Loan Guarantee Business

Even if the SBA were capable of running a program at no cost for taxpayers, government loans are not the way to help small firms. Targeted policies have often proven to be bad policy. For instance, economists have shown that targeted policies that favor small firms over large ones will make it more profitable to stay small rather than grow.⁷¹ This perverse incentive will lead to a misallocation of resources away from the most productive uses and will interfere with the natural growth and evolution of firms.

The federal government should end its involvement in the loan and loan guarantee business. As described in Section 2, the evidence supports the idea that the private banking industry is vibrant and meets the demand for credit effectively. And as Section 3 showed, even if there were a financing gap to fill because of imperfections in the lending market, the SBA probably wouldn't make much of a difference. We know, for instance, that in most years, the 7(a) program represents less than 1 percent of all loans to small businesses, and about 1 percent of all small businesses receive 7(a) loan guarantees. And the SBIC Participating Securities program represents only about 3 percent of activity in the venture capital industry over the period 1994 to 2004.⁷²

Of course, none of these reasons is intended to minimize the benefits that flow from fostering an economic environment that supports the creation and growth of small businesses. In fact, it is precisely because a vibrant business sector is important that government subsidies and other preferential policies should be abolished. Market economies generate faster growth because resources are allocated on the basis of profit-maximization rather than political considerations. In the absence of government intervention, resources are quickly shifted from inefficient uses to more productive uses.

Special programs designed to help small businesses are likely to hinder this process and will distract entrepreneurs and investors from focusing on serving the needs of consumers. Instead of preferential policies, the government can best help small business – and other segments of the economy – by creating an environment conducive to productive behavior. Policymakers should establish a tax and policy environment that encourages small, mid-size firms with strong growth potential to evolve into successful large enterprises. In general, they should establish an environment where firms of all size can thrive. This means low tax rates, low levels of regulation, and a stable legal structure that protects property rights.

Section 4: Conclusion

Supporters of the SBA's loan programs argue that the government's assistance aids small businesses by filling a gap in financing when banks and other traditional sources do not provide loans for the purposes, in the amounts, and with the terms required by small business borrowers. However, a large economic literature dismisses this argument and demonstrates no failure of the private sector to allocate loans efficiently, thus discrediting the economic justification for any government-sponsored small business lending or loan guarantee program. Absent such a clearly identified problem, the SBA's activities are simply a wasteful, politically-motivated subsidy to this sector.

Moreover, even if to some extent the private sector fails to allocate loans efficiently, it remains to be proven that government intervention is a more desirable alternative. In fact, the data demonstrates that even if credit were a serious problem for small firms, SBA loans wouldn't be of much help to them. The SBA's 7(a) loan guarantees serve only a tiny fraction of the nation's small businesses that are very likely to default costing taxpayers large amount of money.

In addition, poor oversight by the SBA of its lenders has led to waste, fraud and abuses. Evidence shows for instance that most of the program's borrowers could obtain financing without the SBA's help.

To conclude, most of the nation's 25 million small businesses are funded and grow without government subsidies. Entrepreneurship is definitely one thing that Americans know how to do without government help. The SBA loan guarantee programs should be terminated.

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Appendix: Tables and Figures

Table 1: Reason the Discontinued Business is No Longer Operating by Employment Size of Firm, 1992

If the businesses is no longer operating because it was unsuccessful, the reason why the business was unsuccessful¹

	Inadequate cash flow or low sales	Lack of access to business loans/credit	Lack of access to personal loans/credit	Other reason	Not reported
All businesses	71.7	8.2	3.3	71.7	1.3
Hispanic-owned businesses	67.1	8.8	5.8	68.3	3.2
Black-owned businesses	63.4	15.5	8.4	69.3	4.3
Other minority-owned businesses	67.6	6.1	6.4	75.9	2.6
Women-owned businesses	70.2	9.3	3.3	75.8	2.8

¹Data represent percentage of owners reporting in the designated categories.

Source: 1992 Economic Census, Characteristics of Business Owners.

