FULL COMMITTEE LEGISLATIVE HEARING ON THE SBA'S MICROLOAN AND TRADE PROGRAMS

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FULL COMMITTEE LEGISLATIVE HEARING ON THE SBA'S MICROLOAN AND TRADE PROGRAMS

THURSDAY, JULY 12, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:06 a.m., inRoom 2360, Rayburn House Office Building, Hon. Nydia M. Velázquez [Chairwoman of the Committee] Presiding.

Present: Representatives Velázquez, Shuler, González, Cuellar, Ellsworth, Sestak, Chabot and Heller.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

ChairwomanVELÁZQUEZ. Good morning. I am very pleased to call to order this morning's hearing on proposals to reauthorize Small Business Administration's microenterprise and international trade programs. As we examine these measures to update the SBA policies, I believe there are two important facts to consider. First, the economy has drastically changed over the past decade. Most notably, we have seen a broadening of the entrepreneurial base to now include a greater number of women and minorities. At the same time, the U.S. economy has become significantly integrated with those of countries across the globe, providing new opportunities, but also increased competition.

However, while many are doing well in these business conditions, some are being left behind. Microenterprises, the smallest businesses in terms of required startup capital and employees, face competition without the resources to enjoy an equal playing field in the market. Global integration poses an additional challenge, leaving many small businesses without the capacity to export their goods abroad or thrive in domestic markets. Together these developments are challenging small firms' abilities to remain competitive.

For small firms to thrive in this new environment, it is important they compete on a level playing field. The two legislative measures we are discussing today will help accomplish this by expanding and modernizing the tools that SBA can offer. This proposal will help ensure small businesses can succeed in a dynamic and challenging economy.

In order to support growth in the country's smallest commercial enterprises, the Committee will hear comments from the Microloan Amendment and Modernization Act which will be introduced by

Mr. Chabot today. This proposal strengthens and broadens the reach of SBA's microlending activities. The measure requires the agency to transmit credit history information to major credit reporting bureaus, which will help borrowers improve their credit scores.

In response to the evolving needs of entrepreneurs, the legislation permits borrowers to draw on longer-term loans, providing them with greater financial stability. Microlenders are also given greater control of their resources, and as a result will be able to direct technical assistance where it is needed most.

If enacted, this legislation will bolster microlending efforts in the United States, and this will occur during a time when such initiatives are being championed around the globe. While some of these global developments are welcome, others have created challenges for small firms to compete in the international marketplace.

To help overcome the these barriers, Representatives Holt and Sestak introduced H.R. 2992, the SBA Trade Programs Act of 2007. This legislation focuses the agency's efforts on the trade concerns of small businesses and will help firms dislocated due to globalization better access to the assistance they need. As trade policies are developed, the measure requires the agency to work with Federal and international organizations to represent small business interests. Finally, it requires an annual trade strategy outlining the agency's effort to boost small business' share in domestic and foreign markets. Through this trade legislation, the SBA will be more prepared to assist the business community in the international marketplace.

The economic changes we are experiencing today present real challenges to the SBA and its programs, whether it is the changing demographics of entrepreneurs or the reduction of trade barriers. The fact is that businesses require assistance regarding challenges that were not envisioned when many of the agency's programs were created. Going forward, Congress will seek to modernize the agency's resources so that they remain relevant in an entrepreneurial economy that continues to evolve. Small firms' innovation and flexibility provide them with a natural ability to remain at the cutting edge of their industry. With adequate assistance and access to tools to realize their full potential, I believe the two proposed legislative measures will ensure their ability to succeed even in a challenging environment.

To conclude, I would like to extend my appreciation to all the witnesses that are before us today. Thank you for coming, for taking time out of your busy schedule. And I would like to also recognize the Ranking Member Mr. Chabot for his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr.CHABOT. Thank you very much, Madam Chair. I want to thank you for holding this hearing to review legislation to improve the operation of the Small Business Administration's microloan and international trade programs, and we want to thank the witnesses all for being here this morning as well.

A reexamination of these two programs is long overdue, and I am interested in hearing from the witnesses on any suggestions that they might have as we prepare for a markup on these two bills next week. The Committee already has heard about the efficacy of microloans to generate economic growth and redevelopment for individuals in areas that are frequently overlooked by commercial lenders and the SBA's guaranteed loan programs. I know that parts of my community, for example in Cincinnati, have areas in which a greater spark of entrepreneurship would lead to increased economic revitalization. I believe that improvements to the Microloan Program can generate that spark; however, those improvements must come within the context of budget constraints.

I look forward to the witnesses' testimony and suggestions for enhancing the Microloan Program. Some suggestions we have heard include increasing the number of loans that intermediaries can make to be eligible for participation in the SBA program, eliminating the cap on interest rates that microlenders may charge to borrowers, requiring that some microloan organizations focus on educational services and others on lending, and centralizing certain back-office operations.

The other program that we are examining today is the SBA's assistance provided to small businesses engaged in international trade. Although there are a number of general entrepreneurial development programs that can provide some assistance in this area to small businesses, the area is fraught with regulatory issues that require an extensive specialized knowledge that may not be available from the SBA's entrepreneurial partners. Thus, it is not surprising to find that the SBA created other programs to meet the needs of small business exporters.

Since 1992, small businesses' participation in international trade has expanded quite dramatically. According to the most recent statistics available from the Department of Commerce, there are about a quarter of a million small businesses that export. Revenue increased from $102.8 billion to $203 billion back in 2004.

There is no doubt that small businesses are playing a vital role in reducing America's trade deficit. Continuation of this success and even greater impetus on small business exporting will benefit the entire American economy. The question becomes how to do this in a manner that fits within the current budget situation.

I look forward to the witnesses providing us with detailed assessments of the current state of SBA international trade assistance and their suggestions for improvement. These might include greater coordination within the SBA, better interaction with other Federal agencies, and increased technical assistance. Of course, those suggestions that can be accomplished without additional expenditure of resources will be most seriously considered by the Committee. On the other hand, simply moving boxes around on an organizational chart without more, without costing anything may not provide the services needed by America's small businesses that currently provide exports or want to go global.

Again, I want to thank the Chairwoman for holding this important hearing this morning, and I yield back the balance of my time.

ChairwomanVELÁZQUEZ. Thank you, Mr. Chabot.

ChairwomanVELÁZQUEZ. Our first witness is Mr. Michael Hager. Mr. Hager is the Associate Administrator for Capital Access at the U.S. Small Business Administration. He manages and oversees all of the agency's programs and operations concerning financial assistance by way of loans and investment, including international trade initiatives. Welcome.

STATEMENT OF MICHAEL HAGER, ASSOCIATE ADMINISTRATOR FOR CAPITAL ACCESS, U.S. SMALL BUSINESS ADMINISTRATION

Mr.HAGER. Good morning, Chairwoman Velázquez and Ranking Member Chabot, distinguished members of the Committee. And I want to thank you for inviting me to discuss legislative proposals affecting the microprogram and international trade programs of the SBA. I would like to begin by asking for the opportunity to submit for the record at a later date a revised version of our written testimony due to the late receipt of the document from your office yesterday, if we could.

ChairwomanVELÁZQUEZ. Without objection.

Mr.HAGER. I will begin my remarks by addressing the Microloan Program. My Deputy Janet Tasker testified on SBA's positions in the microprogram and included in the fiscal year 2008 leg package, and I would like to point out that the Microloan Program as currently structured is costly to the taxpayer. 2006, it cost 85 cents to the government for each dollar loaned to the microloan intermediary. That is compared to about 3 cents for the 7(a) program.

SBA commends the Committee's interest in making sure that microborrowers who make timely payments on their loans are able to establish positive credit history, and the administration is interested in finding a workable solution to provide this data to credit reporting agencies.

We believe that the technical assistance provisions in the bill fall short of what is prudent to ensure that counseling and training is provided to entrepreneurs and contributes to their success.

With regard to the Committee's proposal to move the PRIME program to the Small Business Act, the SBA does not support reauthorization of the PRIME program. We continue to object to the overlapping programs focused in this area of technical assistance.

I would like now to return to the international trade legislative issues, and as you have indicated, international trade is rapidly increasing in importance to the U.S. economy, and it is clear that the exporting of the new growth market for small business is apparent. The SBA helps exporters carry out their export transactions through the Export Working Capital Program, the International Trade Program for long-term financing and Export Express.

In fiscal year 2006, the SBA experienced record export lending, supporting over $2 billion in export sales.

On the policy side of our mission, the Office of International Trade influences the overall international trade environment, which can affect the prospects of each business beyond what the SBA could ever do for businesses on an individual basis.

And now for the legislative proposals. I am pleased to have the opportunity to comment on the Committee's international trade legislation. However, we do have serious concerns about the Committee's proposals to expand SBA's roles and its responsibilities in international trade policy and promotion. We believe that the Committee's legislation would create extensive duplication of existing programs and roles under the statutory authority of other U.S. trade and investment agencies, namely Commerce, USTR and Ex-Im.

With regard to the legislative language in section 301, USTR informs us that our trading partners may find that many of the conditions specific to the proposed loan may be prohibited export subsidies as defined under the WTO Agreement on Subsidies and Countervailing Measures. This section creates a potential new definition of dumping by making the loans dependent upon the influence or the influx of imports below U.S. average production costs. The provision could be interpreted as a double remedy for dumping that would be inconsistent with our international obligations under WTO.

With regard to the trade compliance provisions, Congress has established the SBA's roles as a financial and technical assistance agency. And the SBA does not have the expertise to deal with trade compliance issues and other issues of complexity. The SBA works regularly with Commerce, USTR and other agencies on these issues and agencies that are well equipped with those specific compliance and enforcement roles.

In conclusion, the administration is concerned that the Committee's legislative package is inconsistent with our international obligations and the scope of SBA's role. We appreciate your commitment to the increased opportunities for America's small business in the international marketplace and ask to work with you on alternative ways to accomplish our mutual goals.

Chairwoman Velázquez, that concludes my testimony, and I will look forward to any comments or suggestions.

ChairwomanVELÁZQUEZ. Thank you.

[The prepared statement of Mr. Hager may be found in the Appendix on page 37.]

ChairwomanVELÁZQUEZ. Our next witness is Ms. Kristie Darien. Ms. Darien is the executive director of the legislative offices of the National Association for the Self-Employed. NASE is the Nation's leading resource for the self-employed and microbusinesses, providing a broad range of benefits and support to help the smallest businesses succeed. Founded in 1981, the NASE is made up of hundreds of thousands of microbusinesses, and it is the largest nonprofit nonpartisan association of its kind in the United States.

Welcome. You have 5 minutes.

STATEMENT OF KRISTIE DARIEN, EXECUTIVE DIRECTOR, LEGISLATIVE OFFICES, NATIONAL ASSOCIATION OF THE SELF-EMPLOYED

Ms.DARIEN. Thank you. Nice to see you all again. On behalf of the National Association for the Self-Employed and our 250,000 microbusiness members nationwide, I would like to thank the Committee on Small Business for allowing me to speak here today regarding the Small Business Administration's Microloan Program and how it assists the access-to-capital needs of self-employed and microbusinesses within our Nation.

Shonda Parker is a NASE member in Louisiana. She owns Naturally Healthy, a family business which is a medical and birthing supplies company. A few years ago Ms. Parker was looking to expand her operation. In efforts to find financing, she went to various financing banking institutions in her area to apply for a loan. She indicated to me that the loan officers there she met with either turned her down right away, were concerned about the risk of funding her business, or were uninterested due to the small loan amount she needed.

Shonda, encouraged by a friend, applied and received an SBA loan at an affordable interest rate and thus was able to grow her business. She believes the SBA backing and guarantee of the loan made all the difference in her ability to get funding.

Shonda's story is representative of the experience of many of NASE's microbusiness members. The lack of access to funding is a large hurdle negatively affecting the startup and continued growth of microbusiness. Sixty-one percent of NASE members feel that there are not adequate funding resources for this important business demographic.

Traditional lending institutions, such as banks and investors, are unlikely to offer loans and investment capital to microfirms due to a variety of reasons. One barrier to microlending is a concern that startups and smaller enterprises are risky investments since growing businesses typically exhibit erratic bursts of growth and downturn. The perceived risk of these types of companies reduces the chances of a microbusiness to obtain financing.

Another issue is that microbusinesses by and large require smaller amounts of capital, and thus banks or investment companies often believe that it is not efficient use of their time or resources, nor will they receive a substantive return on investment from such a small loan amount.

With this in mind, you may ask, how are microbusiness loan owners currently funding their business? According to a March 2007 NASE survey, approximately 58 percent of our members use their personal savings to start their business. A little over 9 percent use a home equity loan to start up their business. As microbusiness owners look for ongoing financing in order to maintain and expand their business, 36 percent continue to use their personal savings, while over 21 percent turn to credit cards. Both of these avenues do not promote long-term stability for the owner or the company. The use of personal savings puts a microbusiness owner in a precarious position in which he or she would be unable to recover financially should an unexpected and costly personal or business expense occur. The usage of credit cards and personal lines of credit with their high and fluctuating interest rates can increase debt and make it difficult for a business owner to pay back borrowed money. This in turn can negatively affect a microbusiness owner's credit score.

Credit scores are a central component to our financial system. The reliance on FICO credit scoring by traditional lending resources to examine potential borrowers is a critical hurdle faced by microbusinesses. In fact, 26 percent of our members believe their credit score is their biggest barrier to obtaining financing.

With all that said, one beacon of opportunity for a microbusiness owner in the challenging realm of business financing is the Small Business Administration's loan programs, particularly the

Microloan Program. The Microloan Program addresses all of the above barriers that affect access to capital for microbusinesses. While banks are an important component to the program due to their work with microlending intermediaries, microbusiness owners applying for financing through the Microloan Program are not subject to the same biases or barriers found in traditional lending. They are able to obtain small loan amounts via community-based nonprofit intermediaries whose sole focus is to assist them in their endeavor of starting a microbusiness. Most importantly, these intermediaries have essential expertise on the needs of this key demographic.

The technical assistance component to the Microloan Program is a crucial element which enables intermediaries to assist microbusiness owners step by step through their development and growth. The training and assistance not only increases the likelihood of full repayment of the loan, but augments business survival and success.

The NASE strongly supports the Microloan Program. We have consistently advocated for increased funding, lower lender and borrower fees, and administrative improvements upon SBA loan programs. Based on our initial review, the NASE is supportive of the Committee's impending legislation to improve upon the SBA Microloan Program. In particular, we are pleased to see provisions including a way to facilitate the transmission of credit reporting information about the borrowers from intermediaries to major credit reporting agencies. This would go a long way to help some of our members grow and better their credit history.

In conclusion, I encourage you to continue to support the SBA loan programs, particularly the Microloan Program, and ensure their viability and success by pushing for increased funding and improvements. Thank you.

ChairwomanVELÁZQUEZ. Thank you, Ms. Darien.

[The prepared statement of Ms. Darien may be found in the Appendix on page 44.]

ChairwomanVELÁZQUEZ. Our next witness is Mr. Kevin Kelly. Mr. Kelly is the managing director for policy and advocacy of the Association for Enterprise Opportunity. AEO is the national association of community-based organizations that provide entrepreneurial education, access to capital and support to aspiring and active low-income entrepreneurs. Its members provide most of the loans and technical assistance that are allocated on the Microloan Program.

Welcome, sir. You have 5 minutes.

STATEMENT OF KEVIN S. KELLY, MANAGING DIRECTOR FOR POLICY AND ADVOCACY, ASSOCIATION FOR ENTERPRISE OPPORTUNITY

Mr.KELLY. Thank you, Chairwoman Velázquez, and thank you also to Ranking Member Chabot and to the members of the Small Business Committee.

I am pleased to be here today to discuss the reauthorization of some of the programs at the SBA, specifically the Microloan Program, PRIME, and also the Women's Business Center program, I will just mention, is also a program that is of interest to our members. These small programs, relatively speaking, in the Federal budget, these programs are absolutely essential to our members around the country, groups that do the microenterprise development work. I work with the actual entrepreneurs, and they see how beneficial these are on the ground in their communities.

I want to mention that these programs are, in fact, complementary; that they are not duplicative; that they serve different entrepreneurs. It is basically like a spectrum. They do different things for different people. It is not the same thing.

I also wanted to comment on the administration's proposal to change the Microloan Program so that it would eliminate the subsidy rate and increase the interest rate on the loan portion, and to defund the technical assistance part of the program and have other entities pick up the technical assistance work, such as SBDCs and so forth. Our members know that this is not a workable proposition; that this program has, in fact, been very successful, less than 1 percent default rate in the history of the program. And this is due to this combination of the lending and the technical assistance being provided by the very same organization. When there is problems that pop up, the group is able to discover them and help the entrepreneur work through them immediately. They have a self-interest in the loan being paid back, obviously, since they lent the money. Somebody else would not have that same level of self-interest.

The cost of the program is also, in fact, very low if you look at how much is spent versus jobs that are created and retained. Fiscal year 2006, 9,955 jobs were created or retained through the Microloan Program. If you look at the technical assistance dollars that were appropriated for last year, $13 million, those are really the dollars that are being spent. The loan money is going out, but it is also coming back in. Like I said, there is less than a 1 percent default rate. So if you really just take the TA money and look at how much it has created in the way of jobs, or retained in the way of jobs, during that time, it works out to be very little. If you do the division $13 million by 9,955, I would say it is a better job creation per dollar of the Federal budget than most of the programs that are out there right now. That is a different way of looking at it than you usually hear.

There are some changes that we have proposed to the Microloan Program. Most of them are changes that would make the practice consistent with what the SBA is already doing or to give some added flexibility to the microenterprise development organizations who are working at the local level. And over time we have found there is a couple of impediments to what they are doing. They are fairly minor changes. We have been pleased to see that they have been incorporated in the draft I saw earlier.

I do want to mention something about PRIME. PRIME is different than Microloan. The Microloan Program is for people who want to have a loan and need the technical assistance connected with the loan either before they get it and after they get it, whereas PRIME is for people who they are not ready for a loan yet. In some cases they may not need that capital. They have a kind of business that they don't need a lot of capital, so they really just need the technical assistance. They can't access the Microloan Program because the TA is really connected with the loan itself, and there are not other programs like PRIME out there that really deal with this constituency. There is also a requirement that 50 percent of the funding go to low-income people, which is different than other programs as well.

And on a further note about PRIME, it was once a national program. It has been cut down to where currently only 15 States and the District of Columbia are even eligible to apply for the program. And currently only 12 of the States are actually getting any dollars, and it is only funded at $2 million. So it has really dropped down to what it once was. We would like to see it get back on.

It is true that there are other Federal sources, like the Community Development Block Grant program, CDFI fund and some others that do fund microenterprise organizations, but they are not set up specifically for that purpose, and microenterprise programs are one of many that are eligible. So that is why these programs we are talking about today are so important, because they are really microenterprise specific.

My final point is that the field of microenterprise got a lot of attention last year with the Nobel Peace Prize going to Muhammad Yunus and Grameen Bank. A lot of people know about the international work around microenterprise, but fewer know that we really have a vibrant, healthy microenterprise industry here in the United States, and that reauthorizing the SBA and these programs would go a long way to supporting that vibrant field, and I want to encourage you to do that.

Thank you for allowing me to speak today.

ChairwomanVELÁZQUEZ. Thank you, Mr. Kelly.

[The prepared statement of Mr. Kelly may be found in the Appendix on page 52.]

ChairwomanVELÁZQUEZ. Our next witness is Dr. Hector Cordero-Guzman. Dr. Cordero-Guzman is an associate professor and chair of the Black and Hispanic Studies Department at Baruch College of the City University of New York and a member of the faculty in the Ph.D. programs in sociology and urban education at the CUNY Graduate Center. Dr. Cordero-Guzman is also research associate at the Community Development Research Center and is senior consultant to the Fundacion Chana Goldstein and Samuel Levis.

Welcome. You have 5 minutes.

STATEMENT OF DR. HECTOR CORDERO-GUZMAN, BARUCH COLLEGE, CITY UNIVERSITY OF NEW YORK

Mr.CORDERO-GUZMAN. Good morning, Honorable Chairwoman Velázquez, Ranking Member Chabot, distinguished members of the House Committee on Small Business. I apologize. I am a little bit under the weather. I usually sound even more annoying.

Thank you for inviting me to testify about the SBA Microloan Program. I am Dr. Cordero-Guzman, professor and the chair of the Black and Hispanic Studies at Baruch College. Baruch College is the business school of the City University of New York and one of the largest in the country. We have over 15,000 students, 80 percent of them majoring in business, and one of the most beautiful scenes you can see is in front of Madison Square Garden at the end of every academic year, you see thousands of students of all colors, shapes and sizes, grandmothers graduating from the City University.

For the last 6 years, I have served on the board of directors of ACCION New York. ACCIONis the largest microlending organization in the United States with over 2,300 loans and $18 million in the portfolio and over 40 staff members.

I am here to provide some testimony on the proposed changes to the SBA microlending program based on my research and my experience in the management of the microlending programs. Small, medium and large businesses utilize debt financing for a range of reasons, from securing working capital to making long-term investments. For microbusinesses, small entities with less than five employees, this is no less true, yet due to a combination of factors, including a smaller scale of operations, the product and demographic markets they serve, their often semiformal nature, their lower borrowing needs and the reluctance of formal lenders and financial institutions to work in these markets, microbusinesses do not have access to traditional sources of business financing.

In the United States two broad and differing perspectives characterize the debate over microfinance. On the one side, one side argues there is a potential profit to be made from microlending, but for various reasons formal financial institutions do not see or seek out these opportunities, particularly in low-income and predominantly ethnic minority communities. The other side argues that due to the high cost of information, high risk of the loans, low returns on investment and unrelated resources, there is no money to be made on most of these types of small loans, and that microfinance will always need some form of State subsidy that should be justified on social equity, public benefit, cost-effectiveness or other grounds.

