U.S. SENATE COMMITTEE ON

SMALL BUSINESS

& ENTREPRENEURSHIP

CHAIRMAN BEN CARDIN

THE 2023 DEBT CEILING CRISIS

Impacts of Budget Cuts and Brinkmanship on America's Small Businesses

Majority Staff Report

May 2023

Contents

Executive Summary

This report begins by reviewing the current state of U.S. debt obligations, and summarizes the history of past debt limit increases, including a breakdown of how many times the debt ceiling has been raised under Democratic vs Republican presidents. It also provides an overview of the legislation to address the debt that is currently on the table, notably the House Republicans' *Limit, Save, Grow Act* and the House Democrats' discharge petition plan.

We then summarize the impacts key legislation has had over the past few years on the federal debt, notably COVID-19 legislation and the *Tax Cuts and Jobs Act of 2017.* A brief examination of the 2011 debt ceiling crisis reveals similarities with the current debt ceiling situation in 2023. This analysis demonstrates that bargaining over the debt ceiling has long-term economic and financial consequences, regardless of whether a default ultimately is avoided.

Our focus then shifts to the specificities of small businesses, beginning with an analysis of the potential impacts of budget cuts. We then consider how a reduction in Small Business Administration services would affect small businesses, particularly veteran-owned small businesses. Attestations of this directly from the agency include a letter from the Administrator, and a report from the Office of Inspector General.

We then consider what the potential impacts a debt default could have on small businesses, and examine the opinion and sentiments of small business owners and entrepreneurs around a potential default using two survey studies.

Raising the debt ceiling should never have been up for negotiation, but deep spending cuts should also be taken off the table. They are ineffective for their intended purposes, and they turn everyday Americans, our small business owners and entrepreneurs, into the bargaining chips for what is ultimately a manmade problem. Main street will be on the frontlines of any budget cuts, just as they would be in a default situation, and as they were for the COVID-19 pandemic. The debt ceiling should be raised, and it should not come at the expense of budget cuts affecting vulnerable communities like our main streets.

Background

Secretary Yellen sent a letter to Congress in early May stating that the United States could default on its debt as early as June 1. The Congressional Budget Office (CBO) also reported that it saw a greater risk of the U.S. running out of funds in early June.

Current State of Debt Obligations and Past Debt Limit Increases

The U.S. hit its current $31.4 trillion debt ceiling on January 19, 2023. $24.61 trillion of that is debt held by the public, and $6.85 trillion is held in intragovernmental holdings. Since FY2000, the national debt has increased by $21.76 trillion, and $5.2 trillion since FY2019[1].

While Republicans have stated they cannot raise the debt limit without budget cuts, Republicans have joined Democrats to cleanly raise the debt limit several times in history. Since 1960, Congress has raised the debt limit 78 times — 49 times under Republican presidents and 29 times under Democratic presidents. The limit has been raised 20 times since 2001 alone and was raised by suspension 3 times under the Trump Administration[2].

House Republicans' Debt Default Plan - Limit, Save, Grow Act (Default on America Act)

House Republicans on Wednesday, April 27 passed (217-215) the *Limit, Save, Grow Act,* or the *Default on America Act*. The bill suspends the debt ceiling through either March 31, 2024 or a $1.5 trillion increase from the current $31.4 trillion ceiling, whichever comes first. The bill would return discretionary spending to the Fiscal Year 2022 level in 2024 and cap annual growth at 1 percent for the decade after; rescind unspent COVID relief funds, repeal almost all of the Inflation Reduction Act's energy and climate tax credit expansions; rescind the IRS $80 billion investment; make changes to energy, regulatory, and permitting policies; impose or expand work requirements on several federal safety net programs; and prevent the implementation of President Biden's student debt cancellation and income-driven repayment expansion[3].

