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The overall objective of this dissertation is to measure the economic impact of the Section 8(a) socio-economic program. The author develops a methodology to measure the economic impact of the program and then applies the methodology. The data base used was limited to Air Force contract data. In addition to measuring the economic impact of the Section 8(a) program, the author also develops a cost model and measures the cost to the Air Force of administering the program. This research represents a good

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first step toward developing a general methodology to measure the impact of socio-economic programs. It also addresses the problem of measuring the costs of administering these type programs and thus establishes a means of determining the effectiveness of a socio-economic program. The study also includes an exhaustive bibliography of the socio-economic area of study. ←

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THE RELATIONSHIPS BETWEEN SOCIOECONOMIC PROGRAMS
AND THE DEPARTMENT OF THE AIR FORCE BUDGET:
SECTION 8(a) OF THE SMALL BUSINESS ACT--THE
ECONOMIC DEVELOPMENT AND PUBLIC FINANCE
ASPECTS OF A PUBLIC POLICY PROGRAM

by

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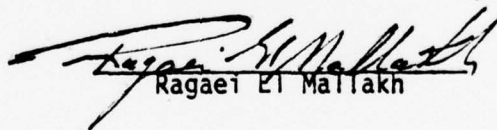
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1977

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by


Ragaei El Mallakh


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King, Arthur Thomas (Ph.D., Economics)

The Relationships Between Socioeconomic Programs and the
Department of the Air Force Budget: Section 8(a)
of the Small Business Act--The Economic Development
and Public Finance Aspects of a Public Policy Program
Thesis directed by Professor Ragaei El Mallakh

Public policy activities are conducted by governments to intervene in market outcomes so as to influence allocation, distribution, and economic growth. The problem of economic underdevelopment which confronts the low income countries of the world also confronts countries which are economically advanced. Economic development sometimes takes place so as to leave some groups less than full beneficiaries of growth in income. Underdeveloped sectors in advanced economies exhibit many of the characteristics of underdeveloped countries. The minority group sector of the United States economy is an example of one such underdeveloped sector which exhibits the primary underdevelopment characteristics of low income and economic dualism.

The purposes of this dissertation are to explore the efficacy of government development policy in relationship to sectoral and national underdevelopment and to decipher the economic development consequences of one public policy program designed to promote development of the United States minority group sector--the Section 8(a) Minority Enterprise Procurement Program. This program is administered by the Small Business Administration under Section 8(a) of the Small Business Act of 1953, as amended. The Small Business Administration contracts with other government agencies for the provision of goods and services and then subcontracts with private firms owned by socially and economically disadvantaged persons. Approximately .7 percent of all Section 8(a) contracts have been awarded to white-owned businesses. Coincidentally this is the same percentage of business receipts which accrued to all minority-owned firms in 1969.

The minority group sector does not receive income as high as the average, in part, because it owns a disproportionately small share of the economic resources in the country. It owns a disproportionately small share of economic resources, in part, because of restricted access to capital markets, distribution channels, and entrepreneurial expertise because of interpersonal and institutional discrimination. The Section 8(a) Program

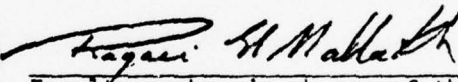
attempted to counter business underdevelopment as a form of sectoral underdevelopment by providing the full range of Small Business Administration services to firms which were capable of performing government contracts. These services include loan and loan guarantees and entrepreneurial training in conjunction with other facets of the Minority Enterprise Program. The Minority Enterprise Program evolved out of the concept of black capitalism, first initiated as a governmental policy goal in 1964. The program took on its current emphasis of helping minority-owned firms to overcome the barriers to growth and development through governmental contracts in 1969.

Public policy programs express the political will of the nation. The Civil Rights Acts which were passed between 1957 and 1968 expressed the political will for greater equality of socioeconomic opportunity for nonwhite minority group members. The Section 8(a) Program, even though it was not mandated by Congress, expressed the political will that minority groups should have greater equality of opportunity in the area of business ownership and control. The program was instituted partially in response to the civil disturbances which occurred in the ghetto areas of the country between 1965 and 1967.

This study uses a stepwise multiple linear regression analysis to determine the economic development effectiveness of the Section 8(a) Program. The regression model analyzes the relationships between a total of twelve variables associated with 935 Department of the Air Force Section 8(a) contracts awarded to 365 firms between 1968 and 1976. The regression results indicate that the program is an effective economic development tool regardless of whether total dollar awards to each firm or dollar amount of each contract is used as a measure of development effectiveness. The study indicates that the incremental dollar cost to the Air Force for program participation is approximately 79,000 dollars per year.

This abstract is approved as to form and content. I recommend its publication.

Signed


Faculty member in charge of thesis

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CHAPTER I

INTRODUCTION

Goals of the Study

The goal of this study is to explore the economic development aspects of the Section 8(a) Minority Enterprise Procurement Program [Section 8(a) Program]. The program is administered by the Small Business Administration (SBA) under Section 8(a) of the Small Business Act of 1953, as amended (Public Law 85-536).¹ The Section 8(a) Program was initiated in fiscal year 1968 and has been actively supported by every President since then. The study is primarily devoted to the economic development aspects of the program. The fields of urban and regional economics, the economics of

¹The text of Section 8(a) of Public Law 85-536 is included at Appendix 1. The Law permits the SBA to contract with Government Agencies and then subcontract the actual work to private firms. SBA has used this authority since fiscal year 1968 to subcontract work to firms owned by "socially and economically disadvantaged" persons. Social and economic disadvantage has been determined to connote members of American minority groups primarily. See U.S., Congress, House, Select Committee on Small Business, Text of Public Law 85-536 (Small Business Act, 91st Cong., 2nd Sess. (Washington: Government Printing Office, 1970).

poverty and discrimination, public finance, and labor economics also provide inputs to this study. Aside from economic theory, these branches of economics are expected to provide the foundation for an exhaustive study of this public policy program. This is first and foremost a study in minority group underdevelopment in the United States. The study will address itself to the applicability of general economic development theory to the economic development problems which confront minority group members and the public policy implementation of that theory most appropriate to solving this underdevelopment problem. Moreover, the choice of American minority groups and the Section 8(a) Program, though important from a public policy standpoint, is a corollary of the study.

The public finance involvement of the Section 8(a) Program is evident when consideration is given to the facts that: (a) Some expense is associated with implementation of the program even if expenditures are only measured in terms of additional time spent by Small Business Administration employees and procurement officials in support of the Section 8(a) Program; and (b) the accomplishment of the socioeconomic objectives associated with the program are, at best, implicit in the charter of the federal procurement process and involve some redistribution of public sector revenues without any explicit consideration being given to the added costs incurred by the procuring agencies.

There is a need to decipher the relationships between public policy activities designed to increase economic development in developed and underdeveloped countries. The Section 8(a) Program offers a unique opportunity for such analysis since it is carried out within the market framework and involves little in the way of incremental appropriated expenditures. This study will explore the assertion that the Section 8(a) Program and others like it are costly to implement through the government procurement apparatus and will simultaneously analyze the impact of the program on minority group economic development. The assertion that the program is costly to implement through the procurement process is inclusive of the class of programs whose goals focus on the accomplishment of socioeconomic objectives. The following nonexhaustive list of programs is included in the class: the Small Business Set-Aside Program, the Section 8(a) Program, the Labor Surplus Area Set-Aside Program, the Davis-Bacon Act, the Buy American Act, the Service Contract Act, and the Walsh-Healy Act.²

It is noteworthy that not all of the programs which impinge upon the procurement process are mandated by enabling legislation. Some of them are matters of policy promulgated

²A brief description of these programs is contained in Appendix 2. See U.S., Commission on Government Procurement, Compilation of Laws Pertaining to Government Procurement (Washington: Government Printing Office, 1970).

by a single federal department or agency, some are the result of negotiations between several agencies, and some are matters of presidential preference for dealing with problems. They are all designed to insure against actions which are perceived to threaten an efficient or equitable distribution of government procurement expenditures. They are all motivated by socioeconomic policy goals. This study attempts an in-depth exploration of the implications of one socioeconomic program implemented through the procurement process. The impact of the Section 8(a) Program will be investigated with respect to its impingement upon the Air Force Budget and its minority group economic development effectiveness.

The Section 8(a) Program is a domestic economic development program. It is specifically oriented toward the principal goal of achieving minority group socioeconomic mobility. The Office of Minority Business Enterprise states that, "The Basic aim of Section 8(a) is to establish [minority] business concerns that will become independent and self-sustaining in a normal competitive environment."³ If the program goals are worthy of accomplishment either Section 8(a) or some alternative vehicle for their accomplishment seems warranted. The Section 8(a) Program is unique in the class of

³U.S., Department of Commerce, Office of Minority Business Enterprise, Special Catalog of Federal Programs Assisting Minority Enterprise (Washington: Government Printing Office, 1971), p. 33.

socioeconomic programs which impinge on the procurement process because it is designed to deal with a leading contemporary social issue which has involved much emotional debate.⁴ The program has been questioned on judicial and political grounds and there has been considerable controversy over the efficacy of the minority capitalism concept from which it arose.

The economic situation of minority groups which gives rise to the need for national socioeconomic action is studied and a comparison of alternative approaches to the problem of racial economic inequality is explored in this study. An attempt will be made to decipher the relationships between the economic development problem in underdeveloped countries and in underdeveloped sectors of countries which are economically advanced.

The Section 8(a) Program must be judged on the basis of whether its goals are worthy of pursuit; whether it is accomplishing its goals; and whether the benefits of goal accomplishment outweigh the costs. The following list of sequential questions will be used as a guide in an attempt to explore the socioeconomic impact of the program.

⁴Several court cases, the most notable of which was the Ray Ballie Trash Hauling Case, have questioned the constitutionality of the program. These are discussed in Appendix 3.

(1) Is the observed income disparity in the United States between Caucasians and minority groups, as a class, of sufficient magnitude to permit classification of the latter as underdeveloped?

(2) If minority groups may be classified as underdeveloped, can governmental interference with the market improve the position of minority groups relative to the majority group?

(3) What types of activities are likely to be effective in combating minority group underdevelopment?

(4) If increasing minority group ownership of business is an effective economic development activity, what is the least costly way to accomplish the task?

(5) If government contracting is chosen as the means by which minority business ownership is to be fostered, what benefits can be expected to accrue from its use?

(6) What costs are engendered by the Section 8(a) Program and how should they be apportioned?

Nature of the Problem

Most writings in the field of economic development have been directed at attempts to analyze problems associated with and prescribe programs designed to improve the standards of living in the underdeveloped countries of the world. It is understandable that such should be the case when the most intractable instances of human suffering attributable to a

lack of the material requisites of a comfortable life occur in these countries. Yet large segments of the populations of economically advanced countries are poor relative to their fellow citizens. The Bureau of the Census shows that 12.6 percent of the United States population was below the poverty line in 1970.⁵ In addition, the poverty rate in 1970 was highest among ethnic minorities, rural dwellers and central city dwellers.⁶ These groups are not mutually exclusive.

These statistics point cogently to a central postulate of this study--that poverty is much less an individual than a class phenomenon, which may be analyzed in terms of broad segments of the population in advanced economies. Moreover, the tools of analysis and policy prescriptions used for remedying underdevelopment in general are applicable for combating underdevelopment in segments of advanced economies.

For purposes of this study minority group membership assigns one to a sector of the society. Such a sector is considered more broadly than the traditional economic sector and could be based upon any identifiable, common group

⁵See Irving Kristol, "The Poverty of Equality," Wall Street Journal, 188, No. 7, July 12, 1976, p. 10, Kristol argues that the poverty rate is overstated because income in kind is not included in poverty population income. Even with the high incidence of poverty among minority groups, they still constitute a minority of the poverty population.

⁶U.S., Department of Commerce, Bureau of the Census, Characteristics of the Population Below the Poverty Level: 1974 (Washington: Government Printing Office, 1976), Tables 1, 3 and 8.

characteristic such as geography or sex. Thus a sector is not necessarily composed of an industry group or a region yet it might include or be included in such a unit. Ethnology is chosen as the sector characteristic for this study only because the public policy program under analysis is ethnologically oriented.

According to the 1970 Census, blacks constituted 22,539,362 of the 25,090,937 nonwhite persons in the population. They compose, therefore, 89 percent of the nonwhite population.⁷ In some instances during the course of this study what may appear inordinate treatment of black underdevelopment will be conditioned by the greater availability of data for this group. No harm is done to the analysis since all nonwhite minority groups have suffered some discrimination and exhibit the low income characteristic of underdevelopment.⁸

Income disparity among segments (sectors) of advanced economies is considered an indicator of underdevelopment just as income disparity among nations is an indicator of underdevelopment. An underdeveloped sector is one in which

⁷U.S., Department of Commerce, Bureau of the Census, 1970 Census of Population: General Social and Economic Characteristics, United States Summary (Washington: Government Printing Office, 1972), p. 1-361.

⁸The national poverty rate for Japanese male family heads is lower than for white male family heads, however, regional rates are always lower for whites. See Stanley Lebergott, The American Economy (Princeton: Princeton University Press, 1976), pp. 112-4.

average incomes are less than average incomes for the society as a whole. More precisely, an underdeveloped sector is one in which income below the average occurs more frequently than in the larger society. A program designed to combat poverty is an economic development program since poverty is one measurable aspect of underdevelopment.

In general, any program designed to alleviate sectoral income disparity promotes economic development whether it be the relief of abject poverty or conveyance of the underdeveloped sector toward the societal norm. Moreover, the norm toward which conveyance is provided might not be measured in money income. While money income represents the most quantifiable aspect of welfare, income is at best, an imperfect measure. From the viewpoint of this study some people might derive relatively more satisfaction from the pride and independence of business ownership than from money income. The importance of non-money and in fact non-economic factors points to the central place of sociological and psychological factors in economic development.

The minority group sector of the United States economy would be considered economically developed if it were comprised of persons who, on the whole, had achieved socioeconomic status roughly equal to that enjoyed by the average member of the society. This does not suggest a completely equal distribution of income but it does suggest that the size

distribution of income among sectors should be roughly equal for the minority group sector to be considered other than underdeveloped.

The Extent of Poverty in the United States

Poverty connotes underdevelopment since the poor have both a shortfall of the money income necessary for a life of basic comfort and a lack of capability to raise their incomes above the poverty level through their own initiatives. The lack of this capability on the part of many of the poor manifests itself as the "vicious circle" of poverty.⁹ It is almost as if the poor are victims of a cruel conspiracy. They are, in general, less well educated, less healthy, and less able than other Americans to involve themselves in market transactions which are most remunerative.^{10, 11}

⁹Lester C. Thurow, Poverty and Discrimination (Washington: The Brookings Institution, 1969), p. 169; see also Gunnar Myrdal, Economic Theory and Underdeveloped Regions (New York: Harper and Row, Publishers, 1957), Cha. 2.

¹⁰Michael Harrington, The Other America (Baltimore: Penguin Books, 1962), p. 22.

¹¹See P.T. Bauer, Dissent on Development (Cambridge: Harvard University Press, 1972), pp. 31-49. Bauer presents a contrary view on the validity of the vicious circles notion. As used in this study the notion of vicious circles does not connote absolute stagnation with no hope for advancement in contradistinction to Bauer's treatment (p. 34). This study takes the view that the intergenerational tendency toward poverty for both countries and sectors is evident.

