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

March 2, 2006

The Honorable Judd Gregg
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 Judd 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 FY2007 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 the Committee's views as you prepare the FY2007 budget.

<u>FY2007 Budget Request Overview</u>

The President has requested $624 million for the SBA's FY2007 budget. According to the SBA, taking into account adjustments for disaster loan funding and Congressional earmarks, the President's request is $17 million less than funding available in FY2006. When put into context, if adopted, the FY2007 budget would mean that the SBA has been cut 41 percent, maintaining its status as the federal agency that has been cut the most since President Bush took office.

To realize those cuts over the years, the President has made the SBA's loans and venture capital more expensive by raising the fees on borrowers and lenders; has caused credit rationing and the shut down of the SBA's largest loan program because of inadequate funding and lack of oversight; has reduced counseling to businesses; has been lax in its oversight of federal contracting, causing small businesses to lose billions out of the $300 billion in federal contracts; and has mismanaged the disaster loan program, which was on the brink of being shut down twice last month, with 130,000 Gulf Coast business owners and homeowners still waiting for their loan applications to be processed.

The President's FY2007 budget request will only exacerbate the past problems as the SBA tries to meet the needs of the country's small businesses. Specifically, the FY2007 budget would eliminate the SBA's microloan programs; cut the Women's Business Centers and the Small Business Development Centers after five years of flat-funding; fold four critical programs into the Agency's operating budget by eliminating their line-item funding, which will prevent Congress and the public from viewing the amount of funds spent on these initiatives that serve under-represented groups in our communities; impose a new fee on borrowers seeking loans and venture capital from the SBA; and increase the interest rates that borrowers pay for disaster loans. These cuts and proposals are unwarranted, and I respectfully request that as you prepare the FY2007 budget resolution, you consider restoring $150.1 million[1] to the SBA, bringing total available funds to $774.1 million.

Business Loans Program Account

There are several problems with the President's proposals for the SBA's loan and venture capital programs. One of the most controversial is a proposal to impose a new fee on borrowers seeking capital through the SBA's 7(a) and 504 Loan Guarantee programs, which are for working capital as well as property and heavy equipment, and through the Small Business Investment Company (SBIC) venture capital program. Specifically, borrowers would pay a fee on deals of more than $1 million to cover the SBA's administrative costs. According to the SBA, 7(a) borrowers would pay $625 more per loan, 504 borrowers would pay $1,625 more per loan, and companies that get an SBIC investment would pay an additional $45,000. Nationwide, that would impact 3 percent of all 7(a) borrowers, 15 percent of all 504 borrowers, and the majority of all SBIC investments. The SBA estimates that this would generate $7 million for the federal government. Considering the fact that these programs already operate at a zero subsidy, and that the fees keeping the program at zero subsidy are already excessive, amounting to more than $1 billion in overpayments,[2] it is unreasonable to impose a new fee and set a precedent of charging borrowers and lenders for the SBA's administrative costs. The SBA has never charged borrowers or lenders fees to cover administrative fees, and we should not start now. I therefore recommend that the Budget Committee reject this proposal and restore $7 million to the SBA's budget for FY2007.

Another controversial proposal would eliminate the SBA Microloan program, and all assistance to micro-entrepreneurs. This is the third year in a row that the President has recommended eliminating the SBA's microloan programs, and I continue to strongly oppose this idea. Once again, the SBA contends that eliminating the Microloan program is warranted because it is excessively expensive relative to the SBA's other loan programs and because microloan borrowers can be served through the SBA's 7(a) Community Express Loan program. The SBA's argument has shifted over the years, from contending these borrowers could be served by the general 7(a) loan program, then the 7(a) Express program, and now the 7(a) Community Express Loan program. In spite of the fact that the SBA has never validated these claims, the comparison, in general, to any of these programs, continues to be overly simplistic. While both the Microloan and 7(a) Community Express programs do make small loans, they do not serve the same type of borrower. The SBA's microloans reach borrowers with average credit scores of

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[1] Including $7 million to offset the proposed 7a/504/SBIC administrative fee on small business borrowers; $1.4 million to leverage $20 million in program level for Microloans; $17 million in program level for Microloan technical assistance; $15 million for PRIME; $24 million for the New Markets Venture Capital program; $41 million in order to offset the cost of not raising disaster loan interest rates; $23 million to increase funding for SBDCs from $87.1 million to $110 million; $4.7 million to increase funding for WBCs from $11.8 million to $16.5 million; $1.5 million to increase funding for the 7(j) technical Assistance Program from $1.5 million to $3 million; $3.5 million to increase funding for the USEACs to $5 million from the $1.5 million they were directed to spend by Congress in FY2006; $2 million to increase funding for SCORE from $4.95 million to $7 million; and $10 million for Procurement Center Representatives.

