



Office of International Trade (OIT)

James F. Wilfong

In June 1999 James Wilfong was appointed by the White House as the Small Business Administration's Assistant Administrator for International Trade. A small business entrepreneur from Maine, Mr. Wilfong has over thirty years experience in international trade, marketing, small business management and public policy.

In his current position, Mr. Wilfong serves as the SBA Administrator's principal advisor on international trade and oversees educational, technical assistance, risk management and finance programs and services designed to assist U.S. small businesses entering or about to enter the international marketplace. Mr. Wilfong views small business trade as a means of creating more vibrant, prosperous and peaceful communities.

Mr. Wilfong previously served as the President of TradeNex, an export management company which assisted small businesses distribute and market products internationally, most notably Volant Ski Corporation. Mr. Wilfong helped to create the U.S. operation of Atomic Ski Austria and for fourteen years operated as its Director of Sales and Marketing; was a member of its International Marketing and Product Design Committee; and assisted in taking the company to second place market share in the world's winter sports industry.

Mr. Wilfong has also served in many advisory capacities, including Chair, Maine Advisory Council of SBA; member of the Maine gubernatorial Advisory Council on International Trade; and as a member of the "Commission on Maine's future." In 1995, he served as the national floor whip on international issues as a delegate from Maine to the White House Conference on Small Business.

Mr. Wilfong spent some time in other public service positions- as an elected official from 1974-1978 as a member of the Maine House of Representatives. In this position, he served on Performance Audit, Natural Resources and Agriculture Committees. His most important piece of legislation, the Maine Sunset and Program Review Act, established a strategic planning process for the state's budget system. He also worked on the staff of U.S. Senator Edmund Muskie from Maine.

Mr. Wilfong holds the status of Senior Entrepreneur at the University of Southern Maine, teaching classes on small business entrepreneurship. He is the co-author of "Taking Your Business Global - Your Small Business Guide to Successful International Trade," published by Career Press in 1997.

A product of a one room schoolhouse and a rural family farm, Mr. Wilfong still lives in the small western Maine town of Stow with his wife, Valerie, and their two children, Liza and Christian. On a seasonal basis, the family owns and operates the Wilfong Family Christmas Tree Farm.

Testimony of
James F. Wilfong
Assistant Administrator for International Trade
U.S. Small Business Administration

Before the
The U.S. Trade Deficit Review Commission
Kansas City, Kansas

April 26, 2000

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I want to thank the Trade Deficit Review Commission for inviting me to testify today concerning the impact of the trade deficit on U.S. small business. I think it is very important that this Commission is focussing attention on the impact of the trade deficit on small business trade and commend you for making the effort to look into this.

You may have read recent statistics in the press about the impact of U.S. small business (SMEs) on our export economy. The focus of my office is on exports and the bottom line is that small business is playing a big role in the U.S. export economy and we expect that role to increase over time. But, I think it is also important to mention that more than two-thirds of the companies involved in direct importing are small businesses. While I do not want to dwell on that import statistic in detail, I believe that it's important that this Committee recognize that we need to look at both sides of the international trade equation. Two reasons immediately come to mind why we need to be cautious in approaching this question.

* Mr. Wilfong wishes to gratefully acknowledge the assistance of Mark E. Rosen, Andreas Kurtsson and Veronica Rivera for their contributions in the preparation of this testimony.

First, when you consider value-added here in the States and the opportunities created for servicing, imports ultimately support approximately 10 million jobs in a variety of industrial and service sectors. Many of those 10 million jobs are held by small businesses in the business service area which includes computer programming, data processing, credit reporting, management, advertising, marketing, etc - - all high-wage jobs which make positive contributions to our economy. Second, it has been my experience that firms which import are just as likely to be exporters, or are export ready - as contrasted with small businesses which have no international business. As I will discuss later in this presentation, my biggest problem is getting businesses to invest the human and financial capital to become initially involved in international trade.

I would like to stress that I am not an economist so there are probably people on the panel who could challenge my statements based on economic studies of one sort or another or analyses by noted economists. But, I will give you my frank views based on 25 plus years as a small businessperson who has traded internationally through all types of business climates and talked to thousands of small businesspersons and heard their views.

How is small business performing in the export area?

Some members of this Commission may be unaware of the major developments that have taken place in international trade as they pertain to the 24 million U.S. small businesses. I would note that those small businesses have accounted for almost all the new jobs added to the economy since 1992 and 55% of the country's technologic innovation. Small business also accounts for approximately 50% of the gross domestic product (GDP).

