

Improving Size Standards for Small Farmers and Ranchers

**Committee on Small Business Subcommittee on Agriculture, Energy and Trade
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Written Testimony by:

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Greetings Mr. Chairman, subcommittee members, staff, and observers. My name is Nick Paulson and I am an associate professor in the Department of Agricultural and Consumer Economics at the University of Illinois at Urbana-Champaign. My research and outreach programs are focused on agricultural finance and risk management, and my teaching responsibilities include courses in small business and agricultural finance.

I'd like to thank the Chairman for the invitation and opportunity to address the subcommittee as part of this hearing. My testimony today will focus on the Small Business Association's current use of a sales-based size standard for agriculture which is fixed by statute, and the implications and appropriateness of making adjustments to that standard as outlined in H.R. 3714. Given my background, I will be addressing this issue from a commodity crop farm perspective, including providing some specific examples for a corn and soybean farm. While the past 8 years have been a period of high commodity prices and excellent returns for most crop farms, the short- to mid-term outlook is for a return to lower prices and returns. Therefore, the small business definition, and the eligibility for SBA programs that it determines, will be a critical issue for America's crop producers in the coming years.

Commodity Price Impacts on Size

The SBA currently defines most small agricultural businesses to be those with average annual sales receipts less than \$750,000 per year. This sales level is fixed by statute, and has not been updated for the past 15 years. While fixed sales-based definitions may appropriately represent a measure of size in other industries, agriculture, particularly for commodity producers, is quite different.

The average price received by farmers for many major commodities has increased dramatically over the past 15 years. For example, the national average price received for corn from 2010 to 2014 was \$5.29 per bushel, up 149% from the average price of \$2.12 from 2000 to 2004. Average soybean prices have increased 123% over the same time period. Average barley, oat, rice, sorghum, and wheat prices have all increased by more than 100%; average cotton prices have increased by 68%; average peanut prices have increased by 22%. For the producers of these crops, these changes in average price levels would significantly increase revenues even if no real changes were made to the scale of their operation. This issue is further exacerbated by the productivity increases experienced in expected crop yields for many commodities.

