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12TH DISTRICT, CALIFORNIA

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GOVERNMENT OPERATIONS
AND
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Congress of the United States
House of Representatives
Washington, D.C. 20515

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May 7, 1982

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7/25/82

~~CONFIDENTIAL~~

The Honorable Michael K. Deaver
Deputy Chief of Staff and
Assistant to the President
1600 Pennsylvania Avenue NW
Washington, D.C. 20500

Dear Mike:

I'd like to ask for your help on a matter of urgency where the White House may suffer a black eye and Speaker O'Neill and Ted Kennedy an unwarranted victory.

H.R. 4326, the so-called "Small Business Innovation Act," is set for a floor vote next Wednesday.

I understand that the President last Fall may have heard the bill's purposes briefly described by Senator Rudman, and responded something to the effect that he was in accord with those purposes. This was also true of 201 members of the House who originally cosponsored the bill but who are now reconsidering upon closer examination.

The bill's chief Senate sponsors are Ted Kennedy, Lowell Weicker and Rudman, and this unlikely combination beguiled the Senate into passing the bill 90-0 last December.

In the House, the Small Business Committee reported the bill out 40-0, and the Speaker has scheduled it for a floor vote next Wednesday, May 12th, to coincide with "Small Business Week."

This is a very bad bill for the reasons described in the enclosed editorials and documents. It would set aside 3% in preference awards for all federal research contracts... requiring that they be given to "small businesses" regardless of the government's need and regardless of competitive merit.

The bill will cost \$38 million in new administrative costs alone. (This estimate is from the Congressional Budget Office.)

Thirteen federal departments award research contracts

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which will total roughly \$40 billion in 1982 (5½% of the whole federal budget.) Defense leads the way with \$22 billion, followed by NASA, DOE and HHS in that order.

The Department of Agriculture, for example, will spend \$766 million in 1982. Last year Agriculture put out only \$790,000 to some 20 private firms. If the law passes, however, Agriculture would have to put out \$23 million... literally having to either find the small businesses to accept this money, or to give more than \$1 million to each of the 20 firms they have thus far found capable of doing such research.

The list of horrors goes on. Defense states that the language of the law requiring a 3% set-aside would actually force them to spend 26% of their R&D work on small businesses.

The CIA doesn't want the bill because it obviously doesn't want to even disclose the nature or amount of the research contracts it awards.

NIH estimates the law will prevent the funding of hundreds of worthwhile research projects.

The largest association of small high-technology businesses, the American Electronics Association (AEA) a group which strongly supported the President last Fall and which includes a number of the 40 members of his business advisory group, doesn't want the bill passed pointing out that small businesses already get 6.8% of the contract dollars, whereas they only employ 5.5% of the scientists who do this kind of research.

Furthermore, small high-technology companies last year attracted \$1.3 billion in private venture capital; they represent the last, best chance for a poor person to become rich quickly today; there is no lack of private capital to fund any exciting new applied research concept... these companies are at the forefront of business success in America and don't need government money.

The American Farm Bureau Federation, representing 3,000,000 families, also opposes the bill.

This bill is a boondoggle from start to finish. It is beginning to receive strong editorial denunciation from papers like the New York Times, Washington Post, National Journal, Los Angeles Times, San Francisco Chronicle, Denver Post, Minneapolis Tribune, Sacramento Bee, Washington

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Monthly, Rocky Mountain News and Oakland Tribune, among others (attached).

The bottom line is that unless the White House steps in, Ted Kennedy and the Speaker are going to have the first legislative victory of 1982.

Can you quietly get the word to House Republicans that the Administration would like to see the bill killed?

If the President gave his acquiescence to Senator Rudman on the bill before the AWACS vote last Fall, can you at least let loose the respective Cabinet Secretaries and agency heads to lobby their constituencies in the House?

I will call you Tuesday morning, May 11th, to see if I can meet with you to discuss any problems you have with these thoughts and the documents enclosed.

Sincerely,



PAUL N. McCLOSKEY, JR.

PNMcC:ddn
Enclosures

The Denver Post Wednesday, April 7, 1982

THE DENVER POST

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Setting aside logic

SO YOU THOUGHT the "Reagan Revolution" meant an end to heavy-handed federal "social engineering" in state and private sector affairs? Friend, you haven't read HR 4326.

