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Empowering Small Businesses: The Impact of Reserved Contracts in U.S. Federal Procurement

Xinyue Xue

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Xinyue Xue*

1. Introduction

Among the measures to support small businesses in public procurement, reserved contracts have been widely adopted across countries, such as the United States (US), Brazil¹, Canada², the European Union (EU), and South Africa³. Reserved contracts refer to public procurement contracts for which only a predefined group of enterprises may bid. The key difference between the above-mentioned countries lies in the scope of the target group to determine whether they involve reserved contracts on a broader scale or targeting a more limited group of enterprises. For instance, the EU Public Sector Directive 2014/24/EU allows Member States to incorporate reserved contracts in public procurement, but the target group of reserved contracts is limited to sheltered workshops and economic operators whose main aim is to integrate disabled or disadvantaged persons.⁴ In US Federal procurement, reserved contracts are open to a much wider range of economic operators, including businesses that meet the small-business definition and size standards provided by the Small Business Administration (SBA).⁵

*Marie Curie Fellow at SAPIENS Network, PhD Candidate in Law at the University of Birmingham. Contact: xinyue.x@outlook.com This project has received funding from the European Union’s Horizon 2020 research and innovation programme under the Marie Skłodowska-Curie grant agreement No 956696. I wish to thank the George Washington University Law School for hosting me for a month in 2023, during which I conducted research for this paper. In particular, I am grateful to Professor Christopher Yukins for his support. I also extend my thanks to Professor Martin Trybus for his feedback on an earlier draft and to the participants of the SAPIENS Network Conference “Sustainability and Procurement” held in Birmingham on 20 June 2024 for their insightful comments on my presentation. The usual disclaimer applies.

¹ Guillermo Cardoza and others, ‘Barriers and Public Policies Affecting the International Expansion of Latin American SMEs: Evidence from Brazil, Colombia, and Peru’ (2016) 69 *Journal of Business Research* 2030.

² Christopher McCrudden, ‘Set-Asides in the United States and Canada’ in Christopher McCrudden (ed), *Buying Social Justice: Equality, Government Procurement, and Legal Change* (Oxford University Press 2007) <<https://doi.org/10.1093/acprof:oso/9780199232420.003.0007>> accessed 30 January 2023.

³ Lerato Shai and others, ‘Public Procurement in the Context of Broad-Based Black Economic Empowerment (BBBEE) in South Africa—Lessons Learned for Sustainable Public Procurement’ (2019) 11 *Sustainability* 7164.

⁴ Article 20 (1) Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC [2014] OJ L94/65.

⁵ A business can qualify as a small business if it meets the size requirements provided by the SBA. It is a self-certified approach. To be eligible to participate in socioeconomic set-aside programmes, a business needs to apply for a certification from the SBA.

Promoting small business participation in Federal procurement has been a bipartisan endeavour in the US.⁶ In 1953, with congressional approval, President Dwight D. Eisenhower enacted the Small Business Act (hereinafter referred to as the Act), codified in 15 U.S.C. Chapter 14A.⁷ The Act stipulates that:

It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to *insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including but not limited to contracts or subcontracts for maintenance, repair, and construction) be placed with small-business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation.*⁸

The fundamental aim of the Act is to preserve and expand competition in the American economic system.⁹ It recognises that full and free competition is necessary for not only the economic well-being but also the security of the country.¹⁰ Given that these benefits of full and free competition cannot be realised without releasing the full potential of small businesses, the Act requires that a fair share of government procurement contracts be placed with small businesses, which are reserved contracts, also termed set-aside programmes.¹¹ To implement reserved contracts and other small business policies, the SBA was established as an independent agency within the Federal government, under the supervision of the President.¹² The SBA is entrusted with the responsibility of assisting Federal agencies in contracting with small businesses and achieving small business contracting goals, which are numerical targets set by Congress.¹³

⁶ Congressional Research Services (CRS), *An Overview of Small Business Contracting*, July 2022, available online <https://crsreports.congress.gov/>, R45576, 3.

⁷ Small Business Act 1953 (USA).

⁸ 15 U.S.C. §631(a) (2021) (emphasis added).

⁹ *ibid.* It is stipulated that ‘the essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed.’

¹⁰ 15 U.S.C. §631(a) (2021).

¹¹ *ibid.*

¹² 15 U.S.C. §633 (a) (2021).

¹³ See 15 U.S.C. §644 (g) (1) (B) (2021). It is mandated that the Small Business Administration shall ensure that the cumulative annual prime contract goals for all agencies meet or exceed the annual Governmentwide prime contract goal established by the President. Currently, the governmentwide goal for participation of small

15 U.S.C. §631(a) also indicates that rather than increasing small business participation in procurement, full and free competition is the purpose, and assisting small businesses in government procurement is a necessary means of achieving that purpose.¹⁴ Congress reaffirmed its commitment to supporting small business development by passing the Small Business Contracting Program Improvement Act (SBCPI Act) 2007 and the Small Business Job Act 2010.¹⁵ The House Committee on Small Business, in its companion report to the SBCPI Act, made it clear that set-aside programmes are beneficial for market competition and local economic development.¹⁶ This report also acknowledged the potential benefits of promoting small business development for Federal contracting, which can increase the diversity of suppliers, and an expanded supplier base would lead to greater product quality and lower prices.¹⁷ Providing contract opportunities for small businesses in government procurement also facilitates their business environment, which might lead to positive economic benefits from a stronger small business sector.¹⁸

Based on the interpretation of the Act, reserved contracts for small businesses are utilised to bolster their competitiveness, and a more competitive small business sector is expected to sustain and enhance overall competition in the national economy. This paper focuses on the question of whether ensuring a fair proportion of small business participation in government procurement can encourage and develop their actual and potential capacity. The other question of whether a stronger small business sector will enhance the well-being of the economy will not be discussed in this paper. To evaluate whether the reserved contracts regime achieves the goal of encouraging and developing the actual and potential capacity of small businesses, the following sections discuss the current legal and regulation regime of reserved contracts and its impacts on small businesses and Federal procurement.¹⁹

businesses is that not less than 23 per cent of the total prime contract value shall be reserved for small businesses for each fiscal year. 15 U.S.C. §644 (g) (2) (A) mandates that the head of each Federal agency shall set targets for contracting with small businesses annually, in consultation with the SBA.

¹⁴ 15 U.S.C §631 (a) (2021).

¹⁵ CRS R45576 (n 6) 2.

¹⁶ *ibid*, at 2 citing US Congress, House Committee on Small Business, *Small Business Contracting Program Improvements Act, report to accompany HR 3867, 110th Cong, 1st sess, 22 October 2007, H Rept 110-400* (GPO 2007) 4.

¹⁷ CRS R45576 (n 6) 2.

¹⁸ *ibid* 2.

¹⁹ 15 U.S.C. §631(a) (2021).

2. Target Groups of Reserved Contracts: Small Businesses and Socioeconomic Small Businesses

In addition to small businesses in general, the Act specifically identifies four types of small businesses to be supported in contracting with Federal agencies: service-disabled veteran-owned small businesses (SDVOSBs), historically underutilised business zones (HUBZone) small businesses, small disadvantaged businesses (SDBs) and women-owned small businesses (WOSBs). The Act stipulates that:

It is the *policy* of the United States that small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women, shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems.²⁰

Initially, there was no overlap between small business set-asides and the support for socioeconomic groups.²¹ The approach to support socioeconomic groups was mainly through monitoring contract performance, prohibiting contractors from discriminating against employees on the basis of ethnicity or race and improving employment opportunities for individuals in minority groups.²² In the late 1960s, the Section 8(a) programme was proposed to support minority-owned businesses through reserved contracts.²³ Subsequently, Congress formalised the socioeconomic set-aside programmes and established government-wide contracting goals for socioeconomic small businesses.²⁴

²⁰ 15 U.S.C. §637 (d) (1) (2021).