As far as international trade is concerned:

- 97% of all exporters are small businesses
- the value of small business exports has increased more than 300% over the past five years so that now small businesses trade accounts for over one-third in dollar value;
- The gap between big and small business trade continues to narrow; and
- The fastest growth in small businesses trade is in the technology and service sectors;

Of great importance to this Commission is the fact that small business trade - - this is something I feel strongly about - - plays an essential role in building communities around the country. Consider these recent Department of Commerce statistics indicating that firms that export are:

- 20% more productive;
- experience 20% greater job growth;
- pay wages that are 15% higher on average
- provide benefits which are 11% higher on average

In other words, small business exporters provide greater stability and prosperity for our local communities through the creation of higher paying jobs. Additionally, small businesses generally have a more direct stake in their communities. Small businesses provide 67 percent of workers with their first jobs and initial on-the-job training. And with an estimated 53 percent of small businesses being home-based,

these businesses typically remain in their communities, obeying labor, environmental, and other state and federal regulations.

These statistics tell only part of the small business trade story. What I think is really significant is that less than 1% of the nation's 25 million small businesses (202,000) are actually involved in exporting. Also, of that number 2/3 are only exporting to one country. SME exporters are now having a dramatic effect on the nation's export economy. Imagine the impact on our export economy if we were able to increase the level of small business participation in exporting by just 1 per cent. Imagine the impact on our export economy if 50% of our current exporters began exporting to a second country. I also believe that if more small businesses were exporting there would be a beneficial impact on the nation's overall merchandise trade deficit.

How we see the deficit. What the numbers really mean.

The service economy surplus may be a better indicator of small business performance in export Markets

After taking the time to put the figures in their proper context, I am less alarmed than some with the current U.S. trade deficit. It is true that there was an overall trade deficit of about \$ 270 billion in 1999. But, in arriving at that figure one needs to recognize that there was a trade surplus in services in 1999 of \$75.8 billion. This surplus has been around for quite a few years (since 1972) and has gotten larger year-by-year; although, we need give this indicator constant attention. I also think that when you look at the deficit figures you need to take into account that recent spikes in the trade deficit were heavily influenced by much higher petroleum prices (158% according to Secretary Daley).

The surplus in services is significant because this is one of the most dynamic areas of small business exports. We do not have firm statistics but the observation by SBA and Dept of Commerce trade specialists is that services is the most dynamic area of small business growth – especially in Information Technology (IT), engineering, and professional services – because their entry costs tend to be the lowest and service providers often do not have to make substantial capital investments in the export destination. Services feed the international manufacturing base. We also see growth especially in the technology fields, because the Internet makes it possible to enter a foreign market “virtually” with no startup or licensing costs. Also, as long as E-commerce remains tariff free in most of the world, there’s a strong economic incentive for this service sector to grow rapidly.

The merchandise trade deficit and small business

The vast majority of our merchandise trade deficit is partially a result of imbalanced trade flows between the U.S. and Asian economies. There are some other areas of concern (e.g., Canada – due to agriculture) but Asia has been a historic source of difficulties. Even though I am not totally comfortable with the size of the trade deficit with Asia (about \$200 Billion in 1998) we need to understand that much of trade deficit involves two countries (Japan and China) with trade practices which are still not up to world standards and which we’re hopeful can be corrected with universal accession to the WTO. Also, the imbalance shows the effects of a strong dollar during the Asian financial crisis. One need only visit a local discount store and see the abundance of low-tech manufactured good from China to gain an appreciation for this phenomenon.

My analysis is that if the effects of a strong dollar and structural market problems could be eliminated, the deficits with China and Japan would be much smaller. Also, when it comes to imports from China I think we're seeing the old rule of comparative advantage in operation because my assessment is that China – because of the cost advantage in low tech labor - has become a haven for high-volume, low-priced goods. During this same time, the United States has held onto higher-cost artisan quality market share. In the high priced sports apparel industry – something which I am quite familiar with – we have seen import strength in low-cost outerwear from China and other low wage countries but at the same time there has been steady growth in sales of high priced outerwear which is predominantly American made. In addition to this shift in market focus, we also have macro economic figures which demonstrate that U.S. manufacturing productivity is experiencing very healthy growth rates. The most recent report on U.S. SME exports to China, for example, indicated that the number of SMEs exporting to China rose faster *than any other major market* and SME's accounted for a growing share of the U.S. exports to China¹.

