AN ESTIMATE OF NEW BUSINESS EXPENSES
WHICH ARE PAID AND SUBSIDIZED
BY U. S. TAXPAYERS

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DGS ASSOCIATES
Potomac, Maryland 20854

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Not having any sales income at their beginnings, entrepreneurs incur negative cash-flow costs to finance a new idea's experimentation and development; a search for outside investors; market research; production and distribution; sales; financial, facility, and equipment planning; the resolution of legal matters such as terms and conditions of equity stock prospectuses, contracts, taxes, and patents; and facility, equipment, material, and personnel acquisitions andhirings.

Interestingly, all such new business costs are tax-deductible when they are incurred by organizations that have already reached sales positions. For example, suppose Corporation A incurred annual costs of $100 million to produce and deliver current products, and sold them for $110 million. Suppose, also, that all the new business activities mentioned incurred an actual cash-flow cost of $10 million, and that this amount was supplied by the $110 million positive cash-flow sales income. The corporation would not have any net taxable income to report, and no corporate tax to pay. The entire $10 million would be tax-deductible, according to IRS rules.

As noted, many new business activities come together in advancing an idea to a consumer sales position. Government, however, requires a public reporting of just one: so-called "research and development" (R&D). For companies over $ annual sales, the Securities & Exchange Commission (SEC) requires a public documentation of indirect, corporate R&D expenses.

According to the SEC's 10-K reports, in 1977, 624 of the nation's largest firms incurred $18 billion R&D, tax-deductible expenses. These expenses were paid by positive cash-flows generated by an aggregate $1 trillion sales income. In effect, U. S. citizens, acting as consumers of these firms' current goods and services, provided their internal R&D cash-flows which were spent to improve their current deliverables or innovate entirely new ones. And all taxpayers, by tax-deductibility of R&D cash-flows, subsidized about $9 billion in foregone federal revenue.

Even so, this amount of taxpayer subsidization had to be only the tip of the iceberg. Costs incurred for new business activities, other than R&D, are not separately reported and instead lie buried in various overhead accounts. These additional new business costs are also tax-deductible. This makes unanswerable, by how much do U. S. taxpayers subsidize the new business costs of ongoing businesses?

On the other hand, U. S. taxpayers do not subsidize the entrepreneurs' new business costs, nor do consumers provide their new business cash-flows. Without any sales income at their beginnings, all new business activities incur negative cash-flow costs. Negative cash-flow payments must come from the entrepreneurs' after-tax equities; savings, refinanced or sold personal properties.

Thus, the financial sources for payment of entrepreneurs' negative cash-flow costs will have been previously taxed, possibly up to 70% maximum
rates (on interest and investment income) compared to a corporation's 46% maximum rate (on net taxable profits).

Clearly, the U. S. tax system favors expanding existing businesses over starting new ones. This favoritism, however, is contrary to the rule of law. It constitutionally requires that all who wish to venture new ideas as a means of hopefully advancing their positions stand equally before all U. S. laws, whether they hope to advance their positions by starting new, profitable enterprises, or by profitably expanding existing businesses.

Nonetheless, all do not stand equally before U. S. law as just demonstrated. The tax code favors corporate savings over individual savings. And positive cash-flow gained from sales income, and directed to finance new business activities is tax-deductible.

We introduce this imbalance in public policy which governs the micro-economics of ideas for a reason. U. S. R&D, procurement, and assistance policies carry forward into administrative procedures the tax code's discriminatory treatment. These administrative policies also favor business expansions over new enterprise starts. A few comments about risk instruments which implement R&D, procurement, and assistance policies are in order.

Federal contracts, grants, and agency in-house R&D budgets financially implement government's R&D, procurement, and assistance policies. With the exception of in-house R&D budgets, these risk instruments fund individuals and private organizations when they act as suppliers to an agency's needs, or undertake scientific and technical activities which are considered in the national interest.

Grants and contracts differ mainly in the degree of government's involvement with the private recipient's activity; grants the least involvement and contracts the most. To further complicate matters, many kinds of grants are employed, as are many kinds of contracts, ranging from cost-type to firm fixed price, and the degree of agency involvement with the recipient's activities will vary even within a financial instrument type.

