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STATEMENT OF
HENRY ESCHWEGE, DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
ON

SEN 05902

THE SET-ASIDE PROGRAM FOR FEDERAL TIMBER SALES

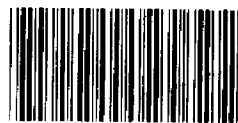
MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

WE ARE PLEASED TO APPEAR AT YOUR REQUEST TO DISCUSS THE RESULTS OF OUR RECENT REVIEW INVOLVING THE SET-ASIDE PROGRAM FOR FEDERAL TIMBER SALES.

OUR REVIEW WAS PROMPTED BY A SERIES OF LETTERS FROM SIX MEMBERS OF THE CONGRESS, ASKING US TO LOOK INTO VARIOUS ALLEGATIONS REGARDING THE SET-ASIDE PROGRAM. WE REVIEWED THE FOLLOWING FIVE AREAS TO DETERMINE THE VALIDITY OF THE INDIVIDUAL ALLEGATIONS:

- THE SMALL BUSINESS ADMINISTRATION'S SIZE STANDARD FOR DETERMINING ELIGIBILITY TO PARTICIPATE IN THE SET-ASIDE PROGRAM.
- PROCEDURES FOR CALCULATING THE SMALL BUSINESS SHARE OF FEDERAL TIMBER SALES AND FOR DETERMINING THE SPECIFIC SALES WHICH ARE RESERVED FOR ELIGIBLE BIDDERS.

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--REVENUES RECEIVED FROM SET-ASIDE SALES COMPARED WITH THOSE RECEIVED FROM OPEN SALES.

--THE SET-ASIDE PROGRAM'S ECONOMIC IMPACT ON COMMUNITIES WHERE INELIGIBLE MILLS ARE DEPENDENT ON FEDERAL TIMBER SALES.

--DEVIATIONS FROM NORMAL AND EXPECTED BUSINESS PRACTICES WHICH MAY BE CAUSED BY THE SET-ASIDE PROGRAM.

I WOULD LIKE TO EMPHASIZE THAT BECAUSE WE LIMITED OURSELVES TO SPECIFIC ALLEGATIONS IN THESE FIVE AREAS, WE DID NOT PERFORM AN OVERALL REVIEW OF THE TIMBER SET-ASIDE PROGRAM. WE SELECTED SAMPLE AREAS IN NINE STATES TO INCLUDE A BROAD GEOGRAPHIC COVERAGE OF DIFFERING TIMBER AREAS, TO INCLUDE LOCATIONS WHERE THE SET-ASIDE PROGRAM HAS BEEN MOST ACTIVE, AND TO INCLUDE SEVERAL LOCATIONS WHERE WE WERE REQUESTED TO ADDRESS SPECIFIC ALLEGATIONS. WE CONCENTRATED OUR WORK EFFORTS IN THE PACIFIC NORTHWEST, THE ROCKIES, AND THE SOUTHWEST AND SOUTHEAST SECTORS OF THE COUNTRY.

BACKGROUND

THE SET-ASIDE PROGRAM FOR FEDERAL TIMBER SALES IS ADMINISTERED JOINTLY BY THE SMALL BUSINESS ADMINISTRATION AND THE FEDERAL AGENCIES WHICH SELL FEDERAL TIMBER. UNDER THE PROGRAM, CERTAIN TIMBER SALES ARE OFFERED PREFERENTIALLY TO DESIGNATED SMALL BUSINESS PURCHASERS, THEREBY INSURING THAT SMALL FIRMS WILL BE ABLE TO PURCHASE SOME PORTION OF

THE FEDERAL TIMBER SOLD. THE PROGRAM'S PRIMARY OBJECTIVE IS TO GIVE THE SMALL BUSINESS COMMUNITY AN OPPORTUNITY TO ACQUIRE ITS FAIR PROPORTION OF FEDERAL CONTRACTS.

SBA DETERMINES WHETHER FIRMS ARE ELIGIBLE TO PARTICIPATE IN THE PROGRAM AND MONITORS HOW THE PROGRAM IS WORKING WHILE THE SET-ASIDE SALES ARE CONDUCTED BY THE FEDERAL AGENCIES SELLING FEDERAL TIMBER. THE DEPARTMENT OF AGRICULTURE, THROUGH ITS FOREST SERVICE, SELLS THE MAJORITY OF FEDERAL TIMBER. CONSIDERABLE VOLUMES OF TIMBER ARE ALSO SOLD BY THE DEPARTMENT OF THE INTERIOR'S BUREAU OF LAND MANAGEMENT.

SIZE STANDARD FOR DETERMINING
PROGRAM ELIGIBILITY

WE REVIEWED TWO ALLEGATIONS CONCERNING THE SIZE STANDARD THAT THE SMALL BUSINESS ADMINISTRATION USES TO DETERMINE ELIGIBILITY TO PARTICIPATE IN THE SET-ASIDE PROGRAM. ONE ALLEGATION IS THAT THE SBA SET THE CURRENT TIMBER INDUSTRY SIZE STANDARD WITHOUT STUDYING INDUSTRY CONDITIONS. IMPLIED IN THIS ALLEGATION IS THAT THE CURRENT SIZE STANDARD HAS NO FACTUAL BASIS AND IS NOT JUSTIFIED.

SBA REGULATIONS SPECIFY SEVERAL FACTORS TO BE CONSIDERED IN FORMULATING INDUSTRY SIZE STANDARDS. HOWEVER, SBA FILES CONTAINED NO RECORD THAT THESE FACTORS WERE CONSIDERED WHEN THE AGENCY INCREASED THE SIZE STANDARD FOR THE TIMBER INDUSTRY IN 1964 FROM 250 EMPLOYEES TO 500 EMPLOYEES. FURTHERMORE, CURRENT SBA OFFICIALS, AS WELL AS A FORMER OFFICIAL WHO WAS

FAMILIAR WITH SIZE STANDARDS AT THAT TIME, WERE UNAWARE OF ANY STUDY MADE TO JUSTIFY THE INCREASE.