Any progress towards a potential resolution on this debate depends on a better understanding of the actual cost of microfinance, a better assessment of the profiles of borrowers and the risks involved, and a development of a lending model with concrete parameters that can be adjusted and calibrated to local conditions and borrower characteristics and risk profiles. Once we have a realistic estimate of the transaction cost of microfinance and the interest rates that may need to be charged to cover its cost, we can be in a better position to understand their effectiveness, evaluate their needs and the levels of public and private subsidy, and analyze why private banks and related financial actors have or have not entered these markets.

And the bulk of my testimony comes from a research paper that was published in January in the Journal of Small Business Management where myself and a theoretical physicist and another colleague, vice president at the time of ACCION, endeavored to try to estimate the actual cost of microfinance and compare the costs with what the industry was, in fact, charging. We used a model to calculate a value-neutral APR over the funding for the product. Very specific direct costs are taken, as outlined in our equation model, and then we present the model that basically estimates for three types of loans how much would you need to charge to be able to recover the cost of making a microloan.

We define three characteristic products. One is a loan of $2,000 for a high-risk borrower, the other is a loan of $10,000 to a medium-risk borrower, and the third is a loan of $20,000 to a low-risk borrower. Our model estimates that in order for to you recover the cost of making a $2,000 loan to a high-risk borrower, you need to charge 34.7 percent APR to be able to recoup the money. For a $10,000 loan for a medium-risk borrower, you would need to charge 17 percent to recover the cost. And for a $20,000 loan for a low-risk borrower, you would need to charge 11.7 percent to recover the cost.

We then looked at what microlending programs actually charged, and we found that it was significantly less than was required to cover the costs. Therefore, they have two options. They either close their operations because there is no money to be made, or they require some form of State or other subsidy to be able to continue their operations.

Our paper basically concludes that in order for us to be able to—we conclude that the industry is significantly undercharging in most of the loans it makes, and it is foundations and governments that are picking up the difference between what they are actually charging and what it costs for them to make the loans.

ChairwomanVELÁZQUEZ. Thank you, Dr. Cordero-Guzman.

[The prepared statement of Mr. Cordero-Guzman may be found in the Appendix on page 55.]

ChairwomanVELÁZQUEZ. Our next witness is Dr. James Morrison. Mr. Morrison is president of the Small Business Exporters Association of the United States, which handles international trade matters for the National Small Business Association, a federation representing 65,000 small and medium-sized exporters. He was appointed by President George Bush to the Advisory Committee on Trade Policy and Negotiation, the U.S. Government's senior trade advisory panel, providing the Office of U.S. Trade Representative with advice on U.S. Trade policies and specific trade agreements.

Welcome, Dr. Morrison.

STATEMENT OF DR. JAMES MORRISON, PRESIDENT, SMALL BUSINESS EXPORTERS ASSOCIATION OF THE UNITED STATES

Mr.MORRISON. Madam Chairwoman Velázquez, Representative Chabot, members of the Committee, thank you for inviting me to appear here today. I am James Morrison, president of the Small Business Exporters Association of the United States. SBEA is the Nation's oldest and largest organization dedicated exclusively to smaller American exporters. We are also the international trade council of the National Small Business Association, serving U.S. small businesses across the Nation. We thank the Committee for its interest in assisting small businesses in international trade.

Reauthorizing SBA provides a welcome opportunity to review the agency's Office of International Trade, to strengthen it where it is succeeding, and provide it with fresh congressional guidance. SBEA supports the Office of International Trade. We think it does a good job. Perhaps its most impressive success is the volume of export sales underwritten by OIT's export finance specialists located in U.S. Export assistance centers across the country.

Export finance guarantees by SBA are important. In the U.S., as elsewhere in the world, commercial banks will not accept the foreign risk inherent in export sales without government guarantees. In fiscal year 2006, SBA guaranteed over $2 billion in export sales by small companies. Many of these transactions were for less than $100,000. What did it take for SBA to pull this off? It took $4 million and 17 people in the field. That works out to about $500 in export sales for every $1 that the taxpayers invested in the program, and over $120 million in export sales underwritten that year by each export finance specialist on average.

This is a remarkable achievement. Those sales helped to create about 8,000 new high-paying American jobs, Main Street jobs. The companies that made those sales will keep on creating jobs at a 50 percent faster clip than other businesses, a recent study shows. Just the taxes paid by the new employees will repay the cost of the export finance specialists many times over.

In SBEA's view, this program is by far the most cost-effective export promotion effort in the entire U.S. Government. Like the weather, everybody talks about the trade deficit, but not many people are as successful as OIT at actually doing something about it. We are very gratified that the legislation being considered today at last acknowledges the program's remarkable success and builds on it. We hope these provisions pass.

There are a number of other useful provisions in the bill as well. OIT will be directed to develop recommendations about small business for U.S. trade negotiators. This is a good idea. At present no one in the U.S. Government focuses on this issue in a full-time professional capacity. Small business needs and international trade ought to be addressed in a focused and systematic way if support for trade is to be strengthened on Main Street, so the Committee offers a valuable innovation here.

The same can be said for the bill's trade adjustment assistance provisions. Restoring the national consensus for a vibrant international trading system depends to a significant degree on reassuring the public that a safety net does, in fact, exist for those who suffer genuine import injury. SBA has the existing authority to provide loans for import injury, but this authority is rarely utilized. SBA needs to work with its banks and borrowers to determine why this is so and to improve its products and outreach to meet the need.

The bill would also authorize OIT to work with small business ministries from other countries, to develop small business trade statistics, to join forces with those who are trying to protect the intellectual property of small businesses in international trade, and to help small businesses navigate trade disputes and utilize trade remedies. Importantly, the bill would also raise the loan limits for at least two of OIT's three loan products.

Having noted these desirable features of the bill, we would also draw attention to what is omitted, and that is authority for OIT commensurate with these new responsibilities. The Committee plans to take up this subject in a separate bill, and we certainly hope that bill squarely addresses this issue.

Even now with OIT buried deep within SBA's hierarchy, very few at SBA see international trade activities as a priority. Adding new responsibilities to OIT will worsen the situation unless, that is, Congress sends a very strong signal to SBA that it wants this treated as a priority. And the way to do this is to consolidate the agency's international trade personnel and resources under OIT and to elevate the office within the agency so that it reports directly to the Administrator. Without such a strong backing from Congress, OIT will continue struggling to keep international trade on SBA's agenda, and it will not be able to accomplish the ambitious new goals that the Committee seeks.

Again, our thanks to the Committee and its staff for this forward-looking bill. That concludes our testimony. We would be happy to accept any questions.

ChairwomanVELÁZQUEZ. Thank you, Dr. Morrison.

[The prepared statement of Mr. Morrison may be found in the Appendix on page 69.]

ChairwomanVELÁZQUEZ. Our next witness is Mr. William Gaskin, president and secretary of the Precision Metalforming Association, which represents the $41 billion industry that produces precision metal components and assemblies found in autos, appliances, computers and thousands of other applications. He serves as president and secretary of the PHA Educational Foundation as well as the association's for-profit subsidiary.

Welcome, sir.

STATEMENT OF WILLIAM E. GASKIN, CAE, PRESIDENT AND SECRETARY, PRECISION METALFORMING ASSOCIATION

Mr.GASKIN. Thank you, Chairwoman Velázquez, Ranking Member Chabot and members of the Committee. Thank you for holding this hearing today. My comments will focus on aspects of the SBA Trade Programs Act of 2007 other than the Microloan Program, which many have already addressed.

The vast majority of PHA members are small businesses. They make component parts for a wide variety of industries. Virtually all manufactured products that are exported from the United States have metal components. So while many small companies may look at international trade and exporting with great skepticism, it can bring tremendous opportunities.

Whether our industrial customers are domestic or overseas, cost is a key factor in determining whether the metal parts or assemblies are bought from an American manufacturer or an international source. Of course, quality and delivery are important, but the primary driver is cost. Metalforming is highly automated, a high-skill industry. Our largest operating expense is purchasing raw materials, in our case steel, like flat rolled metal, which amounts to 50 to 70 percent of our costs.

Over the past 4 years our members have found their foreign competitors often supply metal components and assemblies or finished products cheaper than the cost of our raw materials alone in the United States. This clearly puts small American manufacturers at a disadvantage and seriously restricts our export opportunity.

Hopefully the SBA Trade Programs Act of 2007 will offer some much-needed assistance.

When we experienced 40 to 60 percent price increases in steel, as we did as a result of the government-imposed 201 steel tariff in 2002 or a doubling of our steel costs in 2004, small businesses are placed in a squeeze. They simply do not have the ability to raise prices to their larger industrial customers like the automotive industry.

Small manufacturers have been injured by the unintended consequences of our trade policies because they are not friendly to small companies in many cases. When the U.S. International Trade Commission determines whether to levy tariffs or taxes on imports of raw materials such as steel, aluminum or copper alloys, the current law bars it from considering the impact any decision would have on domestic industrial consumers of those products. The ITC's view is that trade cases are entirely between importers and domestic producers of a product. American companies who use these products as their raw materials do not have standing in those cases.

According to the Department of Labor Statistics, there are more than 9 million steel-consuming jobs in this country. Because of our outdated trade laws, none of these companies or their employees are represented in hundreds of cases at the Department of Commerce. That is why we support H.R. 1127, legislation that is offered by Representatives Knollenberg and Kind to provide domestic industrial consumers a seat at the trade remedies table.

We also need a system to track small business imports and exports, which would provide a better snapshot of our industries. Due to current classification systems, the government does not adequately collect and report data on imports and exports. For example, the products produced by 1,700 companies, most of them small, in NAICS code 332116, metal stampings, which represents nearly 100,000 jobs, appear nowhere in the HTS codes used by Customs and the Department of Commerce to track imports. While the Commerce Department has a robust program to accurately track some products, they do not track ours. This lack of data and analysis hinders policymakers and harms businesses and employees.

A good example of this recent—a good example is the recent announcement by China that they would impose an export tax on raw steel. Well, that is good for the steel industry in the U.S., and we support the steel industry, but it harms smaller American manufacturers who are trying to be competitive globally in producing parts.

Section 402 of the SBA Trade Programs Act seeks to establish an annual trade strategy for small business. Big Business is represented in our current trade policy, Big Labor is represented, but where is Small Business? We applaud this action. Fundamental currency misalignment by China and other nations provides a clear subsidy and places small companies in America at a competitive disadvantage.

Section 202 of the SBA Trade Programs Act would address a growing problem for our members, intellectual property theft and lax enforcement by trading partners. Minster Machine Company, located north of Dayton, Ohio, recently discovered that a Chinese company is counterfeiting its metal stamping presses, frustrating efforts to export high-tech, high-quality machines to China. Small businesses often lack the financial resources to defend themselves.

In addition to IP, participating in countervailing and anti-dumping cases is difficult in large part because they are so prohibitively expensive. Last fall I visited the Department of Commerce's Imports Administration office with a member from Springfield, Ohio, who had lost some $2 million of their business to Chinese companies that were making steel pullies for the lawn and garden industry at a lower cost than the raw materials alone in the U.S. They decided not to pursue a trade case because the legal fees were way out of line with $2 million of their business, and yet it hurt the company desperately.

When export opportunities do exist, our members have found barriers erected by foreign governments impact them. Small, medium-sized American manufacturers can only be globally competitive if the U.S. Government takes a more complete approach to its trade policies and remedies when foreign governments fail to abide by trade agreements, especially for small companies.

Small manufacturers stand to benefit greatly from exporting, but in order to take advantage of these opportunities, we must have a domestic environment that will strengthen small businesses.

Thank you very much.

ChairwomanVELÁZQUEZ. Thank you, Mr. Gaskin.

[The prepared statement of Mr. Gaskin may be found in the Appendix on page 81.]

ChairwomanVELÁZQUEZ. Mr. Hager, I would like to start my questions with you.

The agency has demonstrated a declining interest in expanding its trade-related services. Loans from the international trade program dropped last year, and the number of specialists at U.S. export assistance centers fell by nearly 30 percent over the last 5 years. The agency has also focused largely on export assistance, neglecting the needs of the rest of small businesses negatively impacted by trade. At the same time it has become critical that small firms incorporate trade into their business strategy.

How can you come before this Committee and tell us to stay the course when we have so many communities suffering job losses due to overseas competition?

Mr.HAGER. Madam Chairwoman, the initiative for international at the SBA, as a matter of fact, in the field staff, we are back up to staff that certainly since I have been there, we are back to those levels. We are committed to this cause. We spend a great deal of time in international operations. We support many conferences, attendance to development of the program. We are not taking our eyes off this initiative. We are largely in support of many of the issues that have been proposed today. We are anxious to work with you with a breakout of Subcommittee staff members from this Committee as well as the SBA to engage in meaningful discussion how can we come to agreement on many of these key initiatives.

ChairwomanVELÁZQUEZ. Dr. Morrison, do you think that the current efforts by SBA are sufficient to help small businesses prepare for this globalized economy?

Mr.MORRISON. What SBA is doing so far is good and, as I indicated in my testimony, has been very beneficial. But as was noted, I think, in Mr. Hager's statement, there are close to a quarter million small business exporters in the United States, and the SBA is touching on a very, very small fraction of them.

Even in terms of the need for export finance, I think there would be general agreement amongst those who know the field that SBA is doing a very, very minor fraction of what it could be doing in this area where the demand enormously exceeds the supply.

ChairwomanVELÁZQUEZ. Mr. Gaskin, or even Dr. Morrison, you know, I am a teacher, so let us grade them in terms of assistance to small businesses regarding trade.

Mr.MORRISON. I guess I would break it into two categories. I would give them something like an A minus for effort, and I would give them something like a gentleman's C minus for resources devoted to the cause.

ChairwomanVELÁZQUEZ. Thank you.

Mr. Hager, the country's trade deficit has reached $800 billion annually, and China-U.S. surplus is up 84 percent since last year. This has resulted in the loss of many small U.S. firms in the manufacturing industry and increasingly in services and agriculture sectors. Entrepreneurs, however, could play a critical role in lowering the trade deficit. The trade deficit is a national crisis, and everybody should play a part in reducing it. You say USTR, UCA, the Department of Commerce, USDA, it is everybody's responsibility but SBA. The current administration always talks about the importance of personal responsibility. When is the agency going to take responsibility for the current poor trade performance?

Mr.HAGER. I would like to point out that 2005 the agency was responsible for and helped support almost 3,000 loans, 2,950 loans. In 2006, that number rose to 3,304. Is that taking care of the world? Absolutely not. But when we have other departments and functions in the government, it behooves all of us to work closely together.

ChairwomanVELÁZQUEZ. So let me give you your own facts. Over the last 5 years the agency has drastically cut UCA staff and eliminated its budget. Tell me, how is that taking responsibility?

Mr.HAGER. The budget since I have been there, the number of USEAC members in the field is currently at 16. I don't think at any time—I have been there 2 years. I don't think at any time I have been there that number has been greater than 16.

ChairwomanVELÁZQUEZ. So let me ask you this other question. Since 2003, there have been vacancies in SBA trade finance specialists assigned to U.S. export assistance centers located in New York City and New Orleans. New York City and New Orleans, these are both significant ports. While the latter is clearly in need of economic assistance as a result of the Katrina disaster, can you explain why the agency will neglect to fill such critical positions?

Mr.HAGER. We feel that the coverage throughout the country in total is being covered by the 16 USEAC members we have today.

ChairwomanVELÁZQUEZ. Sixteen for the entire country.

Mr.HAGER. We have in addition to that 68 district offices throughout the United States with numerous members in each office to assist and help us in this initiative.

ChairwomanVELÁZQUEZ. Do you agree with me, New York City and New Orleans, two critical ports, and then New Orleans, this is the administration's commitment to help the victims of Katrina to recover?

Mr.HAGER. Let me break out. I have been to New Orleans a number of times.

ChairwomanVELÁZQUEZ. No. This is not about New Orleans.

Mr.HAGER. May I answer your question? The answer that I would like to subscribe to and present to you is that in New Orleans we are taking goods and products from around the United States that ends up in a port for shipping. We don't believe that— we firmly believe that we have New Orleans covered. We do not believe that adding more USEAC people in New Orleans would help the production of goods and services throughout the country. It would at best help the shipping of those goods and services out of New Orleans.

ChairwomanVELÁZQUEZ. So let me ask Dr. Morrison, do you feel that one of the major problems that we have is that while export is increasing, small exporters are not benefiting from it because they don't have the financing? And you are telling me that two specialists that are important in two key ports are not necessary?

Mr.HAGER. I am saying that we—

ChairwomanVELÁZQUEZ. Dr. Morrison. Mr. Gaskin.

Mr.MORRISON. With all due respect for Mr. Hager's point of view on this, I am afraid I would disagree. If you look at the output of the export finance specialists, it comes to on average about $120 million in export sales underwritten per year. I think that $120 million would be enormously beneficial for New York City and New Orleans. I do not know why those positions have been vacant for so many years. I strongly believe they ought to be filled, and I think it is an important part of the New Orleans recovery from Katrina to do that.

ChairwomanVELÁZQUEZ. Mr. Gaskin.

Mr.CORDERO-GUZMAN. Thank you.

I think that—as I mentioned in my testimony, there are many small companies, manufacturers who could use help, financial help exporting. But they also need financial help in the U.S. dealing with the trade bureaucracy. The SBA could be a remarkable advocate for small manufacturers who are trying to find their way through the ITC and the USTR requirements, and especially when it comes to the antidumping/countervailing duty areas, but it is prohibitively expensive for any company to do that. So financial help there would be very helpful.

ChairwomanVELÁZQUEZ. Thank you, Mr. Gaskin.

Mr. Hager, you indicated that the financing sections of the bill may violate international dumping rules. However, SBA currently administers a loan program which aids small business, and I quote, confronting increased competition with foreign firms, and I quote, are injured by such competition. The legislation that we have before us simply builds on this existing initiative. We are not creating new initiatives. We are adding layers. We are expanding the size of the loans. So how could you come before the Committee and say that we are in violation of international dumping rules? Yes.

Mr. HAGER. Madam Chairwoman, I don't pretend to be an international attorney or have—please let me finish.

Chairwoman VELÁZQUEZ. Yes.

Mr. HAGER. We believe and we have been advised that it may be in conflict with WTO. It is up to WTO to make that final determination. We are raising it as an issue to be discussed. We are not saying it absolutely will. We have been told it may. And we want to bring it to the Committee's attention so it can properly be addressed.

By the way, I just want to make one quick comment. New York is still our largest producer of loans in international trade for the SBA.

Chairwoman VELÁZQUEZ. Mr. Hager, I will ask you to go and revisit the testimony and the statement that you made regarding violation of WTO. Don't come here, sir, and make such accusations. And I have to tell you after you finished reading your note that I don't mind having thoughtful disagreement here. That is part of the deliberations that needs to take place here. But I do not—I really resent the fact that you come here and say—and make a statement that this is in violation, the same thing you did when we were considering the lending bill of Mr. Chabot and Mr. Sarbanes. You said that it violated the Credit Reporting Act. I presented you with a copy of the Credit Reporting Act, and you were unable to point to the accusation that you were making. So if mid-level staff is going to come here and not provide the facts, then I will request from now on to have the Administrator to come before the Committee.

Mr. HAGER. May I respond to you?

Chairwoman VELÁZQUEZ. Yes.

Mr. HAGER. Number one, I said in my testimony just a few minutes ago that it may be. I did not say—I am not an international attorney. I cannot absolutely tell you. I raised it as an issue for us to deal with, and I think we should deal with it. Let us investigate it and get our staffs together and evaluate it to determine—

Chairwoman VELÁZQUEZ. Are we creating a new lending program under the bill? Are we? No.

Mr. HAGER. But what I am—I am raising it as an issue. I thought that was the purpose of our comments.

Chairwoman VELÁZQUEZ. Thank you.

Yes, Mr. Gaskin.

Mr. GASKIN. If I could just add a comment. You know, the U.S., the administration approach seems to be in flux on the WTO. There is areas like this where loans maybe are ruled illegal against or they think they might be illegal with WTO rules. But why don't we let the WTO figure that out?

Chairwoman VELÁZQUEZ. Well, also let me add, Mr. Gaskin, how many complaints did this administration have filed before the WTO?

Mr. HAGER. I don't know.

Chairwoman VELÁZQUEZ. You don't know? Let me tell you: Three, three so far.

Mr. HAGER. Yeah.

Chairwoman VELÁZQUEZ. What about the manipulation of the—

Mr. HAGER. There have been complaints filed.

Chairwoman VELÁZQUEZ. I will go to Mr. Chabot.

Mr. CHABOT. Thank you, Madam Chair. Just a few questions. If you would like to pour yourself a glass of water, Mr. Hager.

Mr. HAGER. I am fine. It is not personal.

Mr. CHABOT. In any event, let me follow up on a couple of things. First of all, Mr. Kelly and Mr. Hager, relative to the Microloan program, Mr. Kelly you made the point in your opinion that it is complementary, not duplicative. And I think there is some disagreement. The Microloan program I am referring to, Mr. Hager's point of view and Mr. Kelly, I would be interested to hear a little bit of discussion from both of you on that particular point.

Mr. KELLY. This is specifically the duplication between Microloan and PRIME?

Mr. CHABOT. Yes.

Mr. KELLY. Is that what you are referring to? They serve different people. First of all, the PRIME is more targeted to low-income folks than Microloan is, although Microloan does certainly serve mostly low-income people. The difference is entrepreneurs who need capital versus those who don't need capital. And if you don't need a loan, at least right now, PRIME is a program that was really created to help those entrepreneurs.