Grants and contracts, however, have some notable similarities. They transfer risk and expense of research and innovation from private investors to U. S. taxpayers, and neither grants nor R&D contracts demand from recipients ownership dilution, debt assumption, nor mortgage of current assets. Thus, the quid pro quos demanded from recipients for award of government's risk instruments are exceptionally more attractive to recipients than the quid pro quos demanded by Wall Street's risk instruments; equity stocks (ownership dilution demanded), bonds (unsecured debt demanded), and commercial loans (secured debt demanded).

Clearly, if and when Congress intervenes in the private economy to finance the development of new goods and services, government's risk instruments will always drive Wall Street's less attractive ones out of private capital markets. In short, demand for private venture capital will reduce as risk-taking is transferred to the public sector by means of
relatively attractive risk instruments. Like bees to honey, entrepreneurs, universities, nonprofits, and firms of any size, not wishing to dilute ownership of their ideas, not wishing to be burdened by debt, will swarm to federal agencies in hope of federal R&D contract or grant awards. Or, in another way, why should private investors risk their relatively meager savings to compete against government's "seed" capital which is distributed to private organizations by means of matchable risk instruments?

Thus, entrepreneurial chances become reduced to "single shot," up-or-down, agency "peer" committee decisions. Over the long term, and by narrowing entrepreneurial chances to "single-shot" committee decisions, government's financial instruments will tend to dramatically reduce the number of new market entries and foster the economic concentration of any industry that is mainly financed by government's exceptionally attractive risk instruments, such as aerospace and energy industries for example.

The remedy to this public policy promotion of economic concentration has been to treat "small" firms unequally in relation to "large" firms; that is, to favor "small" firms in government policies, and by this unequal treatment to hopefully balance-out discriminatory tax code treatment. The hope is, that by such unequal treatment, "small" firms will be encouraged to challenge the market positions held by "large" firms. "Small" firm R&D set-asides are an example. Unfortunately, this inequality is based on a false premise; namely, that ideas proposed by so-called "small" firms are somehow better than ideas proposed by so-called "large" firms.

Obviously, public policy favoritism of "small" firms also violates the rule of law, yet leaves untouched the discriminatory policy disjoint between those already in business of any size, and others not yet in business, but who hope to be.

This is the real issue. It cannot be addressed by centering remedies on relative sizes of ongoing businesses, but rather on remedies which promote equality of venture opportunity before the law, for individuals who are not yet in business, and ongoing businesses alike. According to current federal law and administrative policy, a firm that has already reached a sales position of any amount will be favored in the gaining of even more sales over the gaining of the very first sale hoped for by an entrepreneur not yet in business.

The issue raised here is a political issue which needs political resolution. It is not our intent to further develop one position or another, but, instead, we will estimate taxpayer-supplied, tax-deductible new business expenses which are incurred as indirect charges to current contracts, or are directly charged to grants specially awarded for the purpose of financing independent scientific and technical activity preparatory to soliciting NIH for Research Project Grant awards.

We hope the information will aid policy-makers in gaining new insights about the taxpayer's role in supporting the new business objectives of both private nonprofit and profit organizations.
LIMITATIONS

This study is limited to indirect, new business expenses which are cost-recovered in federal contract sales prices, or directly paid by special grants.

Unfortunately, new business expenses must be estimated because little audited data is available. All new business expenses which mark-up sales prices for delivered goods and services sold to or financed by the government and delivered to non-federal consumers cannot be isolated as separable cost elements. Only indirect contract costs incurred by weapons contractors for independent technical activity and new weapon's proposals have been audited and thus can be isolated from all other contract costs. Moreover, the audited data covers only 93 of the Defense Department's largest contractors out of over 24,000 separate suppliers. This audit limitation is serious because of the sheer magnitude of cash-flow which passes from the public to the private sector by means of contracts and grants. Some overall dimensions are in order.

In fiscal 1979, government contracted for $94.4 billion goods and services. Almost 17 million separate contract actions were involved. Also, in the same fiscal year, 58% of the federal budget (about $300 billion) was transferred to other government levels, private organizations, and individuals by means of government-to-recipient assistance arrangements; mainly by means of grants, direct payments, cooperative agreements, subsidies, loans, loan guarantees, insurance, services, information, and property donations.

Fiscal 1979 procurement expenditures of the Department of Defense (DoD), with 67% of all federal contract actions and 75% of all federal contract dollars, dominated federal procurement data.