Table 2: Percentage of All Small, Minority-Owned, and Women-Owned Firms That Used Credit, 1998

	All Small Firms		Small Minority- Owned Firms		Small Women- Owned Firms	
	% of Firms	% of Credit Users	% of Firms	% of Credit Users	% of Firms	% of Credit Users
Any Credit	82.5	100.0	76.9	100.0	78.2	100.0
Any Traditional Credit	55.0	66.7	49.4	64.2	46.1	59.0
Commercial Bank	38.2	46.3	27.3	35.5	28.4	36.3
Any Non-Financial Institution	9.6	11.6	12.0	15.6	8.9	11.4
Any Non-Traditional Credit	70.7	85.7	54.9	71.4	68.8	88.0
Owner Loans	14.2	17.2	12.5	16.3	12.9	16.5
Personal Credit Card	46.0	55.8	45.5	59.2	47.5	60.7
Business Credit Card	34.0	41.2	28.6	37.2	28.9	36.8

Source: SBA (2003), "Financing Patterns of Small Firms: Findings from the 1998 Survey of Small Business Finance," Table C.2.

Table 3: SBA 7(a) Loan Program: FY2002 Lending by Industry (2-Digit NAICS Codes)

Industry		SBA Lending				Industry Characteristics	
NAICS Code	Description	# of Loans	Share of SBA Total ¹	Loan Amount (\$1,000)	Share of SBA Total ²	# of Small Business Establishments ³	SBA Loan Ratio ⁴
11	Agriculture, Forestry, Fishing, and Hunting	581	1.1%	\$222,291	1.8%	246,102	0.2%
21	Mining	99	0.2%	30,870	0.3%	102,644	0.1%
22	Utilities	41	0.1%	8,139	0.1%	21,519	0.2%
23	Construction	3,512	6.8%	672,656	5.5%	2,774,684	0.1%
31-33	Manufacturing	4,957	9.6%	1,501,743	12.3%	598,445	0.8%
42	Wholesale Trade	3,036	5.9%	837,903	6.9%	746,209	0.4%
44-45	Retail Trade	10,217	19.8%	2,341,171	19.2%	2,669,307	0.4%
48-49	Transportation and Warehousing	1,472	2.8%	240,452	2.0%	977,373	0.2%
51	Information	731	1.4%	150,971	1.2%	316,444	0.2%
52	Finance and Insurance	579	1.1%	97,491	0.8%	949,270	0.1%
53	Real Estate and Rental and Leasing	757	1.5%	199,170	1.6%	2,159,941	0.0%
54	Professional, Scientific, and Technical Services	4,202	8.1%	662,140	5.4%	3,284,654	0.1%
55	Management of Companies and Enterprises Administrative and Support and Waste Management and Remediation Services	14	0.0%	6,810	0.1%	22,974	0.1%
56	Remediation Services	2,457	4.8%	345,622	2.8%	1,560,899	0.2%
61	Educational Services	487	0.9%	90,729	0.7%	413,853	0.1%
62	Health Care and Social Assistance	4,156	8.0%	1,010,585	8.3%	2,091,068	0.2%
71	Arts, Entertainment, and Recreation	1,072	2.1%	312,715	2.6%	971,336	0.1%
72	Accommodation and Food Services	7,487	14.5%	2,205,679	18.1%	709,723	1.1%
81	Other Services (except Public Administration)	5,809	11.2%	1,270,891	10.4%	3,163,065	0.2%
	Total for Services, Retail, and Wholesale Sectors	38,923	75.3%	9,077,434	74.4%	15,610,114	0.2%
	Total	51,666	100.0%	12,208,027	100.0%	23,818,871	0.2%

¹Share of total 2002 SBA 7(a) loan approvals.

²Share of total 2002 SBA 7(a) loan guarantees.

³A small business is defined as an establishment with fewer than 500 employees, including establishments with no paid employees. This is the definition used by the SBA for research purposes; for determining loan eligibility, the SBA uses different definitions for different industries. See <http://app1.sba.gov/faqs/faqindex.cfm?arealD=24> and <http://www.sba.gov/size/index.html>.

⁴SBA loans divided by total number of small business establishments in the industry.

Sources: SBA lending data from Small Business Administration; industry characteristics from 2002 Statistics of U.S. Businesses and 2002 Economic Census.

