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United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510-6350

June 29, 2004

The Honorable Hector V. Barreto
Administrator
U.S. Small Business Administration
403 Third Street, S.W.
Washington DC 20416

Dear Administrator Barreto:

As Ranking Member of the Committee on Small Business and Entrepreneurship, I recommend that the SBA rescind its proposed regulations on restructuring size standards. My office has been contacted by numerous small businesses and representatives from the small business community, raising concerns regarding the deleterious impact the new rule would have on this nation's small firms if the Small Business Administration were to proceed to issuing final regulations. Given the fact that the current system works well and the rule would change the small business status of over 34,000 firms, I recommend that the SBA rescind its proposal to restructure the small business size standards and implement an employee-based system.

The SBA has failed to make a compelling case for the need to change the existing rules. In its draft proposal dated March 19, 2004 (13 CFR Part 121), the SBA itself stated, *"the current structure of SBA's size standards has worked well."* While recognizing this point, the SBA attempts to justify this proposal by raising questions about the *"complexity of determining if a business is small, the fairness of defining a business as small in some industries and not others, the influence of Federal procurement programs in establishing size standards, and the intentional misclassification of Federal contracts or the primary industry activity of a business to apply a different, and usually a much higher, size standard."*

First, if the system is admittedly effective, simplification is not a compelling argument for changing the size standards, especially when said change will adversely affect tens of thousands of small businesses. Further, contrary to the requirements of the Administrative Procedure Act, in the proposed rule, the SBA fails to offer a meaningful analysis of the significant impact this change would have on the 34,000 businesses it

assumes would lose their small business status and on the individuals they employ. Small business advocates have informed me that this proposal could threaten or eliminate over 8 million jobs.

The implementation of this rule would have a significant negative impact on job creation in an already struggling economy. Implementing the new rule would force small firms to decide to forego the advantages afforded to small businesses or to reduce their number of employees to fit under new size standards, which could most easily be accomplished by layoffs, shifting the hiring away from entry-level employees to senior employees, shifting current and future employment away from part-time, seasonal or job sharing arrangements, and requiring more overtime and greater workloads for the remaining employees. This proposal would create a disincentive to firms classified as small to hire full, or even part-time, workers. With the national unemployment rate averaging 5.7%, now is the wrong time to hamstring small business' ability to drive economic growth through job creation. I do not believe that simplification is a compelling argument to justify the potential loss of tens of thousands of jobs.

Second, the SBA's argument regarding *"the fairness of defining a business as small in some industries and not others"* is arbitrary and does not address the needs of this nation's small businesses. Small businesses are well aware of the requirement that they be "non-dominant" in a specific field in order to be considered small. A concern is not dominant in its field of operation when it does not exercise a controlling or major influence on an industry, as compared to its competitors that are offering like-products or services. As small business advocates discussed in their correspondence with my office, understanding the market in which you wish to compete and the rules and regulations governing that industry is a part of the due diligence that needs to be performed by any business, large or small. Understanding the challenges and/or opportunities created by their status as a small business in the new industry classification is simply a part of the due diligence that should be conducted before entering the new market.

Small firms have already familiarized themselves with the current SBA regulations and size standards, and have worked diligently within those requirements. Reducing its current structure of 37 different size levels which apply to 1,151 industries and 13 sub industry activities in the North American Industry Classification System (NAICS) to a system that would be limited to just 10 employee based standards with numerous exceptions does not improve the "fairness" of the system.

Third, the SBA argues that the simplification of size standards will eliminate barriers to small businesses that seek to participate in procurement programs. I am concerned, however, that the positive impact on small businesses from the size standard change assumed by the SBA will not come to fruition, as it claims. Small companies have made it clear that the significant obstacles to participating in the Federal procurement system do not come from confusion over size standards, but from burdensome paperwork and reporting requirements, the complexity and difficulty of complying with Federal Acquisition Regulations, availability of contracts and an un-level playing field in the

competition between small businesses and firms that are other than small. Implementing this proposal could immediately eliminate many small firms that currently participate in Federal procurement assistance programs under the existing receipts–based definition.

Fourth, the SBA claims that another justification for the change is to prevent "*the intentional misclassification of Federal contracts or the primary industry activity of a business to apply a different, and usually a much higher, size standard.*" There is no clear evidence that changing the size standard will prevent the manipulation described by the SBA. The proposal opens new doors for the manipulation of the employee-base to ensure that a business receives small business benefits. For example, the proposed change would count part-time and temporary workers towards the employee cap, however it does not count subcontractors. Hypothetically, because the rule retains size standards based on a firm's annual receipts in only a few industries, a company could keep their full time employees below the threshold and continue benefiting from small business procurement assistance while subcontracting more and more work.

The SBA claims that the size standards have become complicated and burdensome to many users. However, small businesses and advocates have made it clear that they prefer working within the existing parameters to having to learn a new system, which is complicated in its own way. Further, I am concerned that the 35,000 new businesses receiving small business status while 34,000 lose their status simply represents a transfer of the benefits of small business set asides and assistance from one group to another without convincing justification for doing so.

The proposal would also punish the 34,000 firms that are currently considered small, have been acting in good faith with the Federal government, but will lose their small business status abruptly as a result of the change. Further, the proposal offers no transition phase or "grandfather" provision for these firms, which is often made available when rules or laws make sudden changes that would adversely impact a specific community. Under the proposal, firms that are considered small in the current receipts based system would have no protection from immediately losing their eligibility for small business contracting benefits, which may be directly contrary to their short and/or long-term business plan.

Further, the SBA's proposal is contrary to section 3(a)(3) of the Small Business Act (15 USC 632) which states that *"the Administrator shall ensure that the size standard varies from industry to industry to the extent necessary to reflect the differing characteristics of the various industries..."* The variety of goods and services being provided to the government has increased not declined. This is not a justification for a more consolidated system, but the continuation of the current system, which, by SBA's own admission, is successfully handling the diversity of the current procurement arena.

As a result of the comments I have received from small businesses in my state and throughout the nation, as well as various national small business advocates, I strongly believe that the SBA's proposal to restructure the size standards for small businesses could have severe, far-reaching unintended consequences on small businesses and their local communities. Therefore, I strongly recommend that the SBA rescind its proposal to restructure the small business size standards and not implement a strictly employee-based system.

Sincerely,

John F. Kerry

Cc: Gary M. Jackson, Assistant Administrator for Size Standards