²¹ Congressional Research Service, 'SBA's "8(a) Program": Overview, History, and Current Issues' (2022) R44844 <https://crsreports.congress.gov> accessed 12 Jan 2024, 4.

²² *ibid* 4.

²³ Jonathan J. Bean, *Big Government and Affirmative Action: The Scandalous History of the Small Business Administration* (University Press of Kentucky, 2001), 66.

²⁴ Congress codified the 8(a) set-aside programme in 1978 and the Small Disadvantaged Business (SDB) programme in 1987. Set-asides for Women-Owned Small Businesses (WOSBs) were proposed by Congress in the Equity in Contracting for Women Act of 2000 and incorporated into the Small Business Reauthorization Act of 2000. For a discussion of the history, see Congressional Research Service, 'Minority Contracting and Affirmative Action for Disadvantaged Small Businesses: Legal Issues' (2010) RL33284 <<https://crsreports.congress.gov>> accessed 12 Jan 2024; For small business contracting goals, see U.S. Small Business Administration, 'SBA Goaling Guidelines | U.S. Small Business Administration' <<https://www.sba.gov/document/report-sba-goaling-guidelines>> accessed 29 November 2023.

The purpose of socioeconomic set-aside programmes is to redress the discrimination experienced by the owners of these small businesses in the past.²⁵ Providing business opportunities for enterprises within these target groups ultimately benefits the individuals who own or work for these enterprises.²⁶ This objective differs from that of general small business set-asides. Socioeconomic set-aside programmes are, in essence, part of a broader initiative known as affirmative action.²⁷ Affirmative action is typically associated with historically discriminated groups, whether based on race, ethnicity, or gender.²⁸

In summary, small business policy and affirmative action are two distinct movements despite both employing reserved contracts to support their respective target groups of enterprises. This paper argues that it is important to differentiate between the set-aside programmes for socioeconomic groups and those for small businesses in general. From a definitional perspective, small businesses are typically defined by economic indicators, such as the number of employees and annual revenue. In contrast, socioeconomic small businesses are defined by the social attributes of the owners or employees. If a policy is designed to support small businesses, the economic characteristics of the business may change over time, whereas changing the social attributes might prove challenging, regardless of the incentives offered by the policy. It is reasonable to assume that socioeconomic set-asides or other affirmative action measures do not seek to change the social attributes of the target groups but rather aim to compensate for past discrimination and improve their business development. Therefore, this paper focuses on reserved contracts for small businesses in general, irrespective of their social attributes.

3. Regulation on Reserved Contracts for Small Businesses in US Federal Procurement

Section 15 of the Act stipulates that small businesses shall receive any contract award when the Small Business Administrator and the contracting agency determine that it is in the interest

²⁵ William M Leiter and Samuel Leiter, *Affirmative Action in Antidiscrimination Law and Policy: An Overview and Synthesis, Second Edition* (State University of New York Press 2011), 19. Also see Robert Fairlie and Justin Marion, 'Affirmative Action Programs and Business Ownership among Minorities and Women' (2012) 39 *Small Business Economics* 319, 319.

²⁶ Fairlie and Marion (n 25) 320.

²⁷ Defining affirmative action is challenging as it comprises components from various sources of legislation and court rulings rather than constituting a single coherent policy. It is considered to encompass policies in different spheres, including employment, education, and government contracting. See Harry Holzer and David Neumark, 'Assessing Affirmative Action' (2000) 38 *Journal of Economic Literature* 483. Also see James E Jr Jones, 'The Origins of Affirmative Action Essay' (1987) 21 *U.C. Davis Law Review* 383; Leiter and Leiter (n 25).

²⁸ Holzer and Neumark (n 27) 1.

of ‘maintaining or mobilising the full productive capacity of the United States’, ‘war or national defense programs’, or ‘assuring that a fair proportion of the total purchases and contracts for goods and services of the government in each industry category (as defined under paragraph (2)) are awarded to small business concerns’.²⁹ Codified in Chapter 1 of Title 48 of the Code of Federal Regulations, the Federal Acquisition Regulation (FAR) stipulates rules regulating procurement activities of all executive agencies.³⁰ Part 19 of the FAR provides detailed rules on reserved contracts for small businesses.

3.1 Procurement below the simplified acquisition threshold

FAR 19.502-2 provides that Federal agencies are generally required to reserve contracts valued between the micro-purchase threshold and simplified acquisition threshold exclusively for small businesses unless the contracting officer reasonably expects that there would be fewer than two or more small businesses bidding for this contract.³¹ According to FAR 2.101, the micro-purchase threshold is USD 10,000, and the simplified acquisition threshold is USD 250,000 in most cases.³² Agencies are required to use simplified acquisition procedures to the maximum extent for contracts valued below the simplified acquisition threshold, including contracts not exceeding the micro-purchase threshold.³³ The purpose of simplified acquisition procedures is to reduce administrative costs, which is one of the guiding principles for Federal procurement, but also to improve opportunities for small businesses by reserving contracts.³⁴ Although simplified acquisition procedures have fewer procedural requirements, agencies are still required to ensure that best value is guaranteed. For instance, contracting officers shall display the procurement needs publicly, but the solicitation can be done orally if this is more efficient.³⁵ Competition is required in these procurement procedures, but mainly from small businesses, including all socioeconomic small businesses.

Although this appears to be a broad set-aside for small businesses, some resources have a higher priority over small businesses. Before applying a simplified acquisition procedure, agencies shall assess if their procurement needs can be satisfied by the required sources of supply,

²⁹ 15 U.S.C § 644 (a)(1) (2021).

³⁰ 48 C.F.R. § 1.101 (2023), the FAR can be accessed online via www.acquisition.gov.

³¹ 48 C.F.R. § 19.502-2 (2023).

³² 48 C.F.R. § 2.101 (2023).

³³ 48 C.F.R. § 13.003(a) (2023). According to FAR 2.101, the micro-purchase threshold is USD 10,000, and the simplified acquisition threshold is USD 250,000 in most cases.

³⁴ 48 C.F.R. § 13.002 (2023).

³⁵ 48 C.F.R. § 5.101(a)(2)(ii) (2023).

including the Federal Prison Industries (FPI), the Committee for Purchase from People Who are Blind or Severely Disabled, the Federal Supply Schedules operated by the GSA, or any existing indefinite delivery/indefinite quantity (IDIQ) contracts.³⁶ Furthermore, agencies are required to use the government-wide commercial purchase card when the value of the procurement does not exceed the micro-purchase threshold.³⁷ The purchase card is a method of payment, it does not limit the choice of the contracting officer to procure from a sole source or a competitive procedure.³⁸ If the price is reasonable, micro-purchases can be made without a competitive procedure.³⁹ Thus, the contracts below the micro-purchase threshold are not exclusively reserved for small businesses, and it can be challenging for them to find information about those contracts if not publicly solicited.