Table 4: SBA 7(a) Loan Program: FY2002 Lending by Top 25 Industries (4-Digit NAICS Codes)

Industry		SBA Lending				Industry Characteristics		
NAICS Code	Description	# of Loans	Share of SBA Total ¹	Loan Amount (\$1,000)	Share of SBA Total ²	# of Small Business Establishments ³	SBA Loan Ratio ⁴	Market Concentration (Top 8 Share, by Sales)
7221	Full-Service Restaurants	3,240	6.3%	\$770,370	6.3%	210,837	1.5%	11.0%
7222	Limited-Service Eating Places	2,563	5.0%	491,930	4.0%	215,964	1.2%	12.8%
8111	Automotive Repair and Maintenance	2,482	4.8%	686,515	5.6%	429,573	0.6%	2.8%
6213	Offices of Other Health Practitioners	1,355	2.6%	184,748	1.5%	385,541	0.4%	4.5%
8121	Personal Care Services	1,267	2.5%	134,103	1.1%	757,064	0.2%	12.8%
4471	Gasoline Stations	1,208	2.3%	676,454	5.5%	93,233	1.3%	15.3%
5617	Services to Buildings and Dwellings	1,060	2.1%	133,046	1.1%	869,558	0.1%	10.8%
4451	Grocery Stores	1,018	2.0%	282,416	2.3%	114,539	0.9%	43.4%
7211	Traveler Accommodation	987	1.9%	765,969	6.3%	77,741	1.3%	27.8%
2359	Other special trade contractors	929	1.8%	188,049	1.5%	n/a	n/a	n/a
8123	Drycleaning and Laundry Services	900	1.7%	238,570	2.0%	76,578	1.2%	25.9%
7139	Other Amusement and Recreation Industries	834	1.6%	253,038	2.1%	173,074	0.5%	12.9%
6212	Offices of Dentists	821	1.6%	247,771	2.0%	149,874	0.5%	2.1%
6211	Offices of Physicians	769	1.5%	193,160	1.6%	365,264	0.2%	4.3%
5419	Other Professional, Scientific, and Technical Services	748	1.4%	195,601	1.6%	835,976	0.1%	10.7%
5415	Computer Systems Design and Related Services	703	1.4%	93,685	0.8%	373,771	0.2%	21.7%
4539	Other Miscellaneous Store Retailers	700	1.4%	95,321	0.8%	195,517	0.4%	17.1%
5413	Architectural, Engineering, and Related Services	667	1.3%	111,706	0.9%	310,853	0.2%	11.8%
4452	Specialty Food Stores	645	1.2%	104,084	0.9%	61,444	1.0%	9.2%
6244	Child Day Care Services	642	1.2%	209,567	1.7%	682,303	0.1%	21.4%
4481	Clothing Stores	621	1.2%	69,041	0.6%	109,069	0.6%	38.7%
4841	General Freight Trucking	614	1.2%	87,502	0.7%	410,351	0.1%	18.5%
5416	Management, Scientific, and Technical Consulting Services	610	1.2%	56,617	0.5%	577,383	0.1%	15.1%
4511	Sporting Goods, Hobby, and Musical Instrument Stores	608	1.2%	82,492	0.7%	98,912	0.6%	32.9%
4453	Beer, Wine, and Liquor Stores	594	1.1%	167,607	1.4%	37,869	1.6%	10.0%
Total for Top 25 Industries		26,585	51.5%	6,519,361	53.4%	7,612,288	0.3%	
Total for All Industries		51,666		12,208,027		23,818,871	0.2%	

¹Share of total 2002 SBA 7(a) loan approvals.

²Share of total 2002 SBA 7(a) loan guarantees.

³A small business is defined as an establishment with fewer than 500 employees, including establishments with no paid employees. This is the definition used by the SBA for research purposes; for determining loan eligibility, the SBA uses different definitions for different industries. See <http://app1.sba.gov/faqs/faqindex.cfm?areaID=24> and <http://www.sba.gov/size/index.html>.

⁴SBA loans divided by total number of small business establishments in the industry.

Sources: SBA lending data from the Small Business Administration; industry characteristics from 2002 Statistics of U.S. Businesses and 2002 Economic Census.

