THE SBA FY 2004 BUDGET

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

WASHINGTON, DC, FEBRUARY 26, 2003

Serial No. 108–9

Printed for the use of the Committee on Small Business

Available via the World Wide Web: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

92–511 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
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CONTENTS

WITNESSES

APPENDIX

HEARING ON SMALL BUSINESS ADMINISTRATION'S FISCAL YEAR 2004 BUDGET REQUEST

Wednesday, February 26, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to call, at 2:25 p.m., in Room 2360, Rayburn House Office Building, Hon. Donald A. Manzullo [chair of the Committee] presiding.

Present: Representatives Manzullo, Bartlett, Velazquez, Ballance, Beauprez, Christian-Christensen, Davis, Graves, Majette, Marshall, Michaud, Napolitano, and Ryan.

Chairman MANZULLO. Good afternoon. I would like to welcome everybody to the Committee's first hearing for the 108th Congress. The President has developed a clear small business agenda, one that I fully endorse. I believe that one additional component must be added to the President's agenda: America cannot maintain economic security as a post manufacturing society. The government must find ways to ensure and restore a stable manufacturing base to America. This will be my number one priority in this Congress, not just getting Americans back to work, but getting Americans back to work in jobs where they actually make a tangible good. Only with a strong manufacturing base can we truly ensure economic security for today and our posterity.

This is not a new priority, but rather returns the Committee to the reason it was founded, to ensure that America in time of war had a small sound business industrial base. It is within this context that, on examining the SBA budget, to determine whether it has the resources needed to assist America's entrepreneurs, particularly if they wish to start or expand manufacturing enterprises. One way to do this is by ensuring adequate access to capital. Let my make it clear for the record, I do not want a repeat of the problems that occurred with the 7(a) loans in the 504 program.

The conference report of the FY 2003 appropriations states, quote: "Conferees direct the SBA to develop similar more accurate econometric models during this fiscal year for use in other SBA loan and financing programs, especially the 504 program.".

That is a directive from Congress to get this resolved. I completely agree with the directives of the conferees, and expect the SBA to make the development of the econometric model for the 504 loan program by October 1st of 2003 one of its top priorities. I believe the SBA can be the vehicle to help all of America's entrepreneurs, including those that wish to get their hands dirty on the shop floor.

I look forward to working with the President and the administration to enhance our small business industrial base. I recognize the ranking member of our committee, the distinguished gentlelady from New York for her opening statement.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Regardless of the rhetoric, the fiscal year 2004 budget request for the Small Business Administration is as inadequate as the previous three this committee has seen during President Bush's tenure. The $800 billion level is well below the 4 percent increase for government-wide spending that President Bush touted when he released his budget this month. Given our new reality and the budgetary constraints we face, we must prioritize spending to ensure critical items are funded, like homeland security and the war against terrorism. But let me ask this question: What is the point of having international security if we do not have economic security here at home? This budget not only fails to provide for our Nation's economic security, but it also, I believe, would lead to greater economic insecurity in America.

If our economy is to rebound, it will be critical that small businesses, which create half of all new jobs, get the assistance they need. Sadly, this budget fails our Nation's entrepreneurs. First and foremost, it shortchanges small businesses by billions of dollars in lending opportunities. It is through this infusion of capital that small businesses expand as they purchase equipment or start new ventures, both of which create jobs and lead to economic growth.

While there is still much talk by the President and some in Congress about a tax break to supply such a capital infusion, the reality is that much of the President's plan will have no effect and may even harm small business. That is why the SBA loan programs which provide 40 percent of all small business lending—long-term lending are so important. This budget continues the SBA trend of underfunding its flagship loan program, the 7(a), by $3 billion. It also cuts the Microloan Program in half.

Small businesses will not only fail to get the capital they need, but the President's budget only partially solves the miscalculation of the subsidy rate for the 7(a) program which has taxed both lenders and borrowers by over $1.5 billion, and does nothing to correct the subsidy rate problem in the 504 program. This means borrowers who use the program will pay an additional $15,000 over the life of the loan. That is the difference between hiring a part-time employee and a full-time employee, providing health care benefits, or purchasing new equipment.

Even worse, it imposes new taxes under the SBIC program with additional fees on the participating securities program. For an administration that pushes tax cuts to continue these type of policies and then propose yet another tax on small business is backwards. The proposed budget steals lending opportunities as well as Federal contracting ones away from small business by failing to open up the $220 billion marketplace to small enterprise.

For the last 2 years, the Federal Government has not met a single one of its small business goals. This has cost small businesses over $12 billion. While there has been a lot of tough talk by the administration about cracking down of contract bundling and holding agencies accountable, this budget provides insufficient funding for procurement center representatives, the front line of defense in enforcing failure contracting laws. It provides funds for 47 PCRs, not even one per State, leaving several critical procurement centers across the country unstaffed. Little money is available for travel. It is one thing to think someone can do more with less and another to think anyone can make something out of nothing. That is exactly what this budget does.

As President Bush has made compassionate conservatism his motto, this budget continues the administration's policy of completely turning its back on low income and minority communities. Just like in the past, the proposed budget fails to request funding for prime business link one-stop capital shops. All programs that target these areas. Given the deep cuts to the Microloan Program and the administration's failure to get the new markets venture capital program off the ground, this budget sends the message to low income communities that they must go it alone.

Mr. Chairman, my assessment of this budget is simple: It is inadequate. It underfunds critical small business loan programs. It fails to provide contracting for small business, and it leaves our low income and minority communities behind. If our economy is to turn around any time soon, it will be through small business growth, growth that will, in part, rely on SBA programs.

Clearly, this budget does not match the administration's rhetoric of being pro small business. Given the current recession, it concerns me that the most important driver of our economy, small business, will suffer at the hands of the administration's budget. Small businesses cannot work their magic on our economy without the proper tools which this budget fails to provide them.

I look forward to hearing from the witnesses, and I yield back the balance of my time. Thank you.

Chairman MANZULLO. Thank you very much.

The way we will work the witnesses is Mr. Barreto will go first, and then the members of the Committee will have the opportunity to ask questions. And then when the other witnesses give their testimony, Mr. Barreto has advised that he will stick around as long as he can to be able to listen to the testimony direct from the witnesses.

It is my great pleasure to introduce to you Hector Barreto, who has done nothing less than a fabulous job as the head of the SBA. He came into this job because of a desire in his heart to grow small businesses, not just a political appointment, not just a halfway house look for another job in the Federal Government, but a real desire to help out the small businesses.

I wonder—I know he is always a happy person. He would be much happier if he didn't have to worry about the OMB. And because we know what you would do with that budget, Mr. Barreto, if it were up to you and you wouldn't have to worry about the confines of the budgetary process. We look forward to your testimony and thank you for being with us.

STATEMENT OF HON. HECTOR BARRETO, ADMINISTRATOR, UNITED STATES SMALL BUSINESS ADMINISTRATION

Mr. BARRETO. Thank you very much, Mr. Chairman, Ranking Member Velazquez, and members of the Committee. Thank you for inviting me here today to discuss the President's budget request for the U.S. Small Business Administration for fiscal year 2004. President Bush understands the vital role that America's small businesses play in creating opportunities. He also recognizes that as we look toward economic recovery, small businesses play a leading role, and that in such times it is small businesses that account for virtually all new jobs.

Therefore, to support this vital sector of the American economy, the President has designed a small business agenda that bolsters small business and creates an environment in which entrepreneurship can flourish. This agenda includes broad tax relief aimed at boosting small business growth, providing small businesses with information they need to succeed, ensuring full access to government contracting opportunities, and tearing down regulatory barriers to job creation for small business by giving them a voice in the complex and confusing regulatory process.

The President's plan for economic growth and job creation would provide relief for small businesses in the form of reduced marginal tax rates while increasing the amount that can be written off as expenses for equipment purchases from $25,000 to $75,000, encouraging them to buy technology, machinery, and other equipment they need to expand and create new jobs.

And finally, the President has responded to the calls heard throughout the country to permanently repeal the estate tax and allow small business owners the opportunity to pass along the fruits of their life's work to their heirs without being forced to sell the family business to pay the tax bill.

Beyond the need for tax relief, SBA is leading the charge to implement President Bush's small business agenda. To do this, the agency is focusing on three strategic programmatic goals designed to create more jobs. First, SBA is championing small business interests by minimizing the regulatory burden, providing them with easily accessible information about how to comply with regulations, and working to ensure that the regulatory process treats small business fairly.

Secondly, SBA is continuing its efforts to empower entrepreneurs. The agency is working to increase the opportunity for entrepreneurs to start and grow a business by providing increased access to capital and information, technical assistance and counseling, as well as increased access to procurement opportunities.

Thirdly, the SBA is continuing to play a vital role in helping businesses and families recover from disasters. Through its disaster assistance program, SBA provides speedy and customer-friendly assistance to restore homes and businesses to their pre-disaster conditions.

Mr. Chairman, when I appeared before you last year, I testified about a number of challenges facing the SBA in its efforts to retain its relevance. Today, I am pleased to report to you that this administration has met those challenges and has significant accomplishments to report to you. I testified that for fiscal year 2004, SBA would use an improved model to calculate the subsidy rate for the 7(a) loan guarantee program. The 2004 budget request uses such an econometric model. Working with the Office of Federal Housing Enterprise Oversight, we have developed and implemented a more accurate subsidy rate calculation model. Using this revised model for fiscal year 2004, SBA has been able to dramatically reduce the 7(a) program subsidy rate from 1.76 percent as proposed for fiscal year 2003 to 1.02 percent. The administration is requesting $94.86 million for the 7(a) program, which, using the improved subsidy rate calculations, will provide a program level of $9.3 billion.

The new model will enable SBA to allocate its resources more effectively, determine program risk more precisely, and increase its ability to target loans to aspiring entrepreneurs who could not obtain financing without a government guarantee. It also improves the government's ability to forecast loan performance by taking into account a wide range of economic factors.

I also testified that SBA needed to change the way it delivers services to its customers, America's small businesses. Today, we are poised to implement our transformation efforts with a three district pilot project. Many throughout the agency have worked long and hard to ensure the success of SBA's transformation efforts and have addressed each and every concern raised by congressional partners in formulating this plan. I will discuss SBA's budget request for transformation later in my testimony.

Last year, I also testified on the need to improve oversight of the lending partners since the SBA has taken the steps necessary for a more modern oversight system. To assist with this effort, SBA contracted with KPMG Consulting, and last June they provided recommendations as to how to proceed with developing a loan monitoring system that meets both SBAs and Congress's need for lender oversight. In undertaking these actions, this administration has addressed the challenge of modernizing LMS by using the private sector, where the experts in this area are, rather than developing a separate and more costly system.

Now, I respectfully ask for your support of the President's fiscal year 2004 budget request for the SBA. The President's plan proposes a total fiscal year 2004 appropriation of $797.9 million, and maintains the spending level proposed for the fiscal year 2003. It is about 4 percent larger than the budget for fiscal year 2002 and would provide substantial levels of credit, capital, and procurement, and entrepreneurial development assistance to small businesses. This fiscally sound budget would provide more than $20.8 billion in small business loans, loan guarantees, and venture capital, and more than $760 million in new disaster loan funds for victims of natural disasters. It includes funding for $9.3 billion in guaranteed loans under the 7(a) program as well as more than $115 million for the agency's technical assistance programs.

Thus far, in fiscal year 2003, operating under a series of continuing resolutions while dealing with the effects of lowered fees on 7(a) loans as a result of legislation passed last year, SBA has instituted a cap of $500,000 per 7(a) loan. This effective management tool has produced interesting results. By creating an emphasis on smaller loans within the program, we have been able to leverage our resources to provide an increased number of loans to our merging markets. This has allowed SBA to be ahead of its 7(a) lending goals in every category for 2003, including 35 percent a head to women-owned businesses; 65 percent a head to African American businesses; 39 percent a head to Hispanic-owned businesses; and 31 percent a head to veteran-owned businesses.

Now that Congress has enacted both the fiscal year 2003 appropriation for SBA as well as legislation allowing for the use of the econometric model for calculating the subsidy rate for the 7(a) program in fiscal year 2003, SBA has removed the cap on 7(a) loans. We will, however, continue to promote smaller loans. We will also promote smaller loans by expanding the lending program to allow as many as 1,500 of America's more than 10,000 credit unions to join our network of lenders.

This represents a potential increase of some 30 percent in the overall number of storefronts through which entrepreneurs, particularly those requiring smaller loans, can seek capital for their businesses while allowing SBA to reach more communities, a greater number of entrepreneurs, and a more diverse pool of prospective and existing small business men and women, the budget request which will also allow SBA to provide $4.5 billion in loans through the 504 certified development company program with no cost to taxpayers. The 504 program, which was established to increase small businesses' access to real estate and other long-term fixed asset funding has always had a program goal of job creation.

SBA recognizes the need to increase small businesses' access to 504 loans, and will implement steps in 2004 to accomplish this goal. This budget request includes $8.8 million to continue implementation of SBA's transformation efforts. I have spoken with many of you personally about the importance of transformation to SBA's future success. These efforts are crucial to the agency's continued relevance in its second half century. To better meet the needs of our customers, SBA will shift field office efforts from back office functions, such as loan purchases and some liquidation functions, to more direct relationships with customers and resource partners. We will evaluate the results of these pilot programs and incrementally expand the successful practices to more offices until all of SBA has been transformed. We anticipate that the pilots will begin in this fiscal year 2003, and will continue through fiscal year 2005. The budget request includes $16.5 million, which includes all sums necessary for the transformation plan to support the agency's execution of the President's management agenda which emphasizes better management of the Federal government through five areas: Human capital, competitive sourcing, E-government, integrations of budgets with performance, and improved financial management. SBA requests $2.3 million to modernize and streamline business processes to reduce cost and to improve customer service. Additionally, we are asking for $1.7 million to support SBA's information technology infrastructure.

SBAs fiscal year 2004 budget request includes level funding for entrepreneurial development programs, SCORE, and SBDC, WBC, and BIC networks.

It is often said that access to information is the key to small business success. The budget request includes continued funding for the agency's disaster assistance program, and SBA works closely with the Federal Emergency Management Agency to assist those small businesses and individuals directly affected by disasters such as tornadoes, floods, and hurricanes to get them back on their feet in times of trouble when they most need government assistance.

Mr. Chairman, I want to take a moment to recognize the heroic efforts of the employees of the SBA's Office of Disaster Assistance who, through the unprecedented nationwide expansion of the agency's economic injury disaster loan program, were instrumental in delivering $1.1 billion in loans to those directly impacted by the September 11th events. I want to, again, extend my heartfelt thanks to the employees of SBA without whose dedication and their compassion SBA would not have been able to deliver these services. And I commend you, too, Mr. Chairman for your strong leadership on this as well.

Mr. Chairman, as I have noted earlier, SBA celebrates its 50th anniversary this year. On August 1st, SBA will honor that anniversary with a ceremony in Abilene, Kansas, the birthplace of President Dwight D. Eisenhower, who signed into law on that very day 50 years earlier the Small Business Act, the legislation authorizing the creation of SBA.

All of us at SBA are proud of the agency's legacy of achievement. Many businesses with household names today, Staples, Winnebago, Callaway Golf, Outback Steakhouse, but also other important entities such as Black Enterprise Magazine and Juanita's Foods in Los Angeles all have received SBA assistance in their formative stages. Our challenge is to find the next generation of those companies and to make sure that those entrepreneurs have access to our programs and services so they too can become success stories.

We are proud of what we have accomplished over the past year. And while we take pride in our achievements, we are not going to rest on our laurels. We continue to look ahead, and SBA's fiscal year 2004 request offers an opportunity for us to work together with you to ensure that SBA continues to assist small businesses into the next half century.

We ask for your support for this budget. We thank you for the opportunity to appear before you today. And we would be happy to answer any of your questions. Thank you.

[Mr. Baretto's statement may be found in the appendix.]

Chairman MANZULLO. Thank you. I just have one question. In your letter to me, or to Congressman Frank Wolf on February 15th of 2002, in the continuing interest we have had on not using the 504 program as a cash cow to generate funds over and above what is necessary to run the program. You wrote to Mr. Wolf and said: For the 504 program, SBA is working on an interim calculation method for the FY 2004 similar to the 7(a) program which was successful in dropping the subsidy rate.

First of all, thank you for working with us. I think this committee has been working to get the 7(a) rate down for 7 years. I hope it doesn't take 504 years of work to get it down, get the 504 down. But I appreciate your lifting the caps so the 7(a) is back up to a million dollars again, and which is really great news.

But that was in your letter of February 15th of 2002, to get a new 504 econometric calculation. Then the President's budget wants to put it off until 2005–2006, which is interesting because it recognizes there is a problem but puts the fix off for 2 years. And then Congress, in the language quoted in the opening statement where it says, quote: "the conferees direct the SBA to develop similar more accurate econometric models during the fiscal year for use in the SBA loan and financing programs, especially 504, effective October 1st of 2003." .

So I guess the question is, are you going to follow your own advice in your February 15th letter of 2002, the President's directive in the budget for 2005, or the mandate of Congress to have it done by October 1st of 2003? How do you like that question?

Mr. BARRETO. A multiple choice question.

Chairman MANZULLO. You understand the nature of the question, of course?

Mr. BARRETO. Yes, sir. Thank you very much for that question. And I understand the challenges that there have been with our subsidy rates. I can understand the frustration of many of our lending partners, of many of our small businesses with regards to what they feel is a subsidy rate that doesn't really reflect what is actually happening. And we are very gratified that we were able to make such progress working together with this oversight committee to get that subsidy rate down this year. And I want to let you know that we are already working on getting a new econometric model study going as soon as possible. The work is already beginning right now to take a look at that 504 subsidy rate, to take a look at our disaster subsidy rate and to take a look at the SBIC subsidy rate. We think that we need to look at all of those. And no, I don't think that it is going to take 504 years. We are putting it on a fast track. It is our intention to be able to get that out as soon as possible. It is one of our top priorities in capital access this year, and we believe that we are going to be able to make some very good progress in short order in that area. I know how important that is to you.

Chairman MANZULLO. Does that mean October 1st of 2003?

Mr. BARRETO. As soon as it is able to happen. As you know, what we do is that we outsource the study to economists outside of our agency. Last year, we worked with OFHEO, and we were able to make very good progress. This year we may be working with another entity. And again, we think that we will be able to make some progress very quickly. It is our intention to be able to get it done as soon as possible. So, yes, that would be our desire. The only reason that I hesitate is because since we are not the ones that are doing the econometric modeling, we need to work very closely with the partners that will be doing that modeling and make sure that we are making this progress as quickly as we have in the past.

Chairman MANZULLO. So you are not going to do OFHEO? You are going to somebody else?

Mr. BARRETO. Yes, sir.

Chairman MANZULLO. Why is that?

Mr. BARRETO. I believe that there is another agency that actually is better suited to do the modeling on the 504 and some of the other programs that I mentioned. I will be more than happy to provide all the background with regards to what we are doing right now in outsourcing that econometric model. But again, it is our intention to make progress very quickly. We know that that is very important to the Committee.

Ms. VELAZQUEZ. Mr. Chairman, would you yield?

Chairman MANZULLO. Yes.

Ms. VELAZQUEZ. So will you have it done by fiscal year 2006? That is what it says. That is what the budgets call for.

Mr. BARRETO. It is our intention to get that done much sooner than that. Obviously, if we can get it done this year, we are going to try to get it done this year. And again, the only hesitation I have is that the commitment is absolutely there, we know it is important, we know there is a big demand and desire for this to be done. We will need to work again with the economists who will be doing a new econometric model.

Chairman MANZULLO. You know, Will Rogers had something to say about economists, and I want to repeat it. But small businesses, Mr. Barreto, are not going to suffer because a bunch of economists get together and say what if this and what if that. But are you telling us that you are going to do all the new econometric models and all the other programs at the same time?

Mr. BARRETO. Yes.

Chairman MANZULLO. Well, I think the better practice is to get the 504 done before the other ones. If there has been any time— I mean, I will bring them in here next week at another hearing, I have done that before, and we can have a lockdown and we will make sure that we get the work done. But I am very much concerned that there is another agency involved plus all the models that are being done at the same time.

Mr. BARRETO. And I appreciate that comment and I will prioritize the 504 program. I think it is very important. I think there are a lot of small businesses that could take advantage of that 504 program, and that will be the priority.

Chairman MANZULLO. I just want to assure you that if it is not done by October 1st of 2003, you are going to have a very angry chairman and ranking minority member with an accountability session here for that.

We are going to have to go vote. And then how many votes are there? There are two votes? There are a couple of votes and then we will come back. And I presume other members have questions of Mr. Barreto. Would that be correct? That is right. You haven't had your shot at it yet. Okay.

All right. We are going to adjourn here for about—well, until the votes are done. Probably about a half an hour.

[Recess.]

Chairman MANZULLO. If we could call the committee to order.

Ms. Velazquez.

Ms. VELAZQUEZ. Thank you. Mr. Barreto, you state in your testimony how this budget is a 4 percent increase over fiscal year 2002, which, in reality, you are actually requesting virtually the same funding as last year. Also, when you remove the $21 million for this questionable workforce transformation, there is actually a decrease of 2.1 compared to fiscal year 2003. Is that not correct?

Mr. BARRETO. Well, first of all, thank you for that question. And when we look at the total budget, as you said, we do have it as an increase. And when we talk about workforce transformation, we are really talking about SBA transformation. It is not just employees; it is our ability to be able to make sure that all of our offices are much more effective in helping small businesses in all of our programs.

Ms. VELAZQUEZ. But you are not providing any additional money for SBA programs; right?

Mr. BARRETO. In some cases our programs are staying level. They are staying level, in an environment where many agencies are having decreases or programs being eliminated completely.

Ms. VELAZQUEZ. But every press release that I have seen and everything that I have read says that there is an increase, while the only increase I see here is for salaries and expenses and this $28 million for questionable—for whatever transformation, workforce transformation. But not for any of the SBA programs that are tailored and designed to help small business.

Mr. BARRETO. The thing, as you know, Mrs. Velazquez, and I appreciate the intent of the question——.

Ms. VELAZQUEZ. We will never agree on that one and I have other questions and concerns.

Mr. BARRETO. Okay.

Ms. VELAZQUEZ. The agency faces challenges now more than ever. And to highlight just a few I am going to mention, your budget says no solution would be provided for the 504 subsidy rate problem for 3 years. Your workforce transformation plan is unclear. The Women's Procurement Program has yet to be implemented. There is no enforcement of Federal agency small business contracting efforts.

As we look at the SBA reauthorization this year, can you please justify for this Committee why we should give you a blank check by reauthorizing the agency for 3 years instead of 1 year?

Mr. BARRETO. Well, if I could take each of those points by themselves, as we have talked about before, I understand that this Committee has struggled with things like the subsidy rate for more than 10 years. We knew that when we first came on board this was going to be a very important issue for our relationship with this Committee. And in a very short period of time, we have been able to fix the problem with regards to the subsidy rate on the 7(A) program.

I also mentioned in my previous comment, it is our intention to also fix the problem on the subsidy rate that we have on 504, and also on some of the other programs, disaster and SBSC.

Ms. VELAZQUEZ. And that will be done by when?

Mr. BARRETO. It is our intention as soon as possible. We would like to finish it this year. What I hope is as we discussed last year, when we made the commitment, I think there was a lot of question of whether we would be able to fix the 7(a) subsidy rate and do it as quickly as we did. I think a lot of people expected that this would not be something that would be done until 2004. We have a new 7(a) subsidy rate for 2003. That is significant progress. And we are very gratified by that. We also believe that we can make significant progress on these others.

Ms. VELAZQUEZ. Mr. Barreto, the administration requests no funding for PRIME and BusinessLINK, and every year Congress appropriates money for this program. When is this administration going to get it that these programs have a lot of support in Congress? Why do you come back year after year and do not request any money for those programs?

Mr. BARRETO. We agree that technical assistance and education is vital. In fact, it is really the place that we touch the most small businesses. Last year, we were able to help 1.5 million small businesses through education and technical assistance.

However, we also believe that some of the programs are duplicative, and so it is important for us to make sure that when a small business comes to us, oftentimes they do not know that we have 1,100 small business development centers they do not think——.

