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SEQUESTRATION: THE THREAT TO SMALL BUSINESSES, JOBS, AND THE INDUSTRIAL BASE

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BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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SEQUESTRATION: THE THREAT TO SMALL BUSINESSES, JOBS, AND THE INDUSTRIAL BASE

THURSDAY, SEPTEMBER 20, 2012.

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1 p.m., in room 2360, Rayburn House Office Building. Hon. Sam Graves (chairman of the Committee) presiding.

Present: Representatives Graves, Mulvaney, Herrera Beutler, West, Ellmers, Hanna, Velázquez, Schrader, Clarke, Chu, and Hahn.

Chairman GRAVES. I will call the hearing to order. And I want to say good afternoon to everybody, and thank you all for being here today.

We are all acutely aware that the current level of federal spending cannot be sustained. Our national debt already exceeds $16 trillion and it is continuing to grow. Federal debt held by the public will reach 73 percent of GDP by the end of the fiscal year, which is the highest level since 1950 and about twice the share that it measured at the end of 2007, before the financial crisis and the recent recession.

This type of spending absolutely cannot continue. We all hoped that the "Super Committee" would agree on a thoughtful plan to curb government spending to ensure America's fiscal security. Unfortunately, this did not occur and today we are facing the possibility of an indiscriminate, across-the-board cut on January 2, 2013, which is also known as sequestration.

I am committed to cutting spending and getting the nation back on a fiscally sound course, and I am willing to make tough decisions. But I question the wisdom of using sequestration's crude cuts rather than deliberate, targeted cuts. I think we all agree that the patient is sick, but I would rather prefer that the surgeon use a scalpel rather than a meat cleaver. The sweeping, unfocused cuts of sequestration are certain to have unintended negative consequences, including for America's small businesses.

Earlier this week, I heard from Perry Castro, the president and CEO of Allied Associates International, Inc. This year, SBA named Mr. Castro the Virginia Veteran Small Business Champion of the Year. He told me that if sequestration becomes a reality, it would, in one fell swoop, destroy his company. I would like to enter his

full statement for the record if that is okay. And without objection, so ordered.

Unfortunately, Mr. Castro's story is not unusual. We are here today, small firms that will be uniquely harmed by sequestration. It is estimated that over half of the private sector jobs lost to sequestration, which is about 960,000 jobs, are going to be small business jobs. And surely, I do not think that is what Congress intended.

To better understand the effects of sequestration, today we are going to focus on government contracting and the Department of Defense (DoD) for three reasons. First, DoD spends more on government contracts than any other agency. Second, the Small Business Act places special emphasis on the role of small businesses and defense contracting since a strong small business segment is vital to the health of our industrial base and our national defense. And third, DoD has taken the greatest cut of all the agencies, as an additional $55 billion will be cut from DoD's budget in January, and that is on top of the $487 billion previously cut this Congress.

Today's witnesses will discuss how sequestration may irrevocably harm the industrial base, especially in areas such as research and development, manufacturing, and aerospace. And we will talk about the lack of certainty that small businesses are already facing due to sequestration, at the prime and subcontract levels. And they will also talk about the loss to the government. Without strong small business participation in procurement, we will have less competition and innovation in contracting, which will result in higher prices to the government.

However, while we are all talking about the DoD, all agencies are facing very similar challenges—unfocused cuts rather than smart cuts. For example, this Committee identified about $100 million in potential savings to the SBA, and we previously shared that with the Super Committee. However, the $75 million SBA will lose due to sequestration lacks focus and may put some very key lending programs at risk. The General Services Administration, which is an agency not exactly known as of late for its sound fiscal decisions, is only going to lose $21 million, with a quarter of that coming from the very inspector general who uncovered the GSA spending scandals.

As we seek to return our fiscal house to order, I believe today's hearing is going to help form the debate. And again, I want to thank all of our witnesses for being here. Today, we are going to do this in two panels, and I very much look forward to hearing your testimony. And with that I will turn to Ranking Member Velázquez for her opening statement.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

When the Budget Control Act of 2011 was enacted last year, sequestration was included as an incentive for action. Unfortunately, the Super Committee was not so super and was unable to agree on a deficit savings plan.

We are now facing the very sequestration that we had hoped to avoid. Beginning in January, it will become all too real as more than $100 billion in indiscriminate cuts take effect. This outcome should not be a surprise to anyone as it is simply the result of a process that has been held hostage by a few unwilling to have an

open mind on fiscal issues. By not agreeing on a balanced deficit reduction approach, we have chosen to limit our options.

The consequences of this path are seen in the businesses we will hear from today. They are rightfully concerned about losing defense contracts and the impact it will have on their companies and employees. They have worked hard to build their businesses, and the current situation is simply unfair to them. Make no mistake, small firms will be among those hit hardest when these cuts take effect. Indeed, it has been estimated that for every dollar spent in the defense supply chain, 70 cents flows to small companies. These firms developed their business model around what they thought was a reliable customer, the federal government. They now face the very real prospects of revenue shortfalls and layoffs due to mistakes made in Washington.

Of course, the impact is not just limited to businesses that contract with the federal government. Small retailers, like gas stations and grocers, will be hard hit by the ripple effect as unemployed workers scale back on consumer expenditures. Indeed, bipartisan estimates suggest that as many as one million jobs could be lost and we could see gross domestic product reduced by one-half percent. Beyond losing customers, entrepreneurs will be deprived of tools and resources they have relied on to grow, whether it is manufacturing initiatives at the Department of Commerce, loan programs at the Department of Agriculture, or counseling services at the SBA.

So yes, it is clear that no one likes sequestration, but it is the path we are on. And you cannot cut spending without cutting the very benefits that many of our constituents enjoy every day, whether they are defense contractors, franchise owners, or the mom and pop restaurants on our street corners.

For these small businesses, this makes little sense, and I do not blame them for their frustration. They would like a government that is able to problem-solve without making matters worse and doing so in a manner that is not so closed-minded. We cannot help small businesses if we do not put all the options on the table. And that means everything, even if you sign a pledge to Grover Norquist. My first priority is to small businesses, and that means being part of a give and take for the better of this nation.

I yield back, Mr. Chairman. Thank you.

Chairman GRAVES. Thank you. All right. We will start with our first witness, who I would like to welcome to the Committee, the Honorable Mike McCord, who is the principal deputy undersecretary of defense and has been in that role since January 2009. In this capacity he provides advice and assistance to the secretary, the deputy secretary, the undersecretary on budgetary, fiscal, and financial management matters. While Deputy Undersecretary McCord will be providing the DoD's testimony, he is also joined by Mr. Richard T. Ginman, who is the director for defense procurement and acquisition policy, and he reports directly to the undersecretary of defense for acquisition technology and logistics. Mr. Ginman will be able to assist us on some of the more contract-detailed type questions.

So with that, Undersecretary, I look forward to your testimony.

STATEMENT OF MIKE McCORD, PRINCIPAL DEPUTY UNDERSECRETARY OF DEFENSE

Mr. McCORD. Chairman Graves, Ranking Member Velázquez, members of the Committee. Thank you for this opportunity to discuss the impact of sequestration on the DoD.

As you said, I am here today representing the Office of the Comptroller, which has the overall lead in dealing with sequester matters at the DoD, and joining me is Dick Ginman, director of Defense Procurement and Acquisition Policy. His organization is responsible for contracting and for implementing our small business policy through our contracts. Mr. Ginman and I have submitted a joint statement for the record that in interest of time I will summarize briefly, and I ask that our written statement be made part of the record.

As you know, Secretary Panetta has said for months that sequestration would have devastating effects on the department and on national security. He urged Congress to avoid sequestration by approving a comprehensive and balanced deficit reduction package that the president can sign.

As required by the Sequestration and Transparency Act of 2012, the Office of Management and Budget transmitted a report to Congress last week showing the impact of sequester programs across the department—across the federal government that is, including defense. That report shows that national defense programs will be reduced by almost 55 billion in FY 2013 by sequester, which will translate to a 9.4 percent cut.

If allowed to go into effect, the lowering of discretionary caps in the out years would result in reductions of a similar amount each year from FY 2014 through FY 2021. These reductions would force us to change the new defense strategy that the administration introduced just a few months ago. The potential sequester would apply to both the base defense budget and to overseas contingency operations funding. The only exception is military personnel, which the president has exempted from the FY 2013 sequester. However, other DoD budget accounts will have to make up the slack for that exemption. Moreover, the department has little flexibility in determining where to take these cuts, the remaining cuts, which leaves us with limited ability to prioritize.

We are particularly concerned that funds to support our troops in Afghanistan are subject to sequester under the law. We would endeavor to protect these wartime operating budgets as much as possible; however, protecting these wartime funds from sequester would force us to make deeper reductions in other areas, such as civilian personnel funding, possibly including a partial hiring freeze or unpaid furloughs, which would reduce our capability to perform other important missions. Military families and retirees would also be affected through cuts to base support services and to maintenance of our facilities. Commissary hours could be reduced. Funds for the Defense Health Program would be sequestered resulting in delays in payments to service providers and potentially some denial of service to retirees and dependents.

We are also concerned that cumulative impact to these cuts, especially if continued beyond 2013 into the out years, would contribute to the creation of an unready or hollow military force. Se-

questration would also lead to disruption of DoD's investment programs. As outlined in OMB's report there would be the 9.4 percent reduction in each of the accounts that fund our investment in new technology and in facilities through procurement, research and development, and military construction.

We were asked today to address the consequences of sequestration on the small business community specifically. In response, we would say that DoD is committed to ensuring that these essential business partners have their fair share of the contracting dollars. When the pool of available resources is diminished, as it would be under sequester, our ability to partner with small business is going to be likewise diminished, however.

This does not alter our commitment to small business or change any of our small business contracting goals, but sequestration would reduce our overall budget, forcing us to reduce purchases from businesses both large and small. So 9.4 percent less money means we would in general buy 9.4 percent less of everything. We cannot devise a plan that would eliminate or even substantially mitigate these sequester impacts. It was designed to be an inflexible policy that was never intended to be implemented. It was a prod to Congress to devise a balanced comprehensive package to reduce the deficit. If implemented, sequester would be devastating to DoD and to every other federal agency. The best outcome for the DoD and for private companies large and small is for both houses of Congress to enact fiscal changes the president will sign, which will put a halt to the implementation of this inflexible law.

Mr. Chairman, this concludes our opening statement, and we would welcome your questions.

Chairman GRAVES. Thank you, Undersecretary.

I am going to turn to Mr. West and let him open up for questions.

Mr. WEST. Thank you, Mr. Chairman, and also Ranking Member. And thanks to the panel for being here and this is an issue that is very near and dear to my heart having spent 22 years in the United States Military and also being on the HASC and also being on this Small Business Committee.

First of all, let me say that I did vote for the Budget Control Act of 2011. I did not believe that the Super Committee nor this thing about sequester was a good idea, but you know, people always talk about compromise and reaching across the aisle. So that is what I did. And so now I am here to talk about how do we resolve this?

You know, when I continue to hear about taxes increased, I mean, we have to understand that if we increase taxes just on those top two tax brackets, you are only talking about $85 billion of new revenue per year. And when you look at our net interest on the debt that means that you will only fund that for 10 days.

The federal government has a spending problem. We spend $4 billion a year—I mean, a day. Four billion dollars a day. So when I look at this sequestration, while we are here talking about it, I want to give you the numbers from the congressional district that I represent in Florida's 22. Total small businesses jobs lost due to sequestration. The estimation is 35,626. Total small business contract amount loss due to sequestration, $60,983,639. Total contract

amount loss, somewhere about 80 million. This is a big deal for us. We have, you know, places like Pratt Whitney.

The first question I would like to ask is when we look at what is happening as far as the loss of these contractors? Are we taking into account that there may be some type of legal ramifications to these contracts being terminated that the DoD will have to then pay for? I mean, you are going to have an additional cost because of this. Correct?

Mr. MCCORD. We would, I think we would endeavor to minimize that because it would not be our intention to, if it was avoidable, to terminate contracts; rather, we would try and—if we have within the scope of the contract the ability to buy say 10 percent less, we would probably do so. And we would have to scrutinize new contracts. The contracts we are already in, if the money is obligated and on the contract before January, it would not be affected. So I cannot say it is not possible, and I would ask Mr. Ginman to amplify it, but it would not be our intent to go reopen contracts if it is avoidable.

Mr. GINMAN. The vast majority of our contracts are fully funded, fully obligated, dollars obligated on them at award. There are a few, particularly in the R&D world, that are incrementally funded but for product, fully funded. So this sequesterization reduces our budget authority. And so from an existing—and what that says is I have less money to spend going forward. There is no need for me to terminate an existing contract unless the product that was going to be delivered was now not needed into the future. But if the product continues to be needed, there is really no need for me to terminate it. What I need to do is to adjust my spending on a go-forward basis.

Mr. WEST. So if on the 2nd of January this thing is not staved off, anything that goes into calendar year next year, if it is already, the contract has been awarded, there will be no affects on that contract?

Mr. GINMAN. If I may, I will do it in two parts.

For contracts that were awarded with FY 2012 current money or prior, I really do not think there will be an impact. If I have a contract that was awarded in FY 2013, since sequesterization affects all of—what goes into the denominator is all of the FY 2013 budget, if I put a service contract in place with equal spend and I spend through the first three months at that level, I would need to find a way through the last nine months of the fiscal year to, in fact, spend less on that contract.

Mr. WEST. Now, with that being the case then, you know, the unpredictability for the workforce that is out there, you know, one of the things that concerned me when you look at the Warren Act, the Worker Adjustment and Retraining Notification Act, a lot of these notifications will probably need to start going out some time November, at the latest December, for a 2nd January kick-in. Of course, the Department of Labor sent out a recommendation that a lot of these businesses and the defense industrial base do not have to adhere to the law. Do you think that that will set them up for potential lawsuits down the road if they did not adhere to the Warren Act?

Mr. MCCORD. The first thing I want to say is the department, I think, has been—the secretary and the deputy have met with industry leaders and I think they have been clear. I am going to try and restate what they said, that we cannot be in the position of providing legal device as the DoD to corporations about their own relationships with their own unions and workforce.

Mr. WEST. I understand, but the Department of Labor, which I also, I mean, is there no coordination between the DoD and the DoL for what they just sent out? I mean, I think that they can be setting up, you know, a lot of people that service the DoD for a really big pitfall if they are not careful.

Mr. MCCORD. Well, the Department of Labor does have the responsibility and was speaking for the Executive Branch. And so we are deferring to them on that guidance. And I understand that not all corporations are satisfied with the Department of Labor's position, but they are the person, they are the entity in the lead for us on that.

Mr. WEST. If I could ask one more question, Mr. Chairman, if I could.

Chairman GRAVES. Quick, yes.

Mr. WEST. Yes. The key thing that I want to ask, do you think that if sequestration kicks in with our industrial base, especially manufacturing, the aerospace, the shipbuilding, and things of that nature, even weapons and permanent, will we be able to restart these industries down the road or will we maybe lose a technological and innovative advantage at some point?

Mr. GINMAN. The manufacturing and industrial based policy office within AT&L has been and continues to pay a great deal of attention to the industrial base. They call it a sector-by-sector and tier-by-tier analysis, looking expressly at very low levels. What are the exact technologies and capabilities that we need? When we find that one is threatened, then we take action to attempt to protect it. We will continue, you know, that office will continue to do the analysis to ensure from an industrial-base perspective for the key technologies that we need, that we are looking to find ways to, in fact, protect them.

Mr. WEST. Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. Ranking Member Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Mr. McCord, as of September 6, Undersecretary Kendall was stating that he expects the DoD accounts to take an 11 percent cut. However, the report released by OMB last week projected at most 10 percent decrease in funding. To what do you attribute the difference in the projected cut?

Mr. MCCORD. Well, I guess I cannot be sure where Mr. Kendall got his, you know, all of us prior to the report coming out were using approximate numbers. It was common to say 10 percent, 11 percent. Two things. First of all, we in the department tend to think almost exclusive in terms of relationship to the budget that we submitted and calculate differences from what our plan to do was in 2013 and the sequester report that OMB did was not done that way. It was compared to the CR.

Second, as Mr. Ginman was describing, with respect to 2013, the amount of reduction across the entire 12 months is 9.4 percent, but

if you kind of look at the last nine months you would come with a figure close to what Mr. Kendall was using if you look at how you have to get that money out of less than a full year.

Ms. VELÁZQUEZ. Thank you. Small businesses do not have the resources that larger companies do, such as Lockheed Martin or Boeing. And they will not have the money to have the lobbyists to fight to keep their contracts. Given this inequality, how can you assure us and small businesses that their contracts will not be the first one on the chopping block?

Mr. GINMAN. So I think the best answer I can give, what we buy is what we need for our war fighters. If there is something that we do not need, that will be what we stop spending on first. It is not going to be I need to protect large business or I need to protect small business. It will be I need to meet the requirements of the war fighter.

So we will make our prioritization decisions based on what war fighters need.

Ms. VELÁZQUEZ. Well, one of the requirements are for DoD to comply with the 23 percent contracting goal for small businesses. And, you know, traditionally you have had issues and problems not achieving those goals. I just want to make sure that if sequestration takes place that there is a level playing field that would allow for small businesses to have a shot at the door.

Mr. MCCORD. If I could just comment, amplify one point though. There is, if anything, perhaps too much of a level playing field because we are not going to have a great deal of discretion. We are going to endeavor to do exactly what Mr. Ginman said, to do the things that our war fighters need the most. And that was in my opening statement I referred to protecting the funding for the troops in Afghanistan as a top priority. But the law is going to limit our flexibility, especially in the procurement account, so we may not be able to go even as far as we want to to buy what we need. And so some levelness of playing field is enforced upon us by the rigidity of sequester, for good or for ill.

Ms. VELÁZQUEZ. What will it mean in terms of readiness and readiness if small businesses are no longer there to provide the products and services that are necessary for our military Because sequestration could very well threaten some of these small businesses?

Mr. MCCORD. From a sequesterization perspective and our policies with small business, virtually no policy in the department that we have with the requirements to award to small business will change. There is nothing in the sequesterization law that would cause us to do that. We will continue to have the same emphasis to award to small business. We will continue to have the requirement to do the market research. If there are two small businesses capable of doing the work, we will continue to set aside the work for small business.

Ms. VELÁZQUEZ. Okay. As you know, on this Committee we have discussed so much throughout so many hearings. The impact of contract bundling. And it continues to be a prevalent program government-wise, preventing many small businesses from competing in the federal marketplace. With a position workforce likely im-

pacted by discards, what measures will DoD take to ensure that this impediment to small business participation does not grow?

Mr. MCCORD. The first thing I would say is that the acquisition workforce, again, kind of getting back to the rigidity of sequester, we recognize the importance of it and we would not want it to have it take a disproportionate hit but there is probably no part of the workforce that can be totally exempt, so it is going to have to be part of the balancing that everyone participates in if sequester happens.

That said think it was respect to our workforce and our civilian workforce in particular that we would probably be strongly inclined toward looking at furloughs as opposed to RIFs. So the people were not going to try. If it is possible, I think it is not in our interest. It is not helpful to us to divest workers, but we may need to go with furloughs. So I think that we are not going to lose the expertise, although we are probably going to lose some work gears out of this.

Ms. VELÁZQUEZ. Let me just ask you, as we continue to work towards a solution, there are a lot of people that say that there should not be any cuts to defense spending. With our country facing historic deficits, should not all agencies, including DoD, makes sacrifices and not let all the cuts, the burden, fall on social programming?

Mr. MCCORD. I think that is the principle embodied both in the Budget Control Act and really, the backup sequestration, you know, took that approach.

Ms. VELÁZQUEZ. Thank you.

Chairman GRAVES. Ms. Ellmers.

Ms. ELLMERS. Thank you, Mr. Chairman. And thank you to our panel, Undersecretary McCord and Director Ginman.

I represent the 2nd District of North Carolina. In North Carolina, 30,000 jobs are at risk through sequestration. In Fayetteville, I represent Fayetteville and the Fort Bragg area, which accounts for 50 percent of the local economy there.