Most all federal assistance expenditures, however, are not for the purposes of basic research and creating and advancing ideas to production, but instead assist the indigent, unfortunate, and handicapped survive in a competitive society. If we limit the assistance data to basic and applied research and development, fiscal 1979 R&D assistance awards are estimated at $8.6 billion. These were the monies awarded to universities, other private nonprofits, federally-funded R&D centers, state and local governments, and foreign performers. These expenditures financed basic research and applications of new knowledge to future goods, services, and processes.

In addition to R&D activity financed by contracts or grants, an R&D agency will retain some of its total R&D budget to finance its own, independent scientific and technical activity and administratively support to grant and procurement processes. For example, the National Institutes of Health (NIH) obligated a total $3 billion in fiscal 1979 for health research and development purposes, and awarded $2 billion to private performers by means of grants, and $467 million by means of contracts. The remainder, about $500 million, was retained by NIH to finance its own in-house scientific, technical activities, and administratively support grant and procurement processes.
Limiting assistance expenditures to only grants awarded for the purposes of basic research and creating and advancing new ideas to production, the grant activity of the National Institutes of Health (a component of Health and Human Services) dominates the data.

Also, the cooperative agreement, whereby government and the private recipient cooperatively share the cost and risk of a new development, is a relatively new federally-supplied risk instrument. Little formal data is publicly available for analytic purposes, although a DOE official commented that no indirect cost for independent technical and proposal expenses is negotiated into cooperative agreements. The DOE is the largest user of this instrument and in fiscal 1979 incurred approximately a $100 million cooperative agreement expenditure. But, for the reason mentioned, cooperative agreements do not qualify for this study.

It should be also noted that cost accounting and financial disclosures for research and development expenditures, as promulgated by Financial Accounting Standards Board, Standard #2, are different than cost accounting and reporting of independent R&D and proposal expenses, as promulgated by government's Cost Accounting Standard #420. Commercial suppliers are subject to FASB #2, and federal suppliers to CASB #420.

CASB #420 includes cost accounting and reporting of bid and proposal (B&P) expenditures, as such costs are indirectly charged to current government contracts. FASB #2, on the other hand, does not require disclosure of bid and proposal costs. The difference is significant because a federal contractor's B&P costs could range as high as 60% of the total independent technical and B&P costs which are incurred to prepare for and submit proposals to federal agencies. Thus, government's reported IR&D/B&P expenditures are not directly comparable to SEC 10-K reports of industries R&D expenses.
DOD AND NASA CONTRACTS

Background

Contractor independent R&D, bid and proposal costs — called IR&D/B&P — as an allowable, indirect charge to DOD and NASA contracts has had a long and controversial history. In March 1967 the GAO reported a need for improved control by DOD and NASA over the costs of bidding and related technical efforts charged to government contracts. Four years later, in response to an inquiry by Senator Proxmire, the GAO reported that a legislative line-item control of IR&D/B&P payments to contractors (rather than a negotiated, independent cost-recovery) could be developed. However, the GAO recommended no further legislative controls pending evaluation of legislative restrictions that had been placed on IR&D/B&P costs and had become effective January 1, 1971, (Public Law 91-441 had been passed. It required DOD to document relevancy of the contractor's proposed IR&D/B&P program to DOD's longer range interests.)

In early 1973, the Senate debated the military procurement bill for fiscal 1974 at which time Senator Proxmire introduced an amendment which, if adopted, would have reduced total IR&D/B&P expenditure incurred by audited defense contractors to 50 percent of the prior year's amount. However, the amendment was withdrawn when the Comptroller General agreed to conduct an in-depth investigation of the underlying assumptions and the overall justification for DOD's IR&D/B&P program.

The two-year GAO study culminated in joint hearings before the Subcommittee on Research and Development, Senate Committee on Armed Services, and the Joint Economic Committee. The hearings were held September 17, 24, and 29, 1975 and developed 802 pages of testimony and documentation. Aerospace industry leaders, representatives of the Tri-Industry Association (IDSA, NASA, ERDA, and Defense Department officials, representatives of academia, and knowledgeable outside observers testified. The hearings constituted the most thorough examination of IR&D/B&P federal contract cost-allowances to that point in time.

Not much came from the hearings. Documentation of IR&D/B&P relevancy to DOD's longer range interests is still required, and a small number of the largest aerospace contractors continue to expense about 4% IR&D/B&P costs in defense sales, as they had before the hearings were held.

