STEVE CHABOT, OHIO
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–0515

Memorandum

To:	Members, Committee on Small Business
From:	Committee Staff
Date:	June 15, 2018
Re:	Field Hearing: "Exploring the State of Western Kentucky's Small Businesses"

The Committee on Small Business will meet for a field hearing titled, "Exploring the State of Western Kentucky's Small Businesses." The hearing is scheduled to begin at 10:00 A.M. (CT) on Monday, June 18, 2018 at the Paducah Area Chamber of Commerce, Paducah Bank Room, 300 South 3rd Street, Paducah, KY. The purpose of the hearing is for Western Kentucky small business leaders to share their experiences and to provide the Committee with recommendations about federal policies that will help them to grow their businesses and create jobs.

I. Introduction

With roughly 30 million small businesses that employ 47.8 percent of private sector employees and make up 99.9 percent of all firms, small businesses make up a significant part of the United States economy.[1] Small businesses also create roughly two of every three net new jobs in the United States, making them the primary engine of job creation and economic growth.[2] In 2015, 679,072 new businesses were established in the United States.[3] These businesses created 3 million jobs.[4] Because the average new business created in 2015 had roughly 4.5 employees, almost all new businesses fit the criteria to be considered a small business.[5] Entrepreneurship is also a primary contributor to job creation. Business startups account for about 20 percent of gross job creation, and high-growth businesses account for almost half of

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[1] OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION, FREQUENTLY ASKED QUESTIONS 1 (2016) [hereinafter "Advocacy FAQ"], *available at* https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf.

[2] *Id.*

[3] BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, NUMBER OF ESTABLISHMENTS LESS THAN 1 YEAR OLD, MARCH 1994–MARCH 2015 (2016) [hereinafter Startup Statistics], *available at* https://www.bls.gov/bdm/entrepreneurship/bdm_chart1.htm.

[4] UNITED STATES DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, BUSINESS ESTABLISHMENT AGE (2016), *available at* https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm.

[5] There are numerous ways the federal government defines "small business." This memorandum will use the Small Business Office of Advocacy definition of a small business as an independent business having fewer than 500 employees. Advocacy FAQ, *supra* note 1.

gross job creation in the United States.[6] Furthermore, with small businesses accounting for 63 percent of net new job creation, it is the younger and smaller businesses that propel not only economic growth and innovation, but also job growth in the United States.[7]

II. Access to Capital

While large companies regularly raise capital through debt and equity markets, small businesses often finance their endeavors with personal assets or commercial bank borrowing. Unfortunately, the lending environment around the country for small businesses continues to be stagnant. According to research, the total value of loans by small domestic banks has remained flat since the recession and depressed as compared to levels before the recession.[8] Moreover, in the Federal Reserve's most recent Small Business Credit Survey, more than 60 percent of small businesses surveyed reported facing financial hardships within the last year.[9] With capital options limited, small businesses often turn to the SBA to finance their projects. The SBA, which was created in 1953 by the Small Business Act, administers several programs designed to assist small businesses, including capital access programs that aim to bridge the debt and equity gaps that exist in the marketplace.

a. *The 7(a) Loan Program*

In order to increase access to capital, the SBA offers small firms guarantees through private lenders that participate in the 7(a) Loan Program, whereby loan proceeds can be used for general business purposes. Named after § 7(a) of the Small Business Act,[10] the program is SBA's flagship lending option for creditworthy small firms that cannot obtain sufficient capital from conventional lending.[11] The program does not provide direct loans to participating small businesses; rather, SBA guarantees the repayment of loans made by lenders. The maximum loan a small business can acquire is $5 million[12] and the guarantee percentage ranges from 75 to 85 percent based on the loan amount.[13] The interest rate charged to small businesses has an inverse relationship with the size of the loan whereby the smallest loans have the highest rate.