Sequestration may cause the government to make unilateral changes to tens of thousands, if not hundreds of thousands of government contracts and task orders. And I know you are aware of this.

I do want to share a personal business situation in Cary, North Carolina. I recently spoke to Doug Bennett, president of Bennett Aerospace located in Cary, North Carolina. Bennett Aerospace, as mall defense contractor, said their business would come to a grinding halt should sequestration go into effect. And obviously, as you have pointed out, research and development will greatly be affected. Mr. Bennett has already lost three major projects as a result of what he is facing.

Now, I have a couple questions. One, are you aware that in the House of Representatives, we have passed a couple of cases of legislation that will avoid the devastating military cuts by making other budget cuts to keep to the number. Are either one of you aware of that?

Mr. MCCORD. Yes, we are.

Ms. ELLMERS. Okay. Because I know you had mentioned in your opening statement that, you know, certainly we can all work to-

gether, with the president as well, in order to avoid this. And I would say that on behalf of the House of Representatives, I think we have definitely. I think we have definitely made an effort at that.

My other question to you is, and again, I am going back to, I believe it was when you were answering Mr. West's questions. The FY 2012, that any contracts that are FY 2012 that are not FY 2012 would have no impact. Is that correct? Did I understand correctly?

Mr. GINMAN. For existing contracts.

Mr. MCCORD. And prior.

Mr. GINMAN. It is FY 2012 and prior. But if the existing contract was funded with FY 2012 and prior funds, it is fully obligated. There really should be no reasons, sequesterization does not go after funds that were already obligated; it goes after unobligated funds.

Ms. ELLMERS. Okay. So for Mr.——

Mr. GINMAN. It will reduce budget authority in 2012 and prior to the extent that they are unobligated dollars. But it will not cause us to go back to an existing contract already placed, already with funds obligated on it and make a change to that contract.

Ms. ELLMERS. So how would we explain to Mr. Bennett then that he has had three major contracts canceled?

Mr. GINMAN. I do not know the reason why the contracts were canceled. I am comfortable that it was not because of sequestration.

Ms. ELLMERS. Okay.

Mr. GINMAN. But I would be happy to either meet with Mr. Bennett or to entertain a question from him, you know, to help him understand where that is, but it sounds like it was in a competition that he did not win.

Ms. ELLMERS. Okay. I think he would be most appreciative of that.

And I guess from that perspective with the time remaining, what is the advice you are giving to these businesses? What guidance are you giving. I know I heard you mention adjusting spending as a possibility. What other suggestions would you have for any businesses that are faced with this?

Mr. MCCORD. I think one of the things that Mr. Ginman and I have discussed is that probably the more unique a skill that a company has as a subcontractor or a supplier, probably the better shape they are going to be in. Of course, if they have or can diversify a little bit away from federal business, obviously that would probably help them in the coming months as well.

I do not know if, Dick, if you want to talk about what we have seen historically.

Mr. GINMAN. You know, as we spend less, there are going to be less opportunities. I mean, we have put the budget out for 2013 and we have allocated where our priorities are and what they are and that is what companies use to plan and look. If sequestration hits, it is a 9.4 percent hit at every line item level we have that is visible and capable of being seen.

Ms. ELLMERS. Okay. All right. Well, thank you, gentlemen. I appreciate your input. Thank you very much. And I yield back the remainder of my time.

Chairman GRAVES. Ms. Hahn.

Ms. HAHN. Thank you, Chairman Graves, Ranking Member Velázquez. Thank you, Mr. Undersecretary McCord and Mr. Ginman for taking the time today.

I am really glad we are holding this hearing on this specific issue because I know that we, specifically on this Committee and I am sure the rest of our colleagues in Congress, understand the importance of small businesses as it relates to the recovery of this economy and the job creation that we know comes directly from our small businesses. So the threat of sequestration at this time, when they are beginning to recover, it could be devastating.

I have only been here in Congress a little over a year, and I came to Congress last July just to see one of the most bitter partisan fights I think this country has ever seen. I voted against the Budget Control Act because I thought it was a bad idea then and it has proven to be a very bad idea. I did not think it was my job or any of us who came to Congress to set automatic across-the-board budget cuts. And I voted against it because I did not think it was also my job to turn over my authority to a Super Committee to make the decisions for this country. And I think it is bearing out today that these automatic cuts will damage our economy, specifically to our small businesses.

One of the things I think we stand to lose because of sequestration is the innovation, specifically by our small businesses, who stand to suffer the most damage from the loss of federal governments. Can either one of you maybe give the Committee a specific example of the type of technology or innovation you fear that we could lose if sequestration goes through?

Mr. GINMAN. I do not have one off the top of my head.

Mr. MCCORD. Yeah, I guess we do not have a good example in that the cuts going forward are kind of going to be spread everywhere. And our SNT area is not going to be exempt, so there will be impacts there, but I guess I am not familiar enough to know what specific projects might be the ones that fall by the wayside as we deal with 9 percent less, the thing that we would have done with our 13th SNT funding that will now have 91 percent. I agree with your premise; there will be an impact down the road. It is hard for me to assess in advance what projects will not be selected perhaps because we cannot afford to fund them all.

Ms. HAHN. Let me get a little more specific. I know in my district in California, we have benefitted from new, innovative technology that has saved government agencies time and money and even saved lives. And some of these businesses were able to do this through the SBIR grant program. And we know that seemingly unrelated research can often lead to inventions that prove useful for defense and other purposes. And given that nondefense, discretionary spending includes virtually all research and development at agencies like the National Science Foundation, the National Institutes of Health, and NASA. Are you worried that sequestration to these non-defense programs could negatively impact our national security and competitiveness. Is it probable that research for NASA or NIH could benefit our national defense. And maybe you could give us a sense, this Committee, on the role that non-defense research plays in our national defense.

Mr. MCCORD. Well, we certainly understand and I think the administration touched on this, that the effects are bad on our agency as well as other agencies. Secretary Panetta, as the former Budget Committee chairman, used to looking across, you know, the spectrum when he was here as a member, certainly understands that as much as we talk about and think about the impact on ourselves, of course, primarily as a DoD, that is what we are doing and what we are talking about. He does recognize the impacts are damaging and that across-the-board cuts do not make any more sense for domestic agencies like NIH, than they do for us. So yes, we certainly understand that concern and share it.

Ms. HAHN. Thanks. Because I did not want us to get in a thought process in Congress that it is defense and then it is nondefense cuts because I think there is a huge relationship between some of our traditional nondefense research that actually has played into technology and innovation that has clearly benefitted our national security.

Thank you. I yield back my time.

Chairman GRAVES. Ms. Clarke.

Ms. CLARKE. Thank you very much, Mr. Chairman. And I thank the ranking member. I thank Undersecretary McCord and Mr. Ginman, Director Ginman, for this very sobering conversation. I just sit here and I remember the debate distinctly about sequestration. And I just wonder why we are so surprised. Or you know, there is this major concern. The concern would have been we could have compromised with one another. We could have worked with anybody to make sure that we would be sitting here during a hearing trying to avert what can be catastrophic. But we are here nonetheless and so I have a few questions to ask.

Mr. McCord, you indicated that you foresee a possibility where the sequestration could be averted at a late point, yet you will have triggered some of its effects. Understanding that would cause a disruption across the board, can you extrapolate at this point or quantify the level of disruption that would be caused and how long it might take to rectify?

Mr. MCCORD. Well, the type of disruption we are talking about are both things that can be quantified, and I think things that cannot be easily quantified, such as moral impact. If you start telling people we are about to furlough you or we are about to lay you off, and one of the things I know the deputy secretary feels strongly about is that we not do that until we are absolutely certain it is necessary because it conveys a message to your workforce and to the contracting workforce, as well, that you do not want to send unless it becomes you are kind of at that irrevocable point.

In terms of other impacts, again, that we do not want to trigger, certainly as Mr. Ginman said, we do not want to go into contracts. There is no reason for us to go into existing contracts. That is not going to be productive.

I think the other thing that we recognize that we cannot really fix is that uncertainty creates its own bad dynamic. I think Chairman Bernanke talked about that recently in front of one of the other committees, and that we understand that that is out there today and there is not a great deal we can do. So what we are trying to do, and I think what the administration, the OMB director's

memo at the end of July, told people to keep continuing normal operations while we see if there is a way out. And so that is what we are still doing but the uncertainty still remains in people's minds, understandably.

Ms. CLARKE. Yes. It has a very dampening effect.

I would like to get a better idea of the baseline we are using there. As it stands, the surge is ending in Afghanistan and the troops will be coming home soon. And I understand the concept of readiness means the ability to respond to any threat, anywhere across the globe. However, with the evolving nature of warfare moving toward reliance to a certain degree on drones and other military technologies, are we making projections at the same or similar cost of readiness that has, I guess, been the contemporary meaning of readiness? And in the future, as it stands right now with the troops in the field or is there something that you are adding to this equation now going forward that you may put into your thinking should sequestration be a part of that equation?

Mr. MCCORD. I hope I am going to be able to answer the question. I think there were sort of two parts of it.

Sequestration, the readiness impact of either the drawdown or of changing the technology is probably not going to help us in any way that is material, especially as we look at, say, comparing 2012 to 2013. The situation is just not changing enough in a way that would produce any dramatic savings. The reduction in wartime spending that comes with the drawdown was already planned and is not really going to help us. Wartime spending is subject to sequester but having less of it does not lessen the impact. It is kind of an unusual player in the sequester equation. So I do not really see any windfall from that respect or any major changes in operational concepts or readiness concepts that is going to materially affect the discussion that we have been having or that you probably have had with your constituents.

With respect to going forward, I think Mr. Hale, my boss, and the vice chiefs of the services testified this morning, and I know Mr. West was there, that there are going to be readiness impacts of reducing funding for training, things like that. So that, if sequester happens, is going to be a readiness impact of sequester impacting readiness, but the vector going the other way of readiness changes affecting sequester I do not think is really going to be much of a factor. I hope that is responsive to your question.

Ms. CLARKE. That is helpful, sir. And I thank you for your testimony here today. Mr. Chairman, I yield back.

Chairman GRAVES. Ms. Chu.

Ms. CHU. Mr. McCord, thank you for being here today to testify about this important matter.

As you know, the defense budget for FY 2011 was 700 billion, which is over half of discretionary spending in the federal budget. With defense spending making up such a significant portion of our budget as we work together to implement a balanced deficit reduction plan, we will inevitably have to make some cuts to defense spending.

I agree with you that sequestration is not a good policy, and in fact, I voted against the Budget Control Act, which engineered it. Sequestration would have such a devastating effect on every fed-

eral agency and thousands of small businesses who would be directly affected by the reduced number of federal contracts and subcontracts and indirectly affected by the decrease in economic activity.

But my question to you is as we negotiate a better deficit reduction plan, how do we make strategic cuts to the Defense Department that will not threaten our national security while helping us to bring down the mounting deficit?

Mr. MCCORD. Well, we feel, the secretary feels strongly, that we did that in presenting the budget that is before the Congress now that I guess will not be probably dealt with fully until at least after the election.

If we were to do another round as a way to, say, deal with sequester, we understand that defense would be on the table. It is hard for us to assess at this point exactly—to say give a number of what we could live with as a change, if any, but we would want to be part of the conversation if there was another look at a new budget deal. But we feel that what we have done so far was strategically based and although people have disagreed with particular aspects of it, such as the air guard, that the broad outlines we think have been pretty compelling to people, and the secretary is concerned that we will have to walk away from that in some material way if the sequestration happens with no further adjustment.

Ms. CHU. Okay. I want to also talk about the contracts that are given to small businesses. You said that the DoD would still fund contracts from the prior year and these would not be subject to cuts. How would the DoD handle the contracts that small businesses won but those contracts that have not yet been funded? And what if the contracts that were given last year were multi-year contracts that extended beyond 2013? Would they also be subject to sequestration? And also, under sequestration, would small businesses lose the number of contracts or just get a smaller dollar amount per contract? And how would you ensure that the Defense Department's goal to give small businesses 22 percent of contracts and 32 percent of subcontracts, how would you ensure that that goal is met?

Mr. GINMAN. The existing contracts that are there, there is no need to do that. Multi-year contract and the careful definition of a multi-year, the department only has eight of those. All of them are large businesses. Multi-year—if what you meant by multi-year was a contract that had options in it that I would exercise into the future, while the effect of sequestration within whatever budget line item I am in, if in fact I need the requirement and I do not have enough money to spend it, I would have to renegotiate the option to bring it down to the dollar level I could afford.

Many of the contracts that we write, understanding that the money that we ask for is not always necessarily what we get, we tend to write options—contracts with options in them with the flexibility to order varying levels. So my hope would be in most of those levels of those types of contracts, we would, without having to renegotiate, simply be able to exercise the option at a lower dollar value.

Ms. CHU. What about this 22 percent of contracts?

Mr. GINMAN. So as I said earlier, no direction with regard to awarding business to small business will change as an effect of sequestration. We simply wind up with 9.4 percent less money. We will continue to work to do that. Undersecretary Kendall, the deputy secretary, and the secretary have all issued letters recently looking to improve. The deputy secretary has made it mandatory that for all senior executives within the department that have any responsibility for spending money have as an element in their personnel evaluations how did they do in getting work to small business. Secretary Kendall recently issued one in three very specific areas saying we know small business can operate in these areas. We want you to increase the percentage by 10 percentage points. I have recently issued one looking at those orders that are small dollar values, the below $150,000, remind people that it is our policy to set those aside and ask him to do that.

And we have reinforced the Office of Small Business Policy within the department. Created a very sophisticated tool to be able to facilitate market research to help contracting officers find better opportunities for small business so that we can meet the goal.

Ms. CHU. Thank you. I yield back.

Chairman GRAVES. I do want to echo the words of the undersecretary in that and you pointed out that the goal for the Super Committee was not sequestration; it was a prod. The goal of the Budget Control Act was for the Super Committee to find savings to help pay down the debt. Unfortunately, they failed and now we have to deal with this.

But with that, what we are going to do is we have two votes and we are going to recess for approximately 30 minutes. When we come back we will set the second panel out there. And I want to thank the Undersecretary, Mr. Ginman, both of you for being here today. We appreciate it very much. And with that we will recess again for approximately 30 minutes and then we will be back.

[Recess.]

Mr. WEST. We will continue on with the hearing for today and now we will have our introductions for panel number two.

I would like to introduce Stephen Fuller. Our next witness is Professor Stephen Fuller, the Dwight Schar faculty chair and university professor, as well as director at the Center for Regional Analysis, School of Public Policy at George Mason University in Arlington, Virginia. Professor Fuller is an expert in the field of urban and regional economic development. He has authored over 500 articles, papers, and reports in this field, including his newest report released this morning, which looks at the economic impact of the Budget Control Act of 2011 on small business. Thank you for testifying today, Mr. Fuller. You may begin.

STATEMENTS OF STEPHEN S. FULLER, PH.D., DWIGHT SCHAR FACULTY CHAIR AND UNIVERSITY PROFESSOR, DIRECTOR, CENTER FOR REGIONAL ANALYSIS, SCHOOL OF PUBLIC POLICY, GEORGE MASON UNIVERSITY; M. L. MACKEY, CEO, BEACON INTERACTIVE SYSTEMS, ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION; LAURIE MONCRIEFF, PRESIDENT, ADAPTIVE MANUFACTURING SOLUTIONS; MARK GROSS, FOUNDER AND CEO, OAK GROVE TECHNOLOGIES.

STATEMENT OF STEPHEN S. FULLER

Mr. FULLER. Thank you, Mr. West and Committee Members. I want to go back to July of this year when I released another report called "The Economic Impact of the Budget Control Act of 2011." The analyses in that report set the stage for my comments today and it identified the loss of 2.1 million jobs nationwide by the year 2013 or during 2013 from the Budget Control Act or if sequestration is implemented. My subsequent analyses have established the fact that these impacts will disproportionately affect small businesses and their workers, workers in small businesses which suffer more than 50 percent of the projected job losses due to spending reductions mandated under the Budget Control Act. These job losses would show up in small businesses that are prime contractors. Also, subcontractors, suppliers, and vendors, and also thirdly, the businesses that support the retail and consumer service needs of laid-off workers and the loss of their labor income. This latter class of small businesses span the economy, although we find it more concentrated in retail and consumer service sectors. The direct impacts, the federal contractors who are small businesses that would be impacted by sequestration, would involve the loss of about 158,000 jobs. It just represents about 34 percent of the prime contractors. Overall, the loss of jobs that is attributable to small businesses is about 51 percent.

The difference is important. What it says is that the concentration of small business impacts are among subcontractors, and suppliers, and vendors, and those businesses that provide services supported by the payroll spending of laid-off workers. In fact, they represent 58 percent. Small businesses in these other categories represent 58 percent of the job losses that would result from sequestration. It is 58 percent of 1.4 million jobs. It is a very significant impact.

And what is more important about this, these companies have less control over their destiny. They are the subs. They are the suppliers. They are the vendors. And in many cases, they do not even know that they are working on a federal contract. And so as large companies adjust to changes in federal spending, clearly they are going to be impacted, too, as they adjust. One of the typical adjustments is they bring work back from the small—their subcontractors into the main company. They have much deeper pockets and can adjust financially and take time to restructure and reposition their businesses. Small businesses do not have that capability.

I am going to skip forward because time is short.

The small businesses are less able to sustain themselves when they experience a contract loss, whether they be a prime or a sub.

Due to the more limited economies of scale that characterize the operations of most small businesses, the loss of even a small portion of their projected backlog or a cancellation of a contract could result in these firms becoming unsustainable. Small businesses typically do not have the financial resources to sustain unprofitable operations for a sufficiently long term to permit restructuring alternative market or product development.

It should be noted that all of these calculations of job impacts associated with sequestration only measure the job equivalent of the direct spending reductions and their subsequent impacts. What they do not include are any consideration of induced failures of small businesses from partial losses of federal contracts or subcontracts. The literature shows that small businesses are much more vulnerable than big businesses to changes in the business climate. And one of the principal reasons for this is that they have a much smaller margin of operation. Their profit margins are smaller. They cannot adjust as quickly to changes in the business environment, and so with a small reduction in spending, may actually force them out of business. So these of the collateral effects have not really been considered.

The workers for small businesses face some of these same problems. Employees in small businesses may be more specialized or less networked than employees in larger businesses, making their reemployment more challenging than for employees working in large businesses that may be experiencing cutbacks or cancellations in federal contracts. Workers in larger businesses have the opportunity to reassignment to another division. You do not find that in small businesses. Or perhaps a transfer to another location. Small businesses have very little options.

To me the key takeaway from all of this analysis is that besides bearing a disproportionate impact or potential impact of federal spending reductions, small businesses are more vulnerable to actions they cannot control. The larger businesses can move the contracts around and the small businesses are sitting there waiting for something to happen. The fact that 58 percent of all of the job losses are in the secondary kinds of functions I think highlights the vulnerability of small businesses. Most importantly, beyond the loss of jobs it is the survivability of these small companies from partial reductions in federal spending or federal contracting that they might be doing. Thank you very much.

Mr. WEST. Thank you.

Our next witness is Ms. M. L. Mackey, CEO of Beacon Interactive Systems in Cambridge, Massachusetts. Her company was started 18 years ago, and for the last decade has been active as a federal small business contractor. Through government contracts, her innovative firm has developed effective and cost-saving software products used within the DoD. Ms. Mackey is testifying today on behalf of the National Small Business Association. Thank you for being with us, Ms. Mackey, and you may begin.

STATEMENT OF M. L. MACKEY

Ms. MACKEY. Good afternoon, Congressman West and Ranking Member Velázquez, and the members of the Committee. Thank you for the opportunity to testify here today and for your tireless efforts

to promote economic development and job creation in America's small business community. Your continued leadership on critical issues, such as the one before us today and your collective ability to understand and shed light on the challenges facing small business in the federal marketplace is invaluable and greatly appreciated.

My name is M.L. Mackey, and I am the CEO of Beacon Interactive Systems, a small business located in Cambridge, Massachusetts. I am also on the board of trustees of the National Small Business Association.