Neither, apparently, did the U.S. Senate. The resolution, misnamed the Small Business Innovation Development Act, sailed through that body on a 90-0 vote. It is to be hoped the House does read it — and kills it — before universities and high-technology companies are spread-eagled on yet another bureaucratic rack.

The bill demands a "set-aside" of 3 percent of the research and development budgets of 13 agencies, including the Departments of Defense, Energy, and Health and Human Services, and the national space agency.

The resulting slush fund, about \$1.5 billion annually, would be reserved for "small businesses." HR 4326 defines firms employing up to a thousand workers as "small." Since the owner of such a firm is usually a multimillionaire, it's absurd to give him special favors. Yet HR 4326 does just that.

Worst of all, as Donald Kennedy, president of Stanford University, notes, HR 4326 ignores the fundamental distinction between basic and applied research. Fundamental scientific discoveries, such as the recent progress in recombinant DNA research, generally stem directly from basic research which has no immediate prospect for profit. About 70 percent of such basic research

takes place in universities — including major efforts at the University of Colorado and Colorado State University.

The next step is transfer of technology, when the discovery is refined and applied to commercially significant needs. Universities and corporations alike are active in that field, according to Kennedy.

Finally, it generally is small firms which carry out the third step of turning those discoveries into specific innovative process.

"For the best of motivations, HR 4326 reallocates federal dollars between totally different sets of purposes," Kennedy warns. The result could be starving basic research at the university level — already seriously underfunded.

The group that would be most likely to benefit from HR 4326 — the American Electronics Association — opposes it. The association represents 1,800 high-technology firms, 80 percent of them "small businesses" under the bill. "We oppose political intervention in the marketplace on behalf of a special interest — even if it is ours," the association said.

Besides, as the AEA notes, its hustling firms already are doing quite well playing by free-enterprise rules.

HR 4326 would cost an estimated \$38 million a year just to administer. If Congress won't kill it, President Reagan should stand by his free enterprise rhetoric and veto it. What HR 4326 really "sets aside" is logic.

FRIDAY, APRIL 2, 1982

The Washington Post

AN INDEPENDENT NEWSPAPER

A Waste of Money . . .

A PLAN to earmark part of all government research and development money for small businesses—having sailed through the Senate on a 90-to-0 vote and emerged in fattened form from the House Small Business Committee—has run into some deserved opposition on its way to the House floor. Several other major committees are concerned that, despite the good intentions of its sponsors, the legislation would impede rather than assist technological development.

Small, technology-oriented businesses already have a good record of scientific innovation. Recent changes in the tax code have also substantially increased the pool of risk capital available to innovative enterprises, so that record should improve. The sponsors of the new plan, however, think that more help should be provided by requiring major agencies to earmark additional funds for small business—under the House version, 3 percent of all R&D funds would have to be added to the substantial amounts already going to small business.

The House committees directly concerned with defense, intelligence, science and technology and energy and commerce think otherwise. So does the American Electronics Association's small-business committee, which represents most of the innovative

small firms that the bill's sponsors want to help. They note that the small-scale experiment run by the National Science Foundation, upon which the bill is patterned, would be hard to replicate on the scale required by the legislation—and the NSF agrees. Government staffs that monitor research have been sharply cut in many agencies. If past experience is any guide, the new set-aside is likely to operate as a simple subsidy for firms otherwise unable to compete for federal contracts.

The set-aside is also likely to hit most heavily on that relatively small amount of federal money that supports basic research. This is because most R&D money is necessarily spent on expensive development and data-gathering activities for which small technological firms are often unsuited.

Streamlining federal research contracting and making sure that all qualified bidders get a chance to compete are important ways to help the government get the most for its research dollars. Earmarking money for a special group of bidders, however, is almost guaranteed to waste money. If the firms selected are the most qualified to do the work, then the set-aside is not needed. If they are not the most qualified, then government money has been wasted.

The Washington Post

AN INDEPENDENT NEWSPAPER

THURSDAY, MARCH 4, 1982

Bad Business

WHEN A BILL passes the Senate by a 90 to 0 vote you can conclude that one of two things happened: either the measure was viewed as essential to the republic, or no one was paying attention. In the case of the Small Business Innovation Development Act—now working its way through the House—no one in the Senate seemed to be on deck.