Authorized in the 1974 Small Business Amendments,[14] the SBA charges lenders an upfront fee to run the loan program and cover any losses to protect the American taxpayer in accordance to the 1990 Federal Credit Reform Act (FCRA).[15] In previous years, the program has relied on a subsidy from Congress to operate the program. However, because the fees have

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[6] Ryan Decker, John Haltiwanger Ron Jarmin & Javier Miranda, *The Role of Entrepreneurship in US Job Creation and Economic Dynamism*, J. OF ECON. PERSPECTIVES 28:3 (2014), *available at* http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3.
[7] Advocacy FAQ, *supra* note 1.
[8] https://fred.stlouisfed.org/series/EVAXSSNQ.
[9] https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-employer-firms-2016.
[10] 15 U.S.C. §§ 632-57s.
[11] SOP 50 10 5(I), Subpart A., Ch. 1(I).
[12] *Id.* at Subpart B., Ch. 3(I).
[13] *Id.* at (II).
[14] Pub. L. No. 93-386 (1974).
[15] For any government loan program, FCRA requires an agency to collect an appropriation or fee to cover the cost of the program. For the 7(a) Loan Program, SBA charges lenders guarantee fees depending upon the loan amount. 2 U.S.C. § 661.

been sufficient, the program has been running on a zero subsidy cost to the American taxpayer for the last five fiscal years, including FY 2018.[16]

b. *The 504/CDC Loan Program*

As a way to bridge the gap for small businesses that cannot use traditional markets, the SBA also offers the 504/CDC Loan Program, which provides long-term and fixed-rate financing. Originally created in the Small Business Investment Act of 1958,[17] the 504/CDC Loan Program assists small businesses with the acquisition of major fixed assets, such as real estate or machinery or for equipment purchases that expand or update their small businesses.

Unique to the loan program is the role of the certified development company, or CDC, which must be a non-profit corporation and certified and regulated by SBA to participate in the program.[18] Along with the small businesses and the financial institutions that are involved in the credit transaction, CDCs also play a major role in the cost structure of the loan program. A standard loan is organized where the small business or borrower is responsible for 10 percent of the project. The financial institution is in the senior lien position and is responsible for 50 percent of the value of the project, and the remaining balance of 40 percent belongs to the CDC, which is in the second lien position, through a federal government guaranteed debenture. As with SBA's 7(a) Loan Program, funds are not lent by SBA; rather, SBA guarantees the loans made by the CDC.

A hallmark of the 504/CDC Loan Program, and a differentiating characteristic among SBA's many loan products, is the focus on economic development. Eligibility in the loan program and debenture size of the loan is determined based on the borrower either meeting a job creation or job retention requirement. Job creation is defined by creating or retaining at least one job for every $65,000 spent on the project. For small manufacturers, the requirement is one job for every $100,000.[19] If meeting the job creation or retention requirement cannot be achieved, a borrower can still qualify if they meet either one community development goal or a number of public policy goals.[20]

[16] For FY 2014, SBA requested zero subsidy. SBA, FY 2014 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2012 ANNUAL PERFORMANCE REPORT 36. For FY 2015, SBA requested zero subsidy. SBA, FY 2015 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2013 ANNUAL PERFORMANCE REPORT 35. For FY 2016, SBA requested zero subsidy. SBA, FY 2016 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2014 ANNUAL PERFORMANCE REPORT 39. For FY 2017, SBA requested zero subsidy. SBA, FY 2017 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2015 ANNUAL PERFORMANCE REPORT 37. For FY 2018, SBA requested zero subsidy. SBA, FY 2018 CONGRESSIONAL BUDGET JUSTIFICATION AND FY 2016 ANNUAL PERFORMANCE REPORT 28.

[17] 15 U.S.C. § 695.

[18] SOP 50 10 5(I). Subpart A., Ch. 3(I)(B).

[19] *Id.* at Ch. 2(III)(H)(1)(a)(i).