Eighteen years ago, my husband and I co-founded our company out of our rent controlled apartment on Beacon Street. We built the company as a provider of commercial systems, initially providing software products to companies like Olympus, MetLife, and IBM. For the past nine years, we have worked as a federal contractor delivering efficiency, improving, and cost-savings applications to the DoD. The Navy is currently using products we developed through the highly successful Small Business Innovation Research (SBIR) program to improve performance of the equipment maintainers deployed across U.S. Fleet Forces Command, the sailors who keep our ships mission-ready. At full deployment of our software, initial estimates on cost savings and cost avoidance are in excess of $40 million; all on an initial SBIR investment of $5.5 million. This is the kind of cost savings and efficiency improvements that small business provide for the DoD, exactly the approach needed in these austere times.

I, along with many of my counterparts across the country, am very concerned with the proposed arbitrary approach to sequestration. Simply cutting the top-line of nonexempt agency budgets is not based on a rational assessment of the relatively effectiveness or usefulness of various programs. It has the potential to devastate key programs and specifically to have a disproportionate impact on small business. While major program cuts will be necessary inside federal agencies, these cuts should be made with a purposeful and thoughtful approach. In order to not only insure an equal impact across the defense industrial base, but also to ensure a rational approach that does not gut the advances made in government procurement to this point.

Today, I am speaking to you as someone who has already felt the effects of this uncertainty. We, like many other businesses in this sector, have had to tighten our belts in anticipation of the rough times ahead. In spite of successful pursuit of new opportunities, we have purposefully trimmed our workforce. This is counter to how we have strategically built our business over the last 18 years. Previously, once we closed a big opportunity, the first thing we did was evaluate our team and act on ways to improve our capabilities, like defining new roles and hiring new employees. This approach has not only kept us viable, but has helped us expand our business and create jobs. Unfortunately, give the uncertainty surrounding sequestration, this is not the approach we are taking now.

I am by no means the first business owner, nor will I be the last, to tell a congressional panel that sequestration will have major, negative impacts in areas ranging from business survival to national security. Nor will I be the last to argue that something must

be done to stabilize our economy. Surely Congress can craft a more deliberate and careful approach than the current strategy, which will lead to considerable job loss and greater economic uncertainty at a time when job creation and economic growth remain a top priority for our country.

The federal contracting and acquisition systems are overtaxed and have struggled with efficiency and transparency issues for years. This problem will only get worse with sequestration in place. The contracting staff of Federal agencies will likely face major personnel reductions under sequestration. As a result, we are likely to see an increase in contract bundling and less efficient, less predictable contracting system. This will have a major impact on small business contractors who are likely to be the first to go on many projects. According to NSBA's most recent Politics of Small Business Survey, 99 percent of small business owners are registered to vote, 97 percent said that they regularly vote in national elections, and the 25 percent of small business owners who have contacted their elected officials on a small business issue have done so on the matter of contracting.

Small businesses create efficiencies. We are agile and flexible, which saves the government money. We believe that program managers and contracting officers should be incentivized to create efficiencies and cost savings through increased work with small business, not the other way around. Small businesses around the country are waiting on funds from previously awarded contracts, large businesses are contemplating mass layoffs, and the end users, our men and women in uniform and the people who are served by our Federal Government, are waiting for products and services they expected months ago.

Washington needs to set their differences aside and not use the excuse of an election year or partisan gridlock to shortchange America's small businesses and the broader public. We cannot afford to wait and fix our economy or shore up our industrial base after it has been decimated. If sequestration happens, DoD contracts being competed now or in the near term may be canceled with little recourse for contractors. Business owners do not know which opportunities are real and which are illusory, causing a massive waste of our limited resources. Businesses are frozen, in need of personnel, but unable or willing to hire because of this uncertainty.

Congress, to its credit, has increasingly recognized the benefits of small business engagement. The small business contracting reforms incorporated into Title XVI of the 2013 National Defense Authorization Act (NDAA) are a positive step forward and incent behavior that incorporates the efficiency and cost-savings approach that our small business are known to provide. These are the kind of proposals that will push the federal government toward greater efficiency.

I know that pointing out problems is far easier than finding solutions. The path ahead will definitely be challenging. Having said that, as a small business owner, I can state unequivocally that we are a critical component of the solution to our government's fiscal concerns.

I applaud this Committee for your vigilance in promoting small business-friendly policies and your work to reinforce the idea in your colleagues that small business is a value-added proposition for the government and an enabler of innovation and growth.

I appreciate the opportunity to be here today. It is an honor and a privilege, and I welcome your questions.

Mr. WEST. Thank you, Ms. Mackey.

Our next witness is Laurie Moncrieff, president of Adaptive Manufacturing Solutions in Burton, Michigan. Adaptive Manufacturing Solutions formed by Ms. Moncrieff in 2007, is a group of small tooling and manufacturing companies that work together to bid on contracts. She is also president of Schmald Tool and Die, one of the companies within Adaptive Manufacturing Solutions, a small tooling and die company which has been in her family for over 60 years. She is testifying today on behalf of the National Defense Industrial Association. Thank you for testifying today, Ms. Moncrieff, and you may begin.

STATEMENT OF LAURIE MONCRIEFF

Ms. MONCRIEFF. On behalf of the 1,756 corporate and over 96,000 individual members of the National Defense Industrial Association (NDIA), I would like to thank Chairman Sam Graves, Ranking Member Nydia Velazquez, and all the members of the Committee for holding this important hearing.

We are all painfully aware that in the past 10 years the U.S. has experienced an economic downturn second only to the Great Depression. The most severe impact has been experienced by small businesses.

Even in a good economy, small businesses have to navigate barriers and challenges. But through this downturn, we have seen it at an unprecedented magnitude. The resulting erosion has decimated many critical sectors that are still widely needed and in demand to produce product worldwide and also recognized as integral to part of our national innovation system. The vast majority of the companies classified in these critical industries are small businesses with less than 50 employees.

As a representative of small business and manufacturing, I ask each of you to consider how can we ever revitalize these industries that have sustained considerable economic injury, encourage innovation and invention, increase production and demand, and support and approve national security if small businesses are hit with yet another blow from astounding budget cuts the DoD faces with sequestration?

The challenges of the last 10 years have made it difficult to find and identify individual businesses in these segments. It can be easily demonstrated that these companies hold irreplaceable intellectual knowledge, which may not reside in the prime contractor community. Yet with the structure of the supply chain today, small business innovation and value-added work is often unrecognized, unrewarded, and under-represented in government contracting.

Some examples of companies and communities that could in the future or have already been impacted include TACOM LCMC awards of the FHTV, M–ATV, FMTV, Stryker, and HMMWV include $539.6 million directly to small businesses and an additional

$563.5 million in subcontract awards through March in FY 2012. The totals of over $1.1 billion in the first half of the year, demonstrating the importance of small business in this supply chain.

A manufacturer of High Tech "Hot Press" furnaces used in the manufacture of ceramic body armor plates will simply shut their doors if this demand for sustainment of furnaces is decreased or eliminated. There is no other application for these furnaces outside of the military. It would take us between 18 and 24 months to get this business operational yet again.

A small manufacturer who makes "high strength" carbon used to produce armor felt the impact of demand decrease back in 2010 when the DoD allowed this key component to be diverted to support other worldwide demand. When DoD later wanted to reinstitute the manufacture of body armor, it suffered a 12–month lag in delivery times for body armor in theater. We cannot afford to repeat this scenario.

The manufacturer of carbon tooling, special foils, and other unique production products are all supported and maintained by small businesses, many of whom only have two to three people per company in their operations. If lost, it could take up to 24 months to replace such lost capabilities.

Miller-Holzwarth, a 2007 recipient of the SBA Subcontractor of the Year recently announced the closing of their doors. The business located in Ohio manufactured periscopes, vision blocks, ballistic window armor, and had been in the defense industry for over 35 years. Among the issues that impacted their decision to close was the potential of budget cuts with sequestration. There are many other businesses like that that we could see similar instances arising.

It is documented that small businesses are critical to the economy. Thirteen times more patents per employee, 99.7 percent of all employer firms are small businesses.

There are several ways we could strengthen small business and increase the value to the government, presenting a win-win situation.

We can encourage more sourcing to small business. The executive office of the president in management and budget published a memorandum dated February 11, provided examples of savings in excess of $383 million due to targeted set-asides to small business.

Develop a program to reverse engineer "low hanging fruit" already in the DoD inventory.

Review processes of DCMA, as many have minimal value and are costly to small business as well as government.

Many great products and processes originate in small businesses. However, they struggle to connect and bring their product to market. We must work towards the support of more robust avenues for these products to reach the federal and commercial market.

Streamline and reduce the amount of paperwork and effort required to find and bid on contracts.

We need to celebrate and support the strength that small businesses bring to the market and better leverage these valuable resources. There are many ideas of how to reduce cost, but with every decision there are many unintended consequences. We must consider how decisions could support, uphold, and encourage small

business, innovation, and growth, and revitalize critical industrial sectors. These actions will move us forward to create jobs, improve the economy, and our national security. It is time to step up and support the industrial sector and the small businesses which are the backbone of our country. Thank you.

Mr. WEST. Thank you, Ms. Moncrieff.

I now yield to Ranking Member Velázquez to introduce our final witness.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

It is my pleasure to introduce Mr. Mark Gross. Mr. Gross is the founder and CEO of the Oak Grove Technologies, a service-disabled, veteran-owned small business located in North Carolina. Prior to starting his business, he worked for DoJ's antitrust division and in management-level positions of several Fortune 500 companies. Additionally, Mr. Gross served on the SBA Veterans Advisory Committee and was a founding member of the American Legion's Small Business Task Force. Welcome to the Committee.

STATEMENT OF MARK GROSS

Mr. GROSS. Good afternoon, Ranking Member Velázquez, Congressman West, and members of this Committee. Thank you for the invitation to come before you and share my concerns relating to the topic of sequestration and the impact it is having on small businesses today and the potential impact it will have on small businesses in early 2013.

I am a veteran of the United States Army, founder of Oak Grove Technologies, a service-disabled veteran-owned small business focused on training, strategic communications information technologies, and intelligence and analytical services. We employ over 390 employees, over 70 percent of those are veterans, and over 20 percent of those are service-disabled veterans. Geographically, we are dispersed in 21 states, Africa, Afghanistan, and Iraq.

The threat of sequestration creates uncertainty, which paralyzes small businesses. Most small businesses do not have the robust or diversified contract portfolio supporting their operations. Small businesses often wait until they have a contract before they acquire the resources necessary to perform the contract. Without reasonable assurances of future business, small businesses cannot plan for the future and are not likely to invest in the company's growth by acquiring additional equipment, facilities, or personnel. However, small businesses that fail to invest or grow will find themselves less competitive for the opportunities that do remain.

Many of the business owners that I speak with in North Carolina, excuse me, are taking a similar approach as we are considering the uncertainty of sequestration. We are putting expansion, infrastructure, expenditures, and indirect hiring on hold. We are forced to prepare for the worse case in order to regroup and/or recover. Oak Grove Technologies has in the past year purchased over 200 acres of land in Richmond County, Hoffman, North Carolina, which is the most economically disadvantaged company [sic] in the state. It is adjacent to Camp Mackall Army Air Field, where we support training for special forces, military information support operations, and civil affairs soldiers. We are putting much of our planned construction on hold, minimizing our marketing campaigns

and trade show participation, and in general, tightening our belts because of the uncertainty surrounding sequestration.

Sequestration in the short term will have the most impact on the agency's budget for operations and service contracts that are a large part of that budget. Most small business federal contractors provide the government with services rather than products because there are fewer barriers to entry in the service market than the market for manufactured items and supplies. For supplies, companies need personnel, equipment, facilities, distribution channels, et cetera. For services, companies just need people. It is easier for an agency to eliminate two data processors from a contract than to eliminate a section of a fighter jet. By cutting services in a greater proportion than products, sequestration will affect many more small business contractors than large contractors.

A small business with 10 federal contracts will feel the effects of a loss of one of those 10 contracts more than a company with 100 contracts that loses 10 of those contracts. Although both scenarios reflect a 10 percent cut in each company's contracts, larger companies have a greater ability to reallocate personnel and idle resources to other contracts because of the large number of contracts remaining. Large contractors, moreover, are more likely to have commercial and/or international contracts that can offset the effects of the stymied federal market. Small businesses rarely have the ability to diversify in this manner.

We completely understand the necessity of budget cuts, especially while we have two military conflicts ending. However, an across-the-board cut will hurt everyone. Although the same economic engine that powers America, small business will be the one that suffers most.

I appreciate the opportunity to address this Committee today. Thank you for all you do for us, and I welcome any questions.

Mr. WEST. Thank you. And thank you for your service in the Army. Army Strong.

I would like to start with a simple question. DoD just told us earlier, and if you were here you saw the first panel, that they would not be terminating contracts but yet we just found out that the Air Force has reported it may cancel the tanker contract with Boeing and Northrop is laying off about 600. One of my big concerns, of course, is the trickle-down effect, not just to the small business but also to the suppliers and the subcontractors that you all use. What do you see as being those effects in your line as far as to those suppliers and the subcontractors that some of you alluded to earlier from the effects of sequestration?

Mr. GROSS. Congressman, I think many of us small businesses, the predominance of our contracts are subcontracts from larger contractors, Oak Grove included. When the large contractors feel the squeeze, there is a trickle-down effect to the subcontractors, whether it is in rates, whether it is in reduction in your staff, or they will take some of the positions in-house. It is certainly something we are concerned with currently on a number of the operations that we are involved in in contracts, so I definitely think it is going to happen for certain and it is definitely a concern.

Ms. MACKEY. So I would answer that question in terms of how it specifically affects small business. So when you ask about sort

of the down-line of your supply chain, I would also perhaps, if I could expand that question to your up-line, who you have relationships to that you are the subcontract to? Who do you team with as other small businesses? So as small business, sometimes people say to me, oh, you are the CEO of a business. I go, you know, it is a small business. Maybe it is not quite as glamorous as you think. I spend a lot of time doing a lot of things. I do not have a lot of time to build relationships. So the relationships, the extended team that I have, took a long time to get in place. And I think some of the trickle-down that Dr. Fuller was talking about is that it will be very difficult for me to recoup all that time and investment in relationships. I hope that is helpful.

Mr. WEST. Dr. Fuller, is there a concern in your analysis that you see as we start to push out and decimate the small business contributions to the defense industrial base that maybe there will be more of a monopoly by some of the larger businesses and companies and therefore you could end up seeing higher costs because you reduced the amount of competition?

Mr. FULLER. That is certainly one of those collateral impacts that need some attention. I think we have seen this in very recent days where some of the very large defense contractors are talking about mergers and we have seen increasing acquisitions. I guess my biggest concern is that first, the numbers are really big. We are talking about a million jobs among small businesses and two million overall. So the small businesses just are extremely exposed, and they are exposed in a way that I think the other witnesses have illustrated so well, is that they in effect are sitting ducks. They are at the mercy of the primes in so many cases. And I have seen as we have analyzed these data that approaching 60 percent of the potential job losses coming out of companies that are not primes and who are small businesses, that they have very little recourse. And adjusting is not an option to them. They go out of business increasingly and I think we—I am more concerned that we are losing the innovative talents of small businesses either because they are threatened at this point or they actually go out of business later on as times get tougher.

Mr. WEST. Last question. Ms. Moncrieff, you kind of alluded to it. The start-up time. If you go to zero, I mean, how long does it take to kick this back in? You know, because the question I asked to the first panel, are we looking at an industrial base at capacity and capability and therefore, our technological advantage and innovations may be lost? So I would like to get your input as far as what would it take, what type of timeline you would look at to try to recover yourself to get back to a full operating capacity or capability?

Ms. MONCRIEFF. I, myself, am not going to be impacted, and I think, I guess I cannot say it like that. I am not as concerned about my impact as some of the other companies that I work with because I went through an economic time five years ago where I lost 75 percent of my business overnight. So when I got into government contracting, what I did is I purposefully contracted first direct with the military knowing that should there be a downturn, you are in a worse position if you are in a subcontract mode.

Now, on the innovation piece, there are 16 industries that are key to innovation, 13 times more patents per employee, and a lot of these folk are behind the scenes. Without them in business, you cannot make anything anymore. So there are businesses that are upstream from them that will lose the ability to make product. And we have got a lot of product in the military that we have one supplier left in the country. We have one manufacturer for chaff for our jets. No other manufacturer in the United States. They are already struggling. To rebuild them, it is not just time; it is an incredible amount of money. I do not know that we would have the ability to bring that back. So there are a lot of industries that I think it is not just a matter of time but it is the amount of money to rebuild those industries down the road.

Mr. WEST. Thank you. And I yield to Ranking Member Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Mr. Gross, with the wars in Iraq and Afghanistan coming to a close, there has been a concerted effort among federal agencies to promote entrepreneurship among veterans coming home, and one of the issues is high unemployment among veterans that are coming back. It seems DoD is the largest provider of contracts to all veterans. How do you think sequestration will impact the decision of these veterans to enter the federal marketplace?

Mr. GROSS. That is a great question. I think if you look at across-the-board cuts, especially in DoD, most of the veterans coming out are more than likely looking at opportunities within DoD based on their background, their skills, their training. With less opportunity within DoD, obviously it creates far more competition and it makes the barrier to entry far greater. I think for companies like myself, you know, veterans hire veterans. It is what we do. And so for us, you know, a down, a decrease in DoD dollars, unfortunately, that is generally who gets impacted.

Ms. VELÁZQUEZ. Mr. Fuller, in your study you estimate that 45 percent of job losses will come from small businesses, and you also discussed the fact these losses will have on other mom and pop shops that are patronized by employees of defense contractors. Does your estimation of job losses also include this multiplier effect or do you expect the impact to be even greater?

Mr. FULLER. The numbers that have been cited include the indirect effects as well. And also, the scope of our work, even though we are focused on DoD because it is the single largest source of federal contracting, includes all the non-DoD agencies. So this is even a bigger problem than we are talking about. And we are at 51.6 percent of all of the potential job losses coming from small businesses, and that would include those subcontractor suppliers and vendors as well as those companies across—you find them in every single county in the country that are supported by the spending of those jobs that might be terminated.

Ms. VELÁZQUEZ. Thank you. Ms. Mackey, while the cuts to DoD's discretionary spending will be significant, there will also be 75 million dollars in cuts to SBA. And SBA is the agency in charge of making sure that small businesses get their fair share of federal contract dollars. So what will the cuts to these agencies mean for

small businesses and their ability in the federal marketplace to enter the federal marketplace?

Ms. MACKEY. The SBA is the agency that watches all our small businesses' backs. We need to make sure that they stay in the game and funded in a way that they can perform effectively. The challenges that are going to come up around contracting and deciding with limited resources who to contract and when, we need to make sure that that level playing field you were talking about stays level by having an ombudsman, by having people that watch and make sure that we are not doing the bigger contracts because then we can get more of the money committed, but just leaving the small business contracts because we have to cut some out; we might as well cut the smaller ones. We need to keep the whole industrial base performing and engaged through the difficult times ahead.

Ms. VELÁZQUEZ. Thank you. Thank you.

Mr. WEST. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

Dr. Fuller, does government spending create jobs?

Mr. FULLER. Yes.

Mr. MULVANEY. And the lack of government spending causes us to lose jobs?

Mr. FULLER. Yes.

Mr. MULVANEY. And using your numbers, I think you said that this sequester, you have got it at $115 billion in FY 2013. I think the number we use around here is $110 billion. It leads to roughly $215 billion in loss of GDP and 2.1 million jobs lost. Am I reading this correctly?

Mr. FULLER. That's correct.

Mr. MULVANEY. Okay. I recognize the fact that there is not a perfectly inverse relationship between spending cuts and jobs lost and spending increases and job loss, but just running the basic back-of-the-envelope numbers, Dr. Fuller, using your numbers, the $800 billion stimulus that we had here several years ago should have created 15 million jobs and at the two times multiplier that you have, should have added $1.6 trillion or 10 percent to our GDP. And I just have not seen it yet. And I am sympathetic to folks who come in here and say that government spending will cost us jobs, but I am very much concerned about making the same argument the other way in light of the fact we have just been through that economics experiment where we spent $800 billion and did not get anywhere near 18—excuse me, 15 million jobs. In fact, there is another report that you wrote that said that $1 billion in investment—excuse me $1 billion—in government savings would lead to 28,500 jobs, which means that the $110 billion represented by this cut would be 3.1 million jobs but conversely, the stimulus should have created 21 million jobs.