Much SME export growth is in the technology sectors and, as this Commission is well aware, there are no systemic unemployment problems in the technology fields. From everything that I have heard from my small business colleagues, there are persistent shortages of technology workers. This shortage is particularly acute in the Dulles Airport Corridor which some have labeled the Internet capital of the world.

The merchandise trade deficit and employment and inflation, savings and investment, and future directions of the U.S. Economy

Employment and Inflation

¹ DOC Report. In 1997 SMEs generated 35.1 % of all merchandise exports to China. This is compared with a 27.6 share in 1992.

Some analysts like to argue that the merchandise trade deficit is pushing workers into lower paying service jobs (like restaurants and health care) thereby eliminating higher paying manufacturing jobs. There is also a concern that trade deficits mean depressed wages as cheap imports drive down the costs of U.S. manufactured goods and, in some cases, put American manufacturers out of business.

I generally agree with the statement that a continued influx of overseas goods will dampen inflationary pressures and potentially force American manufacturers out of business that are not competitive. But, I am not sure that this is a bad thing because from a small business perspective inflation is a profit *killer* since it drives up the costs of capital and makes it almost impossible for small business to do sound economic planning. Larger businesses can often weather inflation in a particular country because they may be invested in multiple markets. Small businesses are typically not that well diversified. Therefore, to the extent that imports stimulate competition and thereby hold down prices (and the cost of borrowing), that is a good thing. Second, I am not sure that as a government we can or should do anything to protect businesses, which cannot compete on a global scale. The SBA and other trade agencies are doing everything in their power to increase market access opportunities for U.S. business as U.S. industrial productivity is at an all-time high. It is true that there are some firms employing high wage employees that will lose their comparative advantage because someone overseas will have figured out how to manufacture the same widget at half of the cost. The trick is for the company's management to catch-on before it's too late and retool or transition workers to into new, more economically efficient positions. These events are not painless and that's where agencies like the Department of Labor and SBA can help. But let me reiterate that I do not subscribe to the thesis that trade deficits result in the loss of high-wage job. That's not what's happening today. In

fact, Daniel Griswold testified before this same Commission last August that “during years of worsening trade deficits, unemployment rates have, on average, *fallen* by 0.4 percent.” I am not prepared to go as far out on a limb as Griswold. What I will say is that deficits, which are small relative to GDP, have a very little influence on employment.

Savings and Investment

Some opponents of free trade argue that trade deficits siphon-off capital which would otherwise be destined for the domestic economy and ship it overseas. The net effect, they argue, is that this loss of domestic capital means less capital available to finance plant expansion, new hiring, and other actions necessary to compete globally.

This argument has some amount of appeal from a logical standpoint but when you really look at this issue closely you reach the opposite result. In fact, the trade deficits made it possible for the United States to import foreign capital into our debt and equity markets to support our rising level of investment in plants and new equipment, including new computer technologies. Since 1992 annual real private investment in plant and equipment in the United States has risen 81 percent from \$557.9 billion to an annual pace of slightly more than \$1 trillion in 1999.

Even if you do not support the notion that trade deficits result in foreign investment in the U.S. economy, I think you need to consider that the merchandise trade deficit is a comparatively small phenomena as compared with the GDP of the United States. Over the past decade the average yearly trade deficit was .6% of 1% of GDP.

Conclusion. I admit to falling into the trap of thinking about the deficit issue like someone balancing his family's checkbook. After analyzing this, I think it is wrong to think of trade deficits as a competitiveness scorecard because there are too many factors (like exchange rates) which have nothing to do with competition, which influence the outcome. Therefore, I am less concerned about negative numbers because:

- We have a strong dollar;
- The U.S. is posting a surplus in the service economy and this sector should grow at a fast rate;
- Unemployment is low across the board; and
- There is continued demand for workers in various high-wage technical areas.

What does the future hold in store?

I would like again to stress that I am not an economist but it is my opinion that so long as the U.S. economy continues its dynamic growth and the U.S. dollar is strong, we will continue to have merchandise trade deficits. This is also the view of Secretary of Commerce Daley. Foreign goods will be comparatively cheaper as a result of a strong dollar. Also, foreign manufacturers (and their state sponsors) will continue to forgo more profitable rates of return for their goods in exchange for an economic toehold in the U.S. and a steady supply of U.S. dollars. From my vantagepoint at SBA as an advocate for U.S. small business trade, I see greater opportunities here for U.S. small businesses. Namely, U.S. exporters enjoy some advantage over foreign competitors because the U.S. dollar is a standard medium for many international transactions and U.S. exporters do not have to pay commissions to obtain dollars or are subject to foreign exchange rate fluctuations. And, as we move to greater

numbers of dollar denominated e-commerce transactions on the Internet (because of the use credit cards) this currency advantage which U.S. exporters enjoy will become more apparent.

