

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

To: Members, Subcommittee on Agriculture, Energy and Trade
From: Committee Staff
Date: November 16, 2015
Re: Hearing: "Improving Size Standards for Small Farmers and Ranchers"

On Thursday, November 19, 2015 at 10:00 a.m., the Subcommittee on Agriculture, Energy and Trade will meet for the purpose of examining H.R. 3714, the "Small Agriculture Producer Size Standards Improvements Act of 2015." The bill would amend the Small Business Act (the Act)¹ and require the Small Business Administration (SBA) to establish small business size standards for agricultural producers through the notice and comment rulemaking process.² In contrast to the size standards established for all other industries by the SBA, the size standard for agriculture enterprises is established by statute and has not been updated in 15 years.

I. The Small Business Act and Small Business Size Standards for Businesses Other Than Agricultural Enterprises

a. Statutory Framework

The SBA size standards establish the maximum size a business can be and still be considered small. Section 3(a)(1) of the Act provides that "a small business concern . . . shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation."³ This definition includes "enterprises that are engaged in the business of production of food and fiber, ranching and raising of livestock, agriculture, and all other farming and agricultural related industries," although the Act never defines the term "agricultural related industries."⁴ However, the Act further states that, "notwithstanding any other provision of law, an agricultural enterprise shall be deemed to be a small business concern if it (including its affiliates) has annual receipts not in excess of \$750,000."⁵ For all other industries, the Act authorizes the Administrator of the SBA to establish small business size standards for the purposes of the Small Business Act and any other statute.⁶

Small business size standards determine whether small businesses may qualify for special treatment in the sale of goods and services to the federal government;⁷ access to guaranteed loans and

¹ 15 U.S.C. §§ 632-57s.

² A listing of agriculture producer industries can be found in the SBA's Table of Small Business Size Standards, 13 C.F.R. § 121.201 (subsectors 111 and 112 except for cattle feed lots and chicken egg production).

³ 15 U.S.C. § 632(a)(1).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at § 632(a)(2). The Administrator's size standards apply to all other federal programs unless that program contains its own definition of small business. *Id.* at § 632(a)(2)(C).

⁷ There are numerous procurement programs available to small businesses that restrict competition for federal contracts or give small businesses a preference. See COMM. ON SMALL BUS., SMALL BUSINESS ACT PROGRAMS FOR SMALL FEDERAL CONTRACTORS (2013), available at

other types of financial assistance; and obtain technical advice through various SBA resource partners. They also may be utilized by federal agencies as part of their regulatory analyses during the rulemaking process. Given the importance of the size standard determination, it is useful to explain in greater detail the process by which SBA establishes size standards.⁸

b. The SBA Size Standard Methodology

The SBA size standard methodology can best be described as a granular analysis of specific industry characteristics. The agency performs a statistical analysis of primary and secondary factors to establish a size standard for a specific industry, and that standard is expressed as the number of full-time employees at the concern over 12 months, the average annual receipts of the business over three years, or as an alternate size standard that looks at the level of production.⁹

The primary factors assessed by the SBA include an examination of four economic characteristics of the industry, such as average firm size, startup costs and entry barriers, industry competition, and the distribution of firms by size.¹⁰ An additional factor is the impact of a size standard change on SBA's federal contract assistance to small businesses.¹¹ The SBA also may assess industry specific considerations, such as technological changes and industry growth trends.¹²

Upon completing its analysis, the SBA then publishes a proposed size standard in the Federal Register. Final size standards are selected after input from the public through notice and comment rulemaking. In addition, size standards are subject to periodic review and revision every five years,¹³ again through notice and comment rulemaking.

In 2013, Congress enacted reforms to the Act that codify the factors SBA must consider and address when revising, modifying, or establishing size standards. As part of the notice of the proposed and final rule, the SBA must include: 1) a detailed description of the industry; 2) an analysis of the competitive environment for that industry; 3) the approach and sources of all data used to develop the proposed rulemaking; and 4) the anticipated effects of the proposed rule on the industry.¹⁴ This ensures that the size standard setting process is transparent and interested parties have adequate information on which to comment.