[20] The community development goals are: improving, diversifying, or stabilizing the local economy; stimulating business development; generating new income; helping manufacturing firms; or assisting the labor supply. The public policy goals are: revitalizing a business district with a redevelopment plan; increase of exports; increase of women owned small businesses, veteran owned small businesses, or minority owned businesses; assisting with rural development; increasing productivity or competitiveness; modernizing facilities to meet health, safety and environmental requirements; helping businesses in areas impacted by Federal budget reductions or base closings; or reducing the unemployment rate. 13 § CFR 120.862.

c. *The Microloan Program*

In order to meet the needs of low dollar borrowers, the SBA offers the Microloan Program, which began as pilot program in 1991 and was made permanent in 1997. As with all SBA financial assistance programs, the SBA does not make a microloan directly to a small business. Rather, it makes a direct loan to a non-profit called a microloan intermediary.[21] The intermediary, in turn, makes loans of up to $50,000 to borrowers.[22] Borrowers then repay the intermediary, which in turn repays the SBA.

Unlike the banks operating in the 7(a) Loan Program, the SBA requires that the intermediaries provide education and training to its borrowers. The intermediaries can provide such training or contract other enterprises to provide training and counseling. Funds for training and counseling are provided, in part, by appropriated funds made available to the intermediaries.

d. *The Small Business Investment Company Program*

As a way to increase the amount of private equity flowing to small businesses, SBA offers the Small Business Investment Company (SBIC) program. SBICs are for-profit enterprises organized under state law as either a corporation or partnership. SBICs receive a license to operate from the SBA pursuant to authority in the Small Business Investment Act of 1958.[23]

Once licensed, the SBIC is able to "borrow" money from the federal government to invest in small businesses. These borrowed funds are denominated "leverage" (as in leveraging private dollars with federal funds) in tiers. For every dollar of private investment, a SBIC is entitled to draw up to three dollars in government funding (but is not required to draw that maximum amount). Rather than simply borrowing directly from the federal government, SBICs sell securities to private investors and the federal government guarantees that the lenders to the SBIC are repaid with interest. The SBICs must repay the federal government for the leverage.

III. Regulatory Relief for Small Businesses

Across every industry, small business owners continue to be burdened by federal regulations. The cost in time and money to research, understand, and comply with regulations continues to be a problem for small businesses, and federal agencies have not always taken the proper steps to ensure they are adequately assessing how they are impacting small businesses when issuing new regulations.

Complying with federal regulations continues to be one of the biggest challenges for America's small businesses. In an effort to reduce the continuing burden, both Congress and President Trump have taken steps to reduce the regulatory burden on small businesses by rolling back and revising existing regulations. The President has also taken steps to reform the

[21] SBA, Partner Identification & Management System (2016), *available at* https://www.sba.gov/sites/default/files/articles/microlenderrpt_160927.pdf. Although 210 microloan intermediaries exist, only 140 are making at least 4 microloans each year, which is considered the threshold for success by SBA.
[22] Maximum loan size in the program was $35,000 before it was raised in the Small Business Jobs Act of 2010 to $50,000.
[23] 13 C.F.R. §107.

regulatory process and require federal agencies to review their existing regulations and identify candidates for removal or revision.

a. *Actions Taken Under the Congressional Review Act*

Congress's use of the CRA to more quickly invalidate regulations has been "one of the most important ways it has pursued deregulation" during the Trump Administration.[24] Prior to the Trump Administration, the Congressional Review Act had only been used to invalidate an agency rule once, and is typically used during a change in presidencies. In 2001, President Bush signed a joint resolution of disapproval from Congress to invalidate a rule finalized near the end of the Clinton Administration regarding ergonomics standards.[25]

Since President Trump has taken office, Congress has used the CRA to invalidate 15 rules issued by 13 agencies that were finalized near the end of the Obama Administration.[26] The most recent rule that was invalidated on November 1, 2017 under the CRA was an arbitration rule finalized by the Consumer Financial Protection Bureau, which marked the first time a president disapproved a regulation under the CRA during his own presidency.[27] The Government Accountability Office also recently confirmed in a letter that the CRA can be used to invalidate guidance documents that did not go through notice-and-comment rulemaking.[28]

b. *Regulatory Reform Legislation*

Many bills have been introduced in Congress that would reform the regulatory process.[29] Of particular importance to small businesses is H.R. 33, the Small Business Regulatory Flexibility Improvements Act of 2017, which would amend the RFA in significant ways.[30] H.R. 33 would clarify which rules are covered under the RFA, require agencies to assess the indirect and cumulative economic effects that a rule will have on small entities, require agencies to include more detailed statements in their RFA analyses, modify the SBAR panel process to provide more participation for small businesses in the rulemaking process, and require an agency to justify its decision to certify a rule will not have a significant economic impact on a substantial number of small entities in a more detailed manner.[31]