Ms. VELAZQUEZ. It seems to me, administrator, that there is a disconnect between what you think is important and what we members and appropriators think that is important. These programs have been designed to help low-income minority communities. What kind of message are we sending to them?

Mr. BARRETO. We are very dedicated to low-income minority communities.

Ms. VELAZQUEZ. That is why you are requesting money for these programs?

Mr. BARRETO. Those communities benefit from many of our programs. They do not just benefit from one, they benefit from small business development centers, they benefit from 12,000 retired executives in SCORE. They benefit from women——.

Ms. VELAZQUEZ. Those programs are totally different and they provide different services. These programs were designed particularly to help this sector of our economy. And again I remind you that the face of small business is changing in America.

Mr. BARRETO. I agree.

Ms. VELAZQUEZ. And you cannot come and lecture us about how important small businesses are and exclude the one segment that is the fastest growing sector of our economy.

Mr. BARRETO. I would never intend to lecture this Committee. I promise you I will not do that. What I do want to do is let you know what the actual results and are what is happening right now year to date in 03 is our lending in all of those upon communities is up significantly. 40 percent up in Hispanic community, 67 percent in African American community, 35 percent in women owned community accident 33 percent in Asian community. 23 percent in Native American community. That is the fastest growing segment of small business. That is the changing face of small business in the country. And so we are gratified that many more of those small businesses now are not only getting access to capital, they are getting technical assistance, they are getting many opportunities. And part of is it is that they are starting to understand and become educated about the whole menu that the SBA provides.

Ms. VELAZQUEZ. The talk about minority loans in your testimony you said loans to minorities were ahead of your internal goals. But as of a percentage of your portfolio, what has been the change from fiscal year 01, 02, and 03?

Mr. BARRETO. Well, I would be more than happy to provide you——.

Ms. VELAZQUEZ. I have the answer right here because you come here and you throw numbers at us that sound wonderful and beautiful. But I can tell you that it has remained exactly the same: 30 percent. Fiscal year 2001, fiscal year 2002, and 2003.

Mr. BARRETO. Obviously, we are not finished with fiscal year 2003, and that is where we are seeing this marked improvement.

Ms. VELAZQUEZ. What happened to fiscal year 2001 and 2002? They remained the same. So do not come and cook the books and tell us that the numbers are ahead of the goals that you established.

Chairman MANZULLO. I would ask that you allow the administrator to answer the questions.

Mr. BARRETO. Thank you, Mr. Chairman. The number that I was quoting, Ms. Velazquez, is not with regards to a comparison of 2001 and 2002, and 2003. They are year-to-date 2003 numbers. Right now in 2003, this fiscal year we are ahead in all of those categories by those percentages. It is our intention to maintain that level of lending in those communities. And I don't think it happens by accident. I think a lot of the things that we have done to streamline our programs, to communicate our programs, to outreach to those communities is what is helping us achieve those numbers. We are very proud of those numbers but we can do better and we will.

Ms. VELAZQUEZ. The percentage is the same, these, of your numbers. These are not my numbers.

In the omnibus appropriation bill, the appropriators chastised SBA for using schemes to fund the program and directed the Agency to halt this practice. The recent budget submission for 2003 cuts $3 billion in loans from the program, a 25 percent cut. How can the agency, given the appropriator—what the appropriators told you, justify this inadequate funding?

Mr. BARRETO. I am not exactly clear where that number comes from. I will tell you that our numbers show that in fiscal year 2001, we did $9.1 billion in 7(a) loans. In fiscal year 2002, we did $9.4 billion in 7(a) loans. In fiscal year 2003, we believe that we will do $9.4 billion in 7(a) loans. And in 2004, the monies that we have asked for budget authority should yield us an approximate level that we have been experiencing over the last 4 years, about $9.3 billion.

Ms. VELAZQUEZ. Tony, would you please bring some clarification here?

Chairman MANZULLO. What I would like to do is keep the order here and allow the other members to ask questions to Mr. Barreto under the 5 minute rule. You have taken up 12 minutes.

Ms. VELAZQUEZ. Would you please allow Mr. Tony Wilkinson to answer that? Because apparently there is a disparity here.

Chairman MANZULLO. Do any of the members here have any questions of Mr. Barreto that you wanted you do have questions? All right. Let Mr. Wilkinson clear up that issue, whatever it is, and then we will let the other members ask questions of Mr. Barreto.

Mr. WILKINSON. Just in terms of loan volume we did $9.4 billion last year in regular 7(a) but in addition to that in a special program called STAR we well an additional $1.7 billion. In fiscal 2002 the total net loans in the 7(a) program was $11.1 billion. In fiscal year 2003 year to date combines 7(a) and STAR 7(a) together we are ahead of last year's pace.

Chairman MANZULLO. Dr. Christian-Christensen.

Mrs. CHRISTENSEN. Thank you, Mr. Chairman. Welcome to the panelists. Welcome, again, Mr. Barreto. I have a different sort of question on a 504 program before I ask about disaster loans. One of the budget goals of the 504 program is to increase the number of 504 intermediaries. How do you plan to accomplishing that?

Mr. BARRETO. Thank you very much for that question. We think that that is very important. We are right now, as you may know, seeking comment from the industry. One of the things that we would like to see is to expand the number of 504 lenders in this country. We believe having additional competition in these markets have been very, very important and we have received a lot of requests from areas all across the country to open up 504 in those areas. And so we are attempting to do that.

Obviously, we need to wait for the end of the comment period to come back, but it is our intention to be able to move forward and to allow more competition and more providers of the 504 loan. As you know, the 504 program can be a very important program for small business. It is also a program that unfortunately we have not fully maximized. At end of every year we usually have budget authority left. And so we think it would be a very effective development for us if we had more 504 providers around the country and we hope to get that accomplished this year as well.

Mrs. CHRISTENSEN. Okay. There are probably some follow-up questions to that, but I want to get into the disaster loan while I still have some time.

You know we have gone over this several times. And we are still having a lot of difficulty. Let me start out with this. When disaster loans are sold, do you give the purchaser any notice or guidelines that these loans are different and should not be viewed as conventional loans?

Mr. BARRETO. Well, absolutely. In the actual loan documents, there is actually language there that states that a loan can be sold. One of the things that is very important is that even though that loan may be sold, the terms of that loan cannot be changed by the future purchaser of that loan. So in other words, if somebody has a 4 percent loan over 30 years and they are making payments, even if that loan is sold, somebody else cannot say now you are going to pay a higher rate of interest, you will pay for a shorter period of years.

Mrs. CHRISTENSEN. We understand that those things do not change, but you know in practice how the SBA dealt with the loans has changed with the financial institution.

When the mission of that program is to assist the borrower to return to pre-disaster conditions, and that seems to come in conflict with the profit-driven mission of a financial institution. So even though the hard rules and regulations governing that loan do not change, a lot of how those loans are administered do change.

In the case of my district, those loans—most of the loans came in before the loan sale started, so they did not know that their loans were going to be sold.

And but now, when they are sold, do you give the purchaser notice that they are going to be sold?

Mr. BARRETO. We do. There is a letter that goes out 3 months before that loan is sold letting them know that this loan is going to be included in a loan sale. Now one of the things that we have said is that if somebody has extraordinary circumstances, maybe a change in status, something serious has happened, they can call us up and talk to us and make a case for why that loan should not be included in an asset sale. So we have the flexibility, we have the flexibility before that loan gets included in that loan sale that if we needed to treat that loan differently, we would be able to do that. So we are trying to be much more sensitive and improve the communication, because I think that is vital.

I would also say just my last point, and I want to let you follow up, we have truly done a lot of disaster loans and we have done some loan sales. But we have not gotten a huge volume of complaints or people saying that they have been mistreated.

Now, the ones that we have gotten are very important to us and obviously very vocal, and so we want to make sure that we are sensitive to that and we respond to that. But I don't think that we have had a huge issue with this at this point.

Mrs. CHRISTENSEN. You mentioned the disaster loans made as a result of 9/11. Do you anticipate extending any special treatment to the loans or would you provide—did you provide any special instructions to the financial entities around those loans compared to the other loans that you have sold?

Mr. BARRETO. We have already.

Mrs. CHRISTENSEN. You haven't sold those?

Mr. BARRETO. We haven't sold those loans, but we are being very sensitive to those loans that we made after September 11th. In some cases, people could not make payments right away, and we did require payments right away. We do want to be sensitive to that. As you know, Congresswoman, we are not currently planning any asset sales at this time. It does not mean that we will not at some future time. We want to be very practical and judicious. We understand that there has to be a balance here. There has to be a balance of the people that has gotten those loans and there also has to be a balance to make sure that when we can do loan sales effectively and we can return taxpayer money back to the Treasury so that we can operate more effectively ourselves as an agency and help more small businesses that we do that as well.

Chairman MANZULLO. Mr. Marshall? Mr. Michaud?

Mr. MICHAUD. Thank you, Mr. Chairman. Mr. Barreto, I want to talk a little bit about the disaster assistance. I notice you mentioned it a couple of times in your speech. Talking about tornadoes, floods, hurricanes. What does your agency do with economic disaster? Back in my district, there are two paper mills that have been shut down. They employ over 1,100 employees. In one community they pay 70 percent of the tax base. The school and the students in the senior class do not know whether they are going to be able to graduate because there is no money to fund the schools, particularly with 70 percent of the tax base threatened.

You go 30 miles north, another mill shut down last December. 30 miles south another mill in Chapter 11. A lot of it deals with manufacturing. We do have an economic disaster.

What does SBA do to help stabilize these type of communities because it is having a devastating effect on the small businesses in the communities. And we are seeing small business after small business now closing because of the rippling effect because of the large anchor in the community.

Mr. BARRETO. Thank you, Congressman. You are absolutely right. You know, half of that $1.1 billion that we did after 9/11 was economic and disaster loans. I would say it was probably more than that. And those were loans that actually happened outside of the declared disaster area in New York City. And we have very specific guidelines as to when we can provide disaster loans both direct disaster loans for people who have had their business damaged by a tornado or earthquake or a terrorist act. We also help homeowners and renters as well.

But in some cases and we saw that in 9/11, there are also businesses that haven't had physical damage but have had economic damage and we have been able to help them as well. For us this has to be declared a disaster. And the definitions for our disaster program are usually some extraordinary, either a natural disaster or something that was through no fault of anyone, a terrorist attack or something of that nature, and we can help.

However, I am very concerned about those small businesses in your area that have been affected and I want to make sure that we reach out to them and they are working with our district offices there. There may be programs that we can offer them right now that they are not aware of. Obviously we have a number of loan programs from small loans to venture capital. We have all kinds of training and education programs. There are procurement programs as well. So there are opportunities for those small businesses.

Mr. MICHAUD. I haven't seen that assistance up in my area and part of the reason why these businesses are failing, at least around two of the mills anyway, is because of our trade policies which are killing us but also because of September 11th where businesses have cut back dramatically on their advertising and therefore we have seen a dramatic shift.

And also part of it is because the Federal Government is not doing their procurement the way they should. Thirty miles down the road from where I used to work is a mill that makes recycled copying paper and I have seen as I go through Federal buildings paper bought from Canada, which I think is a crying shame. I guess my second question is is it possible that through the BusinessLINK program that small businesses might be able to hook up with larger businesses in other areas to open up new markets for them?

Mr. BARRETO. I think there are a number of different opportunities. We have had a number of different mentor protege-type programs that can help small businesses joint venture with a larger business, and we would be glad to work with you and those businesses that were effected and introduce them to some of those opportunities.

One of the things that we are doing right now that I am excited about is that we are doing procurement matchmaking sessions all across this country this year. We have already done two where we identified 3,000 small business appointments for small businesses, $3 billion in potential contract opportunities, and we have 12 more planned this year across this country.

We are having the next one in Florida next week, and we have businesses traveling from 12 States to go to this business matchmaking session. It is our way of bringing businesses that actually have capability and capacity and matching them up with people who have demand who are buying things. And then no guarantees, but what we know that happens is that when those small businesses get together with those buyers, business takes place. And we have already seen that happen already in those two that we are having. But we would be glad to reach out and work with you. And if we need to customize something that will work for some of those mills that are struggling right now.

Mr. MICHAUD. You still did not answer my questions. Somebody mentioned the BusinessLINK program. It was my understanding that SBA did not ask for any funding in fiscal year 2004, and that is one of the programs that they can use. Why haven't you asked for any funding in 2004?

Mr. BARRETO. As I said, there are a number of programs that we felt that other programs could also help them with. We have some programs that are very similar in nature and there is some duplication and some repetition. Sometimes those programs are not requested funding for an upcoming year. But as I said, we are still doing mentor-protege and helping small businesses match up with big businesses so they can get contracts.

Chairman MANZULLO. Mr. Michaud if you want to see me after the hearing, the U.S. American—the American Canadian parliamentary exchange will take place in Canada the weekend of May 16th and 17th. You should be on that delegation. Talk to me about it.

Mr. Bartlett?

Mr. BARTLETT. Thank you very much. I have a large paper mill in my district in one of the three counties, two of them really in Appalachia. This is Westvaco, and they hire 2,700 people. They never have to advertise because they have a waiting list of 2,000 people that would like to have a job there. They pay 50 percent more than the other employers in the county can pay. This is really a depressed area until fairly recently. We had 14 percent unemployment there. The head of the National Guard up there told me several years ago that nearly half of the young men in his guard unit up there were unemployed.

And just about 2 or 3 years ago, the EPA decided they were going to put these people out of business. They have a tough enough time competing with paper from overseas. But now the EPA was coming after them for infractions of rules. It was like, you know, you are hauled into court and the judge says we are going to fine you for going through a stop sign and you say, gee, the stop sign wasn't there yesterday but the judge says, yes, it is now. So we will fine you for not stopping at it yesterday.

This is the kind of thing they are being changed with. What can Small Business do to help in a situation like this? By the way, you can't even smell them when you get near it. I am familiar with paper mills through the south and you know before you see the town, you can smell the town. You can't smell it there. They are a great corporate citizen. They have great support from the citizens there. They have bent over backwards to run a really clean mill.

They are located in both West Virginia, they make the pulp in West Virginia and they pump it across the river to the mill which is in Maryland. What can your organization do to help in a case like this?

Last year we had about a $400 billion trade deficit. We do not need our regulators in this country moving more jobs overseas so that next year our trade deficit is bigger. Can you stand up and point at this and say this is crazy and keep yelling that it is crazy until somebody does something about it?

Mr. BARRETO. I think you are right. And there are many small businesses that come to us all the time and tell us how much they are paying to for regulations that maybe do not make any sense anymore. And that is one of the reasons why the SBA has two very important programs. We have the Office of Advocacy, which really deals with small businesses before regulations go into place. But we also have another very important office that is called the Office of the National Ombudsman. The Office of the National Ombudsman helps those small businesses when they are dealing with Federal agencies, especially when they feel that they are being treated unfairly and improperly.

Both of those agencies, those are both major programs in our organization, can be very helpful to a whole class of businesses or individual businesses. In fact, one of the things that the national ombudsman does is that when he hears about issues like this, he can even plan regulatory hearings in the area and bring all of the stakeholders together and take testimony and actually report that back to the powers that be in those Federal agencies, and obviously to our administration.

Also of that is available to constituents in all of your districts, but especially when there are businesses that are being hurt right now and have no place to turn, especially when they are dealing with a major Federal agency. We have heard this many, many times before, and that is what they are there for and we would be glad to help you any way we can.

Mr. BARTLETT. Do you need additional legislation so that you can be more effective in this area? Because they have been bedeviled by this suit for several years. It was started under the previous administration. I have encouraged this administration to come in as a friend of the court saying this is crazy, trying to put a good company out of business in this country so their jobs go overseas.

Mr. BARRETO. Well, as I said, that is one of the things that our Office of Advocacy takes a very close look at.

Mr. BARTLETT. Present legislation is adequate?

Mr. BARRETO. Again, I think it depends on the specifics of the case and what that regulation is intended to do. I would tell you that most of our small businesses think that we have too much regulation right now. We did a study that shows that every small business in America could pay $8,000 per employee just complying with current Federal regulation. I think it depends on the situation. I would be more than glad to get information to you and have our folks back in advocacy and ombudsman follow up on that.

Mr. BARTLETT. Several years ago we had a major drought in Maryland, and our government people came in to help and one of the farmers made a point and said: I am drowning in 10 feet of water now—talking about his debt—and you want to make it 11 feet deep? This is not what our farmers needed was another loan. They have lots of equity in their farmland and the bankers are happy to loan them money. And you heard the joke about the farmer who won the million dollar lottery and they asked him what he was going to do and he said: I guess I will keep on farming until it is gone.

Do we have any programs that will help in an emergency like this? If they do not get a grant they are going to be out of business and that is one more family farm that is gone. Another loan will not help them, they are drowning in loans.

Mr. BARRETO. I would be more than happy to follow up on that. That is probably something that would be part of the Department of Agriculture. We currently do not have very much of grant authority. We do not do very many grants in our agency. But there are agencies that are very focused on this. Again, the Department of Agriculture is one of those agencies, and we would be more than glad to follow up with them and find out what they might be able to do to help in a situation like this.

Mr. BARTLETT. Thank you, Mr. Chairman. In cases like this, somebody needs to be there to help.

Chairman MANZULLO. Well, but unfortunately, Mr. Barreto can't be in all these situations. This is Small Business and that is the Department of Agriculture.

Mr. BARTLETT. Well, farmers are small business.

Chairman MANZULLO. I understand. If Mr. Barreto were in change, we would get a lot more things done in this government. I am convinced of that.

Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Let me thank you and the members. This Committee is so interesting that I got a waiver so I could remain on it.

Mr. Barreto, and you may have answered the question because I have been out for most of the hearing, BusinessLINK activity—and there was a little comment about it—what is actually the status? Do we really have any BusinessLINK activity that we are going to be funding in the budget?

Mr. BARRETO. You are asking about the 2004 budget?

Mr. DAVIS. Yes.

Mr. BARRETO. I don't believe that we right now have any plans right now to ask for any funds in the BusinessLINK program. It has been a program that, as the Congresswoman has said, is very—there are companies that are very appreciative of it and feel very strongly about it, but as we have said, we feel that there are some programs that we have that are duplicate, and I have where we can help some of those small businesses with some of the other technical assistance and education that we currently provide through many of our other resources.

Mr. DAVIS. Could you maybe share what some of those are?

Mr. BARRETO. As I mentioned, the place that we help the most small businesses is in this area of education and technical assistance. We are able to do incredible things. Last year we helped more than 1.5 million small businesses in the United States through a whole host of technical assistance and education programs. Obviously led by the small business development centers, of which we have basically in every State in the Union. There are thousands of people that work at SBDCs that can provide any kind of technical assistance to small businesses, everything from how do you put a business plan together to how do you go about getting government contracting. How do I put a loan package together? We also have 12,000 retired executives that volunteer their time every single year. We have experts in every field. I wish I had twice as many of these retired executives. Many of them have the expertise because they worked for large companies.

Of course we have business information centers throughout the United States. We have women business centers as well throughout the United States. And so as I said, many times small businesses are not aware of all of those tools that we have that can provide them this kind of information, this kind of help, this kind of linking together. Obviously this is something that our government contracting and business development department is very focused in on as well.

Mr. DAVIS. I had an excellent opportunity the other day, as a matter of fact, where we had some retired executives who had been very instrumental and very helpful. And as a matter of fact, we even gave them some, you know, some awards and things like that.

Is there any—many small businesses are having difficulty getting access to capital. I mean, needing a few additional dollars in order to market, to do business. Are there any activities that you would recommend that a small business can find money from?

Mr. BARRETO. Well, I think there are many, many activities. One of the things that somebody reminded me is that SBA is the largest backer of small business loans, but one of the things that we, I think, have been partly able to assist is that there are many, many new resources for small businesses. Not only through banks and non-bank lenders, but there are a whole host of providers of access to capital now. We take our role very, very seriously. In fact, one thing that I mentioned before we are on track to have the best year in our history with regards to small business loans. We think that we will do more than 60,000 small business loans just in the 7(a) program. And the thing that is very exciting to us, Congressman, is that we are getting our average loan size down. When I first came into the agency the average loan size was $230,000. Inc. Magazine reported that the majority of small businesses in the United States are capitalized with $50,000 or less.

So the fact that we have been able to get those average loan size down does not mean that we will not do big loans because we will, and those are important as well. But it means that we will touch more small businesses, especially in the emerging markets, which are fastest growing segment of business in the United States.

I don't have to tell you that 15 percent of all businesses in the United States are minority-owned businesses or 40 percent of the total are women-owned businesses and those are the fastest growing segments in the United States.

So I think there are tremendous opportunities. We are excited about what we are going to be able to do for those small businesses this year, and obviously we want to continue to facilitate opportunities and continue to enroll and encourage others to help small businesses as well.

Chairman MANZULLO. Congresswoman Majette.

Ms. MAJETTE. Thank you, Mr. Chairman. Thank you, Mr. Barreto, for being here this afternoon. I am pleased to be a part of the Small Business Committee. I sought a waiver to be able to join this Committee and I am excited about working with you and the other members of the Committee to make sure that we are properly serving almost half of all of the working Americans who are employed and who run small businesses.

Obviously, I do not have to tell you that small businesses are truly the backbone of our economy. I represent the fourth district of Georgia, which is a growing and thriving suburban community just east of Atlanta in the State of Georgia. Almost 98 percent of the State's almost 200,000 businesses have fewer than 500 employees and these companies employ about 44 percent of the state's private sector workforce. So obviously it is a very important part of our economy.

We have been seeing a great growth in the numbers of minority and women business owners, particularly in my district. And I am formerly a small business owner myself, having been a partner in a small law firm and also before eventually running for Congress, I was an administrative law judge in the workers' compensation board in Georgia. And so I think I have a very unique perspective to bring to this arena.

I would like to get to the point, and I guess you want me to do that same thing. I have reviewed the SBA budget request for 2004, and it appears that the budget is substantially unchanged from last year. And there still appears to be little or no funding for programs that are targeted at helping low-income communities and minority businesses. Particularly with respect to government contracts and women-owned businesses, the SBA has still not met its goal of having 5 percent of the contracts awarded to women-owned businesses.

Part of the problem may be that the SBA has not implemented its women's procurement program and thereby costing women-owned businesses millions of dollars in lost opportunities. What is the office of contract assistance for business owners doing to ensure that the 5 percent statutory goal for women business owners is achieved?

Mr. BARRETO. Thank you very much for the question, and I am looking forward to working with you. I have a great background and I know you will be a great contributor to this Committee. Women-owned businesses are vitally important, as I mentioned before. Right now, 40 percent of all of the businesses are women-owned businesses. I have had a lot of time, especially recently, to meet with leaders and the organizations that represent some of the largest associations of women business owners in the country.

I spoke with NAWBO, the National Association for Women Business Owners, just a couple of weeks ago. I just got back yesterday, I was in Florida, speaking to a business woman's conference in Florida. It is a conference that is done every year by Office Depot, very exciting and some incredible businesswomen. I am also speaking to the Women's President Organization this week. This is not an afterthought or something that we spent some time on. This is something in the forefront of our thinking and we will measure ourselves by the results that we get from these business owners, and what they tell us is that they are not concerned about the process, they are—what they are concerned about is getting tangible results. What they want is more access to contracts. They want more opportunity. They tell us all the time, we will do the rest, we just need to be able to get in. And that is one of the things that we have really tried to attempt to do with a lot of this procurement matchmaking that we are doing this year. I said last year that it was very important for us to grow the pie of opportunity for those businesswomen. And not only with the government, but also with the private sector.

These events that we are doing all across the country are really going to help us to do that. With regards to the women's reg, this is also something that is very important. What we realized when we first came in is that the reg that was currently being offered had a study that was not comprehensive enough. It was a study that we did not believe that would pass the scrutiny of a court attempt against it. And that concerned us because if we are go to have a regulation, we want to make sure that we have all of the ammunition and background that we need so that it will sustain that kind of a challenge. What we have done is that we are now in the process of outsourcing a contract to an expert that can help us to determine what needs to be in that study, what is a comprehensive study that will pass all constitutional muster. And we are right now in the process of getting that contract, and we will be moving forward with this very expeditiously this year.

However, having said that, we are by no means going to be delayed in actually providing some of those tangible results that women business owners are so urgently seeking from us.