SBA REVIEWED THE 500-EMPLOYEE SIZE STANDARD IN 1966 AND AGAIN IN 1975. ON BOTH OCCASIONS, THE AGENCY DECIDED TO RETAIN THE STANDARD. THE 1966 REVIEW WAS MADE TO DETERMINE WHETHER THE INCREASE TO 500 EMPLOYEES HAD ADVERSELY AFFECTED FIRMS WITH LESS THAN 250 EMPLOYEES OR IMPROVED THE COMPETITIVE POSITION OF FIRMS WITH 250 TO 500 EMPLOYEES. THE REPORT ON THIS REVIEW INDICATED THAT THE TOTAL IMPACT ON FIRMS WITH LESS THAN 250 EMPLOYEES HAD BEEN MINIMAL AND RECOMMENDED RETAINING THE 500-EMPLOYEE STANDARD, BUT STATED THAT THE AGENCY COULD NOT DETERMINE WHETHER THE INCREASED SIZE STANDARD IMPROVED THE COMPETITIVE POSITION OF FIRMS WITH 250 TO 500 EMPLOYEES.

IN 1975 SBA HELD PUBLIC HEARINGS ON WHETHER THE 500-EMPLOYEE CRITERION SHOULD BE RAISED, LOWERED, OR RETAINED. FOLLOWING THE HEARINGS, A NOTICE WAS PUBLISHED IN THE FEDERAL REGISTER ANNOUNCING THAT ON THE BASIS OF EVIDENCE SUBMITTED DURING THE HEARINGS, THE 500-EMPLOYEE STANDARD WOULD BE RETAINED.

THE OTHER ALLEGATION WE EXAMINED IS THAT THE CURRENT TIMBER INDUSTRY SIZE STANDARD OF 500 EMPLOYEES IS SO INCLUSIVE THAT FIRMS WITH 100-500 EMPLOYEES RECEIVE A DISPROPORTIONATELY LARGE SHARE OF BENEFITS COMPARED TO THOSE

FIRMS WITH FEWER THAN 100 EMPLOYEES. MANY SMALLER SIZE FIRMS IN THE TIMBER INDUSTRY ARE ENGAGED IN LOGGING, AND THEY WERE ALLEGED TO RECEIVE FEW, IF ANY, BENEFITS FROM THE SET-ASIDE PROGRAM.

WE ASSESSED THIS ALLEGATION BY ANALYZING A SAMPLE OF OPEN AND SET-ASIDE TIMBER SALES SOLD BY THE FOREST SERVICE BETWEEN 1971 AND 1977 AND THE BUREAU OF LAND MANAGEMENT BETWEEN 1973 AND 1977. WE DIVIDED THE SIZE CLASSIFICATION INTO FOUR GROUPS BASED ON EMPLOYMENT LEVELS. ALTHOUGH THE ALLEGATION ADDRESSED ONLY TWO SIZE CLASSIFICATIONS (THOSE BELOW 100 EMPLOYEES AND THOSE ABOVE), WE DIVIDED EACH OF THESE CLASSIFICATIONS INTO TWO SMALLER GROUPS. WE SPLIT THE 0-100 EMPLOYEE GROUP AT 25 BECAUSE MOST FIRMS ENGAGED IN LOGGING HAVE 25 OR FEWER EMPLOYEES. WE SPLIT THE 100-500 EMPLOYEE GROUP AT 250 BECAUSE BEFORE THE 500-EMPLOYEE SIZE STANDARD WAS SET, 250 EMPLOYEES WAS THE MAXIMUM SIZE ALLOWED.

OUR ANALYSIS CONFIRMED THAT COMPANIES WITH LESS THAN 100 EMPLOYEES, AND ESPECIALLY THOSE WITH 25 OR FEWER, HAVE USED THE SET-ASIDE PROGRAM LESS THAN COMPANIES WITH MORE THAN 100 EMPLOYEES. SPECIFICALLY, THE ANALYSIS SHOWED THE LARGER COMPANIES WERE ABLE TO OBTAIN A GREATER PROPORTION OF THEIR PUBLIC TIMBER PURCHASES THROUGH SET-ASIDE SALES THAN THE SMALLER FIRMS. THIS HAPPENED BECAUSE THE SMALLER SIZE COMPANIES DID NOT COMPETE AS SUCCESSFULLY FOR SET-ASIDE

SALES AS THEY DID FOR OPEN SALES. WE ALSO FOUND THAT LOGGING FIRMS, IN COMPARISON TO FIRMS THAT MILL TIMBER, HAD A PARTICULARLY DIFFICULT TIME COMPETING FOR SET-ASIDE SALES. ALTHOUGH FIRMS WITH LESS THAN 100 EMPLOYEES USED THE SET-ASIDE PROGRAM LESS THAN FIRMS WITH OVER 100 EMPLOYEES, AN EARLIER STUDY MADE BY AN INDEPENDENT FOREST ECONOMICS CONSULTANT SUGGESTED THAT THE SMALLER FIRMS MAY NEED THE SET-ASIDE PROGRAM MOST BECAUSE THEY ARE THE FIRMS THAT MOST OFTEN FAIL.

PROCEDURES FOR CALCULATING
THE SMALL BUSINESS SHARE

WE REVIEWED TWO ALLEGATIONS CONCERNING PROCEDURES FOR CALCULATING THE SMALL BUSINESS SHARE OF FEDERAL TIMBER SALES AND FOR DETERMINING SALES TO BE OFFERED TO SMALL FIRMS. THE FIRST ALLEGATION CONCERNS THE DETERMINATION IN 1971 OF THE INITIAL SHARES OF TIMBER SALES TO BE OFFERED TO SMALL BUSINESSES. IMPLEMENTING PROCEDURES REQUIRED THAT THE INITIAL SHARES BE DETERMINED BY COMPARING HISTORIC PURCHASES OF TIMBER BY SMALL BUSINESSES TO THE TOTAL VOLUME OF TIMBER SOLD. THE ALLEGATION ENTAILS THE CLAIM THAT IN SOME INSTANCES THE INITIAL SHARES DID NOT ACCURATELY REFLECT THE DEMAND FOR TIMBER BY THE LARGE AND SMALL FIRMS.