In short, the process established by Congress as implemented by the SBA for determining size standards creates a logical method for establishing small business size standards in order to facilitate the accomplishment of federal policy objectives as they relate to small business concerns. Unfortunately, the definition of a small business agricultural enterprise does not follow the same granular analysis as it is set by statute and only would be subject to periodic review if Congress acted regularly. As the production of agricultural goods has changed and is likely to change, a static definition of small business agricultural

http://smallbusiness.house.gov/uploadedfiles/small_business_act_programs_for_small_federal_contractors.pdf, for a discussion of small business procurement programs.

⁸ A detailed explanation of SBA's size standard methodology may be found in SBA, SBA SIZE STANDARD METHODOLOGY (2009) [hereinafter SBA White Paper], available at

http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

⁹ *Id.* at 10. This mirrors the grant of authorization in the statute. 15 U.S.C. § 632(a)(2)-(3).

¹⁰ SBA White Paper, *supra* note 8, at 11.

¹¹ *Id.* Despite the applicability of these size standards across federal agencies, the SBA does not examine the implications of such change on other federal statutes or programs.

¹² *Id.* at 12.

¹³ *Id.* at 1.

¹⁴ National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, § 1661, 126 STAT. 1632, 2083-84 (2013).

enterprise may not achieve various policy objectives designed to help small businesses. To understand this concern, it is necessary to examine the changes in agricultural production.

II. Modern Structure of Agriculture Operations

The United States agriculture industry continues to be defined by a large number of closely-held, family-owned operations.¹⁵ Of the nation's approximately 2.1 million farms and ranches, approximately 97.6 percent of farms are family-owned.¹⁶ These family farms account for 85 percent of domestic agricultural production.¹⁷

However, over the past few decades, a number of factors have altered the structure of farms and industry dynamics. New technologies and production methods have increased the productivity of the agriculture sector.¹⁸ This productivity also has resulted in increased competition¹⁹ among producers which has resulted in more output per acre and lower relative prices for agriculture commodities.

These changes compel agricultural enterprises to achieve larger economies of scale in comparison to their predecessors in order to maintain a viable agriculture production enterprise.²⁰ Achieving these economies of scale often requires the addition of more lands or livestock in order to justify investments in new production technologies.²¹ As the Subcommittee previously examined at a February 2, 2012 hearing,²² many individually family-owned farms have consolidated their individual operations into larger, enterprise unit family-owned operations in order to achieve economies of scale.²³ However, on 86.1 percent of farms, families still provide the majority of the labor.²⁴

Unfortunately, the influences of these changes may not fully be reflected in the current size standard for small agricultural enterprises. If the current definition does not encapsulate these changes in the agricultural sector, there could be negative consequences for small agricultural enterprises.

¹⁵ ERIK J. O'DONOGHUE, ECONOMIC RESEARCH SERVICE, UNITED STATES DEP'T OF AGRICULTURE, EXPLORING ALTERNATIVE FARM DEFINITIONS: IMPLICATIONS FOR AGRICULTURAL STATISTICS AND PROGRAM ELIGIBILITY 22-23 (2009), available at <http://www.ers.usda.gov/publications/eib-economic-information-bulletin/eib49.aspx>.

¹⁶ JAMES MACDONALD, ECONOMIC RESEARCH SERVICE, UNITED STATES DEP'T OF AGRICULTURE, FAMILY FARMING IN THE UNITED STATES (2014) [hereinafter USDA Family Farms], available at <http://www.ers.usda.gov/amber-waves/2014-march/family-farming-in-the-united-states.aspx#.U8K3pk1OW70>.