[2] President's budget, "Table 8. – Loan Guarantees: Subsidy Reestimates" and GAO report (GAO-01-1095R), "Small Business Administration Section 7(a) General Business Loans Credit Subsidy Estimates."

550 and representatives of the 7(a) lending community and banks have told the Committee that they will not make loans with such low credit scores.

As for cost, the Microloan and Microloan Technical Assistance programs are not expensive. In conjunction, they are a great investment and have brought great returns to our taxpayers in local communities. Since its inception in 1992, the Microloan program has had only two total losses and creates one job for every $1,800 loaned, compared to the SBA's other loan programs which create one job for every $33,000 loaned. Further, more than any other SBA credit program, microloans disproportionately benefit women and minorities and rural businesses.

| Percent of Number of Loans – FY2005 | | | |
|---|---|---|---|
| **Group** | **Microloans** | **7(a) Loans** | **504 Loans** |
| Women | 45.59% | 25% | 15% |
| African Americans | 21.42% | 7% | 2% |
| Hispanic | 21.06% | 8% | 8% |
| Rural | 38.16% | 20% | 26% |

For these reasons, I oppose the President's recommendation and respectfully request that the FY2007 Budget Resolution include $1.4 million to leverage $20 million in program level for Microloans, and $17 million in program level for Microloan Technical Assistance.

For the sixth year in a row, the SBA's FY2007 budget proposes eliminating the PRIME (Program for Investment in Micro-entrepreneurs) program. Unlike any other SBA program, the PRIME program provides highly in-depth and intensive, one-on-one business counseling and training, and is targeted to help very low-income families. With the poverty rate continuing to increase, the need for PRIME assistance is now greater than ever. While access to credit is vital to micro-entrepreneurs, for low-income individuals there is often a severe gap between their business experience and the experience needed to be deemed credit-worthy. Receiving PRIME technical assistance can fill that gap and help them become successful in business. In addition to need, the PRIME program is a good return on the investment. The International Labor Organization estimates that the return on investment in micro-enterprise development (through programs such as PRIME and the Women's Business Centers) ranges from $2.06 to $2.72 for every $1 invested. In commenting on the importance of micro-enterprise development, the SBA's current Administrator Hector Barreto has said: "The PRIME program was created to help the smallest of small businesses. These are entrepreneurs at the most basic stage of starting a business and who typically require the greatest amount of committed service and guidance. In order to succeed, they require training, and technical assistance that must be accessible." I respectfully request that the FY2007 Budget Resolution provide $15 million for the PRIME program.

As with years past, I oppose the President's zero subsidy for the SBA's largest loan program, known as the 7(a) Loan Guaranty Program. This is the fourth time the President has proposed eliminating all funding for these loans, contending it brings stability to the program and saves taxpayers $100 million. These arguments are misleading for many reasons, the most obvious being that the SBA realized this so-called savings by shifting the cost of the program to the borrowers and lenders by reducing the types of loans offered and by raising program fees. To borrowers and lenders, this "savings" is a tax. The stability argument is misleading because it blames the appropriators and continuing resolutions for the instability in the program instead of accepting responsibility for requesting too little money or unrealistic program levels. In reality, Congress met or exceeded the President's requests in each year – FY2002, FY2003, FY2004, FY2005, and FY2006. The instability in the program was caused by the Administration because it dismissed the loan demands estimated by the oversight Committee and industry and refused to request sufficient funding in the budget, or proposed failed funding schemes to avoid requesting a realistic amount.

Last, if the business community is going to pay the entire subsidy cost for the SBA's credit programs through fees, program levels should be sufficiently high to enable the SBA to back the maximum amount of loans, as estimated possible by the industry, along with a cushion in order to avoid credit rationing or shutdowns. For FY2007, instead of $17.5 billion in program level for the 7(a) Loan Guaranty Program, I recommend $18 billion. And for the 504 Loan Guaranty Program, instead of $7.5 billion, I recommend a program level of $8 billion.