If you do need a loan, the Microloan program is for you. And then you can also get some technical assistance through that, but it is specifically for people who need a loan. If you don't need a loan, you can't go to a Microloan intermediary and say, give me technical assistance but not a loan. You have to have both together.

If I could just give a little background, the Microloan program is older than PRIME. And when our industry, our field, in the late 1990s was polled by—we were told that the biggest need out there among the entrepreneurs that they were working with was the program that became PRIME. It was to help the entrepreneurs who did not at that time need a loan but they only needed technical assistance.

And, in fact, what is different here in the United States versus Microenterprise abroad is that abroad is very lending-focused. That is mostly what Grameen Bank does, almost all of it. Here, probably half of our groups don't do any lending at all; they only provide technical assistance to entrepreneurs.

Mr. CHABOT. Mr. Hager, did you want to comment on any of that?

Mr. HAGER. I don't know that there is anything I could add other than our whole position on PRIME has been we have programs of SCORE, SWBC, SDIC, the district offices. We think that there is some duplication that can be corrected. But I agree with so much that you said. The Micro-programs certainly emerged before you needed the PRIME. And once it was there, let's take a look at PRIME to help with the number of loans and help those small emerging companies deal with the issues they have to deal with to enable them to apply to the loan and, more importantly, get it.

Mr. CHABOT. Let me turn to you, Ms. Darien. Again, in the programs that we are referring to this morning, particularly the Microloan program, you mentioned that a lot of folks when they are starting up or expanding a business, rather than utilize one of these loans because of the availability of them, they end up either going to personal savings or borrowing money from perhaps relatives—I don't know that you mentioned that, but that is something that occurs. You mentioned they use their credit cards. If they use their credit cards and if they pay it off every month, they are not paying an interest rate. But if they are not, they are paying anywhere from 25 percent and up.

Could you discuss the impact that would have, and why these are so important to businesses starting up, or relatively small and expanding?

Ms.DARIEN. We did a poll—in fact I included it and attached it to my written testimony—on financing for microbusinesses so you would get a good snapshot of everything they are using in terms of their finances. But particularly credit cards, personal savings, and home equity loans were their main source of financing to start up their business. And in terms of ongoing financing, it was personal savings and credit cards.

And the big issue, particularly with credit cards and lines of credit is, again, that interest rate. What is occurring with credit cards is that they are paying minimum balances with microloans, they get affordable rates due to the subsidy, the backing, they get the size loan they need. It creates stability within their financials for their business versus credit cards, which puts an undue burden on their business.

With personal savings, as mentioned, should they have an incident, whether there is an economic downturn—which is a perfect example—and all of a sudden they have liquidated their personal savings to go into their business. Or if there is a personal situation—for example, a medical illness occurs and they have no more personal savings, it is all invested in their business—these are the persons you will find filing for bankruptcy.

So it is a big issue in terms of how someone is going to start up and finance their business. That is why the Microloan program is so important. It offers funding at affordable rates and also offers that technical assistance to teach the microbusiness owner how to properly apply for the loan and how to use that money to the best of their interest, and supports them throughout the whole repayment of the loan.

Mr.CHABOT. Thank you very much.

Dr. Guzman, if I could turn to you next, you had made the point that in the study that you did, when you are talking about the smaller loans and depending on the three categories that the loans were in, that they cost anywhere from 11 percent—the actual cost of the loan—to 30-some percent, and made the point that what that ultimately says is that it is being subsidized by somebody, and that is essentially the State or the government in some form, which is essentially the taxpayers that are funding that.

Would you talk to, maybe, the overall broader either public good or the reason—the justification for the taxpayers or the government, or whatever terminology you want to use, picking up that thing that is necessary and what that ultimately does for the overall economy and employment, et cetera.

Mr.CORDERO-GUZMAN. There are two points:

One on the cost of providing the loan and understanding why it takes 35 percent, for example, for the small loan and what do you need to do to be able to put that money out there, the amount of staff time and others. That is one end of it.

The subsidy is picked up mostly by a combination of State, foundation funding, individual donations. It is up to the individual nonprofits that are the members of the Association for Enterprise Opportunity. Each of the members has a particular funding proportion that helps them cover the gap between what they are charging and what it actually costs them to do the work.

It is not only the government that covers that. In the case of ACCION New York, for example, it receives very little government money and most of that is covered by foundation support. On the order of $700,000 per year that has to be raised from numerous foundations.

The second part of the question, more about what do we get in return for that investment—it is not a question that in the paper we necessarily analyzed. The question we wanted to get at in the paper was, why are banks not giving out these loans? And we had two options: that they are very smart and they realize that there is no money to be made on these loans, or that they are very stupid and they are not taking advantage of opportunities.

And what we found was that the banks in fact are relatively smart, because it costs them, they are paying a bank loan officer $100,000 to evaluate a $2,000 loan? How much does it cost Citibank to pay someone just to look at that piece of paper? We found for a $500 loan it is easier to flip a coin than to pay someone to begin to look at the paperwork. That is what we wanted to get into: Why is it that banks are not providing this financing? And the answer is because for the very small amount for the somewhat risky borrowers, it is a very risky thing to do.

The second side is, is that investment worthwhile? We in the paper did not look at what happens to the microbusinesses once they received the loan. We have a lot of other evidence from the businesses themselves and from others that they benefit significantly from receiving that access to financing.

In order for a business to survive it needs three m's: money, management and markets. And we believe that the small businesses are finding markets very well. The have to some extent—and the TAs are designed to give them the management skills they need to grow their businesses. The biggest obstacle that they reported is always the money and the expense it costs them to get that money.

The credit cards, 25 percent. We interviewed people that were borrowing from loan sharks at a rate of 20 percent per month. The most common form of payment for the shark was to pay the interest rate every month until you have the money to pay the entire lump sum. It ended up in some cases to be 240 percent a year.

While we did not look at evidence of the positive social businesses of microlending, there seems to be plenty of evidence that the small businesses do create jobs for the owners of the business and for others around them, and do provide income to the family members. Whether it is worth the social investment is up for you who are lots smarter than I could ever be to decide that.

Mr.CHABOT. I agree with everything except the last point that you made.

Madam Chair, rather than go to Dr. Morrison and Mr. Gaskin, I yield back the balance of my time to be fair to other members.

Chairwoman VELÁZQUEZ. Mr. Shuler.

Mr. SHULER. Madam Chair, thank you. To Ranking Member Chabot, it is almost my questions exactly. I will have to come up with some new ones.

Dr. Guzman, obviously, as you have indicated, a tremendous amount of expense that banks would have in order to be profitable to review these loans. And we talk about loan sharks. But don't you think we could agree that the SBA is not in a for-profit organization?

Mr. CORDERO-GUZMAN. Correct.

Mr. SHULER. Not having the profit, I mean, if I look at the people who are looking at—we talk about 50 percent are almost in poverty level or below the income necessary to be able to qualify for some of the banks and to go get a $50,000 or $100,000 loan. It is much better to get a helping hand than a handout. And so thank you for your testimony, because I think it really gave us a true sense of who the people that we are dealing with are, that the SBA should be dealing with, and, probably more important than anything that you talked about, the loan sharks that are being substituted by the lack of work that the SBA has done.

And so I want to commend you on your testimony and what you have been able to give us and provide us a truly inside of what is going on.

And to Mr. Kelly, I would like to hear from you, or Ms. Darien, is talk about some people that have been turned down and why they have been turned down on these microloans. And tell me about a success story.

Mr. KELLY. Thank you, Congressman Shuler. I can tell you about one. There is a woman whose name is Susan Brown in the Denver, Colorado area, and she had an idea. She went to a bank and asked for a loan to start up a business. And she didn't have a great credit score, I guess, and not enough collateral and some other issues, and they basically said, no, we are not interested.

She then went to the local Micro Enterprise Development Group who gave her a loan, and she took the money and went to a trade show. And she has a product called a Boppy. Probably a lot of the women know about it. It is for newborns. It is a U-shaped pillow. You know what I am talking about? That thing has been selected as the best baby shower present in the United States several years running. She has a multimillion-dollar company in Colorado that employs 25 people or more, and she couldn't get a loan from the bank. If it were not for the Microloan program she wouldn't exist. She would, but the company would not exist.

She has said several times that she would be happy to come and testify. It has never worked out with her schedule to do that. Because if it wasn't for the Microloan program I wouldn't be here, I wouldn't be where I am right now.

And there is a guy who is not that far along, Victor Valdez in southern Arizona. He got a loan for a plastic thing that you put around your trash can that helps holds your trash bag up. And he has a contract to sell those in the Ace Hardware Stores throughout the Tucson, Arizona area. If it does well, there is a chance for him to go statewide.

There certainly are a lot of examples like them. Those companies pay a lot of taxes, employees are paying taxes, employing people who were unemployed, in some cases, before. So there is a lot of benefit coming around as a result of these. Some of them are small and want to remain small, but you have some of these big stories as well.

Ms.DARIEN. In the testimony that I submitted, I will be glad to read a quote from our member who received an SBA loan and had substantial trouble getting lending from a bank due to lack of collateral and credit score.

NASE member Mark Zoller, President of Zoller's Outdoors Odyssey's Inc. He said, and I quote, ″My father started a white-water rafting business 34 years ago and he and the operation was simply tired, and at end of his tenure he had a great vision for how he would like the company to expand, but not the energy or the capital. I applied and received an SBA loan which enabled us to purchase and build a new facility and expand our offerings. In the 6 years since, we have more than doubled the business and now have 30 white-water guides on staff along with several support staff. Six years ago our annual revenue was $200,000. This year it looks like it is going to be $550,000. The SBA kept our family operation alive and gave us the opportunity for great achievement.″

This is a perfect example of one of our members. All of our members are microbusiness, 10 or less, and this is how these loans help. A majority of them have a lot of difficulty getting loans through traditional lending institutions. In fact, our association has gone to a whole series of national banks requesting to start a loan program particularly for our members, and they all turned us down. And we are a national association with 250,000 members.

So we ourselves had to create a grant program. We currently have the NASE business development grant program in existence. We give out $200,000 a year, $5,000 grants to our members, but we were unable to start a loan program. Banks refused to work with us.

Mr.SHULER. Thanks. The reason I ask this, Mr. Hager, is one simple fact: The people need help. They are asking for truly a helping hand, not a handout. And we can take these testimonies by the people here and take them back to the administration and truly work for the common good. I mean every time someone from the Small Business Administration comes in here, it is the same process that we go through. You want to continue to cut and cut, and it is truly the people who are making the differences in our small businesses.

North Carolina lost 78 percent of its textile industries. 78 percent, most which have now become small business owners. And we have to keep that in mind. They are not asking for a handout. They are asking for a helping hand.

ChairwomanVELÁZQUEZ Mr. González.

Mr.HAGER. May I make just a comment? You know, I appreciate your comments. I worked in the textile industry in Alabama. The company now no longer exists. The one reason I am up here now—Russell Athletic. We are in support of many of the programs to expand micro. I mean, there is very little we have any issues with at all. We applaud the efforts being made to expand this program.

The export business, the same thing. There are so many issues, I wish we could focus more on the commonality, the things we agree with, as opposed to the few things we don't. But clearly the microlending programs, the testimonials here are so impressive and we again are very supportive of the majority of what has been proposed here today. We don't disagree.

Mr.SHULER. Thank you.

ChairwomanVELÁZQUEZ Mr. González.

Mr.GONZÁLEZ. Thank you very much, Madam Chairwoman. I am going to be asking a question based on testimony by Mr. Kelly, and the question will be going to Mr. Hager and Dr. Cordero-Guzman. This is the statement from Mr. Kelly—this is on the Microloan program.

Raising the interest rate program on the Microloan program will make this program much less appealing to microenterprise development organizations. The value of the program is that it allows Microloan intermediaries to keep interest rates down to their borrowers. By raising the interest rate to the intermediaries they will be forced to raise interest rates to the borrowers, which will create an economic hardship for them and make it more difficult for them to grow their businesses. This strategy is counter to the original reason that Congress created the Microloan program.

And of course we started off with the testimony by Mr. Hager as to why it is so expensive and such. But this is a very troubling statement made by Mr. Kelly.

And so I would start with Mr. Hager. And do you agree or disagree with what Mr. Kelly believes is going to be the outcome of your proposed rule change?

Mr.HAGER. I respectfully disagree only from the standpoint if you look at the interest rates in the nonsubsidy we have in the traditional 7(a) program, and look at the growth that has doubled in the last 4 years, I believe would support the fact that we don't believe that we should be carrying the same subsidy as we are today in the Micro-program.

Mr.GONZÁLEZ. All right. I think Dr. Cordero-Guzman, his work and his paper that he prepared, I am not sure if he is going to agree or disagree—I will just ask. How do you view Mr. Kelly's testimony?

Mr.CORDERO-GUZMAN. The type of subsidy that is required depends on the borrower and the characteristics of the borrower. The problem I am having with the discussion is that we are lumping all the different types of borrowers in the same basket. You would want to, for a value-neutral interest rate, want to change the same to all borrowers. You want to break it down a little. And what we did not want as a result of our paper was to have the better borrowers subsidizing the worst borrowers.

We wanted to find out what is the fair price you need to charge someone who is requesting $20,000 that has a good record, and that is 11 to 12 percent, versus someone who is asking for $2,000 that has not such a good record, which is 34 percent. So the answer as to what you should charge and how much you should subsidize depends on who the borrower is.

Now, if you cut the subsidy, it is going to be passed on to somebody. The groups that administer the programs are nonprofit organizations; they do not have anywhere to pull the money from. They would have to raise it from a foundation or local government or somewhere to cover the spread, or pass it down to the borrower. And there is a moral question as to whether you do or don't want to do that.

And in the literature there are arguments that—the credit rationing literature—there are arguments that there are reasons why you don't want to set the interest rate way too high, because you would only attract people who can pay an interest rate or would want to pay an interest rate that is exorbitant. They are not the best-quality people. They know more information about themselves than you do.

So my answer is it really depends on the borrower. What we don't think should happen is certain borrowers subsidizing other borrowers. We believe that each category of borrowers should get the interest rate they deserve, and the spread should be covered by somebody or the loan will not be made.

Mr.GONZÁLEZ. Which is the biggest fear. This is testimony from Mr. Hager—we propose eliminating the cost to the taxpayers for the Microloan program. Currently, the intermediaries pay less than the 5-year Treasury rate to SBA for their loans. We are proposing they pay just over 1 point more than that rate, still a very favorable rate. This would bring their interest rate to 5.99 percent in comparison to the average rate of 10.5 percent charged to microborrowers.

In my way of looking at it, I think you do place a lot of borrowers in jeopardy because costs will be obviously passed on in the greater cost to the intermediary. And I think by your own testimony you indicated, look, I mean you have to subsidize. Because if you have an officer—loan officer looking over a $5,000 loan application as opposed to a $500,000 loan, good business sense would tell you that you can't spend any time on the 5,000. That is why we have these programs.

I do want to get into the export business. I think it is very, very interesting. Mr. Hager, I don't question your good intentions, but this is where I am going to disagree with you and just about every administrator that we have had from SBA. I know there may be other departments and agencies that should have an interest in the small business exporter. But that is not their charge. But the Small Business Administration, it is your charge. And that is the difference.

We have had someone from the United States Trade Representative's Office sit exactly where you are sitting today and I will tell you, after her testimony everyone here—I don't care if it is Republican or Democrat, conservative, liberal or whatever—had to come to the same conclusion: that they don't have anybody addressing the interests of the small businessman and -woman exporter. They just don't. And there was no coordination, nothing within the Department of Commerce, nothing within the Trade Representative's office.

And so I keep emphasizing to the Small Business Administration, this is your mission. This is your goal. This is your charge. This is your mandate.

You question why we are now going to do something on the export side and you question whether it is going to impede or diminish or in any way jeopardize what is going on out there with the World Trade Organization, the United States Trade Representative. I am going to tell you at this point, I am not sure we care. Someone has got to do it. And we are going to have to push you guys in that direction.

Is there going to be conflict? I will tell you why the others agencies and departments are putting that bug in your ear, that there may be a conflict and overstepping and such. Because they really don't want you involved. They really don't. They are ignoring the situation. They don't want in any way to invest the resources to address this issue. It really is the Small Business Administration that has to initiate this. There is not even coordination with our Trade Representative's Office, and, to a great extent, the whole Department of Commerce.

So I don't have a question at this time. Thank you very much, and I yield back.

ChairwomanVELÁZQUEZ time has expired Mr. Ellsworth.

Mr.ELLSWORTH. Thank you, Madam Chair. This is very informative. If Mr. González wants my time, I would be happy to give to him. I have learned a lot. I don't have any questions.

ChairwomanVELÁZQUEZ Ms. Clarke.

Ms.CLARKE. Thank you very much, Madam Chair. I want to just sort of direct my comments to Mr. Hager as well. And you know, principally we do agree with the mission and what has been said here today. You talked about it is the small things. Let me just say to you that it is the small things that are the heart of the problem here. What it has done is created a chasm of economic disparity. And the SBA has become a partner in that, by these cuts and by not recognizing the nuances of what microbusiness and microenterprise is all about.

I would want to recommend to you that you really take an in-depth look at Mr. Cordero-Guzman's paper, because it truly reflects and gives a real, real-time window into the challenges that our microenterprises are facing. And the value in them to constituencies like mine in Brooklyn, New York, where you have growing interests and expertise in being entrepreneurs, but denial of capital to get it going. We rely on those small entrepreneurs to be our future corporate entities, and when we deny them the opportunity to take that step, when we are not in the position to take that leap of faith with them at the United States of America, we are doing ourselves a disservice.

And so I think the energy that you feel coming from the membership here—I am a new member and these folks got me going—you really should take another look at this. We need your assistance in getting these businesses the assistance that they need. I come from a constituency where immigrants are a big part, second generation, they are coming with entrepreneurial ideas. They come from an environment that inspires entrepreneurship. They become the employers of people who have been systemically unemployed in our communities for a very long time.

So you are going to feel the pressure, you are going to feel the heat. These are individuals who also have connections to their homeland, so exporting business is almost a natural for them in terms of the things that they can create based on the knowledge and innovation that we have in this Nation.

I think that Congressman González hit on the point that I wanted to make with respect to the percentage point that you are requiring of intermediaries. I would like to recommend, Madam Chair, that something be submitted in the form of a report of how this proposal would impact small businesses, showing the data and how they would basically make loans more available. Because this is the argument that we are hearing. And I would like you to, prior to doing that report, read Mr. Cordero-Guzman's report and see if you are really on the mark.

I don't like the fact that there is some speculation involved here, and we need to get to the facts so that we can really go to the heart of the challenges that our businesspeople are facing at the microlevel.

Thank you very much, Madam Chair.

ChairwomanVELÁZQUEZ thank you.

I would like to ask some more questions and then I will go to you. Congresswoman Clarke just mentioned about the fact that there is some speculation but there are not facts. So let me give you some facts and see what type of response you have, Mr. Hager.

You heard from the witnesses that are seated next to you that Microloan borrowers cannot qualify for 7(a) loans and community express loans. Their scores, if they have, are in the 500s, whereas the 7(a) program frequently requires 680 and above. Do you believe that borrowers who normally use microloans could qualify for 7(a) or community express loans if their credit scores are in the 500s?

Mr.HAGER. You know, the decisions on credit are made by the lenders for the most part. We don't tell the lender who qualifies and who does not qualify.

ChairwomanVELÁZQUEZ based on data that you have seen—because I suppose when you come here with a proposal like that, that you have seen evidence and facts that will tell you that there is no risk of denying capital to microborrowers because their score will enable them to go and make a 7(a) or business express loan. Have you seen that data?

Mr.HAGER. A couple of things. I have seen data to say that moving the loan structure from 3.7 to 5.9, we did not believe, would make a major impact to the intermediary. The intermediary would then charge the borrower.

But I want to emphasize here throughout, and if the Committee would please listen to me, we are the advocate of these programs. I can't testify what happened 10 years ago, but I am a public servant that is passionate about this program.

Last year was an all-time record overall for SBA loans. We are advocating loans by the day to get more and more made. We don't fundamentally disagree with what has been proposed here in legislation. It is some of the fine-tuning issues that we are wanting to discuss with you—

ChairwomanVELÁZQUEZ it is a simple question, Mr. Hager, and you don't answer my question. You were a loan officer weren't you? You were a banker.

Mr.HAGER. I spent a lot of years—yes.

ChairwomanVELÁZQUEZ tell me, if a borrower goes to your bank with less than a 500 credit score, would you approve a loan?

Mr.HAGER. It would be based on a lot of conditions with that borrower. I would not as a banker say—

ChairwomanVELÁZQUEZ what is the complaint that we hear over and over and over from small businesses across this country? The problem is access to capital, and banks not taking an interest in their loan applications because they are too small.

Mr.HAGER. Yes, ma'am. And our loan products hit an all-time record in 2006. We did more loans than in the history of the SBA. So far, year to date, we are ahead of last year, I might add.

ChairwomanVELÁZQUEZ Mr. Hager, you said that the technical assistance part should be provided by the SBDCs and the Women's Business Centers; that they should be providing the technical assistance component to the Microloan program. Can you tell me what is the estimated cost to the SBA for the SBDC and Women's Business Centers to take on this additional duties?

Mr.HAGER. We don't believe it would require any additional budget. We would use the budget we have. We think it is more than adequate—

ChairwomanVELÁZQUEZ. You are giving more responsibility to the Women's Business Centers and to the SBDCs but you are not requesting—

Mr.HAGER. We think it is well within their capability to do this, yes, ma'am. Without exception.