Most attempts to define poverty in the United States are based on Mollie Orshansky's work at the Social Security Administration.¹² The present study makes no attempt to define poverty. Whether an unrelated individual or family should be counted among the poverty population depends critically upon time and circumstance. For example, a similarly sized family (with similar income) might fare quite differently depending upon whether or not it enjoys imputed income, where it lives, how many family members contribute to family income, or a number of other variables, some of which might be under control of the family. For purposes of this study the poverty population is that portion of the United States population which has insufficient money income to meet individual or family needs as determined by the Bureau of the Census or any other widely recognized authority.

Both the absolute number of the poor and their proportion of the total population have steadily declined since President Franklin D. Roosevelt said, "I see one-third of a nation ill-housed, ill-clothed, and ill-nourished."¹³ Poverty, however, remains a serious problem in the United States. As Hildebrand states:

¹²Mollie Orshansky, "Counting the Poor: Another Look at the Poverty Profile," Social Security Bulletin, January 1965, pp. 3-29.

¹³U.S., President Franklin D. Roosevelt, "Second Inaugural Address, January 20, 1937," Inaugural Addresses of the Presidents of the United States (Washington: Government Printing Office, 1974), p. 243.

Over the past century and a half. . .poverty has changed in character over much of the industrialized world. In 1800 the basic problem of the poor was to get enough to eat. Today it is much less a question of diet than it is one of aspiration--of gaining a fair chance for their children and of having access to those goods and services that modern technology alone can provide and that make up a conventional middle-class standard of life.¹⁴

The point is clear that poverty has a relative as well as an absolute component. It is also obvious that some absolute minimum amount of money income or income substitute is necessary for sustenance.

The minimum amount of income needed for an unrelated individual or a family is called the low income level by the Bureau of the Census. The count of the poverty (low income) population is determined by adjustments to the Department of Agriculture Economy Food Plan for family consumption requirements. The Bureau of the Census estimates that in 1971 the poverty population of the United States consisted of 25,559,000 persons. This number comprised 12.5 percent of the total population. The aggregate income deficit below the poverty line of the poor was estimated to be 12.034 billion dollars. The minority group population accounted for a substantial portion of all poor persons. In 1971 30.9 percent of the nonwhite population was below the poverty level while

¹⁴George Hildebrand, Poverty, Income Maintenance, and the Negative Income Tax (New York: State School of Industrial and Labor Relations, Cornell University, 1967), pp. 5-6.

9.9 percent of the white population was poor.¹⁵ These figures serve to point out the problem of poverty only in terms which are quantifiable. They do not interpret the impact of being poor in an affluent society. The figures are indicative of the poverty problem from the standpoint of its absolute rather than its relative component given the level of prices. They say nothing of the impact which the condition of poverty has on the poor. The figures might be interpreted in light of the societal credo of the United States, which argues for the infinite dignity and worth of each individual. In this light a large proportion of the minority group population has been hampered in its capability to enjoy the material fruits of American life. To be sure the American poor are better off economically than the poor of most other countries.

The percentage of the total population which lives in poverty has steadily decreased during this century. The past several decades have witnessed a dramatic decline in this percentage. Table I shows the decline in the poverty population during the years 1959 through 1971. The figures presented in Table I do not include in-kind transfers and may be distorted on that account. Browning estimates that per capita federal in-kind transfers to the poor amounted to

¹⁵U.S., Department of Commerce, Bureau of the Census, Statistical Abstracts of the United States, 1973 (Washington: Government Printing Office, 1973), Tables 548, 552; pp. 336, 338.

537 dollars in 1972. Total in-kind benefits (federal plus state and local) amounted to 17 billion dollars. By extrapolation half of this amount went to poor persons in families.¹⁶

¹⁶Edgar K. Browning, "The Trend Toward Equality in the Distribution of Net Income," Southern Economic Journal, 43, No. 1 (July 1976), 912-23.

TABLE I
 POVERTY POPULATION (CONSTANT DOLLARS),
 TOTAL AND NONWHITE, 1959 TO 1971

Year	Percent of total population below low income level	Percent of minority group population below low income level
1959	22.4	56.2
1960	22.2	55.9
1961	21.9	56.1
1962	21.0	55.8
1963	19.5	51.0
1964	19.0	49.6
1965	17.3	47.1
1966	14.7	39.8
1967	14.2	37.2
1968	12.8	33.5
1969	12.2	31.1
1970	12.6	32.0
1971	12.5	30.9

Source: Executive Office of the President, Social Indicators 1973, Tables 5/17 and 5/19.

Another important aspect of the percentage of the total poverty population is the rate at which it has declined. Table I shows that while the rate of decline was 5.1 percentage points between 1959 and 1965, it was only 2.2 percentage points between 1966 and 1971. Stated, alternatively, the

average rate of decline was .72 percentage points a year between 1959 and 1965 but was only .37 percentage points a year between 1966 and 1971. Gallaway noted an even more dramatic decline and reduction in decline of the poverty population between 1947 and 1968.¹⁷ Table I also shows that the reduction in the rate of decline of poverty has been even more dramatic for the minority group poverty population. Minority group members suffer an incidence of poverty significantly greater than the population as a whole. The slowing of the decrease in poverty population has led to contentions that the remaining poverty population might be more immune than previous poverty populations to general economic progress as a prescription for alleviating poverty.¹⁸ If the society desires a reduction in the incidence of poverty and the relative size of the poverty population does not respond to economic growth, some other public policy program to reduce the incidence of poverty seems warranted. Moreover, if minority groups are more isolated from the mainstream of American economic life, they will be even more

¹⁷Lowell E. Gallaway, Manpower Economics (Homewood: Richard D. Irwin, Inc., 1971), p. 147.

¹⁸John Kenneth Galbraith, The Affluent Society (New York: The New American Library, Inc., 1958), p. 254; see also James Gwartney and others, Economic Development Administration, Differential Impact of Economic Growth on Minority Groups (Washington: Government Printing Office, 1974), pp. 88-94.

immune to economic growth than the average American because of socioeconomic strictures.

Income Disparity in the United States

Aside from the issue of poverty, income and wealth are not evenly distributed in the United States between the majority race of the society and minority group races. Table II depicts the income distribution by race for white and minority group races. These figures do not reflect in-kind transfers. To the extent that minority groups constitute a larger proportion of the poverty population, and thus receive a larger proportionate share of in-kind benefits, their income is understated. A recent report to the Congress concludes that:

Empirical evidence for 1974 and several earlier years indicates that, if food stamps were included as income and if the poverty thresholds were not changed, about 5 to 15 percent of the poor (depending on the method of valuation used) would no longer be counted as poor.¹⁹

The addition of unrealized or imputed income from assets would reduce poverty most dramatically for the self employed, the aged, whites and other groups in which the average net worth is higher than it is for the population as a whole.²⁰ Thus

¹⁹Bette Mahoney and George Grob, Federal Interagency Committee on Education, U.S., Department of Health, Education and Welfare, The Measure of Poverty (Washington: Government Printing Office, 1976), p. XXV.

²⁰Ibid.

the tendency toward understatement of minority group income would be lessened by inclusion of imputed income.

TABLE II
RATIO OF MEDIAN INCOME OF MINORITY GROUP TO WHITE
FAMILIES AND INDIVIDUALS, 1947 TO 1971
(Constant Dollars)

Year	Ratio of minority group to white median income		Dollar differences in median income	
	Families	Unrelated Individuals	Families	Unrelated Individuals
1947	.51	.71	-\$2,784	-\$584
1950	.54	.72	- 2,669	- 537
1955	.55	.66	- 3,116	- 724
1960	.55	.58	- 3,566	- 1,066
1965	.55	.73	- 4,151	- 786
1970	.64	.69	- 3,868	- 1,071
1971	.63	.67	- 3,958	- 1,140

Source: Statistical Abstracts of the United States, 1973, Table 535.

These figures are not startling in light of poverty incidence figures presented in Table I. The figures are in accord with

the findings of Brimmer.²¹ However, the divergence of income between whites and nonwhites is related to but quite different than the insufficiency of income to provide some minimum living standard. If high incomes occurred frequently enough in the minority group population to offset the number of low incomes, median incomes would not be different between the two groups. They do not. While the ratio of nonwhite to white family income has increased, the magnitude of the difference has also tended to increase.

Both poverty and the divergence of white and minority group incomes are issues of distributive justice and impinge upon upward mobility. On the one hand a large proportion of the poverty population is composed of children who are poor through no fault of their own. They are poor by an accident of birth the consequences of which they are totally helpless to alter. They begin at a disadvantage in the drive toward average income. On the other hand many minority group members otherwise born into average economic circumstances are unable to hurdle the social and economic barriers to the upper rungs of the income ladder--regardless of ability or the willingness

²¹Andrew F. Brimmer, "Economic Situation of Blacks in the United States," U.S., Congress, Joint Economic Committee, The 1972 Economic Report of the President, Hearing, 92nd Cong., 2nd Sess., February 23, 1972 (Washington: Government Printing Office, 1972), p. 645.

to work.²² While they may have been subjected to educational and environmental influences conducive to remaining far above the poverty level and have the requisite motivation to do so, their chances of achieving remunerative success in business or similar endeavors are severely limited by their racial background. They are victims of discrimination.

According to the President's Council of Economic Advisers:

Discrimination is said to exist when two or more groups that are differentiated on the basis of some characteristic irrelevant to an objective measure of productivity are not granted equal treatment in some activity.²³

This is the definition of discrimination used in this study. Discrimination thus defined may be manifested through interpersonal or institutional activities.

Methodology

The method used in the first portion of this study is primarily descriptive. An investigation is conducted of the applicability of economic development theory to underdeveloped sectors of economically advanced societies. A comparison

²²Christopher Jencks and others, Inequality (New York: Harper and Row, Publishers, 1972), p. 218; see also Rashi Fein, "Profile of the American Negro," Labor and the National Economy, eds. William G. Bowen and Orley Ashenfelter (Rev. ed.; New York: W.W. Norton and Company, Inc., 1975), pp. 96-7.

²³Council of Economic Advisers, Economic Report of the President, 1974 (Washington: Government Printing Office, 1974), p. 150.

of economic conditions and public policy prescriptions between underdeveloped countries and underdeveloped sectors of advanced economies will be made. The study will center on the minority group sector of the United States economy as a prototype of underdeveloped sectors in advanced economies.

The minority group sector is unique to traditional economic development treatment because the external sociological, political and psychological forces attendant to sectoral underdevelopment are stronger than that normally treated where economic dualism is prevalent, yet sectoral income differences exhibit many of the characteristics of dualistic economies. These characteristics bear on the analysis as do the issues of trade, even on a regional basis, and the availability of technology to support development.²⁴

The first two chapters of this study are devoted to a presentation and analysis of the setting in which minority group economic development must take place. Chapter three establishes the framework for an analysis of minority group economic development. This chapter first analyzes the role of governmental activity in economic development, then it analyzes the public policy activities undertaken by the United States Government to promote minority group economic development.

²⁴See Gustav Ranis, "Economic Dualism at Home and Abroad," Public Policy, 18, No. 1 (Fall 1969), 41-53.

Chapter four analyzes the potential impact of the minority capitalism approach on minority group economic development. Chapter five recounts the development of the Section 8(a) Program from its inception to the present, including the political and social climate in which the program was implemented.

Chapter six contains the quantitative portion of this study. After an analysis of program goals in light of chapter four conclusions, a multiple linear regression analysis is conducted to measure the effectiveness of the Section 8(a) Program as a development tool. The analysis of the program is limited to Air Force participation in it on the basis that Air Force participation is representative and that a large enough sample is provided to give unbiased results. The regression analysis contains twelve variables on each of 365 Section 8(a) firms and 935 contracts written between fiscal years 1968 and 1976. This information was extracted from Small Business Administration and Air Force procurement sources. An estimate of the cost to the Air Force of participating in the program is presented, which is based upon a questionnaire survey sent to all Air Force procurement offices. The questionnaire will permit measurement of dollar as well as nonmonetary costs. Chapter seven will present the summary and conclusions drawn from this study.

This study is based ^{on} in economic development theory for several reasons. The neoclassical model of discrimination

developed by Becker²⁵ and extended and generalized by Arrow²⁶ was considered as a foundational alternative. The problems with that analysis as a basis for this study were considered insurmountable. The basis of Becker's analysis is the purely competitive economy where (white) employers were assumed to act as if they were willing to pay for nonassociation with (black) employees. This assumption is critical to development of the Marginal Discrimination Coefficient (MDC) which is critical to the model. As noted by Marshall the neoclassical model, though theoretically rigorous, does not square with the reality of racial discrimination in the United States. In addition, since discrimination itself is treated as exogenous to the model, it does not explain much about discrimination or provide a basis for public policy formulation.²⁷

This study seeks to evaluate a public policy program which is already in operation in light of its stated goals.

²⁵Gary S. Becker, The Economics of Discrimination (2nd ed.; Chicago: The University of Chicago Press, 1971), Cha. 1.

²⁶Kenneth J. Arrow, "Models of Job Discrimination in the Labor Market," Racial Discrimination in Economic Life, ed. Anthony H. Pascal (Lexington: D.C. Heath and Company, 1972), pp. 83-102.

²⁷Ray Marshall, "The Economics of Racial Discrimination," Journal of Economic Literature, 12, No. 3 (September 1974), 859.

This could only be done within a framework which considered those goals operationally meaningful. Minority group members own proportionately less businesses partly because of discrimination in input and output markets. More importantly the program under study seeks to increase ownership of businesses, and consequently the income and power positions of minority group members, regardless of the reasons for its paucity. Economic development seems to provide the best foundation for this study since underdevelopment characteristics abound in the minority group sector of the United States.

CHAPTER II

MINORITY GROUP UNDERDEVELOPMENT IN THE UNITED STATES

The Optimal Distribution of Income

The problem of a "fair" distribution of income is at least as old as the economics discipline. Acceptance of the notion of governmental subsidization of the ingredient even if it resulted in deficits was first widely accepted in the United States during the Great Depression. This entry of the public sector into income maintenance schemes represented the first explicit, widespread acceptance of the proposition that economic circumstance and economic mobility could not always be controlled by the individual. It would have been difficult to foretell what the entry of government into income security programs portended for governmental activity in future years. The entry of government into the field of income security led to the acceptability of government as the guarantor of some private citizens against the exigencies of age, physical incapacitation, nonemployability, race and sex. Whereas these circumstances had previously been considered private problems, they gradually became public problems. The need to insure against suffering because of circumstance became in this century a worthy public policy goal.

This study does not attempt to prescribe an income distribution for the United States which is totally equitable from the standpoint of any individual or group. The major concern here is to decipher whether there are any compelling reasons to believe that income for minority group members diverges sufficiently from white incomes to merit a consideration of public policy rectification. The data presented earlier suggest that the income divergence is significant. Public policy action is considered to be warranted if the amount of inequality causes the share of income which accrues to minority groups to be less than proportional to their representation in the population since their potential productivity is similar to that found in the population as a whole.

