SHUTTING DOWN THE SBA WOULD HELP SMALL BUSINESS

Small businesses are the backbone of the American economy. Businesses with fewer than 20 workers provide two-thirds of all net new jobs and generate a substantial portion of the gross national product. For this reason, strong concern has been raised regarding the Office of Management and Budget (OMB) proposal to abolish the Small Business Administration (SBA), an independent government agency intended to assist small firms. If the SBA effectively promotes small business, it should not be abolished. The fact is, however, that the SBA has proven to be relatively ineffective in generating new business; even worse, it misdirects resources, thus denying them to those entrepreneurs who may have been able to make better use of them. As such, the White House should endorse the OMB recommendation to eliminate the SBA.

SBA supporters insist that the bureau's primary function, providing loan guarantees and direct loans, is essential to the small business sector--and especially to start-up companies in need of capital. But in FY 1984, the $3.65 billion in SBA loan commitments went to less than two-tenths of one percent of the nation's small businesses--a mere 21,461 out of 14 million. Nearly 80 percent of SBA beneficiaries were receiving assistance for the second time; this indicates that new start-up businesses are not the primary beneficiary of SBA programs. SBA cannot claim credit, moreover, for the soaring rate of U.S. business formation in recent years--less than one percent of U.S. businesses have ever received SBA loan assistance.

The default rate on SBA loan assistance has been high. In 1984, for instance, 18 percent of guaranteed loans had to be paid off by the government, at a cost of $544 million in taxpayers' dollars. In 1983, the default figure was 26.8 percent, and in 1982 it was 39.9 percent. The SBA has attempted to tighten loan qualifications to reduce such losses. But this seems to defeat the very purpose of the SBA. If SBA's loan record is so bad, then it should retire from the loan business and leave this function to banks and other institutions. There can be little justification for gambling the public's tax money on a program that picks such a high percentage of losers. But if loan qualifications are so tightened that only "safe" businesses can obtain loans, then surely such businesses, with a little persistence, could obtain loans from other sources. Indeed, under the current system, there is an incentive for bankers to turn down promising small business loan requests. The reason: Such businesses have a good chance of securing an SBA loan guarantee, which can then be used to protect the bank from any risk. So the business gets its money and the bank receives interest from a risk-free loan.

Even if the SBA improved its lending practices, it would not be the best vehicle to help America's budding entrepreneurs. Institutional loans--whether guaranteed by the SBA or directed from banks and other lending agencies--are simply not the primary source of capital for small businesses. A survey by the National Federation of Independent Business (NFIB) reveals that of the 3 percent of existing small businesses that have received government aid, less than half relied on it as the primary source of their capital. For nearly 60 percent of America's small businesses, start-up funds come from the the savings of the owners or those of their friends and family. This suggests that the best way to help new firms is to 1) encourage risk-taking and 2) enable Americans to retain and save a greater portion of their earnings. Measures to achieve this include reducing capital gains taxes, cutting personal income taxes, and shielding savings from tax. By making private capital more available, these measures would do far more to help new firms than is now done by the SBA.

Other SBA activities should be handled by other means or agencies. Disaster relief for homeowners, for instance, is hardly appropriate for an agency established to help small businesses. And SBA's program of disaster relief for farmers duplicates Department of Agriculture programs. Even relief to businessess for losses suffered due to "changing economic conditions" is a deservedly disputed use of taxpayers' money--and is often abused. SBA-funded training programs, moreover, duplicate the services offered by business consultants and universities.

The SBA wins less than enthusiastic support even among its supposed beneficiaries. A recent NFIB survey, for instance, finds that two-thirds of small businesses have had no experience at all with the SBA, and half of the small firms surveyed oppose direct government loans. Only 10 percent said they would seek market or management help first from the SBA.

The SBA is not an efficient means of promoting small business. It diverts credit from more worthy to less worthy businesses or it helps those businesses that could secure loans without SBA assistance. Since so few businesses receive assistance, even if there were beneficial effects, they are minimal and costly. The best means of promoting small business is to reduce government regulation of these firms and to spur personal savings and investment by such steps as reducing the capital gains tax. This is the way to provide new entrepreneurs with the capital they need; continuing the costly existance of the SBA is not.

Edward L. Hudgins, Ph.D.
Policy Analyst

For further information:

Murray Weidenbaum, "Loan Subsidies: This Kind of Help Small Business Doesn't Need," Inc., March 1981.
"Small Business Evaluates SBA," National Federation of Independent Business, June 1984.