

SMALL BUSINESS INNOVATION

MARCH 16, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BOLAND, from the Permanent Select Committee on Intelligence, submitted the following

R E P O R T

[To accompany H.R. 4326]

The Permanent Select Committee on Intelligence, to whom was referred the bill (H.R. 4326) to amend the Small Business Act to strengthen the role of the small, innovative firms in federally funded research and development, and to utilize Federal research and development as a base for technological innovation to meet agency needs and to contribute to the growth and strength of the Nation's economy, having considered the same, report favorably thereon with an amendment to the bill and recommend that the bill as amended do pass.

The amendment (stated in terms of the page and line numbers of the bill as reported by the Committee on Small Business) is as follows:

On page 11, line 10, strike the semicolon and insert thereafter the following:

“, except that it does not include any agency within the Intelligence Community (as the term is defined in Section 3.4(f) of Executive Order 12333 or its successor orders);”

HISTORY OF THE BILL

H.R. 4326 was introduced on July 29, 1981. It was the subject of public hearings before the Subcommittee on General Oversight of the Committee on Small Business on September 15, 1981. The bill was marked up by the Committee on Small Business on October 22, 1981. An amendment in the nature of the substitute was adopted and the bill was ordered reported by a vote of 40 to 0. The Committee's report was filed on November 20, 1981.

H.R. 4326 was sequentially referred to the Committees on Armed Services, Energy and Commerce, and Science and Technology on November 20, 1981. On December 8, 1981, the bill was referred to the

Committee on Veterans Affairs. On March 2, 1982, the bill was referred to the Committee on Foreign Affairs and the Permanent Select Committee on Intelligence.

COMMITTEE CONSIDERATION

The Permanent Select Committee on Intelligence requested referral of H.R. 4326 because of its concern that the bill, which requires certain federal agencies to establish set aside programs for small business participation in their research and development activities, would impose requirements on intelligence agencies inimical to the security of intelligence research and development. 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.

H.R. 4326 would require all federal agencies with annual research and development budgets in excess of \$100 million to set aside from those research and development funds .5 percent in the first fiscal year after enactment, 1 percent in the second year, 2 percent in the third year and 3 percent in the fourth and succeeding years, to be awarded to small businesses. Agencies with more than \$20 million in annual research and development expenditures also would be required to adopt goals for awarding research and development contracts to small businesses at levels at least equal to the level of such awards in the preceding fiscal year. Each Small Business Innovation Research program (SBIR) established under the bill must be consistent with policy directives issued by the Small Business Administration. These directives must, among other requirements, stipulate uniform public solicitation formats and outside peer review. The Office of Science and Technology Policy must monitor all programs under the bill and report annually on all aspects of such programs to the House and Senate Small Business Committees. Finally, the Small Business Administration is charged with coordinating and overseeing the operation of the bill, and reporting annually to the Committees. These Committees would exercise regular oversight of the implementation of H.R. 4326 if it is enacted.

The Committee's concerns are several. First and foremost, intelligence research and development activities are often highly sensitive, not only for the technology they produce, but because the indication their very existence would convey of the direction U.S. intelligence planning is taking and the intelligence opportunities being pursued.

The Small Business Administration has no expertise or jurisdiction in such matters nor the necessary security apparatus to oversee intelligence community implementation of the bill.

Although, to take the Central Intelligence Agency as an example, small business' share of intelligence research and development is good—16.5 percent for the CIA in fiscal year 1981—the Committee is concerned that a fixed set-aside program could become inflexible in the future. It is the view of the Committee that this could result in underutilization or failure to use funds in the set-aside program because many small businesses would not have the capability to respond to the intelligence agencies' requirements. This is particularly important since the bill's set-aside programs must fund small business contracts

in excess of those already awarded by the agencies which must comply with the bill's provisions. Fundamentally, there is room for doubt that the structure of H.R. 4326, which is based on a model program at the National Science Foundation, is compatible with the kind of problem-specific research and development conducted by CIA and other parts of the intelligence community.