Table 5: SBA 7(a) Loan Program: FY2002 Lending to Most and Least Concentrated Service, Wholesale, and Retail Industry Sectors

NAICS Code	Description	Loan Amount (\$1,000)	Share of SBA Total*	Market Concentration (Top 8 Share, by Sales)
15 Most Concentrated Industry Sectors				
4521	Department Stores	\$1,300	0.0%	88.8%
4529	Other General Merchandise Stores	32,709	0.4%	87.9%
7131	Amusement Parks and Arcades	12,476	0.1%	74.3%
4231	Motor Vehicle, Motor Vehicle Parts, and Supplies Wholesale	55,326	0.6%	67.4%
4512	Book, Periodical, and Music Stores	11,127	0.1%	61.2%
5621	Waste Collection	16,195	0.2%	60.8%
7223	Special Food Services	54,634	0.6%	60.5%
4242	Drugs and Druggists' Sundries Wholesale	10,315	0.1%	57.6%
5622	Waste Treatment and Disposal	11,136	0.1%	53.5%
4461	Health and Personal Care Stores	76,620	0.8%	53.0%
4482	Shoe Stores	14,164	0.2%	52.4%
4431	Electronics and Appliance Stores	57,297	0.6%	51.4%
4532	Office Supplies, Stationery, and Gift Stores	46,280	0.5%	49.6%
4441	Building Material and Supplies Dealers	101,561	1.1%	45.3%
5612	Facilities Support Services	6,701	0.1%	43.9%
	Subtotal	\$507,840	5.6%	
15 Least Concentrated Industry Sectors				
6212	Offices of Dentists	\$247,771	2.7%	2.1%
4531	Florists	27,432	0.3%	2.4%
8111	Automotive Repair and Maintenance	686,515	7.6%	2.8%
7224	Drinking Places (Alcoholic Beverages)	85,166	0.9%	2.9%
5411	Legal Services	66,794	0.7%	3.2%
5611	Office Administrative Services	3,729	0.0%	3.6%
6213	Offices of Other Health Practitioners	184,748	2.0%	3.9%
6241	Individual and Family Services	16,269	0.2%	4.1%
6211	Offices of Physicians	193,160	2.1%	4.3%
5414	Specialized Design Services	32,694	0.4%	4.4%
8134	Civic and Social Organizations	100	0.0%	4.5%
8139	Business, Professional, Labor, Political, and Similar Organizations	1,483	0.0%	4.8%
4412	Other Motor Vehicle Dealers	44,955	0.5%	6.1%
7115	Independent Artists, Writers, and Performers	4,331	0.0%	6.2%
4411	Automobile Dealers	84,292	0.9%	7.2%
	Subtotal	\$1,679,437	18.5%	
	Total for Services, Retail, and Wholesale Sectors	\$9,077,434		

*Share of total 2002 SBA 7(a) loan approvals to service, wholesale, and retail industry sectors.

Sources: Lending data from Small Business Administration; concentration data from 2002 Economic Census.

Table 6: SBA 7(a) Loan Program: FY2002 Lending for Selected Industries (6-Digit NAICS Codes)

Business Sector	SBA Lending			Industry Characteristics	
	# of Loans	Loan Amount (\$1,000)	Share of SBA Total ¹	# of Small Business Establishments ²	SBA Loan Ratio ³
Bars, Restaurants, Liquor Stores					
Full-Service Restaurants	3,240	\$770,370	6.3%	210,837	1.5%
Bars	351	85,166	0.7%	73,217	0.5%
Beer, Wine, and Liquor Stores	594	167,607	1.4%	37,869	1.6%
<i>Subtotal</i>	<i>4,185</i>	<i>1,023,143</i>	<i>8.4%</i>	<i>321,923</i>	<i>1.3%</i>
Professional Services					
Physicians	769	193,160	1.6%	365,264	0.2%
Dentists	821	247,771	2.0%	149,874	0.5%
Other Health Services	1,355	184,748	1.5%	385,541	0.4%
Accountants	216	37,705	0.3%	92,233	0.2%
Real Estate Agents and Brokers	129	29,950	0.2%	642,853	0.0%
<i>Subtotal</i>	<i>3,290</i>	<i>693,334</i>	<i>5.7%</i>	<i>1,635,765</i>	<i>0.2%</i>
Personal Care Services					
Barber shops/beauty shops	1,003	99,410	0.8%	651,060	0.2%
Laundromats	317	76,713	0.6%	26,776	1.2%
Dry cleaners	554	154,049	1.3%	45,556	1.2%
<i>Subtotal</i>	<i>1,874</i>	<i>330,172</i>	<i>2.7%</i>	<i>723,392</i>	<i>0.3%</i>
Other Services					
Pet Care Services	147	29,438	0.2%	46,962	0.3%
Child Day Care Services	642	209,567	1.7%	682,303	0.1%
Exterminating and Pest Control Services	43	10,352	0.1%	18,028	0.2%
Landscaping Services	552	64,565	0.5%	282,306	0.2%
<i>Subtotal</i>	<i>1,384</i>	<i>313,922</i>	<i>2.6%</i>	<i>1,029,599</i>	<i>0.1%</i>
Discretionary Goods					
Florists	270	27,432	0.2%	48,417	0.6%
Clothing Stores	621	69,041	0.6%	109,069	0.6%
Shoe Stores	118	14,164	0.1%	12,878	0.9%
Sporting Goods Stores	336	48,787	0.4%	43,482	0.8%
Book Stores and Newsstands	94	9,120	0.1%	34,345	0.3%
Music Stores	34	2,007	0.0%	9,611	0.4%
<i>Subtotal</i>	<i>1,473</i>	<i>170,550</i>	<i>1.4%</i>	<i>257,802</i>	<i>0.6%</i>
Other Retail					
Movie Rental	79	9,525	0.1%	14,513	0.5%
Pharmacies and Drug Stores	167	33,972	0.3%	24,603	0.7%
Used Car Dealers	205	58,336	0.5%	109,310	0.2%
Furniture Stores	280	63,739	0.5%	40,159	0.7%
Hardware Stores	190	53,041	0.4%	18,228	1.0%
<i>Subtotal</i>	<i>921</i>	<i>218,613</i>	<i>1.8%</i>	<i>206,813</i>	<i>0.4%</i>
Total for All Industries	51,666	12,208,027		23,818,871	0.2%

¹Share of total 2002 SBA 7(a) loan guarantees.

²A small business is defined as an establishment with fewer than 500 employees, including establishments with no paid employees. This is the definition used by the SBA for research purposes; for determining loan eligibility, the SBA uses different definitions for different industries. See <http://app1.sba.gov/faqs/faqindex.cfm?areaID=24> and <http://www.sba.gov/size/index.html>.

³SBA loans divided by total number of small business establishments in the industry.

Sources: SBA lending data from the Small Business Administration; industry characteristics from 2002 Statistics of U.S. Businesses and 2002 Economic Census.

Table 7: SBA 7(a) Loan Program: Business Turnover in Top 25 Industries

Industry		1998-2002 New Starts			1998-2002 Gross Turnover ¹		2002 7(a) Loans	
NAICS Code	Description	Base # of Small Business Establishments (1998) ²	Number	% of Base	Number	% of Base	Number	% of Base
7221	Full-Service Restaurants	148,916	80,590	54.1%	157,756	105.9%	3,240	2.2%
7222	Limited-Service Eating Places	147,329	76,766	52.1%	151,262	102.7%	2,563	1.7%
8111	Automotive Repair and Maintenance	144,302	58,660	40.7%	118,293	82.0%	2,482	1.7%
6213	Offices of Other Health Practitioners	79,258	36,731	46.3%	65,251	82.3%	1,355	1.7%
8121	Personal Care Services	79,385	39,700	50.0%	79,085	99.6%	1,267	1.6%
4471	Gasoline Stations	85,496	27,977	32.7%	63,116	73.8%	1,208	1.4%
5617	Services to Buildings and Dwellings	113,361	70,780	62.4%	139,074	122.7%	1,060	0.9%
4451	Grocery Stores	64,358	34,112	53.0%	66,836	103.9%	1,018	1.6%
7211	Traveler Accommodation	35,219	16,435	46.7%	31,555	89.6%	987	2.8%
2359	Other special trade contractors	55,649	36,588	65.7%	66,784	120.0%	929	1.7%
8123	Drycleaning and Laundry Services	38,997	13,979	35.8%	30,778	78.9%	900	2.3%
7139	Other Amusement and Recreation Industries	45,260	20,285	44.8%	39,382	87.0%	834	1.8%
6212	Offices of Dentists	108,796	22,015	20.2%	41,771	38.4%	821	0.8%
6211	Offices of Physicians	169,732	61,055	36.0%	114,811	67.6%	769	0.5%
5419	Other Professional, Scientific, and Technical Services	42,665	27,653	64.8%	45,248	106.1%	748	1.8%
5415	Computer Systems Design and Related Services	60,901	65,410	107.4%	119,360	196.0%	703	1.2%
4539	Other Miscellaneous Store Retailers	34,520	20,272	58.7%	39,204	113.6%	700	2.0%
5413	Architectural, Engineering, and Related Services	84,484	37,827	44.8%	72,007	85.2%	667	0.8%
4452	Specialty Food Stores	16,970	14,352	84.6%	25,078	147.8%	645	3.8%
6244	Child Day Care Services	52,958	26,783	50.6%	49,887	94.2%	642	1.2%
4481	Clothing Stores	44,838	19,352	43.2%	42,873	95.6%	621	1.4%
4841	General Freight Trucking	34,926	32,724	93.7%	59,855	171.4%	614	1.8%
5416	Management, Scientific, and Technical Consulting Services	65,754	62,646	95.3%	110,971	168.8%	610	0.9%
4511	Sporting Goods, Hobby, and Musical Instrument Stores	33,259	12,992	39.1%	28,705	86.3%	608	1.8%
4453	Beer, Wine, and Liquor Stores	24,201	9,341	38.6%	18,498	76.4%	594	2.5%
Total for Top 25 Industries		1,811,534	925,025	51.1%	1,777,440	98.1%	26,585	1.5%

