CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

February 22, 1999

S. 314
Small Business Year 2000 Readiness Act

As ordered reported by the Senate Committee on Small Business on February 5, 1999

SUMMARY

Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 314 would cost about $20 million over the 2000-2001 period; however, the actual costs could be substantially higher or lower depending on the severity of economic injury associated with year 2000 computer problems.

S. 314 would amend existing law to allow the Small Business Administration (SBA) to guarantee loans to small businesses to address costs associated with year 2000 computer problems. Small businesses would use those loans either to repair information technology or to provide relief for economic injury associated with such problems. The bill would allow SBA to relax credit standards for small businesses applying for year 2000 loans.

S. 314 would not affect direct spending or receipts; therefore, pay-as-you-go procedures would not apply. S. 314 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 314 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Millions of Dollars				
	2000	2001	2002	2003	2004
SPENDING SUBJECT TO APPROPRIATION					
Estimated Authorization Level	16	4	0	0	0
Estimated Outlays	10	10	0	0	0

BASIS OF ESTIMATE

S. 314 would allow SBA to guarantee loans under the 7(a) general business program for year 2000 computer problems and associated economic injuries. Under current law, many small businesses that will be affected by such problems will be able to receive general business loans. The federal costs associated with S. 314 would result from guaranteeing loans to small businesses that would not qualify for loans under current law. CBO estimates that implementing S. 314 would cost about $20 million over the 2000-2002 period for about $500 million in additional SBA guarantees at an average subsidy cost of about 4 percent of the guaranteed amounts.

Loans under S. 314 would differ from regular 7(a) general business loans in five respects:

- S. 314 would require that any reasonable doubts regarding a small business's ability to repay a loan be resolved in favor of the borrower.

- Most small businesses can borrow no more than $750,000 under the 7(a) general business program. Small businesses would be able to borrow up to $1 million under S. 314.

- Under the 7(a) general business program, SBA guarantees as much as 80 percent on loans of $100,000 or less and 75 percent on loans of more than $100,000. Under S. 314, SBA would guarantee as much as 90 percent on loans of $100,000 or less and 85 percent on loans of more than $100,000.

- S. 314 would require that SBA be as flexible as possible when establishing terms and conditions of loans.

- Finally, S. 314 would provide for a one-year moratorium on principal repayments.

The first three factors would likely allow SBA to guarantee loans with higher risks of default than the agency would guarantee under current law. Resolving all reasonable doubts in favor of prospective borrowers would have such an effect. Also, historical default data from SBA show that larger loans are more likely to default than small or average size loans. Thus, increasing the maximum amount a small business could borrow would increase the risk of loss. Finally, by increasing the percentage of a loan that SBA would guarantee, S. 314 would decrease the risk that a bank must bear and increase the likelihood of higher-risk lending.

CBO estimates that the default rate of borrowers that are approved under S. 314 but that would not receive approval under current law would be about 18 percent, which is 20 percent higher, on average, than the default rate for the 7(a) general business program. This higher rate is similar to the default rate that SBA expects for the defense loan and technical assistance program, which has loan conditions similar to those stipulated in S. 314. This rate also reflects the general risk that the effects of the year 2000 problems pose to all businesses.

The last two of the five factors listed above could allow SBA to guarantee loans with lower chances of recovery from defaults. The one-year grace period on principal payments would allow virtually all businesses to delay defaults. Most small businesses have assets that quickly decline in value, and computer equipment declines in value more quickly than other assets. The one-year grace period on principal payments would delay the time when SBA begins liquidating loans, and thus may result in lower recoveries.

The requirement for more flexible terms may make it possible for a small business to receive a loan with a balloon payment, so long as that structure does not increase the risk of default. CBO assumes that borrowers with such loans that eventually default would generally be able to make their interest payments until balloon payments were nearly due. Thus, SBA would not begin liquidating defaulted loans for many years, reducing the probability of recovery. CBO estimates that recoveries from year 2000 loans with normal amortization schedules would be 25 percent lower than recoveries from 7(a) general business loans, and that recoveries from year 2000 loans with balloon payments would be negligible.

We expect that the fees SBA would collect on year 2000 loans would be higher than those SBA would collect on 7(a) general business loans. The fees that SBA charges to originate a loan increase with loan size, and S. 314 would allow for larger loans than under current law. In addition, SBA charges a 0.5 percent fee on the outstanding balance of general business loans. Year 2000 loans would generally have higher outstanding balances than normal 7(a) general business loans because of the grace period on principal payments and the possibility of balloon payments. This factor would partially offset the increased cost of the loans made under S. 314.

On balance, CBO estimates that year 2000 loans would cost more to guarantee than 7(a) general business loans. The Federal Credit Reform Act of 1990 requires appropriation of the subsidy costs and administrative costs for credit programs. The subsidy cost is the estimated long-term cost to the government of a direct loan or loan guarantee, calculated on a net present-value basis and excluding administrative costs. Based on information from SBA and the Office of Management and Budget, CBO estimates that the 7(a) general business program will have a subsidy rate around 1.2 percent in 2000 and that the loans guaranteed under S. 314 that would not be funded under current law would have a subsidy rate of around 4 percent.

The total subsidy costs for implementing S. 314 largely depend on the demand for the year 2000 loans. Predictions of the impact of the year 2000 computer problem range from 1 percent of all businesses failing to global economic crisis. CBO estimates that small businesses would require about $500 million in SBA guarantees of year 2000 loans, assuming that small businesses will require about $1 billion in guarantees and that half of those businesses would not qualify for the 7(a) general business program. Therefore, CBO estimates that S. 314 would cost around $20 million over the 2000-2001 period, but the costs could be significantly higher or lower depending on the severity of the economic injuries associated with the year 2000 computer problem. CBO estimates that any impact on SBA's administrative costs would not be significant.

PAY-AS-YOU-GO CONSIDERATIONS: None.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

This bill contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

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