It must be kept in mind that IR&D/B&P expenses represent only the tip of the iceberg when all new business costs are considered, as they must be considered by entrepreneurs who wish to enter DOD's R&D markets for the first time. Also, the IR&D/B&P amounts taxpayers indirectly pay and also subsidize are significant, even when considering that the data applies to only 93 of DOD's largest contractors of its over 24,000 suppliers.

Fiscal 1979 IR&D/B&P Payments to DOD Contractors

Audited IR&D/B&P costs incurred by and paid to 93 of DOD's largest contractors during the contractors' 1979 fiscal year were reported by the DCAA as follows:

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Contractors' Fiscal Year 1979
(in millions)

<table>
<thead>
<tr>
<th>Costs Incurred</th>
<th>Accepted by Gov't</th>
<th>DoD Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>IR&amp;D</td>
<td>$2,104</td>
<td>$1,517</td>
</tr>
<tr>
<td>B&amp;P</td>
<td>839</td>
<td>723</td>
</tr>
</tbody>
</table>

Total IR&D/B&P Costs (Excl. Foreign Mil Sales) $1,122

Sales - Total Government & Commercial $72,669
Sales - DoD (Excluding FMS) 32,584

Source: Congressional Record, 512392, September 10, 1980.

The audited 93 DoD contractors recovered 3.44% of DoD sales in IR&D/B&P indirect charges.

Other IR&D/B&P Payments

What, then, about DoD's remaining 24,000 suppliers? How much taxpayer subsidized and indirectly paid IR&D/B&P expense was recovered in their DoD contracts? In fiscal 1979, DoD's total procurement came to $70.4 billion and 85% was negotiated, not sealed bid, price competitive. This means that DoD contract negotiators had access to contractor cost break-outs for most DoD procurement, and presumably negotiated the IR&D/B&P amounts which had been proposed. However, no audited data is available and we must estimate the IR&D/B&P amount.

As previously noted, the 93 largest contractors' fiscal 1979 DoD sales amounted to $32.6 billion. The difference between $70.4 billion total DoD procurement, and $32.6 billion DoD sales of the 93 contractors — $37.8 billion — evidently was the DoD sales of all other DoD contractors, including the DoD sales of small businesses.

The question, then, is what is general industry practice in expenseing R&D in sales, as provided by the Financial Accounting Standards Board and the IRS? One would expect it to be followed in negotiating IR&D/B&P costs into DoD contracts.

As noted in a previous section, in 1977 624 of the nation's largest firms expensed $18 billion R&D in an aggregate $1 trillion sales, about 1.8% of sales. This amount, however, does not include equivalent B&P costs which were incurred by these firms. Other company-by-company data demonstrates a close correlation to the averaged 1.8% R&D expense. These percentages correlate closely with DoD's practice of about 4% IR&D/B&P cost-recovery when B&P cost, about 40% of total IR&D/B&P, is added.

However, some technology-intensive firms expense significantly more than about 2% of sales for R&D activities. (System Engineering Laboratories expensed 12.1% in 1977, for example.) On the other hand, most reported data for companies that sell price competitive goods and services to both private
and public consumers, incur a range of R&D expenses between 1 and 2 percent of total sales and report the amount as tax-deductible R&D expense. Lacking audited data over a range of price competitive and technology-intensive negotiated contracts, we must estimate an IR&D/B&P percentage, averaged over all DoD contractors, but excluding the 93 largest.

We believe it reasonable to estimate an average 1.5% of DoD's contracts sales was expensed as equivalent IR&D/B&P costs by DoD's remaining 24,000 suppliers. In FASB #2 terms, 1.5% IR&D/B&P would be roughly equivalent to 0.75% R&D, and the 1.5% IR&D/B&P estimate we believe is a conservative estimate for this reason. One and one-half percent IR&D/B&P costs recovered in $37.8 billion sales of all DoD contractors, excluding the 93 largest, yields an estimated $570 million which, when added to the $1,122 million incurred by and indirectly paid to DoD's 93 largest contractors, totals an estimated $1.7 billion IR&D/B&P expense indirectly paid and subsidized by U. S. taxpayers.