ChairwomanVELÁZQUEZ we have the Small Business Development Centers come here and testify that their counseling hours dropped because they don't have the resources. Were you aware of that? Did you read the Congressional Records of the hearings that we conduct?

Mr.HAGER. I can just say with great confidence, without a doubt, that we can accomplish this training with the resources we have. We have a very strong budget there.

ChairwomanVELÁZQUEZ sir, the administrator and the previous administrator came before this Committee when—the whole Katrina crisis—to tell us that they were doing more with less. I am sure that you know that you cannot do more with less.

Dr. Cordero-Guzman, our bill would allow more of the technical assistance grant money to be used for preloan counseling or what you referred to as the loan origination screening. The SBA opposes more resources for this. I ask you in a relation-based lending model, isn't it wise to allocate sufficient resources to screening in order to increase the success of the Microloan program, that by itself has proven to be a success, when you have a 1 percent default rate?

Mr.CORDERO-GUZMAN. What I do know is that the typical microlender that comes in does not have the type of paperwork that a banker would expect a business to have in order for a loan to be processed. Which means that as part of the job of fulfilling their duty of giving out the loan, the microlenders have to be—have to help the business owner get their own paperwork together, and that adds to the costs of providing the loan.

And in our model we use the cost of providing that assistance and factor it into the interest rate that would need to be charged to recover the cost. Because we know that these types of businesses don't have the type of recordkeeping and paperwork that more formal businesses that have CFOs and comptrollers would have. So it is almost a condition of completing the application that the paperwork has to be put together, and that requires someone's time.

ChairwomanVELÁZQUEZ Ms. Darien, would you like to comment?

Ms.DARIEN. I think it is essential to have any kind of assistance, particularly prior to applying for a loan through the entire development, particularly for our microbusiness members. They are an expert in their field, in their industry. I agree with the doctor that a lot of them don't have the paperwork or understand what is required to be an attractive borrower to a bank.

I think, again, the credit score issue is another factor that would—that particular provision would greatly assist microbusinesses in preparing on how to be a good borrower. And once they got through the Microloan program, it would assist them down the line to being prepared if they wanted to get ongoing financing maybe through a traditional lending institution. So it is an essential component that we support.

ChairwomanVELÁZQUEZ Mr. Chabot.

Mr.CHABOT. Dr. Morrison, let me ask you: Does your trade association have members who export their services as well as their goods?

Mr.MORRISON. Yes, we have both service and product exports.

Mr.CHABOT. More goods, I would assume, but you do both.

Mr.MORRISON. Yes, we do both.

Mr.CHABOT. That being the case, is it harder for small businesses to access the export market in services rather than goods? And would the proposed legislation help those selling services to gain greater access to the export market?

Mr.MORRISON. Well, as to the first part of your question, I think it depends on the type of service that is being offered. Computer services, for example, find it pretty easy to get into the export market. Other services that require professional licensing abroad are more complicated.

I think you can go to SBA as a service exporter and seek some assistance. The program really is designed, I think, originally around goods exports, but it could be made to work for service exports.

Mr.CHABOT. Thank you.

And then, Mr. Gaskin, I was interested in your comment when you went back to 2002 and the famous steel tariff debate we had here in Congress that the President was pushing. And I was one of the Republicans that voted against it because I was concerned about the impact that it would have on other businesses, and I am more laissez faire when it comes to tariffs. I think we ought to keep them as low as possible.

But could you talk about the unintended consequences when we act up here, and sometimes how they end up when we are trying to do something to protect jobs, like we were in that debate, and ultimately passed that legislation and the impact that it did have on smaller businesses like the metal folks that you represent?

Mr. GASKIN. I would be happy to. The reality is that when the government gets involved in making decisions about which industries win and lose, there are consequences. And in this case, it was a decision by the government to add a 30 percent duty on imported steel, which meant that in that period I referenced, steel prices in the United States went crazy. They were increasing by 40 to 60 percent in a 4- or 5-month period. And middle-market companies like Our Technology in your district—30 employees, makes bearings for car jacks—couldn't go to their automotive customer and say I need a 40 percent increase, or a 20 percent increase, because steel was half the cost. Well, they tried, but they said no. So they were faced with losing their business.

There are two factors. One is the direct loss of business. If your primary raw material of a metal forming company is in a market that is protected from global competition so we pay about the same prices here as they do in the rest of the world, then we are not competitive. If we don't pay the same as the rest of the world, we are not competitive. During that period we were paying about $200 a ton more for steel in the United States than they were in China or Europe, about $100, so we weren't competitive. So you lose direct jobs.

More damaging, probably, is the indirect loss. Big companies make decisions to move entire products elsewhere in the world where they have stability of pricing in materials that are a big part of the product. And so that is the larger loss. You lose some jobs directly but others you lose indirectly.

I think some of the key components of this legislation are in Title II, the trade compliance areas, and also Title III, the trade adjustment assistance for companies. I mentioned the trade compliance issues and it is horrendous. The trade laws don't work the same for small companies as I think you said, Chairwoman, as they do for big companies.

Mr. CHABOT. Thank you.

Mr. Hager, we are all on a number of Committees and I am on Foreign Affairs, and we have folks from the State Department come over and we grill them on Iraq. And I am on Judiciary, and we just had the Attorney General over talking about all kinds of things that he is being challenged on and criticized about in Committee.

Let me throw you a softball there. Are there any—are you concerned that there have been any misunderstandings or anything that you would like to explain a bit more fully in defense of the SBA or yourself or your family or anybody else that you know?

Mr. HAGER. Well, you are very kind, and I appreciate that very difficult question.

A couple of things. And thank you, because I would like to respond very strongly. And that is, as a public servant who is here because I want to be here, who left the private sector to say I want to do something for this government, I want to do something for these small businesses, I think we are overlooking the fact that we are in this with you. The proposed legislation on micro, we are talking about some fine-tune issues of disagreement. For example, how you deliver technical assistance. We counsel several hundred thousand people a year. We have 1,100 SBDC locations. Can we absorb it? We believe strongly we can. We can provide that.

But we don't—we are not on opposite ends on what the end game is. We are with you and we want to support you to get there.

We want to work with the Chairwoman to set up some special meetings with some of your staff members.

ChairwomanVELÁZQUEZ I assure you that I am going to be here.

Mr.HAGER. Excellent. Well, I hope you will invite me back and I hope that we can get our staff members together.

ChairwomanVELÁZQUEZ if not, the administrator.

Mr.HAGER. If not, the administrator.

But we are looking very much forward to working with you to, we believe, iron some of the wrinkles out that we don't see as significant. There are some that, yes, are significant; but for the most part they are not. Particularly in the Micro-program. Thank you very much.

Mr.CHABOT. I yield back.

ChairwomanVELÁZQUEZ Ms. Clarke do you have any other questions?

Ms.CLARKE. No.

ChairwomanVELÁZQUEZ again, I would like to thank all the witnesses. Members have 5 legislative days to submit materials and statements for the record. The hearing is adjourned.

[Whereupon, at 11:45 a.m., the Subcommittee was adjourned.]

STATEMENT
of the
Honorable Nydia Velázquez, Chair
Committee on Small Business
Hearing on Legislative Proposals for SBA's Microenterprise and International Trade Programs
Thursday, July 12, 2007

I am very pleased to call to order this morning's hearing on proposals to reauthorize Small Business Administration's microenterprise and international trade programs.

As we examine these measures to update the SBA's policies, I believe there are two important facts to consider. First, the economy has drastically changed over the past decade. Most notably, we have seen a broadening of the entrepreneurial base to now include a greater number of women and minorities. At the same time, the US economy has become significantly integrated with those of countries across the globe – providing new opportunities, but also increased competition.

However, while many are doing well in these business conditions, some are being left behind. Microenterprises, the smallest businesses in terms of required start-up capital and employees, face competition without the resources to enjoy an equal playing field in the market. Global integration poses an additional challenge – leaving many small businesses without the capacity to export their goods abroad or thrive in domestic markets. Together, these developments are challenging small firms' ability to remain competitive.

For small firms to thrive in this new environment, it is important that they compete on a level playing field. The two legislative measures we are discussing today will help accomplish this by expanding and modernizing the tools that SBA can offer. These proposals will help ensure small businesses can succeed in a dynamic and challenging economy.

In order to support growth in the country's smallest commercial enterprises, the Committee will hear comments on *the Microloan Amendment and Modernization Act*, which will be introduced by Mr. Chabot today. This proposal strengthens and broadens the reach of SBA's microlending activities. The measure requires the agency to transmit credit history information to major credit reporting bureaus, which will help borrowers improve their credit scores.
In response to the evolving needs of entrepreneurs, the legislation permits borrowers to draw on longer term loans – providing them with greater financial stability. Microlenders are also given greater control of their resources – and as a result will be able to direct technical assistance where it is needed most. If enacted, this legislation would bolster microlending efforts in the U.S. – and this would occur during a time when such initiatives are being championed around the globe.

While some of these global developments are welcomed, others have created challenges for small firms to compete in the international marketplace. To help overcome these barriers, Representatives Hall and Sestak introduced HR 2992, *the SBA Trade Programs Act of 2007.* This legislation focuses the agency's efforts on the trade concerns of small businesses and will help firms dislocated due to globalization better access the assistance they need. As trade policies are developed, the measure requires the agency to work with federal and international organizations to represent small business interests. Finally, it requires an annual trade strategy, outlining the agency's efforts to boost small business's share in domestic and foreign markets. Through this trade legislation, the SBA will be more prepared to assist the business community in the international marketplace.

The economic changes we are experiencing today present real challenges to the SBA and its programs, whether it is the changing demographics of entrepreneurs or the reduction of trade barriers. The fact is that businesses require assistance regarding challenges that were not envisioned when many of the agency's programs were created. Going forward, Congress will seek to modernize the agency's resources so that they remain relevant in an entrepreneurial economy that continues to evolve.

Small firms' innovativeness and flexibility provide them with a natural ability to remain at the cutting edge of their industries. With adequate assistance and access to tools to realize their full potential, I believe the two proposed legislative measures will ensure their ability to succeed even in a challenging environment.

To conclude, I would like to extend my appreciation to the witnesses for their testimony today. I now recognize Ranking Member Chabot for his opening statement.

Opening Statement

Hearing Name	Legislative Hearing on the SBA's Microloan, PRIME and International Trade Programs
Committee	Full Committee
Date	7/12/2007

Opening Statement of Ranking Member Chabot

"I would like to thank the Chairwoman for holding this hearing to review legislation to improve the operation of the Small Business Administration's (SBA) microloan and international trade programs. A re-examination of these two programs is long overdue and I am interested in hearing from the witnesses on any suggestions they might have as we prepare for a markup on these bills next week.

"The Committee already has heard about the efficacy of microloans to generate economic growth and redevelopment for individuals and areas that are frequently overlooked by commercial lenders and the SBA's guaranteed-loan programs. I know that parts of Cincinnati have areas in which a greater spark of entrepreneurship would lead to increased economic revitalization. I believe that improvements to the microloan program can generate that spark. However, those improvements must come within the context of budget constraints. I look forward to the witnesses' testimony and suggestions for enhancing the microloan program. Some suggestions we have heard include: increasing the number of loans that intermediaries can make to be eligible for participation in the SBA program; eliminating the cap on interest rates that microlenders may charge to borrowers; requiring that some microloan organizations focus on educational services and others on lending; and centralizing certain back-office operations.

"The other program that we are examining today is the SBA's assistance provided to small businesses engaged in international trade. Although there are a number of general entrepreneurial development programs that can provide some assistance in this area to small businesses, the area is fraught with regulatory issues that require an extensive specialized knowledge that may not be available from the SBA's entrepreneurial partners. Thus, it is not surprising to find that the SBA created other programs to meet the needs of small business exporters.

"Since 1992, small business participation in international trade has expanded quite dramatically. According to the most recent statistics available from the Department of Commerce, there are about a quarter of a million small businesses that export. Revenue increased from $102.8 billion to $203 billion in 2004. There is no doubt that small businesses are playing a vital role in reducing America's trade deficit. Continuation of this success and even greater impetus on small business exporting will benefit the American economy.

"The question becomes how to do this in a manner that fits within the current budget situation. I look forward to the witnesses providing us with detailed assessments of the current state of SBA international trade assistance and their suggestions for improvement. These might include: greater coordination within the SBA; better interaction with other federal agencies; and increased technical assistance. Of course, those suggestions that can be accomplished without additional expenditure of resources will be most seriously considered by the Committee. On the other hand, simply moving boxes around on an organizational chart, without more, while not costing anything, may not provide the services needed by America's small businesses that currently provide exports or want to go global.

"Again I would like to thank the Chairwoman for holding this hearing and yield back the balance of my time."

Statement of The Honorable Jason Altmire
House Committee on Small Business Hearing
"SBA's Microloan and International Trade Programs"
July 12, 2007

Chairwoman Velazquez, thank you for holding today's hearing on legislative proposals to update and improve SBA's Microloan and International Trade programs. These are vital components of this Committee's efforts to reauthorize the SBA and will do a great deal to aid small businesses.

The Microloan program has, by all accounts, been a great success for the government and the borrowers who rely on these small loans. The program has experienced very few defaults from intermediary lenders or borrowers and is crucial in helping entrepreneurs get businesses up and running, particularly in underserved areas. I am excited by the steps the Microloan Amendments and Modernization Act takes to further improve this program, by increasing the average loan size, expanding technical assistance, and creating a credit reporting mechanism for borrowers.

Likewise, the SBA Trade Programs Act proposes much needed updates to the SBA's international trade programs. This legislation will provide greater export assistance and requires the SBA to develop a plan to help small firms do business abroad. Helping small businesses better access foreign markets will help create small business growth and job growth here in the U.S. I am also encouraged by the bill's attention to the other side of international trade: the often painful effects visited upon businesses and workers who are undercut by unfair trade practices. The trade compliance initiative and small business trade adjustment assistance contained in the bill are important steps towards helping our businesses compete on an oftentimes unleveled playing field.

Thank you again, Madam Chair, for bringing these bills before the Committee today. I yield back the balance of my time.

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HOUSE SMALL BUSINESS COMMITTEE
HEARING REGARDING
MICROLOAN AND INTERNATIONAL TRADE LEGISLATION
JULY 12, 2007

Testimony of
Associate Administrator Michael Hager

Good Morning Chairwoman Velazquez, Ranking Member Chabot and distinguished members of the Committee. My name is Michael Hager, and I am the Associate Administrator for the Office of Capital Access at the U.S. Small Business Administration. Thank you for inviting me to discuss legislative proposals affecting our Microloan and International Trade programs at SBA.

Microloan Program

In its current design, SBA's Microloan program combines the resources of the U.S. Small Business Administration with those of locally-based nonprofit organizations, acting as intermediary lenders, to provide loan and technical assistance to small businesses. Under this program, SBA makes funds available to intermediaries which, in turn, make loans to eligible borrowers.

It is important to point out that our regular 7(a) program reaches many more members of this community than does the Microloan program. In FY 2006, we approved almost 43,000 loans under $35,000 in our 7(a) program, which accounted for 44 percent of all loans made in this program, our largest and most widespread loan program. We made more than 5,000 loans of $35,000 or less under our Community Express program, in which the SBA makes the loan guarantee and the lending organization provides the borrower with technical assistance. So, in total last year, we did close to 50,000 'microloan' activities, when you add in the approximately 2500 loans made through the Microloan program.

The Agency has a renewed focus on ensuring that its products and services are accessible to entrepreneurs in the nation's most underserved markets – those with higher rates of unemployment and poverty and lower rates of economic progress. Businesses in these target markets can be reached through our regular 7(a) program and also through non-bank microlenders.

SBA's new management team, led by Administrator Steven Preston, is very focused on helping underserved markets, especially though Community Express and other 7(a) loan programs. We also have proposed important changes to the Microloan program, to limit duplication and ensure it effectively complements the financial assistance already available to underserved markets through our other products.

Legislative Proposals

We are pleased to have the opportunity to comment on the Committee's legislative proposal to improve the Microloan program and to move the PRIME program to the Small Business Act. My Deputy, Janet Tasker, testified on SBA's positions on the Microloan program included in our Fiscal Year 2008 Legislative Package, but I would like to highlight a few of those points at this time, as you consider legislative changes to the program.

The Microloan program as currently structured is costly to the taxpayer. In FY 2006, it cost 85 cents to the government for each dollar loaned to a Microloan intermediary, as compared to 3 cents for a 7(a) loan. In FY 2006, the total appropriation required to maintain the subsidy was $1.3 million, and $12.8 million was provided for administrative costs and technical assistance.

To sustain support for the program, to ensure no possibility for program interruption (e.g., during continuing resolutions), and to make most effective use of taxpayers' funds, we propose eliminating the cost to the taxpayers for the Microloan program. Currently, intermediaries pay less than the 5-Year Treasury rate to SBA for their loans. We are proposing they pay just over 1 point more than that rate – still a very favorable rate for them. This would bring their interest rate to 5.99% in comparison to the average rate of 10.5% charged to microborrowers.

With regard to our proposal to eliminate the Microloan technical assistance, SBA already supports a nationwide network of resource partners who provide counseling and training to entrepreneurs, including Small Business Development Centers (SBDCs), Women's Business Centers (WBCs), and SCORE. Through the Microloan intermediaries and district office staff, SBA would direct microborrowers to these sources of technical assistance. This will save taxpayers about $13 million.

Now I would like to comment on the Committee's proposals to amend the Microloan Program:

SBA commends the Committee's interest in making sure that microborrowers who make timely payments on their loans are able to establish positive credit history. In the current lending environment, establishing a positive credit history is a critical link in allowing microborrowers to expand and/or graduate from the program and, ultimately, obtain conventional financing. We understand that there are some minimum volume reporting practices on the part of credit agencies that all microloan intermediaries may not meet. For those microloan intermediaries that do not have sufficient reporting volume, the Administration is interested in finding a workable solution to provide this data to credit reporting agencies. For those microloan intermediaries with sufficient volume to meet credit reporting agency requirements, it would be more effective and efficient for microloan intermediaries to simply share that data directly with credit reporting agencies.

SBA has concerns with regard to the Committee's proposal to require that intermediaries have at least one full-time employee with three or more years experience making microloans to startup and growing small businesses. If our intermediaries are truly focused on providing both technical assistance and lending to microborrowers, then we believe SBA should maintain the authority to certify qualified programs, to best protect the interests of the taxpayers and borrowers.

The Committee's proposal to increase the average loan size in an intermediary's portfolio from $7,500 to $10,000 will not have a dramatic impact on the program, in our estimation. Therefore, we have no objection to this provision.

We believe that the technical assistance provisions in the bill fall short of what is prudent to ensure that the counseling and training provided to entrepreneurs contributes to their success. Under the current Microloan Technical Assistance program, very little information is available on how grant monies are used by intermediaries and what outcomes result from this investment. Furthermore, the SBA is concerned that the increase in use of funds to 35% for pre-loan counseling for prospective borrowers could deprive **actual** borrowers of the assistance they need to succeed.

With regard to the Committee's proposal to move the PRIME program to the Small Business Act, SBA does not support reauthorizing the PRIME program. We continue to object to the overlapping programs focused on this area of technical assistance, and would prefer to focus our management resources on a narrower group of programs, to ensure effectiveness. Given the proposed change in Microloan technical assistance to serve additional "prospective" borrowers, the PRIME program becomes only more duplicative.

International Trade

International trade is rapidly increasing in importance for the U.S. economy. In 2006, the U.S. experienced a record level of exports, almost $1.5 trillion. Millions of jobs are associated with international trade. Small business is a big part of this, accounting for $375 billion of exports, more than one *billion* dollars per day. International trade -- exports plus imports -- is now so important to the U.S. economy that it is equivalent to 28% of GDP, the highest level in modern history. Last year, exports grew *three times faster* than the economy as a whole. It is clear that exporting is the new growth market for small business.

SBA's Office of International Trade (OIT) is involved both in direct service delivery to small businesses and supporting the international trade and economic policies of the United States as they affect small business. On the direct services side, we provide critical technical assistance to small firms seeking to reach export markets. This includes one-on-one counseling by U.S. Export Assistance Center (USEAC) personnel, Export Technical Assistance Partnership (ETAP) training, as well as informational and training material provided on OIT's website.

Through its trade finance programs, SBA helps exporters carry out their export transactions through the Export Working Capital Program (EWCP), the International Trade Loan (ITL) program for long-term financing, and Export *Express,* which reduces paperwork and streamlines the application and review process for EWCP loans of up to $250,000. EWCP finances the short-term export working capital needs of small businesses with an SBA guarantee of up to 90%. With SBA's guaranty limit of $1.5 million, EWCP loans of up to approximately $1,670,000 are eligible to receive the full 90% guaranty.

SBA's International Trade Loan (ITL) is a loan product developed to provide small business exporters the necessary capital not only for long-term capital assets, but also to retrofit and retool their production capacity and capabilities due to adverse impact of foreign imports. SBA also participates in the Americas' Competitiveness Forum, led by DOC, to reach out to businesses and disseminate information on strategic plans to make U.S. firms more competitive in the Americas and the global marketplace.

In FY 2006, SBA experienced record export lending, surpassing $1 billion for the first time in the history of the program and doubling the number of loans compared to three years ago. These 3,300 loans, guaranteed under SBA's 7(a) program, supported over $2 billion in U.S. export sales.

On the policy side of our mission, OIT influences the overall international trade environment, which can affect the prospects of each business, beyond what SBA could ever do for businesses on an individual basis. This policy function is accomplished through collaboration with the Government's international affairs agencies, including the Departments of Commerce and State, the United States Trade Representative (USTR), the President's Export Council, the Export-Import Bank (Ex-Im), and as an original member of the Trade Promotion Coordinating Committee (TPCC), among others.