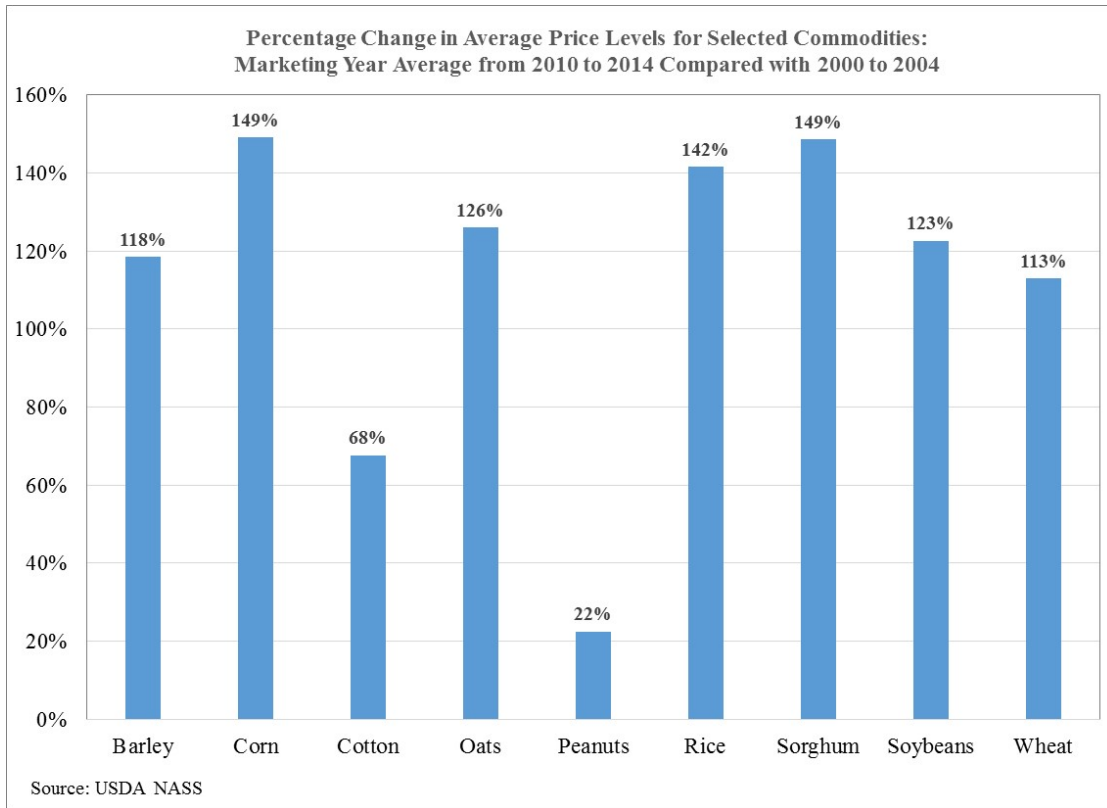


Figure 1. Changes in National Marketing Year Average Prices for Selected Commodities