Small businesses have accounted for most of the job growth and a large part of the technological progress over the last decade. That being the case, you might ask why more help is needed—especially since the tax bill passed last year was designed to encourage investment and risk-taking. The proponents of the measure argue, however, that small business could contribute still more if it were assured a larger share of federal research and development money. Hence the proposed legislation.

The more generous House Small Business Committee bill would earmark 3 percent of the R&D budgets of the 13 largest federal agencies for small business. This would be more than \$1.5 billion annually after the program had been phased in.

The whole dismal history of government procurement preferences and set-asides would suggest that, despite the program sponsors' good intentions, the desired boost to innovation is far more likely to end

up as a prop for shaky ventures. In many agencies the program would quickly degenerate into another pesky set-aside for firms that can, by means fair or foul, become eligible—not a hard thing to do in a program that covers firms with as many as 1,000 workers.

Most government R&D—particularly in the large domestic agencies—is simply not the sort of thing that sustains unrecognized geniuses. As a result, it is also likely that the burden of meeting an agency's 3 percent quota for innovative research would fall heavily on that sometimes small part of the budget that funds basic research. This worries the universities and medical schools.

The American Electronics Association—whose predominantly small-firm membership is presumably just the sort of beneficiary the program has in mind—says that the last thing it needs is another complication in the already Byzantine government procurement process. The electronic firms aren't against government help—they'd like more tax breaks instead. But they are right in insisting that government could help worthy small businesses a lot more by streamlining its procurement process, speeding up its bill-paying and increasing—not reducing—the amount of open competition.

The New York Times

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The Raid on Basic Research

The measure seemed harmless enough — so harmless that it passed the Senate last December without dissent. In fact, however, the Small Business Innovation Development Act is a special interest grab that threatens to siphon off hundreds of millions of Federal dollars for basic research.

Hardly anyone is more cherished by Congress than the owners of small businesses. So when New Hampshire's Senator Rudman proposed that 1 percent more of the \$40 billion that goes for research and development on Government projects be set aside for companies with fewer than 500 employees, nobody blinked. And when Representative John LaFalce of New York raised the ante to 3 percent, he had no difficulty finding 180 House sponsors.

Supporters note that everything from streptomycin to the zipper was invented by small entrepreneurs. If Washington were willing to look beyond the Fortune 500 when it doles out research funds, they insist, more of the same would emerge. Besides, a 1 (or 3) percent cut in R & D funding would only force the big researchers to look a little harder at their paper-clip bills.

There's no question that in some industries, smaller companies are strikingly innovative. But they already get a fair shake from Washington. Small companies employ 5.5 percent of the scientists and engineers in the private sector, but get 6.8 percent of Government funds for private research.

What difference would an extra few percent make? The fear, expressed by Stanford University's

President, Donald Kennedy, is that most of it will come out of the small proportion of Government R & D devoted to basic research. Few agencies would willingly redirect funds tied to specific development projects like new weapons systems. And small businesses simply aren't prepared to do the basic research now mostly performed at the big Government-owned labs.

Actually, the potential loss is still greater. At the Stanford Linear Accelerator much of the budget must be spent on equipment maintenance, whether the machinery is used or not. So a 1 percent cut in funding forces a much larger cut in research operations. The same is true for capital-intensive basic research in fields like biogenetics.

These arguments have made headway in the House, where one committee after another has expressed reservations about the bill. California's Pete McCloskey will lead a floor fight against it, but few other Congressmen seem willing to stick their necks out. The Federal budget office wants no part of the set-aside. But President Reagan is said to have promised neutrality in return for Senator Rudman's support for the Awacs deal last year.

Some believe that the Rudman set-aside is unstoppable, that Congress could not bring itself to vote against a program labeled "small business," no matter how wasteful. This may yet prove to be true. But only by resisting such outrages can Government ever hope to control waste — or manage the economy rationally.

Los Angeles Times

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Research: Blurred Vision

Congress is blurring the distinction between basic and applied research in some pending legislation, and American universities may suffer as a result.