Legislative Proposals

I am pleased to have the opportunity to comment on the Committee's international trade legislation. We commend the Committee's recognition of the opportunities available to small businesses in international markets. As I mentioned earlier in my testimony, exporting is the new growth market for small businesses, and SBA certainly has an important role to play in promoting, assisting and training small businesses as they pursue international opportunities.

However, we have serious concerns about the Committee's proposals to expand SBA's roles and responsibilities in international trade policy and promotion. We believe that the Committee's legislation would create extensive duplication of existing programs and roles under the statutory authority of other U.S. trade and investment agencies, namely Commerce, USTR, and Ex-Im. Because some of the matters covered in the draft bill are outside of our area of expertise, we have consulted with other agencies and some of our testimony is based on these discussions.

Title I of the legislation concerns the expanded role of and staffing of USEACs. SBA believes this is a useful provision. It is important that we closely coordinate to make sure that the different markets served by the two agencies are adequately assisted.

SBA is unclear about the intent of the changes proposed in Section 102, which increase the gross loan amount for IT loans from $2.25 to $3 million. This is a program of limited applicability based upon certified adverse impact of international trade. At the same time, the provision increases the gross loan amount of Export Working Capital Loans but does not increase the maximum guarantee amount. As a result, the effective guarantee percentage is reduced from 75% to 50%. SBA would appreciate an opportunity to work with your staff to clarify the goal the Committee is attempting to reach and provide you with the necessary technical assistance.

As you know, SBA and Ex-Im currently have a "harmonization" procedure specifically designed to prevent overlap between our projects. Increasing SBA's loan size from $2.25 million to $3 million could be duplicative of existing Ex-Im financing and not only increase the administrative burden for SBA, but also neglect the intended smaller borrowers. Also, increasing loan amounts without taking into account the varying guarantee percentages and purposes of our programs may result in unintended consequences.

We have not had the opportunity to fully review legislative language in Section 301, which amends section 7(a)(16). However, it is our belief that many of the conditions specific to the proposed loan could possibly be considered by our trading partners to be prohibited export subsidies as defined under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures.

Further, this section creates a potential new definition of dumping by making loans contingent upon "the influx of imports below average U.S. production costs." Depending on specific legislative language, there may be subsidy concerns regarding the trade adjustment assistance proposal in Section 301. Unlike the other provisions, this provision appears to create a different definition of dumping than the one commonly used by the U.S. government – sales below the producer's sales price in the country of origin or at a price lower than the producer's cost of production. The provision could be interpreted as a double remedy for dumping that would be inconsistent with our international obligations under the WTO. It also creates a new category of lending that would be based upon "products benefiting from currency devaluation practices of foreign governments." Neither SBA nor its lending partners have the technical expertise to make determinations based upon such standards, and any such loans may violate trade agreements.

With regard to the trade compliance provisions in the proposed legislation, we have concerns about expanding SBA's role in these activities. Congress has established SBA's role to be a finance and technical assistance agency, and SBA does not have the expertise to deal with trade compliance policy issues. While SBA works with Commerce, USTR, and other government entities on these issues, we are not equipped to undertake a specific compliance and enforcement role. As a core member of the TPCC, collaborating agency with the USTR, and full partner with the Department of Commerce, SBA's core competencies rest with the activities of providing expert advice to new-to-export companies and providing financing for the export transactions.

Congress and the President have given the responsibility of filing and prosecuting trade disputes to USTR. The Department of Commerce (as recognized under section 2(b)(2) of the Small Business Act) is specifically the lead agency in foreign commercial policy and it is our understanding that Commerce has responsibility for dealing with unfair trade laws, dumping, and unfair foreign government subsidies. Further, the Department of Commerce has a Trade Compliance Center, a one-stop-shop for getting U.S. government assistance in resolving trade barriers or unfair situations encountered in foreign markets and a Petition Counseling Unit which provides small businesses with assistance on preparing and filing antidumping and countervailing duty cases.

The Patent Assistance and Intellectual Property Protections Initiative included in the bill is also duplicative of existing government efforts. The Office of Intellectual Property Rights (OIPR) in the Department of Commerce already provides these services to small businesses through a number of programs. For example, "road shows" are conducted across the country to inform inventors about how to protect their ideas in China and other countries, and OIPR seminars teach Americans how to protect their intellectual property here and abroad. SBA partners with OIPR in many of these initiatives as well as posts the OIPR weblink on the SBA's webpage.

SBA has been working to disseminate information on intellectual property rights (IPR) issues to small businesses through conferences, seminars, and conference calls. The Export Legal Assistance Network (E-LAN), a cooperative program among SBA, Commerce and the Federal Bar Association can also make significant contributions to small businesses with a national network of international trade attorneys who provide pro-bono counseling sessions on topics that include IPR. Therefore, we see no need to duplicate these efforts.

The Committee's Trade Adjustment Assistance proposals are also problematic for the Administration. The Economic Development Administration (EDA) in the Department of Commerce already has a program that benefits small businesses negatively affected by trade. The Trade Adjustment Assistance (TAA) program, authorized though the Trade Act of 1974, as amended, provides technical assistance to manufacturers and producers that have lost employment, sales, and production due to increased imports. EDA administers the TAA program through a national network of 11 Trade Adjustment Assistance Centers (TAACs).

Any changes to the TAA programs should be resolved in the context of TAA reauthorization, which expires in September, not on a piece-by-piece basis.

In closing, it is important to note that SBA **does** make significant contributions tc the National Export Strategy and participates with the USTR's Small Business Trade Capacity Building working group during Free Trade Agreement negotiations to ensure that small business concerns are represented. SBA also provides training for employees of TPCC agencies during the course of TPCC inter-agency training conferences, held in Washington. Further, SBA also represents U.S. small businesses in multi-lateral, international organizations such as OECD, APEC and Summit of the Americas initiatives.

The legislative proposals on small business trade policy are outside the scope of SBA's mission. Trade policy is set by USTR, in coordination with other TPCC agencie – Commerce, State, Treasury, Ex-Im Bank, USAID, SBA and others. We believe that i would be inappropriate and counterproductive for SBA to set trade policy for American small businesses.

In conclusion, I would like to express concerns that the Committee's approach through this legislation is inconsistent with our international obligations and goes far beyond the scope of the SBA. Again, we appreciate your commitment to increasing opportunities for America's small businesses in the international marketplace, and ask t work with you on alternative ways to accomplish our mutual goals.

Chairwoman Velazquez, that concludes my testimony. I look forward to answering any questions you may have.

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Testimony of

Kristie Darien, Executive Director
The National Association for the Self-Employed

"SBA's Micro-Loan Program"

House Committee on Small Business

July 12, 2007

On behalf of the National Association for the Self-Employed (NASE) and our 250,000 micro-business members nationwide, I would like to thank the House Committee on Small Business for allowing me to speak here today regarding the Small Business Administration's Micro-Loan program and how it assists the access to capital needs of this important and unique demographic of the small business population.

The NASE's membership represents a wide variety of industry sectors, with the largest segment from the services/consulting sector and the construction trade. Approximately 60% are sole proprietors and 53 percent run their business out of their home. With an average size of four employees, close to 50 percent of our membership employ family members and spouses in their micro-business. In 2005, an NASE member's business had median gross revenue of \$112,400; the median annual household income was \$71,000. As you can see, our membership is quite reflective of our nation's middle class, family-owned and operated small businesses.

A key obstacle faced by this segment of the business population is the lack of access to financing, which is essential for the start up and continued growth of micro-businesses. Sixty-one percent of NASE's members feel that there are not adequate funding resources for the micro-business community. Traditional lending institutions such as banks and angel investors are unlikely to offer loans and investment capital to these micro-firms due to a variety of issues. One barrier to micro-lending is the concern that start-ups and smaller enterprises are risky investments since growing businesses typically exhibit erratic bursts of growth and downturn. Thus, the perceived high risk reduces chances for micro-business start-ups to obtain financing. Another issue is that micro-businesses by and large require smaller amounts of capital and thus, banks or investment companies often times believe that its is not an efficient use of time or resources nor will they receive a substantive return on investment from such a small amount. Additionally, increasing mergers and consolidations of banks have led to larger regional or national banks buying out small, local banks. Large banks tend to be less interested in making micro-loans to small, local businesses. Where a micro-business owner once had a long-standing, cultivated relationship with his/her local bank, the owner will now be forced to deal with a new system and staff. This all affects lending.

With this in mind you may then ask how are micro-business owners currently financing their businesses. Well, according to a March 2006 NASE survey, approximately 58 percent of our members use their personal savings to start their business. Ten percent utilize credit cards and a little over nine percent use a home equity loan for start-up capital. As micro-business owners look for ongoing financing in order to maintain or grow their business, 36 percent continue to use their personal savings while over 21 percent turn to credit cards. Both of these avenues do not promote long-term stability for the owner and the company.

The use of personal savings puts a micro-business owner in a precarious position in which he or she would be unable to recover financially should an unexpected personal or business expense occur such as a medical illness, necessary home repair, or an economic downturn. In addition, capital from personal savings used for the business takes away money that can be used towards retirement savings for the self-employed individual and their family.

The high usage of credit cards and personal lines of credit put the owner and the business at risk. High and fluctuating interest rates can increase debt and affect the ability of the business owner to pay back the money. This, in turn, can negatively affect a micro-business owner's credit score creating another obstacle towards qualifying for loans. Twenty-six percent of our membership indicated that they believe their credit score was their biggest barrier to obtaining financing. In addition to those entrepreneurs with lower than required FICO scores, many also do not have extensive credit histories which influences their ability to be considered for a loan. Overall, the reliance on FICO credit scoring by traditional lending resources to examine potential borrowers is a critical hurdle faced by micro-businesses.

With all of this said, the one shining beacon of opportunity for a micro-business owner in the challenging realm of business financing, is the Small Business Administration's loan programs, such as the Micro-loan program. This program addresses all of the above barriers that affect access to capital for micro-businesses and gives them a chance to start and grow their business.

While banks are an important component in the program due to their work with microlending intermediaries, micro-business owners applying for financing through the Micro-loan program are not subject to the biases or barriers of traditional lending institutions. They are able to work with community-based, non-profit intermediaries whose sole focus is to assist them in their endeavor of starting a micro-business. Microlending intermediaries offer financing opportunities via the SBA Micro-loan program for those needing small amounts of capital (under $35,000) and for entrepreneurs with lower credit scores or minimal credit history.

Most importantly, these intermediaries have essential expertise on the needs of this key demographic. The technical assistance component to the Micro-loan program is a crucial element which enables intermediaries to assist micro-business owners step by step through the development and growth of their business. This training and assistance not only increases the likelihood of full repayment of the loan, but increases the likelihood for business survival and success.

The National Association for the Self-Employed strongly supports the Micro-loan program and we have consistently advocated for increased funding, lower lender and borrower fees, and improvements upon SBA loan programs. Based on our initial review, the NASE is supportive of the Committee's draft legislation to improve upon the SBA Micro-loan program. In particular, the NASE is pleased to see the bill include provisions to facilitate the transmission of credit reporting information by establishing a process for intermediaries to provide information to the major credit reporting agencies about a borrower's payment records. This would significantly assist in adding to and improving upon a micro-business owner's credit history.

As a membership organization representing micro-businesses, I cannot express to you more intently the importance of the SBA loan programs, especially the Micro-Loan program. In fact, access to financing is so critical to our membership that our association launched in 2006 a Micro-Business Development Grant program to assist our membership. Through this program, NASE members can apply for a grant up to the amount of $5,000 for a specific business need such as equipment, technology, marketing campaigns, etc. Since May of 2006 we have given out 44 grants totaling just under $200,000. We have designated an additional $200,000 to be given out this year in grants. The program is the first of its kind and the grants have been of immense assistance to our members who need small infusions of capital for their micro-business.

In conclusion, I would like to leave you with some comments from some of our micro-business members who have been the recipients of SBA loans over the years so that you may know how important these programs are to self-employed and micro-business communities:

NASE Member Mark Zoller, President of Zoller's Outdoor Odysseys Inc in Washington state said, "My father started a white-water rafting business 34 years ago and he and the operation was simply tired at the end of his tenure. He had great vision for how the company could expand, but not the energy or capital. I applied and received an SBA loan which enabled us to purchase and built a new facility, and expanded our offerings. In the six years since, we have over doubled the business and now have 30 whitewater guides on staff along with several support staff. Six years ago our annual revenue was $200,000, and this year looks to be $550,000+. The SBA kept our family operation alive and gave us the opportunity for great achievement."

NASE Member Shonda Parker, owner of Naturally Healthy a medical and birthing supplies company in Louisiana was trying to expand her operation. In efforts to find financing she went to area banks to apply for a loan. The loan officers were not interested in assisting her and turned her down right away. The only financing she was offered were personal lines of credit at high interest rates. She was encouraged by a friend to look into an SBA loan. She applied and received an SBA loan at an affordable rate with the assistance of her local bank. Shonda was able to grow her business and then ultimately sell it at a substantial profit. She believes the SBA backing made all the difference.

Thank you again for allowing the National Association for the Self-Employed weigh in on the importance of the SBA Micro-loan program and the issue of access to capital for micro-businesses. I encourage you to continue to support these programs and ensure their viability and success by pushing for increased funding and improvements.

nase

NASE Member Poll

March 2007:
Financing your Business

Whether it be financing for a new business or existing business, the self-employed and micro-businesses have a very difficult time gaining access to capital from traditional lending resources such as banking. In addition, government resources such as the Small Business Administration's loan programs are not extensive enough to meet the funding needs of the micro-business community. To assist the growing capital needs of the micro-business community, the NASE launched last year our Business Development Grant program. However, we know more must be done to help you finance your business. Please take this short member survey to assist us on determining how this issue affects you and your business.

1. What primary source of funding did you utilize to initially start your business? (Choose only one)

58% Personal savings
9% Home equity loan
6% Borrow from friend or family
10% Credit card(s)
7% Other loans from traditional lending institution (i.e. bank)
1% Government funds/loans (local, state, federal)
4% Other
3% No Opinion

2. What primary source of funds do you use for the ongoing financing of your business? (Choose only one)

36% Personal savings
8% Home equity loan
4% Borrow from friend or family
21% Credit card(s)
8% Other loans from traditional lending institution (i.e. bank)
0% Government funds/loans (local, state, federal)
15% Other
8% No Opinion

3. Do you believe there are adequate funding resources for micro-businesses?

16% Yes
61% No
23% No Opinion

4. Which is the largest obstacle you face in gaining access to capital? (Choose one)

26%	My credit rating
22%	Lack of collateral
15%	Bank regulations and paperwork
9%	Amount of loans (i.e. too large, too small)
5%	Other
22%	No Opinion

5. What is the likelihood you would apply for funding from associations and nonprofit organizations, if they provided grants and loans for small businesses?

50%	Highly likely
28%	Somewhat likely
11%	Not very likely
6%	Not at all likely
5%	No opinion

Total Respondents: 469

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing on

SBA Reauthorization

June 28, 2007

Written Statement of
Kevin S. Kelly
Managing Director for Policy and Advocacy
Association for Enterprise Opportunity
Arlington, Virginia

Dear Chairwoman Velazquez, Ranking Member Chabot and other members of the House Small Business and Entrepreneurship Committee:

My name is Kevin Kelly and I am the Managing Director for Policy and Advocacy at the Association for Enterprise Opportunity.

The Association for Enterprise Opportunity is the national organization that represents local microenterprise development organizations in the United States.

I am pleased to be here today to discuss the reauthorization of the Small Business Administration. Local microenterprise development organizations around our country know the real value of the microenterprise related programs at the SBA, including the Microloan Program, PRIME, and Women's Business Centers.

All three of these programs are critical to the work of microenterprise development organizations. I want to emphasize that these programs are different and complementary. Each targets a slightly different type of entrepreneur and each provides a different type of service. These programs, while small in the overall size of the federal budget are the lifeblood of the microenterprise field.

I want to comment on the President's proposal to eliminate the subsidy rate for the Microloan Program and to raise the interest rate on the funds borrowed by Microloan Intermediaries. The President also wants to eliminate the technical assistance portion of the program. Our members know that this proposal will make this program unworkable. The reason that the Microloan Program has enjoyed success over the years has been this paring of technical assistance funds with loan capital. By having the same organization that provides the technical assistance and training to the entrepreneur also make the loan, it guarantees a close and constant working relationship that is best positioned to catch any problems that the entrepreneur may encounter and to help them address these problems early on. This is the formula that has led to a default rate of less than 1%. Taking away the technical assistance dollars and asking SBDCs and other entities to take on the technical assistance function will disrupt this winning formula and is likely to increase the default rate.

Raising the interest rate on the Microloan Program will make this program much less appealing to microenterprise development organizations. The value of the program is that it allows Microloan Intermediaries to keep interest rates down to their borrowers. By raising the interest rate to the Intermediaries, they will be forced to raise interest rates to the borrowers, which will create an economic hardship for them and make it more difficult for them to grow their businesses. This strategy is counter to the original reason that Congress created the Microloan Program.

Practitioners in the field would like to have the three programs that I mentioned earlier, PRIME, Microloan, and Women's Business Centers be reauthorized as part of the overall reauthorization of the SBA. It is essential that these programs be continued. The Association for Enterprise Opportunity supports the reauthorization of the Small Business Administration.

As part of the reauthorization process, we would also like to see some technical corrections made to the Microloan and PRIME programs. There are some small changes that can be made to the Microloan Program that would improve the ability of the Microloan Intermediaries to use the program. Some changes would also make the legislative language consistent with the actual practices of the SBA.

These technical changes include such things as giving the Microloan Intermediaries the flexibility to make longer term loans, where appropriate; to provide more technical assistance to potential borrowers that are not quite ready to receive loan capital; and to allow microenterprise development organizations that do not have a long lending history to hire qualified staff with significant experience that will enable them to successfully serve as a Microloan Intermediary. We are also asking that people with disabilities be listed as one of the groups of eligible beneficiaries of the Microloan Program. People with disabilities are a natural group for starting up their own businesses, but they haven't received as much benefit from the Microloan Program as they should and by specifically listing them as possible beneficiaries, we believe that the number of entrepreneurs with disabilities that receive assistance through this program will increase.

I also want to state how important I feel it is to reauthorize the PRIME program in the correct place. Currently PRIME is not authorized under the SBA, although it has been administered by the SBA since its inception in FY 2001. AEO asks that the House of Representatives authorize PRIME as part of the SBA as part of the SBA reauthorization this year. The Senate Small Business and Entrepreneurship Committee has already done so in its version of the SBA reauthorization bill.

PRIME was created as a result of a survey of the domestic microenterprise field, which identified training and technical assistance to microentrepreneurs that are not ready for or do not want a loan as their most pressing need. PRIME enjoyed strong bi-partisan support, including lead sponsorship from Senators Ted Kennedy and Pete Domenici and Representatives Jim Leach and Bobby Rush when it was established. This program needs to be restored to its former stature as a national program. Due to severe budget cuts, only microenterprise development organizations in the 15 poorest states and the District of Columbia are even eligible to receive PRIME funds and only groups in 12 of those states are currently receiving any dollars at all.

The Women's Business Centers program is also a program of importance to women microentrepreneurs. We at AEO were pleased to see recent action by Congress to provide sustainable funding for the more experienced women's business centers as part of the bill increasing the minimum wage.

Although some other federal programs, such as the Community Development Financial Institutions Fund, Community Development Block Grants, and several small business development programs at USDA, can be used for microenterprise development only the three SBA programs that I've mentioned were specifically created to provide assistance to microentrepreneurs. That is why it is critical that these programs be reauthorized.

There are 23.4 million microenterprises in the United States and they comprise 87.5% of all businesses in our country. Microenteprises employ 18.2% of all private sector, non-farm workers in the country, which represents a significant portion of our economy.

The field of microenterprise gained a lot of attention last year when Muhammad Yunus and the Grameen Bank in Bangladesh won the Nobel Peace Prize. While microenterprise abroad is better known by many people, we have a vibrant microenterprise field right here in the United States and the reauthorization of these microenterprise programs at the SBA will go a long way toward helping microenterprise development organizations build strong local businesses in communities across our country.

Thank you for this opportunity to testify and I look forward to answering your questions.

House Committee on Small Business

Written Testimony of
Héctor R. Cordero-Guzmán, Ph.D.
Professor and Chair
Department of Black and Hispanic Studies
Baruch College - CUNY

Honorable Chairwoman Velazquez, Ranking member Chabot and distinguished members of the House Committee on Small Business. Thank you for inviting me to testify about the SBA's micro loan program. I am Dr. Hector R. Cordero-Guzman a professor and the Chair of the Black and Hispanic Studies Department at Baruch College of the City University of New York. Baruch College is the Business School of the City University of New York. For the last six years, I have served on the Board of Directors of Accion New York—the largest Micro lending organization in the United States with over 2300 loans and close to 18 millions in loans outstanding and over 40 staff members.

I am here to provide some testimony on the proposed changes to the SBAs micro lending program based on my research and my experience in the management of micro-lending programs.

Small, medium and large businesses utilize debt financing for a range of reasons from securing working capital to making longer-term investments. For micro-businesses – small entities with less than five employees – this is no less true. Yet, due to a combination of factors including the smaller scale of operations, the product and demographic markets that they serve, their often semi-formal nature, their lower capital borrowing needs, and the reluctance of formal lenders and financial institutions to work in these markets, micro-businesses do not have access to traditional sources of business financing.