Although the Committee has had only a short period of time to consider H.R. 4326, some things are clear:

The amount of intelligence research and development funds that would be affected by the bill is large. The sums involved are classified and involve all the major intelligence agencies, including Central Intelligence Agency, Defense Intelligence Agency and National Security Agency.

Unlike the basic or general research conducted by National Security Foundation, most intelligence research and development is very result oriented, and aimed at rapid development of hardware to fulfill a specific, and often very narrow function.

Security requirements for intelligence research and development contracts are stringent and such contracts most often are not the product of any public solicitation.

The many small businesses which do participate in intelligence research and development often do so as subcontractors and because they have become known to large contractors. Frequently, their contribution is unique and essential, but of narrow application. Sometimes they are not even aware their contribution is to an intelligence program.

Definitions applied by the bill—for "research" and "research and development," and for "small business"—result, respectively, (1) in a great range of activities being included in research and development for purposes of calculations about an agency's total research and development and the size of the set-aside, and (2) in small numbers of firms qualifying for the set-asides.

The Committee believes that security concerns it has identified should be addressed. In the course of its inquiry, however, the Committee came to the conclusion that the bill's approach is simply incompatible with the structure of intelligence research and development activities.

To begin with, the set aside programs established by the bill will be unconnected to small business contracts that are presently let by intelligence agencies. H.R. 4326, as indicated by the report of the Committee on Small Business, "specifies that funding agreements with small businesses resulting from competitive or single source selections other than under an SBIR program shall not be counted as meeting any portion of the percentage requirements set forth in the bill for overall agency research and development funding awards to small business." (H. Rept. 97-349, Part I, p. 21.)

This approach may work for many agencies which, like the National Science Foundation, are interested in a broad range of research activities and which fund research for the sake of such research, as opposed to any specific end goal. It does not work, however, for 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 specific 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. Therefore, many small businesses would be unable to determine whether their capabilities would match intelligence community needs. They would have to be cleared in advance. Such a process involves a dissemination of very sensitive material without any guarantee that the potential subcontractors in question could effectively participate in any intelligence research and development work.

The Committee's understanding is that the purpose of an SBIR program is to generate a statement of needs narrow enough to be useful to potential subcontractors to meet security concerns. Such a statement must be broad enough not to be classified. A statement of needs must then be considered by the community of potential small businesses who might wish to bid. The intelligence agency in question will then be forced to deal with any interested applicants on a classified basis before going further. Development of such a relationship would require the clearing of appropriate employees, the ensuring that the company in question had appropriate storage and other security procedures. Then, a classified solicitation of more specificity could be provided to such applicants. All of this takes time. The problem is that the initial solicitation, being public, would necessarily be very broad. A company might be encouraged to believe that it has something to offer in an area to the intelligence community. After the time and expense of clearance and establishing necessary security standards, such an applicant may find that the detailed solicitation to which the company must actually respond is beyond its capabilities or, in any event, not at all what the applicant had contemplated.

In the meantime, such a company will have been exposed to potentially sensitive classified information. In such an example, neither the intelligence community nor the small business benefits from the SBIR process. The Committee believes that such examples could well be typical of the application of the SBIR concept even within a context designed to protect security.

Another point to be made about intelligence research and development is that little of such work can be described as discretionary, i.e., the early stages of technology development which H.R. 4326 seeks to target with SBIRs. The large majority of research and development funds in the intelligence community are, in effect, parts of large acquisition programs which utilize, in their earlier stages, significant amounts of research and development funds, but little new technology. These funds are directed at the developments of systems for which there are specific and very demanding requirements. All such funds would be included within the base for determination of the 3 percent set aside programs under the bill. Yet, none of this work is logically eligible for set aside to small businesses other than through the normal process of subcontracting through prime contractors for such systems. In light of the structure of such intelligence research

and development activities, it becomes clear that the result of an inflexible set aside program under H.R. 4326 would be to hold hostage nearly the entire discretionary area of intelligence research and development to such SBIRs.