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[24] David Zaring, *Guidance and the Congressional Review Act*, REG. REV. (Feb. 15, 2018), https://www.theregreview.org/2018/02/15/zaring-guidance-congressional-review-act/.

[25] Act of Mar. 20, 2001, Pub. L. No. 107-5, 115 Stat. 7 (congressional disapproval of Department of Labor rule regarding ergonomics).

[26] *See* CONGRESSIONAL REVIEW ACT TRACKER 2017, THE GEORGE WASH. UNIV. REG. STUDIES CTR., *available at* https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/CRA%20Tracker%2011-01-2017.pdf (last updated Nov. 1, 2017).

[27] Act of Nov. 1, 2017, Pub. L. No. 115-74, 131 Stat. 1243 (congressional disapproval of CFPB rule relating to Arbitration Agreements). *See also* SOFIE E. MILLER & ZHOUDAN XIE, 2017 REGULATORY YEAR IN REVIEW, THE GEORGE WASH. UNIV. REG. STUDIES CTR. 3 (Dec. 18, 2017), *available at* https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/RegInsight_2017-Regulatory-Year-In-Review.pdf.

[28] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-B-329272, OFFICE OF THE COMPTROLLER OF THE CURRENCY, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL DEPOSIT INSURANCE CORPORATION--APPLICABILITY OF THE CONGRESSIONAL REVIEW ACT TO INTERAGENCY GUIDANCE ON LEVERAGED LENDING (2017).

[29] For a list of regulatory reform bills introduced in the 115th Congress, see ADMINISTRATIVE LAW REFORM BILLS: 115TH CONGRESS, ADMIN. CONF. OF THE U.S. (Feb. 14, 2018), *available at* https://www.acus.gov/memorandum/administrative-law-reform-bills-115th-congress.

[30] Small Business Regulatory Flexibility Improvements Act of 2017, H.R. 33, 115th Cong. (2017).

[31] *Id.*

H.R. 33 was included in a larger regulatory reform legislative package, H.R. 5, the Regulatory Accountability Act of 2017. This larger package includes six previously passed bills to address numerous issues in the regulatory process, including H.R. 33 as Title III of H.R. 5. H.R. 5 passed the House on January 11, 2017 on a bipartisan vote. The Senate Committee on Small Business and Entrepreneurship held a hearing on H.R. 5 on March 29, 2017.[32]

The Senate's version of H.R. 33 is S. 584, also named the Small Business Regulatory Flexibility Improvements Act.[33] The Senate also has provided two other regulatory reform bills related to H.R. 5: Providing Accountability through Transparency Act of 2017 (S. 577)[34] and REVIEW Act of 2017 (S. 919).[35] All three of the Senate bills were passed by the Senate Homeland Security and Government Affairs Committee and are waiting to be taken up by the full Senate.

c. *Presidential Actions*

President Trump has also taken actions to reform the regulatory process. On January 30, 2017, President Trump signed Executive Order 13771, "Reducing Regulation and Controlling Regulatory Costs."[36] This Executive Order requires agencies to identify two existing regulations for removal for every one new regulation (also known as "two-for-one" or "one-in-two-out").[37] The Executive Order also limits the incremental cost of all new regulations to $0 for fiscal year 2017.[38] The Office of Information and Regulatory Affairs (OIRA) issued guidance to help agencies comply with the Executive Order.[39]