And I guess my question, Mr. Fuller, it is not as much a question as much as it is a comment to anybody who is willing to listen. I believe, Mr. Chairman, that these cuts will hollow out the military. I do believe that. And I believe that is where we should be focusing our attention. I think it is disingenuous of us as a party to have railed against government spending for the last two years as not

creating government jobs and then running to that argument the very first time we actually have job cuts.

Let me ask you this, Dr. Fuller, have you done an economic analysis of the impact of jobs in this country of adding $110 billion of additional debt when 77 cents of every dollar borrowed is printed by the Federal Reserve?

Mr. FULLER. I have not done that analysis. No.

Mr. MULVANEY. Is it fair to say that adding to our debt burden, especially in light of the fact that we are printing effectively 77 cents out of every dollar that we borrow, would have a negative impact on GDP and on job growth in this nation?

Mr. FULLER. I think we could manage this process much more effectively than we have done, and the stimulus, while I believe that the idea of a stimulus could have been more productive than it was, I do not think it was executed very well. It is quite easy to—it is how you spend the money that is important, and we can run—we know what we are going to cut back when we begin to cut back DoD spending, and we know that it has a job impact. And so it is important to know that there are costs associated with these decisions. It does not mean there are not benefits. And you might be able to cite some of the benefits. If these monies were spent in another way, they might have a different kind of impact. The point is that this economy cannot accommodate this kind of loss this quickly. It would throw the economy into another recession. It would add a point and a half, maybe two points to unemployment. And so we need to know what the consequences are.

Mr. MULVANEY. Have you seen the studies, Dr. Fuller, that indicate that traditionally when countries have debt that exceeds 90 to 100 percent of their GDP that it annually takes one percent off of their GDP growth?

Mr. FULLER. I would agree that having more debt—having the debt levels we have is not good for our economy either. That is a different question than do we take it out of the backs of small businesses. It is how we do this that ought to be discussed and not whether it is done.

Mr. MULVANEY. And Dr. Fuller, just so I understand, the numbers that you used, were they just the defense cuts or were they the entire sequester?

Mr. FULLER. The 2.1 million job losses is the entire sequester as spread across the nondefense agencies as well.

Mr. MULVANEY. Thank you, Dr. Fuller.

Mr. Chairman, I will say again, you and I have worked tirelessly over the last two years trying to make the argument that government spending does not create jobs, and yet now I see us relying almost exclusively on the argument that reducing this spending will cost us jobs. We cannot have it both ways, and in fact, by doing this I feel we open ourselves up to claims of hypocrisy. The sequester cuts will harm the military. There is no question about it. It will harm our ability to defend our nation. And I continue to think that that is the focus that we should be taking and we should focus instead not on the job losses that come from the sequester. I think it is easy to make the argument; hard to prove the argument. I think instead it should be focusing on where else we could save the

money instead so that we can move the money from wasteful programs into actually defending the nation.

With that I thank you and I yield back the balance of my time.

Mr. WEST. The chairman yields back. And I would like to dovetail off what my good colleague said because I do not support, you know, looking at the DoD as a job creation program. But when I go to the Constitution and I look at Article 1, Section 8, and a lot of the tasks that are listed for us as members of Congress, to define and punish piracies and felonies committed on the high seas and offenses against the law of nations; to declare war, grant letters of Marque, rules concerning captures on land and water; to raise and support armies but no appropriation of money, to that use shall be for a longer term than two years; to provide and maintain a Navy; to make rules for the government and regulation of the land and naval forces; to provide for the calling forth of the militia; to execute the laws of the Union, suppress insurrections, and repel invasions; to provide for organizing, arming, and disciplining the militia.

So I think that the thing that we have to understand is that the men and women in uniform are not the ones out there building the ships. They are not the ones out there building the planes. I often tell people the great story of the USS Yorktown during World War II and how it was severely damaged during the Battle of the Coral Sea, to the point where the battle damage assessment was six months. When it got back into port at Pearl Harbor, Admiral Nimitz said we do not have six months. The USS Yorktown steamed out of Pearl Harbor in less than two weeks. Those were not sailors that did the repairs on the USS Yorktown. That was a defense industrial base that made that happen.

Now, what is the point of the story? The USS Yorktown joined up with the rest of the Pacific Fleet at a place called Midway. And if you understand your history, you understand exactly what happened in turning the tide in the Pacific at Midway. So I am not an advocate for looking at defense as a job creation program but I know this. Having spent 22 years in the military, all of a sudden we are about to tell our men and women out there that they may not get the support that they need because we are about to gut out an industrial base that supports them and I think that is the stance that we should take and I think that is the stance that everyone can agree upon.

My last question. In DoD's written testimony they said that when the pool of available contracting dollars is diminished as it would be under sequestration, their ability to partner with small businesses is likewise diminished. I know that NDIA and NSBA both sent the Committee letters of support for our contracting reforms earlier this year, but I think this statement makes the need to raise the small business goal more important than ever. As we talk about sequestration for the panel, do you think we should still be focused on these contracting reforms?

Ms. MACKEY. I think it is really important that we enable the DoD to behave in a way that maintains our small business base. So I would say those contracting reforms are important well beyond the goal setting, but the very practical approach to how to manage

contracting and how to make sure there is more transparency to keep the playing field level.

Ms. MONCRIEFF. I also agree that we need to uphold the contracting goals and hold the DoD to the same federal contracting goals of other agencies. And just as an example, I had a recent discussion with a very large multinational global that went through—an industrial base that went through an incredibly bad time five years ago. And their kneejerk reaction was to cut out a lot of small business and depend on larger companies. They have now gone back and analyzed the impact of that and they are now wanting to reverse that trend and reach back now five years later to do more contracting with small business because what they figured out in doing less small business contracting is that in the end it is costing them much, much more money. So, yes, I think it is very important.

Mr. GROSS. I further that sentiment. I believe that DoD should be held to the same standard everybody else is as far as the subcontracting goals for small business or contracting goals for small business. I think that we are all prepared for budget cuts, all of us. It has to happen. We understand that. I do believe taking a more surgical look at redundancies, non-mission critical agency, non-mission critical programs, that sort of thing is the way to do that. I am not a big proponent of cutting SBA. It is the only advocacy agency we have out there and so I would think that any cuts at SBA are really going to hurt small business.

Mr. WEST. Thank you, and I yield to Ranking Member Velázquez.

Ms. VELÁZQUEZ. Thank you. And following what you just said, that you believe that cuts, $75 million to an agency that has suffered so much in the past in terms of budget cuts will be detrimental to the same small business contractors that are sitting here. So if we do not want for DoD—if we do not support DoD's defense cuts because of sequestration, and we do not want to cut SBA because it is the watchdog that will make sure that DoD will achieve those contracting goals, it means that we cannot have it both ways. So there are some of us who are proposing a balanced approach and that will call for domestic spending cuts but also the revenue side. Otherwise, we are going to defeat the purpose. We will not touch DoD. But on the other hand we are going to impact, negatively impact the very same small business contractors that we are trying to protect.

Thank you, Mr. Chairman. I yield back.

Mr. WEST. Thank you, Ranking Member. I think we also need to realize that we already put $487 billion of cuts on the DoD over the next 10 years, and this $500 billion is in addition to that. So you are looking at 19.6 percept of our budget getting about 55 percent of budget cuts.

Thank you all for participating today. While I support strong cuts to curb America's severe spending habit, sequestration is not the proper remedy. Today's testimony highlighting the need for the administration to work with Congress to ensure that small businesses, our nation's innovators and job creators, are not unduly burdened under sequestration.

I ask unanimous consent that members have 10 business days to submit statements and supporting materials for the record. Without objection, so ordered. This hearing is now adjourned.

[Whereupon, at 3:10 p.m., the Committee was adjourned.]

Statement

of

The Honorable Michael J. McCord
Principal Deputy Under Secretary of Defense (Comptroller)

and

Mr. Richard Ginman
Director, Defense Procurement and Acquisition Policy

Before the
Committee on Small Business
U.S. House of Representatives

September 20, 2012

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by the
House Committee on Small Business

Chairman Graves ... Ranking Member Velazquez ... Members of the Committee. My name is Mike McCord. I am Principal Deputy Under Secretary of Defense (Comptroller).

Appearing with me today is my colleague Dick Ginman, Director of Defense Procurement and Acquisition Policy in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (AT&L). He is a career Civil Servant, with more than 40 years' experience in government and commercial business in the fields of contracting, acquisition, and financial management. The Comptroller organization has the overall lead in dealing with sequestration matters, and AT&L is responsible for contracting and small business policy.

We are here this afternoon to speak about the Joint Committee sequestration and its potential impact on the Department of Defense and the industrial base, including the many small contractors that DoD relies on.

We would like to begin by thanking you for your support of the dedicated men and women who wear America's uniform. Your concern for their well-being is much appreciated, as is your commitment to the nation's security.

The leadership of DoD shares your concerns about the Joint Committee sequestration. Consequently, as you know, Secretary Panetta has been emphasizing for many months that sequestration would have devastating effects on the Department, on the Services, and virtually every other Federal agency. He urged Congress to avoid sequestration by approving a comprehensive and balanced deficit reduction package that the President can sign. He also reminded Congress that, back in February, the President's Budget for FY 2013 contained a proposal for just such a balanced reduction.

This message was delivered yet again this morning when Under Secretary Hale and the Vice Chiefs of the Armed Services testified before the House Armed Services Committee.

Their statement reiterated the fact that sequestration was designed to be an inflexible policy that would never be implemented. It was enacted as a way of encouraging Congress to pass a comprehensive package to reduce the federal deficit.

If Congress fails to act on a balanced deficit reduction plan to avoid sequestration, it could harm the management of many defense investment programs, introduce inefficiency into the defense industry that supports us -- including small business – and cause long-term disruptions, even if the reductions only extend for one year. The Joint Committee sequestration would seriously disrupt our forces and programs and our workforce.

Impacts of Sequestration

Last week, as required by the Sequestration Transparency Act of 2012, the Administration transmitted a report to the Congress showing the impact of sequestration on accounts across the Federal government, including in the Department of Defense.

Sequestration requires that the national defense function be reduced by almost $55 billion in FY 2013. Based on the assumptions in the Sequestration Transparency Act report, this would lead to an estimated 9.4 percent reduction in non-exempt discretionary defense programs. If allowed to go into effect, the reductions in FY 2013 and the lowering of the discretionary caps in the out years (FY 2014 through FY 2021) could force us to modify and scale back the new defense strategy that the Administration introduced just a few months ago.

Moreover, sequester would apply to the bulk of the DoD budget, including additional amounts provided for Overseas Contingency Operations (OCO). The only major exception is for military personnel funding, which the President indicated would be exempt from any sequestration in FY 2013. This is the only optional exemption authorized under the 1985 Balanced Budget and Emergency Deficit Control Act (BBEDCA), as amended; all other exempt and non-exempt determinations are based on requirements in the law. However, the reduction in other defense budget accounts will have to be increased to make up the difference because the amount of sequester applied to the national defense function does not change with the exemption of military personnel funding.

In addition to the damage that making cuts of this magnitude necessarily implies, the law requires that the cuts be applied in an across-the-board manner to all non-exempt funding. To the extent we would have any flexibility, we would attempt to protect some high-priority projects from reductions. But our ability to moderate impacts under sequestration would be limited.

We have reviewed the law and identified some of the key impacts sequestration would have on the Department.

As noted earlier, OCO funding – which pays for the added costs of wartime activities – is subject to sequester. Supporting our warfighters in combat is DoD's highest priority. We would therefore endeavor to protect wartime operating budgets as much as possible, within the key operation and maintenance (O&M) accounts.

The O&M accounts contain OCO and base-budget funding, and these two categories of O&M funding merge together during execution of DoD budgets. We could reduce the base-budget portions of O&M disproportionately to reduce the impact on war activities funding through OCO. To some extent, we could take similar steps as needed in some other accounts that include OCO funding.

Protecting OCO funding would lead to larger cuts in base budget O&M, especially for the Army and the Marine Corps. As a result, while we would seek to minimize effects on training and readiness, we could probably not do so fully.

Training in the other military services would also be affected. Air Force flying hours for pilots could be reduced by several hours a month, and Navy steaming days could decline by several days a quarter. The result will be reduced training and lower readiness for some units.

Sequestration would also force us to reduce civilian personnel funding, possibly including a partial hiring freeze or unpaid furloughs, which would curtail important capabilities.

And military families and retirees would be affected, as we would face cuts to base support services, facility maintenance, and maintenance of government owned family housing. Commissary hours could be reduced. Funds for the Defense Health Program would be sequestered, resulting in delays in payments to service providers and, potentially, some denial of service for retirees and military dependents.

Inevitably, sequestration would also lead to disruption of DoD's investment programs. As estimated in OMB's report, there would be a 9.4 percent reduction in each of the non-exempt discretionary budget accounts that fund defense operations; procurement; research, development, test, and evaluation; and military construction projects. Those who manage these programs would be forced to join many other acquisition managers in non-defense agencies as they seek to accommodate the reduced funding for FY 2013, three months into the fiscal year.

We were asked to address the consequences of sequestration on the small business community specifically. DoD is committed to ensuring that these essential business partners have their fair share of contracting dollars. But when the pool of available contracting dollars is diminished, as it would be under sequestration, our ability to partner with small businesses is likewise diminished. It is important to recognize that prior-year funding already obligated on contracts would not be subject to sequestration. Nevertheless, sequestration would mandate cuts in discretionary funding that would disrupt small business funding for defense and non-defense programs alike.

The Secretary, Deputy Secretary, and the Under Secretary for Acquisition, Logistics, and Technology have voiced their commitment to small businesses. DoD has steadfastly worked to sustain, and where appropriate increase, the percentage of contracting dollars it provides to small businesses. We will maintain that commitment, with or without a sequestration, and will give small businesses a fair share of the contracting opportunities. But a sequestration, with its associated spending cuts, would reduce our overall budget, necessarily forcing cuts in buys from all businesses, large and small.

Next Steps on Sequester

While we can foresee the many harmful impacts of sequester, we cannot devise a plan that would eliminate or even substantially mitigate them. Again, sequester defies rational planning, as was intended. Congress has time to enact a balanced deficit reduction plan that would avoid sequestration. In the unfortunate event that sequestration is actually triggered, we will work with OMB and – like all the federal agencies affected by this law – we will be ready to implement it.

At this point we have another undesirable possibility before us, which is that sequestration may not happen but we could end up triggering some of its bad effects anyway. For example, we do not want to unnecessarily alarm our employees by announcing adverse personnel actions or by suggesting that such actions are likely. We do not want to hold back on the obligation of funds – for weapon projects or operating programs. That would introduce inefficiency and waste. Nor do we want to cut back on training, which would harm military readiness in a period when we face a complex array of national security challenges. But in the charged budgetary environment today, this concern is very real.

Finally, we understand that the many private companies – large and small -- that serve the Department of Defense and constitute important members of our national security team will be making decisions on issues related to sequester. They face many of the same dilemmas we do, and a number of them have expressed alarm at the wasteful and disruptive way sequester would affect the management of taxpayer money and the talents of their employees.

Conclusion

In short, sequester would be devastating to DoD and to every other Federal agency. The best outcome for the Department of Defense and for private companies -- large and small -- is for Congress to enact a balanced deficit reduction plan that halts implementation of this inflexible law. The men and women of DoD and their families need to know with certainty that we will meet our commitments to them. Our partners in the defense industry and their employees are likewise entitled to know that we are going to have the resources to procure the world class capabilities they can provide. Perhaps more importantly, allies and potential foes alike need to know that America has the political will to implement the defense strategy we have put forward.

Thank you very much. We welcome your questions.

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Congress of the United States
U.S. House of Representatives
Committee on Small Business

Hearing on Impacts of Sequestration on Small Business

Testimony By

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Arlington, Virginia
September 20, 2012

The Economic Impacts of Sequestration on Small business

Total GDP and Job Impacts of Sequestration

The economic impacts of sequestration, as imposed by the Budget Control Act of 2011 (BCA), have been analyzed and found to be large and significant. I prepared a report entitled "The Economic Impact of the Budget Control Act of 2011 on DOD and Non-DOD Agencies" (July 17, 2012) that measured these impacts building on previously analyses prepared by the Congressional Research Service and the Congressional Budget Office. These analyses establish the magnitudes of these economic impacts across both the public and private sectors inclusive of large and small businesses. These total impacts can be summarized as follows:

With spending reductions totaling $115.7 billion in FY 2013 from FY 2012 authorized levels for DOD and Non-DOD agencies—$56.7 billion and $59.0 billion respectively—U.S. gross domestic product growth projected for 2013 would be reduced by $215.0 billion erasing approximately two-thirds of the currently projected gains in GDP for next year. While the U.S. economy is struggling to sustain its recovery and any sudden loss of economic activity of this magnitude could derail its fragile performance, the loss of jobs associated with these spending reductions would have far reaching implications. My analyses of the BCA of 2011 spending reductions found that these federal spending cutbacks would generate 2.1 million job losses nationwide.

The direct job losses resulting of sequestration would total 746,222 and consist of: (1) federal workers whose jobs would be lost due to reductions in agency payroll

and (2) employees of federal contractors whose employment depends directly on the federal contracts that would be terminated.

These federal contractors support a large number of subcontractors, suppliers and vendors. As a result, the spending reductions directly impacting the prime contractors would result in the loss of 432,978 additional jobs in both the supply chain and in businesses that otherwise depended on indirect transactions supported by federal contract awards.

The loss of these jobs and their payrolls would reduce consumer spending, the loss of which would impact every sector of the economy and their respective businesses across the country. These are the businesses and workers that depend on the spending of payroll of the jobs lot to sequestration and are principally found in retail, restaurant, health care, education, personal services, construction, housing, and local government sectors. These sectors would lose 958,508 jobs as a result of sequestration.

Table 1 below identifies these job losses by source and type.

Table 1

Employment Impacts of the Budget Control Act of 2011 in 2013

Type of Job Loss	Spending Reductions		
	DOD	Non-DOD Agencies	Total
Direct Job Losses	325,693	420,529	746,222
Federal Jobs	48,147	229,116	277,263
Contractor Jobs	277,546	191,413	468,959
Indirect Job Losses*	282,426	150,552	432,978
Induced Job Losses**	482,240	476,268	958,508
Total Job Losses	1,090,359	1,047,349	2,137,708

Source: "The Economic Impact of the Budget Control Act of 2011 on DOD and Non-DOD Agencies," by Stephen S. Fuller, Ph.D. (July 17, 2012). *suppliers and vendors and sub-contractors dependent on federal contractor spending; **jobs supported across all sectors supported by payroll spending by federal workers and employees of federal contactors losses due to federal spending reductions in FY 2013.

The significance of these job losses is seen in their impact on the unemployment rate. The addition of these laid off workers to the unemployment rolls would add an estimated 1.5 percentage points to the current unemployment rate, increasing it to 9.5% if the current rate holds to into 2013.

Collateral Impacts of Sequestration

Sequestration would generate other impacts than those directly linked to reductions in federal payroll and procurement outlays. These impacts would result from the reaction of businesses and individual consumers to the increased uncertainty generated by the national economy's declining performance in response to sequestration. Some of these economic impacts would be driven by behavioral factors—the loss of consumer confidence may suppress spending especially spending requiring credit such as for autos and housing, personal saving may increase taking further disposable income out of the economy, business investment and private sector hiring may be dampened as a result of increased uncertainty all contributing to further weakening of the economy's performance. These and other collateral impacts will enlarge the negative consequences of the initial federal spending reductions and contribute to further deepening a potential economic contraction in 2013 thereby extending its duration and increasing its magnitude.