NASA IR&D/B&P Payments

NASA's major contractors are not separately audited, nor is NASA's IR&D/B&P program subject to the relevancy test as is DOD's. However, during the 1975 hearings, a NASA official estimated that $85 million IR&D/B&P cost was indirectly recovered by NASA contractors in fiscal 1973, with B&P indirect costs constituting an estimated 60% of the total. NASA contracted for slightly more than $2 billion during fiscal 1973, and the $85 million IR&D/B&P represents 4% of total contract dollars.

If we presume 4% of contract dollars has maintained to fiscal 1979, IR&D/B&P for that fiscal year would have amounted to $160 million. This amount would have been likely recovered in $4 billion R&D contracts which were awarded by NASA during fiscal 1979.

Remaining Federal Contracts

In fiscal 1979, DoD and NASA awarded $74 billion of government's total $94 billion procurement, rounding the data to the first two significant figures.

Thus all other agencies awarded an approximate $20 billion contracts, ranging from sealed bid, price competitive, to cost plus fixed fee negotiated contracts. Recognizing that small, technology-intensive firms may negotiate higher than 4% of their federal sales, and sealed bid, price competitive suppliers include in their sales prices significantly less than 4%, we will again use the previous averaged estimate of 1.5% of federal contract sales price to estimate an equivalent IR&D/B&P expense which was cost-recovered in all the remaining federal contracts. Thus, an additional $300 million independent technical proposal expense is estimated to have been indirectly paid and subsidized by taxpayers.
The estimated amount of actual and estimated IR&D/B&P expenses U. S. taxpayers indirectly paid and subsidized amounted to slightly more than $2 billion. The estimated amount U. S. taxpayers subsidized by tax-deductibility of IR&D/B&P expenses in corporate tax-reporting is $920 million, based on a marginal tax rate of 46%. The two sum to an estimated total $2.9 billion taxpayer support of federal contractor new business objectives.

It can rationally be concluded, however, that all new business costs incurred significantly more taxpayer financial support to federal contractor new business objectives than the nearly $3 billion which has been estimated.

IR&D/B&P Cost Accounting and Reporting

IR&D/B&P cost-accounting, as specified by the U. S. Cost Accounting Standards Board (CASB, now disbanded), should be noted. In its Standard 420, "Accounting for Independent R&D Costs and Bid and Proposal Costs," government requires federal contractors to mark-up negotiated independent, direct technical and proposal charges by the appropriate negotiated engineering or production overhead, and report the sum as an indirect IR&D/B&P cost. This negotiated cost is then allocated to General and Administrative corporate expenses and becomes part of the negotiated G&A total amount. The IR&D/B&P total cost, arrived at as described, is the amount incurred by DoD's largest 93 suppliers and publicly reported.

This accounting and reporting procedure develops an interesting situation. No DoD contractor would accept an R&D contract based on a sales price consisting of reported IR&D/B&P costs alone. An R&D contract directly incurs equivalent IR&D/B&P indirect charges, but also includes a G&A expense mark-up, plus a profit for the contracted R&D activity.

A way to illustrate this is to presume two identical technical tasks: one proposed as a contracted R&D activity and the other proposed as the same technical activity, but financed by indirect G&A charges to a current contract. Obviously, the firm's total cost to perform the identical direct technical activity must be the same in either instance, yet the total reported cost to taxpayers would differ in the two cases. The R&D contract could be priced as much as 35% higher than the reported IR&D/B&P amount.
In fact, DoD's IR&D/B&P, as an allowable contract cost, does cause an incremental profit to be awarded because profit is negotiated as a percent of total contract cost, and this includes the negotiated IR&D/B&P amount. Also, the corporate administration of IR&D/B&P programs does involve the time and expense of corporate executives for review, approval, negotiation, monitoring, and direction.

Nevertheless, even though identical direct technical activity must incur the same total cost if performed by means of an R&D contract, or by means of an IR&D/B&P indirect charge to a current contract, G&A costs are not added to reported IR&D/B&P amounts, nor are any incremental profits reported which are negotiated as a percentage of total allowed contract cost. In short, actual IR&D/B&P costs incurred by a federal contractor, as contrasted to those publicly reported, are no doubt higher in actuality.

Such is the audited and reported IR&D/B&P data enlarged by rough estimates across all government contracts. But many new business activities, other than independent R&D activities and proposal preparations, necessarily incur other indirect new business expenses which are needed to advance an idea to a marketable position. These additional, indirect new business expenses, however, are not reported.