In addition, President Trump also signed Executive Order 13777 on February 24, 2017, "Enforcing the Regulatory Reform Agenda."[40] This Executive Order requires the heads of federal agencies to designate an agency official as the Regulatory Reform Officer, who will oversee the agency's efforts to revise and roll back regulations.[41] The Executive Order also requires the agencies to form a Regulatory Reform Task Force, which will identify and make recommendations for regulations that can be revised or eliminated.[42]

OIRA also published its Fall 2017 Unified Agenda of Regulatory and Deregulatory Actions in December 2017. In addition to identifying the regulations that federal agencies plan to issue within the next 12 months, the agenda also reports that federal agencies plan to eliminate

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[32] *See Examining How Small Businesses Confront and Shape Regulations Before the Comm. on Small Bus. & Entrepreneurship U.S. Senate*, 115th Cong. (2017).
[33] Small Business Regulatory Flexibility Improvements Act, S. 584, 115th Cong. (2017).
[34] Providing Accountability Through Transparency Act of 2017, S. 577, 115th Cong. (2017).
[35] Require Evaluation Before Implementing Executive Wishlists Act of 2017, S. 919, 115th Cong. (2017).
[36] Exec. Order No. 13771, 82 Fed. Reg. 9,339 (Feb. 3, 2017).
[37] *Id.*
[38] *Id.*
[39] *See* Memorandum from Dominic J. Mancini, Acting Administrator, Off. of Info. & Reg. Aff., to Regulatory Policy Officers at Executive Department and Agencies and Managing and Executive Directors of Certain Agencies and Commissions (Apr. 5, 2017), *available at* https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2017/M-17-21-OMB.pdf.
[40] Exec. Order No. 13777, 82 Fed. Reg. 12285 (Mar. 1, 2017).
[41] *Id.*
[42] *Id.*

three new regulations for every one new regulation.[43] In fiscal year 2017, OIRA reported that agencies finalized 67 deregulatory actions and imposed only 3 new significant ones, resulting in a ratio of 22 deregulatory actions for every one new regulation.[44] OIRA also reported that agencies imposed no new regulatory costs and created $8.1 billion in present value cost savings, or $570 million per year.[45]

IV. Small Business Tax Reform

On December 22, 2017, President Trump signed into law, Pub. L. No.115-97,[46] the most comprehensive tax reform legislation in a generation. This law changed the process and rates for small businesses including the following provisions: 1) Provides a twenty percent deduction of of qualified pass-through income. Previously these pass-through entities were taxed through their individual tax returns with a top tax rate of 39.6 percent; 2) Allows the ability to immediately write off the full cost of purchases of new or used equipment; 3) Estate tax threshold is doubled from $5.6 million to $11.2 million for single filers, and from $11.2 million to $22.4 million for joint filers, so that small business owners are not subjected to double taxation when inheriting businesses from family members.

Small businesses are the engines of the economy generating nearly two out of three new private sector jobs. Beyond their outsized role in job creation, ninety percent of all businesses in the United States are classified as a pass-through entity: sole proprietorships, partnerships, or S corporations.

V. Conclusion

With over 30 million small businesses in the United States and roughly half of all private sector employees working for a small business, small firms are the strength of the American economy.[47] When small businesses succeed, so does the economy. However, access to capital and the burden of regulations continue to remain among the top concerns for small businesses. This hearing will be an opportunity for the Committee to hear recommendations directly from Western Kentucky small business owners about how the federal government can help reduce burdens to help them succeed.

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[43] *See* OFF. OF INFO. & REG. AFF, *Current Regulatory Plan and the Unified Agenda of Regulatory and Deregulatory Actions*, REGINFO.GOV, https://www.reginfo.gov/public/do/eAgendaMain (last visited Mar. 5, 2018).
[44] OFF. OF INFO. & REG. AFF, *Regulatory Reform: Two-for-One and Regulatory Cost Caps,* REGINFO.GOV, https://www.reginfo.gov/public/do/eAgendaEO13771 (last visited Mar. 5, 2018).
[45] *Id.*
[46] Pub. L. No. 115-97 (2017).
[47] SBA OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE (2017), *available at* https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf.