



MEMORANDUM

To: Obama Transition Team

From: Todd McCracken, NSBA President

Date: December 23, 2008

Re: Small business Stimulus Package

According to a nationwide survey of small- and mid- sized small business owners, commissioned in 2008 by the NSBA (henceforth: NSBA Survey), 55 percent of small- and mid- sized business owners have had difficulty securing credit in the last six months—a finding consistent across firm size and revenue—and the situation has only deteriorated since the survey was conducted.

The effects of this difficulty are profound: 37 percent of those entrepreneurs experiencing trouble securing credit report that they are unable to grow their businesses or expand their operations and fifteen percent report reducing their number of employees. Nearly a third of small-business owners said they would hire additional employees if they were able to obtain additional capital for their firm.

It also is important to note that enacting these measures will not only lead to the creation of new jobs, it will help prevent other jobs from being cut. According to data from the Department of Labor's Bureau of Labor and Statistics (BLS), employers reduced payrolls by 533,000 in November, sending the national unemployment rate to 6.7 percent, the highest level in 14 years. With November's job losses marking the 11th straight month of payroll reductions—bringing the tally this year to 1.9 million, two-thirds of which have occurred since September—this is no small feat.

• Eliminate the borrower and lender fees associated with the SBA's 7(a) and 504 loan programs.

As NSBA Chair Marilyn Landis testified before the House Committee on Small Business in March 2007, “While some have argued that the zero subsidy and lack of appropriations has led to stability in the program, we would argue that stability and funding the 7(a) program are not mutually exclusive.” Since the zero-subsidy rate went into effect in Fiscal Year (FY) 2005, both loan volume and loan size have fallen precipitously. The number of 7(a) loans extended in FY 2008 dropped 30 percent from FY 2007. The number of banks participating in the programs also has plummeted. Nearly 370 banks have quit the program in the last few years and there was an almost 50-percent decline in the number of banks that actually made at least one loan between 2001 and 2005. This is not a coincidence.

- **Increase the percentage portion of 7(a) loans guaranteed by the government.**

This would help entice lenders back to the SBA's lending programs for a relatively small cost. It also could be temporary.

- **Increase or remove the interest-rate cap SBA imposes on lenders.**

This may seem counterintuitive but with so many entrepreneurs struggling to find any available capital, it is logical to make small-business lending more attractive to banks. With 44 percent of small-business owners using credit cards to finance their firms—the largest single source of financing, outpacing even business earnings—many would be happy to have a stable 10 or 15 percent bank loan, rather than be reliant on the capricious practices of the credit-card industry.

- **Temporarily alter SBA's internal policy relating to the circumstances under which the SBA will allow existing 504 borrowers to either refinance their un-guaranteed first mortgages or obtain another bank loan that SBA would agree to subordinate to the existing 504 second mortgage.**

This change would enable borrowers to obtain a reasonable amount of money from their existing business-property equity. The SBA purportedly is already doing this—on a case-by-case basis. We support Sens. John Kerry and Charles Schumer's proposal to establish clear guidelines for the practice.

- **Temporarily expand SBA's disaster lending program to include direct SBA loans to small businesses suffering substantial economic injury due to the credit crunch, with the caveat that these loans must be based on the underwriting principles of the SBA's prior direct lending program and not those used for its current disaster lending program, and that adequate resources are available to permit SBA to "ramp-up" for this new responsibility.**

While not eager to witness the SBA making direct loans to small firms, NSBA believes the current credit crisis simply is too great to ignore—but stresses that any expansion of SBA's disaster lending program must not be based on the underwriting principles used for its current disaster lending program. The temporary program must not be seen as in competition with the few lenders still extending credit to small businesses. Kerry and Schumer assert that this could be accomplished by utilizing the more than \$6 billion still available from the \$6.8 billion appropriated for emergency loans this year.

- **Mandate that Treasury require banks that receive any future TARP funding dedicate at least 25 percent of those funds to expand their small-business lending.**

Simply put, the first half of the \$700 billion rescue package has not reached small business. Hitherto, banks have not used this capital infusion to expand their small-business lending, which is tragic, given that reinvigorating the small-business community would be the quickest way to help lift the country out of its recession.

- **Utilize \$3 billion of the remaining half of the \$700 billion in TARP funding to directly purchase SBA 7(a) pooled securities, which already are guaranteed by the federal government, to help unfreeze the secondary market for SBA loans.**

In normal times, small lenders sell their SBA-guaranteed loans to free up their capital and increase their yields. Unfortunately, the institutional investors which used to buy these loan

packages are not buying them in the current economic environment. In the absence of a secondary market, only the strongest applicants—lately this translates to those seeking a commercial real-estate loan or with credit scores of more than 800—will receive SBA loans. Using federal money to directly purchase these securities—which the federal government, having already guaranteed the loans, already is on the hook for—would help quickly address the lockdown of the secondary market.

• Create a workable term sheet for the TARP and Capital Purchase Program (CPP) for the more than 2,500 Subchapter S banks that represent a third of the banking industry and provide an instrumental source of small-business capital.

As the Independent Community Bankers Association recently wrote to U.S. Treasury Secretary Henry Paulson, “These taxpaying institutions deserve the ability to participate to the fullest extent in the TARP if they are interested as Congress mandated under the EESA. Notably, these community banks are well positioned to get credit flowing to individuals and small businesses across Main Street America.” Community banks have weathered the current economic storm relatively well and are a crucial source of capital for small business. Thousands of them should not be systematically excluded from these programs.

• Mandate that 23 percent of any infrastructure stimulus funds—whether spent at the federal, state, or local level—be contracted out to small businesses and repeal the 3-percent withholding requirement.

Small businesses provide high-quality goods and services to government contracting agencies and infuse the procurement system with much-needed competition. Although small businesses employ more than half of all private sector employees and create more than half of non-farm private gross domestic product, they consistently receive less than the 23-percent of federal contracts mandated by Congress. The Obama administration should ensure that the enormous infrastructure investment expected in the next stimulus package does not only benefit large contractors.

Mandating that federal, state and local governments withhold three-percent of their payments for goods and services, Sec. 511 of the 2006 *Tax Increase Prevention and Reconciliation Act* is primed to unfairly burden small government contractors. The requirement, set to be implemented in 2010, is based on revenues from government payments with no relationship to companies’ taxable income and interferes with the cash flow small firms need for day-to-day operations.

Eliminating this requirement improves the working environment for the millions of small businesses that contract with their local, state, and federal governments. It also will save the government money. A recent study by the U.S. Department of Defense estimated that it would cost the agency over \$17 billion over five years to comply with the requirement. The Joint Committee on Taxation estimated that the provision would increase revenue to the federal government by \$7 billion over the same period, but only about \$1.1 billion of that would be additional revenue. The rest merely would be “float.”

• Abolish the self-employed tax on health insurance, making the tax code fairer and granting more than 21 million entrepreneurs greater access to affordable health insurance. Currently, corporations can deduct the cost of premiums as a business expense, foregoing the accompanying payroll taxes. The self-employed (schedule-C or schedule-E tax filers) are prohibited from taking that deduction, resulting in an additional 15.3 percent tax on their health insurance premiums. This simple correction in the tax code would result in a more fair tax code and would expand more than 21 million entrepreneurs’ access to affordable health insurance.

• **Extend the net operating loss (NOL) carry back rules from two to five years for losses suffered in 2007, 2008, and 2009.** The net operating loss (NOL) carry back rules allow companies to “carry back” current losses to earlier, profitable years and obtain tax refunds. The rules help smooth out swings in income (and tax payments) resulting from business-cycle fluctuations and unexpected financial losses. Typically, companies can carry back NOLs for a two-year period. NSBA supports extending the carry back period to five years for losses suffered in 2007, 2008 and 2009. A further extension of the NOL carry-back provisions would provide relief for small businesses who are struggling to recover from the recent economic recession and free up funds that can be used for much needed investment and job creation.

• **Reauthorize the Small Business Innovation Research program and provide an additional \$2.3 billion for small-business research and development and commercialization funding in FY 2009.**

Patents are the number one indicator of regional wealth. The SBIR program is delivering 58 percent more patents than all U.S. universities combined. Smaller firms produce about 5 times more patents per employee than large firms and 20 times more than universities; and these patents are more important—meaning more often cited in other patent applications—than large firm patents.

Small technology firms employ 38 percent of all scientists and engineers in America (54.8 percent of all industrial scientists and engineers). Yet these nearly 6 million scientists and engineers work with only 4.3 percent of the government research and development (R&D) dollars. In contrast, firms with more than 500 employees account for only 27 percent of all scientists and engineers, but receive 50.3 percent of government R&D funds. Universities employ 16 percent of the scientists and engineers and receive 35.3 percent, non-profit research institutions 9.1 percent, and states and foreign countries 1.0 percent.

We recommend allocating this additional \$2.3 billion R&D funding thusly: \$1.0 billion for additional R&D (Phase I and II SBIR) and \$1.3 billion for a new SBIR Phase IItm, providing advanced testing and manufacturing development funding to put new technologies through advanced testing into initial manufacturing, creating new jobs in advanced technologies. We recommend allocating 90 percent of these new funds to agencies in the same percentage as existing SBIR funds and 10 percent of these new funds to SBIR advanced energy projects.