However, it should be noted that the relative share of production these farms contribute varies depending on commodity group, with family-owned farms accounting for 96 percent of corn, cotton, wheat and soybean production, 75 percent of dairy production, and 62 percent of fruits, vegetables and nursery production. *Id.*

¹⁷ *Id.*

¹⁸ Elizabeth Bechdol, Allan Gray, and Brent Gloy, *Forces Affecting Crop Production Agriculture*, 25 CHOICES 2 (2010), available at http://www.choicesmagazine.org/magazine/pdf/article_152.pdf. In addition to increased competition, there are relatively low barriers to entry into agriculture markets. *Id.* These factors are accounted for in the SBA's size standard methodology, but not in the statutory definition.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *The Future of the Family Farm: The Effect of Proposed DOL Regulations on Small Business Producers: Before the Subcomm. on Agriculture, Energy and Trade of the H. Comm. on Small Bus.*, 112th Cong. (2012), available at <http://www.gpo.gov/fdsys/pkg/CHRG-112hhrg76459/pdf/CHRG-112hhrg76459.pdf>.

²³ CAROLYN DIMITRI, ET. AL., ECONOMIC RESEARCH SERVICE, UNITED STATES DEP'T OF AGRICULTURE, THE 20TH CENTURY TRANSFORMATION OF U.S. AGRICULTURE AND FARM POLICY 12 (2005), available at <http://www.ers.usda.gov/publications/eib-economic-information-bulletin/eib3.aspx>.

²⁴ USDA Family Farms, *supra* note 16.

III. The Size Standard for Agriculture Producers Under the Act

Before 1985, the size standard for agricultural enterprises was established by the SBA through the notice and comment rulemaking process. On February 9, 1984, the SBA published a final rule establishing the size standard for agricultural producers as \$100,000.²⁵ However, Congress soon expressed concerns with the \$100,000 size standard for agricultural enterprises.

A report issued by the Senate Committee on Small Business in early 1985 stated, “this standard is much lower than that used for any other industry, and it excludes virtually all viable family farms in many areas of the country.”²⁶ The report additionally stated that while Senators Tom Harkin, Max Baucus and Dale Bumpers had offered an amendment to raise the size standard to \$500,000, they later withdrew the amendment in favor of an assurance that SBA would immediately revisit the issue.²⁷ Later that year, the Senate Committee on Small Business recommended to the Senate Committee on the Budget that the amendment be incorporated into omnibus budget legislation and noted that the amendment would have no budgetary impact.²⁸

The recommended amendment was included in the omnibus legislation that was enacted in 1986. The definition of a small business concern was amended to state, “[p]rovided, [t]hat notwithstanding any other provision of law, an agricultural enterprise shall be deemed to be a small business concern if it (including its affiliates) has annual receipts not in excess of \$500,000.”²⁹ The \$500,000 size standard was increased to \$750,000 in 2000.³⁰ The statutory size standard applies to 46 diverse categories of agricultural enterprises including: cotton farming; orange groves; tree nut farming; beef cattle ranching and farming; and shellfish farming.³¹

The consequences associated with establishing a single size standard for agricultural enterprises via statute may not have been fully realized or appreciated when the decision was made 30 years ago. For example, the authors included no forcing mechanism to require periodic review of the agricultural producer size standard to determine whether it was still appropriate. Periodic review of all other size standards – at least once every five years – is now required pursuant to the Small Business Jobs Act of 2010.³² The purpose of periodically reviewing size standards is to account for changes in industry structure and economic conditions, such as inflation.³³ Commodity prices and production inputs can fluctuate dramatically. Moreover, the single standard for 46 different agricultural industry subsectors does not distinguish between the various types of agricultural enterprises that may have significantly different economic characteristics. A statutory standard leaves it up to future Congresses to review and update the standard, which has not been done with any regularity.

²⁵ SBA, Small Business Size Standards, Final Rule, 49 Fed. Reg. 5024 (Feb. 9, 1984).

²⁶ S. REP. NO. 99-20, at 48 (1985).

²⁷ *Id.*

²⁸ S. REP. NO. 99-146, at 530 (1985).

