United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510–6350

February 20, 2004

The Honorable Don Nickles
Chairman
Committee on the Budget
United States Senate
Washington, D.C. 20510

The Honorable Kent Conrad
Ranking Member
Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Don and Kent:

As the Ranking Democratic Member of the Committee on Small Business and Entrepreneurship, I submit the following views and estimates on the President's FY2005 budget request for the Small Business Administration (SBA or Agency) and other matters under the Committee's jurisdiction in compliance with section 301(d) of the Congressional Budget Act. I thank you for considering these views as you prepare the FY2005 budget.

FY2005 Budget Request Overview for the SBA

The Administration has requested $678.4 million for the SBA's FY2005 budget. This request is 15 percent less than the $798 million the President requested last year, and it is the most extreme budget request of all four years. Going beyond the proposed cuts of previous years, the FY2005 budget request eliminates all funding for the Agency's largest loan guarantee program, terminates the Agency's program for microloans, and terminates half of the Agency's 20 counseling and contracting assistance initiatives. Though the Committees on Budget and Appropriations historically have restored much of the funding that this Administration has proposed to cut to mitigate the impact on small businesses and the local economies, the cumulative effect of these reductions every year for the past four years has given SBA the unfortunate distinction of being the most cut of all 26 Federal Agencies. To put this in perspective, the SBA has cumulatively had its resources reduced under this Administration by almost 25 percent, whereas the Agency with the next most cuts is the Corps of Engineers with a 15 percent cut followed by the Department of Transportation with a cut of 8.3 percent. I respectfully request that as you prepare the FY2005 budget resolution, you consider including $204 million for the SBA, bringing total available funds for that agency to $882.4 million.

Of the four accounts through which the SBA is funded, I am particularly concerned about the budget requests for loans under the Business Loans Program Account and for entrepreneurial development programs under the Salaries and Expenses Account.

Business Loans Program Account - 7(a) Loan Guarantee Program
Repeating the rejected budget request of FY2002, the budget request of FY2005 eliminates all funding for the 7(a) Loan Guarantee Program. It shifts most or all of the cost to the borrowers and lenders, who have overpaid more than $1.2 billion since 1992, by requiring the participation fees to increase. This will severely impair the program's ability to serve the full range of small businesses it serves today. Further, it will lead many smaller lenders, particularly those in less populated states, to drop out of the program, virtually eliminating access to credit for the small businesses they serve. This is diametrically opposed to the direction Congress set for this program two years ago in a bipartisan fashion when, to make the fees fairer, it rolled back the amount of the fees. The Senate endorsed this approach when it voted last September to make the lower fees permanent as part of S. 1375, the SBA's comprehensive three-year reauthorization legislation.

Based on information from the SBA's Office of Advocacy and the FDIC, the SBA loan programs as currently structured are the largest source of long-term capital for small businesses in this country. The 7(a) loan program alone provides an estimated 40 percent, making it indispensable to the small business community. It is also one of the greatest stimuli for job creation: according to the SBA, for every $33,000 loaned, one job is created or retained. That means for about $101 million invested in this program last year, some 350,000 jobs were created or retained. This is a cost of approximately one dollar for every $100 loaned. Very few federal programs can show so much bang for the buck and these figures do not take into account gains in tax revenues or other economic benefits. To preserve and empower the 7(a) Loan Guarantee program, I respectfully request that you budget enough in appropriations to fund $13.5 billion in loan guarantees for FY2005.[1]

I have two additional concerns about the 7(a) Loan Guarantee Program: 1) the Agency's imposition of a separate subsidy rate for loans sold on the secondary market, with a limit of $10 billion; and 2) the Administration's FY2004 mid-year change of the subsidy rate. According to the FY2005 Budget Request, the Administration is imposing a second subsidy rate on the 7(a) Loan Guarantee Program. In addition to a subsidy rate relating to loan originations, beginning in FY2005, 7(a) guaranteed loans sold on the secondary market will have a separate and additional subsidy rate. Essentially, this amounts to double charging the business community for certain 7(a) loans. While the Administration argues that there is separate risk for these loans, experts

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[1]The SBA has not responded to Committee requests to explain the FY2005 cost of the program in appropriations if the fee reductions are made permanent. However, because the FY2005 Budget Request characterizes the proposal as a savings to taxpayers of about $100 million to provide $12.5 billion in program level, we can assume it is about that amount. We will not know for certain until the Agency is forthcoming with the requested information. Once the Committee on Small Business and Entrepreneurship receives this cost breakdown, we will forward it to the Committees on the Budget and Appropriations.

argue that the master reserve fund for SBA's 7(a) secondary market has never missed a payment to the investors and that the issues identified by the SBA's Inspector General and the General Accounting Office would be better, and more fairly addressed, through programmatic and management changes. There are great fears among the small business community and supporters of this program that this new subsidy rate will ultimately hurt the delivery of loans to small businesses. There are also concerns that the Agency will not work with the lending community and Congress to devise improvements to the program which are workable and acceptable to all parties. I ask for your support in eliminating the $10 billion program cap and to rejecting the imposition of a separate subsidy rate.

