Testimony of Nancy Dorn
Before the House Small Business Committee
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Chairman Manzullo, Congresswoman Velázquez, and members of the committee, I am Nancy Dorn, Deputy Director of the Office of Management and Budget (OMB). I am pleased to be here today to discuss OMB's role in implementing the Federal Credit Reform Act of 1990 (FCRA). It is in that capacity that OMB continually works with SBA on the cost estimations for its loan programs.

Before I begin, let me say that it is unfortunate that the premature release of preliminary and incomplete estimates for SBA's 7(a) business loan program may have led to unrealized expectations. I would like to point out that our efforts to improve the accuracy of the subsidy rate calculation, the first such effort in over a decade, resulted in a 20 percent reduction in cost. Administrator Barreto will explain in further detail the steps OMB and SBA took to improve the methodology and the progress made in developing an econometric model for use in the fiscal year 2004 Budget.

The FY 2003 Budget

While the Administration recognizes the importance of SBA's lending programs, we feel that the best way to address the needs of small business is through sound tax and regulatory policy. Reductions in individual taxes benefit the approximately 20 million small businesses who pay taxes at individual income rates. In addition, the Administration is committed to reducing the financial and administrative burden on small businesses of complying with tax, environmental, health and labor regulations, which again benefits the vast majority of the nation's 25 million small businesses.

To address the lending needs of small businesses affected by the September 11th attacks, the Congress passed and the President signed legislation that temporarily lowers fees for SBA lending programs and transfers more risk to the government. While the fee reductions may help those businesses and lenders that participate in SBA programs, it also means that the subsidy rate and cost of these programs rises. Given the additional cost, the budget supports a 7(a) loan volume that is lower than FY 2002 loan volume even with an increase in appropriations for the basic 7(a) program. With respect to the FY 2003 budget, the increase in the subsidy rate for the 7(a) program is not the result of any Administration proposal. However, we believe there may be opportunities to leverage additional lending in other SBA programs to offset the decreased loan volume in the 7(a) program.

Federal Credit Reform

The Federal Credit Reform Act (FCRA), which became effective in fiscal year 1992, requires Federal agencies to accurately measure the true costs of lending programs by budgeting upfront for the expected net loss to the Government. Prior to credit reform, the cost of Federal loan programs was very uncertain. In many instances, it took years for costs to be apparent. Loan defaults and guarantee claim payments were reflected in the Budget years after loan disbursements and guarantee commitments had been made. The cost of interest subsidies was clear only after several years of experience with market interest rates. The cost of direct loans was systematically overestimated, and the cost of loan guarantees systematically under-estimated.

Credit reform put Federal budgeting and accounting for credit programs on an equal footing by requiring that the cost of loan programs be calculated and recorded up-front in the year that the loan is made or guaranteed. It takes the best information available at a given point in time to measure the budget impact of Federal loan programs. It uses the actual historical cash transactions of loan programs to compare the net present value of payments by the Government (direct loan disbursements and guarantee claims, for example) with the net present value of receipts (such as loan repayments, fees, and recoveries). This allows policy makers to make more informed decisions about credit programs and to compare more accurately the budget impact of credit programs with other Federal expenditures.

Consistent with the Budget Enforcement Act, agencies must also use the technical assumptions derived at the time of the Budget's release for budget execution, which means they must use the default and recovery rates, the discount rate, and other relevant assumptions as provided in the Budget for that fiscal year. This protects the integrity of the analysis – and protects the loan volume provided by Congress – by removing incentives to change the subsidy rate estimate during or after the appropriations process. Credit reform also requires that legislated changes to the subsidy rate be scored accordingly.

Under credit reform, agencies must update their subsidy estimates each year to reflect the actual performance experienced in loan programs. Programs that experience higher costs than projected generate upward cost reestimates, and therefore require an additional mandatory appropriation from the Treasury to cover these losses. Programs experiencing lower costs than projected generate downward cost reestimates, and therefore return excess funds to the Treasury. These reestimates do not require further action in the annual appropriations process.

OMB's Role in Implementing FCRA

The FCRA gives OMB the authority to make subsidy estimates. We have, in many cases, delegated that authority to the agencies, but have retained the right to review and approve all estimates submitted by the agencies as part of their budget formulation and execution.

OMB takes its role very seriously. Staff work to ensure that estimates have been calculated in accordance with the requirements of the FCRA and applicable guidance issued by OMB, Treasury, the Financial Accounting Standards Advisory Board, and other entities. A large part of this role is ensuring that consistent standards are applied to similar programs. To help agencies meet these requirements, OMB has developed a number of tools to estimate and reestimate the cost of credit programs, as well as spreadsheets to assist in end-of-year account calculations. We also provide detailed training, both scheduled and on an as-needed basis, on credit budgeting concepts and applications.

OMB works with agency staff closely throughout the year on issues related to credit subsidy calculation. For example, we assist in developing models for newly enacted programs, or changes to models for existing programs. Recent examples include participation in an overhaul of some of Agriculture's existing cashflow models and developing a new model for the Air Transportation Stabilization loan guarantee program. We are committed to working with agencies to continually improve the accuracy of the subsidy calculations and incorporate new information and modeling theories where appropriate.

During budget formulation, OMB collects and analyzes all subsidy estimates and reestimates to ensure that they have been calculated in accordance with published standards, and that they reflect the program's historical experience. We also ensure that they properly reflect any changes to cashflow models that we have approved prior to budget submission.

SBA and OMB process

SBA and OMB have historically worked together very closely on subsidy estimates. SBA possesses some of the richest credit program data sets in Government, and as a result, their subsidy estimates reflect actual historical performance during a variety of economic conditions. However, as Administrator Barreto will describe in more detail, SBA, like other agencies, is working on improvements to their models and is making excellent progress.

SBA is currently moving towards an econometric model, which will incorporate historical data, programmatic changes, and economic variables. As of now, only two other agencies incorporate elements of econometric modeling. OMB is, in fact, providing staff to assist SBA in developing its econometric model for the 7(a) program for use in the fiscal year 2004 Budget.

I will now turn the discussion over to my colleague, Administrator Barreto, to discuss the specifics of SBA's credit programs. Thank you for the opportunity to appear before you today and I am happy to answer any of your questions.