WE FOUND THAT CONTROVERSY REGARDING DETERMINATION OF THE INITIAL SMALL BUSINESS SHARE HAS FOCUSED ON TWO MARKETING AREAS--THE CARSON NATIONAL FOREST IN NEW MEXICO AND THE ROUTT NATIONAL FOREST IN COLORADO. WE EXAMINED THE SITUATION AT BOTH FORESTS AND FOUND THE SMALL BUSINESS SHARES WERE

INITIALLY ESTABLISHED AS COMPROMISES BETWEEN VARIOUS FOREST SERVICE AND SMALL BUSINESS ADMINISTRATION PROPOSALS. THE PROCEDURES FOR CALCULATING THE SMALL BUSINESS SHARE ALLOW THE TWO AGENCIES TO CONSIDER OTHER FACTORS AND UNUSUAL CIRCUMSTANCES, SUCH AS PAST LONG-TERM SALES AND LARGE SALVAGE SALES, WHEN DETERMINING A SMALL BUSINESS SHARE. THEREFORE, WE CONCLUDED THAT THE ALLEGATION WAS NOT VALID, BECAUSE THE COMPROMISE SHARES WERE DETERMINED BY SUCH PROCEDURES.

THE SECOND ALLEGATION WAS THAT THE PROCEDURES USED FOR THE 6-MONTH SALES ANALYSIS AND THE 5-YEAR RECOMPUTATION OF THE SMALL BUSINESS SHARE MAINTAIN A STATIC ALLOCATION OF TIMBER BETWEEN LARGE AND SMALL FIRMS IRRESPECTIVE OF CHANGES IN INDUSTRY STRUCTURE. OUR ANALYSIS INDICATES A STRAIGHT-FORWARD TRUE OR FALSE CONCLUSION CANNOT BE REACHED ABOUT THIS ALLEGATION AS THE SHARES EITHER INCREASED OR DECREASED FOR MANY MARKET AREAS AT THE RECOMPUTATION. HOWEVER, THE PROGRAM, AS IMPLEMENTED, DOES TEND TO MAINTAIN A STATIC ALLOCATION; THE SMALL BUSINESS SHARES DID REMAIN STATIC IN 93 OF THE NATION'S 152 MARKET AREAS.

THE PRIMARY REASON THE SMALL BUSINESS SHARE OFTEN TENDS TO REMAIN STATIC IS THAT WHILE THE 5-YEAR RECOMPUTATION IS INTENDED TO REFLECT HISTORICAL PURCHASES BY THE TWO SIZE GROUPS, THE PURCHASE HISTORY AVAILABLE AT THE RECOMPUTATION WILL ALMOST ALWAYS INDICATE SMALL BUSINESSES HAVE PURCHASED THEIR SHARE OR MORE. THE SMALL BUSINESS SHARE CAN AND DOES

DECLINE IN SOME INSTANCES. HOWEVER, THE CIRCUMSTANCES WHERE THE SMALL BUSINESS SHARE IS ALLOWED TO CHANGE IN RESPONSE TO CHANGES IN INDUSTRY STRUCTURE ARE LIMITED.

DURING OUR REVIEW, WE ANALYZED SEVERAL MARKET AREAS WHERE MAJOR CHANGES IN INDUSTRY STRUCTURE HAD OCCURRED. ONE SUCH AREA IS THE ROGUE RIVER NATIONAL FOREST LOCATED NEAR MEDFORD, OREGON. IN THE COURSE OF OUR WORK ON THE ROGUE RIVER, WE OBSERVED CERTAIN CONSEQUENCES OF THE PROGRAM'S TENDENCY TO MAINTAIN A STATIC ALLOCATION OF TIMBER WHICH MAY BE CONTRARY TO THE BEST INTERESTS OF THE PROGRAM. THE MOST STRIKING EFFECT OF MAINTAINING THE SAME ALLOCATION FOR THE ROGUE RIVER IS THE WIDE DIVERGENCE IN REVENUES RECEIVED BETWEEN SET-ASIDE SALES AND OPEN SALES. WE FOUND THAT SET-ASIDE SALES, ALTHOUGH OF HIGHER QUALITY, RETURNED LESS REVENUE THAN THE OPEN SALES. ALTHOUGH OVERALL DEMAND FOR TIMBER IS STRONG IN THE AREA, THE VOLUME OF TIMBER ALLOCATED TO THE EXCLUSIVE BIDDING OF SMALL FIRMS IS FAR GREATER THAN THE RELATIVE DEMAND FOR TIMBER BY THIS SUBGROUP WOULD BE IN THE ABSENCE OF THE SET-ASIDE PROGRAM. CONSEQUENTLY, LOCAL SMALL FIRMS HAVE BID MUCH LESS AGGRESSIVELY AMONG THEMSELVES FOR SET-ASIDE SALES.

WE FOUND SIMILAR SITUATIONS IN OTHER MARKET AREAS WHERE THE SMALL BUSINESS SHARE HAS NOT READILY ADJUSTED TO REFLECT CHANGES IN THE LOCAL TIMBER INDUSTRY. IT IS NOT CLEAR WHETHER

THESE RESULTS WERE INTENDED BY THE CONGRESS WHEN THE SET-ASIDE PROGRAM WAS AUTHORIZED. IF THE RESULTS AS DISCLOSED BY OUR REVIEW WERE NOT INTENDED, WE BELIEVE THE PROCEDURES FOR RECOMPUTING THE SMALL BUSINESS SHARE SHOULD BE REVISED TO REFLECT PROMPTLY THE STRUCTURAL CHANGES AMONG TIMBER PURCHASERS. A MORE FLEXIBLE APPROACH WOULD PROVIDE A MORE TIMELY REFLECTION OF STRUCTURAL CHANGES IN THE LOCAL INDUSTRY AND WOULD STILL MAINTAIN THE INTEGRITY OF THE SET-ASIDE PROGRAM'S PROTECTION OF SMALL PURCHASERS.