Additionally, the impacts of sequestration would substantially disrupt the economy as a consequence of reductions in government services from the layoffs of federal workers and curtailment of federal programs. At a minimum these disruptions would slow commerce and undermine efficiency. As some federal services would face elimination or suspension for an extended period, these disruptions could result in significant reductions of business activity and increased costs impacting exports, business travel, tourism, health and food safety, and security, and would likely extend to the public safety and education services provided by local governments.

Other costs will occur over a longer timeframe resulting from deferred or foregone innovation by both federal agencies and private entrepreneurs. These disruptions to the U.S. economy will have cumulative impacts with far-reaching and potentially more significant consequences than the initial first-year impacts. While these costs may be difficult to quantify in the short term, they need to be recognized and acknowledged before the full economic consequences of sequestration can be properly assessed.

The economic impacts of sequestration will not be distributed evenly across all states but they will impact all states. Similarly, these economic impacts will not be equally distributed across all sectors of the economy or types and sizes of businesses. Like all economic impacts, the respective hardships will be a function of the businesses' or workers' abilities to absorb the costs and shift into more promising ventures and occupations. Small businesses and their workers will be especially vulnerable to both the initial economic impacts of sequestration and the consequences of these initial impacts as they affect their abilities to reposition themselves in a national economy struggling to regain traction in a weak global economy.

The Economic Impact of Sequestration on Small Businesses:
By the Numbers

The impact of the BCA of 2011 on both the public and private sectors, with the projected loss of 2.1 million jobs in FY 2013, will have a significant effect on small businesses and their employees. Workers in small businesses would suffer more than fifty percent (51.6%) of the projected job losses due to the spending reductions mandated by the BCA of 2011.

- DOD spending reductions would result in the loss of 520,398 jobs in small businesses accounting for 50.2 percent of all private sector job losses generated by mandated cutbacks under sequestration; and,

- Non-DOD agency spending reductions would result in the loss of 435,782 jobs in small businesses accounting for 53.4 percent of all private sector job losses generated by mandated cutbacks under sequestration.

Table 2

Summary of the Employment Impacts of the
Budget Control Act of 2011 on Small Businesses, FY 2013

Sources of Impact	Federal Spending Reductions		
	DOD	Non-DOD Agencies	Totals
Direct Federal Contractor Job Losses*	81,552	76,047	157,598
Percent of All Federal Contractor Job Losses	29.9	40.1	34.1
Total Small Business Job Losses**	520,398	435,782	956,181
Percent of all private sector job losses	50.2	53.4	51.6

Sources: GMU Center for Regional Analysis and Chmura Economics & Analytics. *See Table 3 for state-by-state distribution of direct jobs losses by small businesses; **see Table 4 for state-by-state distribution of total job losses by small businesses.

Small businesses will be impacted by the immediate reductions in federal procurement spending resulting from sequestration (direct impact), as

subcontractors, suppliers and vendors (indirect impacts), and as businesses supporting the retail and consumer service needs of the workforce (induced impacts) that would experience layoffs and the loss of labor income due to sequestration. This latter class of small businesses would span the economy although would be concentrated in retail and consumer service sectors and be located throughout shopping districts and small communities across the country.

The direct impacts on small businesses from sequestration—small businesses that are federal contractors—would result in the immediate loss of 157,599 jobs representing 34.1 percent of all federal contractor jobs (462,211 jobs) lost under sequestration. That this percentage is less than the 51.6 percent of the total job losses that small businesses would experience from sequestration (direct, indirect and induced) underscores the vulnerability of small businesses to these spending reductions. Many small businesses are subcontractors, suppliers and vendors to larger-scale businesses that are the prime federal contractors. As such, these subcontractors, suppliers and vendors are at the mercy of their primes and the acquisition-policy adjustments these large businesses may implement in response to changes in their backlog, profitability, or business outlook. These subcontractors, suppliers and vendors have little recourse when their contracts with their primes are scaled back or terminated; in fact the suppliers and vendors may not even know that their business is linked to a federal contract that could be canceled due to something called "sequestration."

Approximately 1.4 million indirect and induced private sector jobs—jobs of businesses that are subcontractors, suppliers and vendors, or jobs dependent on the spending of federal and contractor payroll—would be lost due to federal spending reductions with almost fifty-eight percent (57.7%) of these jobs losses coming from small businesses. Small businesses and their workers are particularly vulnerable to these indirect and induced impacts that would undermine these firms' viability and threaten their survival even though many are not even doing business with the federal government.

The Economic Impact of Sequestration on Small Businesses: The Collateral Impacts

That small businesses are more vulnerable to changes in the economy than large businesses is well established in the literature. Among the factors explaining this greater vulnerable is their more limited access to financial resources, their greater dependency on fewer product and service lines of business, their smaller business backlogs, the more limited adaptability of their workforce, and the smaller margins of their economies of scale.

The measurements of job impacts associated with sequestration calculate only the job-equivalent of the direct spending reductions and their subsequent impacts on the economy due to the loss of federal spending or its payroll effects on consumer purchasing power. What is not included is any consideration for the induced

failures of small businesses from the partial losses of federal contracts or subcontracts.

While large firms may suffer financial losses as a result of a federal contract cancelation, these firms have sufficient scale of operations to survive through adjustments to their variable costs and most are able to absorb losses over the period required to adjust their business base, downsize, right size or re-position to regain profitability. A typical strategy of prime contractors when experiencing a reduction of contracting or business slowdown is to bring work that had been subcontracted to outside firms back into the base firm. Large businesses have the ability to re-absorb business from their subcontractors and other suppliers and vendors where this capability is less likely among small businesses. The fact that small businesses are more likely to be subcontractors and constitute a greater percentage of businesses impacted by the indirect and induced impacts of sequestration makes them more vulnerable to the predictor business strategies of larger prime contractors.

Small businesses are less able to sustain themselves when they experience a loss of a contract, either as a prime or subcontractor. Due to the narrower economies-of-scale that characterize the operations of most small businesses, the loss of even a small portion of their projected backlog or the cancelation of a contract could result in these firm's becoming unsustainable. Small businesses typically do not have the financial resources to sustain unprofitable operations for a sufficiently long period to permit restructuring and alternative product or market development.

The same dilemma facing small businesses with their limited resource base that makes adjusting to an abrupt change in business volume applies to their workers. Employees in small businesses may be more specialized or less networked than employees in large businesses thereby making their re-employment more challenging than for employees working in large businesses experiencing cutbacks or cancelations of federal contracts. These workers in larger businesses may have the opportunity for reassignment to another division in the same company when the contract they have been working on is canceled. Additionally, transfers within these companies to other locations may also re-employ some of these workers. And, larger firms tend to be located in larger economies that may offer more opportunities for re-employment. Small businesses and their workers are more vulnerable to cutbacks and the consequences can cascade beyond the immediate impacts accounted for by the econometric models.

Conclusions

The size and specialized nature of small businesses make them more vulnerable to sequestration than large businesses. As a result, small businesses will bear a disproportional impact of the federal spending reductions under sequestration. While these impacts can be measured in the loss of jobs by small businesses that are prime federal contractors (34.1% of all prime federal contractor job losses), small

businesses that are subcontractors, suppliers and vendors and whose existence depend on consumer spending that would be negatively impacted by the losses of labor income resulting from sequestration, would account for 57 percent of the associated job losses across the country. Not only will small businesses shoulder a disproportional share of the jobs losses attributable to sequestration but their ability to survive these losses and remain viable further challenges the efficacy of sequestration.

Table 3

State Employment Impacts on Small Businesses
of the Budget Control Act of 2011in Fiscal Years 2012 and 2013

	Small Business Job Losses, DOD Cuts	Small Business Job Losses, Non-DOD Cuts	Total Small Business Job Losses
Alabama	12,812	4,965	17,777
Alaska	2,813	1,880	4,692
Arizona	16,823	5,801	22,623
Arkansas	1,719	2,308	4,027
California	64,532	37,553	102,085
Colorado	8,802	10,036	18,838
Connecticut	17,292	2,377	19,668
Delaware	31	889	920
District of Columbia	7,240	46,700	53,940
Florida	20,000	15,626	35,626
Georgia	13,177	11,194	24,371
Hawaii	3,750	1,178	4,928
Idaho	469	3,923	4,392
Illinois	11,094	12,653	23,748
Indiana	7,135	3,741	10,877
Iowa	2,500	2,446	4,946
Kansas	2,969	3,193	6,162
Kentucky	8,125	4,835	12,960
Louisiana	9,010	3,975	12,985
Maine	2,031	1,253	3,285
Maryland	18,802	31,373	50,175
Massachusetts	19,792	7,917	27,709
Michigan	6,458	7,356	13,814
Minnesota	2,344	4,628	6,972
Mississippi	2,500	2,677	5,177
Missouri	16,042	7,273	23,315
Montana	468	1,691	2,159

Nebraska	1,249	1,668	2,918
Nevada	2,031	2,561	4,592
New Hampshire	1,719	1,126	2,844
New Jersey	12,136	7,388	19,523
New Mexico	2,344	9,787	12,131
New York	13,750	17,143	30,893
North Carolina	5,677	7,254	12,931
North Dakota	469	1,032	1,501
Ohio	10,156	7,957	18,113
Oklahoma	3,802	3,267	7,070
Oregon	1,406	3,755	5,161
Pennsylvania	19,063	16,025	35,087
Rhode Island	1,250	778	2,028
South Carolina	7,031	6,500	13,532
South Dakota	938	1,139	2,077
Tennessee	4,843	12,055	16,898
Texas	47,240	25,170	72,410
Utah	3,958	3,220	7,179
Vermont	1,094	736	1,830
Virginia	65,000	29,700	94,700
Washington	8,125	10,261	18,386
West Virginia	469	3,772	4,240
Wisconsin	13,177	3,722	16,899
Wyoming	312	884	1,196
Guam	1,041	204	1,245
Puerto Rico	1,041	1,272	2,312
Undistributed	12,348	17,965	30,313
Totals	520,398	435,782	956,181

Table 4

Direct Impact on Small Business Contractors (<500) Employment
of the Budget Control Act of 2011 Fiscal Years 2012 and 2013

	Small Business Direct Jobs Losses DOD Cuts	Small Business Direct Job Losses, Non-DOD Cuts	Total Small Business Direct Jobs Losses
Alabama	2,008	866	2,874
Alaska	441	328	769
Arizona	2,636	1,012	3,649
Arkansas	269	403	672
California	10,113	6,553	16,666
Colorado	1,379	1,751	3,131
Connecticut	2,710	415	3,125
Delaware	5	155	160
District of Columbia	1,135	8,149	9,284
Florida	3,134	2,727	5,861
Georgia	2,065	1,953	4,018
Hawaii	588	206	793
Idaho	73	685	758
Illinois	1,739	2,208	3,947
Indiana	1,118	653	1,771
Iowa	392	427	819
Kansas	465	557	1,022
Kentucky	1,273	844	2,117
Louisiana	1,412	694	2,106
Maine	318	219	537
Maryland	2,946	5,475	8,421
Massachusetts	3,102	1,382	4,483
Michigan	1,012	1,284	2,296
Minnesota	367	808	1,175
Mississippi	392	467	859
Missouri	2,514	1,269	3,783
Montana	73	295	368
Nebraska	196	291	487
Nevada	318	447	765
New Hampshire	269	196	466
New Jersey	1,902	1,289	3,191
New Mexico	367	1,708	2,075
New York	2,155	2,992	5,146

North Carolina	890	1,266	2,156
North Dakota	73	180	254
Ohio	1,592	1,388	2,980
Oklahoma	596	570	1,166
Oregon	220	655	876
Pennsylvania	2,987	2,796	5,784
Rhode Island	196	136	332
South Carolina	1,102	1,134	2,236
South Dakota	147	199	346
Tennessee	759	2,104	2,863
Texas	7,403	4,392	11,795
Utah	620	562	1,182
Vermont	171	129	300
Virginia	10,186	5,183	15,369
Washington	1,273	1,791	3,064
West Virginia	73	658	732
Wisconsin	2,065	650	2,715
Wyoming	49	154	203
Guam	163	36	199
Puerto Rico	163	222	385
Undistributed	1,935	3,135	5,070
Totals	81,552	76,047	157,598

TESTIMONY OF ML MACKEY
CEO OF BEACON INTERACTIVE SYSTEMS
ON BEHALF OF THE
NATIONAL SMALL BUSINESS ASSOCIATION

AT A HEARING BEFORE THE
U.S. HOUSE COMMITTEE ON SMALL BUSINESS

"SEQUESTRATION: THE THREAT TO SMALL BUSINESSES, JOBS, AND THE INDUSTRIAL BASE"

SEPTEMBER 20, 2012

Good afternoon. Chairman Graves, Ranking Member Velazquez, and the Members of the Committee, thank you for the opportunity to testify here today and for your tireless efforts to promote economic development and job creation in America's small-business community. Your continued leadership on critical issues such as the one before us today and your collective ability to understand and shed light on the challenges facing small business in the federal marketplace is invaluable and greatly appreciated.

My name is ML Mackey, and I am the CEO of Beacon Interactive Systems, a small business located in Cambridge, Massachusetts. I am also on the Board of Trustees of the National Small Business Association (NSBA).

18 years ago my husband and I co-founded our company out of our rent-controlled apartment on Beacon Street. We built the company as a provider of commercial systems initially providing software products to companies like Olympus, MetLife and IBM. For the past nine years, we have worked as a federal contractor delivering efficiency improving and cost-savings applications to the Department of Defense (DoD). The Navy is currently using products we developed through the highly successful Small Business Innovation Research (SBIR) program to improve performance of the equipment maintainers deployed across U.S. Fleet Forces Command, the sailors who keep our ships mission ready. At full deployment of our software, initial estimates on cost-savings and cost-avoidance are in excess of $40 million; all on an initial SBIR investment of $5.5 million. This is the kind of cost savings and efficiency improvements that small businesses provide for the DoD, exactly the approach needed in these austere times.

The federal budget deficit has exceeded $1 trillion in each of the last three fiscal years and is expected to exceed that level in Fiscal Year 2012. Concerns over these large deficits, as well as the long-term trajectory of the federal budget, have resulted in considerable uncertainty among small businesses like mine. According to NSBA's recently released Mid-Year Economic Report[1], 68 percent of small businesses said that economic uncertainty is the most significant challenge to the future growth and survival of their business. Today, 34 percent of small-business owners anticipate a recessionary economy in the coming year – the highest it's been since December 2009[2].

Therefore, while I recognize that the current fiscal environment will require lawmakers to make some tough choices that will have a significant impact on the size of the budget deficit and the pace of our economic recovery, I, along with many of my counterparts across the country, am very concerned with the proposed arbitrary approach to sequestration. Simply cutting the top line of non-exempt agency budgets is not based on a rational assessment of the relative effectiveness or usefulness of various programs. It has the potential to devastate key programs and, specifically, to have a disproportionate impact on small business. While major program cuts will be necessary inside federal agencies, these cuts should be made with a purposeful and thoughtful approach in order to not only ensure an equal impact across the defense industrial base but also to ensure a rational approach that does not gut the advances made in government procurement to this point.

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[1] NSBA 2012 Mid-Year Economic Report (http://www.nsba.biz/docs/2012Mid-Year-Economic-Report.pdf)
[2] *Id.*

Today, I am speaking to you as someone who has already felt the effects of this uncertainty. We, like many other small businesses in this sector, have had to tighten our belts in anticipation of the rough times ahead. In spite of successful pursuit of new opportunities, we have purposefully trimmed our workforce. This is counter to how we have strategically built our business over the last 18 years. Previously, once we closed a big opportunity the first thing we did was evaluate our team and act on ways to improve our capabilities like defining new roles and hiring new employees. This approach has not only kept us viable, but has helped us expand our business and create jobs. Unfortunately, given the uncertainty surrounding sequestration, this is not the approach we are taking now. And, generally speaking, we're not alone. The number of small-business owners who project increases in employee size in the coming 12 months dropped from 30 percent in December 2011 to 25 percent today[3].

I am by no means the first business owner, nor will I be the last, to tell a Congressional panel that sequestration will have major, negative impacts in areas ranging from business survival to national security. Nor will I be the last to argue that something must be done to stabilize our economy. Surely Congress can craft a more deliberate and careful approach than the current strategy, which will lead to considerable job loss and greater economic uncertainty at a time when job creation and economic growth remain a top priority for our country.

The federal contracting and acquisition systems are over taxed and have struggled with efficiency and transparency issues for years. This problem will only get worse with

[3] *Id.*

sequestration in place. The contracting staff of Federal agencies will likely face major personnel reductions under sequestration. As a result, we're likely to see an increase in contract bundling and a less efficient, less predictable contracting system. This will have a major impact on small business contractors who are likely to be the first to go on many projects. According to NSBA's most recent Politics of Small Business Survey[4], 99 percent of small-business owners are registered to vote, 97 percent said that they regularly vote in national elections, and the 25 percent of small businesses who have contacted their elected officials on a small business issue have done so on the matter of contracting.

Small businesses create efficiencies. We are agile and flexible, which saves the government money. We believe that program managers and contracting officers should be incentivized to create efficiencies and cost savings through increased work with small business, not the other way around. Small businesses around the country are waiting on funds from previously awarded contracts, large businesses are contemplating mass layoffs and the end users, our men and women in uniform and the people who are served by our federal government, are waiting for products and services they expected months ago.

Washington needs to set their differences aside and not use the excuse of an election year or partisan gridlock to short change America's small businesses and the broader public. We cannot afford to wait and fix our economy or shore up our industrial base after it has

[4] NSBA's The Politics of Small Business Survey (http://www.nsba.biz/wp-content/uploads/2012/06/Politics-of-Small-Business.pdf)

been decimated. If sequestration happens, DoD contracts being competed now or in the near term may be cancelled with little recourse for contractors. Business owners don't know which opportunities are real and which are illusory, causing a massive waste of our limited resources. Businesses are frozen, in need of personnel but unable or unwilling to hire because of this uncertainty.

Congress, to its credit, has increasingly recognized the benefits of small business engagement. The small business contracting reforms incorporated into Title XVI of the FY2013 National Defense Authorization Act (NDAA) are a positive step forward and incent behavior that incorporates the efficiency and cost savings approach that our small businesses are known to provide. These are the kind of proposals that will push the federal government toward greater efficiency.

I know that pointing out problems is far easier than finding solutions. The path ahead will definitely be challenging. Having said that, as a small business owner, I can state unequivocally that we are a critical component of the solution to our government's fiscal concerns.

I applaud this committee for your vigilance in promoting small-business friendly policies and your work to reinforce the idea in your colleagues that small business is a value added proposition for the government, and an enabler of innovation and growth.

I appreciate the opportunity to be here today and I welcome your questions.

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United States House of Representatives
Committee on Small Business
Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base

Testimony for the Record

Presented by Laurie Moncrieff
President, Adaptive Manufacturing Solutions, Inc., Burton, MI
On behalf of the
National Defense Industrial Association

Mr. Chairman, Madam Ranking Member, and Ladies and Gentlemen:

On behalf of the 1,756 corporate members and over 96,000 individual members of the National Defense Industrial Association (NDIA), I would like to thank Chairman Sam Graves, Ranking Member Nydia Velazquez and all the members of the Committee for holding this important hearing on Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base.

We are all painfully aware that in the past 10 years the U.S. has experienced an economic downturn second only to the "Great Depression." The most severe impact has been felt by small businesses, particularly in several critical industrial sectors.

Even in a good economy, small businesses have to navigate barriers and challenges. However, through this downturn they have experienced a significant decrease in customer orders; struggled with layoffs and the associated effects on the workforce; loss of access to capital (including the redlining of geographic regions); watching opportunities for business development slip away; feeling the pain of plant closures; and, all too often, suffering financial ruin-all at an unprecedented magnitude.

During any economic decline, small businesses can only reduce their staff so far and still be a government contractor. As business declines government contractors still need core staff to search for contracts, manage programs, inspect, and perform the necessary administration which requires a tremendous amount of overhead. Also, understand that as demand declines, costs increase due to

the inability to spread overhead costs over the needed volume of work, leading to a vicious cycle downward.

Erosion of critical industrial sectors has escalated the need to study and identify trades that are critical to reviving the U. S. economy and, more specifically, our homeland security and defense industrial base. The output of these eroded industries is still widely needed to produce product worldwide. These industries are critical to national security, needed for the health and revitalization of our national economy, and are recognized as an integral part of our National Innovation System.

The vast majority of the companies classified in the critical industries are small businesses with 50 or fewer employees. Please take a look at the chart[1] in your printout: 13 of 16 are considered "eroded".

NAICS	Industry Description	Employment	Economic Activity	Establishments	Overall Status
3315	Foundries	●	○	●	*Eroded*
33211	Forging and Stamping	●	●	●	*Eroded*
33271	Machine Shops	●	○	○	*Healthy*
332811	Metal Heat Treating	○	●	●	*Eroded*
332997	Industrial Pattern Mfg	●	●	●	*Eroded*
333295	Semiconductor Machinery	○	○	○	*Holding Steady*
333314	Optical Instrument and Lens	○	●	●	*Eroded*
333511	Industrial Mold Manufacturing	●	●	●	*Eroded*
333512	Machine Tools (Metal Cutting)	●	○	●	*Eroded*
333513	Machine Tools (Metal Forming)	●	●	●	*Eroded*
333514	Special Die & Tool, Die Set, Jig	●	●	●	*Eroded*
334412	Bare Printed Circuit Boards	●	●	●	*Eroded*
334413	Semiconductor and Related Devices	●	●	○	*Eroded*
334418	Printed Circuit Assemblies	●	●	●	*Eroded*
3345	Nav, Meas, and Cntrl Instruments	●	●	○	*Healthy*
33591	Battery Manufacturing	●	●	●	*Eroded*

As a representative of small business manufacturing, I ask each of you to consider; how can we ever revitalize these critical industries (that have already sustained considerable economic injury); encourage innovation and invention; increase production and demand for new state-of-the-art products; and support and improve national security when small businesses are hit with yet another blow from the astounding budget cuts already taken by the Department of Defense, and then yet another blow from sequestration?

The challenges of the last ten years have made it difficult to identify individual businesses in these segments, to assess what capabilities and capacities exist, and consequently, to match the current needs with the proper resources. It can be easily demonstrated that these small businesses hold irreplaceable intellectual knowledge, which may not reside in the prime contractor community. Yet with the structure of the supply chain today, small business innovation and value-added work is often unrecognized, unrewarded, and under-represented in government awards. Ultimately, it means

[1] Alliance for American Manufacturing, *Manufacturing A Better Future For America,* 7: 274, 2009.

there is an increasing risk that we will continue to lose more and more of these "behind the scenes", innovative- small business suppliers.

The sequestration mandated defense budget cuts will disproportionately impact small business unless we act in a proactive manner. The United States Government and its military strategic thinkers have always subscribed to the basic ancient military principle: "without industry a country cannot maintain an army." I advocate that a certain outcome of blind implementation of sequestration will be further loss in our country's small businesses and challenges in maintaining our military.

Examples of companies and communities that are facing the potential or have already been impacted include:

- Cuts to primes on contracts such as the MRAP, which totals over $6 billion in contracting, will impact over $1.5 billion of sub-contracts performed by small businesses.

- Many small businesses in the Michigan are reporting that they are holding back on hiring and investing in equipment, even though there is demand today, as they are worried that the cuts will lead to large losses in business down the road. Therefore, they are waiting to invest and grow until they know the outcome of potential defense cuts, which will negatively impact our economy.

- The Procurement Technical Assistance Center (PTAC) in Genesee County, Michigan, that works predominantly with small businesses, (as they have no large prime contractors located in their community), has already seen a 30% decrease since its peak in 2010 due to anticipation of defense budget cuts. They are concerned about the number of small businesses that may need to close their doors and the negative economic impacts for an already hard hit community.

- Miller-Holzwarth, a 2007 recipient of the SBA subcontractor of the year award, announced recently that they would be closing their doors. The business located in Salem, Ohio, employed 48 at the time of closing, and manufactured periscopes, vision blocks, ballistic windows, transparent armor and specialty components for the defense industry for more than 35 years. Among the issues affecting their decision to close, was the potential impact of significant business loss due to budget cuts and their concern over evolving trends in defense procurement practices.

- TACOM LCMC awards on the FHTV, M-ATV, FMTV, Stryker, and HMMWV include $539.6 million directly to small businesses and an additional $563.5 million in subcontract awards through March in FY12. This totals over $1.1 billion in the first half of the year, demonstrating the importance of small business in this supply chain.

- Manufacturer of one of a kind High Tech "Hot Press" furnaces used in the manufacture of ceramic body armor plates – If the demand for sustainment of such furnaces is decreased or eliminated the manufacturer which is a small business comprised of 6 employees will simply shut his doors. There is no other application for these furnaces and this business is completely dependent on the DoD supply chain to remain in business. The ability for DoD to reconstitute this capability, if at all, in a minimum of 18 -24 months based on long lead items and unique equipment that is used in the design of the furnace supplied by 2d and 3d tier small businesses.

- Manufacturers of "high strength" carbon used in the manufacture of body armor. Small business suppliers of this item have already demonstrated what happens when the supply chain fails to keep them energized. In 2010 the DoD allowed this key component supplied by small business to be diverted to other worldwide demand for high strength carbon. When DoD again wanted to institute the manufacture of body armor that required this component to be available in the supply chain it simply was not available and the DoD suffered a 12 month lag in delivery times for body armor that was needed in theater. Suppliers of this component will again either divert to other industries our close their doors if the demand for this item evaporates due to DoD's inability to sustain requirements for body armor. To support a DoD surge requirement for this component would again take 12 months or more to support expanded manufacturing requirements.

- Manufacture of carbon tooling, special foils and other production products unique to the manufacture of body armor components. All of these things are manufactured, supported and maintained by small businesses that will be heavily impacted by any reduction in current sustainment requirements. Many of these companies are 2-3 person operations and exist to only support the requirements of Ceradyne body armor manufacturing. If lost, it could take up to 24 months to replace such lost capabilities if needed to support surge requirements within DoD.

Many of these examples highlight negative impacts in anticipation of what is to come but there are perhaps others unknown. Further degradation of the small business base could result in the loss of sectors that are costly to rebuild, if not impossible; reduce competition, lead to the loss of innovation, increase unemployment, further erode skill sets, and a myriad of other unknown repercussions.

Utilizing goods and services produced by our allies is an important part of defense contracting, however this strategy must be more carefully considered. The Department of Defense has already felt

the impact of an ever-increasing number of counterfeit and defective parts in the defense market—a risk that is mitigated by using parts sourced from domestic small businesses. The number of counterfeit parts reported represents only those found; thousands more defective, damaged and substandard parts are likely installed throughout DoD weapons systems and within massive inventories of spare parts. We must consider the safety of our soldiers even as we consider pathways to cost savings.

It is a documented fact that small businesses are critical to the economy: according to the Small Business Adminstration, 99.7% of all employer firms are small businesses. They have created 60-80% of net new jobs since 1990, and account for half of the nation's private sector workforce and GDP. Small business produces 13 times more patents per employee than large firms. The SBA's first Advocacy report produced in 1979 by a task force stated:

"Innovation is an essential ingredient for creating jobs, controlling inflation, and for economic and social growth. Small businesses make a disproportionately large contribution to innovations. There is something fundamental about this unusual ability of small firms to innovate that must be preserved for the sake of healthy economic growth".

That statement is still as true today as was in the 70s.

So what are the considerations that could create new opportunities to revitalize small business, grow the U. S. economy, and strengthen national and global security?

There are several ways we could strengthen the small businesses and increase the value to the Government:

- More direct sourcing to small business. The Executive Office of the President, Office of Management and Budget published a Memorandum dated February 11, 2011 regarding the need to increase small business participation in federal contracting and provided examples of tremendous savings due to small business awards in NNSA, EPA, NASA, DHS, and DoD totaling in excess of $383 million dollars.

- Develop a program to reverse engineer "low hanging fruit" parts that are already in the DoD inventory (examples: vehicle cylinder head assemblies, axles, etc.). Again, to increase the opportunity for small businesses to provide part price reduction.

- Review the process of DCMA. If a quality assurance rep recommends "NO AWARD" on the Pre-Award Survey, the small business has one last chance with the SBA Certificate of Competency (CoC) program. The SBA is responsible for determining if the small business is capable and competent after the contracting officer has determined the company "non-responsible", but in most instances relies on the DCMA Pre-Award Survey and supports the

non-award. I have personal experience with the reams of paperwork and negative results. This process is not only costly to the small business but also to the Government.

- There are many great products and processes that have and continue to originate in small businesses. However, they struggle to connect and bring their product to market. We must work towards the support of more robust avenues for these products to reach the federal and Commercial market so that the $180 billion invested in early stage innovation can actually be realized and multiply.

- Streamline and reduce the amount of paperwork and effort required to find, understand, and submit bids. It is a cumbersome and time consuming process that far too many small businesses are not willing to participate in as they cannot afford to hire the staff and the overhead needed to be successful.

We need to celebrate and support the strength that small business brings to the market, and better leverage these valuable resources. There are many ideas of how to reduce the costs for the Department of Defense but with every decision there are many unintended consequences. I am here today to advocate and ask each and every one of you to carefully consider how your decisions will impact small business. We must consider how decisions could support, uphold, and foster their innovation and growth. It is important to think about how we can make decisions to help revitalize critical industrial sectors, ultimately, creating jobs and improving our economy and national security. It is time to support the industrial sector and small businesses.

Mr. Chairman, thank you again for the opportunity to express my views and those of the National Defense Industrial Association. I welcome your questions and comments.

Testimony of Mark Gross, Founder and CEO
Oak Grove Technologies
Congress of the United States
US House of Representatives
Committee on Small Business
Sequestration: The Threat to Small Businesses, Jobs, and The Industrial Base
Thursday, September 20, 2012 1:00 P.M.
Washington, D.C.

Good afternoon Chairman Graves, Ranking Member Velazquez, and members of this Subcommittee. Thank you for the invitation to come before you and share my concerns relating to the topic of Sequestration and the impact it is having on small business today, and the potential impact it will have on companies in early 2013.

I am a veteran of the United States Army, and founder of Oak Grove Technologies, a Service Disabled Veteran owned small business, focused on Training, Strategic Communications, Information Technologies, and Intelligence and Analytical Services. We employ over 390 employees, over 70% of those are veterans, and over 20% are service disabled veterans. Geographically we are dispersed in 21 states, Africa, Afghanistan and Iraq.

The threat of Sequestration creates uncertainty, which paralyzes small businesses. Most small businesses do not have a robust or diversified contract portfolio supporting their operations. Small businesses often wait until they have a contract before they acquire the resources necessary to perform the contract. Without reasonable assurances of future business, small businesses cannot plan for the future and are not likely to invest in the company's growth by acquiring additional equipment, facilities, or personnel. However, small businesses that fail to invest or grow will find themselves less competitive for the opportunities that do remain.

Many of the business owners that I speak with are taking a similar approach as we are considering the uncertainty of Sequestration; we are putting expansion, infrastructure expenditures, and indirect hiring on hold. We are forced to prepare for the worse case in order to regroup and/or recover. Oak Grove has over 200 acres of land in Hoffman, NC adjacent to Camp MacKall Army Air Field where we support training for Special Forces, Military Information Support Operations, and Civil Affairs Soldiers. We are putting much of our planned construction on hold, minimizing our marketing campaigns and trade show participation, and in general tightening our belts because of the uncertainty surrounding Sequestration.

Sequestration in the short term will have the most impact on an agency's budget for operations, and services contracts are a large part of that budget. Most small business federal contractors provide the Government with services rather than products because there are fewer barriers to entry in the services market than the market for manufactured items or supplies. For supplies, a company needs personnel, equipment, facilities, distribution channels, etc. For services, a company just needs people. It is easier for an agency to eliminate two data processers from a contract, than eliminate a section of a fighter jet. By cutting services in a greater proportion than products, sequestration will affect many more small contractors than large contractors.

A small business with ten federal contracts will feel the effects of a loss of one of those ten contracts more than a company with 100 contracts that loses 10 of those contracts. Although both scenarios reflect a 10% cut in each company's contracts, larger companies have a greater ability to reallocate personnel and idle resources to the other contracts because of the large number of contracts remaining. Larger contractors, moreover, are more likely to have

commercial and/or international contracts that can offset the effects of a stymied federal market. Small businesses rarely have the ability to diversify in this manner.

We understand completely the necessity of budget cuts, especially while we have two military conflicts ending. However, an across the board cut will hurt everyone, although the same economic engine that powers America, small business, will be the one that suffers most. Thank you for your time.

Respectfully,

Mark J. Gross
Founder and CEO

Committee on Small Business
Hearing: "Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base"
September 20, 2012

Questions – Deputy Under Secretary Mike McCord and Mr. Richard Ginman

1. In your written testimony, you said that when the pool of available contracting dollars is diminished, as it would be under sequestration, your ability to partner with small businesses is likewise diminished. If implemented will sequestration be a proportional cut? Specifically, will small businesses receive 9.4 percent fewer prime contracts from the Department of Defense (DoD) next year, or will small businesses face a greater loss?

2. In your written testimony, you said that DoD does not anticipate terminating any contracts. However, under prior sequestration orders, DoD has had to terminate contracts. Why is this scenario different?

3. In terms of contracts, if DoD chooses not to terminate contracts in the belief that savings can be negotiated that will offset the sequestered amounts, does that put DoD at the risk of either incurring Anti-Deficiency Act violations or simply dropping contracts if the expected savings do not materialize? For example, last year the last 21 percent of prime contract dollars were obligated in the first quarter (Q1). These will be subject to sequestration, but current DoD guidance does not suggest that they need to be cut by 9.4 percent. Thus, 11.9 percent will need to be saved off all of contracts awarded or options exercised in the second, third and fourth quarters (Q2-Q4). However, since negotiations for contracts awarded/options exercised in Q2 begin in Q1, additional savings will likely be needed in Q3 and Q4 contracting. Any savings not achieved on the Q2 or Q3 contracts will be passed forward to Q4, leaving the greatest percentage of savings to be achieved then. At the same time, Q4 accounted for 42 percent of spending last year, so approximately half of all savings would need to be met in three months. Is DoD confidant that it can meet such a rigorous saving goal during the busiest time of year without terminating contracts?

4. Large prime contractors are allegedly replacing small subcontractors with their own employees as a way to protect themselves against possible sequestration. Given this, what is DoD doing to make sure that small subcontractors are protected? Please detail any specific plans or proposals on this topic.

5. On September 28, 2012, the Office of Management and Budget (OMB) issued guidance on allowable contracting costs associated with the Worker Adjustment and Retraining Notification (WARN) Act. In light of this newest memorandum and the prior training and employment guidance letter issued by the Department of Labor (DOL) on July 30, 2012, will DoD accept WARN Act penalties; which can be up to 60 days of back pay plus $500 per day per employee, as acceptable costs on its contracts? Further, will the

DoD accept the costs associated with the 15 states that have mini-WARN Acts? How will these penalties be paid for on firm, fixed price contracts that do not have a method of reimbursement for allowable costs? If DoD does reimburse contractors for these costs, does that mean that additional sources for savings must be identified?

6. In response to questioning from Congressman West, Mr. McCord stated that "the secretary and the deputy have met with industry leaders" regarding sequestration, specifically the WARN Act implementation. With whom did the Secretary and Deputy Secretary meet? What representatives of small businesses were present, and how has DoD conducted outreach with the small business segments of the industrial base?

7. When asked about the difference between the 9.4 percent cuts projected for defense programs by OMB, and the 11 percent cuts projected by Under Secretary Kendall on September 5, 2012, the Committee was told that different methodologies were used. Please explain the basis for the 11 percent projection, and how the methodologies differed. Does either the 9.4 percent or 11 percent figure account for the cost of achieving the savings, such as the costs incurred with changes, terminations, WARN Act costs, or workforce actions?

8. If enacted, sequestration may cause the government to make unilateral changes to numerous government contracts and task orders. How will the Department manage this level of contract dislocation?

9. Under current regulations (*see* FAR 49.101(e)), when seeking to terminate contracts the Government must give priority to keeping small business contracts. What has the DoD done to ensure compliance with this in the past? Moving forward, how will the DoD adhere to this requirement with sequestration?

10. Has the Department issued any guidance on awarding new FY12 fourth-quarter or FY13 first-quarter contracts, as well as whether to exercise options on existing contracts? If not, when will you issue guidance? What criteria will you offer contracting officers who must make these decisions?

11. Under sequestration, please detail the methodology that will be used to determine if contracts will be terminated or modified. Further, please explain how the DoD will determine estimated costs associated with contract modifications.

12. Given that uncertainty is one of the biggest challenges facing small businesses, please describe the guidance being provided to DoD contractors in light of sequestration. If the DoD is merely following with OMB and DOL memorandums please explain why DoD believes that is the best course of action.

13. The Sequestration Transparency Act required OMB to report by program, project or activity where cuts would occur. Instead, OMB reported by agency, bureau and account. For DoD please provide additional information as to what specific program, project or

activity will be cut. If DoD is unable to provide this information, please explain why and when DoD anticipates this information will be available.

14. As sequestration would implement across the board cuts, how does DoD plan to maintain the small business segment of the industrial base?

15. A recent study indicated that as the federal budget declines there is an increase in bid protests. With sequestration enforcing substantial cuts across the board, how equipped is the DoD to handle these increases in bid protests?

16. Under sequestration the DoD will most likely have to substantially reduce its civilian workforce. As many of these individuals oversee government contracting, what plans does DoD have in place to ensure that small businesses are not further ostracized from contracting opportunities?

17. If contracts are modified or descoped, does DoD anticipate that this will make it difficult for small businesses to remain compliant with the limitation on subcontracting clause? Please explain.

18. Will small businesses that have seats on multiple-award contracts face any special challenges if sequestration occurs? Please explain.

19. Since the Department's FY13 small business prime and subcontracting goals are already set, as are the subcontracting goals for all contracts previously awarded, does DoD believe it will still be able to meet those goals? Please explain.

20. At DoD, prior year unobligated balances remain subject to sequestration, but not for other agencies. What special challenges does this pose and how does DoD plan to manage this?

21. Under to current law, the Sequestration Order would be issued and effective on January 2, 2012, and agencies will be required to implement the Sequestration Order. What steps is DoD taking to prepare to implement the Sequestration Order? Please provide a timeline of additional steps DoD plans to take over the next months in anticipation of a sequester.

22. DoD previously stated that it will need 105 days to implement a reduction in force (RIF) of the civilian workforce. Dr. Fuller estimated that 48,147 DoD civilian jobs will need to be RIF'd next year. Since 105 days before January 2, 2012 has already elapsed, has DoD taken any such actions? If not, how does DoD intend to recapture these saving if sequestration is not averted?

23. If DoD were given additional spending reduction targets, would DoD voluntarily apply them across the board, or would they be targeted? Please explain.

24. Despite repeated concerns that the DoD is losing key segments of its industrial base; which would be exacerbated the sequester; the 2012 Annual Industrial Capabilities Report to Congress did not specifically address sequestration. Why is this? Please explain what risks sequestration poses to our industrial base.

25. Under sequestration, a study by the National Association of Manufacturers (NAM) suggests that the biggest losses will be in aerospace manufacturing, ship and boat manufacturing, and search and navigation manufacturing. How does DoD intend to protect these segments of our industrial base?

26. The 2012 Annual Industrial Capabilities Report to Congress states, "that the Department cannot afford to protect the entire industrial base, especially in a time of budget austerity, and the Department recognizes that an effort to protect too much would also stand in the way of innovation, which over time replaces the industrial base that supplies old technologies with dynamic, new industrial capabilities." Please explain how the DoD's inability to protect the entire industrial base will affect small businesses.

27. Based on the 2012 Annual Industrial Capabilities Report to Congress notes that and the Sector-by-Sector, Tier-by-Tier (S2TS) research, please list and explain all industrial base sectors primarily occupied by small businesses and the ramifications the loss of these companies would have on the overall health the industrial base.

28. DoD issued a memo on August 22, 2012 directing procurement officers to stop awarding contracts for services in the military simulator industry through the 8(a) program. However, the DynaLantic decision applied only to military simulators. So, why did DoD's memo go beyond the scope of the court's ruling?