The CBO projected that, if the bill is enacted and if appropriations are subject to caps on discretionary funding in the next 10 years equal to those specified in the legislation, the deficit would be reduced by $4.8 trillion over 10 years ($4.2 trillion of policy savings and $543 billion of interest savings; most notably the repeal of IRS funding would increase the deficit by $120 billion)[4].

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[1] *The National Debt*. Understanding the National Debt | U.S. Treasury Fiscal Data. (n.d.). https://fiscaldata.treasury.gov/americas-finance-guide/national-debt/

[2] *Debt limit*. U.S. Department of the Treasury. (2023, May 15). https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit

[3] H.R.2811 - 118th Congress (2023-2024): Limit, Save, Grow Act of 2023. (n.d.). https://www.congress.gov/bill/118th-congress/house-bill/2811

[4] *CBO's Estimate of the Budgetary Effects of H.R. 2811, the Limit, Save, Grow Act of 2023*. Congressional Budget Office. (2023, April 25). https://www.cbo.gov/publication/59102

House Democrats’ Discharge Petition Plan

House Democrats on Tuesday, May 2 began the process for a discharge petition that would force a vote on a clean increase of the debt ceiling. The petition requires 218 votes to pass. Though most would sign the petition, not all House Democrats are supportive, and it is unclear if any GOP members would sign on. Democrats began collecting signatures on May 17 with a letter from Leader Hakeem Jeffries asking Democrats to sign on[5].

President Biden’s FY2024 Budget/Deficit Reduction Plan

The President’s FY2024 budget request includes proposals to cut the deficit by nearly $3 trillion over the next decade by making the wealthy and big corporations pay their fair share[6]. The proposal explicitly ensures that no one earning less than $400,000 will pay more in taxes. There are several ways the budget proposes to cut the deficit:

1. Making the Wealthy Pay Their Fair Share:
    a. The budget includes a proposal to tax billionaires – a 25% minimum tax on the wealthiest 0.01 percent.
    b. The budget proposes raising taxes on the wealthiest to improve Medicare Hospital Insurance (HI) Trust Fund Solvency for at least 25 years. The budget proposes closing the loophole that allows some wealthy investors with passthrough businesses to avoid paying tax on their investment and it directs that tax into the HI trust fund.
    c. Repealing the Trump tax cuts for the wealthy and reforming capital gains tax. The budget proposes repealing the lower tax rate for the wealthy from the 2017 TCJA and restoring the top tax rate of 39.6% for those earning more than $400,000 a year. It also proposes taxing capital gains at the same rate as wage income for those with more than $1 million in income.
2. Making Large Corporations Pay their Fair Share:
    a. The Budget includes an increase to the rate that corporations pay in taxes on their profits. The budget would set the corporate tax rate at 28% (lower than the 35% prior to the 2017 TCJA).
    b. The Budget aims to build on the OECD global tax framework by proposing to raise the tax rate on U.S. multinationals’ foreign earnings from 10.5% to 21%.
3. Ending Wasteful Spending to Special Interests:
    a. Expand Medicare’s ability to negotiate drug prices. The budget proposes to cut federal spending by $160 billion by increasing the number of drugs Medicare can select for negotiation and bringing more drugs into the negotiation process sooner.
    b. The budget expands the Inflation Reduction Act’s requirement that drug companies pay rebates when they increase prices faster than inflation. The

[5] Hulse, C. (2023, May 17). *House Democrats move forward with petition to Force Debt Limit Vote*. The New York Times. https://www.nytimes.com/2023/05/17/us/house-democrats-petition-debt-limit-vote.html

[6] Budget of the U.S. Government, Fiscal Year 2024 - The White House. (n.d.-a). https://www.whitehouse.gov/wp-content/uploads/2023/03/budget_fy2024.pdf

Budget builds on the IRA by requiring rebates for commercial drug sales, as well as sales to Medicare. That will save the Federal Government $40 billion.

c. The budget eliminates special treatment for oil and gas company investments as well as other tax preferences.
d. The budget proposes to lower Medicaid costs by over $20 billion by requiring that insurance companies that are charging Medicaid far more than they actually spend on patient care pay back some of the excess.
e. The budget proposes saving $19 billion by ending like-kind exchange treatment.
f. The budget proposes saving $24 billion by eliminating a special tax subsidy for crypto currency and certain other transactions by modernizing the tax code's anti-abuse rules to apply to crypto assets just like it applies to stocks and other securities.