Despite the inapplicability of the SBIR concept to intelligence research and development work, it should not be thought that small businesses do not participate in such work. On the contrary, there are numerous contracts and subcontracts to small businesses involved in intelligence research and development work. In fact, a number of small businesses play dominant roles in intelligence research and development work as a result of their ability to provide high quality component parts of systems. An anomaly of this relationship between small business and intelligence is that because such small businesses are supreme in their fields, they do not qualify as small businesses under the Small Business Act nor in the percentage of intelligence contracts to small businesses that counts towards a set aside.

Because the Committee finds the Small Business Innovation Research concept incompatible with intelligence research and development work, it is the Committee's conclusion that intelligence agencies ought to be excluded completely from the requirements of H.R. 4326.

COMMITTEE POSITION

On March 10, 1982, a quorum being present, the Permanent Select Committee on Intelligence approved H.R. 4326 as reported by the Committee on Small Business, with an amendment, by voice vote and ordered that it be reported favorably.

OVERSIGHT FINDINGS

With respect to clause 2(1)(3)(A) of Rule XI of the Rules of the House of Representatives, the Committee notes that it has conducted classified inquiries regarding the implementation of H.R. 4326 within the intelligence community. These inquiries have been directed to all intelligence agencies that would be affected by the bill and have resulted in a classified report presented to the Committee. The Committee's consideration of that report have resulted in its recommendation concerning H.R. 4326. The Committee's reasoning is set out in the body of this report.

CONGRESSIONAL BUDGET ACT

Pursuant to clause 2(1)(3)(B) of Rule XI of the Rules of the House of Representatives, the Committee notes that H.R. 4326 does not provide for new budget authority or tax expenditures.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 2(1)(3)(C) of Rule XI of the Rules of the House of Representatives, the Committee notes that an estimate from the Congressional Budget Act is printed at pp. 26-29 of Part I of this report.

RECOMMENDATION OF THE COMMITTEE ON GOVERNMENT OPERATIONS

Pursuant to clause 2(1) (3) (D) of Rule XI of the Rules of the House of Representatives, the Committee notes that it has not received a report from the Committee on Government Operations.

INFLATION IMPACT STATEMENT

Pursuant to clause 2(1) (4) of Rule XI of the Rules of the House of Representatives, the Committee finds that enactment of H.R. 4326 will have no inflationary impact on prices or costs in the operation of the national economy.

FIVE YEAR COST PROJECTION

Pursuant to clause 7(a) (1) of Rule XIII of the Rules of the House of Representatives, the Committee has determined that the administrative expenses attributable to program administration, oversight and reports to Congress required by H.R. 4326 will be minimal and will be paid from the budgets of individual federal agencies.

EXECUTIVE BRANCH ESTIMATES

The Committee has received no cost estimates from the executive branch and is therefore unable to compare the government's cost estimates with its own estimates pursuant to clause 7(a) (2) of Rule XIII of the Rules of the House of Representatives.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SMALL BUSINESS ACT

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SEC. 9. (a) Research and development are major factors in the growth and progress of industry and the national economy. The expense of carrying on research and development programs is beyond the means of many small-business concerns, and such concerns are handicapped in obtaining the benefits of research and development programs conducted at Government expense. These small-business concerns are thereby placed at a competitive disadvantage. This weakens the competitive free enterprise system and prevents the orderly development of the national economy. It is the policy of the Congress that assistance be given to small-business concerns to enable them to undertake and to obtain the benefits of research and development in order to maintain and strengthen the competitive free enterprise system and the national economy.

(b) It shall be the duty of the Administration, and it is hereby empowered—

(1) to assist small-business concerns to obtain Government contracts for research and development;

(2) to assist small-business concerns to obtain the benefits of research and development performed under Government contracts or at Government expense; [and]

(3) to provide technical assistance to small-business concerns to accomplish the purposes of this section[.]; and

(4) *to develop and maintain a source file and an information program to assure each qualified and interested small business concern the opportunity to participate in Federal agency small business innovation research programs;*

(5) *to coordinate with participating agencies a schedule for release of SBIR solicitations, and to prepare a master release schedule so as to maximize small businesses' opportunities to respond to solicitations;*

(6) *to report annually to the Office of Science and Technology Policy on the SBIR program responsibilities assigned to it under this Act; and*