Market Participation and the Distribution of Income

The distribution of incomes in a market economy is based primarily on the valuation of marginal contributions to production. Labor and proprietors' incomes are consistently two of the largest sources of personal income.¹ If access to these sources of income is not completely free of noneconomic encumbrances the income shares which accrue to any group in the society will be conditioned by such encumbrances rather

¹Council of Economic Advisers, Economic Report of the President, 1974 (Washington: Government Printing Office, 1974), p. 271.

than by market valuations alone. In addition, to the extent that the ability to increase one's income from these sources is affected by other than economic considerations, his economic mobility is thwarted. Social and economic discrimination represents market encumbrances which respond slowly to market mechanisms alone. There is considerable evidence that wage income disparity is only partially attributable to differences in productivity.² The measurement of labor productivity is imperfect. Masters concluded that there is still a substantial earnings differential between blacks and whites after standardizing for productivity. "While this differential is essentially a residual, it appears that it probably results in large part from labor market discrimination."³

Several factors affect labor incomes. Labor incomes for minority group members which are below average even after adjustments for differences in educational attainment or other measures of labor quality imply labor market discrimination. Aside from the fact that such discrimination impacts on the

²Anthony H. Pascal and Leonard A. Rapping, "The Economics of Racial Discrimination in Baseball," Racial Discrimination in Economic Life, ed. Anthony H. Pascal (Lexington: D.C. Heath and Company, 1972), pp. 149-50; see also Paul M. Siegel, "On the Cost of Being a Negro," Race and Poverty, ed. John F. Kain (Englewood Cliffs: Prentice-Hall, Inc., 1969), p. 62.

³Stanley H. Masters, Black-White Income Differentials (New York: Academic Press, Inc., 1975), p. 122.

earnings of the individual discriminated against, it engenders costs to the society in foregone product.⁴ Another factor which impacts heavily on labor incomes is the rate of unemployment for groups of individuals.

As a rule of thumb, the unemployment rate of Negroes is about twice that of whites, regardless of the age or sex of the group that is compared or the general economic climate at the time of the comparison.⁵

The inability to find work, and even if it is found the inability to compete equally for promotion leads to relative stagnation of labor incomes for minority group members. Barriers to hiring and promotion of minority group members, especially blacks, is a well documented fact of the employment scene of the twentieth century United States.⁶ Historical unemployment rates are shown in Table III. Account of differences in human capital endowments might tend to decrease the unemployment rate differentials somewhat.

⁴Lester C. Thurow, Poverty and Discrimination (Washington: The Brookings Institution, 1969), pp. 134-7; see also John P. Formby, "The Extent of Wage and Salary Discrimination Against Non-White Labor," Southern Economic Journal, 35, No. 2 (October 1968), 140-50.

⁵Herman P. Miller, Rich Man, Poor Man (New York: Thomas Y. Crowell Company, Inc., 1971), p. 68.

⁶Paul H. Norgren and Samuel E. Hill, Toward Fair Employment (New York: Columbia University Press, 1964), Cha. 2.

TABLE III
 UNEMPLOYMENT RATES, 1948 TO 1972
 (Annual Averages)

Year	Negro and other races	White	Ratio: Negro and other races to white
1948	5.9	3.5	1.7
1949	8.9	5.6	1.6
1950	9.0	4.9	1.8
1951	5.3	3.1	1.7
1952	5.4	2.8	1.9
1953	4.5	2.7	1.7
1954	9.9	5.0	2.0
1955	8.7	3.9	2.2
1956	8.3	3.6	2.3
1957	7.9	3.8	2.1
1958	12.6	6.1	2.1
1959	10.7	4.8	2.2
1960	10.2	4.9	2.1
1961	12.4	6.0	2.1
1962	10.9	4.9	2.2
1963	10.8	5.0	2.2
1964	9.6	4.6	2.1
1965	8.1	4.1	2.0
1966	7.3	3.3	2.2
1967	7.4	3.4	2.2
1968	6.7	3.2	2.1
1969	6.4	3.1	2.1
1970	8.2	4.5	1.8
1971	9.9	5.4	1.8
1972	10.0	5.0	2.0
1973	8.9	4.3	2.1

Source: U.S., Department of Labor, Bureau of Labor
 Statistics, Handbook of Labor Statistics, 1974, Table 60.

Small business ownership in the United States is considered by the United States Congress to be basic to the economic well-being and security of the Nation through its desirable effects on competition.⁷ Ownership of business represents one of the ways in which individuals can assert themselves in a society which is increasingly interdependent and in which constraints of a work-a-day existence and competition with peers for available promotions can be foregone without excessive pecuniary liability. Minority group members do not own businesses in proportion to their number in the United States population. They are even more grossly under-represented in the proportion of business receipts which they receive. In 1969 minority groups constituted 17.0 percent of the United States population. In that same year they owned 4.3 percent of all business enterprises. They received .7 percent of all business receipts.⁸ The lack of business ownership has a deleterious effect on socioeconomic mobility in addition to its effects on the current income position of minority group members. The lack of business ownership is akin to the lack of general economic advance by minority

⁷U.S., Congress, House, Select Committee on Small Business, Text of Public Law 85-536 (Small Business Act) (Washington: Government Printing Office, 1970), p. 1.

⁸U.S., Department of Commerce, Bureau of the Census, Statistical Abstracts of the United States, 1973 (Washington: Government Printing Office, 1973), p. 29; see also U.S., Bureau of the Census, Minority-Owned Businesses: 1969 (Washington: Government Printing Office, 1971), p. 2.

group members. The economic and social conditions of this group are influenced by an institutional environment which has been hostile to upward socioeconomic mobility.

The Distribution of Talent and the Distribution of Income

The contribution which is made to production processes is the ostensible basis for the remuneration of labor in the United States economy. Labor incomes are conditioned in the first instance by employment. In addition to having a higher incidence of unemployment, minority group members also tend to be hired and promoted on a basis which is more prejudicial to adequate levels of income than white members of the society. There is significant historical evidence that the equal pay for equal work doctrine has not held for minority group members. Title VII of the Civil Rights Act of 1964 was enacted in explicit recognition of this fact. An assumption which is made to facilitate clarity of the present analysis is that innate ability is evenly distributed throughout the population.

If intelligence is discounted as a variable, on the average, incomes accruing to people engaged in similar work should be roughly equivalent. In addition, it would be expected that individuals with similar talents would engage in similar occupations. Minority group members have generally been less likely to be promoted in jobs which they hold especially where promotion would equate to their becoming

supervisors of white persons.⁹ This bias against job and salary advancement has been especially prevalent for black members of the society.¹⁰ A part of its basis lies in the historical fact of slavery yet this type of labor market discrimination has been practiced against minority groups who were not subjected to slavery.¹¹

A highly specialized economy dictates that specialized skill be substituted in the market for the ability to conduct a wide range of economic activities on one's own behalf. Moreover, the demand for services becomes relatively more inelastic in a specialized economy with the consequence that prices are more reactive to changes in supply. On the output side, this implies more dependence on the availability of goods and services and less capability to adjust purchases on the part of consumers. From the standpoint of the laborer, as prices rise his higher specialized earnings must insure that his potential real consumption amounts remain unchanged for constant welfare. The relationship between input and output prices

⁹Dennis P. Sobin, The Working Poor (Port Washington, N.Y.: Kennikat Press, Inc., 1973), p. 47.

¹⁰Clair Wilcox, Toward Social Welfare (Homewood: Richard D. Irwin, Inc., 1969), Cha. 4; see also Kenneth J. Arrow, "Some Models of Discrimination in the Labor Market," Racial Discrimination in Economic Life, ed. Anthony H. Pascal (Lexington: D.C. Heath and Company, 1972), p. 84.

¹¹H. Brett Melendy, The Oriental Americans (New York: Twayne Publishers, Inc., 1972), p. 170.

must be stable if the individual worker is to maintain his relative position in the income distribution. If output prices rise relatively the individual's real purchasing power is understated. To the extent that minority group members are denied job advancement and do not thus reap the benefits of specialization they become relatively worse off as the economy becomes more specialized.

A slightly different problem which should be considered is the extent to which similar consumption amounts are priced evenly throughout the economy. If minority group members are required to pay more on average for necessary purchases, their welfare is diminished relative to their white counterparts for similar amounts of income. Minority groups were more concentrated in urban areas than whites in 1970. Eighty-one percent of the former group lived in urban areas compared to 72 percent of white persons.¹² Industrialization, and thus specialization, is more prevalent in the urban environment. Moreover minority group members, especially central city blacks, have traditionally paid more than their white counterparts for the same market basket of goods and services. The evidence suggests this to be true for most classes of goods and services.¹³ Many retail goods are more highly

¹²U.S., Department of Commerce, *op. cit.*, p. 34.

¹³Lewis L. Knowles and Kenneth Prewitt eds., Institutional Racism in America (Englewood Cliffs: Prentice-Hall, Inc., 1969), p. 25.

priced because of the increased costs of operation in ghetto areas engendered by such things as increased burglaries and thus higher insurance costs. However, the major impact with respect to the income and welfare position of minority group members is associated with large income-share expenditures for consumer durables, consumer credit, and housing.¹⁴

Bowman states that the poor, central city dweller receives inferior goods for the relatively high prices he pays.¹⁵

All minority group members are neither poor nor residents of central cities but to the extent that they are more so than the population as a whole they are more subject to the tendency to be hurt economically. It does not appear that minority groups receive an income share commensurate with their population and talent shares in the United States economy.

Causes of Income Disparity

Income is disparate between minority group races and the white race in the United States economy. The disparity of income between these two groups affects the ability of the former group both to improve its income position relative to the latter group and to share proportionately in the welfare

¹⁴Alan Batchelder, "Poverty: The Special Case of the Negro," The American Economic Review, 55, No. 2 (May 1965), 531.

¹⁵Mary Jean Bowman, "Poverty in an Affluent Society," Contemporary Economic Issues, ed. Neil W. Chamberlain (Homewood: Richard D. Irwin, Inc., 1969), p. 74.

gains of an affluent society. Since one of the benefits of a large corporate sector is the dispersion of business ownership throughout the society, minority group members are less capable of exerting ownership influence in the economy to the extent that their income is lower. Much of the income used to purchase equity in corporate business (and other forms of business organization) derives from the labor share. Less income overall and less proportionate labor income serve as double barriers to full participation in the economy by minority group members. The amount of overall income disparity in the United States is conditioned largely by the capability to exert economic influence which affects market prices and the amount and type of productive resources which are owned by various groups in the economy. A related matter is whether resources which are owned have free mobility in their use. The ownership of productive resources is related to the ability to influence prices but this relationship will be diminished unless an input monopoly prevails. The relationship is left out of this analysis.

Relatively low income is only one of the indicators of underdevelopment among members of nonwhite minority group members in the United States. They also own a disproportionately small percentage of business enterprises and are not proportionately represented in the upper echelons of the management structure of major firms. They are not proportionately represented in policy-making positions of

government. They do not possess socioeconomic power proportionate to their representation in the general population. Racial discrimination affects the income of nonwhite minority group members. This fact sets them apart from whites who are low earners. Discrimination essentially becomes an additional argument in the vicious circle of poverty model for minority group members; it also hinders upward mobility for those above the poverty line.

The Capability to Influence Market Prices

Market prices are taken as given to any individual who interacts in the market in a freely competitive economy. That is, demand for any output is infinitely elastic at the prevailing price,¹⁶ and input prices are independently determined by production decisions and dictated to suppliers of inputs. This interaction of independently determined supply and demand determines equilibrium. This picture of simplicity is much more complicated when market imperfections are introduced. To begin with, the purely competitive demand curve is seldom, if ever, observed. In addition the existence of externalities in production and consumption decreases the predictive power of the model of perfect competition. This

¹⁶Joan Robinson, "What Is Perfect Competition?," Readings in Microeconomics, eds. William Breit and Harold M. Hockman (New York: Holt, Rinehart and Winston, Inc., 1971), p. 197.

discussion relates to minority group underdevelopment in that minority group members may be excluded from earnings opportunities where factor returns are higher than those in competitive areas of the economy because of market discrimination through monopoly power.¹⁷ This type of monopoly power discrimination is likely to be present in both labor and capital markets.

The imperfect competition (monopolistic competition) model though also inadequate is probably more germane to the United States economy of the twentieth century than the model which depicts prices as given. There are several institutionalized facts of the economy which serve as hindrances to perfect competition. First, the economy has some monopoly elements. It is alleged that some large sellers of commercial products might set prices irrespective of temporary demand conditions and only use target profits as constraints.¹⁸ Second, externalities are ubiquitous.

The inability of minority group members to participate freely in markets and institutions has lessened their returns from the advances in living standards and ownership of businesses. Such freedom of participation would have caused

¹⁷Thurow, *op. cit.*, p. 124.

¹⁸William J. Baumol, *Economic Theory and Operations Analysis* (3rd ed.; Englewood Cliffs: Prentice-Hall, Inc., 1972), pp. 325-6.

incomes between this group and the majority group to be less disparate than has been observed.¹⁹

Command over Economic Resources

Income disparity depends upon the ownership of productive resources as well as the capability to exert influence over the price for which a resource may be sold in the market. The resource to which the largest share of national income accrues is labor. Capital ownership is less widespread than labor ownership. The latter statement may seem obvious, however the diversity of capital ownership in the United States economy dictates that explicit consideration be given this fact. In traditional marginalist theory, the quality as well as the quantity of a resource applied to the productive process is an important matter. Moreover, the nature of the complementary and substitute resources which accompany the resource in question plays a significant role in determining its rate of remuneration or even whether it will be used at all.

The economy of the United States is highly industrialized and therefore dictates much labor specialization. Specialization in turn dictates that labor be highly skilled. Highly skilled labor in combination with highly

¹⁹Thurow, op. cit., p. 124.

specialized capital leads to high productivity and thus relatively large remunerations to both labor and capital. To the extent that a given laborer is unable to attain a skill level comparable with that of the average laborer he will command less for his labor services. ". . . Most actual job skills are acquired informally through on-the-job training after a worker finds an entry job and a position on the associated promotion ladder."²⁰ A lack of access to some job categories has had an adverse impact on skill attainment by minority group members.

If an individual owns both capital and labor resources, ceteris paribus, his chances of economic success are improved. Moreover, if he has entrepreneurial ability he is even more likely to succeed. In terms of either quality or quantity, the individual who owns the greatest reserve of productive resources stands to reap the greatest harvest from the economic system of the United States.

The union-nonunion wage differential has corresponded to the business cycle but has shown a steady upward trend except for the Depression and World War II periods.²¹

²⁰Lester C. Thurow, "Education and Economic Equality," The Public Interest, No. 28 (Summer 1972), p. 71

²¹Lowell E. Gallaway, Manpower Economics (Homewood: Richard D. Irwin, Inc., 1971), pp. 104-8.

It is tempting to impute the post-1933 behavior of the wage structure to the presence of trade unions within a public policy framework which accepts collective bargaining as an instrument of national policy for resolving labor disputes.²²

Minority group members have been unable to enter the labor market at wage scales comparable to their white counterparts. They were indeed not permitted to become members of some unions at all. That is, labor unions have consciously discriminated in permitting minority group members to join. Such discrimination has been especially prevalent where the craft unions are concerned.²³

Implication of Income Disparity for Public Policy

Each society sanctions the existing distribution of income either implicitly or explicitly. Large-scale disaffection from the social and economic order of society can result in disruptive social upheaval. Ironically, "Revolutions do not occur during periods of hopelessness. They occur during periods of rising aspiration."²⁴ There is

²²Ibid., p. 106; see also Milton Friedman, "Labor Unions and Economic Policy," Labor and the National Economy, eds. William G. Bowen and Orley Ashenfelter (Rev. ed.; New York: W.W. Norton and Company, Inc., 1975), pp. 34-5.