Chairman MANZULLO. I will recognize the Ranking Minority member for 5 more minutes with the administrator, and then we will get on with the rest of the testimony. So I set the clock.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. I really appreciate it. Mr. Barreto, in answering the question of Ms. Majette, you said that how important the women's sector is for our economy. And yet you failed in terms of the women's procurement goal. And then in 2000 we reenacted the women's procurement program and last year you came before us and gave the same excuse that you are giving us. And in the Small Business regulatory agenda there is nowhere that you can find about the women's procurement program. When do you intend to implement it?

Mr. BARRETO. As you know, one of the challenges that we have had is that we have been on a continuing resolution for quite some time now. We finally have gotten our 2003 appropriation. It was impossible for us to move forward with a number of different initiatives that we had planned without knowing what kind of resources that we would have to work with.

Now that the continuing resolution is over and we have our budget, we are able to move forward. Again, what we are doing is making sure that we have the right study, the right substance of a study that needs to be done so that there is no challenge to that rule.

Ms. VELAZQUEZ. But how did you intend to proceed with it when you do not include it in the budget? It is not here. So what that is telling me is that you have no intention of implementing the women's procurement program? It is not in the budget. It is not in the regs that you put out, the list.

Mr. BARRETO. What we have to do before we are able to ask for resources is that we have to know what we are going to be asking for. The purpose of this contractor is to be able to help us to put together what is going to be necessary for us to get that done. And that is the work that is taking place right now. But it would be imprudent for us to ask for an amount of money that we were not sure that we were going to need, or even if it was going to be the accurate amount.

Ms. VELAZQUEZ. Is the program going to be up and running this year?

Mr. BARRETO. I don't know. It depends on what comes back from the contractor that we have hired. We think that he should be—or the company should be able to finish their work very quickly, but I am not sure exactly what that final recommendation is going to be yet.

Ms. MAJETTE. Will the gentlewoman from New York yield?

Ms. VELAZQUEZ. Sure.

Ms. MAJETTE. Mr. Barreto I would like to offer my services as a former trial court judge having served for 10 years. One of the reasons that I resigned from the bench and wanted to come and that I am here in Congress is to assist in the process in that legislative process, policy-making process. And bring the perspective of someone who has the experience of making sense out of rules and regulations, and so I offer my assistance for free in terms of trying to move that process forward and helping you come up with the kind of program that will withstand judicial scrutiny.

Ms. VELAZQUEZ. Good luck.

Mr. BARRETO. We would like to work with you, and obviously we will make sure that we are communicating and letting you know what work that our contractor is doing with regards to helping us with this study as well.

Ms. MAJETTE. I would like to be involved in that process as it is going forward.

Ms. VELAZQUEZ. Reclaiming my time. Is the firm that you hired to do the study, is that a small firm?

Mr. BARRETO. I believe it is a small business.

Ms. VELAZQUEZ. You believe? I would love if you had a straight answer and that answer should be yes.

Mr. BARRETO. I do not want to give you an incorrect answer. I will be happy to find out all the particulars of the company. It is always our intention when we have a procurement to choose a small business, a minority business, or a woman-owned business.

Ms. VELAZQUEZ. One of the priorities that you stressed today for the agency is to make more small loans; correct?

Mr. BARRETO. That is correct.

Ms. VELAZQUEZ. That is why you are asking—you cut the Microloan Program by half?

Mr. BARRETO. Well, one of the things that has been happening, it is an incredible thing. Last year we made some changes to our

SBA Express program and what we are finding is that 13 percent of all of the SBA Express loans are actually smaller loans. So there are also many small loans that are coming out, not just out of the Microloan Program, but also programs like the SBA Express program. It was very interesting in 2002, there were about $17 million of microloans that were done but those loans were actually leverage and created $35 million of small loans to small businesses so we think that has been a very effective program.

One of our big concerns was that when we looked at our portfolio last year, 87 percent of our loans were actually loans under $500,000, and 13 percent of the portfolio was absorbing 51 percent of the budget authority, and that concerned us, and that is why we have made such a strong push to do smaller loans. And the other reason we have done smaller loans as well is that we found out that small loans create more jobs. It actually, the Department of Labor did a study that showed that for every small loan, $14,000 would create a job of a small loan. Whereas it would take $153,000 of a larger loan to create the same jobs.

And so that is one of the reasons that we spent so much time focusing on not only streamlining our programs but creating more outreach so we can do more of those small loans.

Chairman MANZULLO. Thank you, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you for not answering my questions.

Chairman MANZULLO. Well, if you would like Mr. Barreto to answer a question in writing.

Ms. VELAZQUEZ. Yes, please, I have a lot of other issues, Mr. Barreto, and I hope and I expect for those questions to be answered in a timely manner.

Mr. BARRETO. I promise they will be.

Ms. VELAZQUEZ. The way that your staff is responding to our requests?

Mr. BARRETO. We will answer posthaste.

Ms. VELAZQUEZ. It is so questionable.

Chairman MANZULLO. All right. Okay. You have been here for 2 hours. It is always good to see you.

Mr. BARRETO. Thank you so much.

Chairman MANZULLO. You can sense the frustration as many of us have had our districts that have just been destroyed by job loss and manufacturing, and it is written over the faces of many of the members here. You have done an excellent job. You can only do so much. You are not the President of the United States. But I just want to thank you for your patience. Thank you for working with us. Look forward to the new 504 econometric model being adopted by October 1st of this year. And if you would like to stick around and listen you are welcomed, but otherwise you are excused.

Mr. BARRETO. I want to thank you very much, Mr. Chairman, and Ranking Member Velazquez, I look forward to working with this Committee. And you are absolutely right, there are small businesses all around this country that need us more than ever now. And so it is at times like this that we really need to work closely together. I appreciate the support that this Committee has given me. I appreciate the support that this panel has give the SBA and the small business community. And I also appreciate your warm words and support. And I very much look forward to having the best year in our history working together. Thank you very much for the opportunity to be here today.

Chairman MANZULLO. Thank you, Mr. Barreto.

Mr. Wilkinson, you are up for the next 5 minutes, and we will proceed with your testimony.

STATEMENT OF ANTHONY R. WILKINSON, PRESIDENT, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

Mr. WILKINSON. Thank you, Mr. Chairman. Before I cover anything else, for the record I want to thank Chairman Manzullo, Ranking Member Velazquez and the other members of this Committee for your efforts in preventing the 7(a) program from being a disaster. The President's budget request for 2003 only asked for $4.85 billion, or less than half of this year's loan demand. This Committee, however, led the budget fight on two fronts. First, to obtain passage of legislation, S. 141, which will change arcane budget law and allow the immediate use of a new econometric model to estimate subsidy rates. This will immediately reduce the subsidy rate by 41 percent and increase lending authority by approximately $3.4 billion.

Mr. WILKINSON. Second, to reprogram STAR money which otherwise would have lapsed. This action will add about another $1 billion to this year's level and hopefully more, hopefully another $1 billion to a billion and a half, depending on OMB's action in applying the econometric to STAR loan approvals earlier this fiscal year, an action that you, Chairman Manzullo, described as the only reasonable interpretation of Senate bill 141. Small business borrowers are deeply indebted to all of you for these efforts, and I thank you on their behalf and on behalf of the NAGGL membership who delivers the 7(a) program.

As we have discussed today, the SBA has developed a new econometric model for estimating defaults that reportedly leads to a more accurate subsidy estimate. NAGGL has not been briefed by the SBA or OMB on the new model, so we cannot offer an opinion about the model. What we can say is that the results of the new calculation are much more reasonable than before.

One purpose of the Federal Credit Reform Act is to measure accurately the cost of Federal programs. NAGGL is hopeful that the new model being used by SBA does just that. We look forward to a full briefing on the new model. We are hopeful that the SBA will show that, had the model been used on previous loan cohorts, it would have proved to be much more predictive that the old model and that the results are ones that this Committee and that program participants would have determined to be reasonable. In our view, the subsidy rate is still probably a little bit too high, but at least it is much more reasonable than before.

I want to offer preliminary congratulations to SBA for the development of the econometric model. It appears to be a giant step in the right direction. I know that many worked long and hard on the development of the model, and I look forward to being able to offer unqualified congratulations in the near future.

The administration's budget request for fiscal year 2004 for the 7(a) program has requested only a $9.3 billion program level in

7(a). This would be more than 25 percent below our projected level of demand. Small businesses continue to need access to long-term capital. NAGGL requests your support of sufficient appropriations to fund a $12.5 billion 7(a) program for fiscal year 2004.

Loan volume for the current fiscal year is running ahead of last year's pace, even though a $500,000 loan cap has been in place. Given the nature of our economy, we believe that the increase in borrower demand will continue into fiscal year 2004. The administration's proposed program level of $9.3 billion will be insufficient to meet borrower demand. With you support of a twelve and a half 7(a) program in fiscal year 2004, we can hopefully avoid the need to put loan size caps in place again.

As also has been mentioned today, at the start of the current fiscal year SBA implemented credit rationing by instituting a $500,000 maximum loan cap. This cap was put in place due to a combination of an inflated subsidy rate and an inadequate budget request. While some borrowers who needed loans greater than 500,000 were accommodated through the STAR program, others were directed to the 504 program or did not get the financing their business operation needed. But now even the STAR program has expired.

Mr. Chairman, I know you are all too familiar with Reeden Heavy Hauling of Woodstock, Illinois. That company is reportedly in credit limbo because their operation has needed more than $500,000 and they did not qualify for the 504 program.

Chairman MANZULLO. But it is going now back a million dollars.

Mr. WILKINSON. It is going back.

Chairman MANZULLO. And it is retroactive. So that should help them.

Mr. WILKINSON. It will help them get their loan now, but there have been many, many businesses across the country that have been caught in that same credit limbo. But you are correct, thanks to the enactment of H.J.Res. 2 and Senate Bill 141, and now that the loan size caps have been removed, borrowers like Reeden can get the loans their operations need. But to avoid this same situation next year, we need support for a $12.5 million program level. If we start a $9.3 billion program as the President has requested, I don't see any choice but the agency to put loan size caps right back in place next October 1st.

The next issue we wanted to cover was the fact that larger loans subsidize the cost of smaller loans, and this is done in two ways. First, larger loans pay more fees than do the smaller loans. Loans above $150,000 pay, on average, three times the rate of smaller loans of 150,000 or less. Second, longer term loans have a substantially lower default rate and thus a lower cost.

Season loan data from SBA shows that the average default rate for loans with a greater than a 15-year maturity is one-half of that of loans with maturity of 7 years or less. Thus, this Committee should be aware that the administration's policy of encouraging smaller loans and discouraging larger loans will increase the subsidy rate. This will then necessitate larger appropriations or higher user fees or both.

Chairman MANZULLO. Well, the red light is on, Mr. Wilkinson.

Mr. WILKINSON. One last thing, and I am finished. As you urged on the floor debate on SB 141, Mr. Chairman, we hope that Senate Bill 141 is applied to the STAR loans that have been approved this year. That did not come up in the administrator's testimony. Clearly, STAR loans are 7(a) loans. We hope they get rescored using the econometric model and we free up that additional money for this year.

Thank you.

Chairman MANZULLO. Thank you.

Mr. Wilson.

STATEMENT OF DONALD T. WILSON, PRESIDENT, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

Mr. WILSON. Thank you, Mr. Chairman. I very much appreciate the opportunity to appear before.

Chairman MANZULLO. Can you put the mike close to you?

Mr. WILSON. Thank you, Mr. Chairman and Ms. Velazquez and members of the Committee, for inviting the ASBDC to testify on the President's 2004 SBA budget.

We will be celebrating the 50th anniversary of SBA very shortly. It should be a time of celebration. For small businesses in this country, it is not a time of celebration. Small businesses are closing. Bankruptcies are up dramatically.

Two years ago, I testified before this Committee and said if business assistance programs were not better funded, the bankruptcy rate would skyrocket. In your State, Mr. Chairman, small business bankruptcies are up 21 percent; and in Ms. Velazquez's they are up 24 percent.

President Bush 2 years ago in his State of the Union message said far more eloquently than I could ever say and more succinctly: Help for small business means jobs for Americans. Obviously, the people who write his budget were tuned in to another channel that night.

I heard Congressman Michaud talk about the small businesses suffering in his district. His State is one of about 14 where the SBDC has been level funded for 8 years in a row. The past 2 years after the President made those remarks was the worst job creation 24-month period since President Eisenhower was in office. When I had the privilege of working on the Hill and working for small businesses with Congressman Marks and Congressman Broyhill and Congressman Ridge, the SBA budget was about two and six-tenths of one percent of the budget. It is now four-one hundredths of one percent of the budget. That is unconscionable.

We talk the talk. We say they represent 99 percent of employers. We say they generate 52 percent of the GDP. We say they provide 70 percent of the jobs. It was estimated during the last recession big business lost two million jobs, small business gained ten million. It is estimated that, right now, small businesses are creating 100 percent of the net new jobs. And look at job creation. If it weren't for them, where would unemployment be? Eight point six million Americans unemployed, most of that in the last 2 years.

This budget is disastrous for small business. The issue is we say we don't have the resources. The economy is down. We are on the face of a war. At the height of the Vietnam war, Mr. Chairman, four-tenths of one percent of the budget. We are at peace today, four-one hundredths.

I was looking at some budget documents sent over by OMB. SBA is an asterisk. If you are not five-one hundredth percent of the budget, you don't even warrant a number. You are an asterisk. What are we saying to the men and women who create jobs in this country? We are saying you are an asterisk. You are unimportant.

Now, I understand the issue of the tight budget situation. The tight budget situation is because we don't have anybody working, and nobody is working because small businesses are not creating jobs.

I hear level funding. Go look at the number for management and technical assistance in the last 2 years. It is probably off 27 percent. Congress generously gave us more than the President asked for for 2003, and they come right back and propose to cut us another million dollars, and they are cutting others. I talk with the Women's Business Center and you talk about duplication. Yes, Women's Business Centers do much of what we do. It says we serve 1.25 million people. SBDC serve 1.5 alone. But, all combined, what percentage are we serving? A minuscule amount.

The VA called me the other day and said we had a veteran, a disabled veteran who went to your SBDC at Temple University. Five-week waiting list.

Twenty-four States, Mr. Chairman, were severely cut as a result of the census. Your State, Ms. Velazquez's State, Ohio, Indiana, Michigan. Look at their employment rates.

Mr. Chairman, for a heartland State like yours, you can understand this metaphor. Perhaps Ms. Velazquez doesn't. We are eating our seed corn. This is a program that brings money into the Treasury. By every measure it pays back the Treasury at least two to three dollars for every dollar it spends. If you double the size of this program, you would get twice that amount back to the Treasury; and the bean counters and the green eyeshade crowd at OMB do not understand the concept of profit centers that we teach our small business people every day.

Chairman MANZULLO. Mr. Wilson, your time has expired. And I agree with you with the dudes over at OMB.

[Mr. Wilson's statement may be found in the appendix.]

Chairman MANZULLO. Mr. Gast.

STATEMENT OF ZACH GAST, POLICY AND RESEARCH MANAGER, ASSOCIATION FOR ENTERPRISE OPPORTUNITY

Mr. GAST. Thank you, Mr. Chairman, Ranking Member Velazquez, and members of the Committee for the opportunity to testify before you today. My name is Zach Gast, and I serve as Policy and Research Manager for the Association for Enterprise Opportunity. We represent more than 450 microenterprise development organizations around the country.

AEO has three policy priorities within the SBA budget this year. AEO would like to see the SBA Microloan Program funded at $25 million for lending and technical assistance, PRIME funded at $15 million, and the Women's Business Centers program funded at $14.5 million. I will expand on these requests later in my testimony, but first I would like to talk a little bit about microenterprise and what it is.

I heard a lot of the members of the committees talk about mom and pop shops and the help they needed. That is microenterprise. We are small businesses of five or fewer employees with initial capital needs of $35,000 or less. Many microentrepreneurs are low-income, women, minorities, or other individuals who may face other challenges to business success. For example, both the Microloan Program and Women's Business Centers predominantly serve minorities, and PRIME is by statute required to serve more than 50 percent very low-income clients.

Locally-based microenterprise development programs provide credit, training, and technical assistance to microentrepreneurs to help them succeed. Microenterprise technical assistance is typically more intensive to meet the specific needs of our target market. As an industry, we define a client not as someone who receives a service but as someone who receives 10 or more hours of service.

Conventional sources of business credit such as bank financing are often beyond the reach of our clients. The SBA Microloan Program continues to solve this problem by funding community-based intermediaries to help entrepreneurs gain access to credit. To date, Microloan intermediaries have made nearly $190 million in loans. The administrator quoted $14,000 as the loan size to create a job. Our average loan size is $15,000. $190 million in loans. These loans have resulted in the creation and retention of more than 47,000 jobs.

As with many entrepreneurs, Microloan borrowers require specialized technical assistance to grow their businesses. The Microloan Program meets this need by providing limited assistance to borrowers in becoming credit ready and more extensive assistance once they have received microloans.

The $15 million that Microloan received in 2003 represented a $2.5 million cut. That, however, will not be the true impact on the provision of services. There is a regulation that ties technical assistance grants to the percentage of microloans outstanding from the SBA. As that grows, the technical assistance grants grow smaller. They have already been cut by 40 percent last year. The $2.5 million that was just cut will cut that even farther, and the President's budget does nothing to increase that but only exacerbates the problem.

But technical assistance is also important for those entrepreneurs that do not need or want loans. Debt is not always the answer to business success. PRIME provides grants to microenterprise development organizations to offer training and technical assistance to entrepreneurs regardless of whether they seek access to capital, and 90 percent of our clients do not seek access to capital at the time. Governing legislation stipulates that 50 percent of PRIME funds be used to support training and technical assistance for very low-income entrepreneurs. We have a 5-year study by the Aspen Institute that shows these entrepreneurs have highly favorable outcomes in household income and assets, business income and assets, and reduced reliance on Federal benefits. These programs are a net benefit to the government.

PRIME is authorized to receive $15 million a year. Last year's $5 million funding level will continue to underfund the program which has experienced incredible demand from low-income entrepreneurs.

Much as the SBDCs can't serve everyone they need to, we can't either. The administration's lack of support for the program—they have continued to recommend that it not be funded—is disheartening. AEO strongly encourages Congress to increase funding in the coming year.

Finally, the SBA's Office of Women's Business Ownership is the only Federal office that specifically targets women business entrepreneurs. Last year alone, Women's Business Centers provided consulting, training, and technical assistance to more than 80,000 women. The $12 million contained in the administration's budget is insufficient to meet the needs of women entrepreneurs and is not level funding. They actually received 12.5 last year.

Finally, I would like to share a face to all this. In 1997, Deborah Pierce, who lives in Calumet Park, Illinois, was facing a divorce and working 2 days a week at $10 an hour. Confronted with the need to now support herself, she approached the Women's Self-Employment Project in Chicago. She enrolled in their entrepreneurial training program and started up a full-service child development center now serving 75 children with a growing waiting list and glowing reputation in the community. The Children's Depot Play Station, which is her business, now employs six additional individuals and has annual revenue of nearly a quarter of a million dollars—starting from zero. And she has recently received a microloan to expand her business. The future is certainly bright for this amazing woman.

I thank you for this opportunity.

[Mr. Gast's statement may be found in the appendix.]

Chairman MANZULLO. Mr. Mercer.

STATEMENT OF LEE W. MERCER, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. MERCER. Thank you, Mr. Chairman and ranking member Velazquez. My name is Lee Mercer, and I appreciate the opportunity to be here today to discuss the President's budget proposal for the SBIC program. I appear on behalf of the National Association of Small Business Investment Companies and the SBIC industry.

We actually urge that the President's budget for the SBIC program be approved as submitted. The budget would make $4 billion in participating security leverage and $3 billion in debenture leverage available to SBICs for investing, together with their required private capital, in U.S. small businesses.

SBICs are a very important part of the national economic recovery that we hopefully are about. SBA estimates that currently SBICs account for 60 percent for all venture capital investments—by number of investments, not by dollars. For comparison, in 1997, the number was 38 percent. The increase is likely to continue to grow in the face of the substantial and continuing contraction in overall venture capital. To illustrate, the number of all annual venture capital investment transactions has dropped by 60 percent since the high watermark of fiscal year 2000, but the number of SBIC investment transactions has dropped just 14 percent over the same period. The data underscores the important countercyclical nature of the SBIC program and the role it will play in our national economic recovery.

As has been the case for some years, the fiscal year 2004 budget provides that the leverage will require no appropriation to establish the subsidy reserves required by the Budget Act. Rather, the budget provides the leverage subsidy reserves will be supported 100 percent by various fees, interest, and profit shares paid to the government by the two types of SBICs.

For the debenture program, no change in the law will be required to implement the budget. Section 303(b) of the Small Business Investment Act imposes an interest rate fee of not to exceed 1 percent per annum on applicable leverage. For the debenture fiscal year 2004 authority, that rate required to maintain the zero subsidy rate will be 0.855 percent per annum, down slightly from the current rate of 0.887 percent.

Section 303(g)(2) of the Act provides the counterpart for the participating security program. This section provides that the prioritized payment rate, the variable rate, is not to exceed 1.38 percent per annum. For fiscal year 2004 leverage authority, the required rate will be 1.454 percent per annum. That is 0.074 percent greater than the current statutory authority. Thus, for implementation of the President's budget, there must be a change in the law increasing that authority by a minimum at least of 7.4 basis points. That translates to 7.4 cents per $100 of leverage as an annual rate increase.

The reason for the increase in the participating security program has nothing to do with loss assumption. It has to do with, actually, the falling in the Treasury rate. There is a direct correlation—the rates that participating securities SBICs pay their profit share to the government, profitable share, goes down as the rate goes down. Therefore, in a counterintuitive situation, the actual prioritized payment rate or the interest portion has to go up slightly to counterbalance the falling of the profit share that participating security SBICs will pay the government.

The increase is well within the ability of SBICs to pay, given the market conditions, and we urge the Committee to support it.

The importance of the SBIC program cannot be overstated. The $2.7 billion in venture capital invested in fiscal year 2002 was down 40 percent from the year before, but the number of companies financed was only down 12 percent, 1,979 from the previous 2,254. Those companies employ over 300,000 employees.

SBICs continue to be a significant source of venture capital for new businesses, with 48 percent of fiscal year 2002 investments made to companies less than 3 years old. They are particularly important for low- and moderate-income businesses.

Chairman MANZULLO. We are on the red cue.

Mr. MERCER. I see that. I will sum up right now.

Twenty-seven percent of all investments went to LMI companies.

To sum up, we believe the President's budget will help the SBIC program continue to do its job. We look forward to working with you on implementing the budget, on reauthorization, and we urge you to continue to support our UBTI proposal which is in my written testimony and which I urge be included in whole in the record.

[Mr. Mercer's statement may be found in the appendix.]

Chairman MANZULLO. It is too bad that Mr. Barreto wasn't here to hear somebody say that he liked his budget. Thank you, Mr. Mercer.

Mr. Crawford, I look forward to your testimony.

STATEMENT OF CHRISTOPHER CRAWFORD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Mr. CRAWFORD. Thank you. Good afternoon. My name is Chris Crawford, and I am pleased to comment on the SBA's budget request.

I ask that my written statement be entered into the record of this hearing.

Chairman MANZULLO. All of the written statements of the witnesses and the statements of any members that wish to put them into the record will be admitted without objection.

Mr. CRAWFORD. Thank you, Mr. Chairman.

First, I want to thank the Chairman and the ranking member for your support in the 2003 spending bill by demanding that SBA implement the improved 504 subsidy model quickly. The budget reveals plans to further delay our subsidy model, as you have already noted. We believe that the cost of this in the year fiscal year 2005 will be $100 million in excess fees over the 20-year span of the loans.

NADCO's members and first mortgage partners provided more than $6 billion in long-term capital to job-creating small businesses last year. SBA requests $4.5 billion in loan authority for 504. We asked for $5 billion. Our loan demand is up 25 percent year to date, and we are concerned that tight bank credit will push demand even higher. This increased ceiling will cost the taxpayer nothing since we require no subsidy.

We appreciate the administration's decrease in our borrower fee for 2004. This change may seem small, but it will result in millions of dollars saved for thousands of small businesses.