The fears that future 7(a) secondary market subsidy rates will not be accurate or will treat borrowers, lenders and investors unfairly are not unfounded. Just this year, the SBA changed its subsidy rate for the 7(a) Loan Guarantee Program from 1.02 percent to 1.06 percent, as noted in the FY2004 Omnibus Appropriations Act. This action contradicts testimony from the Office of Management and Budget before our Committee in September 2001 in which the Committee was told that the budget could not be changed mid-year, even when it includes a mistake or acknowledged problem. In FY2004, the subsidy change used up appropriations that otherwise could have resulted in $375 million in loans, denying as many as 1,500 small businesses hard-to-access capital. This reinforces distrust towards the SBA and the OMB because, despite testimony to the contrary, the Administration can change the budget when it is to the benefit of the government but not when it is to the benefit of the small business community.

Business Loans Program Account - The SBA Direct Microloan Program

The SBA's FY2005 budget proposes entirely eliminating the microloan program, and all assistance to micro-entrepreneurs. The SBA contends this is justified because the Microloan program is "excessively expensive relative to alternative programs," specifically naming the 7(a) SBAExpress Loan Program as an example. This comparison is unfair and overly simplistic. While both programs do make small loans, they do not serve the same size or type of borrower. The SBA microloan program reaches those with the least access to capital and the least access to opportunities and tools for becoming economically self-sufficient. The average loan in the microloan program is $11,000. The average loan in the SBAExpress Program is $47,000. The 7(a) SBAExpress lenders use credit scores to determine eligibility, which work against minorities and women, and generally will not lend to those with a score of under 640. SBA micro-lenders have borrowers in the 500 score range.

SBA's mission is to fill the financing gaps in the private sector, and commercial lenders will not make microloans because they are not profitable enough and the counseling is too time-intensive and expensive. The need remains for the SBA's microloan program, its microloan technical assistance component, and also the PRIME program, described later in this letter. I respectfully request that the FY2005 Budget Resolution include $35 million in program level for microloans ($3.3 million in budget authority), and $35 million for microloan technical assistance. The technical assistance is key to the success of the borrowers and therefore repayment of the loans. The lenders will not make the loans without the technical assistance. Though the direct loans and the technical assistance have separate line items in the budget, they are one program, designed to work together and proven to be extremely successful. Since the first microloan was made in 1992, the program has only had one loss. Few programs can match that success. I certainly support efforts to reasonably reduce program costs, but this proposal to substitute SBAExpress for microloans and technical assistance is nothing more than another problematic funding scheme that sends the wrong message to the women, veterans, African-Americans and Hispanics who are the main borrowers of SBA microloans.

Business Loans Program Account - 504 Loan Guarantee Program

The SBA's FY2005 budget fails to recognize the increased loan demand for the SBA 504 Loan Program, SBA's program to spur economic development by helping small businesses buy or expand their plants or equipment. The program is growing, up almost 28 percent in lending dollars in FY2003 compared to FY2002, with the possibility that more small businesses could turn to this program if banks ration credit further. The small business community has requested an increase in the 504 authorization from the President's request of $4.5 billion to $5 billion. As you know, these loans have long terms and fixed rates, and cannot be used for working capital. It is a proven job-creation program that by law requires a business to create one job for every $35,000 loaned, and it is funded entirely through borrower and lender fees. Last year, small businesses borrowed $3.1 billion in SBA 504 loans and created an estimated 90,000 jobs. I strongly disagree with the SBA's continued efforts to steer borrowers from the 7(a) Loan Guarantee program to the 504 Loan program if they are seeking a larger loan because I believe the borrower should get financing based on its needs and which program best meets those needs. Not all large loans are the same, just as not all small loans are the same. I request that the Budget Resolution recognize the value of this assistance and increase the program level from $4.5 billion to $5 billion for FY2005.

Salaries and Expenses Account

For the SBA's entrepreneurial development programs, this is the most damaging budget the Committee has received in four years. If enacted, the Administration's proposals will all but decimate entrepreneurial development assistance - particularly for those who need it most: women, minorities, and low-income enterpreneurs. The FY2005 Budget for SBA proposes terminating 10 of the 20 programs at the SBA, cutting three, and flat-funding seven. All of these programs are designed to provide targeted, expert, and unique assistance to sectors of the small-business community that have few, if any, other resources. In the end, these programs help create jobs, spur economic growth, and return more to the Federal government than they cost.