²³Herbert Hill, "Racial Inequality in Employment: The Pattern of Discrimination," Race and Poverty, ed. John F. Kain (Englewood Cliffs: Prentice-Hall, Inc., 1969), pp. 85-7.

²⁴Attributed to Thomas Pettigrew, Carl E. Haugen, "Short-Term Financing," Business Leadership and the Negro Crisis, ed. Eli Ginzberg (New York: McGraw-Hill Book Company, 1968), p. 97.

generally an evolution toward the desired income distribution over an extended period of time in most societies, and there is almost continuous modification of what is desired by the majority of the population. This observation partially negates the impact of discussions about the static, "desired" distribution of income. While discussions of functional income shares may be somewhat moot, discussions of the size distribution of income which accrues to members of the society on a basis which is atypical of income share determination are not. The impact on the economy of denying income to one group on other than the generally accepted basis for individual income determination is real and crudely measurable provided only that national income accounting is not an infantile art and transactions are primarily carried out in money.

There are at least two major steps which must be taken before policy action to alter the distribution of income is made. In the first place, there must be a recognition that the income distribution is at variance from what is socially desirable and a decision made to alter it. In terms of the present problem, income shares which accrue to minority group members diverge from what would be expected on the basis of market mechanisms alone. Secondly, a conscious decision must be taken to intervene in the mechanisms by which the existing distribution of income is determined toward the goal of

rectifying the perceived inequality. This decision includes the necessity to decide upon the nature of the intervention.

The last decade has witnessed a barrage of equal opportunity and treatment legislation and executive branch action which indicates a recognition that the income share which accrues to minority group members is too low to satisfy social norms. These actions imply both a nationally sanctioned need for alteration in the distribution of income and a decision to do so. The alleviation of differential economic status between majority and minority group Americans has been a stated policy of every President since 1960. Regardless of individual resistance, the collective choice of the "body politic" appears to favor equality of economic opportunity for all Americans.

The slogans of "equal economic opportunity" if they mean what they say, imply for nonwhites an even chance with whites--not simply at scraping by above some arbitrary minimum but at doing moderately well, and with a fair chance of making it big.²⁵

The overall benefits which would be expected to accrue if equal economic opportunity existed are offset to some extent by costs to some individuals. Some of the benefits of a more equal distribution of income between majority and minority groups are discussed below.

²⁵Albert Wohlsetter and Sinclair Coleman, "Race Differences in Income," Racial Discrimination in Economic Life, ed. Anthony H. Pascale (Lexington: D.C. Heath and Company, 1972), p. 16.

The Potential for Increased Output

It is in the material interest of each society to produce as efficiently as constraints on resources and technological capability permit. Most economists view this efficiency problem as on a par with the problem of equity in the distribution of output and growth in the annual output of the economy.

An economic system contains the momentum which could potentially keep it going. To the extent that productive resources are not fully utilized the output of an economy suffers. Moreover increases in output made possible by fuller resource utilization multiply themselves through spending and responding actions on the part of consumers; and consumer expenditures serve an incentive purpose for business investment which generates more employment.²⁶ The relationship between this analysis and the problem being discussed in this study is both clear and immediate: Fuller utilization of unemployed and underemployed minority group members would result in increased output and income for the economy as a whole. Thurow estimates that the efficiency losses in the economy owing to discrimination are approximately 19 billion

²⁶Paul A. Samuelson, "Interactions between the Multiplier Analysis and the Principle of Acceleration," Macroeconomic Readings, ed. John A. Lindauer (New York: The Free Press, 1968), pp. 153-7.

dollars per year.²⁷ Herber has concluded that:

If Negroes also had the same educational attainment as white workers and earned the same pay, and experienced the same unemployment as whites their personal income. . . and that of the nation would be 20.6 billion dollars higher.²⁸

The Council of Economic Advisers has estimated the cost of discrimination because of loss of potential production at 20 billion dollars.²⁹

The decision to subsidize individuals and families to ensure achievement of some minimum acceptable standard of living is necessarily political. The implementation of such a policy is likely to generate perception of some inequities on the part of non-recipients. Fiscal discrimination occurs more frequently on the expenditure side than on the tax side of the budget. Transfers and subsidies are often based on the political strength of pressure groups.³⁰ Political rather than economic considerations are often the basis for extending benefits. Of course, the admission of the marginal group to participate in the transfer scheme may have overriding moral implications but the group will only be admitted when the

²⁷Thurow, Poverty and Discrimination, op. cit., p. 158.

²⁸Bernard P. Herber, Modern Public Finance: The Study of Public Sector Economics (Revised ed.; Homewood: Richard D. Irwin, Inc., 1971), p. 582.

²⁹Council of Economic Advisers, Economic Report of the President, 1965 (Washington: Government Printing Office, 1965), p. 167.

³⁰James M. Buchanan, The Public Finances (Homewood: Richard D. Irwin, Inc., 1970), p. 96.

consensus among decision makers is that this group is somehow deserving of special treatment.

Decreased Public Expenditures and Increased Social Utility

Aggregate income will be less than need be if minority group members are not permitted to compete on an equal basis for income because of discrimination. In addition, the magnitude of government income maintenance expenditures will be less if this portion of the population is permitted to compete on an equal footing with others. Transfer expenditures would be less both because the increases in aggregate income discussed above would permit less unemployment and because spending activity on the part of the newly employed would generate more income indirectly through the multiplier effect. Aside from the costs of discrimination, poverty itself entails economic costs through wasted human resources.³¹

Another important cost category of poverty (and discrimination) is that associated with social costs. It may be argued that poverty and discrimination impose costs upon both those who suffer the affliction and those who are merely witnesses to it.³² Thus if a society has a preference

³¹The President's Advisory Commission on Income Maintenance Programs, Background Papers (Washington: Government Printing Office, 1971), pp. 13-5.

³²Harold M. Hochman and James D. Rodgers, "Pareto Optimal Redistribution," American Economic Review, 54, No. 4 (September 1969), 543.

for equality of opportunity and minimum living standards for all, a divergence from these goals will be socially unacceptable and the general welfare would be increased by eradicating the divergence.

Market Mechanisms and Income Disparity

The market will allocate resources efficiently and distribute the product equitably (on the basis of inputs to production) in the absence of externalities and market imperfections. However, economic writings and social history are replete with examples of divergence from efficient and equitable solutions. The mainstays as culprits are the issues of monopoly elements and externalities. A different problem which eludes efficient and equitable market solution is that imperfection which results when economic units act on the basis of noneconomic motives such as racial prejudice. It is noteworthy that such action may not be predicated on any personal dislike for members of the group against whom prejudice is directed. That is, market activities which discriminate on the basis of race may merely follow established patterns of doing business which are institutionally biased. This type of market imperfection is illustrated by assignment to job classes based on racial identity. This practice has

been prevalent throughout much of the United States.³³ It is also illustrated by marketing and purchasing strategies which exclude minority group members from participation in some market processes as surely as if the strategies were designed to be discriminatory.

Exclusionary activities which exist within the institutional framework of economic life in the United States have worked to the detriment of minority group members by denying them equal access to neighborhoods, schools, and jobs with the consequence that they have been denied access to promotions, capital markets, and economic institutions generally.³⁴ The market economy is only efficient and equitable when it is impersonal--it is only impersonal in the absence of excessive personality influences. Biases are learned early and changed only slowly. Denial of equal access to markets is a major contributing factor to the fact of minority group underdevelopment in the United States. The denial of equal access has been perpetuated through market

³³ Barbara R. Bergman, "Investment in the Human Resources of Negroes," Race and Poverty, ed. John F. Kain (Englewood Cliffs: Prentice-Hall, Inc., 1969), p. 55.

³⁴ See Thomas Sowell, "Patterns of Black Excellence," The Public Interest, No. 43 (Spring 1976), pp. 26-58. This article states that some few black schools have provided excellent educational opportunities and produced extremely successful black men as a result. Sowell implies that equal educational opportunities are less important to the progress of blacks than traditional school discipline.

discrimination. The figures on minority ownership presented above suggest that the manifestation of access denial has been prevalent in the area of business ownership.³⁵

Market institutions in the United States have not generally been open to the accommodation of minority group members' aspirations for upward economic mobility. One of the primary reasons for lack of accommodation can be traced to the prevailing socio-economic structure. As the country became industrialized immigration was perceived as threatening to job security particularly in industrial centers. All immigrant ethnic minorities met with some opposition on this count.³⁶ The "melting pot" solution, through which cultural values and racial attributes are fused through intermingling has resulted in the assimilation of the white ethnics into mainstream America. European and Nordic immigrants were assimilated but such has not been the case with Black, Oriental, and Spanish-speaking Americans.³⁷ The differences in tendency toward assimilation are striking. A convincing argument can be made that the primary reason for this difference is that one can change his

³⁵Samuel I. Doctors and Anne S. Huff, Minority Enterprise and the President's Council (Cambridge: Ballinger Publishing Company, Inc., 1973), pp. 1-6.

³⁶cf Thomas Sowell, Race and Economics (New York: David McKay Company, Inc., 1975), p. 162.

³⁷Charles P. Kindleberger, Economic Development (New York: McGraw-Hill Book Company, Inc., 1965), p. 27.

language and lifestyle but not identifying racial features such as skin hue and hair texture.

There is no apparent, overwhelming economic reason for the majority of the United States citizenry to be concerned about the lagging economic status of nonwhites. Such concern would not be in the best interest of the individual worker or businessman since it would be tantamount to increasing competition for his economic position.³⁸ While the long run social welfare may be served by the economic development of this sector as suggested earlier, minority group economic development has the short run nature of a public good. Even if a consensus could be arrived at on the specific issue of promoting economic development for minority group members at the local level, the method of doing so would be subject to hindrance because of perceptions of threats to individual economic positions. A broad-based, long-term program is needed if the institutional environment is to be altered sufficiently to accommodate minority group economic development.³⁹ Institutions change only slowly and democratic institutions appear to change more rapidly only in reaction to shocks or crises which are potentially threatening to their underlying goals.

³⁸Thurow, Poverty and Discrimination, *op. cit.*, p. 133.

³⁹Roy F. Lee, The Setting for Black Business Development (Ithica: New York School of Industrial and Labor Relations, Cornell University, 1972), p. XVI.

There is a considerable historical background for societal refusal to extend equality of opportunity to nonwhite minorities. Just as in the case of poverty, the "stylized facts" of racial discrimination are self-perpetuating and socioeconomic phenomena based on race relations follow the vicious circle pattern. A lack of job opportunities, capital market access, production distribution channels access, housing market access, education and training opportunities and sociocultural interactions have all served as mutually reinforcing conditions which interact to deny minority group members a full measure of economic development capability. Moreover, the inherited aspects of institutional arrangements have insured intergenerational transfer of racial attitudes with the consequence that the socioeconomic position of racial minorities has not improved as much over time as it otherwise would have. There has been passed into law several pieces of equal opportunity and treatment legislation in the last decade.⁴⁰ There has not been a corresponding improvement in equality of opportunity. Meaningful social change is only guaranteed through changes in institutions. Yet institutions change only slowly and marginally. Institutional change is conditioned by the breadth and strength of societal commitment.⁴¹

⁴⁰Civil rights public policy activities are discussed in chapter three, below.

⁴¹cf Robert A. Solo, The Political Authority and the Market System (Dallas: South-Western Publishing Company, 1974), pp. 4-8.

In the absence of institutionalization of the ideology necessary to promote minority group economic development, government activity to promote mid-term achievement of this public policy goal is warranted. That is, extramarket activity of a public policy nature should be used to counter interpersonal and institutional activity which impedes minority group economic development.

CHAPTER III

THE ROLE OF PUBLIC POLICY IN ECONOMIC DEVELOPMENT

Introduction

Chapter two of this study summarized the problem of minority group underdevelopment in the United States. This chapter is concerned with the presentation of an economic development perspective through which the economic development problems and prospects of underdeveloped sectors of advanced economies may be viewed. The role of government in promoting development will be analyzed and the extent to which public policy action is likely to be effective will be assessed. In this study the minority group sector of the United States economy is chosen as the prime example of an underdeveloped sector to which the analytical tools of economic development theory may be applied. The present chapter begins a more detailed consideration of the impact of the Section 8(a) Program by analyzing the relationship between public policy activity in underdeveloped countries and underdeveloped sectors of advanced economies.

There are strong similarities between the problems faced by economically underdeveloped countries and underdeveloped sectors of advanced economies both in the manner in which

underdevelopment manifests itself and in the types of governmental activity which may be used to combat it. That their income is low relative to whites is testament enough to the underdeveloped condition of minority groups. In addition they are subjected to the same types of anguish regarding their economic security and the prospects that their children will be unable to penetrate the middle class as the majority of persons in underdeveloped countries. Poverty and underdevelopment are self-perpetuating in both the case of underdeveloped countries and underdeveloped sectors.

Public policy can be either an aid or a hindrance to economic development prospects. Both the type and intensity of governmental activity can have far-reaching effects on economic interrelationships. In addition, the consequences of action or inaction in a particular sphere of economic activity can have a lasting effect as it becomes a part of the institutional fabric of the society. Missed opportunities might be costly and erroneous decisions might be difficult to reverse if not soon discovered.

It should be noted that one of the primary distinctions between treating underdevelopment in low income countries and treating it in sectors of developed countries revolves around the existence of resources and institutions favorable to development. Thus the problems of sectoral underdevelopment primarily concern growth in output or redistribution while

those of underdeveloped countries primarily concern broad-based economic development.¹

The Case for Governmental Intervention in the Economy

Much has been written about the role which the state should play in economic affairs. The controversy has raged throughout the history of the economics discipline and has included both the polar arguments of total nonintervention and complete state ownership and control of the economic system. The more popular position has been eclectic and has been tempered by time and circumstance. The scope of Adam Smith's three functions of government would have to be stretched considerably to meet the needs of a twentieth century, industrialized economy. Yet the market mechanism has demonstrated its superiority for performing the allocative function in economic activity. There is a strong economic case for government to provide collective goods; law and order; environmental control; monetary stability; regulatory measures, quasi-collective goods such as education and parks; private services such as highways and postal service; and poverty relief.²

¹cf Charles P. Kindleberger, Economic Development (2nd ed.; New York: McGraw-Hill Book Company, 1965), p. 3.

²James M. Buchanan, The Public Finances (3rd ed.; Homewood: Richard D. Irwin, Inc., 1970), pp. 23-34.

Lewis suggests that governmental activity functions to influence economic progress in nine different ways:

Maintaining public services, influencing attitudes, shaping economic institutions, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment and influencing the level of investment.³

When the above functions of government are considered along with the following objectives of governmental development policy stated by Tinbergen, it is evident that the question of governmental activity in economic development is not a matter of whether government should become involved, but rather, a matter of the extent and type of involvement which is proper. Tinbergen writes that the principal objectives of governmental development policy are:

(1) To create the general conditions favorable to development; (2) To acquaint the government itself and the public generally with the potentialities and advantages of development; (3) To make a number of investments usually of the "basic" type; and (4) To take measures designed to facilitate and stimulate private activity and development.⁴

Even when the question of economic development is not at issue Musgrave notes that government should intervene in the economy to influence distribution, stability and resource allocation. Influencing resource allocation is especially

³W. Arthur Lewis, The Theory of Economic Growth (Homewood: Richard D. Irwin, Inc., 1955), pp. 3-4.