3.2 Procurement exceeding the simplified acquisition threshold (the Rule of Two)

For procurement above the simplified acquisition threshold (USD 250,000), FAR 19.502-2 requires that contracting officers shall set aside any acquisition for small business when there is a reasonable expectation that ‘offers will be obtained from at least two responsible small business concerns’ and ‘award will be made at a fair market price’.⁴⁰ To determine whether there is a reasonable expectation, a contracting officer shall consider factors such as past procurement experiences and market research of an item or a similar item.⁴¹ Apart from soliciting a single award, agencies can award multiple delivery order contracts, which are the aforementioned multiple-award contracts. FAR 19.504 states that ‘contracting officers may, at their discretion, set aside orders’ placed under multiple-award contracts for small businesses.⁴² Thus, the Rule of Two does not automatically apply to multiple-award contracts. If the contracting officer decides to reserve contracts for small businesses in a multiple-award

³⁶ 48 C.F.R. § 13.003(a) (2023). IDIQ contracts are multiple-award contracts which involve more than two contractors in one solicitation. See 48 C.F.R. § 2.101 (2023). Multiple-award contracts are similar to framework agreements in the EU. For a comparative analysis, see Christopher R Yukins, ‘Are IDIQs Inefficient? Sharing Lessons with European Framework Contracting’ (2008) 37 Public Contract Law Journal 545.

³⁷ 48 C.F.R. § 13.201 (b) (2023).

³⁸ According to 48 C.F.R. § 32.1108 (2023), a purchase card charge authorises a financial institution to make instant payments to the contractors, and the government will reimburse the financial institution.

³⁹ 48 C.F.R. § 13.203 (2023).

⁴⁰ 48 C.F.R. § 19.502-2 (b) (2023). According to 48 C.F.R. § 19.502-3 (2023), if a total set-aside is not appropriate, the contracting officer shall consider partial set-asides, which reserve part of a contract exclusively for small businesses to compete.

⁴¹ 48 C.F.R. § 19.502-2 (b) (2023).

⁴² 48 C.F.R. § 2.101 (2023). A multiple-award contract can be a contract that is a Multiple Award Schedule issued by the GSA (for example, a GSA Schedule Contract) or an indefinite delivery/indefinite quantity contract that involves more than two sources in the same solicitation.

contract, there are three approaches. First, the contract can be fully set aside for small businesses or any socioeconomic small businesses, thereby requiring all bidders and suppliers under the multiple-award contract to be small businesses.⁴³ The second approach involves reserving a portion of a multiple-award contract exclusively for competition among small businesses or socioeconomic small businesses, while the remainder of the contract is solicited through open competition.⁴⁴ The third approach, known as ‘reserves’, permits contracting officers to reserve orders for small businesses or socioeconomic small businesses under a fully and openly competitive multiple-award contract, provided that at least two small businesses are on the supplier list for this contract.⁴⁵ Orders under ‘reserves’ are only permissible when total or partial set-asides are not feasible.⁴⁶ The rule concerning ‘reserves’ appears across multiple provisions in the FAR, potentially causing confusion for small businesses. Firstly, ‘reserves’ cannot be utilised if total or partial set-asides are feasible. Secondly, one precondition for employing ‘reserves’ is that small businesses have already secured awards under a multiple-award contract, meaning at least two small businesses are included on the supplier list after succeeding in the initial competition. Once the supplier list is established, reserving a portion of the multiple-award contract for small businesses is unfeasible. The intricacies of implementing reserved contracts in multiple-award contracts adds additional burdens on contracting officers to reserve contracts for small businesses. Thus, set-asides in multiple-award contracts are not frequently used by Federal agencies.⁴⁷ Although there are three approaches to reserve contracts for small businesses under multiple-award contracts, the decision to reserved a contract remains within the discretion of the contracting officer. The White House announced an executive memorandum through the Office of Management and Budget (OMB) for all chief acquisition officers and senior procurement executives to urge Federal agencies to increase small business participation in multiple-award contracts.⁴⁸ The Memorandum specifically mandates that agencies apply the Rule of Two to all contract orders under multiple-award contracts, with limited exceptions.⁴⁹ Despite being a presidential

⁴³ 48 C.F.R. § 19.504 (b) (2023).

⁴⁴ *ibid.*

⁴⁵ 48 C.F.R. § 19.504 (c) (2023).

⁴⁶ 48 C.F.R. § 19.501 (a)(2) (2023).

⁴⁷ Executive Office of the President, Office of Management and Budget, ‘Memorandum for Chief Acquisition Officers, Senior Procurement Executives’ (25 January 2024) https://www.whitehouse.gov/wp-content/uploads/2024/01/REV_Increasing-Opportunities-to-Small-Businesses-under-MACs-CATS-Final-Copy-1-25-24.pdf accessed 20 February 2024, 2.

⁴⁸ *ibid.* 2.

⁴⁹ Executive Office of the President (n 47) 2.

mandate for Federal agencies, implementation may be delayed without accompanying regulatory changes.

3.3 Limitations on subcontracting and the nonmanufacturer rule

When a set-aside contract is awarded, FAR 19.505 stipulates that a small business shall not allocate more than 50% of the payment from the agency to subcontractors that are not ‘similarly situated entities’.⁵⁰ Certain exceptions apply, such as in construction procurement, where the permissible percentage is 85%.⁵¹ A ‘similarly situated entity’ refers to a subcontractor within the same category as the contractor. For instance, if the prime contractor is a small business owned and controlled by women, the ‘similarly situated entity’ is such a business.⁵² This rule ensures that a small contractor does not subcontract the majority of the reserved contract to businesses not in a similar situation. Without this rule, Federal agencies might divert the contract to a preferred subcontractor, which is not selected through a competitive process.⁵³ A scandal occurred with the Food and Drug Administration (FDA) in 2008 when an Alaska Native-owned business, Alaska Newspaper Inc. (ANI), was awarded a public relations campaign contract valued at USD 300,000 through a set-aside.⁵⁴ After the award was made, ANI subcontracted most of the contract to Qorvis Communications, a company that the FDA initially intended to contract with, as reported by the Washington Post.⁵⁵ This case demonstrated how the set-aside programme was used to circumvent competition and manipulate procurement outcomes. As Schooner noted, this practice contravenes the principles of Federal procurement; being neither transparent nor competitive.⁵⁶ While the selection of subcontractors is not regulated by procurement law, the limitations on subcontracting serve to mitigate the risk of manipulation. As discussed earlier, set-aside programmes are a justified exception to open and full competition in Federal procurement. The limitations on subcontracting ensure that set-asides are not exploited by Federal agencies to evade

⁵⁰ 48 C.F.R. § 19.505 (b) (1) (2023).

⁵¹ 48 C.F.R. § 19.505 (b) (iii) (2023).

⁵² 15 U.S.C. 657s (e)(2).

⁵³ Kate M Manuel, ‘The Inapplicability of Limitations on Subcontracting to “Preference Contracts” for Small Businesses: Washington-Harris Group’ (2010) Congressional Research Service R40998 <<https://crsreports.congress.gov>> accessed 14 Jan 2024, 8.

⁵⁴ Robert O’Harrow Jr, ‘FDA Takes End Run to Award Contract to PR Firm’ (2 October 2008) <<http://www.washingtonpost.com/wp-dyn/content/article/2008/10/01/AR2008100103061.html>> accessed 15 January 2024.

⁵⁵ *ibid.*

⁵⁶ O’Harrow Jr (n 54).

competition. Additionally, they ensure that small businesses perform the awarded contracts, thereby gaining experience and enhancing their capacity.