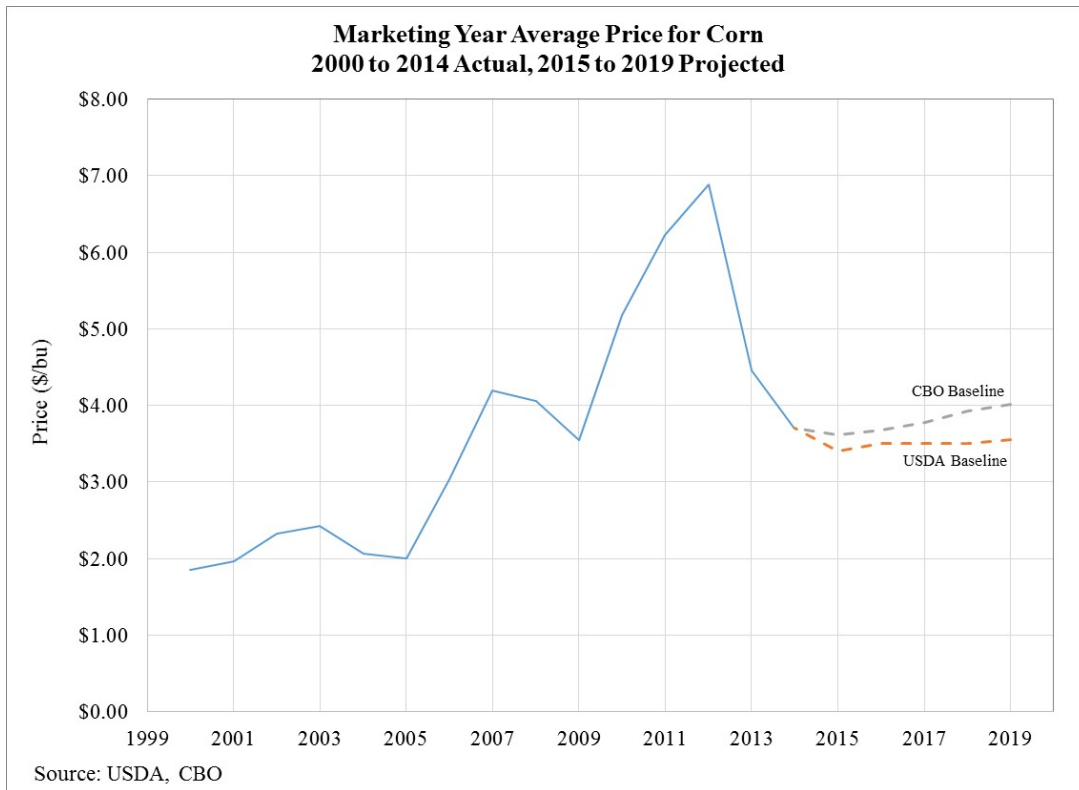


Figure 2. National Marketing Year Average Price of Corn, 2000 to 2019P

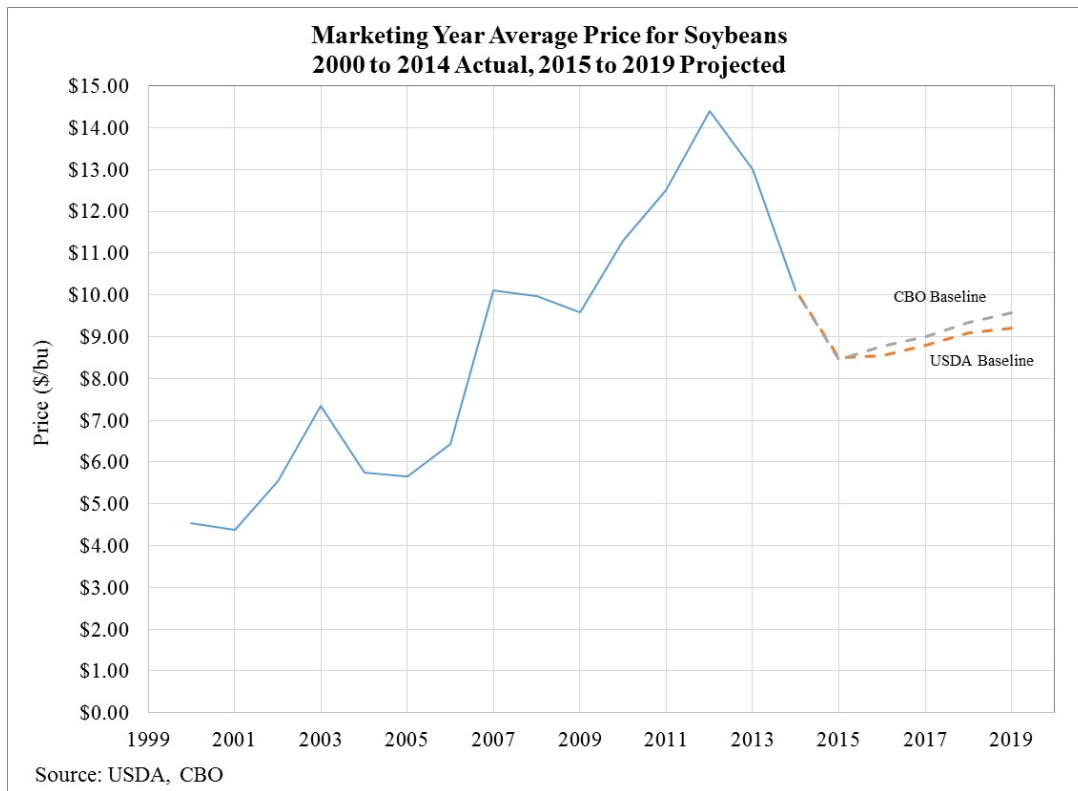


Figure 3. National Marketing Year Average Price of Soybeans, 2000 to 2019P

As an illustration, consider the specific example of a corn and soybean farmer with average productivity who receives average prices. The \$750,000 size standard would have implied a maximum small farm size of nearly 3,000 acres from 2000 to 2004. The maximum small farm size would have declined to just over 1,700 acres from 2005 to 2009. With even higher price levels from 2010 to 2014, the maximum small farm size over this time period would have been just over 1,100 acres. Looking ahead over the next 5 years and using the Congressional Budget Office’s (CBO) baseline prices, the average maximum size for a corn and soybean farmer would be just under 1,450 acres to be eligible for SBA programs, or roughly half the maximum size to be considered a small farm under the current standard when it was established 15 years ago.

While the acreage sizes in this example are specific to a corn and soybean farm, the key point is that the implied maximum farm size to be defined as a small business is now much smaller than when the small business size standard was established. This reduction in maximum size would also impact producers of all other crops whose prices have increased since the size standards were established 15 years ago.