For example, one large aerospace contractor expenses $5 million annually in G&A to finance the costs of a Washington office. This amount, or even a portion of it spent to assist the DoD contractor in the acquisition of new DoD business, is not charged to IR&D/B&P expense and thus is not reported. Entrepreneurs, however, must personally incur all new business costs, paid from after-tax equities, in marketing their first sales to DoD.

In brief, the $1.12 billion audited and reported as IR&D/B&P expensed in the DoD sales of 93 contractors must represent only the tip of the iceberg, when consideration is given to all indirect costs which must have been incurred by these firms during fiscal 1979 to finance the acquisition of new DoD business. Even the reported IR&D/B&P amount is likely under-reported, and other new business costs lie buried in the complexities of federal contract indirect cost-accounting.

All these actually incurred, new business costs are indirectly paid and subsidized by U. S. taxpayers, but are either under-reported or not reported at all.
Of the nation's fiscal 1979 $7 billion costs for health research and development, federal funds accounted for $4.3 billion, with NIH alone obligating $3 billion of this total. State and local funds provided an additional $400 million; industry $2 billion; and private nonprofits such as foundations, about $300 million.

NIH's percentage distribution of its $3 billion health R&D program was in-house 18%; higher education 60%; and other, 22%. By method of distribution, NIH externally distributed 66% of its $3 billion by means of research grants, and 16% by means of contracts. Twelve percent was retained in-house for intramural research and 6% retained for management costs, and for costs incurred by other agencies as required by interagency agreements.

In absolute terms, during FY 1979 NIH distributed $1.9 billion by means of 19,039 research and development grants, and $467 million by means of 1,836 contracts. It awarded $32 million grants to 2,200 people, $116 million to 1,256 institutions, and $12.5 million construction grants to 10 nonprofit recipients. The National Library of Medicine awarded $17 million. This left $464 million for NIH internal scientific and management activities out of its total $2,957 million fiscal 1979 R&D budget.

As can be appreciated, the research and development grant (called a "Research Project Grant") is NIH's dominant financial instrument for linking private performers to NIH's health research development goals.

Unlike DoD that separately accounts for and audits the IR&D/B&P expenses of 93 of its largest suppliers, NIH does not account for or audit independent scientific, technical and grant proposal costs which are incurred by private grant recipients and indirectly paid and subsidized by taxpayers. In short, it does not have an "IR&D/B&P" indirect cost equivalent in its grant cost structure.

Instead, a recipient's independent scientific, technical activity is directly financed by means of special grants called "Biomedical Research Support and Development Grants," shortened to "Supplemental Grants." In fiscal 1979, 489 Supplemental Grants were awarded, amounting to $45 million total taxpayer expenditure.

The award of these special grants is governed by internal NIH administrative policy. Any grantee that has been awarded three or more Research Project Grants (the main grant activity of the NIH) amounting to $200,000 or more aggregate award is then qualified to apply for a Supplemental Grant. In fiscal 1979, out of $1,928,636 total grant awards, consisting of Research Project grants ($1.4 billion), Research Center grants ($340 million), and other grants ($190 million), Supplemental Grant awards amounted to 2.25% of all grants awarded.

One might conclude that this percentage is less than the 4% average incurred by DoD's largest firms. But it must be recalled that about half of DoD's IR&D/B&P expense is B&P, and NIH's Supplemental Grant does not
include B&P. Thus, Supplemental Grant cost-reporting is similar to SEC reporting required by FASB 2 for financial reporting of industries independent R&D expenses. It requires a reporting of R&D expenses only, and not B&P.

In brief, NIH does not include a "B&P" DoD cost-equivalent in its Supplemental Grant cost structure. Presumably, such Research Project Grant proposal technical, marketing, and administrative costs, including the costs of marketing visits to NIH for the purpose of preliminary discussions, attendance at scientific symposia, preparation of papers, and the like, incur costs which are preparatory to preparing a Research Project Grant proposal. Apparently these "new business" costs are indirectly charged to other overhead operating expenses and thus are not separately accounted for, nor reported. Thus, the costs for independent scientific and technical activity which leads to a Research Project Grant proposal are directly paid, but proposal and marketing costs are not, and instead, must be paid from existing Research Project Grant indirect accounts.