However, our concerns continue about both the default and the recovery estimates SBA uses to calculate our program fees. The 7.5 percent default rate is higher than historical reality. The 17 percent recovery forecast seems disconnected from the successes of both the asset sale and the 504 liquidation pilot created by this Committee. Each of these programs have demonstrated recovery rates of over 45 percent, so we cannot understand how SBA can project a rate of 17 percent in net recoveries.

504 was reviewed during 2002 by OMB using their Performance Assessment Rating Tool, or PART. I believe that some of their conclusions are completely wrong.

First, OMB says that 504 and 7(a) duplicate each other by providing long-term fixed asset lending. In fact, the two programs are fundamentally different as to congressional purpose and financing structure. 504 involves long-term fixed rate financing, and our goals are community economic development and job creation. 504

provides low down payment terms to help borrowers conserve operating cash.

Austin Westrand in Byron, Illinois, used 504 to save 200 jobs in a town of 2,000. American Building Supply of the Bronx, New York, needed 504 to save four jobs and create 31 new jobs. Neither borrower could qualify or obtain either a 7(a)or a regular bank loan. Clearly, 504 and 7(a) are very different, which seems obvious to everyone but this administration.

Second, the OMB PART states that 504 has not demonstrated adequate progress in achieving its long-term goals. The Small Business Investment Act of 1958 makes clear that the congressional purpose and intended goals for 504 are economic development, community growth, and job creation.

Let me share SBA's own 504 statistics: Over one million jobs created or retained since 1996; over $42 billion in long-term capital provided to small businesses; over 45,000 jobs are businesses assisted; and nearly 50 percent of our projects go to assist minority, women, veterans, and rural business borrowers.

I am astounded at OMB's blindness to 504's long record of success, and I urge you to reject this PART analysis by reauthorizing this program.

Mr. Chairman, America needs 504's job-creating abilities more than ever. 504 needs your help in and the leadership of Administrator Barreto. My industry wants to open our window to Wall Street to more businesses. We have given SBA many recommendations over the years that could expand this program substantially. Now is the time to implement those improvements and bring our program out of the bureaucratic shadows that it sits in today. Please help us grow 504 and create more jobs for our economy.

Thank you, Mr. Chairman.

[Mr. Crawford's statement may be found in the appendix.]

Chairman MANZULLO. Well, thank you very much.

You know, we are all talking here about a credit crunch. We have a company back home that spun off from Ingersoll. Ingersoll Milling Machine Company and their associated subsidiaries was about 3,000 employees. They are now 200. You talk about a hit in the manufacturing sector.

But in Ingersoll's production line—these are the lines on which you put a block for an engine, for example. As the production line group at Ingersoll was suffering along with the rest of the company, a constituent said, here is an opportunity to go in there to buy that off and to treat it as a sole company to try to reconstruct it.

He went to 10 banks and venture capital firms. They all turned him down. The loan was too much for the SBA. It was several million dollars. You know where he got his loan? From the Chinese. So he has some Chinese investors that salvaged a company in Rockford, Illinois, that provides 100 jobs building these huge machines for lines, and that company has over 200 subcontractors.

I am just sitting here thinking, you know, we talk about jobs going to China and now we have got foreign direct investment from China to the United States because the lending industries—and I am not critical of the SBA programs because this is much greater; it is a several million dollar loan—but the lending industries which this year have astounding profit, the bank's profits are up about a third, over 35 percent over last year's across the board, banks are making a tremendous amount of money, and yet we are seeing such a credit restriction going on—and I am sure you are too, Mrs. Velazquez. Can you imagine, this 100-year-old Rockford firm has to go to the Chinese to get capital? Because they saw an opportunity for long-term investment, because these lines are extremely important, and they ended up with—it is a part of American monies but mostly Chinese money.

I don't know how to turn this thing on its head. Every morning I get up and I find out that there are more manufacturing jobs that are fleeing. And simply trying to get a handle, it is as if we are wearing a sweater and a thread came loose at the sleeve and it continues to unravel and we can't stop the hemorrhaging.

But one of the things that we are going to be asking you to do in this reauthorization bill that Mr. Pinellas is working on for the SBA is going to have a heavy emphasis on manufacturing. Washington doesn't get it. The policymakers here think that these two million manufacturing jobs are coming back, and they aren't. They are leaving. I could lose entire cities back home. Cities, Angkor, a little manufacturing facility. So we fight continually with the Federal government.

I want to tell you something. We are going to stop this bleeding, and we are going to stop the hypocrisy, the Federal government talking about investments and jobs while at the same time taking procurement contracts and giving them to foreign countries. Got into a big fight with Northrop Grummann. They are making one of the American portions of the Joint Strike Force fighter under subcontract from Lockheed Martin.

I mention this publicly because it is only when I brought it up public that things perhaps may turn it around at Northrop Grummann. We noticed that they had been looking for a manufacturing company to drill precision holes for the Joint Strike Force fighter. This is the NATO fighter. It is seven Europeans countries in the consortium plus the United States.

For the U.S. component, Northrop Grummann let out four contracts to the Europeans. Now this is U.S. taxpayers' dollars for the U.S. portion of that fighter saying that we are going to go to the Europeans. And instead of giving a contract to Ingersoll Milling in Rockford, Illinois, it went to the Spaniards.

As I talked to one of the vice presidents from Northrop Grummann. We had a very interesting meeting. He said, there is not an American company capable of drilling the precision holes necessary for the Joint Strike Force fighter; and I turned to him and I said, you don't know what the hell you are talking about. I said, you had better get to Rockford, Illinois, and you take a look at 100 years of quality engineering in the old Swedish tradition of the people who are known as the tool and die center of the world, the last vestiges of artistry in metal left in this country.

They came. And it is very interesting, because the people who had said that Ingersoll couldn't build a machine to drill holes for an airplane was also building a very similar machine for Lockheed Martin, their major contractor on another project.

That is the extent of disconnect in this country. I turned to the Northrop Grummann lobbyist who was there; and I said, I want to tell you right now, if you let out another contract to a foreign company and you destroy American jobs, you are going to have hell to pay. And the Speaker joined in that. The Speaker had been in a meeting with the president of Northrop Grummann just a few weeks before that and said, stop giving those contracts to the Europeans and give them to the American firms.

It is going to stop. You guys are going to have a part of it, because we are going to revitalize remanufacturing in this country. Otherwise, we are going to be dead. We have got no place to go. My people are desperate. When the factories close and there is nothing left in America and all the service jobs, GE—if your refrigerator is broken and you call for service, it gets picked up in India. Fleeing to Ireland, India. You know, where is the sense? Isn't anybody going to wake up in this country and say if all these jobs flee, who is going to be here to buy the stuff they are making overseas?

So get involved. We are going to be in a big fight this Congress. We have to take on everybody, but it is worth it because we have to salvage these jobs.

Mrs. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Wilkinson, I know that you have to leave soon, so I need to ask you two questions. For the record, do you think that the President's budget request for the 7(a) loan program is adequate?

Mr. WILKINSON. No, ma'am. The budget request is for $9.3 billion. We did 11.1 last year, and year to date we are already ahead of that pace. We even had a $500,000 loan cap in place for the first 4 or 5 months of this fiscal year.

Ms. VELAZQUEZ. How short is it?

Mr. WILKINSON. It is going to be at least $3 to $3.2 billion in loan authority, which would be about $35 million in additional appropriations that will be needed.

Ms. VELAZQUEZ. Thank you. And given your experiences with the nightmare created by the subsidy rate situation, what advice do you have for the SBIC industry as the SBA launches into fixing its subsidy rate?

Mr. WILKINSON. Well, first of all, I wish Mr. Mercer luck. Be prepared for a good long fight.

The one thing I would say is, to get the information you want, you are going to have to be very specific in the way you ask a question. OMB in the past was not terribly forthcoming with information. So you have got to ask the right question to get the right answer.

Ms. VELAZQUEZ. Thank you.

Mr. Crawford, in this year's budget, the administration seemed to make the claim that there is no difference between the loan programs. Could you please comment on this or express your views?

Mr. CRAWFORD. Yes, ma'am. Thank you.

Well, it is very clear that the programs are extremely different. The 7(a) program in our view is set up to help distressed businesses that can't qualify for regular bank financing. I mean, Tony can speak to that better than I can.

Our program was established with the 501 program in 1958 and subsequently modified by several additions by this Congress to focus on job creation. Our one mission is job creation. I have got to ask myself the question, why do they want to conceivably deauthorize a program that creates jobs? And that is our one mission, community and economic development. We make long-term loans, fixed rate loans, low cash down. We do the things that the banks—maybe they can do, maybe they can't. We do them every day.

Ms. VELAZQUEZ. Thank you, Mr. Crawford.

Mr. Gast, we keep hearing from the administration that PRIME is duplicative of other SBA programs. Without taking anything away from the other programs, would you please explain to us why PRIME is different from SCORE, SBDCs, microloans, and the Women's Business Centers.

Mr. GAST. Sure. I am sure all the members of the Committee are aware that small businesses are extremely diverse. It takes a different type of service to work with someone who might be extremely skilled in a particular area like carpentry, like light manufacturing but may have no knowledge of business who wants to strike out, start their own business, and create jobs.

That is what we specialize in. We specialize in building businesses from the ground up. We will spend 10 or 15 hours because that is the level of effort it takes to build these businesses. And what we found is it is not only cost effective, it is cost efficient. It is the right way to do it because the end benefit works.

Ms. VELAZQUEZ. Thank you.

Mr. Wilkinson, we heard from Mr. Barreto their interest and focus in terms of increasing the amount of small business loans, and yet they cut the funding level for the Microloan Program.

Mr. WILKINSON. That does seem a little odd that they would do that. If they really want small loans, I think they would fund both.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman MANZULLO. Mr. Bartlett.

Mr. BARTLETT. I am sorry, I was called away and couldn't hear your testimony.

Let me ask you one question that may help us more than any other question I could ask you to understand your concerns and what we ought to be doing. Had you been on the panel—let me ask each of you to tell us, had you been up here, what question would you have asked Mr. Barreto or what observation might you have made for Mr. Barreto's benefit? If we could just go down the line quickly and tell us that one question or that one observation.

Mr. WILKINSON. The big question would be why the 7(a) program was not adequately funded. Their 9.3 level is significantly insufficient for next year. We are on pace to do between 11 and a half and $12 billion this year, and we think we need a $12.5 billion program next year.

Mr. BARTLETT. Thank you.

Mr. WILSON. Mr. Chairman, I think the major question is to ask why the budget does not compare to the rhetoric. There is a dramatic decrease in the funding for management assistance programs at a time when the need is the greatest. SBA knows—OMB has the data—that an investment in management and training assistance programs returns a positive return to the Treasury, and yet they say there is not enough money. Small business people understand that when you invest in a profit center, you are going to get more than you put into it. We have demonstrated year after year that the rate of return is two to one, three to one and better.

Now if I am making a budget, and I do every year for my organization, I understand where you put your money. You put your money into things that are making you money. Right now, everybody is concerned about the size of the deficit. The reason we have a deficit is that people are not working. And all of these programs that you hear up—that you have heard from create jobs. The data is overwhelming, where the jobs come from and who helps them create jobs, and yet this administration—unfortunately, it has been going on for a number of years, declining amounts to these job creation programs that provide a positive rate of return to the Treasury.

Mr. BARTLETT. Mr. Gast.

Mr. GAST. That answer just stole my thunder. How you can cut these programs that are doing just that, providing a positive rate of return, particularly completely eliminating programs that focus on very low-income people and minorities where sometimes there is the greatest return to be gained.

Mr. MERCER. My question would relate to the availability of capital. In the economic conditions we are in right now, the banks have pulled back so that non-SBA-related loans have contracted significantly. Obviously, we are happy with our section of the budget, but SBICs, when they invest in a company, as you know, there is going to be more senior debt required for that company to grow. And to the extent that the senior debt that is represented by some of the other programs, whether it is 7(a) or 504 that would be senior to SBIC financing, to the extent that data is not available, sometimes an SBIC literally cannot make the investment. If it can't see where the senior debt is coming from, there is no ability to finance the company.

Mr. CRAWFORD. I would like to know why the administration wanted to sacrifice $100 million of borrower income to save one year of subsidy on the econometric model.

Mr. BARTLETT. Sorry you couldn't have been up here to ask the questions. Next time, prompt us so we will ask them for you.

Thank you very much, Mr. Chairman.

Chairman MANZULLO. If we had had time in the way we run our hearings here, you would have had an opportunity to ask the questions of Mr. Barreto. We got interfered with the voting, plus we had a really good turnout of people here with a lot of good questions.

I want to thank you all for coming. We have a lot of work ahead to do.

There are some bright spots out there. I was with the 504 people. Chris, was it yesterday? I just happened to be at the wrong hotel. But I made it. I made it on time. It was the wrong Marriott over in Crystal City. But we were hearing some—you know, when times get tough, Americans always put their ingenuity to work.

There are four—two furniture factories closed up shop in Vermont, and the 504 people stepped in, and now they are about—I just talked to Bernie Sanders on this. There are about 20 of the former employees there that have formed this wholly-owned company. And is it Middlebury College in Vermont? And Middlebury College has stepped in. I don't want to say it is a partnership or a consortium, but they are adding their business knowledge and know-how. So this little town is fighting back to regain some of those manufacturing jobs.

You know, I think that is what we are going to have to do. It is going to have to take some new type of thinking—perhaps that is the appropriate word—in order to revitalize the businesses that have been wiped out.

I know you guys have marvelous backgrounds. One of the things I would like to do is to invite Mr. Barreto in a very informal setting with the people from the industry—because he is really good at this. He is extremely bright, and he really wants to help out—and come up with some new models on how these businesses could be helped out.

Let me give you an example. You know, the Economic Development Administration comes in and they can provide some infrastructure, et cetera. Somewhere along the line maybe somebody ought to take a look at whether or not there could be some type of program to help offset communities that want to give a tax incentive to keep a business operational, but because of the impact it has on the base for funding the schools it becomes very difficult to do that. What I am saying is that we are going to have to think differently in the way companies do business, the whole idea of employee-owned businesses, the guys and ladies that are left behind when the industries close being able to come together.

Perhaps there should be a different type of tax structure in areas that are severely impacted by manufacturing losses. Perhaps there should be a way that they could operate their business as a co-op and be not—you know, be a for-profit but in a cooperative method which would be in a special taxing bracket.

I don't know the answer to it, except that we are going to have to think very, very differently than we have in the past because of these new models that have to be invented.

Lee, did you have a comment?

Mr. MERCER. No, I just want to tell you, there is some forward-looking confidence in manufacturing. Over the past 5 years, SBICs just in the direct NAICS codes have invested an average each year of about 30 to 32 percent of all—in dollars have gone to manufacturing companies. Then if you add indirect and related NAICS codes, you are probably talking somewhere around 33 percent. So there is—so the money managers are betting on some of these young manufacturing companies being able to find a new way to do the business.

Chairman MANZULLO. Well, what Austin Westrand did in Byron, they make a custom trailer leg. They make the only round trailer leg. You know the big 18-wheelers where you have to jack it up? Everyone makes a square one. They make a round one, and they are exporting those to Mexico, and soon they are going to be exporting those to China. This is a union shop, but they found a market in there somewhere.

Because 504 is long-term, looks at increasing jobs in a community and is very much interested in economic development. The studies go on to determine the market in a very intensive way. What we are doing back home is we formed a consortium with Northern Illinois University and a manufacturing council to bring together the best minds in the area to take a look at the whack that we are getting hit with in the fastener industry, the tool and die industry, and the molding industry, and to try to assess how we can do it.

For example, a lot of U.S. manufacturers have moved overseas. And Matt Szymanski, who is the chief of staff of our Small Business Committee, is going back to China for the sixth time in 13 months with two manufacturers from the district I represent and two manufacturers from the Speaker's district—our districts touch. One is a mirror image of the other, and he is being wiped out also in manufacturing jobs—and we have had to turn to Chinese companies—Chinese companies—because they are taking the long view of what is going on in America and, as chairman of the American Chinese Interparliamentary Exchange, meeting with my counterparts.

Chinese understand that their recovery depends upon the U.S. recovery. They have a workforce of 450 million people. It grows by 10 million each year. They need 7 percent increase in GDP just to stay even.

But what the Chinese are telling us is that if American manufacturers continue to pull out and continue with the loss of jobs in America, there won't be anybody in America left with high-paying enough jobs to buy the stuff that is being made in China. So the Chinese are looking very long range, and the American companies aren't.

So what we are trying to do with the American companies involved in manufacturing overseas is to get them at the minimum to still use U.S. molds and use tools and dies that can be easily serviced in China and around the world. So that is part of——.

You know, it is amazing where you have to go to try to turn the corner on this. When we were in China in January, we were in Shenzhen at the invitation of Wal-Mart. Wal-Mart came to me and said, Chairman, could you help us export more U.S. products? And, also, could you find more U.S. products to be sold in the American stores? American Wal-Mart stores.

It just sucked all the air out of me. I said, these people understand. Wal-Mart has about 2,300 stores in the United States. Half are in small towns. Those small towns have as an anchor an industry, and Wal-Mart is smart enough to realize that if that industry gets wiped out, half of their stores are going to be in dire distress because the jobs will have left.

So it is a—you know, this thing is very difficult to get our arms around it, but I think it can be done. And we are asking American companies to simply step up. I mean, Emerson moved everything to China. Everything. All their manufacturing, their sales force, their research, everything went to China. But at least Emerson can still use American molders for part of their manufacturing.

Just some of the things to think about. In our hearings that we are going to have on manufacturing, we are going to be bringing in people to talk about the change in nature of corporate responsibility. I am not talking about a social program here. We are going to try to—we are inviting Warren Buffett to come. Warren Buffett, a major shareholder in Coke. Coke has stopped making estimates or making comment on quarterly earning estimates. Pepsi-Cola stopped. The new president and CEO of AT&T stopped it. The stock fell 22 percent the next day. But we are seeing corporate executives stepping up to the plate and saying that because the longest range plan in America is only 3 months, this is disaster to America's companies, especially the small businesses which are the subs and the sub-subs of the larger ones.

I talked to a professor from Harvard Business School yesterday, wrote an astounding article on ethics in the Harvard Business Journal. She was astonished that we had read it. And we invited her to come and testify, also. What she does is she has a flow chart on the thinking process for what a corporation should go through, and she makes the one statement: Is it ethical? The first statement is, well, obviously, is it legal? And then from there, if it is legal—obviously, then you—if it is not legal, you stop. If it is legal, the next question is: Does it enhance shareholder value? But she doesn't stop there. And that is where most Americans stop. Because she goes to another level that says: If it enhances shareholder value, is it ethical? In other words, does the impact on the consumers, the environment, the workforce, the supplier offset the increase in shareholder value? It is astounding.

Then we hope to bring in a fellow by the name of Allen Kennedy who wrote a book called The End of Shareholder Value, written in 1999, where he talks about this race to increase the value of stock, and the next 30 days—the next 90 days will lead to overinflation of the stock, disaster in the market, and nothing but greed taking place. Because when long-range planning is gone, there is nothing to build upon, and you will find the collapse of our industries.

So it is going to be a lot of fun. I look forward to your work in it. We will be tasking you with a tremendous amount of responsibility to help us in these models.

This hearing is adjourned.

[Whereupon, at 5:14 p.m., the Committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
Committee on Small Business
2361 Rayburn House Office Building
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Statement of Donald A. Manzullo
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC
February 26, 2003

Good afternoon and I would like to welcome everyone to the Committee's first hearing for the 108th Congress. I look forward to the testimony from Administrator Barreto and the groups that have formed partnerships to help deliver SBA services to America's entrepreneurs.

Washington is abuzz with talk about homeland security. The President deserves our full support in making sure that America is secure. Of course, Americans can feel very insecure if they are worried about their jobs and their economic future. This Committee can play a key role in achieving economic security by ensuring that the federal government and America's small businesses work together in a sound partnership to spur growth in the economy, in jobs, and, most importantly, in wages.

The President has developed a clear small business agenda – one that I fully endorse. Removing unnecessary regulatory burdens on small businesses through compliance with the Regulatory Flexibility Act is vital. Assisting small businesses in paying for health care will help them attract and keep employees. Eliminating bundling of contracts so that small businesses get a fair share of federal contracting dollars is not only good for the small businesses but is good for the taxpayer because small businesses provide better service at lower costs. Finally, tax relief will help spur investment by small business owners.

I believe that one additional component must be added to the President's agenda. America cannot maintain economic security as a post-manufacturing society. The government must find ways to ensure a stable manufacturing base. This will be my number one priority in this Congress – not just getting Americans back to work but getting Americans back to work in jobs where they actually make a tangible good. Only with a strong manufacturing base can we truly ensure economic security for today and our posterity. This is not a new priority but rather returns the Committee to the reason it was founded – to ensure that America in time of war had a sound small business industrial base.

It is within this context that I am examining the SBA budget to determine whether it has the resources needed to assist America's entrepreneurs particularly if they wish to start or expand manufacturing enterprises.

I am extremely interested in the Administrator's testimony concerning the resources available to develop accurate default rate estimates for financing programs other than 7(a) including: 504, disaster loans, small business investment companies, and microloans. Availability of capital is critical to entrepreneurs wanting to start businesses; 7(a) loans only provide financing for certain types of businesses. For example, given the amount of capital needed, manufacturing enterprises may find 504 loans or investment by SBICs a better tool than 7(a) loans. On the other hand, an entrepreneur starting a business from the home may only need a microloan. If the default rates are not calculated correctly, less money is available to lend as we have seen with the recent performance of the 7(a) loan program and the caps on the size of loans.

Let me make it clear for the record – I do not want a repeat of the problems that occurred with 7(a) loans in the 504 program. The conference report on the FY 2003 appropriations states that the "conferees direct the SBA to develop similar, more accurate econometric models during this fiscal year for use in other SBA loan and financing programs, especially the 504 Loan program." I agree completely with the directive of the conferees and expect the SBA to make the development of the econometric model for the 504 loan program by October 1, 2003 one of its top priorities.

The SBA stands as the first line of defense against federal agencies bundling contracts. Therefore, the budget request should have sufficient resources and personnel to carry out, in an effective manner, the President's pledge to reduce contract bundling.

SBA has significant outreach activities to America's entrepreneurs. This outreach should provide adequate advice and assistance to small businesses wishing to enter manufacturing or expand existing manufacturing enterprises. If the SBA or its partners, such as SCORE or SBDCs, do not have the technical expertise to answer specific questions from manufacturers, I would like to know how the SBA coordinates consultations between its small business clientele and the Manufacturing Extension Partnership at the National Institutes of Standards and Technology in the Commerce Department.

I believe that the SBA can be the vehicle to help all of America's entrepreneurs including those that wish to get their hands dirty on the shop floor. I look forward to working with the President and the Administrator to enhance our small business industrial base.

Now I will recognize the ranking member of the full committee, the distinguished Gentlelady from New York, for her opening statement.

House Committee on Small Business

"U.S. Small Business Administration's Budget FY 2004"

February 26, 2003

Prepared Remarks of Ranking Member Nydia Velazquez (NY-12), U.S. House Small Business Committee

Thank you, Mr. Chairman.

Regardless of the rhetoric, the fiscal year 2004 budget request for the Small Business Administration is as inadequate as the previous three this Committee has seen during President Bush's tenure.

The approximately $800 billion level is well below the four percent increase for government-wide spending that President Bush touted when he released his budget this month. Given our new reality and the budgetary constraints we face, we must prioritize spending to ensure critical items are funded, like homeland security and the war against terrorism.

But let me ask this question – what is the point of having international security if we do not have economic security here at home? This budget not only fails to provide for our nation's economic security, but it also, I believe, will lead to greater economic insecurity in America.

If our economy is to rebound, it will be critical that small businesses – which create half of all new jobs – get the assistance they need. Sadly, this budget fails our nation's entrepreneurs.

First and foremost, it shortchanges small businesses by billions of dollars in lending opportunities. It is through this infusion of capital that small businesses expand as they purchase equipment or start new ventures – both of which create jobs and lead to economic growth.

While there is still much talk by the president and some in Congress about a tax break to supply such a capital infusion – the reality is that much of the president's plan will have no effect, and may even harm, small business. That is why the SBA loan programs – which provide 40 percent of all small business long-term lending – are so important.