The limitations on subcontracting do not apply to non-reserved contracts, even when a small business is awarded the contract with a preference in the evaluation process.⁵⁷ In a bid protest, a contract was awarded through a negotiation procedure where the solicitation specified that being an SDVOSB and understanding the requirements were the most important evaluation factors, where price was the least important factor.⁵⁸ The Government Accountability Office (GAO) refers to this type of procedure as a ‘preference contract’ for the target group, in this case, SDVOSBs.⁵⁹ After the contract was awarded, the contractor subcontracted more than 50% of the contract with a non-SDVOSB.⁶⁰ The bid protestor alleged that the contractor violated the limitation on subcontracting rule.⁶¹ However, the GAO determined that this rule only applies to reserved contracts, whereas the contract in question was openly competed with a preference for SDVOSB bidders.⁶² Consequently, it is argued that this may lead to an increased use of preference contracts compared with reserved contracts among agencies, as preference contracts are not subject to the limitations on subcontracting.⁶³

Another rule that limits the transfer of benefits from reserved contracts to large businesses is the nonmanufacturer rule, which applies to small businesses that do not manufacture, process, or produce the product themselves.⁶⁴ This rule mandates that the products supplied by the small contractor to the agency must also be produced by small businesses, unless the SBA grants a waiver for this requirement.⁶⁵

3.4 The coherence between the pursuit of competition and reserved contracts

FAR 1.102(a) stipulates guiding principles for the Federal procurement system, which is to ‘deliver on a timely basis the best value product or service to the customer while maintaining

⁵⁷ See Manuel (n 53) 1.

⁵⁸ US Government Accountability Office, ‘Washington-Harris Group | U.S. GAO B-401794,B-401794.2’ (Nov 16 2009) <<https://www.gao.gov/products/b-401794%2Cb-401794.2>> accessed 15 January 2024, 3.

⁵⁹ *ibid* 1.

⁶⁰ US GAO (n 58) 3.

⁶¹ *ibid* 5.

⁶² US GAO (n 58) 5.

⁶³ M Manuel (n 53) 7.

⁶⁴ 48 C.F.R. § 19.505 (c)(1) (2023).

⁶⁵ *ibid*.

the public's trust and *fulfilling public policy objectives*.⁶⁶ Following this overarching provision, Paragraph (b) outlines four expectations for the Federal procurement system.⁶⁷ The procurement system shall satisfy customers regarding cost, quality, and timeliness of the delivered product or service, which requires agencies to maximise the use of commercial products and services, contract with experienced businesses or businesses with a superior ability to perform, and to *promote competition*.⁶⁸ The other three aspects of the guiding principles include minimising administrative operating costs, conducting business with integrity, fairness, and openness, and *fulfilling public policy objectives*.⁶⁹ It can be inferred from this provision that Federal procurement is intended to achieve 'best value' while simultaneously fulfilling public policy objectives, including small business policy.

Reserving contracts for small businesses constitutes an exception to the principle of full and open competition.⁷⁰ Nevertheless, the Act illustrates that the purpose of reserved contracts for small businesses is to preserve competitive enterprises and foster full and free competition in the national economy.⁷¹ It may seem counterintuitive that the aim of an exception to competition is to promote competition. However, the first 'competition' refers to the principle of full and open competition as stipulated in FAR 6.101, while the latter 'competition' refers to the results of competition. Indeed, reserved contracts prohibit competition from large businesses, but may enhance competition from small businesses. Although it is an exception to the principle of full and open competition, it may result in increased competition. Evidence indicates that reserved contracts in Federal procurement from 2008 to 2018 attracted more bids than non-reserved contracts, thus offsetting the decreased competition from large businesses (firms outside targeted groups).⁷² FAR 6.000 also distinguishes the principle of open and full

⁶⁶ See 48 C.F.R. § 1.102 (a) (2023) (emphasis added). For a discussion about the principles of Federal procurement, see Steven L Schooner, 'Desiderata: Objectives for a System of Government Contract Law' (2002) 2 Public Procurement Law Review 103. It is argued that the underpinnings of the US procurement system rest upon three pillars: 'system transparency, procurement integrity, and competition'. While additional goals exist, they remain the subject of ongoing debate. For instance, Schooner contends that the 'efficiency' of procurement has not universally been accepted as a fundamental goal within the procurement process. The anti-bundling rule exemplifies this stance, specifying that 'the reduction of administrative or personnel costs alone shall not be a justification for bundling of contract requirements unless the cost savings are expected to be substantial....' See 15 U.S.C. § 644(e)(2)(C) (2021).

⁶⁷ See 48 C.F.R. § 1.102 (b) (2023).

⁶⁸ See 48 C.F.R. § 1.102 (b) (2023) (emphasis added).

⁶⁹ *ibid* (emphasis added).

⁷⁰ 48 C.F.R. § 6.101 (2023) provides that '[...] with certain limited exceptions (see subpart 6.2 and 6.3), that contracting officers shall promote and provide for full and open competition in soliciting offers and awarding Government contracts.' 48 C.F.R. § 6.203 excludes set-asides for small business concerns from the principle of full and open competition.

⁷¹ 15 U.S.C. § 631(a) (2021).

⁷² Matilde Cappelletti and Leonardo M. Giuffrida, 'Targeted Bidders in Government Tenders' (2022) ZEW Discussion Papers, No 22-030, ZEW - Leibniz-Zentrum für Europäische Wirtschaftsforschung, Mannheim, 5.

competition and the results of the competition, noting that ‘this part does not deal with the results of competition (e.g., adequate price competition)’.⁷³ According to FAR 15.403-1(c)(1), adequate price competition involves two or more responsible offerors competing independently at reasonable prices, with their offers meeting the solicited requirements.⁷⁴ Although the determination to reserve contracts for small businesses is clear, in principle, a contract may not be reserved if the cost of the contract exceeds a fair market price.⁷⁵ Thus, in theory, contracts reserved for small businesses do not incur additional procurement costs to the agency. This aligns with the purpose of the small business set-asides, which is to increase the competitiveness of small businesses rather than to subsidise them to secure government contracts at inflated prices.

The discussion about open and full competition in procurement is more idealistic than practical in Federal procurement. Among contracting methods, sealed bidding (including two-step sealed bidding) and competitive proposals are competitive procedures that pursue open and full competition, whereas contracting by negotiation is not a competitive procedure.⁷⁶ Contracting officers are not permitted to discuss or negotiate with bidders in a sealed bidding procedure, and the award is made solely based on price or price-related factors.⁷⁷ Even though the FAR clearly states that agencies shall pursue competition and use competitive procedures, most procurement contracts are awarded through negotiated procedures.⁷⁸ Sealed bidding was frequently used until the twentieth century when contracting officers began to favour multilateral competitive negotiations.⁷⁹ In 2014, sealed bidding was used in only 2.06% of all Federal procurement contracts.⁸⁰ Negotiated proposals are the most used procedures, accounting for 38.64% of all Federal procurement.⁸¹ Single source solicitation (28.68%) and

⁷³ 48 C.F.R. § 6.000 (2023).

⁷⁴ 48 C.F.R. § 15.403 – 1 (c)(1) (2023).

⁷⁵ 15 U.S.C § 644 (a)(4)(7) (2021). According to 15 U.S.C § 637 (a)(3) (2021), a ‘fair market price’ shall be determined by the contracting agency based on the procurement history of the procurement requirement or a cost analysis if there is no satisfactory procurement history.

⁷⁶ 48 C.F.R. § 6.102 (2023).

⁷⁷ 48 C.F.R. § 14.101 (2023).