In the late 1980s and 1990s, microfinance institutions developed in the United States to serve capital markets in low income and predominantly ethnic minority communities stimulating what Servon (1999) calls "Bootstrap Capital." Most micro-finance institutions have some degree of "mission" component that shapes the types of borrowers that end up participating in the program. Many organizations focus their lending activity on entrepreneurs whose income falls below the federally-designated poverty line, or who reside or work in particular ethnic minority and\or low-income neighborhoods; or the proportion of clients that are near-bankable but do not have access to mainstream sources of credit. Individual lending mandates will dictate the specific distribution of loan types and population targets but in most cases the program selection criteria assures some percentage of higher-risk, non-bankable borrowers in the lending portfolio. In all cases, microfinance is characterized as targeting borrowers who do not have access to formal or mainstream financial markets (Von Pischke 2002).
At present, there are more than 500 organizations in the United States that provide supports to micro-business owners, with approximately 200 lending capital, and the

majority less than ten years old.[1] Microfinance in the United States context is defined as the extension of credit up to $35,000.[2] For purposes of the paper, we refer to microfinance organizations and programs that lend capital in the United States as "MFIs" and the businesses they serve as "micro-businesses" and it is important to note that MFIs in the United States are not depository institutions.

The growth in MFIs has been fueled by changes in state social welfare policies towards focusing on economic development and job creation at the macro level and inducing employment, including self-employment, as a strategy for improving the lives of the poor (Servon 1999), and increases in Latin American and Asian immigrants who come from societies where micro-enterprises are prevalent. Some legislation has created particular incentives and generated public and private subsidies for micro-lending activity in the United States where most MFIs are structured as non-profit institutions.

However, despite the interest in the sector and the subsidies that have flowed into mission-oriented MFIs, it appears challenging to make an MFI viable over the long-term. One survey found that 30 percent of domestic microfinance programs operating in 1996 were either no longer in operation or were no longer lending capital two years later (Bhatt, Painter, and Tang 2002). Further, U.S. microfinance programs report difficulty in covering expenses without continued reliance on grants, external fundraising or other subsidies.[3]

International counterparts appear to have fared better but it is quite difficult to compare the different sets of market conditions. Developing nations typically have a more tiered banking system with high demand for micro loans but less access formal banking and a large tier of informal lending channels. As a result, international MFIs operating in countries such as Bangladesh and Bolivia have experienced much greater scale of demand for lending services and have facilitated the flow of capital to several million micro-business owners.[4] Depository services further complicate comparison of international and domestic MFIs: Bank Rakyat Indonesia, one of the more successful international MFIs, had 26 million savings accounts in 2004 that provide some lending capital. Table 1 provides a simple comparison of international and domestic microfinance operations along four key dimensions that highlight the differences between these organizations and the contexts where they operate.

In the United States, two broad and differing perspectives characterize the debate over micro-finance. One side argues that there is a potential profit to be made from micro lending but, for various reasons (e.g. discrimination, costs of information, ignorance, etc.), formal financial institutions do not see or seek out these opportunities particularly in low income and predominantly ethnic minority communities. The other side argues

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[1] The 2002 Directory of U.S. Microenterprise Programs (FIELD 2002) lists 650 "microenterprise programs," of which 554 are "practitioners" that provide loans, training or technical assistance to microentrepreneurs. There were 108 programs in the 1992 Directory. Elaine Edgcomb (2004) of the FIELD program at The Aspen Institute quotes 554 MFIs of which 230 are lenders.

[2] The FIELD program of the Aspen Institute sets the upper bounds of microfinance at $35,000, as does the Small Business Administration (SBA).

[3] As reported by the Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination -- FIELD (2004) and Edgcomb (2004), the average MFI covers less than half of their operational costs with income from lending operations. A sample of 25 MFIs who participate in Microtest, a FIELD initiative, reported 45 percent coverage. A sample of MFIs excluding the top 12 lenders by portfolio size reported only 30 percent.

[4] The Grameen Bank, founded in 1976, reported 3.7 million borrowers at July 2004. ACCION International, established in 1961, had more than 1.1 million active borrowers at July 2004. By contrast, the ACCION USA network, established in 1991, is serving approximately 5,000.

that due to high cost of information, high risks on the loans, low returns on investment and related reasons there is no money to be made on most of these types of small loans and that micro-finance will always need some form of state subsidy that should be justified on social equity, public benefit, cost effectiveness, or other grounds.

Any progress towards a potential resolution in this debate depends on a better understanding of the actual costs of microfinance, a better assessment of the profiles of borrowers and the risks involved, and the development of a lending model with concrete parameters that can then be adjusted and calibrated to local conditions and borrower characteristics and risk profiles. Once we have a realistic estimate of the transaction costs of microfinance and the interest rates that may need to be charged for an MFI to cover its costs of lending we can be in a better position to understand their effectiveness, evaluate their needs and levels of private and public subsidies and analyze why private banks and related financial actors have or have not entered these markets.

Berger and Udell (1995) maintain that bank financing often involves a long-term relationship that may help attenuate information asymmetries and that banks solve these problems by producing, analyzing, and updating client information and by setting loan contract terms to improve borrower incentives. Their study of loan rates and collateral requirements on small business lines of credit finds that borrowers with longer banking relationships pay lower interest rates and are less likely to pledge collateral.

The financial intermediation literature concludes that relationship-based financing provides an opportunity for more informed credit decisions based on better exchange of information. The microfinance model deployed in the United States by MFIs largely meets the definitions of relationship-based financing; MFIs may, in fact, rely more on relationship-based methods than traditional lending institutions. Given their informal nature, micro-business owners frequently do not have transparent financial information available and collateral may be non-existent or of insufficient value. In both screening and monitoring, MFIs rely on contact with the applicant and references to learn about the business' ability to repay. Loan monitoring is more intensive as micro-borrowers are more likely to become delinquent and require more attention than prime borrowers. After an MFI has vetted a pool of borrowers in accordance with relationship lending, they are better positioned to rate their credit quality and can charge borrowers an interest rate that better reflects the risk.

Marketing

Marketing drives the business model in terms of the volume of potential borrowers that an MFI is able to access and the pool of loans it can develop. Given that MFIs do not accept deposits and have no formal prior insight into a fresh potential customer base, they must invest in attracting new borrowers. Marketing leads are generated from a variety of sources: soliciting loan renewals from existing borrowers, marketing to existing clients for referrals, 'grassroots' networking with institutions possessing a complimentary footprint in the target environment, and the mass media.

At the outset of operations, before a borrower base is developed, portfolio growth is determined by the effectiveness of marketing through network and mass media channels. Once a borrower pool is established, marketing efforts can be shifted towards lower-cost marketing to existing borrowers and their peer networks. Even so, loans will likely attrite

from a portfolio at a faster rate than renewals and borrower referrals can replenish it – new leads must continue to be generated through other, less effective channels.
Other sources of clients for MFIs include banks who may refer loan applicants on the grounds that MFI lending feeds successful borrowers back to the formal sector; community-based organizations, such as churches and business improvement offices that offer an alternative conduit into tight-knit communities; and Small Business Development Centers that provide services to both nascent and established businesses. Up-front investment of labor is required in order to establish relationships, referral expectations and procedures, but is worthwhile in that costly loan origination can effectively be outsourced to third parties with minimal maintenance.

Loan Origination Role

The function of loan origination is to identify the credit applications in the population that satisfy the MFI lending mandate. These can then be handled according to MFI specific guidelines for borrower risk, through a combination of principal caps, collateralization or, as needed, declining the application.
In economic terms, the application represents an investment at origination with the aim of minimizing credit losses in the future. All else being equal, a greater investment in the credit application process will result in lower subsequent rates of delinquency and default; conversely, a less stringent process would result in greater rates of credit loss in the future. Setting the appropriate level of rigor in a credit application process is an exercise in analyzing loan applicant characteristics and forecasted future behaviors while being cognizant of the cost of performing these analyses.
Three steps characterize the loan application process:
Preliminary Screen. The applicant is asked a short set of questions to establish the applicant's eligibility for credit under the MFI's guidelines. This is sufficient to determine the likely strength of an application and whether an offer of credit could, in principle, will be extended.
Interview. At the interview stage, relationship-based financing methods come into play as due diligence is performed to ensure that the loan purpose is legitimate and that the borrower's business has sufficient capacity and prospects to make consistent repayments. Cash-flow analysis is the core of the MFI due diligence procedure and for microfinance borrowers the data is often insufficiently formal, hindering easy examination of cash flow stability and loan payment coverage. As a result, this is a less standardized, more time-consuming task than its equivalent in the formal lending markets.
MFI agents frequently perform primary technical assistance concurrently with the loan origination, helping the borrower to structure financial statements, for example. This lies within the broader social mandate of many MFIs but acts as a drag on the efficiency of core lending activities. Conversely, larger businesses may not require this type of technical help, but this is offset by the increased complexity of their businesses.
Microfinance borrowers often lack conventional collateral assets, in lieu of which MFIs require high-risk loans to be secured through guarantees by cosigners. This can be waived for low-risk loans, as arranging for a cosigner presents a significant hurdle to the timely execution of the loan application. In the event of delinquency, the cosigner

generates an economic benefit in excess of the cost of their recruitment by applying pressure on the borrower to repay.

The relationship can be further deepened through a site visit during which the applicant's business operations can be observed. This facilitates the accrual of information, but is more time intensive. Loan officers in the field know their lending area, its markets, and the particular occupation\industry niches

Underwriting and Approval. If a loan is recommended by an officer following the interview the application is then stress-tested by an underwriter, who validates the cash flow and performs auxiliary analysis to ensure that the loan represents a positive addition to the lending portfolio.

The dynamics of loan origination illustrate the trade-offs to be made to ensure an efficient credit process. Improved rigor could lead to a higher rate of declined applicants, and so higher subsequent portfolio quality, but at the expense of increased processing costs. For medium and larger loans, as application costs increase past an optimal point, the marginal benefit of improved portfolio quality is outweighed by the marginal expense of the credit application itself. But, for small loans there exists no such balance point – the optimal application cost is the least that can be practically. This motivates a less intensive credit application process, administered when a loan request falls beneath a certain threshold, typically a principal less than $5,000. MFIs can disburse such loans more quickly and cheaply by fast-tracking them through a transaction-based process and context learning.

Loan Monitoring

Post-loan monitoring furthers the relationship and is critical towards minimizing loss. In contrast to the credit application process, which attempts to preempt the onset of borrower delinquency by declining high-risk loans, monitoring efforts minimize the economic impact of delinquency once a borrower has fallen into arrears. In addition to the explicit risk to institutional equity through default, managing delinquent borrowers is an intensive and costly process.

When dealing with repeat clients there exists the opportunity to leverage information captured through monitoring on previous loans, enabling the MFI to shorten the full credit application without materially impacting the risk filter. In short, there is an opportunity to reduce operational costs without a corresponding increase in future loss rates. Repeat borrowers enable the information accrued during the relationship to be leveraged to mutual benefit of MFI and borrower. In this case much of the information required to validate a loan application has been gathered during the previous lending relationship. An MFI will also possess the borrower's payment history, a more accurate indicator of future performance than an isolated financial snapshot taken during the standard application process. The challenge, however, is that for many MFI, a part of their mission is to graduate customers into mainstream commercial banking which would not allow the MFI to collect additional interest payments from those customers.

Overhead Costs

For an MFI to sustain itself, each outstanding balance must contribute a proportional amount to institutional costs. Institutional costs are driven primarily by the size of the portfolio being maintained. The necessary staff, tools, technology, work environment and management are functions of portfolio scale[5].

We outline in Table 2 the institutional-level costs of five MFIs with varying portfolio sizes in order to identify the proportional cost loading necessary to guarantee that central costs are compensated for. The table shows that institutional costs increase at a slower rate than the loan portfolio grows, so that the overhead allocation declines as an MFI achieves scale. We find that an MFI with a \$500,000 portfolio will incur indirect costs of 26.0 percent, while an MFI with a \$20 million portfolio will experience a much lower indirect cost loading of 6.0 percent. In the United States, the largest institution engaging solely in microfinance presently has a portfolio of \$15 million.

Direct costs. Direct costs are tied to the production of an individual loan and exclude centralized costs, not associated with any particular loan, such as management and occupancy. An interest rate that compensates for direct costs only can be considered as the minimum economically permissible; given sunken infrastructure costs, accepting a loan at this marginal rate will not destroy additional value.

Indirect costs. Indirect costs represent expenditure associated with general operations and not directly associated with any single loan type. A price determined at this loading level ensures the transaction is fully self-sufficient – it contributes both its origination, running costs and a proportional amount to infrastructure.

For purposes of this paper, borrowers are grouped into two risk categories, *low* and *high* with differing expectations of payment profiles, and five loan sizes spanning the micro-loan product space - under \$2,000, to \$5,000, to \$10,000, to \$20,000, and to \$35,000 - which drives behavior as a proxy of business size. A high-risk, sub-\$2,000 loan can be viewed as a mission-mandated loan, for individuals with either no or highly damaged credit. Conversely, a low-risk borrower with a large loan can be said to be on the threshold of formal banking status.

The ability to offset interest income with fee income (and vice versa) yields a diverse set of pricing schemes available to MFIs. To facilitate comparison we define the annualized percentage rate (APR) as the total income in lending, taking into account all interest rates, points, and flat charges converted into an equivalent compounding interest rate. We present our results as a margin above the relevant funding rate.

On Funding. MFI funds are usually drawn from many sources, with varying costs. MFIs may receive grants, with no expectation of repayment, although their deployment may be restricted to certain borrower types at particular terms. In this case, the cost of funds is close to 0 percent. The Small Business Administration or other governmental agencies may partner with MFIs to channel federal funds to microentrepreneurs. Such agencies may also restrict the terms that can be offered by an MFI[6] as a condition of partnership. In October 2004 for a typical MFI, SBA funding is available at 1.3 percent. Non-

[5] Scale refers to the achievement of sufficient portfolio size that centralized expenditure are small compared to total lending assets.

[6] The SBA intermediary's cost of funds is broadly calculated after their first year of operation as the five-Year T-Bill less 1.25 or 2 percent depending on the underlying portfolio. In extending a loan of less than \$10,000, the intermediary may charge up to 8.5 percent over its cost of funds, otherwise, it may charge up to 7.75 percent over its cost of funds.

governmental institutions, such as banks and for-profits, motivated by the Community Reinvestment Act, have also been a significant source of subsidized funding to MFIs[7]. Around October 2004, MFI were able to secure funding from these sources at a cost of approximately 3.0 percent. Credit unions providing microfinance loans will have access to current account deposits whose cost is the (usually negligible) interest paid; for simplicity we take the cost of such funds as 0 percent. As a last resort, an MFI can buy funds on the open market – the most expensive funding source, as the market will demand a significant risk premium. We estimate this at 10.3 percent, by adding a credit-risk premium of 7.0 percent, equivalent to that of B-rated US corporate bonds of appropriate maturity (Amato and Remolona 2003) to the risk-free cost of borrowing, the 5-Year T-Bill rate,[8] in October 2004 at 3.3 percent.

On Interest Income. The borrower payment schedule for a basic amortizing loan can be readily calculated and, at each payment period, the MFI effectively earns the interest paid by the borrower less their own interest expense on the outstanding amount. In order to make explicit the impact of funding subsidies, we charge the MFI the market rate for funds, before crediting back the market rate less the realized (subsidized) cost of funds. For example, an SBA-funded MFI can obtain funding at two percent beneath the 5-Year T-Bill rate, where the market would charge seven percent over it, for credit risk, amounting to a subsidy of 9.0 percent. An MFI that has to go to the capital markets experiences a dramatic increase in the cost of funds compared to one that can draw on subsidized funding.

Fee Income. We include any flat fees and points charged by the lender at origination. Fees arising from third party charges in origination that are passed onto the borrower, such as UCC filing fees, are excluded.

Other Key Assumptions. We identify the loan products available to microfinance borrowers, as characterized by their loan request, borrower risk and borrower type. Implementing the two-fold credit application process previously discussed all loans beneath $5,000, irrespective of borrower risk and type, go through a less-cost intensive transactional-based financing arrangement. Above this threshold, new borrowers are served by a relationship-based financing approach.

Restricting the loan term of smaller loans allows the MFI to both control risk and limit the maintenance costs incurred. In our analysis, loans of $2,000 are issued with a term of 12 months; loans of $5,000 are given 18 months; $10,000, 24 months; $20,000, 36 months; and $35,000 loans, 48 months. This scheme is moderated in that high-risk borrowers are capped at a loan size of $10,000 – their potential default with larger balances represents too significant a concentration of credit risk for most MFI portfolios.

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[7] The Community Reinvestment Act (CRA), enacted by Congress in 1977 (12 U.S.C. 2901) and strengthened in 1995 encourages depository institutions to help meet the credit needs of the communities in which they operate. Typically, banks lend capital through MFIs at favorable rates to be on-lent to borrowers in communities in which bank branches are not located. The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically (Board of Governors of the Federal Reserve 2004).

[8] Five years is taken as typical of the funding horizon for MFIs.

Pricing Results

We use the model to calculate the value-neutral APR margins over funding for the product space detailed in the previous section. Product-specific direct costs are taken as outlined in the quantitative cost model section and we include indirect costs as a proportional contribution from each loan as appropriate for an MFI having achieved a scale of $20 million in loan assets. We present the fully-loaded value-neutral APRs over funding in Table 3. The APR margins exclusive of indirect costs are shown in brackets. For an organization with $20 million in loan assets, a $2,000 low-risk loan should generate an APR of 34.7 percent over funding to ensure it contributes suitably to institutional self-sufficiency.

see Table 3

It is instructive to decompose the rates for three characteristic microfinance products into their component parts to identify the most significant contributions to value-neutral price. The results are shown in Table 4 and discussed below.

See Table 4

Origination Charge. While the origination charge is a significant proportion of the total APR for the $2,000 loan product, this would be significantly greater had we not applied a transaction-based process.

Maintenance Charge. Maintenance costs are fixed, and so comprise a significant proportion of the small loan APR. For each $10 of flat monthly cost incurred, the rate on a 12-month $2,000 loan must increase by fully 10 percent. By comparison, the same extra cost on a 36-month $20,000 loan, yields a rate increase of just one percent.

Delinquency Charge. This is a fixed cost per instance of borrower delinquency, and so has a disproportionately high cost for smaller high-risk loans than for larger, less risky ones.

Risk Charge. This represents the total net present value of risk costs over the lifetime of the loan, amortized and converted into a flat rate. Note that as the product term lengthens the relative contribution of risk charge increases as the borrower population has greater opportunity to default.

Equity Charge. All MFIs maintain a pool of equity as a reserve to protect against insolvency. This is charged at the institution's cost of capital net of the risk free rate, and has a negligible effect.

Indirect Cost Loading. Note that the indirect cost loading of 6 percent is calculated for an institution achieving significant scale of operations. For smaller institutions, the proportional allocation from indirect costs to each individual loan must be higher: 26.0, 16.5, 8.9 and 6.6 percent for institutions with $0.5 million, $1 million, $5 million and $10 million lending asset bases respectively.

Market Funding, Funding Benefit and Funding Cost. As discussed in the previous section, we calculate the subsidy on borrowed funds using a composite cost of MFI funds of 3.0 percent.

Subsidized APR. The model calculates value-neutral APRs above funding for a mature MFI which would guarantee self-sufficiency. For the three characteristic products, these are 34.7 percent for the $2,000 high-risk product, 17.0 percent for the $10,000 medium-risk product, and 11.7 percent for the $20,000 low-risk product.

We have shown how, in principle, risk and cost can be factored into a value-neutral product price, which results in high APRs for small products. MFI practitioners may be reluctant to charge such APRs for fear of overburdening the borrower with exorbitant costs of debt. We emphasize that, for small loans, high APRs translate to modest absolute monthly payments. For example, the high-risk APR (including funding costs at 3 percent) of 37.7 percent on a 12-month $2,000 loan corresponds to a monthly payment of $203, with the interest-free monthly payments alone amounting to $167. An individual incapable of repaying $203 will most likely experience similar difficulty maintaining interest-free repayments of $167, and a microfinance program is probably not the most appropriate option for such an individual.

We have so far considered microfinance pricing only from a supply-side perspective. Although the near-bankable segment of the population may be price sensitive, studies have shown that riskier borrowers are less sensitive to price. In a survey of borrowers who have taken loans from both MFIs and loan sharks, Gurski (2003) suggests that high-risk microfinance borrowers are largely insensitive to interest rates. This is supported by the broad spread of APRs charged to such individuals by existing practitioners, discussed in the next section.

Industry Pricing Survey

We surveyed current microfinance pricing schemes of 46 active MFIs, representing approximately 20 percent of known MFIs, to assess the extent to which the industry appears to be pricing appropriately based on the results from our model. Each institution was questioned regarding the rates and fees charged on three characteristic microfinance products. Rates and fees were then amalgamated into a single APR figure levied on the borrower using the standard methodology and presented as a margin over funding cost. We identify each institution's funding source as discussed in the pricing methodology section in order to show results independent of funding source. These are shown in Figure 2.

$20,000, Low-Risk Microfinance Loans. The APR over funding on large, low-risk microfinance loans ranges between 6 and 13 percent while the value-neutral APR over funding is determined to be 11.7 percent. 90 percent of sampled MFIs price within five percentage points of the value-neutral rate. It is apparent that this distribution of pricing is rather narrow - we hypothesize that this is a result of pricing pressure from the formal banking sector for loans that may be considered near-bankable.

$10,000, Medium-Risk Microfinance Loans. The APR over funding on medium sized, moderate-risk loans ranges between 7 and 16 percent while the value-neutral APR over funding is determined to be 17.0 percent. 70 percent of sampled MFIs price five percentage points or more beneath the value-neutral rate; none priced at the value-neutral APR.