⁴Jan Tinbergen, The Design of Development (Baltimore: John Hopkins Press, 1958), pp. 3-4.

crucial to the extent that externalities, imperfect competition and decreasing cost industries are present.⁵ Governmental intervention in the Western economies has increased in the post-World War II era due to an increased interest in economic growth.⁶ The extent of intervention in underdeveloped countries has been more significant because their fiscal institutions are also less developed and less effective, and because the development task which confronts them is more formidable.

Governmental Role in Traditional Development Activity

Some governmental activity is inevitable in the economy. Some portion of governmental activity should be devoted to economic developmental aspects of the country if development is to be speeded in underdeveloped countries. Effective fiscal planning of programs is necessary given the scope of needed activities.⁷ The activities most needed are those which

⁵Richard A. Musgrave, The Theory of Public Finance (New York: McGraw-Hill Book Company, 1959), p. 5.

⁶Andrew Schonfield, Modern Capitalism (New York: Oxford University Press, 1965), pp. 61-7.

⁷Robert L. Heilbroner, The Great Ascent (New York: Harper and Row, Publishers, 1963), Cha. 7; see also P.T. Bauer, Dissent on Development (Cambridge: Harvard University Press, 1972), Cha. 2, this is not an argument for comprehensive central planning in the manner interpreted by Bauer as being a mainstay of treatises on economic development. Rather, what is suggested is that careful account be taken of those activities for which there is an economic case for government intervention and that programs of significant magnitude to capture existing externalities be planned and executed.

increase both public and private investment and increase the availability of goods and services with significant consumption externalities. The goods which governmental activity should be directed toward range from pure public goods to those which would increase development but for which private consumption purchases would likely be too low. That is, some goods with significant consumption externalities should likely be provided by government.

There is a preponderance of externalities in underdeveloped countries owing primarily to the fact that these countries have neither the infrastructure, the sophisticated financial institutions nor the established markets which are prevalent in developed countries.⁸ Externalities under these circumstances can only be captured if conscious governmental programs are established which create an institutional setting more favorable to development.

Government economic development activity must be tied together through planning in underdeveloped countries. During the period after World War II when colonial powers began granting political independence to the countries of the underdeveloped world, many of the leaders of these countries

⁸Kindleberger, *op. cit.*, Cha. 9; see also Gerald M. Meier, "Sources of Capital Formation--Note," Leading Issues in Economic Development, ed. Gerald M. Meier (2nd ed.; New York: Oxford University Press, 1970), p. 186.

turned their concentration from the all-consuming struggle for independence to the problems of industrialization and economic development.

Before independence the proceeds from . . . primary exports were mainly plowed back into these very [export-oriented activity] enclaves with little spillover effect for the rest of the economy. After independence the desire to match political with economic independence naturally led to the attempt to capture these proceeds and utilize them for national development by redirecting them toward an expansion of public overheads and the industrial sector.⁹

Aspirations in these countries outstripped the increases in output which they had been able to achieve. Active governmental intervention was seen as the only alternative to continued stagnation.

Capital Formation

One of the most formidable problems facing underdeveloped countries is accumulating sufficient capital economy-wide to get development started and, once it is started, to sustain it. "In the view of many economists, capital occupies the central position in the theory of economic development."¹⁰ Capital formation has both output and capacity effects. It increases current aggregate demand in the economy through its active role as net investment; simultaneously, it insures that the

⁹Gustav Ranis, "Economic Dualism at Home and Abroad," Public Policy, 18, No. 1 (Fall 1969), 42.

¹⁰Kindleberger, op. cit., p. 83.

capability of the economy to produce in future periods is increased.¹¹

Economic development depends critically upon the formation of physical capital; however, almost equally as crucial is the need for human capital accumulation since it is complementary to physical capital accumulation. Estimates indicate that returns to investment in human beings have made major contributions to economic growth.¹² Human capital accumulation includes all investments which increase the capabilities of individuals to contribute to the productive process. These investments include but are not limited to education, health, and migration. Efforts to increase capital formation must include both physical and human capital. Since private means or incentives may be lacking, government may need to insure that these investments are undertaken.

Physical capital formation. One of the identifying features of an underdeveloped economy is a lack of infrastructure or social overhead capital. It is essential that transportation, communications, housing, and supplies of power and water be

¹¹Edward Shapiro, Macroeconomic Analysis (2nd ed.; New York: Harcourt, Brace and World, Inc., 1970), Cha. 11.

¹²Theodore W. Schultz, "Reflections on Investment in Man," Journal of Political Economy, 70, No. 5, Part 2 (October 1962), 3.

available before development can take place on a national scale. In addition it is not likely that investments which have substantial economic development potential but lack a public goods character will be undertaken in sufficient quantity in the private sector. In these instances the government should be prepared to supplement private investment.

The provision of infrastructure is one of the most imposing problems which underdeveloped countries must face. Social overhead capital investments constitute what Tinbergen calls "basic" government investments.¹³ Expenditures for them must be undertaken by government because of the significant external benefits which accrue from their provision. In the absence of a market for the use of infrastructure facilities, some objective criteria for expenditure on them must serve as the basis for priority of expenditure. It might be possible to decrease the amount of government investment expenditures and substitute private investment through subsidies and tax structures which increase private initiative.¹⁴

Aside from social overhead capital requirements government must make a determined effort to guarantee a climate in which favorable private business investment decisions can

¹³Tinbergen, op. cit., p. 6.

¹⁴Gerhard Colm and Theodore Geiger, "Public Planning and Private Decision-Making in Economic and Social Development," The Challenge of Development, ed. Richard J. Ward (Chicago: Aldine Publishing Company, 1967), p. 6.

be made. Government must show a willingness to undertake investments with a high development potential if private concerns are either unwilling or unable to do so. The introduction of plant and equipment is one of the major ways through which technological innovation is perpetuated. The availability of updated plant and equipment is necessary to development and in some cases must be allowed for by government.

Human capital formation.¹⁵ The essence of the concept of human capital as it relates to economic development can be stated in the following terms: A significant portion of the increases in output per worker which are not explained on the basis of quantity increases in the traditional input factors labor and capital are likely attributable to investment in human capital.¹⁶

"Human resources development. . . may be a more realistic and reliable indicator of modernization or development than any other single measure."¹⁷ This statement by Harbison and Meyer is representative of an approach to economic development of

¹⁵See Gary S. Becker, Human Capital (New York: Columbia University Press, 1964), Chas. 1-3, this section is basically in accord with Becker's analysis.

¹⁶Schultz, op. cit., pp. 4-9.

¹⁷Frederick H. Harbison and Charles A. Meyers, Education, Manpower and Economic Growth (New York: McGraw-Hill Book Company, 1964), p. 14.

recent years which accords increased importance to factors other than purely economic ones. Economic development is no longer the exclusive province of the economist. The current emphasis on human capital investment was largely pioneered by Theodore W. Schultz through his article, "Investment in Human Capital," which appeared in the American Economic Review, March 1961.¹⁸ Before the publication of Schultz's article most economic writings on the subject of economic development confined their treatment of investment to the more quantifiable physical capital. Schultz suggests that to take account of human capital formation is probably at least as revealing in an analysis of economic growth as to take account of physical capital formation. Schultz included expenditures on education, health and internal migration to take advantage of better job opportunities as examples of investment in human capital.¹⁹

Schultz was not the first economist to accord importance to investment in man. Adam Smith considered investment in education to be additions to the stock of "fixed capital."²⁰ A thread of thought persisted throughout the writings of the classical economists which suggested that education was

¹⁸Mark Blaug, "Introduction," Economics of Education, ed. Mark Blaug (Baltimore: Penguin Books, Inc., 1968), p. 11.

¹⁹Theodore W. Schultz, "Investment in Human Capital," American Economic Review, 51, No. 1 (March 1961), 1-3.

²⁰Harbison and Meyers, op. cit., p. 3.

important to economic development.²¹ Senior, McCulloch, and Mill each conceded that investment in education was desirable for economic growth but stopped short of an analysis of the impact of human capital investment on the capacity of the economy to increase its real output per capita.

Much of the literature addressing itself to economic development in the last decade has dealt with the impact of education. One of the most ambitious efforts of analyzing the contributions of education to economic development was a volume edited by Mary Jean Bowman (and others) for the United Nations Education Scientific and Cultural Organization (UNESCO) entitled Readings in the Economics of Education. Much less work has been done in the areas of health and internal migration. The contributions of education to economic development are numerous and include greater productivity per manhour, external benefits, and greater appreciation on the part of individuals for the components of the "good life."²² Education has both investment and consumption aspects; there are future as well as present benefits from it; and the investment component of education includes payoffs which

²¹Randolph C. Blintz, "Education in the Writings of Malthus, Senior, McCulloch, and John Stuart Mill," Readings in the Economics of Education, eds. Mary Jean Bowman and others (Paris: UNESCO, 1968), pp. 41-6.

²²Fritz Machlup, Education and Economic Growth (Lincoln: University of Nebraska Press, 1970), p. 22.

accrue to the individual who has received it as well as payoffs which accrue to other individuals as external benefits.²³

Machlup suggests that education plays a significant role in promoting economic growth through its effects on improvements in the quality of labor. He states that:

Positive effects may be expected on five scores: (a) better working habits and discipline, increased labor efforts, and greater reliability; (b) better health through more wholesome and sanitary ways of living; (c) improved skills, better comprehension of work requirements, and increased efficiency; (d) prompter adaptability to momentary changes, especially in jobs which require quick evaluation of new information and, in general fast reactions; and (e) increased capability to move into more productive occupations when opportunities arise. All levels of education may contribute to improving the quality of the labor force.²⁴

One of the hallmarks of economic development is change. These changes may be pervasive and may have cultural and political aspects. Vaisey suggests that one of the major contributions of education is that it creates an appetite for change.²⁵

The contributions of health to economic development are almost obvious. Given that manpower is the key vehicle by which most production processes are operated, a healthy

²³Theodore W. Schultz, *The Economic Value of Education* (New York: Columbia University Press, 1963), p. 38; see also Burton A. Weisbrod, "External Effects of Education," *Economics of Education*, ed. Mark Blaug (Baltimore: Penguin Books, Inc., 1963), p. 157.

²⁴Machlup, *op. cit.*, pp. 7-8.

²⁵John Vaisey, *The Residual Factor and Economic Growth* (Paris: OECD, 1964), p. 212.

work force is essential if a society is to realize its potential for increasing output. Most of what has been said about education is applicable to health as a human capital investment. However, there are striking differences between investment in health and education. The impact of health investment on economic development is more difficult to assess because of problems with conceptualization and measurement. Mushkin notes that one of the primary differences between these two types of human resources development is that:

Educational investment is a developmental process which ferrets out and encourages native talent. It proceeds step by step from one level to another, transmitting a cultural environment by building on the existing store of knowledge. Health programs seek basically to prevent a hostile environment from killing and crippling. They seek to stay the natural forces of biological selection.²⁶

Three other differences between health and education noted by Mushkin are: (a) health programs increase the quantity as well as the quality of the work force while education only increases the quality; (b) units of quality change in health programs cannot be defined as tidily as units of education embodied in the labor force; and (c) earnings differences attributable to health programs cannot be assessed to the extent possible with education.²⁷

²⁶ Selma J. Mushkin, "Health as an Investment," Journal of Political Economy, 70, No. 5, Part 2 (October 1962), 135.

²⁷ Ibid., pp. 132-4.

Health, like education has both consumption and investment components, and both are subsidized by public sector expenditures to some extent in most countries. The extent of externalities involved in health appears to be conceived of as being less than those for education. For example, in the United States, public expenditure for each was approximately 25 billion dollars in 1962, however the ratio of public to private expenditure was 4:1 for education and only 1:5 for health.²⁸ The fact that life expectancy is longer in developed countries with the consequence that the potential productive life is longer suggests that there is an upward cycle of development associated with better health care. One way to provide for a development climate in underdeveloped countries is to eliminate the diseases which cause shorter life expectancy.

The final type of human capital investment to be considered is that associated with the ability of people to be geographically, sociologically, and economically mobile. There is little doubt that mobility is a form of investment.²⁹ The ability to move to different career ladders represents potentially higher current and future remuneration at the same time that it increases the output of the society. In addition, the free flow of human resources provides the

²⁸Ibid., p. 132.

²⁹Schultz, "Investment in Human Capital," op. cit., p. 4.

best assurance that talents will be most nearly matched with production requirements. This implies for underdeveloped countries that the horizons of young people be broadened from opportunities available in their localities to opportunities available nationwide. The national government is probably in the best position to provide adequate insurance against unforeseen exigencies under these circumstances.

Social and economic mobility are closely related. Where one is lacking the other is likely to be lacking as well. Hoselitz argues that not only do social structures impact on economic mobility but the reverse is also true.

The social structure of a modern industrial society has been described as presenting universalist, achievement oriented norms in the assignment of roles (as opposed to ascription oriented norms in traditional societies).³⁰

Deyrup concludes the consumption generates the mobility between classes which is necessary to development. The central role which consumption plays is based upon widening the domestic market for manufactures. This can only be done when redistribution is made possible through substantial social mobility.³¹

³⁰Bert F. Hoselitz, Sociological Aspects of Economic Growth (Glencoe, Illinois: The Free Press of Glencoe, Inc., 1960), p. 133.

³¹Felicia J. Deyrup, "Social Mobility as a Major Factor in Economic Development," Social Research, 34 (Summer, 1967), 334-8.

Financing Capital Formation

Consumers in underdeveloped countries just as those in economically advanced countries have two alternative dispositions for income accruing to them. They may either spend it for consumption or save it. The act of saving makes funds available for investment in either the private or public sectors. The incomes which accrue to most consumers in underdeveloped countries are near the subsistence level. Under such circumstances private savings are likely to be low. The marginal propensity to consume may vary widely in underdeveloped countries because of the "demonstration effect" or a long tradition of want and privation.³² The consequence of a lack of sufficient private saving is that private investment is likely to stagnate in underdeveloped countries. The main source of private saving in these countries is the profits of business enterprises which also account for virtually all private investment. The rate of saving out of national income is too low, and this fact accounts for the inadequacy of investments which impinge upon increased output per capita.³³

If the private sector does not save enough to satisfy basic investment needs, the alternative is to generate sufficient public saving to bridge the gap between investment

³²Ursula K. Hicks, Development Finance (New York: Oxford University Press, 1965), p. 50.

³³W. Arthur Lewis, Development Planning (New York: Harper and Row, Publishers, 1966), pp. 115-20.

expenditures which need to be made and private investment forthcoming out of private saving. The rate of private saving has been inadequate to support the necessary levels of investment in underdeveloped countries.

This is why so much emphasis is now placed on the importance of raising the rate of public saving (government revenue minus expenditure on current account) in countries seeking to accelerate their economic growth.³⁴

The form of public saving discussed here is forced saving through taxation.

On the basis of available evidence, the most plausible conclusion is that higher income groups of low-income countries could provide sufficient saving to finance the innovational projects that are technically feasible.³⁵

Economic development has distributional as well as output aspects. The incidence and operational impact of taxes on efficiency and equity are not neutral matters. Governmental activity to raise revenues must avoid adverse impacts. In the field of taxation, it is difficult to assess reactions in advance. If development is the primary goal, the distributional burden and incentive problems, though important, are minor by comparison with the problem of diverting resources from the consumption to the saving stream. Taxation for development is essentially a problem of resource allocation.³⁶

³⁴Ibid., p. 121.