¹Combined number of establishments that started or disappeared during 1998-2002 in each industry.

²Establishments with fewer than 500 employees, *not* including establishments with no paid employees.

Source: Small Business Administration.

Table 8: SBA 7(a) Loan Program: Growing, High-Tech Industries

Industry		1998-2002 Net New Jobs			2002 7(a) Loans	
NAICS Code	Description	Base # of Small Business Jobs (1998) ²	Number	Percent Increase	Number	Ratio ³
3254	Pharmaceutical and Medicine Manufacturing	44,883	11,992	26.7%	24	1.9%
3342	Communications Equipment Manufacturing	65,075	4,485	6.9%	30	1.7%
3391	Medical Equipment and Supplies Manufacturing	135,007	8,746	6.5%	107	1.0%
5112	Software Publishers	142,176	17,357	12.2%	20	0.2%
5133	Telecommunications	115,671	66,792	57.7%	158	1.9%
5141	Information services	66,580	66,312	99.6%	98	1.6%
5413	Architectural, Engineering, and Related Services	781,483	116,539	14.9%	667	0.8%
5415	Computer Systems Design and Related Services	502,814	159,837	31.8%	703	1.2%
5416	Management, Scientific, and Technical Consulting Services	412,716	168,511	40.8%	610	0.9%
5417	Scientific Research and Development Services	145,378	66,850	46.0%	47	0.5%
5419	Other Professional, Scientific, and Technical Services	336,300	98,929	29.4%	748	1.8%
6215	Medical and Diagnostic Laboratories	76,343	18,875	24.7%	77	1.3%
Total		2,824,426	805,225	28.5%	3,289	1.1%

¹ Establishments with fewer than 500 employees, *not* including establishments with no paid employees.

² Jobs at establishments with fewer than 500 employees, *not* including establishments with no paid employees.

³ 2002 SBA 7(a) loans divided by total number of small business establishments in the industry in 1998.

Source: Small Business Administration.

Table 9: Women and Minorities in Business

FY	U.S. Businesses: Number of Firms*					SBA 7(a) Loans Approvals				
	Women	Minorities	Total	% Women	% Minorities	Women	Minorities	Total	% Women	% Minorities
1990						2,530	2,450	19,129	13.2%	12.8%
1991						2,422	2,821	19,468	12.4%	14.5%
1992	6,407,000	2,149,484**	19,286,000	33.2%	11.1%	3,279	3,461	24,176	13.6%	14.3%
1993						3,799	4,067	26,690	14.2%	15.2%
1994						7,125	6,646	36,419	19.6%	18.2%
1995						13,396	10,308	55,786	24.0%	18.5%
1996						10,470	8,979	45,980	22.8%	19.5%
1997	5,417,034	3,133,655	20,821,934	26.0%	15.0%	10,077	9,538	45,378	22.2%	21.0%
1998						10,271	10,133	42,268	24.3%	24.0%
1999						9,470	11,134	43,636	21.7%	25.5%
2000						9,216	11,110	43,748	21.1%	25.4%
2001						9,011	10,745	42,958	21.0%	25.0%
2002	6,489,483	4,115,900	22,974,685	28.2%	17.9%	10,364	13,202	51,666	20.1%	25.6%
2003						14,332	18,702	67,306	21.3%	27.8%
2004						17,682	23,481	81,133	21.8%	28.9%
2005								95,900		

* Data from different years are not directly comparable due to changes in methodology.