⁷⁸ See Patrick Bajari, Robert McMillan and Steven Tadelis, ‘Auctions Versus Negotiations in Procurement: An Empirical Analysis’ (2009) 25 *The Journal of Law, Economics, and Organization* 372, 373; also see Brad Nathan, ‘Show Your Hand: The Impacts of Fair Pricing Requirements in Procurement Contracting’ n/a *Journal of Accounting Research* <<https://onlinelibrary.wiley.com/doi/abs/10.1111/1475-679X.12561>> accessed 5 July 2024, 7.

⁷⁹ Christopher R. Yukins, ‘The U.S. Federal Procurement System: An Introduction’ (2017) *UPPHANDLINGSRÄTTSLIG TIDSKRIFT* 69 <https://www.urt.cc/?q=node/187> GWU Law School Public Law Research Paper No 2017-75; GWU Legal Studies Research Paper No 2017-75 (SSRN) <https://ssrn.com/abstract=3063559>, 79.

⁸⁰ *ibid* 81.

⁸¹ Yukins (n 79) 81.

IDIQ contracts (21.42%) were also used frequently.⁸² Regarding the number of bids, sealed bidding has the lowest ratio of one bid, and it is common to have only one bidder for a solicitation across all Federal procurements.⁸³ Competitive procedures are less used compared with non-competitive procedures, especially contracting by negotiation. This observation may reveal that agencies favour procedures other than sealed bidding because they would evaluate fewer bids, whereas sealed bidding often necessitates evaluating more bids.

In summary, reserved contracts are an exception to the principle of open and full competition, but the actual competition might not be compromised as more small businesses are incentivised to compete with similarly situated businesses. This paper argues that the criticism that reserved contracts reduce competition is untenable.⁸⁴ In fact, the principle of open and full competition is a compromised principle, which has to coincide with the pursuit of various policy objectives.⁸⁵ It can be argued that public policy objectives are not secondary in the US Federal procurement regulation; they are an integral part of the system.

4. Achievement of Small Business Contracting Goals in Federal Agencies

As discussed earlier, Congress establishes numerical targets for the Federal government to contract with small businesses, referred to as small business contracting goals. The first government-wide goal in prime contracting with small businesses was enacted in 1988, and these goals have since evolved to encompass various subgroups of small businesses.⁸⁶ Presently, the Act mandates that 23% of total eligible prime contract spending for the Federal government shall be allocated to small businesses.⁸⁷ The current contracting goals, categorised by socioeconomic groups, are listed in Table 1.

Small Business Category	Small Business Contracting Goals
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⁸² *ibid* 81.

⁸³ Karam Kang and Robert A Miller, ‘Winning by Default: Why Is There So Little Competition in Government Procurement?’ (2022) 89 *The Review of Economic Studies* 1495, 1496.

⁸⁴ There is criticism that reserved contracts for small businesses distort competition in the public procurement marketplace. For example, see William Kirkwood, ‘The Evolution of Small Business Preferences in the United States and Selected Lessons Learned for the European Union’ (2016) 11 *European Procurement & Public Private Partnership Law Review* 311.

⁸⁵ 48 C.F.R. § 1.102 (a) (2023) provides that ‘the vision for the Federal Acquisition System is to deliver on a timely basis the best value product or service to the customer, while maintaining the public’s trust and fulfilling public policy objectives’.

⁸⁶ For more information, see SBA, ‘SBA Goaling Guidelines | U.S. Small Business Administration’ (n 24).

⁸⁷ 15 U.S.C § 644 (g)(1)(A) (2021).

Small Business Concerns	Not less than 23% of the total value of all prime contract awards for each fiscal year.
SDBs	Not less than 12% of the total value of prime contract and not less than 5% subcontract awards for each fiscal year.
WOSBs	Not less than 5% of the total value of all prime contract and subcontract awards for each fiscal year.
SDVOSBs	Not less than 3% of the total value of all prime contract and subcontract awards for each fiscal year.
HUBZone	Not less than 3% of the total value of all prime contract and subcontract awards for each fiscal year.

Table 1 Statutory Small Business Contracting Goals⁸⁸

Each Federal agency is required to establish individual agency contracting goals with small businesses and subgroups of small businesses after consulting with the SBA.⁸⁹ These goals of individual agencies may differ from the government-wide goals.⁹⁰ The SBA, in addition to meeting its own goals, tracks and reports on the performances of other Federal agencies toward meeting these goals. While the SBA ensures that each agency sets annual goals and monitors their achievements relative to these goals, there are no punitive consequences for agencies that fail to meet them.⁹¹ When an agency falls short of a small business contracting goal, the result is simply a corrective action report to be delivered to the SBA.⁹² Government-wide goals are statutory, whereas agency-specific contracting goals are typically outlined in annual agency reports and do not carry administrative mandates or legal obligations.⁹³ In 2021, Executive Order 13985 proposed that the annual spending on SDBs should reach 15% by 2025. To achieve this goal, the Office of Management and Budget issued a Memorandum in 2024 requiring agencies to reserve 13% of contract value for SDBs.⁹⁴

⁸⁸ SBA, ‘SBA Goaling Guidelines | U.S. Small Business Administration’ (n 24).

⁸⁹ 15 U.S.C § 644 (g)(2)(A) (2021).

⁹⁰ SBA, ‘SBA Goaling Guidelines | U.S. Small Business Administration’ (n 24).

⁹¹ CRS, ‘Federal Small Business Contracting Goals’, (IN12018, 26 July 2023) <<https://crsreports.congress.gov/product/pdf/IN/IN12018>> accessed 15 December 2023, 2.

⁹² *ibid* 2.

⁹³ Kidalov and Snider hold a similar opinion. Congress uses a mixed approach of discretionary and mandatory tools to achieve the ‘fair share’ and ‘maximum practicable opportunity’ for small businesses. See Max V Kidalov and Keith F Snider, ‘US and European Public Procurement Policies for Small and Medium-Sized Enterprises (SME): A Comparative Perspective’ (2011) 13 Business and Politics 1, 20.

⁹⁴ Executive Office of the President, Office of Management and Budget, ‘Memorandum for the Heads of Executive Departments and Agencies M-24-01’ (25 October 2023) <https://www.whitehouse.gov/wp-content/uploads/2023/10/M-24-01-Increasing-the-Share-of-Contract-Dollars-Awarded-to-Small-Disadvantaged-Businesses_Final.pdf> accessed 20 January 2024, 1.

The Federal government’s performance in implementing small business contracting goals has not always been satisfying. As stated by the SBA, ‘the Federal government *tries* to award at least 5% of all Federal contracting dollars to small disadvantaged businesses each year’, ‘the Federal government *tries* to award at least 3% of all Federal prime contracting dollars to HUBZone-certified small businesses each year’.⁹⁵ To monitor and assess agency performance in meeting these goals, the SBA annually compiles a scoreboard, and the General Services Administration (GSA) also publishes annual reports. Since 2013, progress has been made towards meeting these goals, but the goals for WOSB and HUBZone small businesses have rarely been met, except in 2015 and 2019 for WOSBs. The SDB goal has been consistently met since 2006, and the SDVOSB goal since 2012. Despite the satisfaction with exceeding the goals, concerns have arisen about the accuracy of calculations and proper attribution of credits to small business programs by agencies.⁹⁶ In 2014, the SBA’s Inspector General reported that approximately USD 400 million in contracts were awarded to ineligible small businesses, which were nonetheless included in agencies’ calculations to meet small business goals.⁹⁷ Additionally, controversy surrounds the inclusion of contracts awarded to former programme participants towards contracting goals.⁹⁸ These issues suggest a potential overestimation in calculations, which may inaccurately portray Federal agencies as effectively achieving their contracting goals with small businesses. To address these concerns, the SBA requires that a contract cannot be counted twice against the overall small business contracting goal if it is awarded to a WOSB but simultaneously an SDVOSB.⁹⁹

Fiscal Year	Overall	WOSB	SDB	SDVOSB	HUBZone
2022	√	×	√	√	×
2021	√	×	√	√	×

⁹⁵ See SBA, ‘Types of Contracts | U.S. Small Business Administration’ <<https://www.sba.gov/Federal-contracting/contracting-guide/types-contracts>> accessed 15 December 2023 (emphasis added).

