

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

To: Members, Subcommittee on Agriculture, Energy and Trade
From: Committee Staff
Date: July 22, 2014
Re: Hearing, Size Standards for Agricultural Enterprises

On Thursday, July 24, 2014 at 10:00 a.m., the Subcommittee on Agriculture, Energy and Trade will meet for the purpose of receiving testimony on the process for establishing small business size standards for agricultural producers¹ pursuant to the Small Business Act (the Act).² Unlike the size standards established for all other industries by the Small Business Administration (SBA), the size standard for agriculture enterprises is statutorily established. This inconsistent treatment of agricultural enterprises denies what might otherwise be determined to be small agricultural enterprises access to federal programs intended to help small businesses. The purpose of the hearing is to determine whether reforms to the statutory standard are necessary in order to ensure more equitable treatment for small agricultural enterprises.

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

a. Statutory Framework

The Act states 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, aquaculture, and all other farming and agricultural related industries,” although the Act never defines the term “agricultural related industries.”⁴ However, the Act continues to state 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.” While this provides a concrete size standard for small agricultural enterprises, 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.⁵ These size standards are the maximum size a business concern can be and still be considered a small concern.

¹ 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 (subsector 11 and 112 except for cattle feed lots), *available at* http://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf.

² 15 U.S.C. §§ 632-57s.

³ *Id.* at § 632(a)(1).

⁴ *Id.*

⁵ *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).

Small business size standards determine whether small businesses may qualify for special treatment in the sale of goods and services to the federal government;⁶ access to guaranteed loans and other types of financial assistance; and obtain technical advice through various SBA resource partners. They may also be utilized by federal agencies as part of their rulemaking. Given the importance of the size standard determination, it is useful to explain in greater detail the process by which SBA establishes size standards.⁷

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.⁸

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.⁹ An additional factor is the impact of a size standard change on SBA's federal contract assistance to small businesses.¹⁰ The SBA also may assess industry specific considerations, such as technological changes and industry growth trends.¹¹

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,¹² again through notice and comment rulemaking.

In short, the SBA's process in determining size standards provides a rational basis 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 review if Congress desired to do so. As the production of agricultural goods has changed and is likely to change, a static definition of small business agricultural 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.

⁶ 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* http://smallbusiness.house.gov/uploadedfiles/small_business_act_programs_for_small_federal_contractors.pdf, for a discussion of small business procurement programs.

⁷ A detailed explanation of SBA's size standard methodology may be found in UNITED STATES SMALL BUSINESS ADMINISTRATION, SBA SIZE STANDARD METHODOLOGY (2009) [hereinafter SBA White Paper], *available at* http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

⁸ *Id.* at 10. This mirrors the grant of authorization in the statute. 15 U.S.C. § 632(a)(2)-(3).

⁹ *Id.* at 11.

¹⁰ *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. It is not clear that the SBA even has the capability of making such an inquiry.

¹¹ *Id.* at 12.

¹² *Id.* at 1.

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.¹³ Of the nation's approximately 2.1 million farms and ranches, approximately 97.6 percent of farms are family-owned.¹⁴ These family farms account for 85 percent of domestic agricultural production.¹⁵

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.¹⁶ This productivity has also resulted in increased competition¹⁷ 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.¹⁸ Achieving these economies of scale often requires the addition of more lands or livestock in order to justify investments in new production technologies.¹⁹ As the Subcommittee previously examined at a February 2, 2012 hearing,²⁰ many individually family-owned farms have consolidated their individual operations into larger, enterprise unit family-owned operations in order to achieve economies of scale.²¹ However, on 86.1 percent of farms, families still provide the majority of the labor.²²

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.

¹³ 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>.

¹⁴ 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 industry, 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.

<http://www.ers.usda.gov/amber-waves/2014-march/family-farming-in-the-united-states.aspx#.U8K3pk1OW70>.

¹⁵ *Id.*

¹⁶ 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.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *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 Business*, 112th Cong. (2012), available at <http://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=276662>.

²¹ 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>.

²² USDA Family Farms *supra* note 14.

III. The Size Standard for Agriculture Producers Under the Act

As previously mentioned, the size standards for agricultural enterprises are set in statute and not subject to modification by the Administrator. On February 9, 1985, the SBA published a final rule establishing the size standard for agricultural producers as \$100,000.²³ A discussion of Congress's response to this decision may be found in a report by the Senate Committee on Small Business, which stated "this standard is much lower than that used for any other industry, and excludes virtually all viable family farms in many areas of the country."²⁴ However, the report 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.²⁵ The underlying bill did not become law, and no further discussion of the issue may be found until ten months later.

In December of 1985, omnibus budget legislation amended the definition of a small business concern to include the language, "[p]rovided, 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."²⁶ The \$500,000 size standard was increased to \$750,000 in 2000.²⁷ This size standard applies to 46 diverse categories of agriculture enterprises.²⁸ The factors SBA must consider when establishing size standards was codified in 2013.²⁹

The consequences associated with establishing a specific size standard via statute may not have been fully realized or appreciated when the decision was made nearly 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 2010.³⁰ The purpose of periodically reviewing size standards is to account for changes in industry structure and economic conditions, such as inflation.³¹ Since the agricultural producer size standard was last updated in 2000, commodity prices have increased by 86 percent, reducing the basis value of the standard.³² A statutory standard leaves it up to future Congresses to review and update the standard, which has been an inefficient process. As previously discussed, the standard has only been updated once in nearly 30 years.