Since SBA is very interested with the effects of its programs on communities, I think that we need to look at trade deficits from the perspective of people that make up the communities that it affects. Consequently, I am much more concerned about actual harmful effects of deficits on people rather than how they perform in an economic model. Therefore, I am less concerned with deficits as long as there are trends in the manufacturing labor economy toward high-wage artisan quality goods or high technology employment. I do not think it is necessarily a bad thing if many lower-end manufactured goods with a high labor content come from countries like China - - unless there were significant surplus in low or semi-skilled workers here in the U.S. In fact, there are labor shortages in many employment sectors and unskilled labor is in high demand by the domestic service economy.

I am not totally convinced that bilateral deficits between developed countries are benign if they are a result of head to head competition between high skilled employment. In such a case, the deficit could be an indicator that the country is not open to trade or employs trade-distorting practices. Given the fact that U.S manufacturing efficiency is world class, I would argue that loss of high skill jobs and bilateral trade deficits (working alone or in combination) with developed countries could be an indicator that the playing field may not be level. But, I do not think that measures to structurally attack the deficit are the answer in a case such as Japan because the deficit is a symptom rather than a cause of a problem. Instead, we need to attack unfair trade practices and level the playing field.

Are Continued Trade Deficits the Harbinger of Bad Things to Come? Are we prepared for the Future? Should anything be done?

I try very hard to be a realist when I look at the state of small business trade. Coming from Maine I know what it's like to have people in your community put out of work because of foreign competition or for employers to have worry about making a payroll. In preparing for this testimony today and reflecting on the various trends in small business trade I am upbeat because:

- Small businesses predominate the service sector and that sector registers consistent surplus';
- U.S. SMEs are doing business competitively in all SIC Codes
- There is continued growth in high wage employment; and
- Inflation and lending rates remain comparatively low.

I am also very upbeat about the potential for small business trade to really soar because, as I said, less than one percent of U.S. small businesses are engaged in exporting, and of those 1 percent, two-thirds are exporting to only one country. While I do not have clear idea what percentage of small businesses in the United States should be exporting, the fact that established small businesses are entering the international trade game every day is proof that we are only scratching the surface in terms of involving all U.S. small businesses that could or should export.

Also, given the fact that the Internet now makes it possible for a small business to become involved in exporting without any foreign establishment expenditures, I see tremendous opportunities for U.S. small businesses to export at little or no cost. To succeed, however, U.S. small business needs to make the most of this rare tariff-free

window of opportunity, and the fact that, for now, we have a technological advantage over most of the rest of the world. They also need to aware that SBA is available to provide them various types of international trade assistance.

In terms of the work of this Commission, I would seek your support in allowing me to further the programmatic work, which SBA is now doing in the International Trade arena consistent with the Small Business Act. I do not recommend any major new programs or modifications of existing ones. I will indicate in a minute where some fine-tuning may be needed.

There are four basic prongs to our international trade programs:

- Increase U.S. SME access to foreign markets;
- Ensure the playing field is level and advocate for small business internationally;
- Provide access to capital to facilitate exports; and
- Provide international trade training.

a) International Market Access.

In the areas of market access, SBA has forged alliances with a number of countries, and non-governmental organizations, which can be used to provide trade leads and other trade facilitation assistance to U.S. small business. SBA is also involved on the “groundfloor” with groups like US AID and private organizations to help design SBA-like organizations abroad in the hope that our investment today will result in a trading relationship tomorrow. Thus far, SBA is now working actively with South Africa, Egypt, Ireland, Argentina and Mexico. We hope to add Turkey, India, Italy

and perhaps Korea to the list of countries. With the recent introduction of SBA's new Internet product "Trade Mission On Line" (www.sba.gov/oit/tmonline) it is our hope that we'll be able to use the Internet, in cooperation with our partners, to match U.S. and foreign SMEs. But, in all candor, we have more opportunities to establish international trading arrangements than we have funds to properly implement the agreements we sign or sufficient personnel to administer them. Without a substantial increase in personnel or funding for trade promotion, we will need to continue to "pick and choose" among those markets which seem particularly well suited for small business trade and referring others to trade specialists from the Department of Commerce and the Foreign Commercial Service.

b) Access to Capital.