REVENUES RECEIVED FROM
SET-ASIDE AND OPEN SALES

ANOTHER ALLEGATION WE REVIEWED WAS THAT SET-ASIDE TIMBER SALES HAVE BEEN OF HIGHER QUALITY YET HAVE RETURNED LESS REVENUE TO THE U.S. TREASURY THAN OPEN SALES.

WHILE EXPLORING VARIOUS ALTERNATIVE METHODS TO ANSWER THIS ALLEGATION, WE DISCOVERED THAT A FOREST ECONOMIST WITH THE FOREST SERVICE'S PACIFIC NORTHWEST FOREST AND RANGE EXPERIMENT STATION HAD JUST COMPLETED A STUDY COMPARING THE QUALITY AND REVENUE DIFFERENCES BETWEEN OPEN AND SET-ASIDE TIMBER SALES. HIS STUDY COVERED THE TIMBER SALES SOLD IN FISCAL YEARS 1975 AND 1976 AT NINE NATIONAL FORESTS IN OREGON AND WASHINGTON. HIS METHODOLOGY INCLUDED DEFINING THE QUALITY OF A TIMBER SALE IN TERMS OF VARIOUS SALE CHARACTERISTICS WHICH ARE QUANTIFIED ON THE FOREST SERVICE'S TIMBER SALE REPORT. THE SALE CHARACTERISTICS OF THE OPEN

AND SET-ASIDE SALES WERE TESTED USING STATISTICAL TECHNIQUES TO DETERMINE IF THE CHARACTERISTICS (QUALITY) OF THE SALES WERE DIFFERENT. THEN, TAKING QUALITY DIFFERENCES INTO ACCOUNT, THE ECONOMIST TESTED REVENUE DIFFERENCES AGAIN USING STATISTICAL TECHNIQUES. HE FOUND THE SET-ASIDE SALES DID NOT RETURN HIGHER REVENUES TO THE U.S. TREASURY DESPITE THE FACT THAT THE SET-ASIDE SALES WERE OF HIGHER QUALITY THAN THE OPEN SALES.

THE RESULTS OF OUR STUDY WERE SIMILAR TO THOSE OF THE FOREST SERVICE ECONOMIST. SET-ASIDE SALES WERE NUMEROUS ENOUGH AT 58 NATIONAL FORESTS AND AT 5 BLM DISTRICTS TO MAKE COMPARISONS. WE FOUND SET-ASIDE SALES WERE OF HIGHER QUALITY THAN OPEN SALES AT 50 OF THE 58 NATIONAL FORESTS TESTED. AT 48 NATIONAL FORESTS, SET-ASIDE SALES RETURNED LESS REVENUES THAN OPEN SALES. AT THREE OF THE FIVE BLM DISTRICTS, WE FOUND SET-ASIDE SALES WERE LARGER, A FACTOR GENERALLY INDICATIVE OF A MORE DESIRABLE SALE, THAN OPEN SALES YET RETURNED LESS REVENUES THAN OPEN SALES. THE METHODOLOGY WE USED IN ASSESSING QUALITY AND REVENUE DIFFERENCES FOLLOWS.

QUALITY DIFFERENCES BETWEEN
OPEN AND SET-ASIDE SALES

BOTH THE FOREST SERVICE AND BLM ENDEAVOR TO MAKE THE QUALITY OF SET-ASIDE SALES EQUAL TO THE QUALITY OF OPEN SALES. BOTH ALSO RECOGNIZE THE QUALITY OF ONE TIMBER SALE

CAN DIFFER SUBSTANTIALLY FROM ANOTHER SALE. SUCH FACTORS AS SALE SIZE, DIFFICULTY OF LOGGING THE TIMBER, THE VOLUME AND QUALITY OF TIMBER TO BE HARVESTED PER ACRE, AND THE DISTANCE THE TIMBER HAS TO BE HAULED FOR PROCESSING ARE CHARACTERISTICS WHICH REPRESENT THE OVERALL QUALITY OF A TIMBER SALE. FOR EXAMPLE, A TIMBER SALE COMPRISED OF SCATTERED, SHORT, SMALL DIAMETER TREES LOCATED ON STEEP, ROCKY TERRAIN 100 MILES FROM THE NEAREST MILL WOULD BE OF LOWER QUALITY THAN A TIMBER SALE COMPRISED OF MANY TALL, LARGE DIAMETER TREES LOCATED ON GENTLE SLOPING OR FLAT TERRAIN 30 MILES FROM THE NEAREST MILL. THE LATTER SALE WOULD BE EXPECTED TO BRING A HIGHER PRICE PER BOARD FOOT THAN THE FORMER SALE.

WE REVIEWED FOREST SERVICE TIMBER SALES CONTAINING TIMBER VALUED IN EXCESS OF \$2,000 SOLD BETWEEN JULY 1, 1973, AND DECEMBER 31, 1977. WE SEGREGATED THE TIMBER SALES BY NATIONAL FOREST AND, TO INCREASE VALIDITY, WE DROPPED FROM OUR EVALUATION ALL NATIONAL FORESTS WHERE FEWER THAN EIGHT SET-ASIDE SALES OCCURRED. THIS RESULTED IN EVALUATING 7,106 TIMBER SALES ON 58 NATIONAL FORESTS. THESE 58 NATIONAL FORESTS ACCOUNTED FOR 66 PERCENT OF ALL FOREST SERVICE TIMBER SALES DURING THE PERIOD AND 68 PERCENT OF THE VOLUME.

WE COMPARED 11 QUALITY CHARACTERISTICS OF SET-ASIDE SALES TO THE QUALITY CHARACTERISTICS OF OPEN SALES AND USED VARIOUS STATISTICAL TESTS TO DETERMINE IF QUALITY

DIFFERED BETWEEN THE TWO TYPES OF SALES. INCLUDED AMONG THE 11 CHARACTERISTICS WERE LOGGING COSTS, ROAD COSTS, MANUFACTURING COSTS, DISTANCE TO HAUL TIMBER TO MANUFACTURING FACILITY, AND THE LENGTH OF TIME (IN YEARS) ALLOWED TO LOG THE TIMBER.

