TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

CORRECTED FISCAL NOTE

SB 2080 - HB 1946

March 7, 2014

SUMMARY OF BILL: Effective October 1, 2014, requires the State to use the federal definition of "small business concern" to define small businesses. Defines "Tennessee small business" as a business that is independently owned and operated with at least 51 percent of its controlling ownership residing in Tennessee. Requires the Chief Procurement Officer (CPO) to adopt a plan to maximize participation of Tennessee small businesses in state agency procurement and contracting. Requires the CPO to strive to achieve a minimum participation goal of 20 percent of Tennessee small businesses through both prime and second-tier state agency procurement and contracting opportunities. Requires the CPO to promulgate regulations authorizing an allowance for Tennessee small businesses in the evaluation of proposals for state contracts. Prohibits such allowance from exceeding five percent of the lowest responsive, responsible bidder meeting specifications and would be applied as follows: up to five percent for contracts up to $500,000; up to three and one-half percent for contracts up to $750,000; a mandatory two and one-half percent for contracts up to $1,000,000; and a mandatory two percent for contract that exceed $1,000,000. Mandates a two percent preference for construction contracts over $2,000,000 for general contractors, through the use of subcontractors, to utilize Tennessee small businesses to perform at least 50 percent of the work subject to the contract.

Directs the CPO to identify qualified Tennessee small businesses, to undertake training programs and other educational activities to enable Tennessee small businesses to compete for contracts on an equal basis with other businesses, and to provide necessary assistance to state agencies seeking to maximize participation of Tennessee small businesses. Prior to September 1 of each year, requires the Procurement Commission to include information concerning the effectiveness of the proposed legislation in the annual report submitted to the Governor and to each member of the General Assembly pursuant to the Tennessee Minority Owned, Woman Owned and Small Business Procurement and Contracting Act.

ESTIMATED FISCAL IMPACT:

On February 18, 2014, a fiscal note was issued estimating a fiscal impact as follows:

Increase State Expenditures - $18,476,200/FY14-15
$24,634,900/FY15-16 and Subsequent Years

The fiscal impact for contracts valued between $751,000 and $1,000,000 was based on an average one percent preference allowance rather than a mandatory two and one-half percent preference. The fiscal impact as well as the impact to commerce is being corrected. Based on additional information from the Department of General Services and further review, the estimated impact is:

(CORRECTED)

Increase State Expenditures - $19,406,000/FY14-15
$25,874,700/FY15-16 and Subsequent Years

Assumptions:

- The federal definition allows small businesses to have a maximum of 500 employees. The current state definition allows a small business to have a maximum of 99 employees.
- Currently, the Governor's Office of Diversity Business Enterprise (Go-DBE) has certified 1,016 businesses with 99 employees or less. According to the Department, an additional three diversity business liaisons will be required at a recurring cost of $166,179 [($39,996 salaries + $15,397 benefits and insurance) x 3].
- Based upon information pulled from Edison, in FY12-13, the state paid approximately $43,110,403 on contract payments to out-of-state vendors with contracts valued at less than or equal to $500,000. Assuming an average two and one-half percent preference allowance for in-state contracts, the recurring increase in state expenditures is $1,077,760 ($43,110,403 x 2.5%).
- In FY12-13, the state paid approximately $21,892,253 on contracts payments to out-of-state vendors with contracts valued between $501,000 and $750,000. Assuming an average one and three-fourths percent preference allowance for in-state contracts, the recurring increase in state expenditures is $383,114 ($21,892,253 x 1.75%).
- In FY12-13, the state paid approximately $82,655,319 on contracts payments to out-of-state vendors with contracts valued between $751,000 and $1,000,000. This bill mandates a two and one-half percent preference allowance for in-state contracts, the recurring increase in state expenditures is $2,066,383 ($82,655,319 x 2.5%).
- In FY12-13, the state paid approximately $1,109,064,143 on contracts payments to out-of-state vendors with contracts valued at greater than $1,000,000. This bill mandates a two percent preference allowance for in-state contracts, the recurring increase in state expenditures is $22,181,282 ($1,109,064,143 x 2%).
- The total recurring increase in expenditures is $25,874,718 ($166,179 + $1,077,760 + $383,114 + $2,066,383 + $22,181,282).
- Recurring state expenditures for FY14-15 will be $19,406,039 ($25,874,718 x .75) to reflect costs for three-fourths of the fiscal year due to the effective date of October 1, 2014.
- According to the Department of Transportation (TDOT), the proposed bill would not apply to the TDOT construction and maintenance contracts as the Department is exempt from Title 12, Chapter 3.

CORRECTED IMPACT TO COMMERCE:

Increase Business Revenue – $19,406,000/FY14-15
$25,874,700/FY15-16 and Subsequent Years

Increase Business Expenditures – Exceeds $9,703,000/FY14-15
Exceeds $12,937,400/FY15-16 and Subsequent Years

Other Commerce Impact – The increase in Tennessee small businesses as well as the increase in the number of contracts and procurements that will be awarded to these new Tennessee small businesses will increase business revenue. However, the eight states bordering Tennessee may enact retaliatory legislation that would mandate preferences for the businesses residing in those states. The reduction in state public contracting opportunities may have a negative impact on in-state job growth of those businesses affected by the retaliatory legislation. The costs of goods or services are increased for tax payers when a percentage differential is allowed. Such impact is not quantifiable.

Assumptions:

- Recurring business revenues of $25,874,718 as a result of mandatory preferences for Tennessee small businesses, as defined in the bill. For FY14-15, the increase in business revenue for three-fourths of the fiscal year is $19,406,039 due to the effective date of October 1, 2014.
- There will be an increase in business expenditures for the cost of providing goods and services sold. This increase in business expenditures is reasonably estimated to be 50 percent of any net new business revenue generated as a result of this bill. The increase in business expenditures for FY14-15 are estimated to exceed $9,703,019.50 ($19,406,039 x 50%); and the recurring increase in business expenditures for FY15-16 and subsequent years is estimated to exceed $12,937,359 ($25,874,718 x 50%).
- The current state definition allows a small business to have a maximum of 99 employees. Increasing, from 99 to 500, the number of employees a Tennessee small business may have will increase the number of contracts and procurements awarded to in-state businesses for good, services, and construction.
- According to a National Association of State Procurement Officials (NASPO) briefing paper, the cost of goods or services are increased for all tax payers when a percentage differential is allowed, meaning that the state will not get the same value for the dollars spent. This practice discourages firms that don’t meet the preference from participating in the procurement process which results in a smaller market competing for the state’s business. Experience has shown that when restricting a market, or implementing a preference, prices increase.
- Additional dollars spent locally may generate economic activity in the form of additional sales, jobs, and income. Short term increases in costs to state and local agencies may be offset by increases in tax revenue.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

Lucian D. Geise, Executive Director

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