Table 1. Current Size Standard's Maximum Small Farm Size in Acres Over Time

	Average Corn Price (\$/bu)	Average Corn Yield (bu/acre)	Average Soybean Price (\$/bu)	Average Soybean Yield (bu/acre)	Average Revenue (\$/acre)	Maximum Small Farm Size (acres)
2000 to 2004	\$2.12	141.4	\$5.51	38.4	\$255.54	2,935
2005 to 2009	\$3.37	153.1	\$8.35	42.3	\$434.46	1,726
2010 to 2014	\$5.29	150.3	\$12.26	43.4	\$663.64	1,130
2015 to 2019	\$3.80	165.6	\$9.02	45.1	\$518.18	1,447

Note: Historical national average yields and prices come from USDA NASS. Average revenue is based on a 50% corn, 50% soybean rotation. 2015 to 2019 prices come from the March 2015 CBO Baseline. 2015 to 2019 national average yields are based on simple trendline regressions of USDA NASS yield data from 1972 to 2014.

The increase in gross sales levels can also be illustrated at the national level for all farm operations. The 2012 Census of Agriculture reports that the number of farms with at least \$500,000 in sales increased by more than 38,000 operations compared with the 2007 Census. The number of farms with at least \$1,000,000 in sales increased by more than 24,000 operations. These figures suggest a significant number of farms have shifted beyond the current size standard, losing eligibility status for SBA programs.

Beyond the number of farms potentially impacted by the current small business definition is the issue of the contribution of these farms to the total value of agricultural production. Farms operating at least 500 acres accounted for more than 76% of the total value of agricultural production in 2012, while farms operating at least 1,000 acres accounted for over 55% of the total value of agricultural production (Kuethe, 2014). Thus, the farms most likely to be impacted by potential changes to the small business size standard account for the majority of the value produced in US agriculture.

Rising Production Expenses

With higher price levels, and the resulting shift of US farm operations out of the small business category, a natural response is that these farms must be generating more income and have less need for SBA programs. However, production expenses have also increased dramatically over the past 15 years.