At issue is the Small Business Innovation Research Act, sponsored by Sen. Warren B. Rudman (R-N.H.) and Rep. John J. LaFalce (D-N.Y.). Their idea, which appears laudable enough at first glance, is to set aside research funds for small businesses on the theory that they have produced many of the nation's innovative ideas. But if you set aside money for something in these days of tight budgets, you are probably setting it aside from something else—in this case, universities.

The Senate's version of the legislation, which swept through 90 to 0 in December, provides that 1% of the research money going through five agencies—or \$400 million—would be earmarked for small businesses; those agencies are the National Science Foundation, the Defense Department, the Health and Human Services Department, the National Aeronautics and Space Administration and the Energy Department. The House bill, which sailed through the House Small Business Committee on a 40-0 vote in October, would give small businesses 3% taken from 13 agencies' research-and-development budgets within four years after passage—that is, \$1.5 billion a year. The size of the votes that the bills received makes us suspect that they have not been examined closely.

Rudman thinks the legislation is necessary because big business has frequently "turned its back on uncertain technology or unproven new products" in favor of short-term profits, while small business lacks the capital to develop its ideas and has been frozen out of federal research contracts. He argues that small business is responsible for creating 55% of the new jobs in this country, and so deserves this support.

It seems to us, and to the universities that are opposing the legislation, that Rudman is, first of all, confusing basic and applied research. Donald Kennedy, president of Stanford University, is a

good source on this topic; Stanford knows well the value of the small, highly innovative electronics and biotechnology companies that are its neighbors in the so-called Silicon Valley of California.

Kennedy points out that fundamental discoveries of devices or processes such as the laser or recombinant DNA "most usually arise as a consequence of fundamental research activities, (and) 70% of that kind of activity takes place in our nation's universities."

The intermediate process—known as the transfer of technology, in which the discovery is refined and applied to commercially significant needs—sometimes occurs in universities, sometimes in research institutes, sometimes in corporate settings, Kennedy adds. A third process—the development and application of specific innovative products—takes place mostly in small firms, he says.

"That is our central argument with the present legislation," Kennedy says. "For the best of motivations, it actually reallocates federal dollars between totally different sets of purposes. That, we submit, is not good policy."

On a second point—whether small companies have been frozen out of federal contracts—the American Electronics Assn. says that small businesses employ about 5.5% of the nation's scientists and engineers, and receive about 6.8% of the federal government's prime research contracts. It would seem, then, that their resources are used in proportion to their ability to handle the work.

The association represents 1,800 high-technology concerns, 80% of which would qualify for help under these bills. Yet the association opposes the idea. Historically, it says, such set-aside programs have led to waste and abuse. "Please don't do it" for us, one spokesman says. This attitude toward government involvement in business would seem consistent with the Reagan Administration's viewpoint—but the Administration has endorsed the Rudman bill.

The House should finally look beyond the motherhood-and-apple-pie title of this legislation and defeat it.

Minneapolis Tribune



Established 1867

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12A

Friday, February 12, 1982

Hurting research without helping innovation

It is generally a bad idea to use public money for private development of basic-research discoveries. It is particularly a bad idea when the money is taken away from basic research itself. Yet just such a diversion of public funds would be required by a bill making its way through Congress this winter.

Under an innocuous name — "Small Business Innovation Development" — the bill promotes a damaging purpose. It directs large federal agencies to use a portion of their research money for grants to businesses that are trying to commercialize new products or new concepts. The intent is to support technological advance. One effect, however, would be to substitute an agency staff's judgment about what is commercially feasible for the judgment of investors and financial markets. Given the source of the money, and congressmen's interest in how it might be distributed, some grants would doubtless be influenced by political considerations. The political factor would heighten financial risks in a high-risk field. And those risks of commercial develop-

ment would be shifted to the public purse, instead of being left with private parties using their own money.

Using government money as risk capital in private projects — whether undertaken by small businesses, auto manufacturers or synthetic-fuel conglomerates — is poor policy. Occasional exceptions are appropriate, no doubt. But in this case poor policy is made worse by explicitly taking the funds from pre-commercial basic research. Sponsoring such research, largely in universities and largely selected by panels of independent scientists, is a proper government function. Applying such research for marketable products should remain the responsibility of industry and investors. Slighting the government function in order to intrude on the private-sector function is both practically and theoretically a large mistake.

The bill embodying this mistake has passed the Senate and is pending in the House. The House should defeat it.