³⁵Everett E. Hagen, The Economics of Development (Homewood: Richard D. Irwin, Inc., 1968), p. 134.

³⁶Nicholas Kaldor, "Taxation for Economic Development," Taxation for African Economic Development, ed. Milton C. Taylor (New York: Africana Publishing Corporation, 1969), p. 158.

Given that large sums need to be collected in taxes to accomplish the development program, the tax system used in underdeveloped countries should be virtually universal in its application. The implication of this statement is that a direct tax on income is warranted. However underdeveloped countries have not traditionally used direct taxes because of inherent problems with conceptualization of income, tax administration, and tax discipline (tendency to evade).³⁷ Indirect taxes, though inherently inferior if progressivity is desired, have been used extensively in underdeveloped countries. Due states that in underdeveloped countries, "The most significant merit of indirect taxation is its ability to raise much more revenue than would be politically, economically, and administratively feasible with direct taxes."³⁸

Entrepreneurship

"The lack of entrepreneurship is one of the most frequently cited obstacles to takeoff in such [underdeveloped] countries."³⁹ The existence of individuals who are both

³⁷A.R. Prest, "The Role of Direct Taxation," Taxation for African Economic Development, ed. Milton C. Taylor (New York: Africana Publishing Corporation, 1969), pp. 238-40.

³⁸John F. Due, Indirect Taxation in Developing Economies (Baltimore: The John Hopkins Press, 1970), p. 15.

³⁹Benjamin Higgins, Economic Development (New York: W.W. Norton and Company, Inc., 1968), p. 105.

willing and able to conceive the idea of a business opportunity, organize production to take advantage of the opportunity, and develop the markets for the product is crucial to economic development prospects.⁴⁰ There are conflicting theories on the determinants of the supply and even the source of entrepreneurial talent to promote development.⁴¹ It is clear however that entrepreneurial talent of the management type does make a positive contribution to development. The development of entrepreneurial talent may also be thought of as a human capital investment through education and training.⁴²

Public Policy and the Relationships between Underdeveloped Countries and Underdeveloped Sectors

The reader should be reminded of the connotation of the term "underdeveloped sector" as used in this study. A sector is underdeveloped if income accruing to its members, measured in per capita or median family terms, is persistently below that accruing to other members of the society. The economic development problem in underdeveloped countries and underdeveloped sectors is similar in several important

⁴⁰Hagen, op cit., p. 217.

⁴¹Peter Kilby, "Hunting the Heffalump," Entrepreneurship and Economic Development, ed. Peter Kilby (New York: The Free Press, 1971), p. 19.

⁴²Ibid., p. 36.

respects. The primary indicator of underdevelopment in each case is the prevalence and pervasiveness of a tendency toward poverty. In each case government activity should be directed at diminishing the causes of low income and government policy should be tailored to counter the prevalence of low income. This implies that specific programs should be different in underdeveloped countries than in underdeveloped sectors to counter the same general underdeveloped condition.

While there are conceptual problems with comparing a group within an open society with those who comprise an entire society, these difficulties can be lessened if underdeveloped sectors are thought of in terms of being subject to internal flows only. That is, they may be conceived of as being closed with primarily circular flow possibilities existing. Any interaction with the rest of the economy could then be thought of as "external" in the international trade sense. The writer is not willing to extend the argument of underdeveloped sectors to suggest that some of them are "internal colonies" in the manner suggested by Tabb.⁴³ The problems with such an analysis have been pointed out as being too overwhelming in terms of theoretical constructs and

⁴³William K. Tabb, The Political Economy of the Black Ghetto (New York: W.W. Norton and Company, Inc., 1970), Cha. 2.

policy implications by Harris.⁴⁴ In addition, while the Black Ghetto contains a significant number of minority group members it is not the exclusive residence of minority group or even black economic underdevelopment. Capital flow accounting would be unmanageable given the geographical dispersion of the minority group underdevelopment problem.

Similarities between Underdeveloped Countries and Underdeveloped Sectors of Advanced Economies

The manner in which socioeconomic variables interact in underdeveloped countries and underdeveloped sectors bears striking resemblances. In each case there is a lack of sufficient private saving activity which fails to generate sufficient physical and human capital; the relationships between low income minority group members of the society, those who pay the dearest price as a consequence of underdevelopment, and high income members of the society work to the detriment of the former and affect their attitudes about their worth; and consequently, the incentive to improve their present condition is lessened on the part of those who harbor the greatest development potential. Ranis concludes that both underdeveloped countries and underdeveloped sectors exhibit the characteristics of sectoral dualism. He writes that:

⁴⁴Donald J. Harris, "The Black Ghetto as 'Internal Colony': A Theoretical Critique and Alternative Formulation," The Review of Black Political Economy, 2, No. 4 (Summer 1972), 3-9.

. . . government must concentrate in the first instance, on social and economic overhead construction, particularly in education, health, and transportation, to help begin to redress some of the historical backlog of unequal rates of physical and human capital improvement. Secondly, it must concentrate on reducing market imperfections, i.e., "clearing the boards" and eliminating some of the worse inequalities of access to resources currently faced by the inhabitants of the two sectors. This means not only the elimination of the more blatant manifestations of prejudice in the social and economic spheres, but the provision of basic information on markets and opportunities and the enforcement of legal safeguards for minorities. . . ⁴⁵

Saving, capital formation, and absorptive capacity. In the absence of sufficient saving activity capital accumulation is likely to be low with the consequence that development activities are stifled. Even in the presence of sufficient capital to promote development there may be an inability to effectively utilize available capital because socioeconomic strictures are present which cause distortion of economic incentive or because insufficient technical knowledge exists. It is incumbent upon government to attempt rectification of the latter problem through programs designed to increase human capital on a short-to-medium-term basis. In the former situation the only reasonable alternative is an increase of income which is widely distributed. That is, government effort should be directed toward insuring long term economic and social development through activities designed to create an institutional environment conducive to development.

⁴⁵Ranis, op cit., p. 49.

There is a shortage of savings in underdeveloped countries and underdeveloped sectors for essentially the same reason: The ability to save out of marginal income is low because of pressing consumption needs.

One of the obvious difficulties which plagues an occasional entrepreneur in a low-income country is that he does not have enough capital to finance a venture and cannot find anyone who is willing to lend him money for a venture in which he is willing to risk all of his own.⁴⁶

This difficulty also applies to underdeveloped sectors.

Persons in underdeveloped sectors generally have access to mass media communications. To the extent that the relative income hypothesis reflects actual consumer behavior and advertising is a want-creating activity, they will spend greater proportions of their income for consumption than they otherwise would with the consequence that their consumption will be higher and less funds will be available for saving.⁴⁷ The problem will be exacerbated to the extent that savings constitutes a residual out of current income for most families as opposed to those families whose saving goals are based on calculations involving the interest rate or general target amounts;⁴⁸ that is, to the extent that the population is made up of residual as opposed to target or calculating savers.

⁴⁶Hagen, *op cit.*, pp. 129-30.

⁴⁷*Ibid.*, pp. 132-3.

⁴⁸John F. Due, *Government Finance* (4th ed.; Homewood: Richard D. Irwin, Inc., 1968), p. 242.

Three aspects of capital accumulation are germane to this study. First, capital ownership implies a source of income above that which accrues from labor input alone. Although there are opportunities for the transfer of capital ownership, net increases are preferable to redistribution since net increases (investment) are desirable in their own right. Secondly, the income producing effects of capital accumulation raise the income of capital owners at the same time it raises the current income of the economy. The act of investment serves to insure employment of resources which might otherwise be idle and thus serves as a stimulus which is subject to the multiplier effect. Thirdly, capital accumulation increases the capability of the economy to produce more in future periods. To the extent that the underdeveloped sector owns increases in the capital stock proportionately, its income share from such ownership will tend to increase to a rough parity with other groups of the society. Geographical and cultural boundaries will have some impact on the dispersion of income from capital ownership between this sector and others.

The ability to use capital productively is contingent upon knowledge. The old adage "experience is the best teacher" holds in development matters. A lack of experience in trying new concepts of production can be detrimental to the development effort. Entrepreneurial talent is necessary to

the productive use of capital when it is available. These shortcomings can be alleviated by concentrated human capital investments.

In the instances of saving, capital accumulation, and absorptive capacity underdeveloped countries and underdeveloped sectors are remarkably similar. The development problems which they face are too overwhelming to be overcome by private activities alone. Public policy action is needed.

Traditional roles, upward mobility, and underdevelopment. The individual's perception of his society and his role in it affect the manner in which he responds to economic variables. The economically less well off in any society have less incentive to accept risk aimed at improving their condition both because the margin of catastrophic error is smaller and because the expected payoff from risk-taking is likely to be smaller given their present economic circumstances. Minority group members, as the poor generally, are treated as persons of little value. The conception of them as being failures becomes a self-fulfilling prophecy currently and intergenerationally.⁴⁹

Self-respect and self-confidence are learned at an early age. The inability of a family to provide materially for

⁴⁹Mary Jean Bowman, "Poverty in an Affluent Society," Contemporary Economic Issues, ed. Niel W. Chamberlain (Homewood: Richard D. Irwin, Inc., 1969), p. 76.

its offspring sufficiently, in accordance with contemporary standards, has adverse psychological impacts upon both the parent and child. Deyrup's observation regarding the central role of social mobility in underdeveloped countries is germane to underdeveloped sectors. Underdevelopment engenders a fatalism which denies the probability of better economic circumstances in the future. This fatalistic attitude is passed on from generation to generation by parents "who discourage as utterly foolish and unrealistic the ambitious son or daughter bent on a 'better' way of life. . . ."⁵⁰ Socioeconomic policy designed to increase opportunity for upward mobility will be effective in raising aspirations and generating an increased measure of development.

Differences between Underdeveloped Countries and Underdeveloped Sectors of Advanced Economies

Government activity to promote development in underdeveloped countries and underdeveloped sectors differs primarily in that the depth and magnitude of the development problem are different. In economically advanced countries the preconditions for development have been met and the problem consists of extending the benefits of development to those who have heretofore been isolated. While the theme of this study is that the same types of activity need to be undertaken, the extensiveness of the action required should be less.

⁵⁰Deyrup, op cit., p. 344.

Underdeveloped countries on the other hand have social and cultural institutions which are likely to be inimical to development and the problem is likely to require societal transformation.

The preponderance of a culture of affluence. The poor are affected not only by their income level but by the income levels of those around them and their perception of prospects for penetrating higher income levels. The existence of widespread affluence around underdeveloped sectors is likely to have the effect of making their poverty seem less endurable at the same time that it whetens their appetite for more income. The countervailing view that upper income levels are *impervious* because of either social or economic strictures will have offsetting effects.

High incomes and personal wealth exist in virtually all countries. Additions to income are more or less equally distributed depending on institutional arrangements. One measure of development is the extent to which income dispersion exists. The distribution of income is likely to be more highly skewed in underdeveloped countries than in economically advanced ones.⁵¹ Incomes in underdeveloped sectors are not likely to diverge from those in developed sectors to the extent that income inequality exists in underdeveloped countries.

⁵¹Gunnar Myrdal, Economic Theory and Underdeveloped Regions (New York: Harper and Row, Publishers, 1957), p. 6.

Widespread higher living levels in developed countries will serve as an inducement to work for an improved economic environment among members of underdeveloped sectors.

Government programs designed to facilitate socioeconomic mobility of those who are outside the economic mainstream in advanced countries will alleviate the underdevelopment problem. In underdeveloped countries it might be necessary to completely restructure institutions to permit more widespread benefits from growth in output.

The existence of national resources favorable to economic development and the efficacy of socioeconomic policy.

Broad-based economic development must be supported by a host of economic, cultural, and social institutions. These range from financial intermediaries to social status relationships and include attitudes toward work, family, and money income. Aside from the requirements for a stock of capital and additions to that stock, underdeveloped countries have requirements for institutions which are more favorable to development. Underdeveloped sectors, on the other hand, are members of societies where these institutions exist but where the benefits of their existence have not been extended to underdeveloped sectors.

The primary problem for underdeveloped sectors is lower income than that accruing to other members of the society and revolves around access to socioeconomic institutions in a

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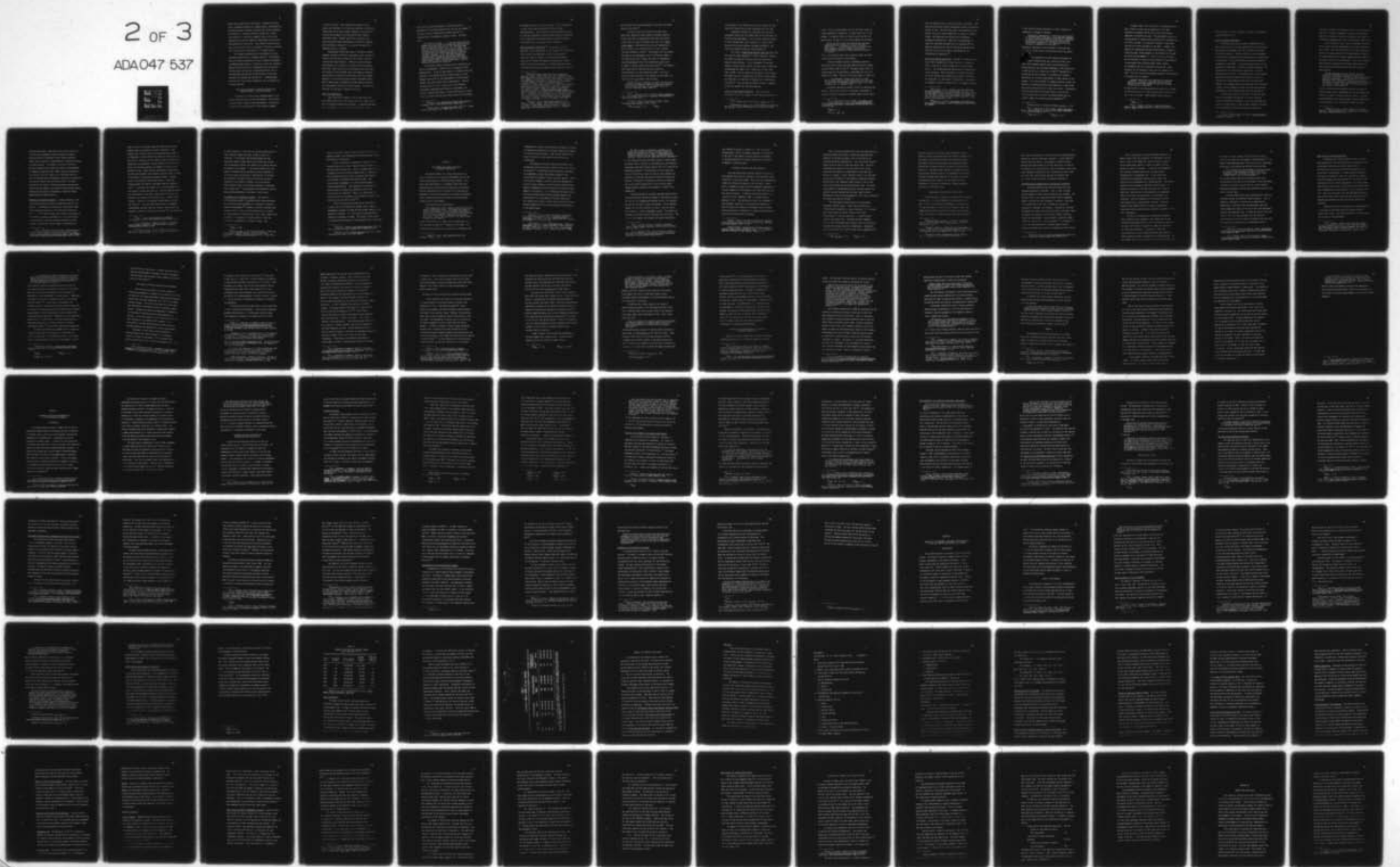
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manner which would rectify the problem. Adequate facilities exist in advanced countries for communications, transportation, harnessing natural resources, education and training programs, and recreation. Organized financial markets and a finely tuned network of distribution channels serve to facilitate transactions of the sort needed for development activity to be most beneficially carried out. The problem of providing more equal access can be solved by government intervention providing only that political institutions will increased access.