The Federal Debt

Impact of Tax Cuts on the Debt

Republicans will claim that the current debt situation was caused by unbridled spending, but data shows the impact tax cuts of the last two decades have had on our debt trajectory[7].

In 2001, the Bush administration enacted tax cuts that will have cost more than $8 trillion by the end of this fiscal year. The tax cuts lowered personal income tax across the board from labor income to capital gains, and significantly increased the untaxed portion of estates and lowered the estate tax rate. In 2013, a significant majority of the Bush tax cuts were made permanent with bipartisan support, locking in lower tax rates and deep cuts to the estate tax.

The most recent major tax legislation was the 2017 Tax Cuts and Jobs Act (TCJA). TCJA was a predominately Republican proposal that passed early in the Trump Administration. The legislation focused on permanently lowering the corporate tax rate and cutting taxes for wealthy individuals. According to the Joint Committee on Taxation, the resulting deficits from the law will substantially reduce revenues and increase deficits, adding approximately $2 trillion to the federal debt over the years of 2018 to 2027. By the end of this fiscal year, it is estimated that TCJA will have cost $1.7 trillion. If some of the temporary provisions are made permanent or extended, the debt increase will be larger. Revenues are actually expected to rise to 18.0 percent of GDP by 2030 if all of TCJA's temporary provisions expire as scheduled [8].

Taken together, the 2001 Bush tax cuts and the bipartisan extensions, along with the 2017 Trump tax cuts, have cost $10 trillion since their creation and are responsible for 57 percent of

[7] Kogan, B. (2023, April 6). *Tax cuts are primarily responsible for the increasing debt ratio*. Center for American Progress. https://www.americanprogress.org/article/tax-cuts-are-primarily-responsible-for-the-increasing-debt-ratio/

[8] *H.R. 1, the Tax Cuts and Jobs Act*. Congressional Budget Office. (2017, November 13). https://www.cbo.gov/publication/53312#:~:text=The%20staff%20of%20the%20Joint,over%20the%20next%2010%20years.

the increase in the debt to spending ratio since then. That percentage grows to 90 percent if the cost of responding to COVID-19 and the Great Recession are removed. It is important to note that these two costs were one-time costs and did not affect the trajectory of the debt ratio.

COVID-19 Legislation

From March 2020 to March 2022, the federal debt grew by over $6 trillion to fund the COVID-19 relief programs, including the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and the American Rescue Plan (ARPA). The packages were $2 trillion and $1.9 trillion, respectively.

ARPA was a Democrat-only bill. Republicans have claimed that the bill exploited the pandemic to force through unpopular liberal policies and characterized it as wasteful spending to benefit blue states and the Democratic elite at the expense of the taxpayer. The vast majority of this funding was used for unemployment insurance, local fiscal recovery funds, and medical assistance programs. The rest went to a variety of state-funded projects, such as child-care development block grants.

Republicans often point to COVID-19 legislation, particularly the ARPA and the Inflation Reduction Act, as one of the main reasons the federal debt has expanded in recent years, but much of this legislation was paid for or offset through increased taxes for the wealthy and corporations. Additionally, other legislation, particularly the 2017 Tax Cuts and Jobs Act, has slashed revenue, adding to our nation's debt. In recent history, the Tax Cuts and Jobs Act has been a driving force in increasing our debt because of the tax cuts given to the wealthy and large corporations at the expense of everyday Americans and small businesses.