ONCE WE DETERMINED THAT THE QUALITY OF THE SET-ASIDE TIMBER SALES DIFFERED FROM THE OPEN TIMBER SALES, WE ANALYZED WHETHER THE DIFFERENCE MADE THE SET-ASIDE SALES HIGHER OR LOWER IN QUALITY THAN OPEN SALES. TO OFFSET THE EFFECT OF INFLATION DURING THE 4-1/2-YEAR TEST PERIOD, WE DEFLATED ALL COST AND PRICE DATA BY THE APPROPRIATE QUARTERLY VALUE OF THE WHOLESALE COMMODITY PRICE INDEX.

REVENUE DIFFERENCES BETWEEN
OPEN AND SET-ASIDE

TO ASSESS WHETHER SET-ASIDE TIMBER SALES RETURNED LESS REVENUES, WE EVALUATED THE REVENUES RETURNED FROM THE SET-ASIDE AND OPEN SALES WHICH WE ANALYZED FOR QUALITY DIFFERENCES. WE TOOK THE QUALITY DIFFERENCES INTO ACCOUNT BECAUSE OBVIOUSLY HIGHER QUALITY TIMBER SALES ARE MORE DESIRABLE THAN LOWER QUALITY SALES AND SHOULD RETURN MORE REVENUES. OUR ANALYSIS INVOLVED (1) CLASSIFYING THE NATIONAL FORESTS AND BLM DISTRICTS INTO GROUPS WHICH CORRESPOND TO THE QUALITY OF THE SET-ASIDE SALES, (2) COMPUTING THE DIFFERENCE BETWEEN THE AVERAGE AMOUNT THE TIMBER ACTUALLY SOLD AND ITS APPRAISED VALUE, COMMONLY REFERRED TO AS OVERBID, FOR SET-ASIDE AND OPEN SALES, AND (3) USING VARIOUS STATISTICAL TECHNIQUES TO TEST WHETHER THE OVERBIDS BETWEEN SET-ASIDE AND OPEN SALES WERE DIFFERENT.

TO DEMONSTRATE THE METHODOLOGY WE USED TO COMPARE REVENUES, WE HAVE ATTACHED TO OUR STATEMENT A DETAILED EXPLANATION OF OUR ANALYSIS FOR 2 OF THE 58 NATIONAL FORESTS IN OUR REVIEW.

SET-ASIDE PROGRAM'S IMPACT
ON DEPENDENT COMMUNITIES

WE EXAMINED THE ALLEGATION THAT THE SET-ASIDE PROGRAM ADVERSELY AFFECTS CERTAIN COMMUNITIES DEPENDENT UPON LUMBER MILLS OWNED BY LARGE COMPANIES. THIS SITUATION ALLEGEDLY OCCURS WHERE A MILL IS INELIGIBLE FOR THE SET-ASIDE PROGRAM AND DEPENDENT UPON FEDERAL TIMBER, BUT THE AMOUNT OF THE TIMBER AVAILABLE TO IT IN OPEN SALES IS INSUFFICIENT TO KEEP THE MILL OPERATING AT ITS NORMAL CAPACITY. THE MILL IS THEN FORCED TO REDUCE ITS OPERATIONS AND EMPLOYMENT OR CLOSE DOWN COMPLETELY. WHEN THESE MILLS ARE THE MAJOR OR ONLY EMPLOYER IN A COMMUNITY, THAT COMMUNITY IS DIRECTLY AFFECTED.

OUR EXAMINATION INCLUDED TWO COMMUNITIES WHICH WERE ALLEGED TO BE ADVERSELY AFFECTED BY THE SET-ASIDE PROGRAM. THE PUBLIC TIMBER PURCHASERS GROUP, AN ASSOCIATION OF LARGE FOREST PRODUCTS COMPANIES, IDENTIFIED TILLAMOOK COUNTY, OREGON, AS A COMMUNITY SUFFERING ECONOMIC SETBACKS BECAUSE OF THE SET-ASIDE PROGRAM. THE ALLEGED ADVERSE IMPACTS OF THE SET-ASIDE PROGRAM ON TILLAMOOK COUNTY WERE ALSO HIGHLIGHTED IN ARTICLES IN A TRADE MAGAZINE AND THE LOCAL NEWSPAPER. THE OTHER COMMUNITY WE EXAMINED WAS JOHNSONDALE, CALIFORNIA WHICH WAS SAID TO HAVE BEEN INJURED BY THE SET-ASIDE PROGRAM.

OUR ANALYSIS SHOWED THAT NO SIGNIFICANT CHANGE HAD OCCURRED BETWEEN THE TIMBER PURCHASES OF COMPANIES LOCATED IN TILLAMOOK COUNTY COMPARED TO THOSE LOCATED OUTSIDE. TILLAMOOK COUNTY'S FOREST INDUSTRIES EMPLOYMENT HAD DECLINED STEADILY SINCE 1960, BUT MOST OF THE DECLINE OCCURRED BEFORE THE SMALL BUSINESS SHARE PROCEDURES WERE IMPLEMENTED IN 1971. MOST OF THE DECLINE SINCE 1971 IS ATTRIBUTABLE TO THE DEMISE OF THE OREGON-WASHINGTON PLYWOOD COMPANY IN 1974. WE CONCLUDED THAT THE SET-ASIDE PROGRAM HAD NOT DAMAGED TILLAMOOK COUNTY'S ECONOMY NOR HAD THE SET-ASIDE PROGRAM CONTRIBUTED MATERIALLY TO THE COUNTY'S DECLINING FOREST INDUSTRIES EMPLOYMENT.