²⁹ Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, Tit. XVIII, § 18016, 100 STAT. 82, 371 (1986).

³⁰ Consolidated Appropriations Act of 2001, Pub. L. No. 106-544, App. I, Tit. VIII, § 806, 114 STAT. 2763, 2763A-706 (2000). Unfortunately, there is no discussion of the provision in the accompanying report.

³¹ These industry categories are delineated under the North American Industry Classification System (NAICS), which is the standard used by federal statistical agencies to classify business establishments for the purposes of collecting, analyzing, and publishing statistical data related to the United States economy.

<https://www.census.gov/eos/www/naics/>.

³² Pub. L. No. 111-240, § 1344, 124 STAT. 2504, 2545-46 (2010).

³³ SBA White Paper *supra* note 8, at 38.

IV. Consequences of an Arbitrary Size Standard

An incorrect size standard may result in negative effects on federal small business policymaking objectives. Primary among these, for purposes of this memorandum, are procurement opportunities as procurement represents the sole scenario when alternative federal programs or standards are not available.³⁴

In terms of contracting and procurement opportunities, a more accurate definition of small agricultural enterprises would increase competition, thereby reducing prices, and strengthen our industrial base. In FY 2014, the federal government spent nearly \$400 million on raw agricultural goods.³⁵ Small businesses received over 89 percent of the awards in agricultural industries where SBA had established size standards.³⁶ However, in those industries using the \$750,000 statutory size standard, small businesses received only 27 percent of awards.³⁷ If more concerns were easily identifiable as small businesses, it could increase the opportunity for competition limited to small businesses, or at a minimum for outreach to small agricultural producers.

While the \$92 million in prime contracting opportunities awarded to industries with a \$750,000 size standard is not a large amount in terms of federal contract spending, a definitional change also could affect subcontracting and grant opportunities. States receive agricultural block grants may choose to prioritize purchases from small businesses, using the SBA definition. At a federal level, programs such as the Food for Peace Program³⁸ may create opportunities for small business sales. Most importantly, though, are subcontracting opportunities.

Pursuant to the Act, federal prime contractors, other than small business concerns, receiving prime contracts in excess of \$650,000 must negotiate a subcontracting plan with the government detailing how they will use small businesses as subcontractors.³⁹ This requirement also applies to subcontractors other than small businesses who receive subcontracts in excess of \$650,000.⁴⁰ This is important because in FY 2014, federal government spent \$5.8 billion on food manufacturing. This included nearly \$4

³⁴ Generally speaking, size standards also are used to determine eligibility for SBA's loan programs, technical assistance programs, and as agencies attempt to assess the effects of regulations on small business concerns under the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA). However, since agricultural enterprises receive the vast majority of financial and technical assistance from the United States Department of Agriculture (USDA), these are not relevant to the memorandum. *See, e.g.* USDA, Rural Development, Business and Industry Guaranteed Loans (2014), available at http://www.rurdev.usda.gov/bcp_gar.html. Likewise, if USDA believes the size standard is incorrect for purposes of the RFA, a process exists to establish an alternative size standard. However, USDA has not utilized this process in the past ten years, and doing so would likely only create additional work for USDA. *See* OFFICE OF ADVOCACY, SBA: HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT 14 (2012), available at http://www.sba.gov/sites/default/files/rfaguide_0512_0.pdf. To the extent that agencies utilize the SBA's standard, a too low standard may lead agencies to improperly conclude and certify their proposed regulations as not affecting a substantial number of small businesses. Letter from the Hon. Donald Manzullo and the Hon. Nydia Velázquez to Gary M. Jackson, Assistant Administrator for Size Standards, SBA, Comment Proposed Rule, Proposed Rule: Small Business Size Standards: Restructuring Size Standards (July 8, 2004) (on file with the Committee Chief Counsel). The USDA's 2010 proposed livestock marketing rule is an example of an agency adopting the statutory definition of small agricultural enterprise when conducting its threshold analysis for a proposed rule. USDA, Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Conduct in Violation of the Act, 75 Fed. Reg. 35,338, 35,348 (June 22, 2010).