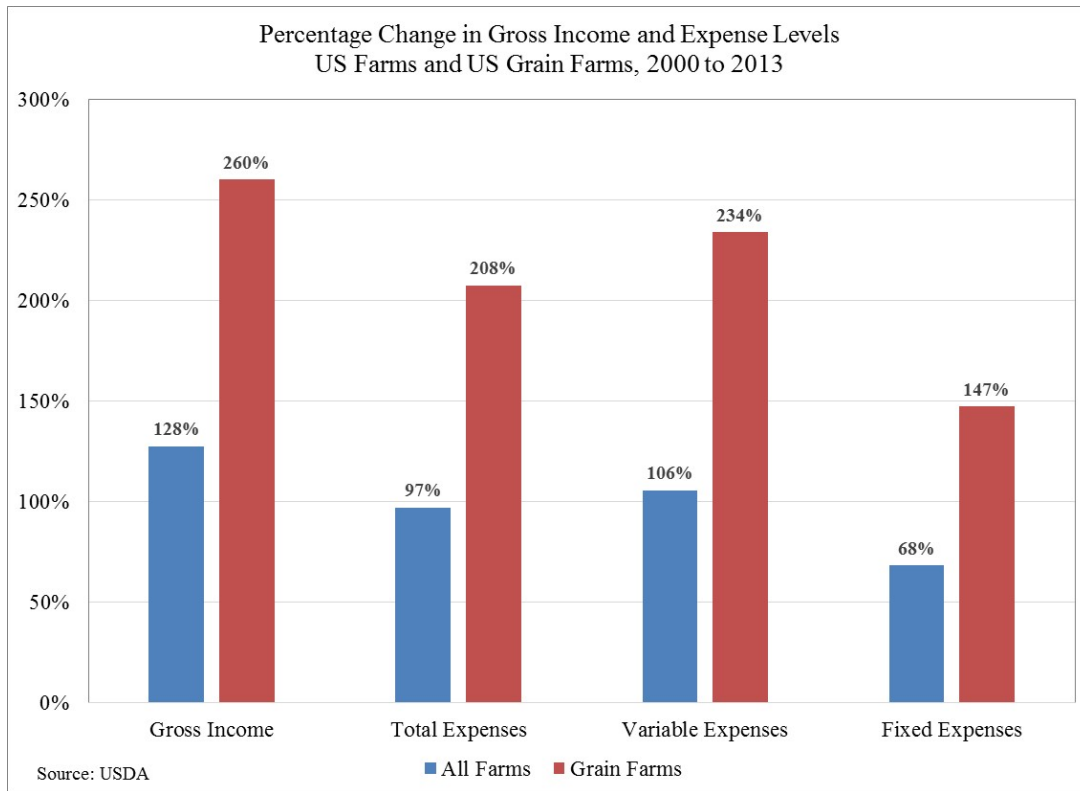


Figure 5. Percentage Change in Average Gross Income and Expenses per US Farm, 2000 to 2013

According to USDA data, total expenses have increased by 97% for all farms, and by 208% for grain farms in the US since 2000. Variable expenses, which include production inputs, have increased at a faster rate – 106% for all farms and 234% for grain farms – while fixed expenses, which include those related to land, have increased at a slightly slower rate – 68% for all farms and 147% for grain farms.

The rate of increase in expense levels is smaller than what has been experienced for gross income, implying increased incomes for farm operations. However, in looking at the recent baseline projections from the USDA and CBO, the short term outlook suggests price levels at below what has been experienced over the past 5 years for most major commodities. Historically, agricultural production costs are “stickier” than prices, meaning that they adjust more slowly. This implies the potential for a return to lower income levels for producers over the next 5 years.

Again, a specific example of a corn and soybean farm may help to illustrate. Crop budget data from the University of Illinois shows a significant increase in production costs since 2009. In central Illinois, the per acre costs associated with corn production have increased by more than 18%, with negative average farmer returns in 2014 and projected for 2015 and 2016. Soybean production costs per acre have increased by more than 30% since 2009, also resulting in negative average farmer returns in 2014 and projected for 2015 and 2016.

Farm Balance Sheet and Credit Needs

As production costs have risen, the working capital and credit needs of farmers has also increased. While US farms continue to have low levels of relative debt, as measured by the debt-to-asset ratio, the amount of debt used by US farms in terms of total dollars has increased significantly over the past 15 years. The average current or short-term liability balance per US farm has increased by more than 90%, while non-current liabilities have increased by 53%. The increase in debt use on US grain farms is even more pronounced with an increase of over 200% in both current and noncurrent liabilities since 2000.

These increased debt levels are a direct reflection of the higher production costs currently facing America's farmers, and represent the potential for increased credit needs over the coming years. This provides yet another reason to carefully consider the small business size standard for agriculture, as the current definition could severely limit eligibility for SBA programs during a time of critical need for a significant number of farm operations.