WE FOUND THAT THE VIABILITY OF JOHNSONDALE IS IN QUESTION BECAUSE THE MILL LOCATED THERE CANNOT OBTAIN AN ADEQUATE LOG SUPPLY. THIS INABILITY, HOWEVER, CANNOT BE BLAMED SOLELY ON THE SET-ASIDE PROGRAM. THE JOHNSONDALE MILL'S INABILITY TO COMPETE AGAINST OTHER MILLS BECAUSE OF HIGHER PRODUCTION, TRANSPORTATION, AND OVERHEAD COSTS AND THE REDUCED ALLOWABLE CUT OF THE SEQUOIA NATIONAL FOREST ARE THE PRINCIPAL REASONS THAT THE JOHNSONDALE MILL CANNOT OBTAIN AN ADEQUATE LOG SUPPLY.

SET-ASIDE PROGRAM CAUSES DEVIATIONS
FROM NORMAL BUSINESS PRACTICES

WE INVESTIGATED THREE SPECIFIC ALLEGATIONS THAT THE SET-ASIDE PROGRAM CAUSES DEVIATIONS FROM NORMAL BUSINESS PRACTICES. THE FIRST IS THAT SOME SMALL OWNERS WHO WISH TO SELL THEIR BUSINESSES HAVE DIFFICULTY OBTAINING MAXIMUM VALUE BECAUSE OF THE SET-ASIDE PROGRAM. WE FOUND THIS ALLEGATION TO

BE TRUE. WHEN THE SMALL BUSINESS OWNER SELLS TO A LARGE COMPANY, THE ALLOCATION OF THE TIMBER SUPPLY BY THE SET-ASIDE PROGRAM DOES NOT CHANGE. THIS DISCOURAGES LARGE COMPANIES FROM PURCHASING SMALL MILLS THAT ARE DEPENDENT ON FEDERAL TIMBER SALES.

ANOTHER ALLEGATION IS THAT THE 500-EMPLOYEE SIZE STANDARD IS A BARRIER TO THE ECONOMIC GROWTH OF SMALL FIRMS. WE FOUND ONLY A FEW INSTANCES WHERE SMALL FIRMS VIEWED THE SIZE STANDARD AS RESTRICTING A FIRM'S POSSIBILITIES FOR FURTHER GROWTH, AND WE NOTED THE CURRENT SIZE STANDARD ALLOWS ELIGIBLE FIRMS TO GROW TO A SIGNIFICANT ECONOMIC SIZE AND STILL REMAIN ELIGIBLE FOR SET-ASIDE ASSISTANCE.

A THIRD ALLEGATION WE EXAMINED INVOLVES CLAIMS THAT SOME FIRMS, WHICH ARE CLOSE TO THE CURRENT EMPLOYEE CEILING, ARE CIRCUMVENTING THE INTENT OF THE PROGRAM THROUGH MANIPULATIONS DESIGNED TO MAINTAIN OR GAIN ELIGIBILITY FOR SET-ASIDE SALES. WE FOUND THAT IN A FEW INSTANCES FIRMS WHICH ARE CLOSE TO THE 500-EMPLOYEE CEILING DO MAKE SPECIAL EFFORTS, SUCH AS CONTRACTING FOR PORTIONS OF THEIR WORK TO KEEP EMPLOYMENT BELOW 500 AND THUS REMAIN ELIGIBLE TO BID FOR SET-ASIDE SALES. WE ALSO FOUND SEVEN FIRMS WHICH HAD DELIBERATELY DIVESTED PORTIONS OF THEIR OPERATIONS OR HAD RESTRUCTURED CORPORATE OWNERSHIP PATTERNS SPECIFICALLY TO BECOME ELIGIBLE FOR THE SET-ASIDE PROGRAM.

AGENCY COMMENTS

THE SBA HAS EXPRESSED OVERALL DISAGREEMENT WITH OUR REPORT. SBA'S COMMENTS AND OUR EVALUATION ARE CONTAINED IN OUR REPORT.

I WOULD, HOWEVER, LIKE TO HIGHLIGHT THE ONE ISSUE ON WHICH I BELIEVE SBA DISAGREES WITH US THE MOST. SBA OBJECTS TO OUR CONCLUSION THAT SET-ASIDE TIMBER SALES RETURNED LESS REVENUE TO THE U.S. TREASURY THAN OPEN SALES. SBA SAID ITS OWN STATISTICS SHOWED A GREATER RETURN TO THE U.S. TREASURY FOR SET-ASIDE SALES THAN FOR SALES AWARDED TO LARGE BUSINESSES. SBA DISAGREED WITH THE METHODOLOGY WE USED FOR OUR ANALYSIS.

WE EVALUATED SBA'S COMPARISON OF REVENUES BETWEEN SET-ASIDE AND OPEN SALES AND FOUND THAT ALTHOUGH THE QUANTITATIVE DATA SEEMS VALID, SBA'S INTERPRETATION OF THE DATA IS BASED ON A FALLACIOUS ASSUMPTION THAT THERE IS NO QUALITY DIFFERENCE AMONG TIMBER SALES.

TO OVERCOME THIS SHORTCOMING WITH THE SBA ANALYSIS, WE USED A METHODOLOGY DEVELOPED BY THE FOREST SERVICE THAT COMPARES THE QUALITY DIFFERENCES BETWEEN OPEN AND SET-ASIDE SALES AND THEN TAKES THESE QUALITY DIFFERENCES INTO ACCOUNT IN COMPARING REVENUES. THE METHODOLOGY RECEIVED EXTENSIVE REVIEW BOTH WITHIN THE FOREST SERVICE AND BY TECHNICAL AND OTHER REVIEWERS OUTSIDE THE FOREST SERVICE. AS FINALLY USED, THE METHODOLOGY WAS SUPPORTED BY THE TECHNICAL REVIEWERS. SBA

REVIEWERS QUESTIONED THE FOREST SERVICE STUDY, BUT SBA'S COMMENTS DID NOT RESULT IN CHANGES TO THE STUDY. THE ONLY SUBSTANTIAL CHANGE MADE TO THE FOREST SERVICE STUDY AFTER THE VARIOUS REVIEWS WERE MADE WAS STRENGTHENING OF ITS CONCLUSION THAT SMALL BUSINESS TIMBER PURCHASERS ARE RECEIVING AN IMPLICIT SUBSIDY FROM FEDERAL TIMBER SALES.