$2,000, High-Risk Microfinance Loans. The APR over funding on small high-risk loans ranges between 4 and 38 percent while the value-neutral APR over funding is determined to be 34.7 percent. 90 percent of sampled MFIs price five percentage points or more beneath the value-neutral rate. The pricing on small loans is very diffuse, spanning nearly 35 points of APR, which may be attributable to the following reasons:

- Restrictions placed by funders on product pricing. Note that this impacts all products, but is most significant for small loans because the value-neutral APR is much higher. However, the majority of programs surveyed are not limited by such restrictions.
- Reluctance to charge high rates. MFIs may feel social and ethical pressure to maintain low rates for the poorest borrowers who tend to be the riskiest.
- Lack of competitive pressure. The lack of cohesion among APRs charged on small loans in the sample suggests a lack of market pricing pressure.
- The leveraged impact of fees. There is a spread of flat fees charged, which manifest as a far greater variation in APR on small products than on large products. For example, origination fees varying from $50 to $100 on a 12-month $2,000 loan add between 4.6 and 9.1 percent to the value-neutral APR. The same fees on a 36-month $20,000 loan add between 0.2 and 0.3 percent.

Finally, the data may suggest that, for those institutions pricing above value-neutrality on large loans, a certain degree of intra-portfolio subsidization may be occurring. Such a pricing strategy could be potentially dangerous in that lower-risk borrowers being charged a premium might ultimately migrate to an institution pricing appropriately. Simultaneously, undercutting the rate for poorer-quality borrowers could lead to a net influx of riskier loans. In such a scenario, the portfolio becomes increasingly weighted to poor-quality loans, the capacity for internal subsidization diminishes with time, and the institution becomes increasingly reliant on external subsidies.

The Impact of Pricing Inefficiencies

The MFIs surveyed in this paper are not charging sufficient APRs to cover their costs on microfinance loans. From the institutional-level costs presented in Table 2 we investigate the influence that a "pricing gap" – pricing beneath the value-neutral APR – can have on self-sufficiency. We model two competing dynamics: economies of scale, which have a positive impact on institutional self-sufficiency, and the pricing gap, which has a negative impact. We use the best-case indirect cost loading, that of the $20 million portfolio, and apply it to all institutions, regardless of size. We then calculate the income shortfall for each portfolio size, using aggregate annual pricing gaps of 1, 2, 5, and 10 percent.
The results are illustrated in Figure 3. We find that self-sufficiency is extremely sensitive to pricing gaps. A one percent pricing gap on a $20 million portfolio amounts to a shortfall of $200,000 in absolute terms. This represents some 10 percent of annual institutional operating costs and thus corresponds to a self-sufficiency level of 90 percent. A 5 percent pricing gap leads to a self-sufficiency rate that increases slowly with portfolio size to a maximum of 60 percent. A 10 percent pricing gap actually leads to declining self-sufficiency with increasing portfolio size, as the absolute operating costs increase more quickly than the absolute revenues generated through such a heavily subsidized pricing scheme.

Tables and Figures

Table 1

Overview of International and Domestic Markets

Definition	International[9]	Domestic[10]
Observations	73	25
Average Number of Borrowers	9,610	337
Average Loan Size	973	9,732
Operational Self-Sufficiency Ratio	121%	49%

Table 2

Institutional Cost Base Required to Sustain a Loan Portfolio

Institution Size	500K	1MM	5MM	10MM	20MM
Loan Portfolio Size [$million]	0.5	1	5	10	20
Number of Loans in Portfolio[11]	65	125	625	1,250	2,500
New Originations Needed per Month	5	10	50	100	200
Renewal Spend Hrs per Month	-	10	50	80	150
Referral Spend Hrs per Month	-	10	80	120	400
Network Spend Hrs per Month	50	50	200	300	500

[9] As referenced from the Microfinance Bulletin in Armandáriz and Morduch (2005), p.121.
[10] As reported by the Microenterprise Fund For Innovation, Effectiveness, Learning and Dissemination – FIELD (2004).
[11] The number of loans within the portfolio is estimated using an average loan balance of $8,000.

Institution Size	500K	1MM	5MM	10MM	20MM
Mass Media Spend per Month	500	1,500	8,000	10,000	10,000
Loan Consultants	1	2	7	10	20
Underwriters	1	1	2	2	4
Back-Office Staff	1	1	2	4	8
Collections Staff[12]	-	-	1	3	5
Annualized Direct Staff Spend [$]	110,000	145,000	435,000	690,000	1,345,000
Staff per Manager	5.0	5.5	6.0	6.5	6.5
Managers Required	1	1	2	3	6
Annualized Indirect Staff Spend[13] [$]	75,000	80,000	175,000	265,000	530,000
Occupancy Space[14] [Square Feet]	600	750	2,100	3,300	6,450
Annual Occupancy Cost [$]	10,000	15,000	40,000	65,000	130,000
Annual IT Costs[15] [$]	10,000	10,000	30,000	45,000	85,000
Annual Consumable Spend[16] [$]	10,000	15,000	35,000	55,000	110,000
Annual Running Costs[17] [$]	20,000	25,000	70,000	110,000	215,000
Annual Marketing Spend [$]	5,000	20,000	95,000	120,000	120,000
Total Annual Indirect Costs [$]	130,000	165,000	445,000	660,000	1,190,000
Overhead Allocation, $r_{Inst.}$ [percent]	26.0	16.5	8.9	6.6	6.0

[12] Assuming delinquency rates of 8 percent across the portfolio, and an average of 4 hours per case per month.
[13] Indirect Staff costs include management and loan agent training and administration at 10 percent of their time and time spent originating loans that do not lead to disbursal.
[14] Assuming 150 Sq. feet per employee are required at a cost of $20 per square foot.
[15] Assuming an $2,000 IT spend per employee per year, with a minimum of $10,000.
[16] Assuming that consumables, paper, printing, meal allowance, etc. amount to $2,500 per employee per year.
[17] Assuming that running costs, utilities, depreciation, etc. amount to $5,000 per employee per year.

Table 3
Loaded [Marginal] APR over Funding Matrix for a Mature MFI

Loan [$]	APR Margin [percent] New Loans Low Risk	Medium Risk	High Risk
2,000	26.3 [20.3]	30.4 [24.4]	34.7 [28.7]
5,000	15.4 [9.4]	19.0 [13.0]	22.7 [16.7]
10,000	13.5 [7.5]	17.0 [11.0]	20.7 [14.7]
20,000	11.7 [5.7]	15.7 [9.7]	NA
35,000	11.0 [5.0]	15.1 [9.1]	NA

Table 4
Decomposition of APR for Characteristic Microfinance Products

Contribution	$2K High Risk	$10K Medium Risk	$20K Low Risk
Origination Cost	6.1	2.0	0.7
Maintenance Charge	10.0	2.0	1.0
Delinquency Charge	6.4	1.0	0.4
Risk Charge	6.1	5.9	3.5
Equity Charge	0.1	0.1	0.1
Indirect Cost Loading	6.0	6.0	6.0
Market Funding	10.3	10.3	10.3
Total Market APR	45.0	27.3	22.0
Funding Benefit	-7.3	-7.3	-7.3
Subsidized APR	37.7	20.0	14.7
Cost of Funds	-3.0	-3.0	-3.0
APR over Funding	34.7	17.0	11.7

Figure 1
Relationship-based Financing Schematic for MFIs

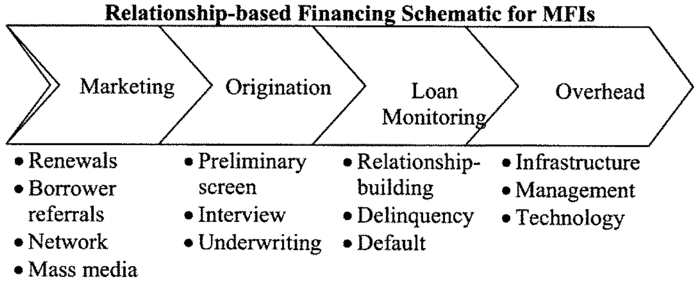


Figure 2
Survey of Microfinance Pricing

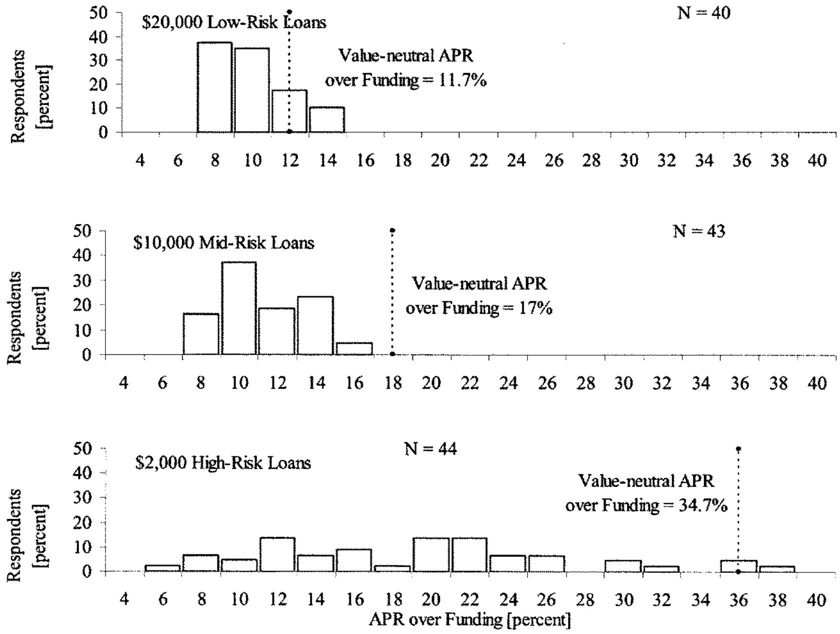
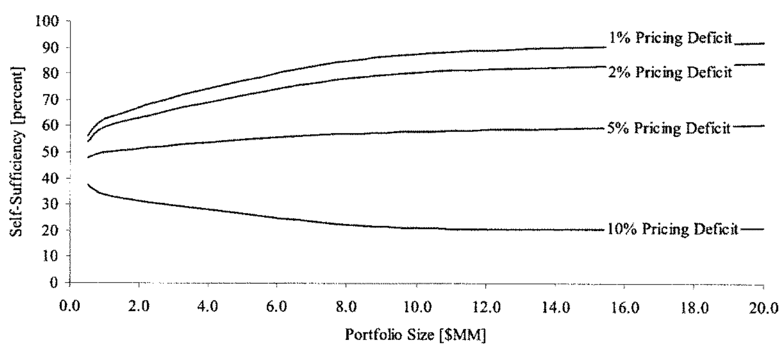


Figure 3
Impact of Portfolio Pricing Deficits on Institutional Self-Sufficiency



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Statement of

James Morrison, Ph.D.

President
Small Business Exporters Association of the United States
Washington, DC

Regarding Small Business Administration International Trade Activities

Before the

COMMITTEE ON SMALL BUSINESS
U. S. HOUSE OF REPRESENTATIVES

Washington, DC

12 July 2007

The Small Business Exporters Association of the United States™

America's Premier Association for Small and Mid-Sized Exporters®

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Madam Chairwoman Velázquez, Representative Chabot, members of the Committee, thank you for inviting me to appear here today. I am James Morrison, President of the Small Business Exporters Association of the United States. SBEA is the nation's oldest and largest organization dedicated exclusively to small and mid-size American exporters. We are also the international trade council of the National Small Business Association, which is celebrating its 70th anniversary this year, and which reaches more than 100,000 small businesses across the United States.

We want to thank the Committee for devoting its attention to SBA's Office of International Trade, and to the agency's export finance products, as part of the larger reauthorization process. SBEA strongly supports OIT and products.

It has been a long time since the two authorizing Committees reviewed the important work of OIT, which plays a unique and valuable role in aiding export financing in the United States. So SBEA is glad to be taking part in today's hearing. The Committee members have before them an excellent bill that will build on OIT's strengths and use it to help articulate the needs of smaller companies in international trade to other agencies of the government.

SBEA would like to begin today by offering a bit of background on small business and international trade. We offer seven main points.

1. *Export promotion activities by the federal government can be most profitably focused on smaller companies.*

The Fortune 1000 companies in the United States are, for all practical purposes, fully globalized. They have a good sense of where their export markets are and what's needed to sell in those markets. They know where to go to finance their foreign sales. They have the resources to handle common types of foreign trade barriers to U.S. exports.

While there is always room for these large corporations to add new products and services to their exports, and while our government should be ready to support them abroad when necessary, by and large these companies don't need government officials to show them why and how to export.

The situation among small and mid-sized companies in our country is dramatically different. On the one hand, the growth of exporting among smaller U.S. companies has been an astonishing success story. In 1987, about 65,000 smaller companies exported. Twenty years later, that number has more than tripled, to about 230,000.[1]

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[1] Source: Exporter Database, Office of Trade and Industry Information, U.S. Department of Commerce

Today, exports from those small companies are worth over $375 billion a year, or more than $1 billion a day.[2]

That's the good news.

The bad, or at least not so good, news is that despite the growth in small business exporting, still only about 9% of U.S. small businesses export.

Smaller American companies, accustomed to our prosperous domestic market, still have trouble grasping that over 96% of the world's consumers, controlling over 70% of the world's purchasing power, live outside the United States. These small companies are often light years removed from the Fortune 1000 in their understanding of the opportunities and pitfalls of foreign markets. *Yet, precisely because the largest companies are already so adept at exporting, small companies represent the real upside potential for U.S. exports*.

Take a look at how small companies in the U.S. fare domestically in a whole series of sectors. Small and medium-size enterprises (SME's) account for 69% of the U.S. heavy construction market. In water, waste and sewage systems, small companies are 48% of the U.S. market. In wholesale trade in durable goods, it's 42%. In computer systems, it's 51%. In geophysical surveying and mapping, 78%. Water well drilling, 93%. The list goes on and on. (See Exhibit 1.) The point is this: *all of these sectors involve products and services that are in high demand abroad.* The challenge is to link up that prodigious domestic capability with the prodigious foreign demand.

Accomplishing that will require some missionary work and some facilitation by government. The payoff for the American people will be more international trade jobs on the nation's Main Streets, stronger and more agile small companies, enhanced economic growth, and lower trade deficits.

2. *SBA is critical to this effort.*

The agency's reach into the U.S. small business community, through its ten regional offices, its national network of District Offices, as well as the Small Business Development Centers and the SCORE Program that it supervises, is unparalleled. Its small business focus and it tradition of assistance are unique within the federal government.

Since Congress established SBA's international trade mandate, under the Small Business Export Expansion Act of 1980,[3] the agency has developed an impressive set of financing products and an efficient, decentralized delivery system that is helping fill a gap in export financing for small companies.

What SBEA has discovered over the years is that small business exporters divide into two major categories – those considering exporting or starting out at it, and those who have gained some experience at it.

[2] U.S. Small Business Administration, *SBA Loans to Small Business Exporters Surpass $1 Billion*, News Release 07-08, February 28, 2007.
[3] The principal House sponsor for this legislation was Rep. Ike Skelton (D-MO), today the Chairman of the House Armed Services Committee.

SBA is helpful with both types of companies. Prospective exporters, for example, want training in the nuts and bolts of exporting. SBA provides this -- through classes at its District Offices and at the thirty or so Small Business Development Centers which specialize in international trade, and through mentoring by SCORE volunteers who are experienced in international trade.

New-to-exporting companies are generally seeking foreign buyers. Here the SBA has a few helpful offerings, like its Trade Mission Online, but it wisely directs most companies to the excellent services offered by the Department of Commerce at its 103 U.S. Export Assistance Centers across the United States and its corps of Commercial Service officers in U.S. Embassies around the world.

Small companies that gain some exporting experience frequently encounter the issue of export financing. As long as an exporter can find foreign buyers who will pay cash in advance for their purchases, there's no need for financing. But sooner or later, most U.S. companies that gain some familiarity with exporting discover that they need access to capital in order to grow and to offer financing terms to their foreign buyers.

It is hard to overstate the importance SBA in this process.

Sales of products and services to foreign countries involve a significant degree of foreign risk, especially when the foreign buyers finance their purchases over time. Commercial banks historically have been reluctant to assume a major share of this risk. For one thing, the collateral securing the loans is often in another country, where recovery can be difficult.

Every exporting nation in the world grapples with this risk. Nearly all of them address it by providing guarantees to commercial lenders and brokers, or by providing credit directly to exporters.

This is particularly vital for transactions by smaller companies. Very few U.S. banks, perhaps no more than 400 out of the 6,000 or so that exist, provide export financing. Of those, perhaps no more than 100 will handle smaller international transactions. Banks that will do so, on a regular basis, for small business exporters that are *not* regular commercial customers probably number less than 25. ***25!*** This is an almost unbelievable situation in a nation of 300 million people that is the world's largest exporter, but there it is. **The only thing keeping even this relative handful of banks in the business of export financing for small international transactions is the guarantees offered by SBA.** Without those guarantees, (as well as the ones provided on larger transactions by the Export-Import Bank of the United States), small business access to export finance would be close to zero.

Congress envisioned SBA as a "bank of last resort" for exporters seeking to finance sales of less than a few million dollars. The truth is that for small exporters, SBA guarantees represent the *bank of only resort* for such sales.

3. SBA's work in this area shows great promise.

Consider this.

According to the Commerce Department, export-related jobs pay about 15% more and have about 40% higher benefits, on average, than other jobs.[4] And small firms that export create, on average, 50% more jobs than other firms.[5] Overall, each $1 billion in exports creates, on average, over 4,000 of these new high-pay, high-benefit jobs.

In FY 2006, SBA underwrote $2.1 billion in export sales.[6]

What did this cost the taxpayers? Well, the actual budget for SBA's Office of International Trade for FY 06 was $4.3 million. Around $3 million of that amount was allocated to OIT's principal trade finance officers in U.S. Export Assistance Centers. The cost of loan processing added perhaps another $1 million to that figure (beyond OIT's budget).

So, for an expenditure of about $4.3 million, the United States got $2.1 billion in export sales. That works out to nearly $500 in export sales for every $1 the taxpayers invested in the program. If there is a better return on investment than this in export promotion --anywhere in the U.S. government -- SBEA has never seen it.

But, wait, as they say on late-night TV, that's not all. We also got over 8,000 new high-value jobs - at a group of small companies that is now poised to keep on generating new jobs at a fast clip. And all those new employees are now paying taxes - which, we can safely assume, will well exceed $4.3 million.

And who accomplished this feat? Seventeen people did nearly all of it. That is not a misprint. SBA posted seventeen export finance specialists to U.S. Export Assistance Centers around the nation in FY 06 (the number has varied by two or three from year to year), and they worked up nearly all of these financing packages themselves. Many of the deals that they financed were for less than $100,000. It's a long way from $100,000 to $2.1 billion, so the scale of their achievement is inspiring. It is also a vivid testament to the enormous demand for small business export financing in the United States.

At a time of record trade deficits, SBA is doing something that works effectively to reduce those deficits by stimulating exports.

Perhaps the Committee will appreciate the frustration that SBEA experienced as we pleaded with the Appropriations Committees, year after year, not to zero out this SBA USEAC program. Rather than zeroing out what is arguably the most successful export promotion effort, dollar for dollar, in the history of the United States government, Congress should at least *think* about expanding it.

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[4] National Association of Manufacturers, "Trade and the American Worker," *To the Point*, July 2006

[5] *Importers, Exporters and Multinationals: A Portrait of Firms in the U.S. That Trade Goods*, Andrew B. Bernard, J. Bradford Jensen, Peter K. Schott, National Bureau of Economic Research, NBER Working Paper 11404, June 2005, pp. 4-5.

[6] U.S. Small Business Administration, *Performance Budget*, Congressional Submission, Fiscal Year 2008, p. 54

4. Despite SBA's remarkable successes in assisting small exporters through its Office of International Trade, there is room for improvement.

SBA's work in the U.S. Export Assistance Centers is stretched far too thin. This program works. Every effort should be made to increase its resources and extend its benefits throughout the United States.

To begin with, the agency has long-vacant posts in several USEAC's. Consider New York City, the hometown of the Committee's Chair. It is the hub of nearly $100 billion in annual exports ($57.3 billion from New York, $27 billion from New Jersey, and $12.2 billion from Connecticut in 2006). New York is also one of the major exporting states where the dollar value of small business exports *exceeds* the dollar value of large business exports.[7]

Yet the post of SBA export finance specialist at the New York USEAC has been vacant since 2002. It's being handled by a "marketing and outreach" person out of an SBA District Office.

Based on concentration of small business export activity in New York and the average financing output of these USEAC specialists elsewhere in the country, it is reasonable to assume that having one of them in the New York USEAC would be worth $125 million a year in small business export sales to the metropolitan area. In the six years since 2002 (inclusive), that works out to about three-quarters of a billion dollars in foregone exports. Perhaps some of these exporters found export financing elsewhere. And perhaps the "marketing and outreach" person was able to put some financing packages together. These are unlikely assumptions, but even if we grant them -- to the generous tune of 25% or so -- the loss to New York is still staggering.

Or the vacancy in the New Orleans USEAC -- since 2003. As this great port city struggles to rebuild after Hurricane Katrina, it seems unconscionable to deprive it of the export financing expertise that could get its small exporters back on their feet, not to mention the export sales and jobs that would boost the entire New Orleans economy. Yet New Orleans continues to be handled out of Dallas, where the export finance specialist already has to contend with the nation's largest exporting state – Texas, with $150 billion in export sales in 2006.

California, with 50,000 small business exporters, finally got its second export finance specialist, after a wait of six years. Presumably each of them can now service 25,000 existing small exporters plus whatever number of new ones emerge and seek financing.