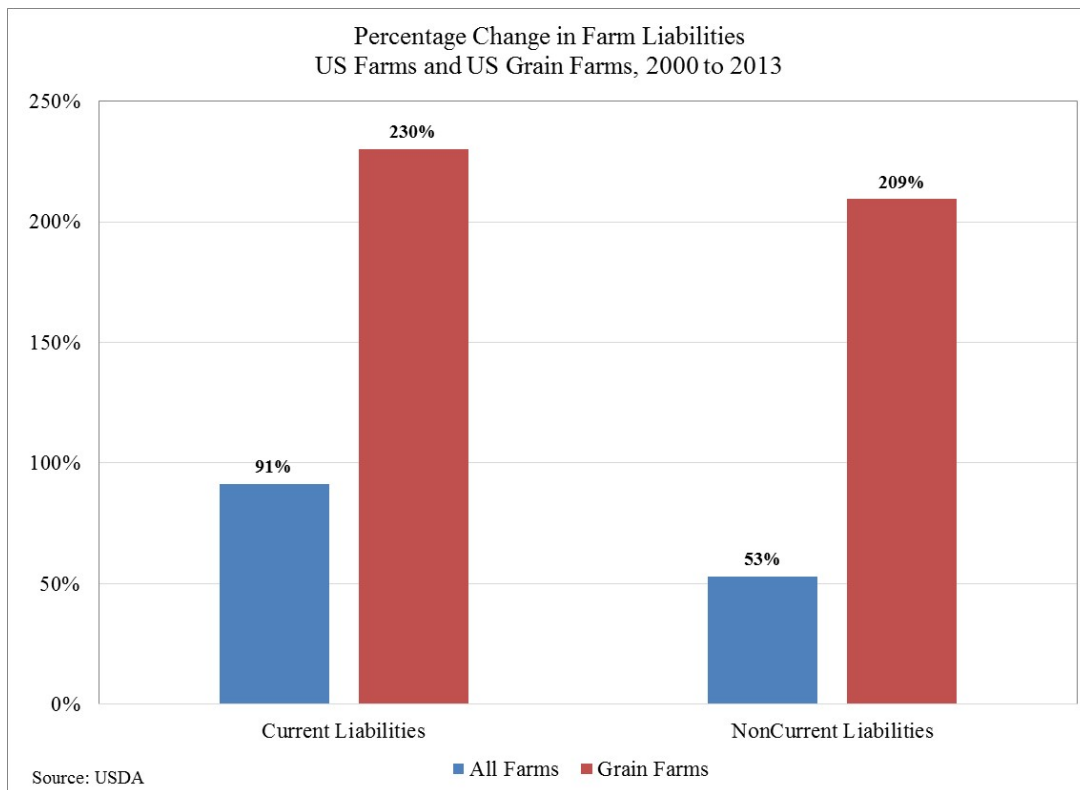


Figure 6. Percentage Change in Current and NonCurrent Liabilities per US Farm, 2000 to 2013

Precedent for Adjustments to Sales-Based Size Standards in Agriculture

Finally, I'd like to make the committee members aware of the precedent for adjustments to sales-based size definitions used in agriculture. The USDA utilizes a typology system which classifies farms into small, midsize, and large size categories. Beginning in 1998, these size categories were based on gross farm sales with the cutoff between small and large family farms set at

\$250,000 per year. In 2010, the USDA revised the definitions of these categories to reflect the structural changes which had occurred in agriculture over the preceding 15 years (Hoppe and MacDonald, 2013).

The revised typology adopted the use of gross cash farm income (GCFI), and significantly increased the threshold for large family farms to \$1,000,000 per year. The revision also created a midsize family farm category for those operations with GCFI between \$350,000 and \$999,999 per year. The changes that were made shifted more than 64,000 operations into the small farm typology category. The main justification cited for this revision was the significant increase of 41% in the producer price index (PPI) from 1995 to 2010. The PPI for farm products has further increased by more than 16% from 2010 to 2015.

Summary

I hope the points outlined in this written testimony have convinced the subcommittee members that sales-based size standards for agriculture should, at a minimum, be periodically considered for adjustment for structural change. With higher commodity price levels, a significant number of crop farms may have shifted out of the small business category, as currently defined by statute, with no real change to the scale of their operations. Furthermore, higher prices have led to higher production costs and capital needs for America's farmers. Finally, the farms most likely to be impacted by the SBA definition are those which currently contribute the majority of the value of production to US agriculture. Thus, it is even more critical to have an appropriate definition in place for small agricultural businesses to ensure continued access to and eligibility for SBA programs.

I urge the committee to carefully consider this issue as deliberations proceed. Thank you again for the invitation to address the committee, and for your time as part of this hearing.

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