The economic preconditions for development of underdeveloped sectors exist in advanced countries. Socioeconomic policy to extend the benefits of overall economic advancement to underdeveloped sectors is a matter of a political consensus. Whatever the political will, socioeconomic policy decisions are more easily carried out in advanced countries than in underdeveloped ones because of the existence of resources necessary to implement the national will. Underdeveloped countries must first concern themselves with the marshalling of these resources.

Public Policy Attempts to Combat Minority Group Underdevelopment in the United States

The attack on minority group underdevelopment in the United States has basically been two-pronged. Public policy has been aimed at breaking down socioeconomic institutional barriers to full participation in the society by members

of minority groups. Equal opportunity programs for this purpose were designed to initiate and perpetuate institutional change which would lead to wider acceptance of the rights of minority group members to achieve proportional economic mainstream status. Federal legislative, executive, and judicial agencies made pronouncements and rendered judgments which reflected a national will to provide for equality of opportunity for all citizens.

Simultaneous efforts were made to intervene in market outcomes on behalf of minority group members with the explicit intent of helping them overcome past and current overt and institutional discrimination. Affirmative action programs were ordered to be carried out in public and private sector activities; public policy activities ensured that sales would be diverted to minority-owned firms; and monetary incentives were provided to stimulate private sector activities deemed beneficial to the minority group economic development effort. Both of these types of programs have been aimed at improving the socioeconomic position of minority groups. They have the character of long-range, strategic activities.

Equality of Opportunity

Equal opportunity programs in the United States have been inextricably tied to the struggle for civil rights on the part of blacks and other minority groups. A convincing argument can be made that civil rights activity led to most of the

public policy programs designed to increase equality of opportunity in the United States during the last two decades.⁵²

The fact of racial inequality has always appeared as a contradiction of the American system of values. As Myrdal said:

The "American dilemma" . . . is the ever-raging conflict between, on the one hand, the valuations preserved on the general plane which we shall call the "American Creed" where the American thinks, talks, and acts under the influence of high national and Christian precepts, and on the other hand, the valuations on specific planes of individual and group living, where personal and local interests; economic, social, and sexual jealousies; considerations of community prestige and conformity; group prejudice against particular persons or types of people; and all sorts of miscellaneous wants, impulses, and habits dominate his outlook.⁵³

An elaborate system of laws and social conventions was devised to perpetuate a system of racial segregation after Reconstruction. It was at these that civil rights activity was directed, first through the court system primarily by the National Association for the Advancement of Colored People (NAACP), and later through direct confrontation. Three of the major areas of civil rights activity with economic development consequence were education, employment, and housing. Changing conditions in these three areas are highly reactive to each other and they impact jointly on the economic

⁵²Thomas R. Dye, Understanding Public Policy (2nd ed.; Englewood Cliffs: Prentice-Hall, Inc., 1975), Cha. 3.

⁵³Gunnar Myrdal, An American Dilemma (New York: Harper and Row, Publishers, Inc., 1944), Vol. 1, p. XXI.

development prospects of minority groups. Racial segregation in these three areas contributed to minority group underdevelopment. Racial separation cannot be benign so long as individual personality values influence market transactions. Racial segregation influences market transactions through interpersonal and institutional racial prejudice.

Equal educational opportunity.⁵⁴ The economic value of education is well established in the literature.⁵⁵ Aside from human capital considerations a sophisticated system of production requires exposure to a learning environment. Education facilitates the advance of technological change. In addition education contributes to lifetime earnings through attitudes of minority group members about themselves and their

⁵⁴See Christopher Jencks and others, Inequality (New York: Harper and Row, Publishers, 1972); Jencks argues that schools have little effect on income inequality (p. 148). This argument is presented in terms of the overall distribution of income whereas this study is concerned with the relative income of minority groups. As stated by Masters, ". . . Variations in schools could have a large effect on the relative position of blacks (our main concern) and still have very little effect on total inequality (Jenck's main concern)." See Stanley H. Masters, Black-White Income Differentials (New York: Academic Press, Inc., 1975), p. 169n; Blaug questions Jencks' conclusion, "Who concludes that nothing counts except luck," on the basis of model construction. See Mark Blaug, "The Empirical Status of Human Capital Theory," The Journal of Economic Literature, 14, No. 3 (September 1976), 843.

⁵⁵Herman P. Miller, Rich Man, Poor Man (New York: Thomas Y. Crowell Company, Inc., 1971), Cha. 10; see also Finis Welch, "Black-White Income Differences in Returns to Schooling," American Economic Review, 58, No. 5 (December 1973), 904.

world; acquaintance with desegregated situations; and better physical facilities.⁵⁶

The courts have led the battle to provide equal educational opportunity among federal government agencies. Rulings favorable to desegregation have been consistently issued since the historic Supreme Court decision in Brown Versus Topeka in 1954 which declared racial segregation in public schools to be unconstitutional in that it denied Fourteenth Amendment rights.⁵⁷ The Supreme Court had ordered that schools be desegregated "with all deliberate speed" in its 1954 decision yet a request for delay in implementing school desegregation had to be turned down by that court in 1969 in a Holmes County, Mississippi case.⁵⁸ The essence of the Supreme Court's 1954 decision was to deny the constitutionality of the separate but equal, "Jim Crow," laws which were prevalent in the Southern United States, but the Court also subscribed to the view that:

Segregation had a "tendency" to retard the educational and mental development of Negro children and to deprive them of some of the benefits they would receive in a racially integrated school system.⁵⁹

⁵⁶U.S., Commission on Civil Rights, Racial Isolation in the Public Schools (Washington: Government Printing Office, 1967), Vol. 1, pp. 103-7.

⁵⁷Brown v. Board of Education of Topeka, Kansas, 347 United States Reports (1954), 483-96.

⁵⁸Dye, op. cit., p. 51.

⁵⁹Ibid.

The substance of the 1954 decision has been applied to other areas with large minority group concentrations since 1954.

Independent research has vindicated the view that a segregated educational environment tends to be detrimental to minority group development. A Civil Rights Commission report of 1967 concluded that racial separation in schools which resulted from housing patterns, de facto segregation, had significant adverse effects on black students.⁶⁰

The ruling in Brown Versus Board of Education dealt with the issue of lawful segregation in public education, however, its impact has been felt broadly across the spectrum of American race relations. It was a benchmark for profound changes in public policy activity at every level of government and predated the federal civil rights acts of 1957, 1964, 1968, and 1972. Each of these acts was passed in the interest of greater equality of opportunity for minority group members and impacted on the entirety of American social and economic traditions.⁶¹ They promised the "American dream" to members of minority groups too; they delivered less.

Equality of employment opportunity. Wage and salary employment is by far the manner in which most Americans make a

⁶⁰U.S., Commission on Civil Rights, op cit., p. 193.

⁶¹See Masters, op cit., pp. 143-4; Masters concludes that the 1964 Civil Rights Act decreased the black-white income differential.

living. Minority group members have not had equal access to income engendered by employment in higher paying jobs in the economy. The federal effort to improve access has met with some success. As the U.S. Civil Rights Commission concludes:

During the last decade some progress has been made toward the Nation's objective of equal employment opportunity. . . . Nevertheless the rate of progress has been inadequate and major problems of systematic discrimination continue to affect adversely minorities and women.⁶²

This is true despite myriad laws, executive orders and court rulings against employment discrimination.

President Kennedy declared a government program of affirmative action rather than mere nondiscrimination through Executive Order 10925 in 1961.⁶³ The major federal effort to increase equality of opportunity in employment was the Civil Rights Act of 1964. Title VII of that act made it illegal for:

. . . any employer or labor union with 25 or more persons after 1965 to discriminate against any individual in any fashion in employment, because of his race, color, religion, sex, or national origin. . . .⁶⁴

Employment opportunity impacts directly on education and housing. Aside from provision of necessary consumables it provides financial resources to purchase these articles, which

⁶²U.S., Commission on Civil Rights, The Federal Civil Rights Enforcement Effort - 1974: To Eliminate Employment Discrimination (Washington: Government Printing Office, 1975), Vol. 5, p. 617.

⁶³Ibid., p. 11

⁶⁴78 U.S. Stat. 255.

have the characteristics of physical capital investments. Both education and housing provide considerable returns for extended periods of time. The individual bears some responsibility for payment for each of these commodities in current or foregone income. Both education and housing have considerable consumption externalities. Where one lives determines in large part the extent and quality of his education;⁶⁵ his education determines the type of housing and job which are available to him; and the type of job determines his neighborhood and education.⁶⁶

Equality of housing opportunity. Housing is a necessity and a major item of expenditure for most families. Its quality impacts directly on income through health and sanitation effects. Yet income determines the quality of housing which can be purchased. Racial segregation in housing has been a fixture of the American society and has served as the basis for segregation in other areas of the society. For example, the concept of community schools which is so deeply ingrained

⁶⁵See Thomas Sowell, "Patterns of Black Excellence," The Public Interest, No. 43 (Spring 1976), pp. 26-9, this article suggests correctly that educational excellence can be provided under adverse conditions, however the author notes that the schools analyzed are the notable exceptions to poor quality black education (p. 28).

⁶⁶Bradley R. Schiller, The Economics of Poverty and Discrimination (Englewood Cliffs: Prentice-Hall, Inc., 1973), pp. 168-82.

in the society dictates segregation in public education if segregation is present in housing.

[Residential Segregation] is relatively more important in the North than in the South, since laws and etiquette to isolate whites from Negroes are prevalent in the South but practically absent from the North, and therefore institutional segregation in the North often has only residential segregation to rest upon.⁶⁷

Residential segregation first directed at blacks has been extended to include other minority groups during the present century.⁶⁸

Housing segregation has been enforced throughout the United States through zoning laws, lending practices, and restrictive covenants despite equal housing opportunity efforts dating to the Thirteenth Amendment to the Constitution in 1865 and the Civil Rights Act of 1866.⁶⁹ Segregation in housing has not only resulted in a diminution of economic opportunity for minority group members in other spheres of the economy, it has also resulted in inadequate housing to meet the needs of an expanding minority group population in urban areas and caused housing available to them to be costly. Consequently minority group families have been forced to pay more for inferior housing while bearing a disproportionate share of economic immobility caused by housing segregation.⁷⁰

⁶⁷Gunnar Myrdal, *An American Dilemma*, *op. cit.*, p. 618.

⁶⁸U.S., Commission on Civil Rights, *Twenty Years After Brown: Equal Opportunity in Housing* (Washington: Government Printing Office, 1965), p. 2.

⁶⁹*Ibid.*, pp. 1-3.

⁷⁰*Ibid.*, p. 9-11.

Although Federal laws and judicial interpretations have been in favor of equal housing opportunity since 1865, government enforcement efforts have not been consistently committed to achieving this goal. The government's entry into housing markets to improve housing conditions in the decade of the 1930's resulted in a substantial increase in the number and quality of units available in the 1940's. However, the benefits of improved housing went differentially to those in middle and upper income brackets to the detriment of the poor and minority group members.⁷¹ Title VI of the Civil Rights Act of 1964 made it illegal for discrimination to be practiced in any program which received federal funds, however, discrimination was still practiced in housing and it was necessary for the Congress to pass the Civil Rights Act of 1968. Title VIII of this act expressly prohibits discrimination in housing sales and rentals.

Congress passed this law in the face of widespread opposition. A survey in June 1967 revealed that 63 percent of whites were opposed to any law forbidding discrimination in housing.⁷²

The implication of this contradiction to public will is clear: Constitutional principles take precedence over social will in law if not in practice. Despite public policy activity

⁷¹ Ibid., p. 7.

⁷² Sar A. Levitan, William B. Johnston and Robert Taggart, Still a Dream (Cambridge: Harvard University Press, 1975), p. 286.

minority groups are still subjected to unequal and inadequate housing opportunities.⁷³

Minority Business Development

The second major type of program implemented through public policy activity has been concerned with linking minority group economic development with the institution of business ownership and control. Promoting minority group development by this method represents the best opportunity of accomplishing a desired goal in the most efficient and desirable manner to proponents of the method. It avoids the high costs of social programs and substitutes a reliance on market mechanisms. The development of the total American economy has a distinct private capitalism bias. Little wonder then, that increasing ownership by minority groups would be seen as a means to improve their socio-economic status once strictures were removed. The immediate section of this study will concentrate on public policy attempts to foster minority group business development and the problems which they have encountered.

Public policy entry into the field of minority group business development programs was at a later stage than equality of opportunity programs. This is as expected since equality of opportunity is more directly related to constitutional guarantees and the most ubiquitous instances of

⁷³U.S., Commission on Civil Rights, Equal Opportunity in Housing, op. cit., p. 168.

inability to compete on an equal basis for a living occurred in this area. A national commitment to foster minority group ownership of business requires an extension of the right to livelihood to encompass the right to a traditional way of life.

The first explicit public policy instrument to promote minority group business development was the Equal Opportunity Act of 1964. This law was the heart of the "War on Poverty" effort of the administration of President Lyndon B. Johnson. It created the Office of Economic Opportunity and placed it in the Executive Office of the President. Title IV of the Equal Opportunity Act established the Economic Opportunity Loan (EOL) program to be administered by the Small Business Administration.

The EOL program was to have flexible credit and collateral requirements and would be specifically restricted to the poor of the Nation; the economically and socially disadvantaged. It authorized small loans of \$25,000 or less, either made directly or with up to a 100 percent SBA guarantee, to be provided for periods of up to 15 years, largely on the basis of the character and the ability of the borrower.⁷⁴

Title IV of the Economic Opportunity Act had an impact on minority group business development for the same reason that the Act as a whole impacted on minority groups: they were overrepresented in the poverty category and any program which decreased poverty had a differential impact on poverty

⁷⁴Anthony G. Chase, "Federal Support of the Vital Majority," The Vital Majority, ed. Deane Carson (Washington: Government Printing Office, 1973), p. 20.

reduction among them. Other major public policy activity in this area was implemented primarily through the Federal Executive branch of government either through executive orders, moral suasion, or interpretation of legislation passed for other purposes. For example, the Office of Minority Business Enterprise was created and placed in the Department of Commerce by Executive Order 11548; the equal opportunity provisions of the Civil Rights Act of 1964 were used as a basis to persuade major governmental contractors to subcontract with minority group firms; and Section 8(a) of the Small Business Act was used to increase procurement from minority group firms even though it was passed to help defense industry contractors who might be threatened by slackening defense demands after the Korean Conflict.