This budget continues the SBA's trend of underfunding its flagship loan program – the 7(a) – by $3 billion. It also cuts the Microloan Program in half.

Small businesses will not only fail to get the capital they need, but the Bush budget only partially solves the miscalculation of the subsidy rate for the 7(a) program, which has taxed both lenders and borrowers by over $1.5 billion, and does nothing to correct the subsidy rate problem in the 504 program.

This means borrowers who use the program will pay an additional $15,000 over the life of the loan. That is the difference between hiring a part-time employee and a full-time employee, providing health care benefits, or purchasing new equipment.

Even worse, it imposes new taxes under the SBIC program with additional fees on the participating securities program. For an administration that pushes tax cuts to continue these types of policies – and then propose yet another tax on small business – is both backward and hypocritical.

The proposed budget steals lending opportunities – as well as federal contracting ones – away from small business by failing to open up the $220 billion marketplace to small enterprise. For the last two years, the federal government has not met a single one of its small business goals. This has cost small businesses $12 billion!

While there has been a lot of tough talk by the administration about cracking down on contract bundling and holding agencies accountable, this budget provides insufficient funding for Procurement Center Representatives – the frontline of defense in enforcing federal contracting laws.

It provides funds for 47 PCRs, not even one per state, leaving several critical procurement centers across the country unstaffed. Little money is available for travel. It is one thing to think someone can do more with less, and another to think anyone can make something out of nothing – that is exactly what this budget does.

As President Bush has made "compassionate conservatism" his motto, this budget continues the administration's policy of completely turning its back on low-income and minority communities.

Just like in the past, the proposed budget fails to request funding for PRIME, BusinessLINC, One Stop Capital Shops – all programs that target these areas. Given the deep cuts to the Microloan Program, and the administration's failure to get the New Markets Venture Capital Program off the ground, this budget sends the message to low-income communities that they must go it alone.

Mr. Chairman, my assessment of this budget is simple – it's inadequate. It underfunds critical small business loan programs, it fails to improve contracting for small business and it leaves our low-income and minority communities behind. If our economy is to turn around anytime soon, it will be through small business growth – growth that will, in part, rely on

SBA programs.

Clearly, this budget does not match the administration's rhetoric of being "pro small business." Given the current recession, it concerns me that the most important driver of our economy – small business – will suffer at the hands of the administration's budget. Small businesses can't work their magic on our economy without the proper tools, which this budget fails to provide them. I look forward to hearing from the witnesses and yield back the balance of my time.

Return to Hearing Summary

Return to Home Page of House Small Business Committee

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STATEMENT OF
HECTOR BARRETO
ADMINISTRATOR
U.S. SMALL BUSINESS ADMINISTRATION
SBA'S FISCAL YEAR 2004 BUDGET REQUEST
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES
FEBRUARY 26, 2003

Mr. Chairman, Ranking Member Velazquez, and members of the Committee, thank you for inviting me here today to discuss the President's Budget Request for the U.S. Small Business Administration (SBA) for Fiscal Year (FY) 2004.

President Bush understands the vital role that America's small businesses play in creating opportunities. He also recognizes that in times of economic downturn, small businesses play a leading role in economic recovery, and that, it is small businesses that generate approximately two-thirds of all new jobs. Therefore, to support this vital sector of the American economy, the President has designed a small business agenda intended to create an environment in which entrepreneurship can flourish. This agenda includes: providing small businesses with the information they need to succeed, ensuring full access to government contracting opportunities, and tearing down regulatory barriers to job creation for small business by giving them a voice in the complex and confusing federal regulatory process.

The President's plan for economic growth and job creation would provide relief for small businesses in the form of reduced marginal tax rates while increasing the amount that can be written off as expenses for equipment purchases from $25,000 to $75,000, encouraging them to buy technology, machinery, and other equipment they need to expand and create new jobs.

And finally, the President has responded to the calls that I have heard from small businesses throughout the country to permanently repeal the death tax and allow small business owners the opportunity to pass along the fruits of their life's work to their heirs without being forced to sell the family business to pay the tax bill.

Beyond the need for tax relief, SBA is leading the charge to implement President Bush's small business agenda. To do this, the Agency is focusing on three strategic programmatic goals designed to create more jobs.

First, SBA is championing small business interests by minimizing the regulatory burden on small businesses, providing them with easily accessible information about how to comply with regulations, and working to ensure that the regulatory process treats small businesses fairly.

Secondly, SBA is continuing its efforts to empower entrepreneurs. The Agency is working to increase the opportunities for entrepreneurs to start and grow small businesses by providing: increased access to capital; increased access to information, technical assistance, and counseling; and, increased access to procurement opportunities.

Thirdly, SBA is continuing to play a vital role in helping businesses and families recover from disasters. Through its disaster assistance program, SBA provides speedy and customer-friendly assistance to restore homes and businesses to their pre-disaster conditions.

The Administration's FY 2004 budget request reflects SBA's lead role in implementing the President's small business agenda. SBA celebrates its 50th anniversary in 2003, and as the Agency begins its next 50 years, SBA will continue to be in the forefront of helping to solve small business problems, such as access to affordable health care and reduced tax and regulatory burdens.

Mr. Chairman, when I appeared before you last year to present SBA's budget, I testified about a number of challenges facing SBA in its efforts to retain its relevance. Today, I am pleased to report to you that this Administration has met those challenges head-on and have significant accomplishments from the past year to report to you.

I testified that for FY 2004, SBA would use an improved model to calculate the subsidy rate for the 7(a) Loan Guaranty Program. The 2004 budget request uses such an econometric model. Working with the Office of Federal Housing Enterprise Oversight (OFHEO), we have developed and implemented a more accurate subsidy rate calculation model. Using this revised model, for FY 2004, SBA has been able to dramatically reduce the 7(a) program, subsidy rate from 1.76% (as proposed for FY 2003) to 1.02%. The Administration is requesting $94.860 million for the 7(a) program, which using the improved subsidy rate calculations, will provide a program level of $9.3 billion.

The new econometric model will enable SBA to allocate its resources more effectively, determine program risk more precisely, and increase its ability to target loans to aspiring entrepreneurs who cannot obtain financing without a government guaranty. The model also improves the government's ability to forecast loan performance by taking into account a wider range of economic factors, including Gross Domestic Product (GDP) and unemployment, as well as a wider variety of loan characteristics that affect performance.

In short, implementing this model is a huge plus for small business. Under President Bush's leadership, SBA has delivered.

I also testified that SBA needed to change the way it delivers its services to its customers – America's small businesses. Today, SBA is poised to implement its transformation efforts with a three-district pilot project. Many throughout the Agency have worked long and hard to ensure the success of SBA's transformation efforts and have addressed each and every concern raised by our Congressional partners in formulating this plan. I will discuss SBA's budget request for transformation later in this testimony.

Last year, I also testified on SBA's need to improve oversight of its lending partners. Under this administration, SBA has taken the steps necessary to move away from the antiquated loan oversight system it inherited towards a more modern system. To assist with this effort, SBA contracted with KPMG Consulting, and last June, KPMG provided the Agency recommendations as to how to proceed with developing a loan monitoring system (LMS) that meets both SBA's and Congress' needs for lender oversight.

In undertaking these actions, this Administration has addressed the challenge of modernizing LMS by using the private sector, where the experts in this area are, rather than developing a separate, more costly system.

SBA has also had successes over the past year in areas beyond those about which I testified. Under President Bush's leadership, this Administration has consistently identified problems and has addressed them directly. For example, the General Accounting Office (GAO) recently issued a report outlining concerns about accounting issues related to the asset sales program that SBA has been running for the past several years. SBA is acting promptly to correct any problems with this program. Even before GAO released its report, I put into place a new financial management team, giving them the top priority of addressing the issues identified in the GAO report.

This financial team has nearly completed its detailed analysis of the situation, and SBA intends to take the appropriate steps based upon its findings.

Now, I respectfully ask for your support of the President's FY2004 Budget Request for SBA.

The President's plan proposes a total FY 2004 appropriation of $797.9 million, maintains the spending level proposed for FY 2003, and is about 4 percent larger than the budget for FY 2002 and would provide substantial levels of credit, capital, procurement, and entrepreneurial development assistance to small businesses.

This fiscally sound budget would provide more than $20.8 billion in small business loans, loan guarantees and venture capital and more than $760 million in new disaster loan funds for victims of natural disasters. That includes funding for $9.3 billion in guaranteed loans under the 7(a) program as well as more than $115 million for the agency's technical assistance programs.

This budget proposal demonstrates that SBA, in line with the President's management agenda, is looking for ways in which to serve the Nation's small businesses more efficiently and to ensure economic security by creating jobs. A prime example of this comes in the request for the 7(a) Loan Guaranty Program, SBA's flagship program.

Thus far in FY 2003, operating under a series of continuing resolutions while dealing with the effects of lowered fees on 7(a) loans as a result of legislation passed last year, SBA has instituted as a management tool a cap of $500,000 per 7(a) loan. This effective management tool has produced interesting results. By creating an emphasis on smaller loans within the 7(a) program, SBA has been able to leverage its resources to provide an increased number of loans to emerging markets. This has allowed SBA to be ahead of its 7(a) lending goals in every category in FY 2003, including 35% ahead to women, 65% to African Americans, 39% to Hispanics and 31% to veterans.

Now that both the FY 2003 appropriations for SBA as well as legislation allowing for the use of the econometric model for calculating the subsidy rate for the 7(a) program in FY 2003 have been enacted, SBA has removed the cap on 7(a) loans. SBA will, however, continue to promote smaller loans.

SBA will also promote smaller loans through expanding its lending program to allow as many as 1,500 of America's more than 10,000 credit unions to join its network of lenders. This represents a potential increase of some 30 percent in the overall number of storefronts through which entrepreneurs, particularly those requiring smaller loans, can seek capital for their businesses. This, combined with building on SBA's existing network of lenders, will allow SBA to reach more communities, a greater number of entrepreneurs and a more diverse pool of prospective and existing small business men and women.

This Budget Request will also allow SBA to provide $4.5 billion in loans through its 504 Certified Development Company program with no cost to taxpayers. The 504 program which was established to increase small businesses' access to real estate and other long-term fixed asset funding, has always had as a program goal job creation. SBA recognizes the need to increase small businesses' access to 504 loans, and will implement steps in FY 2004 to accomplish this goal.

This Budget Request includes $8.8 million to continue implementation of SBA's transformation efforts. I have spoken with many of you personally about the importance of transformation to SBA's future success. These efforts are very crucial to the Agency's continued relevance in its second half-century.

In recent years, SBA's program delivery has changed dramatically to the point at which SBA now relies principally upon its lending and other program partners to directly assist small businesses. However, SBA has not aligned its resources, including personnel, with this changed business practice. Through transformation, SBA will shift field office efforts from "back office" functions (such as loan purchases and some liquidation functions) to more direct relationships with customers and resource partners. SBA's field offices will use outreach, marketing, and customer and resource partner relationship management to ensure they know and meet small business needs.

This new approach, which will not cost <u>any</u> current SBA employee his or her job, will empower SBA to serve more small businesses. SBA will test this new concept through pilot projects in selected district offices to ensure that the new methods achieve the intended results. Upon evaluation, SBA will incrementally expand the successful practices to more offices until all of SBA has been transformed. SBA has carefully negotiated the components and the implementation of the pilots with its union. The pilots began this very week, and transformation will continue through FY 2005.

Realization of the transformation plan is closely entwined with SBA's implementation of the President's Management Agenda (PMA). The budget request includes $16.5 million (which includes all sums necessary for the transformation plan) to support the Agency's execution of the PMA. The PMA shows President Bush's emphasis on better management of the Federal government through five key areas: human capital, competitive sourcing, E-government, integration of budgets with performance, and improved financial management.

SBA requests $2.3 million to modernize and streamline business processes to reduce costs and to improve customer service. SBA will analyze critical business processes of district and loan servicing centers and will identify improvements which may involve system efforts, business process changes, or privatization. Additionally, in order to improve basic infrastructure support for these new processes and pilot efforts, this Budget Request includes $1.7 million to support SBA's information technology infrastructure.

SBA's FY 2004 budget request includes level funding for the Agency's critically important entrepreneurial development programs – SCORE and the SBDC, WBC and BIC networks. It is often said that access to information is the key to small business success. SBA provides this critical access through its highly successful partnerships with SCORE's talented cadre of seasoned business experts; and with college and universities and state, local and private sector management assistance providers around the country. Now, more than ever before, it is important that SBA be able to contribute to the support of these entities that provide access to information and access to counseling.

This budget request also includes continued funding for the Agency's Disaster Assistance Program. SBA works very closely with the Emergency Preparedness and Response Directorate of the Department of Homeland Security (formerly named the Federal Emergency Management Agency [FEMA]) to assist those small businesses and individuals directly affected by disasters such as tornadoes, floods and hurricanes to get them back on their feet in times of trouble when they most need government assistance.

Mr. Chairman, I want to take a moment to recognize the heroic efforts of the employees of SBA's Office of Disaster Assistance who did everything they possibly could over the past year to assist those directly impacted by the tragic events of September 11th. Within hours after the terrorists' attacks, SBA mobilized its disaster teams in New York, and, ultimately across the country to help speed the Nation's recovery. Through the unprecedented nationwide expansion of the Agency's Economic Injury Disaster Loan (EIDL) Program, SBA has delivered $1.1 billion in loans to those directly impacted by the September 11th events. I want to again extend my heartfelt thanks to our employees, without whose dedication SBA's compassionate and prompt deliver of services would not have been possible.

Mr. Chairman, as I noted earlier, SBA celebrates its 50th anniversary this year. On August 1st, SBA will honor that anniversary with a ceremony in Abilene, Kansas, the birthplace of President Dwight D. Eisenhower, who signed into law on that very day fifty years earlier the Small Business Act, the legislation authorizing the creation of SBA.

All of us at SBA are quite proud of the Agency's legacy of achievement. Many businesses with household names today received SBA assistance in their formative stages. Who knows which of tomorrow's industry leaders are today receiving their 7(a) loans, their government contracting opportunities, or their counseling through SBA's programs and services?

However, we at SBA cannot rest on our laurels. The Agency must continue to keep up with and ahead of changes in the marketplace.

We at SBA are committed to doing all we can to make sure those entrepreneurs receive all the assistance the Agency and its employees can provide. But SBA cannot do this alone. I want to take this opportunity while we are all together to enroll you in these efforts so that this record of achievement will continue.

SBA's FY 2004 request is a good one for small businesses. It offers an opportunity for us to work together with you, our Congressional partners, to ensure that SBA continues to assist small businesses into its next half-century. We ask for your support for this budget. Thank you for the opportunity to appear here today. I will be happy to answer your questions.

NAGGL

The Answers You Trust
The Training You Expect
The Voice You Need

Testimony for the House Committee on Small Business

Anthony R. Wilkinson
President and Chief Executive Officer

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P.O. Box 332
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February 26, 2003

Before I cover anything else, for the record I want to thank Chairman Manzullo, Ranking Minority Member Velazquez, and the other members of this committee for their efforts in preventing the 7(a) program from disaster. The President's budget for 2003 only requested $4.85 billion, or less than half of the loan demand. Even with the $500,000 cap, I believe that current approval levels show that we would have run out of money this year!

This Committee, however, led the budget fight on two fronts. First, it obtained passage of legislation (S. 141), which will change arcane budget law and allow the immediate use of a new econometric model to estimate subsidy rates. This will immediately reduce the subsidy rate by 41% and increase lending authority by approximately $3.4 billion. And second, the Committee helped to reprogram STAR money which otherwise would have lapsed. This action will add about another $1 billion to this year's level, and hopefully more depending upon OMB action in applying the econometric model to STAR approvals earlier this fiscal year, an action which Chairman Manzullo has described as "the only reasonable interpretation" of S. 141.

Small business borrowers are deeply indebted to all of you for these efforts and I thank you on their behalf and on behalf of the NAGGL members who deliver the 7(a) program.

* *

The National Association of Government Guaranteed Lenders, Inc. ("NAGGL") is a trade association for lenders and other participants who make approximately 80 percent of the Small Business Administration ("SBA") section 7(a) guaranteed loans. The SBA's 7(a) guaranteed loan program has proven to be an excellent public/private partnership. Over the last decade, the SBA has approved more than 424,000 loans for over $90 billion. We thank the Committee for the opportunity to comment on the SBA 7(a) program and on the Administration's fiscal year 2004 SBA budget request.

Since the beginning of "Credit Reform" in 1992, the SBA 7(a) subsidy rate has fallen from a high of 5.21 to the budget level for FY 2004 of 1.02. This represents a more than 80% reduction in the estimated cost of the program to the government. This reduction in subsidy costs has been achieved by improved underwriting guidelines, establishment of lender review procedures, and fee increases on both borrowers and lenders.

There are many positive attributes of the SBA 7(a) loan program, including:

- SBA loan programs provide approximately 40% of all long-term loans (loans with maturities of three years or longer) to small businesses. The SBA is the largest single provider of long-term loans to small business.

- SBA estimates that recipients of 7(a) loans in 2002 created or retained 370,000 jobs.

- SBA 7(a) loans have significantly longer maturities than conventional loans to small businesses. The average original maturity of an SBA 7(a) loan, according to the Office of Management and Budget ("OMB"), is 14 years. By comparison, only 16% of conventional small business loans have maturities in excess of one year, and of those loans, the average maturity is less than four years.

- Longer maturities mean substantially lower monthly payments for borrowers. For example, the difference in monthly payments for a 10 year SBA 7(a) loan compared to a five year conventional loan (which would be above the average maturity for conventional loans), would be 35-40%. This is a significant monthly cost savings for the average SBA borrower who tends to be a new business startup or an early stage company.

- Small businesses do not have the same access to debt-capital as do large businesses. The SBA programs bridge that capital gap.

- The SBA 7(a) appropriations are leveraged almost 99 to 1 by the private sector, making this one of the governments' best and most affordable economic development instruments.

- The SBA 7(a) loan program is just that – a loan program – which helps qualified small businesses obtain the long-term loans they need for growth and expansion. This means jobs, and a "net return on investment" for our local communities and the US Treasury.

Fiscal Year 2004 Budget Request and Current Issues

There are two pieces of the Administration's fiscal year 2004 SBA 7(a) budget request that we will address in this testimony. We will also cover some current issues that we believe deserve attention.

First, the Administration estimates a fiscal year 2004 SBA 7(a) subsidy rate of 1.02%. We will cover this further in another part of this testimony, but the calculation of the 7(a) subsidy rate for fiscal 2004 appears to result in a subsidy rate that is reasonable. We believe that it is still too high, but reasonable estimates can differ.

Second, the Administration proposes a $9.3 billion program level for FY 2004. This number could be as much as 25% below the FY 2003 level, and is more than 16% below the FY 2002 level. Clearly, the Administrations request will not be sufficient to meet the needs of small business borrowers.

Lastly, we will cover the $500,000 loan cap that has been in place until now for this fiscal year and some issues regarding the STAR loan program that expired last month.

SBA 7(a) Subsidy Rate

For several years, NAGGL has testified regarding the Office of Management and Budget's (OMB) calculation of the SBA 7(a) program subsidy rate. We have documented that small business borrowers and lenders have paid well over $1 billion more in fees than were necessary. Our testimony last year included a chart showing that every single dollar appropriated for the 7(a) program since 1995 plus another $260 million had been sent to the Treasury as a result of the 7(a) subsidy rate being miscalculated. We asked for the Committees help in solving this problem, and that is exactly what we got.

Thanks to the leadership and persistence of Chairman Manzullo and Ranking Member Velazquez and their Senate Small Business Committee counterparts, Senators Kerry, Bond and Snowe, and thanks to the help provided by the House and Senate Budget and Appropriations Committees (including the Treasury-Postal and Commerce, Justice, State and Related Agencies Subcommittees), and thanks to many members of Congress who engaged in this issue, the subsidy rate problem is being addressed by the Administration. The SBA has developed a new "econometric model" for estimating defaults that reportedly would lead to a more accurate estimate. NAGGL has not been fully briefed by the SBA or OMB on the new model so we cannot offer an opinion about the model. What we can say is that the results of the new calculation are much more reasonable than before.

In testimony before the House Small Business Committee in 2000, a representative of SBA's CFO's (Chief Financial Officer) office testified that the default rate for the SBA 7(a) loan program was being managed "in the 8%-10% range." In the FY 2004 Federal Credit Supplement to the FY 2004 Budget, OMB estimates the default rate for the SBA 7(a) program in FY 2004 to be 10.43%. That is still a higher default rate than this program has experienced since the implementation of the Federal Credit Reform Act in 1992, but is a default rate estimate that we would not object to given the nature of our economy.

One purpose of Federal Credit Reform Act is to "measure accurately the costs of Federal credit programs." NAGGL is hopeful that the new model being used by the SBA and OMB does just that. We look forward to a full briefing on the new model. We are hopeful that the SBA will show that, had the model been used on previous loan cohorts, it would have proved to be much more predictive than the old model, and that the results are ones that Congress and program participants would have determined to be "reasonable."

I want to offer preliminary congratulations to the SBA for developing the econometric model. It appears to be a giant step in the right direction. I know that many worked long and hard on the development of the model, and I look forward to being able to offer unqualified congratulations in the near future.

FY 2004 Program Level

The Administration has requested only a $9.3 billion program level for FY 2004. The requested level is far below the estimated level of demand of $12.5 billion. The level of SBA 7(a) program usage (including STAR loans) the last several years is as follows:

1999	$9.5 Billion
2000	$9.7 Billion
2001	$9.1 Billion
2002	$11.1 Billion
2003	$11.8 Billion (estimated)
2004	$12.5 Billion (projected)

The Administration's requested FY 2004 program level would be more than 25% below the projected level of demand. A $9.3 billion program would most likely result in the SBA rationing credit, something that the leadership of this Committee has already objected to for the current fiscal year. Chairman Manzullo recently stated "the $500,000 cap, installed last October, has prevented many small businesses from securing the capital they need to expand and create new jobs." We agree.

Small businesses continue to need access to long-term capital. NAGGL requests your support of sufficient appropriations to fund a $12.5 billion 7(a) program for FY 2004. Loan volume for FY 2003 is running ahead of the FY 2002 pace, even though a $500,000 loan cap has been in place. Given the nature of our economy, we believe that the increase in borrower demand will continue into FY 2004. The Administration's proposed program level of $9.3 billion will be insufficient to meet borrower demand. With your support of a $12.5 billion 7(a) program in FY 2004, we hope to avoid the need to put loan size caps in place again.

Current Issues

$500,000 SBA 7(a) Loan Cap. At the start of the current fiscal year, the SBA implemented credit rationing by instituting a $500,000 maximum loan cap. This cap was put in place due to a combination of an inflated subsidy rate and an inadequate budget request. While some borrowers who needed loans greater than $500,000 were accommodated through the STAR program, others were either directed to the 504 program or did not get the financing their business operation needed. But now, even the STAR program has expired. Mr. Chairman, I know you are familiar with Ryden Heavy Hauling of Woodstock, Illinois. That company is reportedly in credit limbo because the operation needs to borrow more than $500,000, and the company does not qualify for the 504 loan program. There are many, many businesses across the country caught in the same credit limbo. Thanks to the passage of H.J. Res.2 and S. 141, we are hopeful that the 7(a) loan size cap will soon be lifted, and borrowers like Ryden can get the loans their operations need.

Subsidy Rate Impact. What the SBA did not discuss when implementing the loan size cap was the potential subsidy rate impact. Since loans over $500,000 pay substantially higher guarantee fees (currently 1% on loans up to $150,000, but 2.5% to 3.5% on larger loans), eliminating large loans from the mix of 7(a) loans puts upward pressure on the subsidy rate. Without larger loans, the subsidy rate will either rise and more money will have to be appropriated to cover the estimated income not collected by loan fees, or costs/fees to borrowers would have to rise. Knowing that the OMB has already overcharged users of the 7(a) program well over $1 billion in the last ten years, further fee increases on borrowers would be unconscionable.