MAR 24 1982

Congress' high-tech turkey

What could be a better idea than a bill to promote technological innovation and help small business? That certainly was the U.S. Senate's thought when it whooped through the Small Business Innovation Act by a 90-0 vote last December.

The legislation, soon to be considered by the House, would require federal agencies that spend more than \$100 million a year on research and development to set aside 3 percent of their R&D budgets for small businesses. The Senate's hope is that such a set-aside will speed the rate of technical innovation at small firms, which have historically supplied the American economy with most of its best new products.

Surprisingly, though, many of the small businesses that would benefit from the program want no part of it. For example, the American Electronics Association, an organization comprising many of the nation's small high-technology companies, opposes the bill.

Its former president, Dr. Edwin V.W. Zschau, pointed out in congressional testimony that small firms, which employ 5.5 percent of the nation's R&D scientists, already get 6.8 percent of federal research funds going to private contractors, a sign that small business is already getting its share.

Moreover, if small firm were allotted 3 percent of all government research money, estimated Zschau, every small business scientist would be working on a government project.

The legislation would also establish a new pattern of win-

ners and losers.

The winners would be a new class of entrepreneurs who would flock to qualify for the research set-aside for no other reason than that the money was available. High-technology could lend itself as easily to pork barrel politics as water projects and street-car lines have in the past.

The most obvious losers would be the nation's universities, which do much of the nation's basic scientific research.

To set aside research money for small business means taking some of it away from university scientists. And as Bay Area residents well know, basic research in universities — including breakthroughs in lasers, semiconductors, computers and recombinant DNA — has been the deep spring feeding the well of high-technology entrepreneurship in this region.

By all measures, innovation is now flourishing in the U.S. Small, high-technology companies are popping up daily.

If Congress really wants to help the process along, it can increase R&D spending to encourage science and technology across the board. It could also trim the military budget, so that weapons projects do not draw scarce scientific and engineering talent away from the civilian economy. Or it could increase the nation's investment in science and mathematics education, assuring an adequate supply of trained scientists in the future.

But setting aside R&D funds for small businesses only threatens to tangle the nation's encouraging technological boom in red tape.

EDITORIALS

High-Tech Spurs A Subsidy

A BILL GOING THROUGH Congress with a 90-0 endorsement in the Senate and 40-0 in a House Committee would seem reasonably sure to become law. Still, we trust present signs that enough congressmen are waking up to what's in it and will stop it for what it is: a dubious multimillion dollar diversion of federal research funds.

H. R. 4326 would require federal agencies whose research and development budgets exceed \$100 million (there are quite a few of these) to set aside 3 percent for Small Business Innovation Research Programs (SBIR). The House Small Business Committee believes small businesses aren't getting their share of federal R & D funds. So it wants to set up a program to allocate subsidies that will enlarge the small's portion. The Congressional Budget Office estimates it will cost \$38 million a year to manage the applications and deal out the money.

LO AND BEHOLD, the American Electronics Association, representing 1800 high-technology businesses, some large, 80 percent small, a great many of them in Silicon Valley, is fighting the bill. "Fundamentally," says the AEA, "we oppose political intervention in the marketplace on behalf of a special interest — even if it is ours."

Such an extraordinary opposition has attracted the interest and support of Representative Pete McCloskey, R-Palo Alto, who observes, "This may well be the first-known

San Francisco Chronicle
THE VOICE OF THE WEST

Wed., March 10, 1982

instance of a trade group opposing its immediate self-interests."

The point AEA's leadership makes is that small high-tech businesses are already getting a fair shot at R & D contracts with government agencies; that they have in their employ 5.5 percent of all R & D scientists and engineers not working for the government, and that they're receiving 6.8 percent of federal R & D contract dollars. Q. E. D., says AEA, that a mandated, government-wide Small Business Innovation Research program would be wasteful and costly and is unnecessary.

The Association of American Universities, members of which do most of the nation's basic research, are against this subsidy, too. President Donald Kennedy of Stanford, testifying in Washington, warned against diverting federal funds appropriated for research "of the most fundamental long-range sort" (i. e., university basic research) to serve an entirely different purpose, promoting product innovation. Already savaged by Stockman cuts into research funds, the universities can't be happy at seeing 3 percent more set aside out of reach.