29. How did DoD determine that extensions of existing contracts as well as the exercise of options on existing contracts were within the scope of the DynaLantic decision?

30. Why hasn't DoD sought permission from SBA to release these procurements from the 8(a) program as required by law?

31. Will DoD halt the enforcement of its August 22nd memo if DOJ decides to pursue an appeal of the DynaLantic decision?

CHARRTS No.: HSBC-01-001
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #1

Question: In your written testimony, you said that when the pool of available contracting dollars is diminished, as it would be under sequestration, your ability to partner with small businesses is likewise diminished. If implemented will sequestration be a proportional cut? Specifically, will small businesses receive 9.4 percent fewer prime contracts from the Department of Defense (DoD) next year, or will small businesses face a greater loss?

Answer: The law requires that the cuts be applied in an across-the-board manner to all non-exempt funding. To the extent we would have any flexibility, we would attempt to protect some high-priority projects from reductions. But our ability to moderate impacts under sequestration would be limited.

The 9.4 percent reduction contained in the sequester transparency report is our estimate of the total reduction required if sequestration goes into effect. Sequestration, with its associated spending cuts, would reduce our overall budget, necessarily forcing cuts in buys from all businesses, large and small.

CHARRTS No.: HSBC-01-013
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #13

Question: The Sequestration Transparency Act required OMB to report by program, project or activity where cuts would occur. Instead, OMB reported by agency, bureau and account. For DoD please provide additional information as to what specific program, project or activity will be cut. If DoD is unable to provide this information, please explain why and when DoD anticipates this information will be available.

Answer: In the Sequestration Transparency Act Report submitted on September 14, 2012, the Office of Management and Budget (OMB) provided Congress the information it determined was responsive to the statutory requirement. Requests for further refinement of the information should be directed to OMB.

CHARRTS No.: HSBC-01-021
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #21

Question: Under to current law, the Sequestration Order would be issued and effective on January 2, 2012, and agencies will be required to implement the Sequestration Order. What steps is DoD taking to prepare to implement the Sequestration Order? Please provide a timeline of additional steps DoD plans to take over the next months in anticipation of a sequester.

Answer: We have been working with OMB to understand the sequestration law and to assess its impact on DoD. We are continuing those efforts and, as testimony today shows, we have completed enough work to demonstrate the nature of sequestration and its adverse impacts.

Our assessment phase has not been completed and as such, our planning phase has not commenced. But we believe it is premature to plan in detail for sequestration. No plan will mitigate the devastating consequences. We should focus on halting sequester for defense and non-defense agencies.

We will, however, continue our assessment efforts and we will be ready if Congress allows sequestration to take effect.

CHARRTS No.: HSBC-01-006
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #6

Question: In response to questioning from Congressman West, Mr. McCord stated that "the secretary and the deputy have met with industry leaders" regarding sequestration, specifically the WARN Act implementation. With whom did the Secretary and Deputy Secretary meet? What representatives of small businesses were present, and how has DoD conducted outreach with the small business segments of the industrial base?

Answer: The SD, DSD, and USD AT&L have met with industry. The meetings occurred on January 20, and July 23, 2012 at the combined invitation of the Aerospace Industries Association, the National Defense Industrial Association, and the Professional Services Council. All three organizations have small business members as well as traditional large defense firm members. The meetings attended by DoD were organized by the associations. The following industry officials were present: Robert Stevens, Lockheed Martin Corporation; John Jumper, SAIC; Jim Albaugh, The Boeing Company; Dan Allen, CACI International; Wes Bush, Northrop Grumman Corporation; Jay Johnson, General Dynamics Corporation; Scott Donnelly, Textron; Marion Blakey, Aerospace Industries Association; Bonnie Carroll, Information International Associates; Ed Casey, SERCO; Angela Drummond-Rogers, SiloSmashers; Brad Feldmann, Cubic Defense Applications; Ellen Glover, ICF International; David Hess, United Technologies Corporation; Dawn Hickton, RTI International Metals; Linda Hudson, BAE Systems; Ray Jones, TenX Group; Stephen Kelly, Battelle National Security Global Business; Robin Lineberger, Deloitte Federal Government Services; Tom Marotta, Marotta Controls; David Melcher, ITT Exelis; Wood Parker, TASC; Paul Pastorek, EADS North America; George Pedersen, ManTech International Corporation; Arnold Punaro, Punaro Group; Bill Swanson, Raytheon Company; and Hal Yoh, Day & Zimmermann. Several topics were discussed at these meetings, including sequestration and WARN Act issue.

DoD engages in regular outreach to small business. Mr. Kendall has personally hosted two major small business events this year, and there are numerous other regular small business outreach events hosted by the military services, Defense Logistics Agency, etc. The personnel small business outreach events (half or full day) hosted by USD AT&L Carter: March 5, 2011 in Detroit, August 8, 2011 in Orlando; DSD and USD AT&L Kendall: May 4, 2012 in Tampa, August 8, 2012 in San Diego (Navy-led conference), and August 29, 2012 in Dayton, OH. Small business outreach is a major USD AT&L priority.

CHARRTS No.: HSBC-01-017
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: Director (DP&AP) Ginman
Question: #17

Question: If contracts are modified or descoped, does DoD anticipate that this will make it difficult for small businesses to remain compliant with the limitation on subcontracting clause? Please explain.

Answer: Any response to this question without specific facts in the context of a particular contract would be highly speculative. DoD would expect, as with any contract modification, to enter into discussions with the prime contractor.

CHARRTS No.: HSBC-01-022
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #22

Question: DoD previously stated that it will need 105 days to implement a reduction in force (RIF) of the civilian workforce. Dr. Fuller estimated that 48,147 DoD civilian jobs will need to be RIF'd next year. Since 105 days before January 2, 2012 has already elapsed, has DoD taken any such actions? If not, how does DoD intend to recapture these saving if sequestration is not averted?

Answer: We are assessing the impacts of sequestration, but we have not begun detailed planning. To accommodate sequester in FY 13, we would need to focus on hiring freezes and probably unpaid furloughs and would do so consistent with statute; any government-wide guidance from the Office of Management and Budget or the Office of Personnel Management; and DoD guidance including the memo issued by the Deputy Secretary of Defense on September 21, 2012 regarding sequestration. [copy attached]

CHARRTS No.: HSBC-01-023
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #23

Question: If DoD were given additional spending reduction targets, would DoD voluntarily apply them across the board, or would they be targeted? Please explain.

Answer: We do not believe any additional spending reductions are called for. The nature of any future statutory budget reduction would be decided primarily by the Congress.

CHARRTS No.: HSBC-01-020
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #20

Question: At DoD, prior year unobligated balances remain subject to sequestration, but not for other agencies. What special challenges does this pose and how does DoD plan to manage this?

Answer: The overall effect of a reduction in prior year unobligated balances is that the Department will not be able to complete 100% of the programs or scope of work requested within the President's Budget for that year. Initial assessments are being undertaken; however, plans attempting to mitigate the damage have not been completed. We do not anticipate cancelling contracts to achieve such savings. Rather, we anticipate that we would reduce projected quantities, level of efforts or scope of work for contracts or contract options that would be entered into after January 2, 2013.

CHARRTS No.: HSBC-01-007
Hearing Date: September 20, 2012
Committee: HSBC
Member:
Witness: PDUSD(C) McCord, Director (DP&AP) Ginman
Question: #7

Question: When asked about the difference between the 9.4 percent cuts projected for defense programs by OMB, and the 11 percent cuts projected by Under Secretary Kendall on September 5,2012, the Committee was told that different methodologies were used. Please explain the basis for the 11 percent projection, and how the methodologies differed. Does either the 9.4 percent or 11 percent figure account for the cost of achieving the savings, such as the costs incurred with changes, terminations, WARN Act costs, or workforce actions?

Answer: It is not possible to know the percentage of an actual sequester order precisely until Congress enacts a final level of FY13 budget authority, and until we have final estimates of unobligated balances.

However, DoD has made reasonable estimates assuming enactment of the FY13 budget request and using our best of unobligated balances as of the time OMB provides the official sequester cuts. The DoD estimate is 9.4 percent total reduction in budget authority that results from sequestration, based on Military Personnel being exempt.

The Department does not anticipate having to terminate or significantly modify any contracts on or about January 2, 2013, as a result of sequestration. Most department contracts are fully funded; because they are obligated from FY 2012 and prior year funding, they would not be affected by sequestration.

Program managers will assess the best way to accommodate sequester cuts, if they occur. They will consider the overall schedule for their program an how best to accommodate lower budgets. Contracting officers will recommend contract changes depending upon the size and nature of the affected contracts.

We will assess the desirability and cost of contract changes during budget execution, as we do for regular budgets. The 9.4 percent reduction contained in the sequester transparency report is our estimate of the total reduction required if sequestration goes into effect. That amount is owed regardless of any compliance costs which might result.

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September 19, 2012

Chairman Sam B. Graves, Jr.
House Committee on Small Business
2361 Rayburn House Office Building (RHOB)
Washington, D.C. 20515
202.225.5821 Phone
202.226.5276 Fax

Subject: Written Testimony of SEBAC to the House Small Business Committee on its Hearing Regarding "Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base," September 20, 2012

Dear Chairman Graves:

The Small Environmental Business Action Coalition's ("SEBAC") membership is comprised of small environmental businesses across the nation, all of which are engaged in work with the federal government. This letter addresses the grave and disparate impact that the Budget Control Act of 2011 and sequestration will have on our membership as well as other small businesses that work with federal agencies, an issue of paramount importance to SEBAC and the House Small Business Committee and the nation.

The Small Business Administration estimates that there are approximately 28 million small businesses in the United States that employ over 60 million Americans, accounting for half of the private sector workforce. In 2011, federal agencies awarded $91.5 billion in prime contracts to these small businesses, representing 21.65 percent of federal contracting dollars. The $1.2 trillion in budget cuts that will be imposed, should sequestration be implemented, will have a significant and disproportionately adverse affect on these small businesses and their employees. Although the specific details of how each agency might implement the required cuts remains uncertain, recent information provided by the White House makes it strikingly clear that agencies will have no choice but to reduce personnel and new contracts. Agencies will also change the way they administer existing contracts and rethink the procurement vehicles that they use to carry out agency objectives. These actions will have a devastating impact on the economic viability of small businesses, not only because of decreased contract opportunities, but because of an associated increase in bid protest and claims activity. Small businesses have already seen an increase in costs resulting from the uncertainty of the impact sequestration will have on business viability, uncertainty that will certainly continue should the budget cuts be implemented.

Small businesses will undoubtedly bear a disproportionate burden as a result of sequestration. While, in general, government contractors will experience a decrease in contract opportunities and an increase in administration costs, small businesses will be particularly affected by contracts that are prematurely terminated or subject to a reduction in scope. Businesses will not only lose expected revenue, but will likely be forced to lay off a substantial number of employees and reduce hiring. In situations where layoffs are unavoidable, many businesses will be responsible for the costs associated with compliance with the federal WARN Act and state sister statutes. Moreover, small businesses will incur increased claims costs to recover the full value of the work performed where contracts are terminated prematurely or subject to a reduction in scope. Should sequestration move forward, SEBAC urges this Committee to implement processes that will quickly compensate small businesses for work completed and implement an expedited claims process to reduce administrative costs, an initiative beneficial to both the government and small businesses.

Small businesses often perform as subcontractors to larger prime contractors on federal projects. Subcontractors will have even less control over the administration of the prime contract and the impact on subcontracts should sequestration affect the continuance and scope of the prime contract. It is essential that major contractors are not permitted to shift the burden of de-scoping disproportionately on small businesses by eliminating subcontracts, while keeping themselves relatively insulated from impact. In situations where the scope of the prime contract changes, it is imperative that any negative impact be flowed down proportionately to small businesses, thereby leveling the playing field for small businesses to compete in such an unfavorable environment. SEBAC urges this Committee to implement policies that ensure that any reductions in the scope of contracts do not disproportionally impact small businesses.

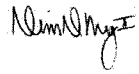
Sequestration is also expected to incentivize agencies to modify the way they achieve desired objectives. Federal agencies will likely increase the use of indefinite duration indefinite quantity ("IDIQ") and firm fixed price contracts, which they perceive to provide more flexibility to the agency. However, these models dramatically affect the economic viability of small businesses and increase uncertainty. An increase in IDIQ contracts is particularly troubling because these vehicles require that small businesses incur the cost of maintaining a contract-ready business and workforce without confidence or assurance that the agency will issue any task orders at all. Many small businesses will simply not be able to effectively compete in such an environment, considering their profit margins are small and their challenges to growing successful enterprises are already disproportionately large.

Informal comments from agency officials have also suggested that agencies could implement sequestration by insourcing currently contracted work on the faulty assumption that doing so will "save money." However, evidence gathered from recent insourcing initiatives makes it clear that this assumption is not supported by the facts. Therefore, SEBAC urges this Committee to require that agencies complete comprehensive cost analysis of the potential cost savings that might be derived through competition and/or through bilateral modifications to the existing contract. Agencies must also be required to examine the impact of insourcing on small businesses that currently perform the work and to provide timely notification to all contractors of the agency's intentions.

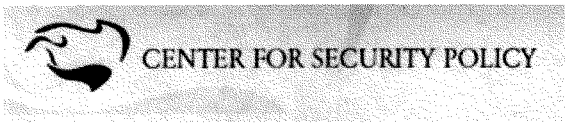
It is imperative that any and all changes to the administration of contracts are informed by the facts and make economic sense. Failure to make reasoned decisions, not only thwarts the spirit of budget reduction, but needlessly damages small businesses, the heart of the nation's economy.

Thank you in advance for your attention to this important issue and for your leadership during these challenging times. Please do not hesitate to contact me if you have any questions or like to discuss our position in greater detail.

Sincerely,
SEBAC



Dennis D. Morgan, II
President



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United States House of Representatives

Committee on Small Business

Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base

TESTIMONY FOR THE RECORD

Presented by the Center for Security Policy

4 October, 2012

Mr. Chairman, Madam Ranking Member, and Members of the House Committee on Small Business:

As a national security educational organization, the Center for Security Policy (CSP) believes that defense sequestration will have severe consequences for national security at a time when the United States faces growing threats, both conventional and asymmetric. While the nation's debt also constitutes a national security threat that needs to be addressed, the Center's research shows that attempting to solve this economic crisis through the defense sequestration mechanism – cutting $500 billion to defense over the next ten years – will in fact significantly worsen that crisis, particularly with respect to America's small businesses.

The Center's conclusion that defense sequestration will cause significant harm to America's small businesses – and by extension, to the defense industrial base that underlies our national security – is based upon the findings of our *Defense Breakdown* series, a comprehensive set of reports examining the

projected impacts of defense sequestration on state/local economies (available at www.forthecommondefense.org/reports/.)[1] The reports use the figures of 9% for implementation of the original defense cuts as contained in the Budget Control Act of 2011, and 18% to account for the additional 9% cuts that will be activated starting in January 2013 if sequestration is not reversed. [2] The reports examine the impact both from the "contractor location" perspective (the contractor business office) and the "place of performance" perspective (the location at which the contracted work is carried out). The data is further broken down to analyze projected impacts on small businesses, minority-owned businesses, women-owned businesses, and veteran-owned businesses. The data captures any business that had a contract with the Department of Defense in 2011, irrespective of the size of the business or the type of work in which the business is engaged.

National Level Impact

At the national level, small businesses – as well as several separate categories which include many small businesses – are projected to suffer the following losses if defense sequestration is not reversed[3]:

USA Defense Contractor Businesses Projected Revenue Reductions Based On National Average

Type of Business	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	$33,047,059,681	($2,974,235,492)	($5,948,470,981)
Small Businesses 8A	$16,425,472,092	($1,478,292,550)	($2,956,585,096)
Small Disadvantaged	$12,374,299,824	($1,113,687,032)	($2,227,374,058)
Veteran-Owned	$8,353,266,125	($751,793,981)	($1,503,587,964)
Service-Disabled Veteran	$9,001,937,140	($810,174,376)	($1,620,348,747)

[1] See Center for Security Policy, "Defense Breakdown Economic Impact Reports, 2011 Data Edition", Sept. 11, 2012. http://forthecommondefense.org/reports/ (accessed Oct. 2, 2012)
[2] See Center for Security Policy, "Defense Breakdown Economic Impact Reports, 2011 Data Edition; Frequently Asked Questions", Sept. 11, 2012. http://www.forthecommondefense.org/reports/FAQ.html (accessed Oct. 2, 2012)
[3] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition; The USA Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/usa.pdf (accessed Oct. 2, 2012)

Women-Owned	$11,818,100,313	($1,063,629,068)	($2,127,258,143)

Impact by State: House Small Business Committee Representation

At the state level, the following tables illustrate projected revenue losses for small businesses – as well as several separate categories which include many small businesses – in each of the states represented by Members on the House Committee on Small Business, in alphabetical order:

California[4]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	1,505	$2,932,249,036	-$263,902,424	-$527,804,847
Small Businesses	467	$1,318,154,187	-$118,633,882	-$237,267,763
Small Disadvantaged	791	$789,087,702	-$71,017,896	-$142,035,792
Veteran-Owned	583	$528,250,609	-$47,542,557	-$95,085,113
Service-Disabled Veteran	332	$478,685,732	-$43,081,718	-$86,163,435
Black American	195	$241,147,930	-$21,703,315	-$43,406,629
Hispanic American	532	$788,240,521	-$70,941,650	-$141,883,299
Asian-Pacific Owned	515	$832,547,631	-$74,929,290	-$149,858,580
Women-Owned	1,354	$1,239,750,964	-$111,577,591	-$223,155,182

[4] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The California Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/ca/contractorlocation/defensebreakdownsummaryreport_CA.pdf (accessed Oct. 2, 2012)

Colorado[5]:

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	180	$495,209,228	-$44,568,832	-$89,137,665
Small Businesses	113	$438,830,338	-$39,494,732	-$78,989,464
Small Disadvantaged	109	$183,232,021	-$16,490,883	-$32,981,765
Veteran-Owned	111	$77,452,803	-$6,970,753	-$13,941,505
Service-Disabled Veteran	114	$216,044,245	-$19,443,983	-$38,887,966
Black American	37	$22,188,985	-$1,997,009	-$3,994,017
Hispanic American	79	$220,299,991	-$19,827,000	-$39,654,000
Asian-Pacific Owned	29	$46,896,611	-$4,220,695	-$8,441,390
Women-Owned	251	$223,759,096	-$20,138,319	-$40,276,639

Florida[6]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	624	$1,334,532,063	-$120,107,890	-$240,215,781
Small Businesses	236	$884,108,701	-$79,569,786	-$159,139,573

[5] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Colorado Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/co/contractorlocation/defensebreakdownsummaryreport_CO.pdf (accessed Oct. 2, 2012)

[6] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Florida Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/fl/contractorlocation/defensebreakdownsummaryreport_FL.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	292	$509,597,503	-$45,863,777	-$91,727,554
Veteran-Owned	364	$726,322,915	-$65,369,065	-$130,738,130
Service-Disabled Veteran	263	$757,408,537	-$68,166,771	-$136,333,542
Black American	148	$173,050,207	-$15,574,519	-$31,149,038
Hispanic American	293	$570,177,942	-$51,316,017	-$102,632,034
Asian-Pacific Owned	85	$412,092,209	-$37,088,300	-$74,176,601
Women-Owned	725	$453,572,383	-$40,821,516	-$81,643,032

Illinois[7]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	187	$637,211,253	-$57,349,015	-$114,698,030
Small Businesses	53	$241,501,186	-$21,735,108	-$43,470,215
Small Disadvantaged	126	$514,185,876	-$46,276,731	-$92,553,461
Veteran-Owned	132	$43,996,714	-$3,959,704	-$7,919,409
Service-Disabled Veteran	58	$383,841,498	-$34,545,736	-$69,091,472
Black American	55	$23,629,852	-$2,126,687	-$4,253,374
Hispanic American	33	$41,562,299	-$3,740,607	-$7,481,214
Asian-Pacific Owned	48	$360,958,185	-$32,486,238	-$64,972,476
Women-Owned	305	$276,261,531	-$24,863,539	-$49,727,078