Loan term also plays an important role in the subsidy rate. Longer term loans (15-25 years) have much lower repurchase or default rates than do loans with shorter maturities (7 years or less). Smaller loans are most likely short term loans, while many of the large loans are real estate loans with longer maturities. From data provided by the SBA Chief Financial Officer (CFO) as of 11/30/2002, the following repurchase or default rates highlight that larger/longer maturity loans have much lower purchase rates than do smaller/lower maturity loans:

Cohort	Maturity < 7 years Purchase Rate	Maturity > 15 years Purchase Rate
1992	19.68%	9.65%
1993	16.87%	6.85%
1994	19.02%	5.12%
1995	20.65%	5.17%
1996	20.71%	6.44%
1997	20.09%	5.31%
1998	19.33%	5.47%
1999	14.46%	5.66%
2000	7.55%	3.55%

Loans made prior to FY 1999 have gone through the "peak of the default curve", meaning a significant portion of the defaults in any given cohort has occurred. For every cohort since 1992, the default or repurchase rate on longer term loans has been less than one-half of default rate of shorter term loans.

Because larger loans pay the highest guarantee fees, and because the longer maturity loans have lower repurchase rates, ***larger and/or longer term 7(a) loans subsidize the cost of smaller, shorter term loans.*** Any time the SBA says they want to concentrate on smaller loans (as they do in the FY 2004 budget) or perhaps move 7(a) real estate loans to the 504 program (as they did in the FY 2003 budget), they should also disclose to Congress that those actions will cause the subsidy rate to rise. Properly funding this program is equally important to small 7(a) borrowers as it is to borrower seeking larger loans. The fees of smaller borrowers would likely have to rise if the fees/lower repurchase rates of larger/longer maturity loans are not part of the 7(a) mix.

STAR Program Snafu. The STAR loan program authorization expired on January 10, 2003. For some reason, the SBA PLP center decided to no longer accept applications for processing after 3 pm PST on 1/10/03. This was done without giving any notice to lenders of the 3 pm deadline. Several applications were received in the PLP center after 3 pm and were declined. Borrowers, whose applications were completed with the necessary paperwork to the SBA prior to the expiration of the STAR program, were turned away. In the future, if the SBA is going to set arbitrary deadlines, those deadlines need to be communicated to their lending partners.

Additionally, the SBA has reportedly identified 26 approved loan applications that were not given SBA loan numbers prior to the expiration of the STAR program due to "SBA clerical error." The SBA has told the lenders/applicants that the situation would be resolved, but to date, few if any loans have been formally approved. Six weeks have gone by and these borrowers are still in credit limbo. It is time for the SBA to take the necessary action to get these loans resolved.

STAR Reprogramming. The one unresolved issue for FY 2003, now that H.J. Res 2. has been enacted and S. 141 has been passed by Congress (and possibly signed by the President this week), is whether the SBA will re-score, using the new econometric model, STAR loans made this fiscal year before the expiration of the program on January 10, 2003. Clearly, STAR loans are 7(a) loans, since the terms and fees are identical to 7(a) loans made this fiscal year, and S. 141 provides for the econometric model to be used retroactive to October 1, 2002. The SBA has not responded to any questions regarding its or OMB's intentions to re-score STAR loans made in FY 2003. We believe these loans should be re-scored, and we ask Congress to vigorously pursue this issue if the SBA/OMB does not re-score FY 2003 STAR loans, in order to free up much needed budget authority that could be used to fund loans for the balance of this fiscal year or carried forward and made available for loans next year.

Reauthorization Bill. In the next few weeks, NAGGL will be submitting to the Committee our requests for the upcoming SBA reauthorization bill. NAGGL respectfully requests the opportunity to work with Committee as you develop this reauthorization bill.

Thank you for the opportunity to testify.

Statement of

Donald Wilson

President, Association of Small Business Development Centers

February 26, 2003

Before the

U.S. House of Representatives Committee on Small Business

Chairman Manzullo, Ranking Member Velazquez, and Members of the House Small Business Committee; I am Donald Wilson, President and CEO of the Association of Small Business Development Centers (ASBDC). ASBDC represents the fifty-eight Small Business Development Center programs comprising America's Small Business Development Center Network. SBDC programs are located in all fifty-states, the District of Columbia, Puerto Rico, The Virgin Islands, Guam and American Samoa.

On behalf of the ASBDC, and the nearly 6,000 dedicated men and women serving small businesses through America's Small Business Development Center Network, I would like to thank you, Mr. Chairman, for inviting the Association to testify at this important hearing on the Administration's FY 2004 Budget for the Small Business Administration. In light of the nation's current economic conditions it is extremely important that Congress focus its attention on what federal resources will be allocated to assist and support the small business sector of the economy. I would first like to direct some of my comments to the state of the nation's economy and the overall SBA budget for FY 2004. I will then focus my remaining remarks on the Administration's recommended funding level of $88 million for the Small Business Development Center program for FY 2004. I will seek to highlight for you why the SBDC program needs to be funded at its currently authorized level of $125 million in order to more adequately serve its small business customers.

Members of this committee are keenly aware that the state of our nation's economy is not good. Unemployment in December stood at the highest level in eight years. Last month, employment figures improved slightly. However, those figures are viewed by many such as Ethan Harris, U.S. Chief Economist at Lehman Brothers as possibly aberrational. Richard DeKaser, chief economist at National City Corp. suggests that we should take January's employment figures, "at a little bit less than face value." Skepticism regarding January employment figures is due in part to the fact that new Census 2000 figures were incorporated into unemployment rate calculations for the first time which, I have read could impact seasonal adjustment factors. Also, the normal January layoffs of seasonal holiday workers were less this January than last year because 100,000 fewer workers were added in December of 2002 compared to December 2001 to accommodate holiday staffing needs.

In early February, the New York Times declared the job market the most crushing in twenty years. Last month, companies such as Toys "R" Us, Coca-Cola, Dow Chemical, Circuit City, Applied Materials, Dell Computer and a host of other firms announced job cuts of over 132,000, a 42% increase over the nearly 93,000 layoffs announced in December according to the outplacement firm Challenger, Gray & Christmas, Inc. *The Houston Chronicle* reported in mid January that **job creation in the U.S. was the worst since the 1950's.**

The Houston Chronicle article noted that the total number of unemployed workers in this country increased to 8.6 million this past December, up 82,000 from November, and 381,000 since October. The number of workers unemployed for at least 15 weeks climbed to 3.2 million, up 815,000 for the year. The hardest hit were retail trade employees, who worked in restaurants, car dealerships and general merchandise stores. These types of establishments cut 104,000 jobs in December. Manufacturing continued to contract. There were 65,000 manufacturing jobs lost in December. The manufacturing sector lost 592,000 jobs in 2002 and 2.4 million jobs since April 1998.

People are nervous about their jobs and are cautious about spending. Businesses are not seeing sufficient sales to justify hiring new people or even retaining all of the workers they currently have. Sophia Koropeckyj, an economist at the consulting firm Economy.com says "There's a general paralysis in hiring." Unless action is taken to alleviate that paralysis, where are the 8.6 million workers currently not working to find employment? Where are the roughly 2.7 million high school seniors who will graduate this spring going to find work? Where are this year's graduating college seniors going to look for jobs?

Mr. Chairman, these disturbing unemployment numbers tell us that all is not well with the economy's small business because small businesses over the last decade generated better than 70% of the nation's net new jobs. The well known small business expert, David Birch, stated in a recent interview with *Fortune Small Business* magazine that, " I'd be willing to bet on a net basis, small firms are currently responsible for 100% of job creation." According to Birch, **from 1994 to 1998, a period during which the economy was growing rapidly, large firms lost two million jobs and small companies created ten million jobs.** However, job creation by small businesses has declined over the last two years as America's entrepreneurs struggle with declining sales, higher energy prices, continuing regulatory costs and a growing credit crunch. President Bush stated the issue very clearly in his first State of the Union when he said, "Help for small business means jobs for Americans." That was two years ago and today small businesses are still waiting for some of that help and million of unemployed Americans are looking for those jobs.

Mr. Chairman, ASBDC testified two years ago before this committee and predicted that without additional assistance, small business bankruptcies would increase. The latest data available from SBA's Office of Advocacy confirms that in 2001 small business bankruptcies approached 40,000, an increase of nearly 13% over the previous year. No doubt, newer figures will show those numbers further increasing. And these numbers are not surprising when you take into consideration the fact that a very significant percentage of existing small businesses were not in operation prior to 1992. Many of today's business owners, prior to the year 2000 had never had to manage a business during an economic downturn. Mr. Chairman, business bankruptcies increased 21.8 percent over 2000 in your state of Illinois. And new employer firms were down nearly 2 percent. In Ranking Member Velazquez's state of New York, business bankruptcies increased 24.1 percent in 2001 and business terminations were up 14.1 percent.

The difficult times small businesses are facing are due in part to the fact that the nation's small business sector apparently has become less and less of a priority to those who craft our federal budget. Some will no doubt take issue with my contention that our economy's twenty-two million small business owners are of marginal importance to federal budget makers. I believe, however, that the facts support my contention.

As recently as 1980, the SBA budget was three-tenths of one percent (.3%) of the overall federal budget. Indeed, in 1978 the SBA budget was six-tenths of one percent (.6%) of the budget. But today, the SBA budget is an embarrassingly insignificant four one hundredths of one percent (.04%) of the federal budget. This infinitesimally small figure flies in the face of the fact that the small business sector's share of the nation's gross domestic product has risen in recent years to 52% of GDP or the fact that 51% of non-farm private sector workers are employed by small businesses. Ninety-nine percent of employers today are small business owners. Mr. Chairman, the numbers I have shared with you would clearly indicate that we are neglecting the most critical job creating component of our economy. The small business sector of the economy has performed so well in recent years until the recent downturn that we have come to take this amazing job creation machine for granted. We have come to ignore the fact that there are millions of small businesses out there struggling to survive and that need various forms of assistance.

Some will say that, at a time when war may be imminent, it is not reasonable to expect a larger share of the federal budget to be directed toward the needs of the small business sector of our economy. The fact is Mr. Chairman that, in 1968 at the height of the Vietnam War, the SBA budget was two-tenths of one percent (.2%) of the federal budget. SBA was hardly a budget priority in 1968. However, it was certainly a higher budget priority then than it is today.

Clearly, those in the executive branch who craft the federal budget appear to have a lack of appreciation for the contribution small businesses make to job creation. You would think, however, that those who propose how best to allocate federal financial resources would take note of where the resources they propose to allocate come from. The IRS two years ago reported that 42% of federal revenues coming into the Treasury came from small businesses. Of course these figures take into account employee payroll taxes.

Some would maintain that small businesses do not need or want federally supported management and technical assistance. These voices contend that small business owners simply want lower taxes and fewer regulations. Certainly, most small businesses want lower taxes and fewer regulations, just as larger firms do. But if there is no need in the small business community for non- credit assistance programs, why do the number of clients served by the SBDCs and other non credit small business assistance programs continue to increase? Why are there waiting periods of three to four weeks and even longer at many service centers to see small business counselors? Why do SBDC clients say they could not afford to purchase the same level of assistance?

We believe that the economy is at a critical juncture. There is clearly a need to stimulate the overall economy and a critical need to strengthen the nation's small business sector. We have watched as competing stimulus plans have been developed and proposed. Most of these plans contain very positive elements. For example, many of the plans call for increasing expensing levels from $25,000 to $75,000. These proposals appear on balance to be a positive step. However, many small firms lack the financial resources to purchase $25,000 in equipment, much less $75,000.

Accelerating tax rate cuts will undoubtedly provide some level of benefit to millions of small business owners. However, many small business owners with barely profitable operations will likely realize minimal benefits. And clearly recent studies indicate that the last round of tax rate cuts and rebates did not appear to have provided the level of economic stimulation originally envisioned. It should also be pointed out that the current financial crisis at the state level is adversely impacting efforts to stimulate the nation's economy. As the federal government considers reducing taxes, many state governments are proposing or enacting tax increases in order to meet constitutional requirements of a balanced budget.

On February 11th of this year, the President of the National Conference of State Legislatures testified before the Senate Finance Committee regarding the budget crisis in the states. States are facing the most serious budget problems since the Great Depression. State legislatures face a minimum $68.5 billion budget shortfall for FY 2004. State budget cuts, compounded by proposed federal budget cuts for small business management and technical assistance programs could gravely jeopardize effective delivery of badly needed assistance to the economy's small business sector. As counselors are laid off and service centers are closed, we will unquestionably see business failures increase and job growth remain stagnant.

Just as many small businesses fall on hard times by projecting overly optimistic revenue growth, the same appears to be true at both the state and federal governmental levels. However, many contend that the financial problems faced by state governments appear to be due in part to unfunded mandates imposed by the federal government. We would submit that a major cause of the budget crisis at the state and federal levels is lower than expected revenues resulting in large part from a slow growth economy and a jobless recovery. Forty-five states rely heavily on sales tax receipts. Those receipts are well below projected levels and reflect our nation's slow economic growth and high unemployment. State income tax receipts are off as well, due in part to high unemployment. Members of this committee can well identify with these problems as federal revenues for FY 2003 are projected to be roughly $200 billion below FY 2001 levels.

Mr. Chairman, policy makers at all levels of government are being forced to make difficult budgetary choices. Small business owners make those types of choices every day. Most small business owners understand the need to reinvest in their business if it is to grow and prosper. They spend resources on marketing because they understand those expenditures can increase sales and profitability. Unfortunately, many states are cutting funding for economic development programs when economic development and business assistance programs should be budget priorities in order to begin to grow the economy again. States are also cutting funding for institutions of higher education, institutions that often host SBDC programs and provide part of the match necessary for state programs to receive federal funding. If government fails to reinvest in the entrepreneurial economy it will do so at its own financial peril. Failure to assist the nation's struggling entrepreneurial sector will only result in a continuing downward spiral for government revenues, threatening education, health and safety net programs for years to come. Indeed, to use a metaphor that a resident of America's heartland would understand Mr. Chairman, our failure to invest in small business is like eating our seed corn.

I met in Des Moines, Iowa a few weeks ago with several state legislators from both parties. They indicated they had sharply cut economic development funding last year and that their budget problems have continued. No one should have been surprised by that fact. These lawmakers acknowledged they probably made a mistake.

As a result of the 2000 census, twenty-four states lost federal SBDC funding. They did not lose funding because they had lost population but because the population in those states did not grow as fast as the national average. Last year we urged Congress to provide at least a $105 million appropriation for the SBDC program to insure that federal funding for those 24 states would remain at FY 2001 levels. The Administration recommended essentially level funding. As you know, Congress increased the SBDC program appropriation by about $500,000 for FY 2003 to approximately $88.5 million, well below the $125 million authorized by Congress and this committee. Please understand, we are very grateful for that modest increase. However, an increase of that magnitude clearly fails to address the needs of the small business sector and the overall economy.

America's Small Business Development Center Network will do the very best it can with that level of funding for this year. SBA figures for FY 2002 show that SBDC counseling cases and training attendees combined increased from 610,000 in FY 2001 to 650,000 in FY 2002 despite an increase in federal funding of less than $ 100.000. These numbers represent real people, your constituents with families and dreams. Real people like Dr. Harris Goldberg, a chemist from Hillsborough, New Jersey who was featured in a December 16, 2002 article in the Wall Street Journal. Dr. Goldberg had been laid off, decided to seek assistance at his local SBDC and now has his own successful firm These numbers also reflect the countercyclical demand for management and technical assistance services among our client base and the productivity of SBDC counselors and trainers. But those numbers do not reflect what could be accomplished with a larger appropriation. Based on historical performance levels an SBDC appropriation of $125 million would allow the network to assist its clients in generating over 100,000 new full-time jobs, and increase federal revenues by nearly $270 million and state revenues by nearly $400 million.

Some on this committee may believe that $88.5 million is all the government can afford in the current economic and budget climate and with a war looming. We would submit that the government can no longer afford to continue to neglect the growing needs of the small business sector. Between FY 1994 and FY 2004, federal revenues are projected to increase 26% in real dollar terms. Despite this fact, funding for the SBDC program declined during that same period by 2.6% in constant dollar terms. What kind of message does that send to America's 23 million entrepreneurs? Does the Administration's budget request of $88 million reflect a real belief that small business is the engine of our nation's economy? Clearly a proposed half- million dollar decrease in SBDC federal funding will not contribute to fueling an economic recovery and jobs creation.

To those on the committee concerned about rising budget deficits, let me point out that OMB in its Budget appendix acknowledges that independent studies reflect that the SBDC program has a positive return on investment. A national study of SBDC long term counseling clients (five hours of counseling or more) was conducted last year by Dr. James Chrisman of Mississippi State University. The Chrisman study found that the additional federal tax revenues generated by

SBDC clients who received counseling during 2000 exceeded $182 million dollars. This figure is more than twice the SBDC program's federal appropriation. Those figures, generated at the height of the recession were unusually low for the program. Figures from Dr. Chrisman's year 2000 study reflected a positive rate of return of better than 2.6 to 1.00. Clearly, dollars spent on SBDC management and technical assistance for small business owners are increasing federal revenues. And this does not reflect the true budget impact of the program.

In 2001, according to Dr. Chrisman, the average change in employment for new firms receiving SBDC counseling assistance was more than ten times the rate of employment growth for the average U.S. business. The jobs created at firms assisted by SBDCs reduce the cost of federal income support programs such as unemployment compensation, disability compensation, food stamps, and other safety net programs.

The studies by Dr. Chrisman are replicated by others. In Vermont, a private firm, Economic Policy Resources Inc. found that in 2001, Vermont SBDC business assistance resulted in approximately $3.2 million in new state tax revenues. Economics professors at Ohio University using the nationally recognized Economic Development Modeling Program, IMPLAN, created by MIC, Inc of Massachusetts, found that the Ohio SBDC helped create and save 7,097 jobs and $302 million in payroll in 2001 with a total economic impact of $1.1 billion. A 2002 study funded by the Oregon Economic and Community Development Department and conducted by Campbell –DeLong Resources found that clients of the Oregon SBDC generated $44 million in new payroll, increased productivity by 23% and increased sales by $66.6 million.

Recent and pending state budget cuts in SBDC funding will assure that America's Small Business Development Center network will contract even further this year without a significantly increased federal appropriation. Rural areas which have unique economic development needs have already been adversely impacted by the closing of centers and the laying off of counselors.

Unlike other federal management and technical assistance programs, federal dollars appropriated to the SBDC program leverage roughly three additional non-federal dollars. The decline in state resources as result of the crisis in state budgets cannot possibly be made up from private sector sources in the current economic climate. The federal government needs to recognize the growing financial plight of the SBDC network in these trying economic times. If the Federal government does not allocate resources to the SBDC program at a level approximating $125 million for FY 2004, the management and technical assistance needs of tens of thousands of small firms will go unmet and thousands of private sector jobs will likely be lost. The resulting decline in economic activity will surely have a significantly negative impact on state and federal budgets. The remarkable infrastructure of over 900 SBDC service centers developed over the past twenty-three years will deteriorate even further as more service centers are closed and dedicated counselors are laid off.

I look back at recent historic floods in North Dakota, hurricanes and floods in North Carolina, earthquakes in California, and terrorists' attacks in New York and Virginia. In all of those instances government officials and small business owners in those states turned to the SBDC network in a time of crisis and the men and women of the network performed heroically. And there will be future crises. The question is whether the network will have the capacity to respond adequately to those future crises. The SBDC network is somewhat like a law enforcement officer. We don't respect it until we need it. This remarkable educational infrastructure is no different than roads, bridges, and water systems. If we allow the SBDC network to continue to deteriorate, we will all suffer the consequences.

This committee has a unique insight into the needs of the small business community. You also understand better than most the contribution small businesses make to our economy. In the coming days Mr. Chairman, you will be submitting a letter to the House Budget Committee regarding the needs of programs under this committee's jurisdiction. If this committee will not advocate for small business programs to be a higher priority in the budget, who will? We have watched the SBA budget and its non credit programs remain essentially stagnant or modestly decline in the last five years. And we have watched our economy stall and millions of Americans lose their jobs. The result has been a return of budget deficits and hardship for millions of Americans. Congress need to make some modest adjustments in the Administration's budget priorities. Doubling the funding level of non credit assistance programs at SBA would be less than a rounding error at most other agencies. And compelling evidence exists that increased funding for these programs would more than pay for itself. We appeal to you to forcefully advocate with your colleagues on the budget and appropriations committees to focus renewed attention on the needs of America's small business owners and aspiring entrepreneurs. Benign neglect of the SBDC infrastructure is no longer a viable governmental option.

In closing let me thank you again for the opportunity to appear before you. I also want to acknowledge the outstanding work of this committee in strengthening the 7a and 504 loan programs in recent weeks. These are important programs to SBDC clients and these improvements were long past due.

At this time, I will be glad to respond to any questions that you Mr. Chairman or other members of the committee might have.

Testimony before the House Small Business Committee
Zachary Gast, Policy & Research Manager
The Association for Enterprise Opportunity

Wednesday, February 26, 2003

Thank you, Mr. Chairman and members of the Committee, for the opportunity to testify before you today. My name is Zach Gast. I serve as Policy & Research Manager for the Association for Enterprise Opportunity, which represents more than 450 microenterprise development organizations around the country.

AEO, founded in 1991, provides its members with a forum, information and a voice to promote enterprise opportunity for people and communities with limited access to economic resources. AEO has four policy priorities for this Fiscal Year. AEO would like to see the SBA Microloan program funded at $25 million for both lending capital and technical assistance, PRIME funded at $15 million, the Office of Women's Business Ownership's Women's Business Centers Program funded at $14.5 million, and the CDFI Fund funded at $80 million. I will expand on these requests later in my testimony, but would like to talk about microenterprise development briefly before doing so.

Microenterprises are small business with five or fewer employees with initial capital needs of $35,000 or less. Many microentrepreneurs, particularly those served by microenterprise development organizations, are low income, women, minorities, or disabled individuals who may face other challenges to business success. For example, both the Microloan program and Women's Business Centers predominately serve minorities. A market study completed recently estimates the potential demand for microenterprise services, particularly loans, at more than 13 million microenterprises. Furthermore, the Aspen Institute estimates that there are at least 2-million very-low-income microentrepreneurs in the United States.

Locally based microenterprise development programs provide credit, training, and technical assistance to microentrepreneurs to help them succeed. Microloans are loans of $35,000 or less. Training and technical assistance are typically more intensive services than other business development programs. We provide these intensive services to meet the needs of our target market – which typically requires assistance in developing proficiency with formal business management practices. In fact microenterprise programs consistently provide training and technical assistance to nine entrepreneurs for every loan that they make.

Microenterprise is an effective economic development and self-sufficiency strategy that reduces reliance on public assistance, creates jobs, and raises income, education levels, job skills and assets of poor and moderate-income entrepreneurs.

Conventional sources of business credit, such as bank financing, are often beyond the reach of microentrepreneurs. These potential borrowers often seek very small amounts of capital, have poor credit histories and can offer banks little or no collateral. The SBA

Microloan Program continues to solve this problem by funding community-based intermediaries to help microentrepreneurs gain access to credit. To date, Microloan Intermediaries have made nearly $190 million in loans - averaging less than $15,000 per loan. These loans have resulted in the creation and retention of more than 47,000 jobs since program inception.

As with most entrepreneurs, many Microloan borrowers require specialized technical assistance to grow their businesses. The Microloan program meets this need by providing technical assistance grants to Microloan Intermediaries and Technical Assistance Partners to allow them to provide limited assistance to borrowers in becoming credit-ready and to provide more extensive business technical assistance once they have received Microloans. Technical assistance resources are the key reason that the Program has experienced a low loss rate despite the many high-risk loans that it is able to make.

The $15 million that Microloan received in Fiscal Year 2003 represented a $2.5 million cut in funding, or 14.3%. That however, will not be the true impact on the provision of services. Technical assistance grants are calculated as a percentage of outstanding loans for Intermediaries, which are growing as the program experience more and more success. In 2002, when technical assistance was cut by $2.5 million, technical assistance was actually cut by 40% to Intermediaries. Microloan Intermediaries are being forced to lay off staff and reduce assistance to businesses already – this year's cut will only exacerbate the problems we are seeing.

In order to succeed in our complex economy, microentrepreneurs need training and technical assistance is areas such as financial management, book-keeping and marketing. In fact, a 2002 study by the Aspen Institute found that nearly 90% of microentrepreneurs do not seek microloans, but instead seek training, technical assistance and access to markets services. The Program for Investment in Microentrepreneurs (PRIME) provides grants to microenterprise development organizations to offer training and technical assistance to entrepreneurs, regardless of whether they seek access to capital. Governing legislation stipulates that 50% of the PRIME Act's funds be used to support training and technical assistance for low-income entrepreneurs. A five year study by the Aspen Institute, the Self-Employment Learning Project, found that entrepreneurs receiving these services had highly favorable outcomes in household income and assets, business income and assets and reduced reliance on federal benefits.