As mentioned above, this legislation was one time spending and did not affect the trajectory of the debt to spending ratio. This spending was critically necessary to respond to the catastrophic impact of COVID-19 and avoid an economic recession, which would lead to greater costs to the economy long term.

The Inflation Reduction Act of 2022

The Inflation Reduction Act (IRA) passed via reconciliation with no Republican support and included provisions to lower prescription drug costs; fund new energy, climate, and health care provisions via tax credits; raise revenue; and reduce budget deficits. It also increased the IRS budget by roughly $80 billion over 10 years.

Republicans frequently claim that the energy and climate tax credits are handouts for the wealthy, especially the tax credit for electric vehicles, which has an income cap for eligibility and was included in the IRA to incentivize domestic manufacturing.

Another common misconception is that increased IRS funding is an attack on everyday Americans, and that more stringent tax enforcement will increase the financial burden on the middle class. The increased funding to the IRS simply bolsters a chronically underfunded agency and allows them to improve their customer service. The IRS can use the funding to hire more staff, allowing them to process returns more quickly, improve wait times on service call lines, and update their IT infrastructure. Increased enforcement activity does not and will not affect those in low- and middle-income brackets.

Closing common tax loopholes and consistently enforcing tax laws on the wealthy will significantly raise revenue. This bill is fully funded by bringing in higher tax revenue from large corporations and the extremely wealthy. According to the CBO, the IRA will reduce the deficit by $240 billion over 10 years at no cost to everyday Americans[9].

The 2011 Debt Ceiling Crisis

There have been several contentious debt ceiling episodes in the 105-year history of the U.S. debt limit, but the crisis in 2011 stands out in terms of volatility and long-term effects[10]. By many measures, 2011 is the closest the U.S. has historically come to a binding default, and it can serve as a useful comparison measure for the current situation in 2023.
President Obama, a Republican House, and a Democratic Senate reached an agreement on July 31, 2011, just two days before the X-date. On August 2, the Budget Control Act (BCA) of 2011 was signed into law, having passed the House 269-161, and the Senate 74-26.

As prescribed by the BCA, the debt ceiling was raised three separate times once certain predetermined criteria were met for each increase: $400 billion immediately on passage in August, $500 billion in September, and $1.2 trillion in December. The bill also imposed caps on discretionary spending to reduce funding by more than $1 trillion over 10 years, and required the Joint Select Committee on Deficit Reduction to propose legislation reducing deficits by another $1.2 trillion. Ultimately the Joint committee failed, and a backup measure included in the bill — sequestrations, or across-the-board spending cuts — was enacted to meet the $1.2 trillion goal.

Brinkmanship and Financial Impacts from the 2011 Debt Ceiling Crisis

As seen in 2011, brinkmanship is dangerous and has economic consequences, whether a default ultimately happens or not.

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[9] *Estimated budgetary effects of public law 117-169, to provide for reconciliation pursuant to Title II of S. con. res. 14*. 2022, September 7). https://www.cbo.gov/publication/58455

[10] Austin, D. A. (2022, December 23). *The Debt Limit Since 2011*. Congressional Research Service. https://crsreports.congress.gov/product/pdf/R/R43389

In 2011, just the threat of an impending default was enough to produce significant financial damage[11]. The U.S. Government Accountability Office (GAO) estimates that the 2011 debt ceiling impasse increased Treasury's borrowing costs by about $1.3 billion in FY2011[12]. From June to August 2011, consumer confidence fell 22 percent and business confidence fell 3 percent, according to the University of Michigan Consumer Sentiment Index, and the National Federation of Independent Businesses Small Business Optimism Index, respectively. (Measures of both had already begun to fall earlier in 2011, in part because of unrelated development abroad, but as the debate about the debt limit grew increasingly contentious, these measures of confidence fell further.) It took months for confidence to recover fully, well into 2012, even though the debt limit standoff was ultimately resolved before a default.