³⁵ Report generated on November 4, 2015, using the Federal Procurement Data System. [Hereinafter FPDS Report]. Report on file with the Committee.

³⁶ *Id.* Small businesses received \$263,647, 420.29 out of \$295,699,071.59.

³⁷ *Id.* Small businesses received \$25,265,178.86 out of \$92,239,568.96.

³⁸ 7 U.S.C. § 1691.

³⁹ 15 U.S.C. § 637(d)(4).

⁴⁰ *Id.*

billion in contracts requiring subcontracting plans.⁴¹ Given that the current administratively set goal for subcontracting with small businesses is 34.06 percent of all subcontracted dollars, and food manufacturing requires that the contractor obtain raw agricultural products, the application of subcontracting rules to these contracts could result in billions of dollars of subcontracts being competed among small agricultural enterprises.⁴² Holding all else constant, to the extent that an updated size standard increases the number of small agriculture enterprises, more small firms would be able to compete for these contracts, which would strengthen the base of small agricultural enterprises.

V. The Need for Legislation and H.R. 3714, the “Small Agriculture Producer Size Standards Improvements Act of 2015”

Last Congress, the Subcommittee held a hearing to examine whether the existing statutory size standard for agricultural enterprises meets the needs of small agricultural businesses.⁴³ The Subcommittee received testimony from the SBA, a farmer, a cattle rancher, and an agriculture industry representative. The witnesses discussed how the input and labor costs of producing crops and livestock has risen and that the annual receipts of agricultural operations can vary significantly from year to year. Furthermore, the witnesses representing agricultural enterprises recommended that Congress consider eliminating the statutory size standard and allowing the SBA to establish size standards through the rulemaking process.⁴⁴ In his testimony, Mr. John Shoraka, the Associate Administrator for Government Contracting at the SBA, stated that the agency was capable of conducting the analyses to establish size standards for agricultural enterprises, and if given the authority, the SBA would use the same notice and comment process it currently uses to establish size standards for other industries.⁴⁵

On October 8, 2015, Rep. Mike Bost (IL-12) introduced legislation to modernize the size standard for agricultural enterprises. H.R. 3714 would amend the Small Business Act by striking the statutory size standard of \$750,000 for agricultural enterprises and require the SBA to establish size standards for agricultural enterprises through notice and comment rulemaking, as it does for all other industries. In addition, the legislation clarifies that the size standards for agricultural enterprises would be subject to the periodic review process established by the Small Business Jobs Act of 2010. Thus, the legislation would establish a transparent process for setting size standards for agricultural enterprises, which would be periodically reviewed to ensure that they accurately reflect the changing economic characteristics of various agricultural enterprises.

VI. Conclusion

The statutory size standard for agricultural enterprises has not been revised since it was last updated by Congress 15 years ago. H.R. 3714 would amend the law to ensure that size standards for agricultural enterprises are established through the notice and comment process after a granular analysis of specific industry characteristics and reviewed on a periodic basis to determine if changes are needed. If enacted, this legislation will ensure that size standards for agricultural enterprises are established and regularly reviewed through a transparent process that permits input from small farmers and ranchers.

⁴¹ FPDS Report, *supra* note 35.

⁴² SBA, Government-Wide Procurement Scorecard (2015), available at https://www.sba.gov/sites/default/files/files/FY14_Government-Wide_SB_Procurement_Scorecard_Public_View_2015-04-29.pdf.

⁴³ *Modernizing Agriculture Producer Size Standards: Before the Subcomm. on Agriculture, Energy and Trade of the H. Comm. on Small Bus.*, 113th Cong. (2014), available at <http://www.gpo.gov/fdsys/pkg/CHRG-113hhrg88924/pdf/CHRG-113hhrg88924.pdf>.

⁴⁴ *Id.* at 5-10.

⁴⁵ *Id.* at 4.