⁹⁶ SBA Office of Inspector General, ‘Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020’ (11 October 2019) https://www.sba.gov/sites/default/files/2019-10/SBA-OIG-Report-20-01_0.pdf accessed 20 May 2023, 2.

⁹⁷ *ibid* 2.

⁹⁸ SBA Office of Inspector General, (n 96); also see U.S. Government Accountability Office, Report to Congressional Requesters, ‘Small Business Administration: Leadership Attention Needed to Overcome Management Challenges’ (GAO-15-347, September 2015) <<https://www.gao.gov/assets/680/672929.pdf>> accessed 15 January 2024.

⁹⁹ See SBA Office of Policy, Planning & Liaison, Office of Government Contracting & Business Development, ‘FY2023 Goaling Guidelines’ (20 December 2022) <https://www.sba.gov/sites/sbagov/files/2023-01/FY23%20Small%20Business%20Goaling%20Guidelines_Final_221130%20%281%29.pdf> accessed 15 December 2023.

2020	√	×	√	√	×
2019	√	√	√	√	×
2018	√	×	√	√	×
2017	√	×	√	√	×
2016	√	×	√	√	×
2015	√	√	√	√	×
2014	√	×	√	√	×
2013	√	×	√	√	×
2012	×	×	√	√	×
2011	×	×	√	×	×
2010	×	×	√	×	×
2009	×	×	√	×	×
2008	×	×	√	×	×
2007	×	×	√	×	×
2006	×	×	√	×	×

Table 2: Small Business Contracting Goals Scoreboard¹⁰⁰

In 2022, approximately 26.5% of the total Federal contract value, amounting to approximately USD 162.9 billion, was awarded to small businesses, representing new heights in contracting with small businesses.¹⁰¹ Under the Act and the FAR, there is no prescribed maximum limit for agencies in contracting with small businesses. Federal agencies are encouraged to prioritise small business set-aside programmes over open and full competition, a principle underscored by pertinent case law.¹⁰² In the case of *Management & Training Corporation v. United States*, the US Court of Federal Claims upheld the authority of agencies to reserve contracts for small businesses, even after meeting the small business contracting goals.¹⁰³ This legal framework

¹⁰⁰ The data before 2019 (including 2019) is obtained from the Bipartisan Policy Center, ‘Supporting Small Business and Strengthening the Economy Through Procurement Reform’ (July 2021) <<https://bipartisanpolicy.org/report/supporting-small-business-and-strengthening-the-economy-through-procurement-reform/>> accessed 15 December 2023; the data after 2019 is obtained from the SBA website ‘Small business procurement scoreboard overview’ <<https://www.sba.gov/document/support-small-business-procurement-scorecard-overview>> accessed 15 December 2023.

¹⁰¹ *ibid*, ‘Small business procurement scoreboard overview’.

¹⁰² 48 C.F.R. § 19.203 (e) states that ‘Small business set-asides have priority over acquisitions using full and open competition. See requirements for establishing a small business set-aside at subpart 19.5.’

¹⁰³ *Management & Training Corp v United States* (2014) 115 Fed Cl 26, 36.

theoretically allows agencies to reserve as many contracts as possible for small businesses and socioeconomic small businesses. However, in practice, the total value of contracts awarded to small businesses has consistently been approximately the same as the established contracting goals, indicating that agencies are not substantially incentivised to contract with small businesses beyond the numerical targets.

The performance of agencies in meeting small business contracting goals has garnered attention in economic and management literature. Hemmatian et al. identified three critical organisational factors influencing decisions on set-asides within Federal agencies: administrative discretion, workplace discrimination, and legislative oversight.¹⁰⁴ Of these factors, legislative oversight demonstrates a positive correlation with the contract values of socioeconomic set-asides, whereas administrative discretion and workplace discrimination show negative correlations.¹⁰⁵ This finding is corroborated by Resh and Marvel, whose study underscores the positive impact of an internal SBA oversight office on the contract value of small business set-asides.¹⁰⁶ Thus, effective oversight plays a pivotal role in ensuring agencies achieve their small business contracting goals.

In summary, despite Congress assigning oversight responsibilities to the SBA for small business contracting within Federal agencies, there is no statutory framework empowering the SBA to enforce action against agencies failing to meet small business contracting goals.¹⁰⁷ The GAO has recommended enhancing SBA oversight of both prime contracting and subcontracting with small businesses.¹⁰⁸ However, without statutory authority, substantial change to the current framework is unlikely.

¹⁰⁴ Iman Hemmatian and others, 'Exploring the Effects of Discretion, Discrimination, and Oversight on the Inclusiveness of Small Business Contracting' in Jeffrey A Robinson (ed), *Entrepreneurship for Social Change* (Emerald Publishing 2021) 203-231, 205.

¹⁰⁵ *ibid* 214.

¹⁰⁶ See William Resh and John Marvel, 'Loopholes to Load-Shed: Contract Management Capacity, Representative Bureaucracy, and Goal Displacement in Federal Procurement Decisions' (2012) 15 *International Public Management Journal* 525, 540.

¹⁰⁷ CRS, 'Federal Small Business Contracting Goals' (IN12018, 18 January 2024) <<https://crsreports.congress.gov/product/pdf/IN/IN12018#:~:text=According%20to%20the%20FY2023%20Guidelines,aggregate%2C%20meet%20or%20exceed%20the>> accessed 15 Jan 2023.

¹⁰⁸ GAO, 'Small Business Subcontracting: Some Contracting Officers Face Challenges Assessing Compliance with the Good Faith Standard | U.S. GAO' <<https://www.gao.gov/products/gao-24-106225>> accessed 5 December 2023.

5. Impact Analysis of Reserved Contracts on Small Businesses and Federal Procurement

Previous sections have discussed the regulatory framework in the FAR governing reserved contracts for small businesses in Federal procurement, as well as the performance of agencies in meeting small business contracting goals. This section shifts focus to the impact of reserved contracts on small businesses and Federal procurement, aiming to evaluate whether reserved contracts have achieved or will achieve the objective outlined in the Act. These objectives include encouraging and developing the actual and potential capacity of small businesses while also preserving free competitive enterprises.¹⁰⁹ It is also crucial to understand the impact of reserved contracts on competition and the cost of Federal procurement. Achieving the objectives at a high cost and with adverse effects on competition raises important trade-offs that legislators and Federal agencies must consider. Conversely, if the objectives are not met and higher costs are incurred, alternative measures to support the development of small businesses should be explored.

5.1 The impact of reserved contracts on small businesses

From the perspective of small businesses, reserved contracts do not reduce contract sizes or participation costs, nor do they ease the qualification requirements. However, reserved contracts lower the barrier to entry by allowing small business bidders to compete exclusively against businesses with similar levels of capacity and development. This reduces the pressure of competing with large businesses, thereby motivating more small businesses to participate in government procurement. Nakabayashi estimated that without set-aside programmes, approximately 36% of small businesses would not participate in the procurement market.¹¹⁰

Winning public procurement contracts can indeed facilitate the growth of small and young businesses.¹¹¹ However, these businesses typically secure public procurement contracts through competitive auctions designed to promote open competition. Reserved contracts, in contrast, foster a dependence among small businesses, and this has been shown to be

¹⁰⁹ See Section 1.