The 2011 crisis also spurred several financial market effects, most notably a drop in stock market prices and an increase in stock market volatility, reducing U.S. household wealth, and creating a credit crunch for traditionally riskier lendees like small business owners seeking business loans, and homeowners seeking mortgages. The VIX, a common measure of stock volatility, doubled around the time of the 2011 debt ceiling impasse, and remained elevated through the end of the year. Greater volatility has several negative economic impacts, but most notably causes investors to avoid potentially more unstable investments, further raising the cost of borrowing for many households, businesses, and other "riskier" lendees.

S&P 500 index prices fell 17 percent immediately following the 2011 crisis and did not recover to its previous averages until 2012. This reduced U.S. household wealth by a total of $2.4 trillion between Q2 and Q3 of 2011. Additionally, dropping stock prices also reduced retirement security; U.S. retirement assets fell by $800 billion in Q2 and Q3 of 2011[13].

Finally, and perhaps most memorably, the S&P 500 downgraded the U.S.'s credit rating for the first time ever, from AAA to AA+. The two other major rating companies, Moody's Investors Service and Fitch Ratings, lowered the U.S.'s credit outlook from stable to negative[14] [15]. This signaled the first time ever the U.S.'s financial dominance had shown signs of deterioration.

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[11] U. S. Department of the Treasury. (n.d.-c). Potential macroeconomic impact of debt ceiling brinkmanship. https://home.treasury.gov/system/files/276/POTENTIAL-MACROECONOMIC-IMPACT-OF-DEBT-CEILING-BRINKMANSHIP.pdf

[12] July 2012 debt limit - U.S. government accountability office (U.S. GAO). (n.d.-c). https://www.gao.gov/assets/files.gao.gov/assets/gao-12-701.pdf

[13] Ibid.

[14] *Moody's Updates on Rating Implications of US Debt Limit*. Moody's - credit ratings, research, and data for Global Capital Markets. (n.d.). https://www.moodys.com/research/Moodys-Updates-on-Rating-Implications-of-US-Debt-Limit-Long?lang=en&cy=global&docid=PR_220066

[15] *Fitch Affirms United States AAA Outlook Revised to Negative*. Fitch Ratings: Credit Ratings & Analysis for Financial Markets. (n.d.). https://www.fitchratings.com/research/sovereigns/fitch-affirms-united-states-at-aaa-outlook-revised-to-negative-28-11-2011

Impact of Budget Cuts on Small Businesses

A default would be catastrophic to small businesses, but budget cuts, for different reasons, will carry significant costs for the small business community as well. Dr. Louise Sheiner, a Senior Fellow and Policy Director with the Hutchins Center on Fiscal and Monetary Policy at the Brooking Institution, notes that cutting social programs to reduce the debt carries longitudinal costs for future Americans:

"The questions of how to address our long-term fiscal sustainability problem—when changes should be made, what is the mix of spending cuts and tax increases we need, which specific policies are best—require careful deliberation. And it is crucial to remember why we care about the debt. We worry that too large a debt will impose costs on future generations—because they will have to make interest payments on a larger debt and because debt can crowd out private investment. But then bringing down the debt through cuts like those in the House debt limit package—to programs like Medicaid and SNAP—which have been shown empirically to help children prosper as adults—and programs that address climate change, makes no sense. Cutting these programs to reduce the debt leaves future generations worse off, not better off.

Mr. Shaundell Newsome, a small business owner, Air Force veteran, mentor in the small business community, and Co-Chair of Small Business for America's Future, shares his perspective of what budget cuts would look like for him and his community:

"Cuts to the Small Business Administration would have a significant impact on small business owners, and especially veteran small business owners. The agency plays a crucial role in assisting veterans navigate the process of accessing capital, especially in the current economic climate. For example, the Small Business Administration's Boots to Business program helps veterans transition out of active military service and into entrepreneurial careers. This commendable program could be adversely affected by proposed cuts to discretionary spending by limiting the program's effectiveness and hindering the success of veterans starting their own businesses."