The PRIME program is authorized to receive $15 million per year. Last year's $5 million funding level will continue to underfund the program – which has experience incredible demand from both non-profit applicants and low-income entrepreneurs seeking services. AEO strongly encourages Congress to increase funding in the coming year.

The SBA's Office of Women's Business Ownership (OWBO) is the only federal office that specifically targets women business owners. Its Women's Business Centers provide training and technical assistance to women starting or expanding businesses. The Centers are required to target services to economically and socially disadvantaged women, some of whom are microentrepreneurs. The Centers create opportunities for networking among women business owners and are particularly responsive to their needs. Last year alone, Women's Business Centers provided consulting, training and technical assistance to more than 80,000 women.

In conclusion, Mr. Chairman and members, I would like to put a human face on the statistics, facts and numbers I have shared with you today.

In 1997, Deborah Pierce, who lives in Columet Park, IL, was facing a divorce and working two days a week at $10 per hour. Confronted with the need to now support herself, Ms. Pierce approached the Women's Self-Employment Project in Chicago. She enrolled in their Entrepreneurial Training Program and a Financial Education program and opened an individual development account (IDA). Three years ago, she started up a full-service child development center that is now serving 75 children, with a growing waiting list and glowing reputation in the community. The Children's Depot Play Station employs 6 additional individuals and has annual revenue of $245,000 a year. Deborah Pierce's income has increased significantly and she has received a microloan to expand her business. The future is certainly bright for this amazing woman.

Thank you very much for this opportunity. I would be happy to answer any questions at the appropriate time.

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program
Proposed FY 2004 SBA Budget
& OMB P.A.R.T. Performance Assessment

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

by

Mr. Christopher L. Crawford
Executive Director

February 26, 2003

The National Association of Development Companies (NADCO) is pleased to provide a statement to the House of Representatives Committee on Small Business concerning the SBA budget proposed by the Administration for FY 2004. NADCO is the trade association for SBA 504 Certified Development Companies (CDCs). We represent 250 CDCs and more than 175 affiliate members, who together provided 99% of all SBA 504 financing to small businesses during 2002. NADCO's mission is to serve as the key advocate for the 504 program, and to provide program technical support, marketing assistance, strategic planning, and professional education to our membership.

504's objective is economic development and specifically job creation by funding the expansion of successful, growing small businesses. No other Federal economic development program can claim to have created over 1,100,000 jobs, as the 504 program has done. This mission is more important today than ever before, with our economy stuck in neutral at best, and in recession at worst.504 is a critical economic stimulus program designed to assist growing businesses create jobs and invest in their communities.

NADCO would like to thank Chairman Manzullo, Ranking Member Velazquez, and the entire Committee, for continued support of the 504 program. Your Committee has worked closely with the Congressional leadership, SBA, and our industry to ensure the availability of capital to small businesses through the 504 program. We would especially like to thank the Chairman and Ranking Member for their strong support for the econometric subsidy model implementation for 504 during the recent FY 2003 Omnibus Spending Bill debate.

We have two objectives in providing this testimony to the Committee. First, NADCO would like to comment on the FY 2004 SBA budget. This includes the Administration's 504 authorization level, as well as the proposed borrower fees and subsidy model assumptions by SBA.

Second, we will comment on several program issues raised in the *Performance and Management Assessment*, which is part of the Administration's budget proposal.

PROPOSED SBA FY 2004 BUDGET

1. 504 PROGRAM AUTHORIZATION LEVEL

SBA has proposed that the authorization level for the 504 program be set for FY 2004 at $4.5 billion. We recommend a $5.0 level of authorization for 504. As the program continues to fund itself through borrower, CDC, and first mortgage lender fees, there is no cost to the Federal government, nor any Congressional appropriation. With program growth up 30% year-to-date, we are concerned that, should banks continue their tight credit for small businesses, 504 demand may grow at an even greater rate than anticipated today.

The benefits to the country are numerous. New 504 projects provide new jobs in their communities by expanding the plants, equipment, buildings, and employment levels for our borrowers. In turn, this expansion leads directly to new tax bases, including:

- **City & County real estate taxes from new construction projects**
- **State & local sales taxes from increased business revenues**
- **Federal & State income taxes from new and expanding businesses**
- **Federal & State payroll taxes from new employees.**

It is clear that businesses assisted by this no-cost program are contributing to the tax revenues received by all levels of local, State, and Federal governments. We encourage this Committee to support this authorization level during this economic downturn when every job we create is putting an American back to work.

2. 504 BORROWER FEE DECREASE

SBA's proposed FY 2004 budget decreases the annual fee charged each 504 small business borrower from 0.425% to 0.393%. We appreciate this decline in the borrower fee, and hope it is evidence that the subsidy model work of SBA is headed in the right direction.

This "subsidy" model is actually a program cost model. There is no Congressional appropriation needed to provide a 504 subsidy. The fees paid by borrowers, our CDCs, and our first mortgage lenders offset completely the program loan loss expenses. Thus, except for the small SBA staff required to maintain and implement program policy, this is a no-cost program for the taxpayer.

Several factors influence the program cost model, which leads directly to the annual borrower fee. I will address each separately, based on knowledge of our program's true historical portfolio performance, rather than subjective assumptions or arbitrary forecasts.

Loan Default Rate:

The budget states that the 504 loan default rate improves from 8.32% down to 7.52%. While we welcome this improvement, it brings up an issue: How does this new default rate compare to the historical 504 portfolio default rate? The default rate is by far the most influential factor in OMB's calculation of the subsidy cost and the borrower fee.

SBA has previously committed to both this Committee and our industry that, as rapidly as the econometric model of the 7(a) program was completed, work would begin on the 504 model. This would lead to implementation of this model for the FY 2005. Now, we learn through the SBA Budget Request that management has delayed this effort until FY 2006. We sincerely appreciate this Committee's opposition to this delay in the development and implementation of the econometric model.

Any delay will result in all of our borrowers for this year, FY 2004, and FY 2005 being charged fees that we believe to be in excess of those required to fully pay for the program. The new econometric model resulted in a 42% decline in the subsidy rate for the 7(a) program. If 504 received a similar decrease in its subsidy forecasts, the savings to our future borrowers could be substantial. NADCO has calculated that, for FY 2005 borrowers alone, the savings in fees will exceed $100 million for the twenty years of their 504 loans.

We urge the Committee to demand that SBA honor its previous commitment to implement the econometric forecasting model for FY 2005 at the very least, and for FY 2004 if possible. There is simply no reason why our small business borrowers should continue to pay inflated program costs for the next two fiscal years.

Loan Recovery Rate:

SBA's forecast of their recoveries on defaulted loan collateral again declines – to an abysmal 17% from last year's 20% forecast. We do not understand this forecast, given the clear results of two on-going SBA programs. One program, the Congressionally-mandated 504 liquidation program, has had very positive results. With virtually all loans accounted for, the average recovery rate for both CDC and SBA staffed efforts has easily exceeded 45% of the outstanding 504 loan balance.

The other program, the SBA asset sale program, has resulted in sale of about 1,000 504 loans for over $200 million. Again, we have been told for some time that the recovery rate for the asset sales program has exceeded 45%. Even the Administration's own budget last year noted that **"the Agency implemented a highly successful asset sale program and will continue to strategically sell our loan portfolio."** If a 17% net recovery is the definition of highly successful, SBA should seriously consider allowing more private lenders and CDCs to perform the recovery process. Neither the Administration nor this Committee should accept this low recovery rate as the norm.

504 Loan Currency Rate:

SBA forecasts that 504's currency rate will remain the same for FY 2004 as the FY 2002 actual of 99.5% (see page 30, SBA Budget Request & Performance Plan). The footnote explains that this is the rate for the debenture that funds the 504 loan, which is guaranteed by SBA. First, we don't understand why this rate is not 100%, since all debenture investors are being paid their semi-annual principle and interest on time all the time by our Central Servicing Agent. Why is there ANY delinquency in these payments?

Second, why is this statistic relevant to our subsidy model at all? The more important figure is the currency rate of the actual borrower loan portfolio, which the SBA Budget Request indicates is not available from its loan accounting system. We believe that SBA's Central Servicing Agent can readily provide the complete list of delinquent 504 loans and their months in arrears – as they do for every CDC as part of the normal servicing of the portfolio. Added to those few 504 loans that SBA may be directly servicing, the total portfolio servicing rate should be readily available. We note that OMB's PART analysis has also indicated that SBA should improve its financial controls of the program through better analysis of the portfolio and of loan defaults. Given the continued economic downturn, we believe it is critical that SBA improve its monitoring of the portfolio performance, and this begins with analysis of its currency rate.

PERFORMANCE & MANAGEMENT ASSESSMENT

504 PROGRAM P.A.R.T. RATING:

The Office of Management & Budget has devised a means of evaluating Federal programs in order to report on progress on the President's Management Agenda. This methodology is called the Program Assessment Rating Tool, or "PART". This system looks at the following areas:

- Program purpose & design — weight: 20%
- Strategic planning — weight: 10%
- Program management — weight: 20%
- Results/accountability — weight: 50%

OMB has rated the 504 program as "results not demonstrated" during its FY 2003 analysis.

In light of this rating being a major consideration within the Administration's budget activities, NADCO will address two of the critical OMB findings for the 504 program.

OMB Conclusion: 504 and the SBA 7(a) program are duplicative in that both programs provide long-term fixed asset lending (program purpose & design).

NADCO believes that the programs are not redundant. In fact, the two programs are fundamentally very different from one another – as to purpose and to financing structure. The intent of 504 is economic development through job creation. 7(a) provides access to capital.

The 504 program exclusively involves financing long-term fixed assets, and its primary goal is providing community economic development through job creation. 504 does not provide short term or working capital loans. The 7(a) program can meet a variety of financing needs for small business, and its primary incentive is to induce private lenders to offer credit to borrowers who do not meet their regular lending criteria. Thus, 504 generally makes job creation loans to healthy, growing small businesses, while 7(a) may make loans to businesses with generally weaker credit that banks would not normally finance. Note that the results of these characteristics may be seen in the different default rates of the two programs. This demonstrates that each program is addressing its intended audience.

Additionally, the two programs provide very different credit structure to borrowers. Given the deposit volatility for most commercial banks, they will almost always provide variable rate small business loans, often tied to "bank prime". With today's prevailing interest rates, this is attractive to borrowers. However, banks cannot usually maintain such low rates as their cost of funds increases when overall market rates go up. Thus, the annual cost of a variable rate loan is almost certain to increase in the future, creating further risk for small businesses in planning their debt service requirements. To mitigate this risk to both the borrower and the lender, banks will usually provide shorter term loans.

On the other hand, the 504 loan provided by CDCs is always a fixed rate, ten or twenty-year loan. Given its length, businesses use 504 to acquire either expensive heavy equipment or buildings and real estate to house equipment that provides new jobs – the Congressional intent of 504. Further, 504 is viewed by our bank lending partners as an "inducement program". That is, in providing the SBA guaranteed 504 second mortgage, lenders are more favorably disposed to provide attractive terms to borrowers through their 50% first mortgage. They have a better loan-to-value ratio, and thus are taking less risk. This translates directly to improved borrower credit pricing by the bank lender. The result of this "blended" financing package is that a smaller, non-subsidized Federal guaranty leads to a lower borrower cost and potentially less overall risk for the business.

It is clear that neither the terms & conditions, the program structure, nor even the Congressional program objectives are the same for both programs. NADCO believes it makes no more sense to consider combining these programs than putting together 504 and FHA-guaranteed residential lending. We urge rejection by this Committee of any attempt by SBA to combine the 504 and 7(a) loan programs.

OMB Conclusion: 504 has not demonstrated adequate progress in achieving its long-term outcome goals (program results).

The Small Business Investment Act of 1958, P. L. 100-590, and P. L. 101-574 all make clear that the purpose and intended "outcome goals" of Congress for 504 are economic development, community growth, and job creation through provision of long term capital to growing small businesses. Our specific program goals include direct access to capital by traditionally underserved borrower groups, including minority, women, veteran, and rural borrowers.

These Congressional goals could not be more clearly stated, and have long been recognized by this Committee, our CDC industry, our banking industry partners, and even past Administrations. NADCO does not understand how this Administration can suddenly conclude that 504 is now not demonstrating adequate progress towards its Congressional objectives. In fact, the program's successes are numerous:

- Over 1.1 million jobs created or retained for American small businesses.
- Over $42 billion in long term capital provided for economic development.
- Over 45,000 assisted small businesses.
- Over 1 million ADDITIONAL new jobs created by CDCs using grants, loans, and 504 servicing fees to bring other economic development programs to their communities.
- Nearly 50% of our projects used to assist minority, women, veterans, and rural business borrowers.

Incredibly, all of these benefits and results for small businesses are being provided at absolutely no cost to the U. S. taxpayer. The program receives no Congressional subsidy, nor does our industry seek one. We believe the 504 program to be the best economic development tool available today, and suggest that SBA should recognize that the program is achieving all of the objectives set for it by the Congress.

NADCO also believes the 504 program is needed even more during these difficult economic times. Our unemployment rate is at a seven-year high, and traditional commercial lenders have squeezed small businesses by increasing their credit requirements for long term loans. 504 is responding to these problems by bringing reasonable cost, fixed rate capital to borrowers on a nationwide basis.

As part of our on-going program expansion efforts, we have repeatedly recommended a number of enhancements to SBA management. These include:

- Set specific 504 loan production goals for all SBA District Offices. Loan volume varies greatly between offices, with no real explanation other than lack of focus on the program. Goals will result in increased SBA marketing effort and more loans.
- Streamline the loan approval and loan closing processes. Over the last twenty years, SBA has created a bureaucratic gauntlet for our borrowers, bank partners, and CDCs to get a 504 loan authorized and closed by SBA counsel. These processes add little real portfolio risk protection, as demonstrated by the fact that over 99% of all submitted 504 loan applications are approved by SBA staff. They are simply delayed in the pipeline within the field offices. Surprisingly, this has occurred even as much loan volume was shifting to PLP and PCLP, with less work required by SBA staff.
- Take advantage of twenty-first century computer and communications technologies to speed up the loan-making and loan closing processes, improve service to borrowers, and reduce SBA staff time commitments. This would also enable SBA to improve its

loan monitoring by consolidating and updating 504 loan databases.

- Shift at least some 504 processing to more consistent loan review operations at several centralized loan processing centers. While many SBA field offices provide acceptable processing, few uniformly implement the SBA underwriting or closing standards. Further, as SBA continues to downsize its staff, experienced and skilled loan officers are retiring or moving to private lenders that pay better. SBA must consolidate these operations to maintain portfolio quality, meet small business borrower time requirements, and meet agency budget constraints in the future.
- Update the job creation ratio that now stands at one job for each $35,000 of 504 loan provided to a business. This critical program restriction has not been updated since 1989. Commercial real estate costs have substantially increased in these fourteen years. Further, businesses that create skilled manufacturing, sales, technical, and office jobs have seen substantial increases in the facilities and equipment costs to support higher-paying positions that all Americans aspire to. Too many quality businesses are being turned away from 504 because their expansion costs exceed the existing job capital requirement. These are job growth opportunities that are being lost today.

We believe these program changes, and many others recommended over the years to SBA would result in increased loan volume and access to capital by America's small businesses. We urge the Committee to work with our industry to seek such program enhancements immediately.

SUMMARY

Our Certified Development Company industry is focused on meeting today's critical capital access needs by small business. Our CDCs are closely tied to their communities through their membership, their volunteer boards of business, community, local government, and financial leaders. Our success is based on this local CDC board and member involvement, not on Washington bureaucracy. Our CDCs are non-profit, so every dollar of their 504 servicing income goes right back into their communities to build stronger local economies.

CDC skills and commitments are needed today, more than ever, to put people back to work. Our industry's track record for job creation is unparalleled by any other Federal, State, or local economic development program. We hope that SBA and OMB will perceive the importance of this program and our industry in addressing Congressional goals. Finally, we hope that this Committee will assist us as we seek ways to expand and improve the 504 program in the coming years.

Thank you for allowing us to provide our comments. NADCO will be pleased to work with the Committee and the Administration to improve the program and help America's small businesses create more jobs.

NASBIC
America's Small Business Partners

Statement
of
Lee W. Mercer
President

National Association of
Small Business Investment Companies

Before The

United States House of Representatives
Committee on Small Business

February 26, 2003

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Chairman Manzullo, Representative Velázquez, members of the Committee:

On behalf of the National Association of Small Business Investment Companies, I appreciate the opportunity to testify today concerning the Administration's FY 2004 SBIC program budget proposal. I am pleased to report that the budget has the unqualified support of the SBIC industry. We urge the Committee to support the SBIC budget proposal as submitted.

- **Discussion Of The President's Proposed FY 2004 Budget For The SBIC Program**

The budget would make $4 billion in Participating Security leverage and $3 billion in Debenture leverage available to SBICs for investing (together with their required private capital) in U.S small businesses. SBICs are an important part of our national economic recovery. SBA estimates that SBICs currently account for 60% of all venture capital investments—by number of investments. For comparison, in 1997 the number was 38%. The increase is likely to continue to grow in the face of the substantial and continuing contraction in overall venture capital. To illustrate, the number of all annual venture capital investment transactions has dropped by 60% since the high water mark of FY 2000, but the number of SBIC investment transactions has dropped by just 14% over the same period. This data underscores the important countercyclical nature of the SBIC program and the role it will play in our national economic recovery.

As has been the case since FY 2000 for the Debenture program and since FY 2002 in the Participating Security program, the FY 2004 budget provides that the leverage will require no appropriations to establish the subsidy reserves required by the Budget Act. Rather, the budget provides that the leverage subsidy reserves will be supported 100% by fees and interest paid to the government by Debenture SBICs and by fees, prioritized payments, and profit distributions paid to the government by Participating Security SBICs.

For the Debenture program, §303(b) of the Small Business Investment Act (SBIA) provides that one of the fees is annual interest to be paid directly to SBA for leverage drawn with respect to an applicable year's leverage authority. The interest rate varies from year-to-year as required to keep the subsidy rate at "zero" for Debenture appropriation purposes; provided, however, that the rate may not exceed 1.0% per annum. For Debenture leverage drawn with FY 2004 authority, that rate required to maintain the zero subsidy rate will be 0.855% per annum, down slightly from the FY 2003 rate of 0.887% per annum. No change in the law will be required.

SBIA §303(g)(2) provides the per annum counterpart for the Participating Security program. The section provides that a prioritized payment rate of not to exceed 1.38% per annum on any outstanding leverage related to the annual leverage authority in question shall be paid directly to SBA's account to keep the subsidy rate at "zero" for Participating Security appropriation purposes. For leverage related to FY 2003 authority, the required rate is 1.311% per annum. For FY 2004 leverage authority the required rate will be 1.454% per annum, 0.074% greater than current statutory authority. Thus, for implementation of the President's budget as submitted, the authority of SBIA §303(g)(2) must be increased legislatively by 0.074% at a minimum.

The reason the §303(g)(2) rate must be increased this year has nothing to do with assumption of increased losses in the program. Rather, it is because the profit sharing rate that Participating Security SBICs must pay SBA falls as the 10-year Treasury bond rate falls. At current projections for the 10-year rate, the profit share rate is at its lowest point. In essence, all that is happening this year is a reduction in one rate element and a related increase in another.

We suggest increasing the §303(g)(2) "not to exceed rate" to 1.5% per annum as part of the reauthorization process later in the year. That is the same level we suggested in FY 2002. It is well within the ability of SBICs to pay given current market conditions and would not in any way increase the amount paid by small businesses for Participating Security SBIC financing. The latter are set by market conditions; there is no direct correlation between the cost of leverage to a Participating Security SBIC and the amount it can charge a small business. Total annual cost of leverage has been much higher historically than it is today. The estimated total cost of Participating Security leverage for the next year is approximately 6.5% per annum. This compares to the average for the life of the program of 7.84% per annum. Participating Security SBICs using FY 2004 leverage will be well positioned to contribute to the economic revival so important to our country.

- **Reauthorization And The Importance Of The SBIC Program**

In addition to working with the Committee on the suggested change in §303(g)(2), we look forward to working on the reauthorization of the SBIC program that is required this year. In addition to setting maximum permissible leverage levels for the reauthorization period, we believe we will be able to suggest to the Committee one or two changes in the law that will strengthen the program for all stakeholders. At this time we are working with SBA to further define the portions of the law that might be changes to secure the desired goal. The SBIC program is of great importance at this time and deserves our very best legislative effort.

At a time when the U.S. economy can use all the financial help it can get, SBICs are proving their value as steady and reliable sources of venture capital for America's small business entrepreneurs. For the fiscal year ended September 30, 2002, SBICs invested $2.7 billion in 1,979 U.S small businesses. While down 40% from the previous year, the total compares with a drop of 54% in all venture capital dollars invested for the period. The biggest drop in SBIC dollars invested was in those made by unleveraged bank SBICs—a 63% drop compared to only a 16% drop in investments made by leveraged funds. Banks SBIC investments have fallen both because of economic conditions and because banks can now make venture capital investments out of funds established under Gramm-Leach-Bliley authority. Finally, and of the greatest importance, while SBIC dollars invested fell 40%, the number of companies finance dropped only by 12% (from 2,254 to 1,979), indicating that much of the dollar fall can be attributed to lower valuations of companies securing financing. Given the major contraction in the economy, a fall of just 12% in the number of companies supported by SBICs was a positive result.

What will FY 2003 results show? An extrapolation from investment data through January 2003 indicates that dollars invested will remain level or increase slightly, but that there will be a substantial increase in the number of companies receiving financing. Of course, all projections at this time are clouded by the uncertainty related to the situation in Iraq. What can be said with certainty, however, is that the program is strong and that there is continued growing interest in the program by experienced venture capital management teams. That bodes well for the program and, of greater importance, for the small businesses they will finance.

SBICs continued to be a significant source of capital for new businesses, with 48% of all FY 2002 investments made in companies less than three years old. The average size of investments by all SBICs was less than $1 million mark while investments by non-SBIC funds averaged approximately $9 million for the same period. These numbers speak to the importance of SBIC capital to the great numbers of younger, smaller, less capital-intensive companies that become important parts of the economic foundations of their respective communities, particularly in areas that are traditionally underserved by non-SBIC venture capital firms. In this regard, SBICs invest in virtually every state—48 of 50 in FY'02—and are an important source of capital for businesses located in Low- and Moderate-Income (LMI) areas as defined by the government. In FY'02, LMI investments by SBICs totaled $725 million—27% of all SBIC FY'02 investments. The 27% total was up from 22% in FY 2001—a percentage increase of 23% for LMI businesses.

In terms of employment, based on reports to SBA, average employment at SBIC-financed companies in FY'02 was 157. The median number of employees was 29. Based on the average, SBIC-financed companies employed approximately 310,000 individuals in FY'02. With growing capital resources, SBICs are ready to build on that number in the years ahead.

At year-end FY'02, 442 SBICs were managing $20.1 billion in capital resources, up 7% from $18.8 billion at year-end FY 2001. The increase was significant given the contraction in all other sources of venture capital. During FY'02, private investors committed $800 million in new private capital to the 41 new SBICs licensed in FY 2002. The backlog of current license applications at SBA and the rate at which new applications are being received make it likely that as many as 50 new funds will be licensed in FY 2003. This will ensure the continued flow of critical venture capital to the fast growing U.S. small businesses that are the foundation of U.S. job creation and economic growth.

With the jarring economic contraction we have experienced over the past three years, some losses in the SBIC program are to be expected. Economic business cycles apply to SBICs just as they do to all other business endeavors. However, the SBIC program remains strong. The SBIC program is designed to stimulate the flow of scarce venture capital to U.S. small businesses in a way that, over time, produces revenue neutral results for the government in connection with the augmentation of private capital by government-guaranteed capital. Using a complex model, the Office of Management and Budget (OMB) sets "reserves" that must be set aside each year to meet potential out-year losses associated with the program. While there is no "lock box" for the annual reserve amounts, they are made up of fees, interest, prioritized returns, and profit shares paid directly to the government by SBICs and, when required, annual appropriations. The balance of these "reserves" for the period FY'94–FY'02 was approximately $360 million at year-end FY'02. As more SBICs are licensed, more funds are being added to reserves in FY'03. The program is in a strong position to weather the current economic cycle over time while continuing as an important source of capital for starting and expanding U.S. small businesses.