The great port and exporting nexus of Baltimore is being serviced part-time, by a Washington-based export finance specialist.

And so on.

In 2002, there were 22 of these specialists. Despite rising exports and enormous demand for small business export financing, there are only 17 today. Madam Chair, this program should not be shrinking; it should be growing!

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[7] Florida is the other such state. Small business exports also represent about 48% of the dollar value of California's exports.

And then there is the question of travel. These specialists have responsibility for servicing numerous clusters of bankers and small business exporters over territories spanning tens of thousands of square miles. Most of them handle multiple states. Yet for years, SBA has skimped on their travel budgets. Entire years went by during which these specialists had ***no*** travel funds. So they tried to handle everything by phone or from their offices. Many of the most dedicated saw the absurdity of this and paid for travel out of their own pockets.

So, in addition to increasing the number of these specialists, SBEA strongly urges the Committee to authorize reasonable travel allowances for them to perform the job that is expected of them.

5. The bill before the committee is a good foundation for expanding SBA's work on international trade.

Section 101 of the bill usefully lays out a constructive role for SBA to play in supporting U.S. trade negotiations. While many federal agencies, including the Office of the United States Trade Representative, do take note of the needs of small companies in trade policy, and various advisory groups that meet occasionally do offer recommendations on it, there is no single governmental entity that focuses exclusively on it -- professionally, and on a full-time basis. Until such time as that responsibility is taken up elsewhere in government, SBA's Office of International Trade should lend its expertise to the process.

Sections 102 and 103 of the bill call on OIT to work with the Trade Promotion Coordinating Committee at the Department of Commerce, and other government agencies, in helping craft an annual trade strategy for small business and in tracking small business exports and trade resource utilization. Assisting small business as part of the National Export Strategy is one of the long-established goals of TPCC, and has been supported by other agencies. But making OIT a focal point will probably bring added depth and consistency to the overall design of U.S. trade strategy as it affects small business. The data collection that the bill stipulates will further support informed decision-making.

Title II of the bill strengthens trade remedy and dispute assistance at SBA. Small businesses typically know little or nothing about these processes, and could benefit from the enhanced accessibility of information that the bill would provide.

The same is true of intellectual property protection in international trade, one of the key issues affecting U.S. companies of all sizes that export, and the subject of Section 102 of the bill. In its report on this legislation, the Committee may wish to reference the work of the "Stop Fakes" initiative by several agencies and organizations, which may be a good starting point for the changes that the bill envisions.

In Title III of the bill, the Committee strengthens SBA's work on Trade Adjustment Assistance. SBEA is very supportive of the thrust of this section. We strongly believe that restoring the national consensus for a vibrant international trading system depends to a significant degree on reassuring the public that a "safety net" does in fact exist for those who suffer a genuine injury. As the Committee is aware, SBA has existing authority in this area. Its International Trade Loans can be made for exporting ***or for import injury***. But the tiny trickle of ITL's for import injury suggests that such loans need revising and/or greater publicity. Commercial banks may be SBA's best partner in accomplishing both objectives. This Title of the bill also usefully assigns to the head of OIT the role of coordinating the many parts of SBA's operation that can help ameliorate import injuries.

The work of OIT in the USEAC's is addressed in Title IV. The bill would add six new export finance specialists, starting with USEAC's where there have been vacancies for four years or more. The bill also directs OIT to develop a formula for assigning new export finance specialists, which the Committee sensibly bases on unmet export demand. While the details of this formula may need tweaking, it is in general a good idea. As must by now be obvious, SBEA strongly supports an increase in the personnel for this extremely valuable program, and we commend the Committee for moving forward with it.

Finally, Section 402 of the bill adjusts the loan sizes for SBA's export financing.

SBEA has a few technical recommendations here.

The SBA Export Express Program – a great program that meets a lot of smaller and more immediate business needs, and which is the export version of SBA Express -- should be made permanent, as SBA Express is. For one thing, commercial banks utilizing Export Express need to know that it will continue before they train their people on it. Since Export Express is intended as an "express" program, loans under it should be further streamlined, and as much paperwork as possible eliminated. Simple, rather than complex, business plans should be required. Export Express also should be publicized more extensively. The loan limit should match that of SBA Express, $350,000.

Export Working Capital loans, which permit a business with export orders to ramp up to meet the export demand, should not only rise to $3 million in gross loan amounts, as the Committee stipulates in its bill, but should also take into account SBA's standard 90% guarantee on export financing by increasing the maximum guarantee amount to $2.7 million.

Because small export financing packages are so incredibly difficult to obtain without SBA, we recommend that the traditional $500,000 increment in gross loan amounts permitted to ITL borrowers (over standard SBA 7a loans) be re-established and maintained. In recognition of that acute export financing need, SBA had established the higher ITL loan caps several years ago. Now that the Committee anticipates an increase in 7a loan sizes, we recommend that the reauthorization maintain this $500,000 increment by raising the ITL gross loan maximum to $3.67 million and the guarantee to $2.75 million. Again, it is important to keep the 90% guarantee in mind so as to synchronize the gross loan maximums with the guarantee maximums.

Above all, the Committee should encourage OIT and the SBA leadership to frequently query the export finance specialists for improvements in the "fine print" of Export Express, EWC and ITL loans that would make these products more customer-friendly without exposing SBA to unnecessary risk.

6. SBA's management structure for OIT urgently needs to be addressed.

We understand that the Committee's intention is to deal with this issue in a coming SBA management bill. It would be hard to over-emphasize how important this is to the future success of everything else the Committee wants OIT to do.

SBA is by tradition and internal culture primarily a domestic agency. Its normal operating procedure is to focus entirely on its domestic activities and put the international ones on a far back burner. The reauthorization needs to strongly communicate to SBA that Congress considers strengthening small business' position in international trade to be a major SBA priority-- or the change won't happen.

The most effective way to do this is to permanently place the agency's key international trade resource, its export finance specialists in the USEAC's, under OIT's control, and to have the head of OIT report directly to the Administrator.

An internal administrative change at SBA recently put the USEAC personnel under OIT, but internal administrative changes can always be rescinded. The reauthorization should make the change permanent.

The only way that an SBA Administrator can receive direct and unfiltered information about the agency's international trade activities is for the head of OIT to report directly to him or her. This is perhaps especially true for Administrators like the forward-looking Mr. Steven Preston, who often refers in his speeches to the importance of helping small companies address the international marketplace. The only way that Congress can signal to SBA's staff that international trade is an important part of the agency's mission is to elevate ***both*** the authority and responsibilities of OIT.

<u>This bill addresses the responsibilities, but it does not address the authority.</u>

Obviously, OIT should *coordinate* with SBA's Office of Capital Access. But given the entirely reasonable expanded role for OIT that the Committee envisions – conducting high-level dialog with other federal agencies on trade policy and trade negotiations, intervening in IP protection initiatives, coordinating SBA's trade remedy and trade adjustment assistance with those agencies, working with ministers of foreign governments, and so on – OIT plainly cannot succeed while remaining deeply buried under layers of the SBA hierarchy. Indeed, SBA seems to be going in the opposite direction from the Committee with its recent decision to ***lower*** the head of OIT from an Associate Administrator to a "Director."

Senior official from other agencies and foreign government ministers are highly unlikely to work closely with low-level or mid-level SBA officials. Given the current OIT management framework, the Committee's goals will simply break down.

To have a real chance of succeeding, these heightened responsibilities must be assigned to an individual with real authority – at the level of an Associate Administrator (or SBA's new Associate Deputy Administrator designation) – who reports directly to the Administrator and controls OIT's personnel and programs.

Ideally, this individual should be a political appointee with appropriate background and experience, who will be seen across the government as a senior member of the management team of the Administration in which he or she serves.

SBEA believes that the current status of OIT's head as a "Director," with limited authority over the Office's personnel and products, is inadequate for the Office's ***current*** responsibilities, let alone more challenging ones.

So we strongly urge the Committee to forthrightly address the matter of OIT's authority in the proposed management bill.

7. It makes sense to look ahead on small business export finance and set long-term benchmarks.

If the Committee is looking for a long-term benchmark or goal for SBA, here is one that SBEA suggests considering: Canada's export financing agency. The Canadian equivalent to both SBA and Ex-Im Bank for export financing is called Export Development Canada.

Here's a comparison: In the U.S., in FY 06, SBA financed $2.1 billion in export sales by 2800 companies. Ex-Im financed about $2.6 billion in such sales by about 2000 SME's. Together that's $4.7 billion and 4800 companies.

Now look at Canada. Although the Canadian economy is *one-seventh* the size of the U.S. economy, EDC supplied *6200* Canadian small business exporters with *C$15 billion* in financing. EDC provided export financing to about 17% of Canada's exporters, as against the roughly 2% of U.S. exporters that were supported by SBA and Ex-Im.[8] EDC's own goal is to contact *every single* Canadian exporter *every year*. EDC offers over a dozen products, frequently improving old ones, adding news ones, and discarding non-performing ones. EDC personnel regularly "role-play" as small exporters to imagine how such companies would try to navigate the system.

So as impressive as SBA's statistics are – and they do represent a truly amazing feat by a handful of people -- the U.S. still has a very long way to go in becoming world-class competitive in small business export financing.

[8] Source: Export Development Canada, *Annual Report 2005*, p.2. www.edc.ca/english/docs/2005_annualreport_e.pdf

Exhibit 1:

Examples of economic sectors where strong SME domestic performance could yield more exports -- with the help of export financing

U.S. Domestic Production, 2002, in Billions of Dollars (except as noted)

NAICS Code	Description	Total Receipts	SME Receipts	SME %
2213	Waste, Sewage & Water Systems	$8.3 billion	$4.0 billion	48%
233	Building and developing	$535	$411.4	77%
234	Heavy construction	$174.4	$119.7	69%
2358	Water well drilling	$3.2	$3.0	93%
421	Wholesale trade in durable goods	$2,332.2 (= $2.33 trillion)	$979.3	42%
441	Motor vehicle & parts dealers	$813.2	$683.5	84%
*44122**	*Motorcycle, boat and other motor vehicle dealers*	*$32.9*	*$31.0*	*94%*
4431	Electronic and appliance stores	$92.3	$37.6	41%
444	Bldg equipment, garden equipmt & supply dealers	$288.4	$146.8	51%
45393	Manufactured home dealers	$9.6	$7.2	75%
54136	Geophysical surveying and mapping svcs	$1.0	$ 0.785	78%
54151	Computer systems design and related svcs	$181.8	$93.0	51%
5416	Mgmt, scientific & technical consulting svcs	$130.8	$74.3	57%
5418	Advertising and related svcs	$60.4	$36.0	60%
5419	Market research & public opinion polling	$11.4	$5.5	48%
56	Administrative & support, waste management & remediation svcs	$457.4	$210.3	46%
Total		**$5.1 trillion**	**$2.8 trillion**	**55%**
Total, less 421		$2.8 trillion	$1.8 trillion	64%

Adding just 10% of these SME sales to the export market would increase U.S. SME exports by up to $280 billion annually.

(Sources: *2002 Economic Census* and *2002 County Business Patterns*, U.S. Census Bureau. SME's are small and mid-sized enterprises with fewer than 500 employees.)
* Subset of preceding (441) category, excluded from totals

Exhibit 2: Exports by Company Size and Type
(Value in billions of dollars. Details may not sum to total due to rounding.)

	Known Identified Export Value *By Company Size*				*Number of Identified Exporters* *By Company Size*			
Company Type	**Total[1]**	**Small[2]**	**Medium[2]**	**Large[2]**	**Total[1]**	**Small[2]**	**Medium[2]**	**Large[2]**
2004								
All Types	709.5 *100.0%*	134.1 *18.9%*	68.9 *9.7%*	506.5 *71.4%*	231,736 *100.0%*	208,615 *90.0%*	16,524 *7.1%*	6,597 *2.8%*
Manufacturers	480.5 *67.7%*	34.0 *7.1%*	38.4 *8.0%*	408.2 *84.9%*	66,891 *28.9%*	55,039 *82.3%*	8,986 *13.4%*	2,866 *4.3%*
Wholesalers	133.2 *18.8%*	60.1 *45.1%*	18.8 *14.1%*	54.3 *40.8%*	77,159 *33.3%*	73,604 *95.4%*	2,918 *3.8%*	637 *0.8%*
Other	89.7 *12.6%*	36.7 *40.9%*	11.4 *12.7%*	41.6 *46.3%*	80,089 *34.6%*	72,522 *90.6%*	4,528 *5.7%*	3,039 *3.8%*
2003								
All Types	634.7 *100.0%*	116.9 *18.4%*	56.6 *8.9%*	461.2 *72.7%*	227,300 *100.0%*	203,761 *89.6%*	16,674 *7.3%*	6,865 *3.0%*
Manufacturers	430.1 *67.8%*	30.2 *7.0%*	32.7 *7.6%*	367.2 *85.4%*	65,045 *28.6%*	52,846 *81.2%*	9,240 *14.2%*	2,959 *4.5%*
Wholesalers	119.2 *18.8%*	48.8 *41.0%*	14.5 *12.2%*	55.8 *46.8%*	73,777 *32.5%*	70,249 *95.2%*	2,888 *3.9%*	640 *0.9%*
Other	76.9 *12.1%*	32.5 *42.2%*	9.0 *11.8%*	35.4 *46.0%*	80,337 *35.3%*	72,685 *90.5%*	4,449 *5.5%*	3,203 *4.0%*

[1] Percentages based upon total known value (or number) of all types of exporters. Details will not add to total since "unclassified" company type is not shown.

[2] Percentages based upon total known value (or number) for the row (company type).

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SBEA is the nation's oldest and largest nonprofit organization exclusively representing small and mid-size companies in international trade. SBEA is proud to serve as the international trade council of the National Small Business Association, the nation's oldest nonprofit advocacy organization for small business.

Testimony of
Precision Metalforming Association
William E. Gaskin, President

before the

House Committee on Small Business

July 12, 2007

Chairwoman Velázquez, Ranking Member Chabot and members of the committee, thank you for holding this important hearing. My name is Bill Gaskin; as President of the Precision Metalforming Association (PMA), I am testifying on behalf of our 1,200 member companies located in forty-one states.

PMA is an Ohio-based national trade association representing the $91-billion metalforming industry of North America – the industry that creates precision metal parts, assemblies and products using stamping, fabricating and other value-added processes. The vast majority of PMA members are small and medium-sized manufacturers, known as SMMs. Many are second and third generation businesses averaging one hundred employees. Our industry manufactures products in nearly every congressional district in the country, supplying the automotive, defense, medical, aerospace, agriculture, telecommunications and electrical industries, among others.

For many small companies who manufacture in America, the issue of international trade is met with great skepticism, but it can bring tremendous opportunities. Today I will highlight a few of the serious challenges facing American small and medium sized manufacturers struggling to remain competitive in a global marketplace and the role of the U.S. and foreign governments.

Whether our industrial customers are domestic or overseas, cost is the key factor in determining whether the metal part of assembly is bought from an American manufacturer or an international source. Of course, quality and delivery are important, but the primary driver is cost. Metalforming is a highly automated, high-skill industry. However, our highest operating expense is purchasing raw materials – in our case, steel or other flat rolled metal, which amounts to 50-70% of our costs.

Over the past four years, our members have found their foreign competitors often supplying metal components, assemblies or finished products cheaper than the cost of our raw material alone. This clearly puts small American manufacturers at a disadvantage, and seriously restricts our export opportunities. It is essential that our industry has access to globally competitive supplies of flat rolled metals.

When we experience significant price increases in steel as we did as a result of the government imposed 201 steel tariffs, small businesses are placed in a squeeze. As middle market manufacturers, they cannot renegotiate contracts, nor can they frequently pass along their costs to customers, particularly those supplying the automotive industry.

Middle market manufacturers have been injured by the unintended consequences of our trade policies. For example, when the U.S. International Trade Commission (ITC) determines whether to levy additional tariffs and taxes on imports of steel, copper alloys and aluminum, the law bars it from considering the impact any decision will have on domestic industrial consumers of those products. The ITC's view, apparently, is that trade cases are entirely between importers and domestic producers of a product and that industrial consumers do not have standing as they evaluate Sunset Reviews or new trade cases.

According to the most recent Department of Labor statistics, there are more than 9 million steel consuming jobs in this country, including nearly 600,000 in the Congressional Districts of members of this committee. Because of our outdated trade laws, none of these employees or companies is represented in hundreds of cases at the Department of Commerce and the ITC. Whether regulatory or legislative, policymakers in Washington should consider the impact their decisions will have on small middle market manufacturers. This is why we support H.R. 1127, legislation offered by Reps. Knollenberg and Kind to provide domestic industrial consumers a seat at the table.

We support designing a system to track small business imports and exports which will assist us to provide a better snapshot of our industries. In the case of many middle market manufacturing businesses like ours, due to current classification systems, the government does not adequately collect and report data on import and exports. The products produced by companies in NAICS code 332116 (metal stampings), representing more than 100,000 American jobs, appear nowhere in the HTS Codes used by Customs and the Department of Commerce to track imports. While the Commerce Department has a robust program to accurately track imports of flat rolled steel, it does little to document the volume and export price of the same product. Without this data, steel consumers never have an accurate picture of the supply of flat rolled steel available to domestic manufacturers needing competitively priced steel to produce their products. This lack of data and analysis hinders policymakers and harms businesses and employees.

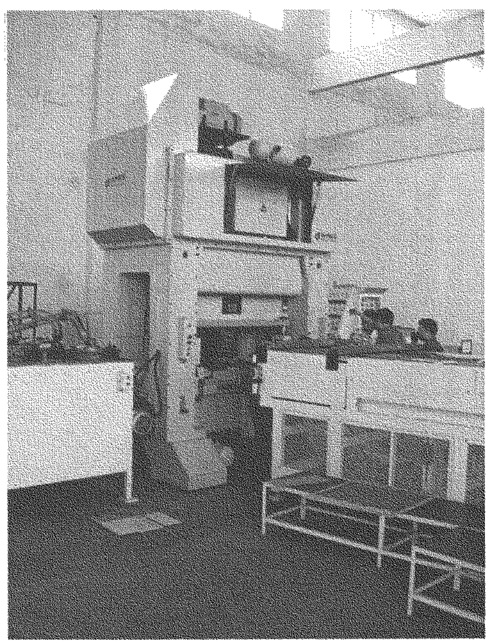
A good example of this is the recent announcement by China that it would tax exports of certain steel products. Many in Congress applauded this decision in an effort to support the U.S. steel industry. Unfortunately, not only will the new tax support higher steel prices for thousands of American companies, it will encourage our customers to purchase steel-containing components, assemblies and products from China instead of from American manufacturers.

Section 402 of the committee's SBA Trade Programs Act of 2007 seeks to establish an annual trade strategy for small businesses. You have hit on a very fundamental point. Big Business is represented; Big Labor is represented; but where are small businesses?

PMA believes national trade policy should foster an environment that strengthens manufacturing in America. I hope that this and future Administrations will use this section as a guideline to ensure their policies do not benefit the few at the expense of the many.

The federal government clearly plays a strong role in the global competitiveness of SMMs. Rapidly rising health care costs, an outdated tax code, and other issues also affect our bottom line. However, policies of foreign governments also directly impact U.S. SMMs.

Fundamental currency misalignment by China and other nations provides a clear subsidy for their companies and places our membership at a considerable disadvantage. PMA continues to work with the Administration and members of Congress to develop a balanced approach to force a change in China and Japan's currency policies. I ask members of this Committee to help ensure that Congress passes an effective legislative solution that does not have an adverse impact on small middle market manufacturers.



Section 202 of the SMA Trade Programs Act would help address a growing problem for our members – intellectual property theft and lax enforcement by our trading partners. A PMA member, The Minster Machine Company, located north of Dayton, Ohio, recently discovered that a Chinese company is counterfeiting its metal stamping presses frustrating its efforts to export its high-tech, high quality machines to China. A photo of one of their pirated stamping presses taken in a Chinese factory is included in submitted statement. Small businesses often lack the financial resources to defend themselves against IP theft due to prohibitive legal fees. We support the IP Protections Initiative of the SBA Trade Programs Act, which takes an important step to address this problem.

In addition to IP enforcement, we find that participating in countervailing and antidumping duty cases are very difficult for small middle market manufacturers in large part because they are so prohibitively expensive. Last fall, I visited the Commerce Department's Import Administration Office with a member company from Springfield, OH, who had lost some $2 million of their business to a Chinese company which was delivering steel pulleys for lawn and garden applications to U.S. markets for less than the cost of the flat rolled steel alone in the U.S. In spite of a very positive meeting at Commerce, this company elected not to pursue a trade action, because of the anticipated high cost of legal fees associated with such a trade case. PMA hopes that Congress will authorize and fully fund programs within agencies at SBA, Commerce, USTR, and others that assist small and medium sized businesses with legal resources. Section 201 of the SBA Trade Programs Act would help accomplish this.

When export opportunities do exist, a few of our members have found barriers erected by foreign governments. Another PMA company with plants in New York, Ohio and Tennessee attempted to follow a customer to China by exporting an automotive steel component into China. The Chinese government placed a 20% tariff on the part, making the American company's quote uncompetitive.

Small and medium sized American manufacturers can only be globally competitive if the U.S. government takes a more complete approach to its trade policies and remedies when foreign governments fail to abide by international trade agreements. Our members recognize we are competing against companies from around the world, but we can't do it with one hand tied behind our backs – whether tied by foreign governments or our own.

SMMs stand to greatly benefit from exporting, both directly and downstream. But in order to take advantage of these opportunities, we must first foster a domestic environment that will strengthen manufacturing in America.

PMA looks forward to continuing to work with you and your staff. Thank you. I am happy to answer any questions you may have.