Letter from Administrator Guzman to Ranking Member DeLauro

On March 20, 2023, SBA Administrator Guzman sent a letter to Ranking Member DeLauro of the House Committee on Appropriations, detailing the potential effects of proposed Republican budget cuts on the agency. She provided outlooks for two funding scenarios: reducing funding to FY2022 levels or cutting FY2023 levels by 22%.

If Entrepreneurial Development program funding levels were capped at FY2022 levels, this would be a cut of $29.9 million from FY2023 funding levels, and SBA would reach 125,000 fewer small businesses and entrepreneurs. If program funding levels were reduced by 22% from FY2023 levels, this would be a reduction of $70.4 million and 295,000 fewer small businesses would be served.

A reduction to SBA's Salaries and Expenses funding would also be detrimental. If funding were reduced to FY2022 levels, SBA would not have sufficient funding to support the Service-Disabled Veteran-Owned Small Business Certification Program, reducing SBA's ability to grant new certifications affecting the 35,000 veterans the program already serves.

Staffing would also be affected across the board. Reverting to FY2022 funding levels would reduce SBA's staffing by up to 203 positions. A 22% reduction in FY2023 funding would cut nearly 385 positions. This would also reduce funding for SBA's Disaster Loan Program by nearly $8 million, hurting SBA's ability to respond quickly when disaster strikes, and their ability to ensure that disaster survivors get the assistance and service they need.

Finally, funding cuts would affect the SBA's Office of Inspector General (OIG). Reducing funding to FY2022 levels would decrease OIG's investigative and enforcement capabilities by over $25 million. In a time where so many are concerned about potential waste, fraud, and abuse, particularly in the COVID-19 aid programs, reducing SBA's capacity to investigate and combat these issues undermines these concerns[16].

Report from the SBA Office of the Inspector General

On May 12, 2023, the SBA's Office of Inspector General (OIG) sent a report to Congress outlining their concerns over a provision in the House Republicans' proposal rescinding unobligated amounts appropriated by ARPA.

OIG received an appropriation of $25 million through ARPA to conduct oversight of SBA's COVID-19 lending programs. The oversight needs of these programs extend far beyond the actual lending time period, with the statute of limitation for fraud against PPP and EIDL being extended to 10 years, in addition to the potential 30-year duration of EIDL loans. The additional ARPA funding is necessary for OIG to sustain its oversight capacity. The common Republican talking point disparaging SBA's COVID-19 programs for fraud is diametrically opposed to rescinding the funding necessary to investigate and ultimately resolve that fraud.

Macroeconomic Impacts of Default

A default is unprecedented, and estimating what the specific effects of one could be, especially long term, is challenging. Economic simulations from the Federal Reserve and Moody's Analytics estimates that a drop in stock prices, decline of real GDP, job losses, rising unemployment and deterioration in the value of the dollar are all effects we can expect to see at minimum in the aftermath of a default. The Federal Reserve simulation estimates that one month in default would lead to a 30 percent decline in stock prices and a 10 percent drop in the value of the dollar[17]. This would trigger a recession, leading to an almost 3 percentage point

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[16] Letter from Administrator Guzman to Ranking Member DeLauro; March 20, 2023

[17] Possible Macroeconomic Effects of a Temporary Federal Debt Default. (n.d.-d). https://www.federalreserve.gov/monetarypolicy/files/FOMC20131004memo02.pdf

increase in the unemployment rate. Such an increase today would mean the loss of about 2 million jobs in 2023 and 2.8 million jobs in 2024.

The Moody's Analytics model predicted that a default would cause a 4 percent decline in GDP, cost the economy more than 7 million jobs over the following years, and push the unemployment rate over 8 percent[18]. At their worst, stock prices would fall by a fifth, and wipe out $10 trillion in household wealth. It forecasted long-term effects as well. A decade from now, the U.S's real GDP would be one percentage lower than if there had been a clean debt limit increase, there would be 900,000 fewer jobs, and the unemployment rate would be 0.1% higher than it would have been without a default.