(7) *to report not less than annually to the Senate and the House of Representatives on the SBIR programs of the Federal agencies and the Administration's responsibilities related to the SBIR programs.*

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(e) *For the purpose of this section—*

(1) *the term "Federal agency" means an executive agency as defined in section 105 of title 5, United States Code, or a military department as defined in section 102 of such title, except that it does not include any agency within the Intelligence Community (as the term is defined in Section 3.4(f) of Executive Order 12333 or its successor orders);*

(2) *the term "funding agreement" means any contract, grant, or cooperative agreement entered into between any Federal agency and any small business for the performance of experimental, developmental, or research work funded in whole or in part by the Federal Government;*

(3) *the term "small business innovation research program" or "SBIR program" means a competitive program designed to involve small businesses in meeting Federal research and development objectives and to promote innovation through a uniform process having—*

(A) *a first phase for determining, insofar as possible, the scientific and technical merit and feasibility of proposals submitted pursuant to SBIR program solicitations;*

(B) *a second phase to further develop the proposals to meet the particular program needs, the awarding of which shall take into consideration the scientific and technical merit and feasibility evidenced by the first phase and, if two or more proposals are evaluated as being of approximately equal scientific and technical merit and feasibility, special consid-*

eration shall be given to those proposals that have demonstrated third phase, private capital commitments; and

(C) when appropriate, a third phase in which commercial applications of the research or research and development are pursued with private capital or in which contracts are made with a Federal agency for products or processes intended to benefit the United States Government; and

(4) the term "research" or "research and development" means any activity which is (A) a systematic, intensive study directed toward greater knowledge or understanding of the subject studied; (B) a systematic study directed specifically toward applying new knowledge to meet a recognized need; or (C) a systematic application of knowledge toward the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements.

(f) (1) Each Federal agency which has total appropriations in excess of \$100,000,000 for research or research and development for fiscal year 1983 or any fiscal year thereafter shall establish a SBIR program.

(2) Each Federal agency which is required to establish a SBIR program under paragraph (1) shall, to the extent required in Acts authorizing appropriations for each such agency, reserve for expenditure with small business concerns in connection with a SBIR program which meets the requirements of subsection (e) (3) of this section—

(A) not less than 0.2 per centum of its total appropriations for research or research and development in the first fiscal year in which it is authorized to establish a SBIR program,

(B) not less than 0.6 per centum of such total appropriations in the second such fiscal year, and

(C) not less than 1 per centum of such total appropriations in all subsequent such fiscal years.

(g) For the purpose of meeting the requirements of a SBIR program (as defined in subsection (e) (3)), no Federal agency shall make available, from that portion of its total appropriations for research or research and development which is available for obligation for basic research, an amount which exceeds 0.2 per centum of such portion in the first fiscal year in which it is authorized to establish a SBIR Program, 0.6 per centum of such portion in the second such fiscal year, or 1 per centum of such portion in subsequent such fiscal years.

(h) Each Federal agency required by subsection (f) to establish a small business innovation research program shall—

(1) unilaterally determine categories of projects to be in its SBIR program;

(2) issue small business innovation research solicitations in accordance with a schedule determined cooperatively with the Small Business Administration;

(3) unilaterally receive and evaluate proposals resulting from SBIR solicitations;

(4) unilaterally select awardees for its SBIR funding agreements;

(5) administer its own SBIR funding agreements (or delegate such administration to another agency);

Those individuals currently participating in the contributory program and those with Vietnam-era eligibility will be covered under the more generous new program as long as they serve the necessary additional time and meet specified requirements. Benefits would not be payable under both programs, however.

Fiscal data

The Congressional Budget Office five-year cost projection ranges from \$306 million in budget authority and \$1 million in outlays in fiscal year 1983 to \$490 million in budget authority and \$187 million in outlays in fiscal year 1987 compared to present policy. The committee concurs in the estimate of the Congressional Budget Office.

Departmental data

The Department of Defense does not support the legislation.

Committee position

The Committee on Armed Services on May 11, 1982, a quorum being present, approved H.R. 1400, as amended, by a vote of 40 to 1.