SBA has a variety of loan programs to meet the domestic and international trade needs of small business. Most of these loans are issued by commercial lenders but SBA provides a loan guarantee. SBA's workhorse in international trade finance is the Export Working Capital Program (EWCP) loan which helps small businesses obtain working capital to complete export transactions. Longer-term international trade loans and regular business loans in which SBA provides a guarantee are also available. We also hope to field test a new international trade loan in which the borrower makes application with a commercial bank using their documentation and SBA will provide a guarantee of up to 80% with variable maturities.

In terms of the actions of this Commission, I think that we have a good selection of loan programs and strongly recommend that we continue the course. As it stands right now, low inflation and liberal monetary policies has meant that international trade financing can be obtained from commercial sources although terms and rates can be

higher than under our programs. But, if monetary policies were to tighten because of increased inflation or other factors then small businesses would have difficulty raising necessary capital to finance their export transactions. Since most small businesses simply are not big enough to access the capital markets in the same way that large corporations through the issuance of debentures and equity instruments, there is a continuing need for SBA capital access programs.

Even though I think we have a good package of capital access programs for our exporters, our loan volume is too low and too few lenders are participating in our export loan programs. I would like to see a larger loan portfolio and I am concerned that our community banks in particular do not know about our loan programs - - which are a good deal for the banks and a good deal for our American exporters. I am worried because community banks are the ones who are closest to our small business clients and should be the ones to encourage them to expand the scope of their business with SBA's assistance. I take this as my challenge to have America's banks more directly involved in helping to make information available about SBA's international loan programs

Before leaving the question of trade finance, I would like to reassure the critics that there is very little overlap, if any, in the programs of OPIC, EXIMBANK, and SBA in the areas of trade finance. About five years ago, SBA and EXIMBANK harmonized their export working capital programs. Both agency's programs now have a 90% guarantee and use the same application form. SBA guarantees export working capital loans up to \$833,000 and EXIMBANK guarantees loans above that limit.

Some larger banks with international departments have delegated authority from EXIMBANK to process their loans. Naturally, these banks with dedicated staff

trained in EXIMBANK programs are permitted to process all export capital working capital loans using EXIMBANK's guarantee. We do not have a problem with that especially because our primary banking focus is on the small community banks. These community banks and other lending institutions make up a constellation of approximately 7,000 banks that participate in SBA's regular 7(a) program. The bottom line is: (a) to the extent there is overlap it is more theoretical than real; (b) SBA's primary focus is on "new to export" firms - - our borrowers typically have less than \$10 million in total revenues and less than 50 employees; and (c) SBA's typical EWCP loan is about \$350,000 while the average EXIM Loan is \$1.5 million. SBA and EXIMBANK are working together to develop better strategies for marshalling our assets in field to increase delivery export financial assistance to a larger number small businesses.

D) Training and technical assistance is the third pillar in SBA's international trade assistance. SBA offers international trade training (often free of charge or for a nominal fee) at numerous locations around the country. We also promote non-SBA international trade training opportunities, which benefit our clientele. From everything I have seen, I think we are meeting the needs of our small business customers. I am also pleased to announce a new Internet product, which is a storehouse of information concerning international trade: www.tradenet.gov.

E) A Favorable SME Trade Policy.

As I mentioned above, trade imbalances with countries like Japan concern me the most because our exporter profiles are largely the same but U.S. industry has narrowed the gap and, in many respects, surpassed the Japanese in terms of plant and worker efficiency. I continue to hear complaints from U.S. small business exporters

who encounter structural problems inhibiting their entry into the Japanese market. There are some who say that there are no longer any restrictions on foreign market access and the current trade deficit is entirely due to strong U.S. imports of automobiles and a strong U.S. dollar vis-à-vis the yen. I tend to think that the bilateral trade deficit – especially because it has been so large and persistent – is also an indicator of an uneven playing field.

SBA is a big believer in the wisdom of a rules-based international trading regime - - that's why we invested so much time and energy participating in the Seattle Ministerial. The rules-based system, which is universally followed, is essential to small business trade because SMEs simply lack the resources to fight unfair trade practices or lack of market access. We have seen in the past where lack of market access/unfair trade practices contributed to bilateral trade deficits. To ensure that this does not happen in the future, I urge the Commission to support establishment of a Special US Trade Representative for Small Business Trade. Having a person on the inside advocating on behalf of small business trade issues is an inexpensive insurance policy against a costly bilateral trade deficit.

Thank you very much for your attention.