A default today would have forced the federal government to drastically cut spending by an estimated $125 billion in the first month alone. The second month would see a cut of an additional $200 billion. The trickle-down effects of such steep cuts would be substantial and would severely limit the ability of the government to provide essential services and resources to Americans.

Even a very short default would quickly trigger a recession. In both the 2011 and 2013 debt ceiling crises, a default was ultimately avoided in both situations, and regardless, consumer sentiment and business engagement both plummeted. In a default scenario, it's reasonable to assume that this effect would be magnified. Skyrocketing interest rates in response to the long-term uncertainty and financial risks posed by a default would also pose significant barriers to peoples' ability to continue paying everyday financial commitments affected by interest rates, like credit cards and mortgages.

Additionally, a default would deteriorate the value of the dollar, affecting economies worldwide. Treasury securities are the world's safest asset, making the dollar the world's primary reserve currency. If they were no longer perceived as risk-free by global investors, the value of the dollar would diminish long-term, deteriorating the U.S.'s status as the global financial stronghold.

Small Business Impacts of Default

Small businesses would be on the frontlines of a debt default, just as they were for the COVID-19 pandemic. They are already a financially vulnerable community during the best of times and have depleted reserves from surviving the pandemic. With very thin profit margins and business only slowly beginning to return to normal, America's main streets would feel the effects of a default essentially overnight. The macroeconomic effects of the default, like low consumer confidence and job losses, would affect small businesses on a larger scale by

[18] Going Down the Debt Limit Rabbit Hole - moodysanalytics.com. (n.d.-b). https://www.moodysanalytics.com/-/media/article/2023/going-down-the-debt-limit-rabbit-hole.pdf

affecting their customer base. On a more specific level, small businesses would face significant challenges in both the short and long term, particularly with access to capital.

Many of the consequences directly felt by small businesses would be the effects of high interest rates. The credit market will squeeze, and loans will become very expensive. A federal default will trigger an automatic downgrade of the U.S. government's credit rating, driving up interest rates overnight. Loans from private lenders will become more expensive as their risk appetites bottom out, and new loans will go primarily to "safe" entities, likely larger firms they have pre-existing relationships with. SBA-guaranteed loans, typically a much more accessible option, are still reflective of market conditions and will become more inaccessible as well.

As interest rates go up and loans become more expensive across the board, it is likely that significantly more people will be forced to default, including on SBA 7(a) and 504 loans. SBA will be obligated to fulfill their guaranty and pay out on more of these loans than they typically budget for while also bringing in less revenue than usual from things like loan administration fees. The longer a potential debt limit breach continues, the more significant the consequences of this would be. If SBA begins to run out of funds to pay out on defaulted loans, they will not be able to rely on Congress to provide additional appropriations as they did during the Great Recession and the COVID-19 pandemic.

Inability to pay back increasingly expensive loans, especially if it were to become an extended problem, poses long-term issues for lenders and for the credit market more broadly. In an extended debt breach scenario, and maybe even in a shorter-term situation depending on how quickly financial conditions change, lenders may suffer significant losses from defaulted loans, especially smaller firms serving local and/or underbanked communities. They would have to build back their losses, and would likely remain risk-adverse for as long as it takes to do that. This would contribute to a tight credit market in the long-term, posing a threat to both aspiring entrepreneurs and existing small businesses alike.

Effects of a debt default on small businesses go beyond access to capital problems. It is estimated that plunging stock prices after a default would wipe out $10 trillion in American household wealth. Small business owners and entrepreneurs, who already face challenges in building retirement options, would likely see a lot of their savings disappear. They would also lose business from customers who are cutting back on spending and dealing with the loss of their own retirement funds.