- **Suggested Legislation To Increase Private Capital Investment In Debenture SBICs**

We ask your continued support for legislation that would exclude Debenture leverage from the type of "Acquisition Indebtedness" that automatically creates Unrelated Business Taxable Income (UBTI) for tax-exempt institutional investors that might be inclined to invest in Debenture SBICs. These investors include pension funds, charitable foundations, and university endowment funds. UBTI is subject to filing requirements and taxation and creates an almost total disincentive for tax-exempt investors that might otherwise invest in one or more Debenture funds. The exemption would provide Debenture SBICs with access to substantial sources of potential private capital that are not available to them at present. Representatives Jim Ramstad (R-MN) and Earl Pomeroy (D-ND) have again filed the required legislation in the House—H.R. 739. The legislation is identical to that filed last year with a "scoring" of just $1.0 million per year in lost tax revenue over the next ten years. According to Thomson Financial / Venture Economics of Newark, New Jersey, tax-exempt institutional investors accounted for approximately 65% of all capital committed to venture capital funds in 2001. Virtually none of it was committed to Debenture SBICs. Passage of H.R. 739 would give Debenture SBICs and the small businesses that depend on Debenture financing a fair chance of securing some of the capital these tax-exempt investors are willing to invest in venture capital funds.

The Debenture SBIC program was designed to enable Debenture SBICs to make loans to small businesses that are generally subordinate to, and may be the basis for, more senior credit facilities from commercial banks. As such, these subordinated loans are often critical to the survival of the small businesses that secure them. Such loans are particularly suited for family-owned businesses that may never reach the growth required to "go public," or, for companies whose owners may never want to give up equity in (or control of) their companies by the sale of large blocks of stock. These companies are often found in the heartland of America, not the "hot" locations that typically attract media attention. Nonetheless, these companies are important to America's economic wellbeing in general and the health of their local communities in particular. They are often primary employers in the areas in which they are located.

UBTI is created automatically by Debenture SBICs because the government-guaranteed capital used to augment private capital in the Debenture program is borrowed capital. It is structured that way by the SBIA. The Internal Revenue Code treats the borrowed capital as "Acquisition Indebtedness," indebtedness that triggers UBTI. This serves as a roadblock for Debenture SBICs and should not apply in the context of the SBIC program. The congressional intent of the SBIA is: "to improve and stimulate the national economy in general and the small business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and <u>long-term loans</u> which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization ... <u>provided, however, that this policy shall be carried out in such a manner as to insure the maximum participation of private financing sources</u>." Section 102 of the Act, emphasis added. UBTI rules effectively put 65% of private capital "off limits." To advance the intent of the SBIA, it is reasonable that Congress exclude Debenture leverage from the definition of "Acquisition Indebtedness"—thus removing a major fundraising hurdle for Debenture SBICs and UBTI any income received by a tax-exempt organization that is derived from an investment in an SBIC.

We believe there is an excellent chance for this important legislation to be included in the economic stimulus tax bill that Congress may pass this year. We urge the Committee to work with Messrs. Ramstad and Pomeroy and the Committee on Ways and Means to secure that result.

Thank you again for your consideration our views. We look forward to working with you again this year to further improve the SBIC program and its ability to help meet the venture capital requirements of America's small business entrepreneurs.

Lee W. Mercer

Lee Mercer is president of the National Association of Small Business Investment Companies (NASBIC), having joined the association in that capacity in 1996. NASBIC represents the interests of the SBIC industry before the U.S. Congress and relevant Federal agencies and provides other professional, educational, and meeting services for industry members. SBICs are government-licensed, government-regulated, but privately managed venture capital firms that form the core of a government-industry partnership established to stimulate U.S. job creation and economic development by way of privately managed investments in growing small companies. Four hundred forty SBICs now manage over $20 billion in venture capital resources. Since creation of the program in 1958, SBICs have invested more than $37 billion in approximately 89,000 U.S. small businesses, with $2.7 billion invested in 1,979 companies in FY 2002. Many successful public companies received early venture capital financing from SBICs—including Intel, Sun Microsystems, Federal Express, Callaway Golf, Staples, Mothers Work, and Outback Steakhouse. These and the stories of many other successful SBIC portfolio companies may be found on NASBIC's Internet site at www.nasbic.org.

Prior to joining NASBIC, Mr. Mercer worked in both the private and public sectors. In the private sector, he was a partner in a New Hampshire law firm, a senior program and government affairs manager for computer company Digital Equipment Corporation, and the president of two privately owned small businesses. In government, Mr. Mercer served as legislative director and counsel for former U.S. Senator Warren Rudman (R-NH) and as a deputy undersecretary of commerce at the U.S. Department of Commerce during parts of both the Reagan and Bush Administrations. While with Senator Rudman, Mr. Mercer was the primary manager of the legislation that created the Small Business Innovative Research (SBIR) program. The SBIR program provides more than $1.0 billion per year in federal R&D contracts to small, technology-based companies. During his career, Mr. Mercer has served as a director of several private companies and as a member of several high-level government advisory boards.

Mr. Mercer received his BA degree from Dartmouth College and JD and LLM degrees from Boston University School of Law. He served in the U.S. Marine Corps from 1966 to 1968. He has three sons and lives in Arlington, Virginia with his wife Deborah.

February 27, 2003

BY HAND

Honorable James Nussle
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, D.C. 20515

RE: Budget Views and Estimates

Dear Chairman Nussle:

The Committee on Small Business submits these views and estimates on the FY 2004 budget submission on matters within our jurisdiction in compliance with Rule X, clause (4)(f), of the Rules of the House of Representatives. These views and estimates are based on the outline supplied by the President's Office of Management and Budget (OMB) for FY 2004 as well the Small Business Administration's (SBA) budget submission. The President's proposed budget for FY 2004 emphasizes national defense, homeland security, and economic vitality. A key part of economic revitalization is creating jobs. Small businesses, as job creators, have always led this nation out of economic downturns and they will do so again.

The Committee believes that most of the provisions of the President's budget request are sound and reasonable, particularly as it applies to the SBA.

These views and estimates will be divided between two areas: the impact of the proposed tax relief on small business and SBA programs. Within the SBA, the views and estimates will be further divided into five areas: (1) Financial Programs, (2) Assistance Programs, (3) Disaster Assistance, (4) Salaries and Expenses, and (5) Office of Inspector General.

(1) SMALL BUSINESS TAX RELIEF

The Committee again applauds the President for endorsing further tax relief proposals, which will help revitalize the economy. Key elements of the President's plan, as it impacts small business, include:

- Accelerating the bipartisan tax reductions passed by Congress in 2001, including the individual rate reductions, which help 85 percent of small businesses that pay taxes on an individual, not corporate, basis;
- Making permanent these same tax cuts, including the all-important estate or "death" tax repeal scheduled to take full effect in 2010;
- Dramatically increase small business expensing – what small businesses can deduct immediately off their taxes – from $25,000 to $75,000;
- Abolish the double tax on dividends benefiting many small "C" corporations that retain corporate earnings because they will not face capital gains taxes on the increase in the value of the firm from retained earnings that could have been distributed as dividends; and
- Health care tax policies that will facilitate individuals' purchases of health insurance and health care, including long-term care, which would provide further assistance to help the self-employed purchase health insurance.

While welcoming the President's initiative, the Committee believes the President's tax package could have contained more small business tax relief including:

1. Accelerating depreciation schedules;
2. Increasing the business meal deduction; and
3. Setting a standard home office deduction.

These tax relief priorities would also boost long-term growth that would help small businesses increase cash flow and allow them to add jobs. The Committee will be working on these and other common-sense small business tax relief and simplification initiatives throughout the coming year.

(2) SMALL BUSINESS ADMINISTRATION PROGRAMS

The Committee supports the overall general spending level at the SBA. The President's budget request proposes essentially the same funding levels for the SBA as in last year's request-- $797.9 million. However, the Consolidated Appropriations Resolution for FY 2003 (H.J.Res. 2) provided a total of $736.46 million for the SBA. While many other domestic agencies suffered budgetary cutbacks, keeping spending at the SBA at the same level as in last year's request is an acknowledgment by the Administration of the importance of small business in leading the way in the economic recovery. However, there are still several problems with the budget request, which are discussed in further detail below.

(A) SBA FINANCIAL PROGRAMS

1) 7(a) LOANS

SBA guarantee-backed lending is the largest single source of long-term loans (those with maturities of three years or longer) to small businesses. The 7(a) loan guarantee program accounts for approximately 40 to 50 percent of all long-term loans to small businesses. The President's budget submission for FY 2004 lowers the subsidy rate for the 7(a) program from 1.76 percent to 1.02 percent thanks to the development of an econometric model that more accurately predicts the future performance of the loan portfolio, a long-standing goal of both of our Committees. The President's budget proposes to spend $94.86 million for the 7(a) loan program to support a $9.3 billion program level all without increasing fees on small business borrowers or lenders.

While the Committee has concerns that the proposed $9.3 billion program level may not be sufficient to meet expected demand as other outlets for capital have dried up for small business during this economic downturn, as evidenced by the heavy use of the 7(a) and the Supplemental Terrorist Activity Relief (STAR) loan program during the last fiscal year, the Committee recognizes the proposed funding level matches average historical use of the 7(a) program due mainly to a more accurate subsidy rate calculation. This achievement could not have been achieved without the active support of the Budget Committee, which this Committee is extremely grateful.

2) 504 CERTIFIED DEVLEOPMENT COMPANY (CDC) LOANS

Ever since 1996, the 504 loan program has operated at a zero subsidy rate, which means that the program requires no appropriations. This was accomplished through heavy fees that were placed on borrowers and lenders – fees needed to offset a severe increase in the subsidy rate. The Administration proposes a $4.5 billion program authorization for the 504 program and the Committee concurs. The Committee is also grateful that the President's FY 2004 budget request proposes to decrease the annual fee charged each small business 504 loan borrower from 0.425 percent to 0.393 percent.

While the Committee agrees that no appropriation should be required for this program, the Committee is very concerned that the subsidy estimates for the 504 program are overly conservative and consequently keeps fees to borrowers artificially high. Similar to the problem that faced the 7(a) loan guarantee program, the subsidy rates for the 504 program have not accurately reflected the actual performance of these loan portfolios over the past several years. Instead of being a prudent sinking fund, principally to purchase defaulted loans, the subsidy rate has been continually overstated so as to be a tax and not a responsible user fee. The average 504 loan borrower overpays $10,000 in fees to keep the program operating at no cost to the taxpayer. Budgetary re-estimates calculate that the 504 program has returned more than $400 million to the Treasury since 1997. High fees in the 504 program is one of the main reasons why the 504 program has been underutilized at a $2.5 billion program level each year even though it is authorized at $4.5 billion.

In the progress report mandated by P.L.107-77, the SBA Administrator pledged to work on an interim calculation method for the 504 program in FY 2004 with a final resolution of the problem in FY 2005. However, in the President's FY '04 budget request, there is no interim model for the 504 program, which could have reduced fees even lower than 0.393 percent, and the econometric model for 504 is delayed yet another year until FY 2006. In response, report language was added to the Consolidated Appropriations Resolution for FY 2003 (H.J.Res. 2) directing the SBA to develop an econometric model for the 504 program this year to be ready for the next budget cycle, as originally promised. Again, the Committee would welcome a partnership with the Budget Committee in an effort to obtain a more accurate cost-subsidy rate model for the 504 program.

3) SMALL BUSINESS INVESTMENT COMPANY PROGRAM

The Administration proposes the same program level for both parts of the SBIC program, which is welcomed by the Committee. The Administration requests a $3 billion program level for the debenture program and a $4 billion program level for the participating securities program. When added to the minimum required private capital, this would make $10 billion in new capital available for SBIC investments in small businesses. Venture capital from SBICs fill a critical gap as other private sector sources dries up during this economic downturn. In fact, over 60 percent of all venture capital investments in FY 2002 came from SBICs.

The Administration requests no appropriations to fund either the debenture or the participating securities program in accordance with P.L. 107-100, which placed the entire SBIC program on a zero subsidy or no cost to the taxpayer basis. The Committee concurs with this aspect of the President's budget request. The debenture fees are reduced from 0.887 percent to 0.855 percent while the participating security fees increase from 1.311 percent to 1.454 percent. The participating security fee increase will require a change in the Small Business Investment Act by raising the prioritized payment rate a minimum of 0.074 percent to keep the SBIC program at a zero subsidy rate (currently, the rate is capped at 1.38 percent).

4) NEW MARKET VENTURE CAPITAL COMPANIES

The Committee supports the New Markets Venture Capital Companies (NMVCC) program, which make SBIC-type loans in Low and Moderate Income (LMI) areas. The Committee strongly supports the goal of increased lending in LMI areas. While recognizing that NMVCCs received a one-time appropriation for technical assistance, the Committee remains concerned about the zeroing out the remaining funding for the program, which happened in both H.J.Res. 2 and the President's FY '04 budget request that would delay any future enrollments to create more NMVCCs.

5) MICROLOAN PROGRAM

The President's FY 04 budget requests $1.63 million to support a $19 million program level. The subsidy rate decreased from 13.05 percent to 9.55 percent, which explains most of the decrease from last year's level of $3.6 million. However, the overall Microloan program level was cut too, which concerns the Committee.

(B) ASSISTANCE PROGRAMS

SUMMARY

The FY 2004 SBA budget submission essentially proposes the same request on most its non-credit business assistance programs as last year with a few exceptions. The Consolidated Appropriations Resolution for FY 2003 (H.J.Res. 2) provided for $137.58 million for the non-credit programs at the SBA while the President's FY 04 request proposes a spending level of $141 million. This request is welcome during this tight budgetary environment where many other domestic programs in other agencies are being cut, the SBA assistance programs are kept at a slightly higher rate of funding than last year.

DRUG -FREE WORKPLACE

The Administration requests an appropriation of $3 million in funding for this program, keeping it at last year's request level. However, H.J.Res. 2 provided only $2 million for this program. The Committee strongly supports the President's level of funding for this initiative, which recognizes concrete and significant efforts to improve the small business climate and workplace conditions.

MICROLOAN TECHNICAL ASSISTANCE

The Administration is requesting this time $15 million in technical assistance funds for the Microloan program, which is the same level as provided for in H.J.Res. 2. However, this represents a $2.5 million reduction from the President's FY '03 request. The Committee has concerns about this funding level, noting that the number of firms helped and jobs created or retained through the Microloan program is projected to decrease to pre-2000 levels.

OFFICE OF ADVOCACY

Even though the Office of Advocacy does not receive a direct line-item appropriation, the Committee strongly supports a vigorous Office of Advocacy. The Office of Advocacy serves as an independent voice for the interests of small business through the federal regulatory process and through research projects focused on the role small businesses play in the economy. The President's budget request specifically contains $1.1 million for the Office of Advocacy to support research and economic analysis. All totaled, the cost of the Office of Advocacy is approximately $7.7 million. Over the last few years, the Office of Advocacy has lost staff through attrition. Despite this handicap, the Office of Advocacy saved small businesses $4.4 billion in regulatory costs in FY 2001 and $3.1 billion in regulatory costs in FY 2002 (not counting $18 billion in savings due to revising one Environmental Protection Agency rule), which represents a handsome return on the very modest investment. The Committee doubts that any other government program can match this level of success. The budget request proposes to fund the Office of Advocacy to support a 50 staff, which is the level prior to attrition loss. The Committee strongly supports going beyond this proposal by encouraging a higher spending level and a separate line item for this function.

WOMEN'S BUSINESS PROGRAMS

The Administration proposes funding the Women's Business Council at $750,000, which is the same level as last year's request and in H.J.Res. 2. The Administration also proposes level funding the Women's Business Centers at $12 million, which is the same as last year's request but $500,000 less than provided for in H.J.Res. 2. The Committee supports level funding for these programs.

BUSINESS INFORMATION CENTERS/US EXPORT ASSISTANCE CENTERS

The Administration proposes level funding for BICs at $475,000, which was the amount provided for in H.J.Res. 2. However, no funding was provided for USEACs in H.J.Res. 2, which is of great concern to the Committee. The Committee supports the President's FY '04 budget request of $3.1 million to pay for the SBA share of the USEAC program to help small business exporters, a key concern of this Committee.

SMALL BUSINESS DEVELOPMENT CENTERS (SBDCs)

The Administration proposes the same request as last year for the SBDC program at $88 million. However, H.J.Res. 2 provided an additional $1 million over the President's request for a regulatory compliance simplification program to increase coordination of environmental, Occupational Health and Safety Administration (OSHA), and Internal Revenue Service (IRS) compliance requirements and to avoid duplication among programs for compliance assistance to small businesses. This initiative is a down payment on a very similar idea to what the Committee has been trying to do for many years in setting up pilot programs around the country where selected SBDCs could provide regulatory compliance counseling to small businesses. Currently, this idea has been reintroduced as the *National Small Business Regulatory Assistance*

Act of 2003 (HR 205), which the Committee strongly supports. Thus, at a minimum, the Committee supports the same $89 million level of funding for SBDCs as contained in H.J.Res. 2.

The Committee is once again pleased that this budget request does not contain the proposal to require SBDCs to charge counseling fees. The Committee has held numerous hearings and has voted against this proposal in the past. The Committee believes this budget request is the minimum level of support that is needed for the SBDC program.

BUSINESS-LINC

This is a relatively new authorized program designed to encourage large business to small business mentoring. The Administration once again proposes to eliminate this program. H.J.Res. 2 provides $2 million for this program in FY '03. There are several Members of the Committee who take a personal interest in this program because they believe the mentoring received in this program is qualitatively different from other SBA mentoring programs that are more focused around government procurement opportunities. However, there are many companies that already engage in this type of mentoring on their own. Perhaps if the SBA made more of an effort to link up existing private sector efforts with interested small businesses, particularly from low- and moderate-income areas of our nation, the Administration's proposal would be more acceptable to the Committee.

PRIME

The Administration's budget proposes elimination of this program. H.J.Res. 2 provides $5 million for PRIME Technical Assistance. In previous views, the Committee expressed strong reservations regarding this program and its potential for duplication of existing SBA efforts. The legislation authorizing this program was not the language approved by this Committee to prevent such duplication; consequently the Committee supports its elimination.

SERVICE CORPS OF RETIRED EXECUTIVES

The Committee welcomes the Administration proposal to fund the SCORE program at $5 million, which was the same level as requested in the President's FY 03 budget and as provided for in H.J.Res. 2.

VETERANS BUSINESS DEVELOPMENT ASSISTANCE

The Committee supports this request for $750,000 to fund implementation of the provisions of P.L. 106-50 that still fall within the SBA, which is the same level as requested in the President's FY '03 budget request and as provided for in H.J.Res. 2. Even though the National Veterans Business Development Corporation is formally out of the SBA's annual budget request and is funded under a separate line item as an independent agency, the Committee is still very much interested in its work, particularly on monitoring its path towards financial self-sufficiency. In keeping with the path outlined in P.L. 106-50, the Administration has requested $2 million for the Corporation in 2004, which the Committee supports, keeping the NVBDC on a glide-path towards not needing any more federal appropriations by the 2005 budget cycle.

NATIVE AMERICAN OUTREACH

The Committee remains concerned that a proposed $1 million outreach to Native Americans, which was contained in the President's FY 03 budget request, has now been rescinded, particularly after Congress built on this proposal by including $2 million for this initiative in H.J.Res. 2. This initiative is expected to assist small business and economic development only in the most disadvantaged tribal areas, particularly in remote areas. In 2001, the House passed HR 2538, the *Native American Small Business Development Act*, authored by a Committee Member and will hopefully will soon be reintroduced, which would funnel grants to existing state Small Business Development Centers (SBDCs) to establish training programs and services unique to Native Americans. The Committee believes this is a better and more comprehensive approach to help Native American small business development, working through an established network of experts in the field to help advance the goal of assisting only the most disadvantaged tribes as envisioned by H.J.Res. 2.

GOVERNMENT CONTRACTING

For FY 2004, the President's budget request proposes the same level as in the previous FY 2003 request. However, H.J.Res. 2 made several changes to the President's FY '03 funding proposal – 7(j) Technical Assistance was cut by more than half to $1.5 million; and funding for some other programs such as Small Business Innovation Research (SBIR) Technical Assistance and HUBZones were eliminated altogether. The Committee supports the President's FY '04 requests for these programs, particularly the $2 million for the HUBZone program.

WHITE HOUSE AND STATE CONFERENCES

Last year, the Administration's budget request contained a new proposal to spend $1.5 million to fund a series of state and federal conference to celebrate the success of small business over the past 50 years and to highlight the emerging issues that face small business owners in anticipation of passage of legislation to authorize these conferences. Congress did not pass this legislation last year and no funds were appropriated for such a purpose in H.J.Res. 2, thus, there is no request for funding this year. The Committee supports this change.

(C) DISASTER ASSISTANCE

With the various supplemental appropriations added to the regular appropriation for the SBA disaster loan in response to the terrorist attacks of September 11, 2001, the President's FY 2004 budget request for disaster loans is reasonable. The budget proposes $89 million (with $10 million in carry-over from prior years) to support funding $760.3 million in disaster loans, based on a five-year average at a 11.72 percent subsidy rate, which is a decrease from 13.98 percent. Unlike previous requests, there is no proposal to raise interest rates on disaster loans for anyone. It continues to remain the view of the Committee that during a time of natural disaster, our government should not compound an already difficult recovery period by imposing higher interest rates on small business borrowers. Also, the Administration plans to develop a more accurate subsidy-rate cost model for the disaster loan program, which could produce an even lower subsidy rate. The Committee supports this endeavor.

(D) SALARIES AND EXPENSES

For FY 2004, the Administration requests essentially the same level as last year -- $362 million for SBA's operating budget. Also, the President's budget request anticipates no change in the total employment levels at the SBA from this fiscal year to the next. However, the Consolidated Appropriations Resolution for FY 2003 (H.J.Res. 2) included $314.46 million for the salaries and expenses account of the SBA. In addition, there is some confusion between the Full Time Equivalent (FTE) numbers provided in the SBA budget submission (3,927) versus the FTE numbers provided in the budget documents provided by the Office of Management and Budget (3,802).

Included in SBA's operation budget proposal is $21 million for initiatives designed to improve the operational efficiency and service to its customers; $11 million to support Electronic-SBA initiatives (E-SBA); $4 million to modernize and streamline SBA internal processes; and $500,000 for "outsourcing" analyses. While many of these objectives of these initiatives are commendable, they are similar to requests proposed last year that were rejected in H.J.Res. 2. The Committee remains skeptical as the need for all these initiatives yet the employment levels will still remain the same at SBA.

The Committee also encourages the SBA to begin to focus on the problem of reversing "institutional memory loss" at the agency, as it will soon lose a significant portion of its senior career FTEs over the next decade because of retirements.

(E) OFFICE OF INSPECTOR GENERAL

The President FY 2004 budget request proposes $14.5 million for the Office of Inspector General and $500,000 transferred from the administrative expenses of the disaster loan program for a total of $15 million. The Consolidated Appropriations Resolution for FY 2003 (H.J.Res. 2) provided $12.4 million for the Inspector General of the SBA to be supplemented by an additional $500,000 from the disaster loan account. The Committee supports the President's budget request for the Inspector General to protect the interests of the taxpayer and the integrity of the programs of the SBA.

CONCLUSION

Overall, the President's budget request for small business can be supported, with modest exceptions, both in terms of his tax relief proposals and the SBA budget. In particular, the

SBA's FY 2004 budget does not repeat most of the mistakes from previous budget requests. The Committee acknowledges the Administration for changing these prior contentious proposals on behalf of all small businesses. There is only one major item of contention, and the Committee on Small Business looks forward to working with you again, Chairman Nussle, to help resolve the subsidy rate calculation problem in the 504 loan program at its relationship to the Federal Credit Reform Act of 1990.

Sincerely,

Donald A. Manzullo
Chairman