** Unlike other data for U.S. businesses, "C" corporations are not included.

Sources: Firm data from the 1992 and 1997 Surveys of Minority- and Women-Owned Business Enterprises and the 2002 Survey of Business Owners; 2000-2004 women and minorities loan data from SBA's Performance and Accountability Report, Fiscal Year 2004; 1990-1999 women and minorities loan data from Minorities in Business 2001 and Women in Business 2001, Office of Advocacy, SBA; 1998-2005 total loans data from SBA's Performance and Accountability Reports, Fiscal Years 2005 and 2002; 1990-1997 total loans data from Minorities in Business 2001.

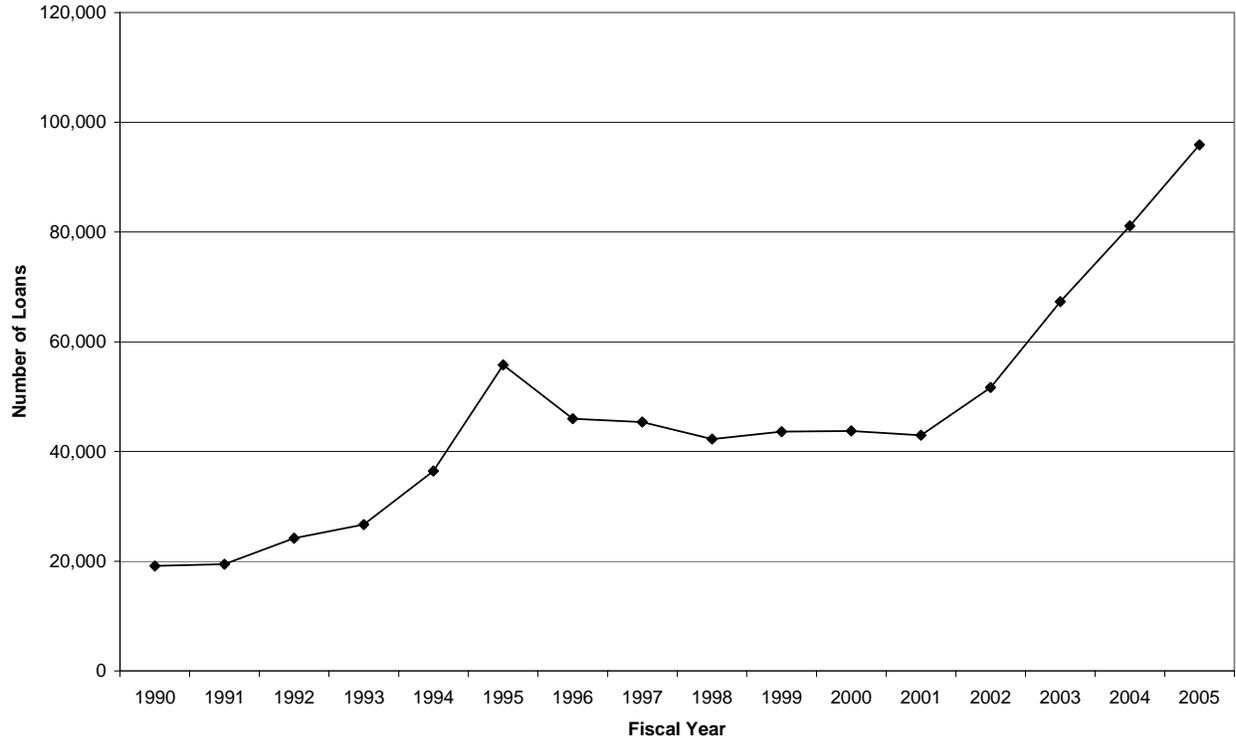
Table 10: SBA Requested Outlays vs. Actual Outlays (in millions)

Fiscal Year	Requested Outlays	Actual Outlays
2002	687	493
2003	587	1,558
2004	770	4,075
2005	683	2,502
2006	790	1,188*
Total	3,517	9,816

* Estimated.

Source: Budget of the United States, Historical Tables FY00-FY07.

Graph 1: SBA 7(a) Loan Approvals



Sources: SBA's 2002 and 2005 Performance and Accountability Reports, and Minorities in Business 2001.