Government payments will also be affected by a default. Among other things, paychecks for active-duty personnel will be delayed, along with certain veterans' benefits like disability payments. For veterans who are small business owners, any delay in disability benefits or pensions is yet another financial burden added to an already difficult situation. Federal government contractors, particularly those who are not mission critical, would also likely see a lag in payments. For small businesses whose primary income streams are federal contracts, this would be a devastating blow.

As is so often the case, minority and underserved small businesses would feel these effects the most. Minority and underserved communities tend to rely on entrepreneurship and small business ownership as a career path at a higher rate than others; it is a path of self-determination for those who may not have that option elsewhere. Underserved communities have very little safety net and often operate on very thin profit margins. Sustaining, much less recovering from, such significant losses caused by a default would be an uphill battle that spans years.

Small Business Sentiments on Default

Small business owners are deeply concerned about the potential fallout from a debt default and the ramifications it would have on their lives. Two small business advocacy organizations, Small Business for America's Future, and Goldman Sachs' 10k Small Businesses, fielded surveys among their members and participants to determine their sentiments around a potential debt default, from the small business perspective.

According to the survey conducted by Small Business for America's Future, 76 percent of small business owners believe a debt default would have a negative impact on their small businesses. 59 percent said a default could result in higher interest rates, difficulty accessing credit, and a loss of customers. 67 percent said that they are concerned that a debt default would stall progress being made recovering from the pandemic, and 66 percent believe that a default will lead to a recession. 82 percent of respondents agreed that Congress should address spending during the federal budgeting process, allowing for targeted discussions around spending without jeopardizing the economy.

The Goldman Sachs survey found that 65 percent of small business owners believe a default will have negative impacts on their businesses and 90 percent believe that it is important for the federal government not to default on its debt with 53 percent believing that it is absolutely essential[19]. 60 percent said that rising interest rates are already affecting their ability to service their existing business debt. The survey also revealed significant concerns around a credit crunch, with 77 percent small business owners reporting concerns about their ability to access capital. The results from the previous year were the opposite: 77 percent of respondents in 2022 said they were confident in their ability to access capital.

[19] *Survey: Small Business Owners Face Credit Crunch as the Debt Limit Looms and Workforce Challenges Remain Stagnant*. Goldman Sachs. (n.d.). https://www.goldmansachs.com/citizenship/10000-small-businesses/US/infographics/small-business-owners-face-credit-crunch/index.html

Conclusion

Small businesses and entrepreneurs would be on the frontlines of a debt default just as they were for the COVID-19 pandemic. They would also be on the frontlines of budget cuts. Many small business owners rely on resources provided by the SBA along with other resources like disability compensation for veterans.

Brinkmanship increases interest rates and interrupts the flow of capital and resources available to entrepreneurs. This critically weakens a reliable wealth building avenue for entrepreneurs of color, women-owned small businesses, and underserved small business owners.

House Republicans' legislation originally proposed cutting funding for federal agencies, including for the Small Business Administration, to FY2022 levels. The SBA will not be able to adequately serve the growing number of small businesses under the Biden Administration if spending is capped at FY2022 levels. With a 22 percent cut, SBA would serve approximately 125,000 fewer small businesses in the Entrepreneurial Development programs alone.

Avoiding default should never have been up for negotiation. Small businesses are the American economy, and curtailing services and access to capital for small businesses will devastate local economies, main streets, and communities nationwide. As an agreement to raise the debt ceiling is reached, deep spending cuts should also not be up for negotiation. Budget cuts are the most expensive for vulnerable communities like small businesses. If a debt default would be devastating to underserved small businesses and entrepreneurs, deep federal spending cuts, for different reasons, would be as well. In a post-pandemic world, resilient small businesses and entrepreneurs deserve uninterrupted support and investment. They should never be a political bargaining chip. The debt ceiling should be raised but not at the expense of our small businesses – the backbone of the American economy.