Important to the scope of financing that the SBA offers small businesses is the New Markets Venture Capital program. For the sixth year in a row, the President seeks no funding for this program. As with years past, I respectfully request that you consider restoring the funding for the New Markets Venture Capital (NMVC) program that was rescinded in the FY 2003 Omnibus Appropriations Act Conference Report: $10.5 million for guaranteed debentures, and $13.75 million in grants for NMVC technical assistance. The NMVC program was part of a broad bipartisan initiative agreed to by Speaker Hastert and then-President Bill Clinton to stimulate investment in low-income urban and rural communities. The other elements of that agreement included in the Community Renewal Tax Relief Act were New Markets Tax Credits, additional empowerment zones, and a new program – Community Renewal Zones. The goal of the legislation was to test a number of different approaches to poverty alleviation to better understand what works the best. With the exception of the NMVC program, all of the other programs are going forward. The NMVC program should also be given a fair chance to demonstrate its potential for success.

<u>The Disaster Loans Program Account</u>
I strongly urge the Budget Committee to oppose the President's proposal to raise the cost of disaster loans on borrowers. One of the most important SBA services available to Americans is the SBA's disaster loan program. This program provides low-interest loans to small businesses, homeowners and renters who, after a disaster, need to rebuild or replace personal property, or who need working capital for their businesses to make ends meet until operations return to normal. Currently, for borrowers with no access to other credit, disaster loans are available at fixed interest rates, capped at four percent. To "contain costs," the President proposes to change rates in FY2007 by eliminating the fixed rate, eliminating the interest rate cap, and moving to "graduated interest rates." According to the budget request, rates during the first five years of a loan would be deeply discounted, but in the remaining years of the loan the rates would increase,

tied to a "comparable-maturity Treasury instrument." When the Committee met with the SBA to get an explanation of the budget and the various proposals, the SBA could not explain exactly how this would impact the borrowers. The SBA only seemed to know that this would save the Agency an estimated $41 million.

This disaster loan program has historically worked extremely well, and so it has been a great frustration to members of the oversight Committee and victims of the Gulf hurricanes that in the last six months the SBA has been unable to process loans with a sense of urgency, has been neglectful in its oversight of spending, and has tried to hide its funding problems from the Committee. To illustrate some of the problems, twice during the month of February, the disaster loan program was on the brink of running out of funding, and six months after the hurricanes made landfall, more than 130,000 applicants are still waiting for decisions on their loans.

While there are many changes needed to the SBA's disaster loan program in order to better serve the business owners and families who rely on this source of capital after a disaster, and we all support reasonable proposals to reduce spending, raising fees on disaster loan victims is not the answer. I oppose raising fees on disaster loans and ask the Budget Committee to increase the SBA's budget by $41 million in order to offset the cost of not adopting this proposal.

<u>Salaries and Expenses Account – Counseling and Contracting Assistance</u>

In general, the funding requests for the SBA's counseling and contracting assistance programs remain insufficient to meet the needs of small businesses seeking help and weaken the power of matching federal grants necessary to raise non-federal money.

The President's FY2007 budget request reduces funding for the Small Business Development Centers (SBDCs) to $87.1 million, an amount that is inadequate to serve the small businesses that seek counseling from the SBDCs. The request for this year is almost $1 million less than what was requested and appropriated last year, which will exacerbate the negative effects of virtual flat-funding since 2001. The reduced purchasing power of this funding pattern has amounted to a more than 20-percent cut for the SBDCs in New Hampshire and North Dakota from their peak funding levels. The New Hampshire and North Dakota SBDCs are responsible for creating or retaining nearly 1,000 jobs in each state, and the insufficient funding for the past several years has limited their reach. I respectfully request a level of $110 million in the FY2007 Budget Resolution. With this additional funding, it is estimated that the SBDCs could create or save nearly 200,000 additional jobs nationwide and generate $292 million in federal tax dollars.