IF THE CONGRESSMEN don't stop H. R. 4326 when they vote in committee today and on the House floor later this month, it will probably be up to President Reagan to ride once again to the rescue of small business from the trammels and paperwork of bureaucracy and by veto to get "government off its back."

The Sacramento Bee



A Needless Subsidy

Proposed federal legislation that would set aside hundreds of millions of dollars to finance research and development by small business firms, a proposal seemingly as unassailable as motherhood, is meeting fierce resistance, ironically from among some of its intended beneficiaries. And with good reason.

HR 4326 (and an almost identical Senate bill, S 881) would require the 18 federal agencies with R&D budgets over \$100 million to set aside 1 per cent of those funds to finance projects by firms with fewer than 500 employees. The basic idea, laudable in itself, is to give such firms access to government money that now goes mainly to larger corporations. After initial federal support, those projects with the greatest merit would be expected to obtain private financing.

The bill had already moved unopposed through the Senate and one House committee before opposition developed. Leading the counterattack are a number of major universities already subject to federal cutbacks in research funds; the American Electronics Association, 80 per cent of whose members would qualify for grants, and a number of federal agencies. Even the National Science Foundation, whose \$5 million Small Business Innovation Research Program serves as the bill's model, is cool. Why?

Objections stem from the fact that small high-technology firms already get a large share of R&D money, especially when subcontracts are factored in: that capital gains tax reductions and new tax credits enacted in the late 1970s have brought forth larger amounts

of cash from venture capital firms; that set-aside programs with their bureaucratic controls violate basic free-market principles, and that the mandatory, governmentwide nature of the proposed law would lead to an even more bloated bureaucracy, higher costs and the inevitable temptation to pad the program to meet spending quotas. And since the entire cost of the program would come out of existing R&D budgets — no new funds would be appropriated — university research programs, which have lost 16 per cent in real dollars of their funds for basic research just since 1980, would be further pinched.

Opposition in the House has been led by Rep. Paul McCloskey, R-Calif., who has succeeded in reducing the set-aside total from 3 per cent to 1 per cent, subjecting the program to annual congressional review and exempting several agencies, among them the Pentagon with well over half the federal R&D total. But the measure still has extensive backing in Congress, and at least nominally from the administration. It may yet become law.

That would be regrettable. Small high-technology firms are perhaps the most dynamic segment of the U.S. economy at present, and to the extent that their progress is hampered solely by a lack of capital they need support. This bill, however, is not the way to provide it. In the present economic environment, government can play a more creative role through monetary and fiscal policies and in promoting freer trade than in tying budding entrepreneurs to a rigid program laden with arbitrary mandates and artificial formulas.

Don't Do Us Any Favors

It isn't often that a trade association representative appears on Capitol Hill to refuse federal largess. But that's just what Randy Knapp, a spokesman for the American Electronics Association, did last month. "We have strong feelings about the bill before you," Knapp said, "though unfortunately not those its authors intended."

Knapp was addressing members of the House Science and Technology Committee on Jan. 28 at a hearing on the proposed Small Business Innovation Development Act (HR 4326). "Mr. Chairman," he said politely, "the proponents of this bill are trying to help young high-technology companies. They are trying to help us. We sincerely appreciate that . . . , but please don't do it."

This bill would set aside 3 per cent of federal research and development money exclusively for contracts with small firms. And "small," while not specifically defined in the bill, generally means those firms that are independently owned, do not dominate their fields and have no more than 500 employees. About 80 per cent of the association's 1,400 members employ 500 people or fewer. Knapp himself is chairman, president and chief executive officer of Wespercorp, a high-technology company in Tustin, Costa Mesa and San Diego, Calif., which employs about 180 people. In short, his is just the sort of firm the lawmakers have in mind.

Why, then, are the association members balking? After all, the Senate passed a similar though less costly bill (S 881) last December by a 90-0 vote. The House version, the Congressional Budget Office estimated, would set aside more than \$400 million for small business during the next fiscal year and almost \$2 billion by fiscal 1986.

Quite simply, the association's members are fed up with the strings attached to federal contracts. Despite the obvious benefits, they just don't think they're worth the bother. After all, about 6.8 per cent of federal research and development funds already go to small firms. Unlike other trade associations that represent small companies, the electronics group isn't worried about an anti-small-business bias among federal bureaucrats. It's just concerned about what Knapp calls "the unbelievable complexity of the federal procurement process itself."