THE FOREST SERVICE'S PACIFIC NORTHWEST FOREST AND RANGE EXECUTIVE STATION RELEASED THE STUDY TITLED "A COMPARISON OF OPEN AND SET-ASIDE TIMBER SALES ON NATIONAL FORESTS IN THE DOUGLAS-FIR REGION" ON MARCH 13, 1979. THE STUDY HAS BEEN ACCEPTED FOR FUTURE PUBLICAITON IN THE JOURNAL--"LAND ECONOMIES."

WE DID NOT RELY SOLELY ON THE RESULTS OF THE FOREST SERVICE STUDY BECAUSE IT ONLY COVERED TIMBER SALES IN THE PACIFIC NORTHWEST. WE ASKED THE FOREST SERVICE TO LET US USE ITS METHODOLOGY BECAUSE IT WAS THE BEST AVAILABLE FOR COMPARING TIMBER SALES NATIONWIDE. USING THE FOREST SERVICE METHODOLOGY, WE FOUND THAT IN MOST INSTANCES THERE WAS A SIGNIFICANT DIFFERENCE BETWEEN THE QUALITY OF SET-ASIDE AND OPEN SALES; THE SET-ASIDE SALES WERE GENERALLY OF HIGHER QUALITY. THE FACT THAT SET-ASIDE SALES ARE GENERALLY OF HIGHER QUALITY THAN OPEN SALES ALSO HELPS EXPLAIN WHY SBA FOUND THAT SET-ASIDE SALES RETURN MORE DOLLARS PER THOUSAND BOARD-FEET THAN DO OPEN SALES. PURCHASERS PAID MORE FOR SET-ASIDE SALES BECAUSE THEY WERE BUYING A HIGHER QUALITY PRODUCT.

BECAUSE OF QUESTIONS RAISED BY SBA WE RECONFIRMED WITH THE FOREST SERVICE AND BLM OUR EARLIER UNDERSTANDING THAT THERE WAS NO DISAGREEMENT WITH THE FACTS CONTAINED IN THIS REPORT.

MR. CHAIRMAN, THIS CONCLUDES OUR PREPARED STATEMENT. WE WILL BE PLEASED TO RESPOND TO ANY QUESTIONS.

REVENUE DIFFERENCES ON
FOREST SERVICE TIMBER SALES

TO DEMONSTRATE THE METHODOLOGY WE USED TO COMPARE REVENUES, A DETAILED EXPLANATION OF OUR ANALYSIS IS DISCUSSED BELOW FOR 2 OF THE 58 NATIONAL FORESTS IN OUR REVIEW. AT BOTH NATIONAL FORESTS, THE SET-ASIDE SALES WERE OF HIGHER QUALITY THAN THE OPEN SALES. AT THE GIFFORD PINCHOT NATIONAL FOREST, THE HIGHER QUALITY SET-ASIDE SALES ALSO RETURNED HIGHER REVENUES THAN THE OPEN SALES. THIS RESULT IS WHAT WOULD BE EXPECTED UNDER NORMAL COMPETITIVE BIDDING CONDITIONS. AT THE UMPQUA NATIONAL FOREST, HOWEVER, THE HIGHER QUALITY SET-ASIDE SALES RETURNED LESS REVENUES THAN THE OPEN SALES. THIS RESULT IS NOT WHAT WOULD BE EXPECTED UNDER NORMAL COMPETITIVE BIDDING CONDITIONS.

THE RESULTS OF THE UMPQUA NATIONAL FOREST AND AT THE 31 OTHER NATIONAL FORESTS WITH SIMILAR RESULTS EXEMPLIFY THAT RESTRICTIVE BIDDING CONDITIONS DO EXIST ON SET-ASIDE SALES; THE RESULTS ALSO SERVE AS A ROUGH MEASURE OF THE IMPACT OF THE RESTRICTIONS AT THE VARIOUS NATIONAL FORESTS. AT MOST OF THE NATIONAL FORESTS, THE RESTRICTIONS RESULTED IN LESS REVENUES OF VARYING MAGNITUDE.

GIFFORD PINCHOT NATIONAL FOREST

OUR EVALUATION OF THE 84 SET-ASIDE SALES SOLD AT THE GIFFORD PINCHOT NATIONAL FOREST DISCLOSED THAT SET-ASIDE SALES WERE OF HIGHER QUALITY THAN THE OPEN SALES. FOR

EXAMPLE, COMPARED TO THE OPEN SALES, THE SET-ASIDE SALES

- CONTAINED 84 PERCENT MORE TOTAL VOLUME AND 28 PERCENT MORE VOLUME PER ACRE,
- COULD BE LOGGED OVER A LONGER TIME PERIOD,
- HAD LOWER LOGGING AND MANUFACTURING COSTS, AND
- CONTAINED MORE HIGHER VALUED TIMBER.

THE ACTUAL DIFFERENCES BETWEEN ALL THE QUALITY CHARACTERISTICS ON THE GIFFORD PINCHOT NATIONAL FOREST CAN BE FOUND IN APPENDIX IX OF OUR REPORT.

THE HIGHER QUALITY SET-ASIDE SALES AT THE GIFFORD PINCHOT NATIONAL FOREST HAD A 44-PERCENT, OR \$11.20, HIGHER OVERBID THAN THE FOREST'S LOWER QUALITY OPEN SALES. THE METHOD USED TO COMPARE OVERBID WAS AS FOLLOWS.

<u>TYPE OF SALES</u>	<u>SELLING PRICE - APPRAISED VALUE = OVERBID</u>		
	(\$ PER THOUSAND BOARD-FEET)		
SET-ASIDE	\$83.75	-	\$47.29 = \$36.46
OPEN	<u>67.92</u>	-	<u>42.66</u> = <u>25.26</u>
DIFFERENCE	<u>\$15.83</u>	\$	<u>4.63</u> <u>\$11.20</u>

THUS, AT THE GIFFORD PINCHOT NATIONAL FOREST, SET-ASIDE TIMBER PURCHASERS PAID MORE FOR HIGHER QUALITY SET-ASIDE SALES. THIS RESULT IS WHAT WOULD BE EXPECTED UNDER NORMAL COMPETITIVE BIDDING CONDITIONS.