Cuts to or inadequate funding of the SBA's entrepreneurial development programs are routinely attributed to vague and unfounded claims of duplication. Such claims mistake a common mission of training and counseling for duplication, ignoring the reality that small businesses vary greatly and have different needs. Just as it would be ineffective to only have one type of loan or venture capital financing structure for the 23 million small businesses in this country, it would be ineffective to water down specialized management and training programs to impose a one-size-fits-all approach.

These programs are cost-effective, returning much more to the economy in taxes and job creation than the Federal investment. Most of these programs have cost-sharing components with state and local entities, such as matching grants, so they leverage more for small businesses than the face value of the Federal grant. Moreover, where these small businesses have the SBA guaranteed loans, business training and counseling protects the taxpayer investment because the borrower is more likely to operate a successful business and to repay a loan.

Salaries and Expenses Account- PRIME Program

As important as capital is to entrepreneurs, loans are not always the answer. According to the well-respected Aspen Institute, 90 percent of micro-entrepreneurs do not seek microloans but instead training, technical assistance and access to market services. The Program for Investment in Micro-entrepreneurs (PRIME) fills this need by providing grants to micro-enterprise development organizations to offer training and counseling to entrepreneurs, 50 percent of which must be used to help low-income entrepreneurs, regardless of whether they seek access to capital. The International Labor Organization estimates that the return on investment in microenterprise development (through programs like PRIME) ranges from $2.06 to $2.72 for every dollar invested. Microenterprise contributes to our national economy through public tax revenues, increases in personal income, and reduced dependence on public assistance, such as Welfare. For the fourth year in a row, the budget eliminates all funding for this program. I request the full authorized amount of $15 million for the PRIME program.

Other necessary non-credit programs for small businesses were cut or all together eliminated. The SBA expects the Small Business Development Centers (SBDCs), Service Corps of Retired Executives (SCORE), and the Women's Business Centers (WBCs) to fulfill the duties of eliminated programs without additional funding. In fact, the SBDC and WBC programs are expected to take on significantly more responsibilities with less funding in FY2005. For BusinessLINC I request $2 million, for WBCs I request $14.5 million, for the U.S. Export Assistance Centers (USEACs) $3.1 million, for Veterans Outreach $1 million, $7 million for SCORE, and for the SBDCs I request $125 million. The Administration requested only $88 million for the SBDC program, a reduction of $1 million from last year's funding. The SBDCs served more than 685,000 small businesses across the country last year, providing more than 3.5 million hours of invaluable business counseling and training. An increase of $37 million for a total of $125 million in grants to states is substantial, but it is necessary to compensate for funding losses caused by the 2000 Census and to restore matching funds from the states. Twenty-four states have seen their Federal SBDC funding reduced. They did not lose funding because they lost population or performed poorly, but because the population in those states did not grow as fast as the national average. This could be rectified at a time when Congress should be strongly supporting small business, our country's biggest job creator.

Salaries and Expenses Account - Native American Outreach

I am disappointed that for the second year in a row the Administration eliminated all funding for Native American Outreach. With unemployment rates as high as 70 percent and poverty rates well above the national average, Native American communities need a commitment from the Federal government to build sustainable economic opportunities in their communities. In the FY2003 Omnibus Appropriations Act Conference Report, the Conferees provided $2 million for Native American Outreach and said in the Explanatory Report that they "expect the SBA to develop a strong outreach capacity with this initiative to ensure that underserved Native American tribes have the opportunity to participate in this program and other SBA non-credit and loan programs." Consistent with the level provided for in the FY2003 and FY2004 Omnibus Appropriations Act Conference Reports, I respectfully urge you to provide $2 million for the Native American Outreach program in the FY2005 budget.

<u>Salaries and Expenses Account - 7(j) Technical Assistance Program</u>
The 7(j) Technical Assistance program which provides essential technical assistance to developing minority-owned 8(a) companies was cut by approximately 25 percent, a reduction of almost $500,000. The lack of effective technical assistance that trains these businesses in areas such as accounting practices, how to bid on Federal contracts, and writing Federal grant applications has been repeatedly listed as the main reason why so many 8(a) companies fail after graduation from the program. Sufficient technical assistance funding will allow these companies to gain the management, self-marketing and proposal-writing skills needed to compete with larger firms after graduating from the program. I request that you include $2 million in the budget to ensure that these developing firms receive the training they need to successfully compete in the Federal procurement arena.

Thank you for the opportunity to comment on the FY2005 budget request as it affects programs within the Committee's jurisdiction, and thank you for your past support of SBA assistance which helps small businesses in every state thrive and grow. I look forward to your continued support and to working with you to develop this portion of the Budget Resolution for FY2005 so that it has reasonable funding of $882.4 million to give much needed help to American small businesses and in turn to the local communities they help prosper.

Sincerely,

John F. Kerry
Ranking Member