Similar to the SBDCs, the Women's Business Centers (WBCs) need more than the President has proposed for FY2007. Nearly half of all privately-held U.S. firms are women-owned and, as of 2004, minority women owned an estimated 1.4 million privately held firms in the United States, employed nearly 1.3 million people, and injected our economy with $147 billion in sales. Between 1997 and 2004, the number of women-owned businesses in the United States has grown at more than double the rate of all businesses. Despite the dramatic growth in women-owned businesses, the funding for the Women's Business Centers program still does not reflect the increased demand for WBC services. For the past five years, the Women's Business Centers have been flat-funded and their purchasing power has declined because their funding level has not kept up with inflation. The President's FY2007 budget cuts the funding for the Women's Business Centers to $11.8 million, $461,000 less than the appropriated level for FY2006. When taking into account inflation, the Women's Business Centers should be funded at a minimum of $14 million. However, to meet the current commitments and to continue to expand the program to meet demand in areas currently not served, I respectfully request the FY2007 Budget Resolution include $16.5 million for the Women's Business Centers.

The President has proposed flat-funding the 7(j) Technical Assistance Program. This program provides management training and business counseling to small disadvantaged businesses, such as those operating in areas of high unemployment or firms owned by low-income individuals. This essential training includes accounting and marketing services, feasibility studies, marketing/presentation analyses and advertising expertise, loan packaging, proposal/bid preparation, and industry-specific technical assistance. This program has been reduced from $3.6 million in 2000 to its current level of less than $1.5 million. By providing targeted technical assistance, the 7(j) program uses a comparably small amount of funds to have a significant return in the success rate of companies participating in SBA contracting assistance programs such as the HUBZone program and the 8(a) Business Development program. To serve these businesses, I request a funding level of $3 million for FY2007.

The U.S. Export Assistance Centers (USEACs) operate in partnership with several federal agencies, including the SBA, in more than 100 locations across the country. The USEACs provide small and medium-sized businesses with trade loan assistance and export-related marketing advice. Trade is a major component of the U.S. economy, and record-high trade deficits reinforce the need to encourage the growth of trade among small and medium-sized businesses. However, for the past several years the SBA has received insufficient funding to hire employees to assist entrepreneurs at the USEAC hub locations. For that reason, I request the SBA receive $5 million to fund its USEAC program. That amount will fund 20 SBA employees at USEAC hubs, provide for a sufficient travel budget that is necessary for counselors within their regions, and allow for the expansion of the program, which is particularly necessary when the country is experiencing record trade deficits.

The SBA's SCORE program is a training and counseling program that relies heavily on a team of retired business executives who volunteer their time to assist entrepreneurs, both online and in-person. SCORE has assisted more than 7.2 million entrepreneurs since its creation, and provided over 400,000 services in FY 2005 alone. Yet, SCORE has been virtually level-funded since 2000. Again in FY 2007, the President's budget requests just $5 million for the program. I respectfully request that this amount be raised to the maximum authorized level of $7 million so that SCORE counselors can increase the number of entrepreneurs they assist.

The Small Business Administration currently has only 43 full-time Procurement Center Representatives (PCR) to review more than $300 billion in federal contracts awarded annually throughout the United States. These PCRs are to be assigned to major procurement centers and are responsible for creating contracting opportunities for small and local firms as well as reviewing potentially bundled federal contracts. This shortage of staff makes it virtually impossible for them to be effective in advocating on behalf of small businesses with respect to prime contracting opportunities. In May 2005, the Inspector General of the SBA released a report stating that contrary to the requirements in the Small Business Act (13 CFR § 125.2 (b)(1)) and an October 2002 Executive Order on Contract Bundling, more than 87 percent of the potentially bundled contracts reported to the SBA were not reviewed, costing small businesses over $384 million. The IG further stated that one of the main reasons for the lack of oversight is the shortage in the number of PCRs available to perform the analysis. Given the need, I request $10 million in additional funding for FY2007 in order to hire 100 more PCRs.

Overall, the funding proposals in the President's FY2007 budget request are not fiscally responsible and will not foster the growth of small businesses and our economy. As I stated previously, the President's FY2007 budget request is a $17 million cut from FY2006. Raising fees, inadequately funding programs, flat-funding programs, and creating roadblocks to minorities that depend on programs such as microloans to help them start their business are not the solutions to bringing jobs and economic growth to our communities.

Thank you for the opportunity to comment on the FY2007 budget request as it affects programs within the Committee's jurisdiction, and thank you for your past support of small business assistance. I look forward to your continued support and to working with you to develop this portion of the Budget Resolution for FY2007 so that it has reasonable funding of $774.1 million for the Small Business Administration.

Sincerely,

John F. Kerry
Ranking Member