¹¹⁰ Jun Nakabayashi, 'Small Business Set-Asides in Procurement Auctions: An Empirical Analysis' (2013) 100 *Journal of Public Economics* 28, 29.

¹¹¹ See Claudio Ferraz, Frederico Finan and Dimitri Szerman, 'Procuring Firm Growth: The Effects of Government Purchases on Firm Dynamics' (National Bureau of Economic Research 2015) w21219 <<http://www.nber.org/papers/w21219.pdf>> accessed 16 August 2022. In this research, only close auctions are included in the empirical analysis. A close auction is defined as an auction in which both the winner and loser place a bid within the last 30 seconds of the auction, and the winning margin is less than 0.5%. Bids are compared solely based on price.

detrimental rather than beneficial for their development.¹¹² Bates and Williams observed that young firms relying heavily on government procurement are more likely to fail compared with businesses with more diversified revenue streams.¹¹³ There is concern that some short-lived small businesses may function as front companies specifically established to bid on reserved contracts, only to dissolve once the contract concludes.¹¹⁴ This situation introduces risks of manipulation and inefficiency in government contracting, topics to be explored in the subsequent section.

Reserving contracts for small businesses, in principle, benefits those who are more successful in winning contracts, raising concerns that a few successful businesses dominate within target groups. Yukins and Schooner used a vivid metaphor to emphasise that procurement preferences are ‘blunt, rather than surgical’ instruments, highlighting their imprecision that tends to favour a select number of ‘sophisticated participants’ within specified groups.¹¹⁵ Such ‘sophisticated participants’ may exploit their eligibility in multiple set-aside programmes, for instance, a company qualifying as both a WOSB and SDVOSB. The agency will receive credit against two categories in the small business contracting scoreboard, compared to contracting with a small business that has no special socioeconomic status. Although there is no hierarchy among these socioeconomic programmes, the socioeconomic programmes take precedence over general small business set-asides under the Rule of Two.¹¹⁶ Contracting officers perform market research and evaluate performance against the agency’s small business contracting goals to identify the suitable socioeconomic category for reserving a contract.

Given the absence of guidelines for Federal agencies regarding priorities, tension exists among various small business programmes. In practice, a contracting officer may employ a ‘cascade’ approach to assess bids from different categories of small businesses.¹¹⁷ The evaluation

¹¹² Timothy Bates and Darrell Williams, ‘Do Preferential Procurement Programs Benefit Minority Business?’ (1996) 86(2) *The American Economic Review* 294, 297.

¹¹³ *ibid* 297.

¹¹⁴ Bates and William (n 112) 297.

¹¹⁵ Steven L Schooner and Christopher R Yukins, ‘Public Procurement: Focus on People, Value for Money and Systemic Integrity, Not Protectionism’ (The George Washington University Law School Public Law and Legal Theory Working Paper No 460, Legal Studies Research Paper No 460, 2009) 87, 89.

¹¹⁶ 48 C.F.R. § 19.203 Relationship among small business programs: (c) Above the simplified acquisition threshold. For acquisitions of supplies or services that have an anticipated dollar value exceeding the simplified acquisition threshold definition at 2.101, the contracting officer shall first consider an acquisition for the small business socioeconomic contracting programs (i.e., 8(a), HUBZone, SDVOSB, or WOSB programs) before considering a small business set-aside (see 19.502-2(b)). However, if a requirement has been accepted by the SBA under the 8(a) Program, it must remain in the 8(a) Program unless the SBA agrees to its release in accordance with 13 CFR parts 124, 125, and 126.

¹¹⁷ *ibid*.

proceeds in cascading tiers until a successful offeror is identified.¹¹⁸ For instance, if the initial tier is restricted to WOSBs and the subsequent tier to SDVOSBs, the contracting officer ceases evaluation upon identifying a winner in the first tier, thereby excluding tenders in the second tier from the evaluation process. The contracting officer retains discretion over the number of tiers to be assessed.¹¹⁹ The ‘cascade evaluation’ method may have introduced more inefficiencies than anticipated.¹²⁰ The tension created by the cascading evaluation method fails to motivate small businesses towards greater competitiveness but rather encourages them to acquire additional socioeconomic attributes that guarantee benefits from set-aside programmes in the short term.

In summary, while reserving contracts lowers barriers to entry for small businesses by excluding competition from large businesses, it inevitably fosters small businesses’ reliance on set-aside programmes, which is unsustainable for long-term business competitiveness. Small businesses relying on procurement contracts face negative repercussions when government risk is involved.¹²¹ Reserved contracts establish a comfort zone for small businesses to circumvent competition with large businesses. Although business opportunities are provided for small businesses in the short term, reserved contracts do not motivate small businesses to compete with large businesses over non-reserved contracts. Consequently, reserved contracts fail to achieve the objectives outlined in the Act to encourage and develop the potential capacity of small businesses over time.

5.2 An impact analysis of reserved contracts on Federal procurement

Economic literature has explored the relationship between reserved contracts and the costs of contracting authorities, though the extent of any cost increase remains ambiguous. Nakabayashi’s research indicates that contracting authorities may not experience cost increases; in fact, they would potentially see reductions in costs when contracts are reserved for small

¹¹⁸ Acquisition Advisory Panel, ‘Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress’ (January 2007) <https://www.acquisition.gov/sites/default/files/page_file_uploads/ACQUISITION-ADVISORY-PANEL-2007-Report_final.pdf> accessed 12 January 2024, 22.

¹¹⁹ *ibid.* This measure has been limited in procurement by the DoD as it is not efficient for both socioeconomic small businesses and the DoD.

¹²⁰ Acquisition Advisory Panel (n 118) 22.

¹²¹ Rhett Buttle, ‘Looming Federal Government Shutdown Threatens Small Business Growth And Productivity’ (*Forbes*) <<https://www.forbes.com/sites/rhettbuttle/2023/09/28/looming-Federal-government-shutdown-threatens-small-business-growth-and-productivity/>> accessed 7 January 2024.

businesses.¹²² Similarly, Tkachenko et al. observed that reserved contracts attracted more bids than non-reserved contracts in the procurement procedures for homogeneous goods, thereby lowering the price paid by the contracting authority.¹²³ Szerman's study found no discernible effect on unit prices of off-the-shelf goods between reserved contract auctions and non-reserved auctions.¹²⁴ Despite these findings suggesting that set-asides do not increase costs for contracting authorities, in practice, contracting officers note that the limited capacity of small business contractors to handle complex contracts may lead to poor performance of the contract and eventually increased costs.¹²⁵ Cappelletti and Giuffrida's analysis of Federal procurement from 2008 to 2018 revealed higher cost overruns and more frequent contract performance delays in reserved contracts for small businesses.¹²⁶ Moreover, they noted that reserved contracts for socioeconomic small businesses exhibited poorer contract performance compared to those for general small businesses.¹²⁷ It is argued that the more restricted the target group is, the higher the risk of poor performance of the contract, regardless of the competition during bidding.¹²⁸

It is evident that for homogenous products, reserved contracts do not significantly increase costs and may even reduce costs when increased competition among small businesses occurs in reserved contracts. Conversely, for services and works lacking clear standards, the uncertainties surrounding contract performance may escalate contracting authorities' costs. Nevertheless, the risk of suboptimal performance exists in both reserved and non-reserved contracts. This necessitates the implementation of more robust tools to monitor contract performances and the enhancement of supplier qualification evaluation. However, it should not serve as a justification for refraining from reserving contracts for small businesses.