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 are procurement opportunities for purposes of this memorandum, as

²³ 49 Fed. Reg. 5024 (1984)

²⁴ S. REP. NO. 99-20, at 48 (1985).

²⁵ *Id.*

²⁶ Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, Tit. XVIII, § 18016, 100 STAT. 82, 371 (1985). The accompanying conference report does not provide any rationale for the change.

²⁷ 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.

²⁸ These industry categories are delineated in under the North American Industry Classification System (NAICS), which is the standard established in collaboration with Canada and Mexico and by Federal statistical agencies throughout North America to classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the business economy. <https://www.census.gov/eos/www/naics/>.

²⁹ National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, § 1661, 126 STAT. 1632, 2083-84 (2013).

³⁰ Pub. L. No. 111-240, § 1344, 124 STAT. 2504, 2545-46 (2010).

³¹ SBA White Paper *supra* note 7, at 38.

³² Figure from United States Department of Agriculture, Economic Research Service. On file with the Committee.

procurement represents the sole scenario when alternative federal programs or standards are not available.³³

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 2013, the federal government spent nearly \$400 million on raw agricultural goods last year, of which small businesses receive only about 40% of the non-forestry awards.³⁴ If more concerns were easily identifiable as small businesses, it could increase the opportunity for competition to be limited to small businesses. Thus, an additional \$100 million in non-forestry raw agricultural goods could be set aside for small businesses.

While \$100 million in prime contracting opportunities is not a large amount in terms of federal contract spending, a definitional change could also 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 Program³⁵ 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 \$750,000 must negotiate a subcontracting plan with the government detailing how they will use small businesses as subcontractors.³⁶ This requirement also applies to subcontractors other than small businesses who receive subcontracts in excess of \$750,000.³⁷ This is important because in FY 2013, federal government spent \$5.7 billion on food manufacturing, but small business concerns received less than 1% of these prime contracts.³⁸ Given that the current administratively set goal for subcontracting with small businesses is 35.9 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

³³ 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. However, since agricultural enterprises receive the vast majority of financial and technical assistance from the 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 Regulatory Flexibility Act, 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, UNITED STATES SMALL BUSINESS ADMINISTRATION: HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT 14 (20012), *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 Honorable Donald Manzullo & The Honorable Nydia Velazquez to Mr. Gary M. Jackson, Assistant Administrator for Size Standards, United States Small Business Administration, Comment Proposed Rule, Proposed Rule: Small Business Size Standards: Restructuring Size Standards (July 8, 2004). On file with the Committee Chief Counsel. Also, the United States Department of Agriculture's then proposed livestock marketing rule is an example of when an agency adopted the statutory definition of small agricultural enterprise when conducting its threshold analysis for a proposed rule. 75 Fed. Reg. 35,348 (2010).

³⁴ Report generated on June 11, 2014, using the Federal Procurement Data System. [Hereinafter FPDS Report]. Report on file with the Committee.

³⁵ 7 U.S.C. § 1691.

³⁶ 15 U.S.C. § 637(d)(4).

³⁷ *Id.*

³⁸ FPDS Report, *supra* note 34.

enterprises.³⁹ Holding all else constant, to the extent that an updated size standard increases the number of small agriculture enterprises, more small business firms would be able to compete for these contracts, which would strengthen the base of small agricultural enterprises.

V. Issues before the Subcommittee

During the hearing, the Subcommittee hopes to receive testimony to assist with its examination of the following three issues.

a. Status Quo

Though Congress has not revisited the size standard agricultural enterprises in nearly 15 years, recent regulatory and legislative changes to the size standards have gathered public attention, but there has been no organized effort to increase the statutory size standard for agricultural enterprises. Therefore, the Subcommittee encourages testimony addressing the costs and benefits of the current system, and whether these vary between the 46 industries comprising this industrial sector.

b. SBA Model

The obvious alternative to the current statutory model is to allow SBA to establish size standards for agricultural enterprises. However, this raises questions as to the suitability of the current model for agricultural concerns, and whether any modifications would be necessary. Additionally, given the concerns thirty years ago regarding the treatment of family-owned farms, the Subcommittee questions whether past would be prologue, and looks forward to testimony on these issues.

c. Alternative Options

Finally, the Subcommittee realizes that this is not a binary choice between the statutory model and transitioning agricultural enterprises back to the regulatory system. For example, a production or employee based size standard might be appropriate and better withstand pricing fluctuations. The Subcommittee welcomes all suggestions.

VI. Conclusion

The decision of what constitutes a small business is solely within the jurisdiction of the Small Business Committee. Ensuring that the right size standard is applied to agricultural enterprises can promote economic diversity, competition, and protect a way of life.

³⁹SBA, AGENCY PROCUREMENT GOALS (2013) *available at* <http://www.sba.gov/sites/default/files/files/FY2014%20Final%20Agency%20Goals%20Spreadsheet.pdf>.