Knapp and his electronics association colleagues cite more than 80 "separate socioeconomic programs, special interest set-asides, preferences, enforcement responsibilities and other miscellaneous 'good ideas' that Congress has passed over the years, which, taken together, account for a horrendous paperwork muddle." These include preferences for mops and brooms made by the blind, noise pollution controls, Indian labor preferences, buy-America requirements for ships and defense products and restrictions on research performed on dogs. (*For a report on small-business legislative goals, see NJ, 9/26/81, p. 1720.*)

The problem with such set-aside programs, as Knapp sees it, is that they distort the market, cause inefficiencies and frequently result in Uncle Sam's paying higher prices for goods

and services. "Fundamentally," Knapp said, "we oppose political intervention in the marketplace on behalf of special interests—even if it is ours. . . . We do not believe companies can be made more competitive by being sheltered from competition."

Instead of seeking set-asides, the association is after tax credits and deductions. These, the group argues, are more efficient ways to direct capital to specific goals.

It's not that enhanced technical development is an unworthy goal, Edwin V. Zschau, chairman and president of System Industries Inc., testified on behalf of the electronics association. But it just is not the sort of thing that can be forced. Instead, he said, it must be fostered, and federal tax breaks are a better way to achieve what mandatory government set-asides are supposed to accomplish.

Furthermore, he told the committee, the Administration's tax reduction legislation will generate huge amounts of risk capital that will naturally flow to innovative firms, among them small research and development companies.

To be sure, the association's unusual posture has created political waves. Sen. Warren Rudman, R-N.H., appeared before the House committee last month to criticize opponents of the small-business set-aside concept. Rudman is a co-sponsor of the Senate version of the bill, which the Administration strongly prefers to the House bill.

First, Rudman criticized representatives of universities and hospitals that conduct research, arguing that their opposition is based on the desire to garner more direct federal aid for their own facilities. Then he turned on the electronics association, accusing it of being the tool of large business. Rudman counted 16 of the 23 companies represented on the association's governmental affairs and government procurement committees as big enough to be listed on the New York Stock Exchange and another two on the American Stock Exchange. "Thus," the New Hampshire Senator said, "any statement by the representatives of the [association] to the effect that they represent a cross section of the small-business community is misleading at best. The association represents and is controlled by major corporate interests."

Not so, says Kenneth C. O. Hagerty, the association's vice president for government operations. He concedes that such firms are represented on the committees Rudman named but explains that the decision to oppose the bill was made first by the association's small business committee, then unanimously endorsed by its board.

Hagerty thinks the lopsided vote for the bill in the Senate was a sign that few people had really focused on it. "It's become a litmus-paper test for support of the small-business community," Hagerty said.

Maybe so. But if the debate is at all protracted, this bill could also become a referendum on set-asides. And in the climate that prevails today, the association's heresy could become the rallying point around which the business community continues its assault on federal red tape. □

MAR 16 1982

Hands Off Hi Tech

High technology is a key to America's future and should be fostered. But a bill before Congress, the Small Business Innovation Act, is not the way to do it.

The Senate version would require each federal agency whose annual research and development budget exceeds \$100 million to set aside a percentage of that budget for small business. More than half the money spent on research and development in this country comes from the federal government. While small companies employ just 5.5 percent of the nation's R & D scientists, the legislation would raise their share of federal R & D dollars from 6.8 percent to 25 percent.

It's not surprising that universities, which now get most of the R & D money, oppose the plan. But another detractor is the American Electronics Association, whose membership includes some 1,400 companies which qualify for the bill's benefits.

The association's position is simple: "We oppose political intervention in the marketplace on behalf of special interests — even if it is ours... We do not believe

companies can be made more competitive by being sheltered from competition."

In all, there are some 70 separate set-asides, preferences, etc., which make up the federal procurement system. Besides skewing the marketplace, these programs — whether for disadvantaged small businesses, U.S. shipyards, minority construction firms, prison-made supplies — invite abuse, inefficiency and political favoritism. And they are expensive to administer; the latest proposal would cost some \$190 million over five years.