As examples of the relationship between Supplemental Grants and Research Project Grants, one large mid-west university was awarded a $142,000 Supplemental Grant and $4.2 million Research Project Grants in the same fiscal year, a 3.5% relationship. It should be kept in mind that the university's costs to prepare and market new Research Project Grant proposals for follow-on years had not been cost-allocated to the Supplemental Grant, but instead, incurred indirect costs which were allocated to existing Research Project Grants and not reported.

Another mid-west university was awarded two Supplemental Grants totaling $312,000 and $4.6 million Research Project Grants in the same fiscal year, a 6.78% relationship. This percentage relationship is about half again more percentage of awards than the statistical IR&D/B&P 3.44% of fiscal 1979 DoD sales which was negotiated into DoD contracts held by 93 of DoD's largest suppliers. Yet, again, a DoD "B&P" cost-equivalent is not accounted for. This omission is significant because the B&P portion of DoD's overall IR&D/B&P program amounts to about 40% of the total IR&D/B&P indirect expense.

Private nonprofits, such as SRI and Battelle Memorial Institute are also awarded Research Project Grants. One private nonprofit was awarded $4.4 million Research Project Grants and a $150,000 Supplemental Grant in the same fiscal year, a 3.4% relationship.

Overall, no fees are awarded grant recipients, nor are grants awarded profit-incentive firms. Profits or fees, however, may be negotiated into NIH's R&D contract awards, including those held by private nonprofits.

**Summary, Supplemental Grants**

Here again, we see a taxpayer benefit given those who have already reached a grant relationship position with the NIH, but a benefit which is denied others who have not. Negative cash-flow costs to scientifically and technically prepare Research Project Grant proposals are indirectly
paid by the award of positive cash-flow Supplemental Grants. And a nonprofit’s administrative proposal and marketing costs are indirectly charged to existing Research Project Grants, but not reported.

The taxpayer direct cost for Supplemental Grants, however, is not significant when compared to IR&D/B&F indirect costs which were recovered in government’s fiscal 1979, $94.4 billion procurement program. Only $45 million direct taxpayer expenditure was incurred during fiscal 1979.

Nevertheless, the principle of favoring those who have already reached positions of three Research Project Grant awards, totaling $200,000 or more, in the gaining of future Research Project Grants over others who have not yet reached Research Project Grant positions, is starkly evident.
CONCLUSIONS

- Public law and administrative policy combine to favor expansion of existing businesses over the start of new, technical enterprises.

- All do not stand equally before federal law and administrative policy when hoping to advance their positions by venturing their own ideas, by starting a new profitable enterprise or by profitably expanding an existing business.
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13. Armed Services Procurement Regulations, Part I - Procurement of Research and Development, 4-101 ASPR.

14. Armed Services Procurement Regulations, Bid and Proposal Costs, 15-205.3 ASPR.

15. Armed Services Procurement Regulations, Independent R&D Costs, 15-205.35 ASPR.
This report contains estimates of new business costs which are indirectly or directly paid and subsidized by U. S. taxpayers.

Taxpayers play two new business financial roles when government contractually engages private organizations to supply its needs, or enters into a special grant relationship with a private recipient.

As to federal contracts, taxpayers, acting as consumers, pay a small percentage of the contract's total cost to finance the contractor's independent technical and proposal activities which are directed to the agencies longer range interests. And they also act as subsidizers of the amount which they pay, because such costs are tax-deductible in corporate tax reporting.

As to special grants, taxpayers directly pay the recipient's independent scientific and technical costs which are incurred preparatory to proposing Research Project Grants to the National Institutes of Health. The "new business" special grants are called "Supplemental Grants" and their total costs are also tax-deductible.

Taxpayer, new business financial role-playing has a special significance for the Small Business Administration. Commercial firms of any size, that do not have federal contracts or grants as part of their annual sales, place taxpayers in only one new business financial role — that of subsidizers of their new business expenses. Only those taxpayers who purchase a commercial firm's product or service also act as consumers, and partially provide the commercial firm's new business cash-flow which marks-up the delivered item's sales price.

Also, entrepreneurs, not yet having reached sales positions, do not place taxpayers in any new business financial role, as they personally incur negative cash-flow costs while "moving" their ideas to consumer sales positions. These negative cash-flow costs are paid from the entrepreneur's after-tax equities.

Thus, commercial firms gain less taxpayer financial support to further their business objectives than do federal contractors and the recipients of special grants. And entrepreneurs gain no taxpayer financial support whatsoever, either by direct or indirect taxpayer-supplied financial means.