¹²² Nakabayashi (n 110) 41.

¹²³ Andrey Tkachenko and others, 'Efficient Design of Set-aside Auctions for Small Businesses: an Empirical Analysis' (October 2019) <https://www.economia.unipd.it/sites/economia.unipd.it/files/20190240-b.pdf> accessed 19 May 2023, 3.

¹²⁴ Dimitri Szerman, 'Public procurement auctions in Brazil' (PhD thesis, The London School of Economics and Political Science (LSE), 2012) <<https://etheses.lse.ac.uk/681/>> accessed 23 June 2023, 80.

¹²⁵ See 'Exceeding Small Business Contracting Goals – Good News or Bad News? | LinkedIn' <<https://www.linkedin.com/pulse/exceeding-small-business-contracting-goals-good-news-bad-shelley-hall/>> accessed 4 December 2023. In this blog post, a contracting officer shared an experience of contracting with a small business for a window washing service. The small business contractor lacked certain equipment to perform the contract, such as elevated platforms, but they claimed that they would be capable to perform the contract before the contract was awarded.

¹²⁶ Cappelletti, Matilde; Giuffrida, Leonardo M. (2022) : Targeted bidders in government tenders, ZEW Discussion Papers, No. 22-030, ZEW - Leibniz-Zentrum für Europäische Wirtschaftsforschung, Mannheim <https://www.econstor.eu/bitstream/10419/261382/1/1811286933.pdf> accessed 15th December 2023, 2.

¹²⁷ *ibid* 17.

¹²⁸ See Cappelletti, Matilde (n 126) 5.

Athey et al. observed a 5% reduction in revenue from US Forest Service timber sales due to reserved contracts, suggesting potential higher costs associated with reserved contracts in procurement.¹²⁹ Although there are synergies between set-asides in government sales and government procurement, it is important to approach this application to procurement with caution. Although large suppliers are excluded from competition, suppliers in the target groups tend to bid more aggressively.¹³⁰ Federal procurement guidelines mandate the pursuit of fair market prices in set-aside programmes, and contracting officers are empowered under 15 U.S.C. 644 (a)(7) to withhold reserving contracts if small businesses cannot offer a fair price.¹³¹ Therefore, in theory, contracts reserved for small businesses should not result in additional costs for agencies. This aligns with the objective of reserved contracts for small businesses, which aims to enhance small businesses' competitiveness rather than subsidise them to secure government contracts at inflated prices. Given the discretionary authority of contracting officers to assess reasonable pricing expectations, it is reasonable to infer that products or services procured through reserved contracts do not significantly exceed fair market prices.¹³²

As previously discussed, Federal agencies utilise set-aside programmes to reduce the workload of evaluating offers. From the perspective of contracting officers, reserving a contract for small businesses reduces the volumes of tenders they need to evaluate unless there are more bidders in reserved contracts than in non-reserved contracts. Snider et al. highlight that agencies are implement socioeconomic set-aside programmes primarily to facilitate their operation, especially when faced with limited capacity to evaluate a large number of bids.¹³³ This organisational constraint incentivises agencies to utilise reserved contracts, including socioeconomic set-aside programmes.¹³⁴ Yukins argues that agencies lacking sufficient contracting capacity leverage SDB preferences to reduce transaction costs in procurement

¹²⁹ Susan Athey, Dominic Coey and Jonathan Levin, 'Set-Asides and Subsidies in Auctions' (2013) 5 *American Economic Journal: Microeconomics* 1, 2.

¹³⁰ Tkachenko et al (n 123) 23. The same view on this issue is held by Cappelletti and Giuffrida, See Cappelletti, Matilde (n 126) 17.

¹³¹ 15 U.S.C. 644 (a)(7) (2021) stipulates that a contract may not be awarded if the cost of the contract to the awarding agency exceeds a fair market price.

¹³² In a hearing hosted by the House Committee on Small Business, small business owners reported that agencies can avoid reserving a contract by stating that the price could be higher than a non-reserved contract without providing evidence. See House Committee on Small Business, 'Leveling the Playing Field: The State of Small Business Contracting' (Subcommittee Hearing, 11 May 2023) <<https://www.youtube.com/watch?v=tpaLbNRjcOE>> accessed 15th May 2023.

¹³³ Keith F Snider, Max V Kidalov and Rene G Rendon, 'Diversity Governance by Convenience? Federal Contracting for Minority-Owned' (2013) 37 *Public Administration Quarterly* 393, 399.

¹³⁴ *ibid* 399.

processes.¹³⁵ However, if contracting officers can reduce their workload by reserving contracts for small businesses, the small business contracting scoreboard would show improved performance. As noted earlier, while the overall small business contracting goal has been met in recent years, there has not been a significant increase in the value of contracts awarded to small businesses.¹³⁶ Agencies may derive benefits from implementing reserved contracts, but they also incur costs such as cost overruns or delays in contract performance. Contracting officers are likely to opt for contracting programmes with lower transaction costs.¹³⁷ Small business set-asides are not the least expensive option for contract award, yet they are also not the most costly.

In summary, reserved contracts deviate from the principle of open and full competition, but they may not necessarily compromise competitive outcomes, as small businesses bid more competitively and even aggressively when competing with similar companies, thereby avoiding price escalation.¹³⁸ Nonetheless, reserved contracts may entail higher risks of cost overruns and contract performance delays, leading to additional costs for contracting authorities. While existing empirical evidence offers mixed findings on whether reserved contracts increase costs for authorities, it is generally agreed that the long-term benefits of supporting small businesses outweigh the short-term costs for authorities, such as job creation and local economic development.¹³⁹

6. Conclusion

This paper analysed reserved contracts for small businesses in US Federal procurement, focusing on the regulatory framework and the impact of these contracts on small businesses and Federal procurement. Although reserved contracts represent an exception to the principle of full and open competition, they may not necessarily diminish actual competition compared to non-reserved contracts. Actual competition depends on a potential combined effect of increased participation from small businesses and decreased participation from large businesses. The impact of reserved contracts on procurement prices varies case by case, with

¹³⁵ Christopher R Yukins, 'A Versatile Prism: Assessing Procurement Law Through the Principal-Agent Model' (2010) 40 Public Contract Law Journal 63, 69.

¹³⁶ See Section 4.

¹³⁷ As discussed in Section 3.1, there are other contracting programmes apart from small business set-asides, such as placing orders in the Federal Supply Schedules operated by the GSA or contracting with the Federal Prison Industries.

¹³⁸ Tkachenko (n 123) 23.

¹³⁹ Ferraz, Finan and Szerman (n 111) 27.

current evidence indicating that reserved contracts generally do not exert a significant upward pressure on prices. On the other side of the market, the effect of reserved contracts on small businesses in the short term is positive, including potential turnover gains and increased profits. However, in the long term, reserved contracts do not foster incentives for small businesses or socioeconomic small businesses to enhance their capacity and compete effectively with large businesses. The cascade evaluation system, in particular, incentivises small businesses to acquire socioeconomic attributes to qualify for the first tier of bidders and multiple set-aside programmes rather than focusing on growing and developing their capacity. Reserved contracts may provide small businesses with contract opportunities in the short term. However, sustained reliance on reserved contracts can hinder their ability to compete with larger businesses in both the public procurement and private sectors over time. Such reliance contradicts the objectives of small business policies outlined in the Act, which aim to cultivate a robust small business sector and uphold market competition within the national economy.