Finally, small high-tech companies are not short of research and development capital. Investors have been willing to bet on them all along, and recent tax changes have generated even larger amounts of capital. Nearly half a billion dollars of federal money might "crowd out" private investment, misallocate resources and cause projects to be undertaken that shouldn't have been.

High tech is one sector of the economy where the free market is working and working well. The federal government could help it best by staying out of its way.

March 28, 1982

Another subsidy

ON the face of it, the proposed Small Business Innovation Act of 1982 sounds like a good idea. But is it?

The idea is to earmark a percentage of federal research and development funds for small business.

It seems that colleges and big businesses have been getting the lion's share of the government's R&D funds. Since surveys have shown that most new jobs are created by small businesses, the reasoning behind the legislation in Congress is that even more jobs would be created by giving more federal research and development money to small concerns.

The legislation whizzed through the Senate on a 90-0 vote but is running into some opposition in the House.

If giving small businesses more federal R&D money will spur them to even greater innovation, we would be all for it.

But if it's likely to make them flabby and dependent and slow them down, as is the case too often with federal subsidies, we'd say, leave well enough alone.



"Give light and the people will find their own way."

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Congress of the United States
House of Representatives
Washington, D.C. 20515

SMALL BUSINESS INNOVATION ACT:
The Reviews

Armed Services Committee:

"The point the committee wishes to make in assessing the impact of H.R. 4326 on the Defense Department's innovative research programs is that it would not be a three-percent impact, but an impact in the order of 26 percent. The committee finds this to be unacceptable."

Select Committee on Intelligence:

"In the course of its consideration of the bill, the Committee has also become convinced that the bill cannot be implemented satisfactorily within the intelligence community...

"There are a number of highly classified programs within the National Foreign Intelligence Program whose very existence is not acknowledged, or as to which no public description can be made, least of all in terms of their research and development needs. The result of this is that many of the agencies who would be drawn within the requirements of the bill could not effectively participate in SBIR programs. They could not submit public bids. They could not discuss their needs in unclassified solicitations."

Science and Technology Committee:

"The committee believes, however, that the state of small business participation in federal R&D does not warrant, at this time, the use of what amounts to a new entitlement program, a set-aside of agency R&D funds as envisioned in H.R. 4326...

"The committee strongly recommends against a mandatory set-aside of the federal R&D budget. Not only is the set-aside unwise public policy; it is neither a desirable nor a necessary mechanism to implement a federal-wide SBIR program."

Energy and Commerce Committee:

"The \$120 million proposed by H.R. 4326 to be set aside for the SBIR program is almost 25 percent of the total funds committed to new research project grants in any year. If these funds are diverted from the traditional grants process, hundreds of promising, highly rated biomedical research projects will not be conducted."

Foreign Affairs Committee:

"...the committee has serious concern over the impact the bill may have on the foreign assistance programs of IDCA and, in particular, those of AID."

Congress of the United States
House of Representatives
Washington, D.C. 20515

FIVE REASONS TO OPPOSE H.R. 4326,
THE SMALL BUSINESS INNOVATION ACT

The purpose.

The Small Business Innovation Act mandates federal agencies to set aside 3% more of their research and development funds for small businesses than they currently receive.

The cost.

- The Congressional Budget Office has estimated that the new law will cost the federal government an average of \$38 million per year through 1986.

The regulatory impact.

- It has been estimated the bill will require federal agencies to fund 30,000 set-aside proposals each year with small companies. This represents 30 times the number of investments made by the entire venture capital industry in 1981, and would provide nearly one federal R&D contract or grant to every R&D scientist or engineer currently in a small business.

The need?

- Small companies employ 5.5% of the R&D scientists and engineers in the private sector, and already receive 6.8% of federal contract dollars for private research.
- Capital available to small companies, which was scarce only a few years back, has skyrocketed as a result of the 1978 reduction of the capital gains tax rate.

In 1977, only \$75 million was raised by small companies in the public market and \$400 million from private venture capital firms.

With the reduction of the capital gains tax rate in 1978, and subsequent tax changes in 1981 such as the R&D tax credit, further capital gains rate reduction and the incentive stock option, 1981 investment in small companies soared to \$1.8 billion from the public market and \$1.2 billion from venture capital firms.

- The largest association of small, high technology companies, the American Electronics Association, opposes the bill.