UMPQUA NATIONAL FOREST

OUR EVALUATION OF 108 SET-ASIDE SALES SOLD AT THE UMPQUA NATIONAL FOREST ALSO DISCLOSED THAT SET-ASIDE SALES

WERE OF HIGHER QUALITY THAN THE OPEN SALES. THE SET-ASIDE SALES

- CONTAINED 9 PERCENT MORE TOTAL VOLUME,
- COULD BE LOGGED OVER A LONGER TIME PERIOD,
- HAD LOWER LOGGING COSTS, AND
- CONTAINED MORE HIGHER VALUED TIMBER.

IN CONTRAST TO THE GIFFORD PINCHOT NATIONAL FOREST, THE HIGHER QUALITY SET-ASIDE SALES SOLD AT THE UMPQUA NATIONAL FOREST RETURNED 18 PERCENT, OR \$5.84, LESS OVERBID THAN THE LOWER QUALITY OPEN SALES, AS SHOWN BELOW.

<u>TYPE OF SALE</u>	<u>SELLING PRICE</u>	-	<u>APPRAISED VALUE</u>	=	<u>OVERBID</u>
	(\$ PER THOUSAND BOARD-FEET)				
SET-ASIDE	\$72.32	-	\$45.13	=	\$27.19
OPEN	<u>76.62</u>	-	<u>43.59</u>	=	<u>33.03</u>
DIFFERENCE	(\$ <u>4.30</u>)		(\$ <u>1.54</u>)		(\$ <u>5.84</u>)

ON THE UMPQUA NATIONAL FOREST, SET-ASIDE TIMBER PURCHASERS PAID LESS FOR HIGHER QUALITY SET-ASIDE SALES. THIS RESULT IS NOT WHAT WOULD BE EXPECTED UNDER NORMAL COMPETITIVE BIDDING CONDITIONS. AT THE UMPQUA NATIONAL FOREST THE RESTRICTIVE BIDDING CONDITIONS EXISTING ON SET-ASIDE SALES RESULTED IN LESS REVENUES, AND THE \$5.84 DIFFERENCE IN OVERBID SERVES AS A ROUGH MEASURE OF THE EXTENT OF THE COMPETITIVE RESTRICTIONS OPERATING IN THIS FOREST.

THE UMPQUA EXAMPLE ALSO DEMONSTRATES WHY WE BASED OUR ANALYSIS OF REVENUES ON THE OVERBID RATHER THAN UPON TOTAL

SELLING PRICE. AS HAS BEEN SHOWN, SELLING PRICE IS APPRAISED VALUE PLUS OVERBID. IN THE UMPQUA EXAMPLE, THERE WAS ONLY A \$4.30, OR 6-PERCENT, DIFFERENCE IN REVENUES BETWEEN THE SET-ASIDE AND OPEN SALES, WHILE THERE WAS A \$5.84, OR 18-PERCENT DIFFERENCE IN OVERBID. THE DIFFERENCE OF \$1.54 OCCURRED BECAUSE THE SET-ASIDE SALES WERE OF HIGHER QUALITY AND THE SALES APPRAISED VALUE WAS HIGHER BY \$1.54. BY JUST COMPARING THE SELLING PRICE OF SET-ASIDES AND OPEN SALES, WE WOULD NOT HAVE ACCOUNTED FOR THE QUALITY DIFFERENCES BETWEEN THE TWO TYPES OF SALES.

TO INSURE THAT THE OVERBIDS WERE DIFFERENT, WE STATISTICALLY TESTED THE OVERBIDS AT THE 90-PERCENT CONFIDENCE LEVEL. THE STATISTICAL TEST WAS USED TO INSURE THAT WIDELY VARYING OVERBIDS FOR EACH INDIVIDUAL TIMBER SALE DID NOT BIAS OUR ANALYSIS. FOR EXAMPLE, AT THE GIFFORD PINCHOT NATIONAL FOREST, THE SET-ASIDE OVERBIDS AND THE OPEN SALE OVERBIDS DID NOT VARY GREATLY WITHIN ALL THE SET-ASIDE SALES AND OPEN SALES, AND THUS THE OVERBID DIFFERENCE WAS STATISTICALLY VALID. ON THE OTHER HAND, AT THE FREMONT NATIONAL FOREST, THE SET-ASIDE SALES OVERBIDS AND THE OPEN SALES OVERBIDS VARIED GREATLY, AND WE COULD NOT CONCLUDE THAT THE OVERBID DIFFERENCE WAS STATISTICALLY VALID.

WE USED THIS METHODOLOGY AND FOUND THAT THE REVENUES FROM SET-ASIDE SALES ON 48 NATIONAL FORESTS, WHICH ACCOUNTED FOR 74 PERCENT OF THE SET-ASIDE SALES VOLUME SOLD, WERE LESS

THAN SIMILAR OR LOWER QUALITY OPEN SALES. AT THE NINE OTHER NATIONAL FORESTS, THE REVENUES FROM SET-ASIDE SALES WERE EQUIVALENT TO OR GREATER THAN THE FORESTS' OPEN SALES. AT THE ONE REMAINING NATIONAL FOREST, THE REVENUES FROM LOWER QUALITY SET-ASIDE SALES WERE LESS THAN FOR THE HIGHER QUALITY OPEN SALES.

WE DID NOT DETERMINE THE MAGNITUDE OF THE REVENUES DENIED THE FEDERAL GOVERNMENT BECAUSE WE WERE CONCERNED THAT THE AMOUNT CALCULATED WOULD BE PURE SPECULATION SINCE WE COULD NOT DETERMINE THAT THE SET-ASIDE SALES, IF SOLD AS OPEN SALES, WOULD HAVE GENERATED SIMILAR OVERBIDS.