[7] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Illinois Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/il/contractorlocation/defensebreakdownsummaryreport_IL.pdf (accessed Oct. 2, 2012)

Iowa[8]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	26	$70,761,844	-$6,368,566	-$12,737,132
Small Businesses	9	$13,798,543	-$1,241,869	-$2,483,738
Small Disadvantaged	19	$9,028,279	-$812,545	-$1,625,090
Veteran-Owned	45	$21,891,510	-$1,970,236	-$3,940,472
Service-Disabled Veteran	10	$16,945,660	-$1,525,109	-$3,050,219
Black American	6	$5,729,693	-$515,672	-$1,031,345
Hispanic American	7	$50,292,844	-$4,526,356	-$9,052,712
Asian-Pacific Owned	5	$1,428,212	-$128,539	-$257,078
Women-Owned	79	$10,000,148	-$900,013	-$1,800,027

Louisiana[9]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	135	$275,078,595	-$24,757,075	-$49,514,149
Small Businesses	77	$222,381,033	-$20,014,294	-$40,028,588

[8] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Iowa Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/ia/contractorlocation/defensebreakdownsummaryreport_IA.pdf (accessed Oct. 2, 2012)

[9] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Louisiana Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/la/contractorlocation/defensebreakdownsummaryreport_LA.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	51	$59,987,517	-$5,398,877	-$10,797,753
Veteran-Owned	67	$95,962,019	-$8,636,582	-$17,273,164
Service-Disabled Veteran	35	$70,251,551	-$6,322,640	-$12,645,280
Black American	78	$77,234,469	-$6,951,102	-$13,902,205
Hispanic American	28	$52,424,426	-$4,718,199	-$9,436,397
Asian-Pacific Owned	6	$10,290,639	-$926,158	-$1,852,315
Women-Owned	138	$166,957,394	-$15,026,166	-$30,052,332

Maryland[10]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	761	$2,058,046,646	-$185,224,206	-$370,448,411
Small Businesses	387	$1,303,832,304	-$117,344,912	-$234,689,824
Small Disadvantaged	317	$580,220,594	-$52,219,856	-$104,439,711
Veteran-Owned	292	$360,011,394	-$32,401,027	-$64,802,053
Service-Disabled Veteran	173	$272,433,218	-$24,518,991	-$49,037,981
Black American	384	$728,113,448	-$65,530,213	-$131,060,426
Hispanic American	112	$295,735,385	-$26,616,186	-$53,232,371
Asian-Pacific Owned	120	$563,459,960	-$50,711,398	-$101,422,797
Women-Owned	678	$994,390,199	-$89,495,121	-$178,990,243

[10] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Maryland Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/md/contractorlocation/defensebreakdownsummaryreport_MD.pdf (accessed Oct. 2, 2012)

Massachusetts[11]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	111	$242,746,273	-$21,847,165	-$43,694,331
Small Businesses	41	$143,348,736	-$12,901,387	-$25,802,774
Small Disadvantaged	60	$160,759,782	-$14,468,381	-$28,936,762
Veteran-Owned	105	$93,888,824	-$8,449,994	-$16,899,989
Service-Disabled Veteran	53	$50,252,078	-$4,522,687	-$9,045,374
Black American	21	$11,704,135	-$1,053,372	-$2,106,744
Hispanic American	25	$68,355,727	-$6,152,016	-$12,304,031
Asian-Pacific Owned	29	$14,625,123	-$1,316,261	-$2,632,522
Women-Owned	197	$199,811,946	-$17,983,076	-$35,966,152

Michigan[12]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	141	$716,462,253	-$64,481,605	-$128,963,211
Small Businesses	50	$154,579,624	-$13,912,167	-$27,824,333

[11] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Massachusetts Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/ma/contractorlocation/defensebreakdownsummaryreport_MA.pdf (accessed Oct. 4, 2012)

[12] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Michigan Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/mi/contractorlocation/defensebreakdownsummaryreport_MI.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	78	$121,152,407	-$10,903,717	-$21,807,434
Veteran-Owned	129	$98,338,413	-$8,850,458	-$17,700,915
Service-Disabled Veteran	56	$43,749,469	-$3,937,452	-$7,874,905
Black American	51	$18,381,376	-$1,654,324	-$3,308,648
Hispanic American	26	$29,036,813	-$2,613,313	-$5,226,627
Asian-Pacific Owned	23	$60,520,111	-$5,446,810	-$10,893,620
Women-Owned	172	$67,120,582	-$6,040,853	-$12,081,705

Missouri[13]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	120	$519,844,376	-$46,785,996	-$93,571,991
Small Businesses	47	$118,628,245	-$10,676,542	-$21,353,085
Small Disadvantaged	60	$112,984,160	-$10,168,575	-$20,337,150
Veteran-Owned	123	$99,035,991	-$8,913,240	-$17,826,479
Service-Disabled Veteran	49	$55,487,487	-$4,993,874	-$9,987,748
Black American	52	$388,241,412	-$34,941,728	-$69,883,457
Hispanic American	24	$68,082,944	-$6,127,465	-$12,254,930
Asian-Pacific Owned	11	$8,239,089	-$741,518	-$1,483,036
Women-Owned	233	$128,158,121	-$11,534,231	-$23,068,463

[13] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Missouri Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/mo/contractorlocation/defensebreakdownsummaryreport_MO.pdf (accessed Oct. 2, 2012)

New York[14]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	207	$885,177,827	-$79,666,008	-$159,332,015
Small Businesses	74	$776,422,052	-$69,877,987	-$139,755,975
Small Disadvantaged	138	$206,524,160	-$18,587,175	-$37,174,350
Veteran-Owned	195	$115,673,386	-$10,410,605	-$20,821,210
Service-Disabled Veteran	65	$783,914,520	-$70,552,310	-$141,104,619
Black American	62	$29,088,629	-$2,617,977	-$5,235,953
Hispanic American	46	$44,529,820	-$4,007,684	-$8,015,368
Asian-Pacific Owned	47	$725,758,766	-$65,318,292	-$130,636,583
Women-Owned	379	$280,099,569	-$25,208,962	-$50,417,924

North Carolina[15]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	201	$367,056,595	-$33,035,095	-$66,070,190
Small Businesses	73	$297,707,033	-$26,793,634	-$53,587,268

[14] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The New York Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/ny/contractorlocation/defensebreakdownsummaryreport_NY.pdf (accessed Oct. 2, 2012)

[15] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The North Carolina Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/nc/contractorlocation/defensebreakdownsummaryreport_NC.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	129	$144,262,936	-$12,983,665	-$25,967,330
Veteran-Owned	180	$532,815,560	-$47,953,402	-$95,906,805
Service-Disabled Veteran	150	$295,917,554	-$26,632,581	-$53,265,162
Black American	91	$53,007,303	-$4,770,657	-$9,541,315
Hispanic American	38	$192,926,112	-$17,363,351	-$34,726,702
Asian-Pacific Owned	19	$43,565,299	-$3,920,877	-$7,841,754
Women-Owned	365	$195,253,120	-$17,572,781	-$35,145,563

Ohio[16]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	221	$572,694,685	-$51,542,524	-$103,085,047
Small Businesses	70	$207,934,777	-$18,714,131	-$37,428,261
Small Disadvantaged	129	$314,802,565	-$28,332,232	-$56,664,464
Veteran-Owned	197	$149,731,239	-$13,475,812	-$26,951,624
Service-Disabled Veteran	73	$749,170,122	-$67,425,314	-$134,850,627
Black American	82	$262,944,120	-$23,664,972	-$47,329,943
Hispanic American	25	$51,327,635	-$4,619,487	-$9,238,975
Asian-Pacific Owned	39	$39,691,933	-$3,572,274	-$7,144,548
Women-Owned	309	$432,063,939	-$38,885,756	-$77,771,512

[16] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Ohio Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/oh/contractorlocation/defensebreakdownsummaryreport_OH.pdf (accessed Oct. 2, 2012)

Oregon[17]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	48	$28,388,529	-$2,554,968	-$5,109,935
Small Businesses	13	$1,927,587	-$173,483	-$346,966
Small Disadvantaged	45	$32,153,044	-$2,893,774	-$5,787,548
Veteran-Owned	62	$69,101,006	-$6,219,091	-$12,438,182
Service-Disabled Veteran	20	$1,554,991	-$139,949	-$279,898
Black American	6	$504,275	-$45,385	-$90,770
Hispanic American	8	$558,164	-$50,235	-$100,470
Asian-Pacific Owned	17	$26,039,361	-$2,343,543	-$4,687,085
Women-Owned	120	$46,365,607	-$4,172,905	-$8,345,810

Pennsylvania[18]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	175	$479,064,392	-$43,115,797	-$86,231,594
Small Businesses	71	$286,771,072	-$25,809,398	-$51,618,795

[17] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Oregon Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/or/contractorlocation/defensebreakdownsummaryreport_OR.pdf (accessed Oct. 4, 2012)

[18] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Pennsylvania Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/pa/contractorlocation/defensebreakdownsummaryreport_PA.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	121	$325,990,896	-$29,339,182	-$58,678,364
Veteran-Owned	211	$96,775,906	-$8,709,832	-$17,419,664
Service-Disabled Veteran	83	$325,554,180	-$29,299,877	-$58,599,755
Black American	57	$35,106,842	-$3,159,616	-$6,319,232
Hispanic American	29	$59,678,320	-$5,371,049	-$10,742,098
Asian-Pacific Owned	36	$165,695,487	-$14,912,594	-$29,825,189
Women-Owned	359	$277,211,249	-$24,949,013	-$49,898,027

Rhode Island[19]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	4	$323,452	-$29,111	-$58,221
Small Businesses	2	$12,530	-$1,128	-$2,255
Small Disadvantaged	8	$1,109,173	-$99,826	-$199,651
Veteran-Owned	24	$69,056,155	-$6,215,054	-$12,430,108
Service-Disabled Veteran	11	$4,796,417	-$431,678	-$863,355
Black American	1	$128,153	-$11,534	-$23,068
Hispanic American	1	$41,747	-$3,757	-$7,514
Women-Owned	35	$4,193,183	-$377,386	-$754,773

[19] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Rhode Island Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/ri/contractorlocation/defensebreakdownsummaryreport_RI.pdf (accessed Oct. 2, 2012)

South Carolina[20]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	109	$159,427,057	-$14,348,436	-$28,696,871
Small Businesses	49	$170,160,478	-$15,314,444	-$30,628,887
Small Disadvantaged	53	$12,076,782	-$1,086,910	-$2,173,821
Veteran-Owned	120	$101,296,627	-$9,116,697	-$18,233,394
Service-Disabled Veteran	71	$82,758,913	-$7,448,302	-$14,896,605
Black American	60	$80,576,308	-$7,251,868	-$14,503,736
Hispanic American	16	$33,116,374	-$2,980,474	-$5,960,948
Asian-Pacific Owned	15	$3,818,730	-$343,686	-$687,371
Women-Owned	167	$100,943,745	-$9,084,937	-$18,169,875

Washington[21]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	216	$239,313,236	-$21,538,192	-$43,076,384
Small Businesses	78	$138,788,315	-$12,490,949	-$24,981,898

[20] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The South Carolina Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/sc/contractorlocation/defensebreakdownsummaryreport_SC.pdf (accessed Oct. 2, 2012)

[21] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Washington Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/wa/contractorlocation/defensebreakdownsummaryreport_WA.pdf (accessed Oct. 2, 2012)

Small Disadvantaged	121	$88,760,258	-$7,988,424	-$15,976,847
Veteran-Owned	177	$72,175,761	-$6,495,819	-$12,991,637
Service-Disabled Veteran	91	$124,036,483	-$11,163,284	-$22,326,568
Black American	37	$20,881,980	-$1,879,378	-$3,758,757
Hispanic American	41	$39,831,379	-$3,584,824	-$7,169,649
Asian-Pacific Owned	64	$57,190,483	-$5,147,144	-$10,294,287
Women-Owned	294	$140,400,112	-$12,636,011	-$25,272,021

Impact by State: The top five highest revenue-losing states

The five states that are projected to suffer the highest overall revenue losses if defense sequestration is not reversed include, in descending order: Virginia, California, Texas, Maryland, and Florida. As California, Maryland, and Florida are already accounted for in the above tables, the Virginia and Texas projections for small business revenue losses – as well as losses for several separate categories which include many small businesses – follow:

Virginia[22]

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	Revenue Losses for Business Type 2011 - at Least 9% Reduction	Revenue Losses for Business Type 2011 - at Least 18% Reduction
Minority Owned	1,025	$9,137,801,020	-$822,402,124	-$1,644,804,249
Small Businesses	520	$2,635,262,578	-$237,173,641	-$474,347,283
Small Disadvantaged	435	$4,642,503,150	-$417,825,300	-$835,650,600
Veteran-Owned	619	$2,592,989,692	-$233,369,082	-$466,738,163
Service-Disabled Veteran	487	$2,074,238,425	-$186,681,466	-$373,362,931

[22] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Virginia Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/va/contractorlocation/defensebreakdownsummaryreport_VA.pdf (accessed Oct. 2, 2012)

Black American	371	$2,640,887,559	-$237,679,890	-$475,359,780
Hispanic American	183	$3,182,252,524	-$286,402,739	-$572,805,477
Asian-Pacific Owned	226	$1,521,806,256	-$136,962,568	-$273,925,137
Women-Owned	988	$1,905,382,667	-$171,484,447	-$342,968,894

Texas[23]

Type of Business	**Numbers of This Business Type 2011**	**Revenue for This Business Type 2011**	**Revenue Losses for Business Type 2011 - at Least 9% Reduction**	**Revenue Losses for Business Type 2011 - at Least 18% Reduction**
Minority Owned	1,062	$1,795,335,212	-$161,580,176	-$323,160,351
Small Businesses	437	$1,043,612,047	-$93,925,088	-$187,850,176
Small Disadvantaged	424	$465,197,897	-$41,867,812	-$83,735,625
Veteran-Owned	469	$623,565,921	-$56,120,935	-$112,241,870
Service-Disabled Veteran	276	$739,720,491	-$66,574,847	-$133,149,694
Black American	207	$172,060,401	-$15,485,437	-$30,970,873
Hispanic American	583	$932,007,938	-$83,880,718	-$167,761,436
Asian-Pacific Owned	95	$273,098,949	-$24,578,906	-$49,157,813
Women-Owned	962	$841,982,087	-$75,778,391	-$151,556,782

Range of Businesses Affected by Defense Sequestration

Through its *Defense Breakdown* reports, the Center has assessed not only the projected revenue losses by type of business within each state as documented above, but also by *industry classification* within each state. The *industry classification* section of the report illustrates the range of businesses that will

[23] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: The Texas Defense Breakdown Economic Impact Report", Sept. 11, 2012. http://www.forthecommondefense.org/reports/tx/contractorlocation/defensebreakdownsummaryreport_TX.pdf (accessed Oct. 2, 2012)

be affected by defense sequestration.[24] The range of defense contractors is broad: There are over 1,000 (one thousand) industry classifications that will be affected by defense sequestration.

Additionally, *Defense Breakdown* includes a series of Congressional District Reports which show 2011 defense contracts for businesses in each congressional district (and bordering zip codes), including the contract dollar amount, contractor business name, address and phone number, the contractor industry classification, and whether the business is a small or disadvantaged business, woman-owned, minority-owned or veteran-owned. [25]

Follow-up Defense Sequestration Issues Arising from *Defense Breakdown* Reports

Since the release of *Defense Breakdown*, the Center has had the opportunity to brief a wide variety of stakeholders and other entities on the report findings, including Members of Congress, Governors offices, defense contractors, local chambers of commerce, trade associations, veterans organizations, and national/local media. In the course of these briefings, concerns have been raised about significant developments directly relevant to defense sequestration impact on small business, but not addressed in the *Defense Breakdown* reports themselves. These include:

Requirements under the WARN Act. Several defense contractors have previously indicated intent to send out notices to employees of mass layoffs due to defense sequestration per requirements of the Worker Adjustment and Retraining Notification (WARN) Act. The WARN Act requires that such notices be sent sixty calendar days in advance of such layoffs, which would result in several contractors sending out WARN Act notices on 2 November 2012.[26] The Department of Labor issued guidance in July 2012 stating that the possibility of sequestration did not justify the sending of WARN Act notices, stating in part: "In the absence of any additional information, potential plant closings or layoffs resulting from such contract terminations or cutbacks are speculative and unforeseeable..."[27] Subsequently, the Office of Management and Budget (OMB) issued guidance indicating that the U.S. government will cover contractor litigation fees arising from the lack of WARN Act notices if defense sequestration comes about and layoffs take place, provided that those contractors had followed the Department of Labor's

[24] See Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: Defense Breakdown Economic Impact Report By Contractor Location Data -- Sorted by State, Broken Out by Industry Classification – All States", Sept. 11, 2012. http://www.forthecommondefense.org/reports/_all_states/contractorlocation/By_Industry_Classification_-_All_States_-_2011_-_Sort_by_State.html (accessed Oct. 2, 2012)

[25] Center for Security Policy "Defense Breakdown Economic Impact Reports, 2011 Data Edition: 2011 Defense Contracts by Contractor Location for all Congressional Districts" Sept. 11, 2012. http://www.forthecommondefense.org/districts/ (accessed Oct. 2, 2012)

[26] See Zachary Fryer-Biggs, "Labor Dept. Pushes Back Against WARN Act Claims", Jul. 30, 2012, Defense News, http://www.defensenews.com/article/20120730/DEFREG02/307300007/Labor-Dept-Pushes-Back-Against-WARN-Act-Claims (accessed Oct. 2, 2012)

[27] See id.

guidance.[28] Some opponents of defense sequestration on Capitol Hill, including the Chairman of the House Armed Services Committee, are questioning the legality of this guidance.[29]

While the WARN Act does not apply to businesses having less than 100 employees, the Small Business Administration defines a "small business" as an independent business having fewer than 500 employees, meaning that some small businesses are conceivably being affected by the ambiguity that continues to surround WARN Act requirements in the defense sequestration context.

Additionally, the WARN Act does not appear to require prime contractors to give any notice to subcontractors that they are likely to terminate a contract due to defense sequestration, as prime contractors can typically avail themselves of a "termination for convenience" option present in many contracts.

Lack of planning at Department of Defense. Press reports have indicated that Deputy Secretary of Defense Ashton Carter, in late September 2012, instructed military and civilian personnel not to plan for defense sequestration. According to the *Washington Times*, Deputy Secretary Carter's memo stated in part:

> "I am ... directing that all commanders and managers in the Department of Defense continue the defense mission under current laws and policies, without taking any steps that assume sequestration will occur.."
>
> "We do not want our programs, personnel and activities to begin to suffer the harmful effects of sequestration while there is still a chance it can be avoided."[30]

Conclusion

Defense sequestration will not only harm national security, but will harm the defense industrial base that supports national defense and a strong national economy, of which small businesses are an integral part. It is the Center's hope that its *Defense Breakdown* reports will encourage informed discussion at all levels of business and government as to the projected economic impact of defense sequestration, and that such discussion will aid in the reversal of sequestration, or at a minimum, mitigation of its impact on national security and defense readiness.

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[28] See Sara Sorcher, "White House Moves To Head Off Sequester Layoffs", Sept. 29 2012, National Journal, http://www.nationaljournal.com/nationalsecurity/white-house-moves-to-head-off-sequester-layoffs-20120928 (accessed Oct. 2 2012)

[29] See Jeremy Herb, "Sen. Graham: Obama move on defense layoff notices 'patently illegal'", Oct. 1 2012, The Hill, http://thehill.com/blogs/defcon-hill/industry/259517-graham-says-hell-block-reimbursements-in-layoff-notice-fight (accessed Oct. 2, 2012)

[30] See Rowan Scarborough, "Official warns Pentagon managers not to plan for budget cuts", Sept. 27 2012, The Washington Times http://www.washingtontimes.com/news/2012/sep/27/official-to-pentagon-managers-not-plan-budget-cuts/print/ (accessed Oct. 2, 2012)