Ownership of productive capacity. Business ownership is one of the major avenues to greater socioeconomic mobility for families. "Involvement in business has always been a major route toward participation in the mainstream of American life. . . ." ⁷⁵ Minority groups have either not had access to this method of economic betterment on a scale sufficient to achieve success or have not exercised the option to enter business in proportion to their number in the population.

⁷⁵U.S., President Richard M. Nixon, "Statement About a National Program for Minority Business Enterprise," Public Papers of the Presidents of the United States: 1969, Volume 1 (Washington: General Services Administration, 1971), p. 197.

Some of the lack of business ownership among minority group members might be traceable to cultural influences. Light suggests that a part of the lack of ownership among blacks in an atmosphere of credit market discrimination might be due to the lack of a tradition of the "rotating credit association."⁷⁶ Nonetheless the propensity to enter business and the ability to derive from business ownership an adequate living are quite different things. Where minority group members have entered business the businesses have remained relatively small in terms of the number of employees and average receipts. Average receipts increase more than proportionally in those few instances where the number of employees reach one hundred or more.⁷⁷ In addition the industry mix of minority-owned firms was adverse to growth and viability. Minority owned businesses are concentrated in the retail trade and service areas with manufacturing industry as the smallest area. Minority owned business location is also generally detrimental to growth and viability. They are highly concentrated in segregated neighborhoods and where they are located in other areas they represent a miniscule minority of businesses.⁷⁸ The implication

⁷⁶Ivan H. Light, Ethnic Enterprise in America, (Los Angeles: University of California Press, 1972), Cha. 2.

⁷⁷U.S., Department of Commerce, Bureau of the Census, Minority Owned Businesses: 1969 (Washington: Government Printing Office, 1971), p. 142.

⁷⁸Wilfred J. Garvin, "Fostering Minority Business Ownership," The Vital Majority, ed. Deane Carson (Washington: Government Printing Office, 1973), p. 408.

of these statistics is that minority business ownership was in 1969 a marginal proposition where income to owners was concerned. To the extent that minority groups own less productive capacity, they receive less income from business and simultaneously possess less capability to migrate into the mainstream of the economy. It has been estimated that a net growth of 700,000 minority businesses would be required to bring this group to proportional representation in business. Net additional investment of 60 billion dollars would be required to raise capital invested in existing and new minority-owned firms to the average investment in mainstream small enterprises.⁷⁹ The magnitude of the problem of minority group underrepresentation in business is thus scored.

The effects of distributional outlets. The problem of sufficient money capital to operate minority owned businesses has received extensive treatment as a hindrance to business growth and development.⁸⁰ Another of the major problems which presents itself to small, minority-owned firms is a market for output whether in manufacturing, retail trade, construction, or services. The impact of an ethnic market is that the market size is automatically limited in scope. This

⁷⁹Ibid., p. 409.

⁸⁰Light, op cit., p. 19; see also Kenneth E. Knight and Terry Dorsey, "Capital Problems in Minority Business Development," American Economic Review, 66, No. 2 (May 1976), 328-31.

limitation manifests itself in the inability of the firm to expand to optimal size through specialization and thus capture efficiencies in production.

A lack of intrafirm efficiency will result in higher output prices which, in turn, limits the size of the market and feeds back to production. There is evidence that the size of markets available to minority-owned firms is limited not only by higher prices but also by conscious discrimination in willingness to purchase from them by whites. The institutional arrangements in a sophisticated economy are likewise sophisticated. Tacit agreements to purchase from given sources at discount are sometimes a part of the institutional environment.⁸¹ There is no implication that these activities are designed to be sinister or callous toward minority groups but they do exist.⁸²

Under conditions where market access sufficient to provide a basis for expansion to optimal size is lacking governmental programs to bridge the gap through contracting are especially desirable. It is this gap that the Section 8(a) Program has attempted to bridge. The success of the program in accomplishing that goal will be addressed later in the study.

⁸¹Abraham S. Venable, Building Black Business (New York: Carl G. Graves Publishing Company, Inc., 1972), pp. 66-7.

⁸²Edward H. Jones, Black in Business (New York: Grosset and Dunlap Publishers, 1971), pp. 98-101.

CHAPTER IV

THE ECONOMIC DEVELOPMENT POTENTIAL OF MINORITY CAPITALISM

The present chapter will analyze the potential of minority capitalism as an economic development tool for the minority group sector of the United States economy. This begins the establishment of a framework within which the effectiveness of the Section 8(a) Program can be evaluated. Detailed consideration will be given to the strengths and weaknesses of minority capitalism as an economic development policy alternative given the structural and socioeconomic forces at work in the economy.

Cross defines black capitalism as:

The strategy which urges creation of new jobs and profit centers inside ghetto areas. The program also seeks to transfer the ownership of ghetto business from white to black control, at the same time building in the ghetto new banks, insurance companies, production, and service facilities. Today, black capitalism is an insignificant economic force in America.¹

While this definition is a useful point of departure, it is less encompassing than what is needed for this study. For purposes of this study minority capitalism is defined as the

¹Theodore L. Cross, Black Capitalism (New York: Atheneum, 1969), p. 211.

implementation of public policy measures designed to increase the amount and profitability of business ownership by members of non-white minority groups. Most of these opportunities should be created in areas where minority groups are concentrated.

The problems of business start-up and growth are so overwhelming that most business ventures do not last as long as two years.² The problems facing new minority businesses are compounded by social and economic aspects of the institutional environment in which they must operate. From a public policy viewpoint, minority capitalism encompasses a series of policy attempts to foster minority group business ownership commensurate with the proportion of minority group members in the society. It is interesting that many studies which have analyzed minority group underdevelopment have concentrated on the development of business enterprise.³ This concentration results in part from a bias which private business ownership gives to status and power relationships in the United States.

²William A. Strang, "Minority Economic Development: The Problem of Business Failures," Community Economic Development, ed. John C. Weistart (Dobbs Ferry, N.Y.: Oceana Publications, Inc., 1972), p. 122.

³See Frederic E. Case, Black Capitalism: Problems in Development (New York: Praeger Publishers, 1972); see also William F. Hadad and G. Douglas Pugh, eds., Black Economic Development (Englewood Cliffs: Prentice-Hall, Inc., 1969).

One type of asset is profoundly important to the acquisition of power in America--Business Ownership. Besides giving the owner a sense of independence and a chance to determine his own fate, entrepreneurship has provided a major route of upward mobility for immigrants.⁴

It also reflects the fact that money income is highest among the census class of persons in the professional and managerial occupations which most closely parallel the skills required for operating a business.⁵ A requirement to raise income and improve institutional access for minority group members was perceived to exist when the minority capitalism concept was devised. The natural inclination at the time of inception was to use minority capitalism as a tool to help propel incomes upward by improving job prospects in central city communities.

The Administrator of the Small Business Administration initiated the black capitalism concept in 1964 when he started the "six by six" program which granted loans of six thousand dollars for six years to black businessmen. The businessman needed little or no collateral to secure a loan but had to participate in a special management program. The program was overseen by the Small Business Opportunities Corporation. The "six by six" program later became the Economic Opportunity

⁴Sar A. Levitan, William B. Johnston, and Robert Taggart, Still a Dream (Cambridge: Harvard University Press, 1975), p. 174.

⁵U.S., Executive Office of the President, Office of Management and Budget, Social Indicators 1973 (Washington: Government Printing Office, 1973), p. 146.

Loan program⁶ discussed in chapter III. The "six by six" program began a series of programs undertaken as initiatives on the part of the Federal Executive branch of government to encourage ownership of business enterprises on the part of members of minority groups.

Problems in Minority Business Ownership

Less than proportional business ownership by minority group members poses several problems of distributional income inequality in the United States. Both labor and entrepreneurial income are affected by inequality, and the psychic income which is assumed to accrue from the independence engendered by business ownership is diminished to the extent that this group owns fewer businesses. In addition the business owner is in a position to be a community leader in a manner that an employee is not.⁷ The implication of this last statement is that community leadership is relatively more important in minority communities because of the greater need for mutual protection against the vagaries of a larger society which has historically harbored racial animosity.

⁶Samuel I. Doctors and Anne Sigismund Huff, Minority Enterprise and the President's Council (Cambridge: Ballinger Publishing Company, 1973), p. 23.

⁷Andrew Brimmer, "Desegregation and Negro Leadership," Business Leadership and the Negro Crisis, ed. Eli Ginzberg (New York: McGraw-Hill Book Company, 1968), p. 38.

One of the major problems which have confronted minority group businessmen who wanted to extend and perpetuate their ownership of business has been a lack of availability of financing and market opportunities. Thus the problem involves market access on both the input and output sides. Minority businessmen who operate in the slum areas of the country where minority groups are concentrated not only must pay a premium in interest, in many instances credit is not available at any rate of interest.⁸ The problem of undercapitalization which results from inadequate credit sources is one of two major input problems facing minority group firms. The second input problem is entrepreneurship which includes general and specific business know-how and individual qualifications. Shortages of capital and entrepreneurial skills place limitations on location and type of business.⁹

The second major problem area for minority owned businesses concerns output. These firms are subject to limited markets regardless of type of business. It is on this basis that Brimmer and Terrell question the likely effectiveness of minority capitalism as a minority group economic development tool. According to their argument, minority owned businesses have suffered losses as the society has moved to increase equality of opportunity. Segregation served the function of a tariff barrier and as segregation has

⁸Case, op. cit., p. 31

⁹Ibid., p. 27.

declined, especially in personal and professional service markets, minority businessmen have been unable to compete with the larger, more efficient firms in the national economy.¹⁰ Guaranteed financing for businesses and guaranteed product markets are considered essential to ghetto firm survival by McLaurin.¹¹ The Section 8(a) Program is designed to counter both problems through financial and management assistance by the Small Business Administration on the input side, and by ensuring disposition channels for the product prior to commitment of resources to production, through government contracts, on the output side.

Governmental Versus Private Market Sales

The primary goal of business is disposition of products through sales. From the viewpoint of the business firm it makes little difference who the purchaser is so long as the selling price permits returns to the firm above input costs. Indeed the firm might be satisfied to merely cover variable costs in the short run, under depressed business conditions.¹²

¹⁰Andrew Brimmer and Henry S. Terrell, "The Economic Potential of Black Capitalism," Public Policy, 19, No. 3 (Spring 1971), 291-2.

¹¹Dunbar S. McLaurin, "Ghetto Economic Development and Industrialization Plan," Black Business Enterprise, ed. Ronald W. Bailey (New York: Basic Books, Inc., 1971), p. 189.

¹²Richard A. Bilas, Microeconomic Theory (2nd ed.; New York: McGraw-Hill Book Company, 1971), p. 165.

One of the manifestations of the minority group underdevelopment problem is a paucity of business ownership. Private ownership implies the profit motive. Any attempt to promote minority business must take account of the fact that sales, in order to be effective, must be profitable. While governmental contractual sales represent an opportunity for increasing the sales volume of a firm, this type of sales activity also imposes some constraints on the firm which it otherwise might avoid.

The Relationships between Specific and General Production

Increased production and sales are needed to ensure increased prosperity in business. That is, small business success depends critically upon increasing gross revenues. The business firm in its infancy must assure itself an adequate market to provide for such increases in receipts. Even after it is established in its line, a threat of a decline in receipts will threaten its existence. Concurrently, the small businessman must take care that he can obtain sufficient credit to improve the capacity of his business to meet increasing production requirements. Success equates to business growth because to "stand still is to lose ground."¹³ The results of growth are more employees and increased specialization--greater efficiency which harbors the prospects for more profits.

¹³Abraham S. Venable, Building Black Business (New York: Earl G. Groves Publishing Company, Inc., 1972), p. 10.

One of the primary distinctions between production for general market sales and production for governmental contract sales is that in the former the firm must produce a good or service sufficiently general in nature to appeal to large numbers of potential customers. In addition the management of the firm must estimate market sales to ensure against overproduction or underproduction. In the latter case, production for governmental contract sales, there is no possibility for overproduction or underproduction. The precise quantity to be purchased is specified in the contract. In addition the quality of the item contracted for is usually specified. Both parties to the transaction are completely aware of the price and the quantity of the product to be purchased. From the standpoint of the business firm this would appear to be a made-to-order situation. There are, however, some problems which are unique to governmental contractual purchase and which are potentially hazardous to the small businessman.

The first of the obstacles to high profit prospects which confronts the businessman is the charge given to each government procurement officer, with his contracting authority, to ensure that the prices he pays for items to be purchased are "fair and reasonable." In practice, a "fair and reasonable price" to the contracting officer means that he should procure the item at minimum cost to the government. The procurement regulations reinforce this bias which presumes that

the seller is almost always inclined to exact too high a price for the product at the expense of the government.¹⁴ The Federal Procurement Regulation (FPR) codifies this requirement on the part of the contracting officers by stating that:

It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate overall cost to the government.¹⁵

This dictum requires that the contracting officer give consideration to the quality of the product so that the charge is really to "minimize cost per unit for a given quality." Quantity requirements are given the contracting officer by the user of the end item.

A second problem which small businessmen are likely to encounter relates to production schedule maneuver. This is especially important in construction or manufacturing enterprises. Very small firms with employees other than family members may resort to the use of part time employees to even out the production flow. It might be difficult for such firms to hire full-time employees with the requisite qualifications to fulfill contract obligations even when they are able to bid successfully on a government contract.

¹⁴Charles J. Hitch and Roland N. McKean, The Economics of Defense in the Nuclear Age (Cambridge: Harvard University Press, 1960), p. 232.

¹⁵U.S., General Services Administration, Federal Procurement Regulation (Washington: Government Printing Office, January 1976), p. 341.

Lead Time, Lag Time and Uncertainty

A different, but related problem for small, minority owned businesses is that the uncertainty of being able to get a government contract may not merely mean a lack of profitability but can mean the difference between survival and failure of the business. In some instances contractors have waited in excess of a year for a Section 8(a) contract which they thought they would receive.¹⁶ The result of this inordinate time lag is that the managers of firms must spend time trying to land a small contract which might detract from their concentration on other matters of vital concern to the firm. While the time spent might have been worth the delay, the position of the firms could have been threatened had the outcome been different and they had not been awarded the contracts.

Contracting officers are required to promote competition in the award of government contracts wherever possible. Formal advertising is the preferred method of procuring goods and services for the government.

¹⁶U.S., Congress, House, Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise, Government Minority Small Business Programs, Hearing, 92nd Cong., 2nd Sess., on H Res 5 and 19, Vol. 2, April 25, 1972 (Washington: Government Printing Office, 1972), p. 336.

. . . procurements shall generally be made by soliciting bids from all qualified sources or supplies or services deemed necessary by the contracting officer to assure full and free competition consistent with the procurement of the required supplies or services.¹⁷

This procedure requires the contracting office to solicit bids, open them publicly and award the contract to the bidder whose bid will be most advantageous to the government.¹⁸

Negotiation is the other method in contract award. "Negotiated procurements shall be on a competitive basis to the maximum practical extent."¹⁹ In this type of procurement, the contracting officer issues presolicitation notices, meets with all offerers and selects and awards the contract to the offerer whose proposal is most advantageous to the government after which negotiations take place. Negotiation is used when formal advertising is not feasible or it has been determined that negotiated purchase is in the best interest of national governmental policy.²⁰ Section 8(a) contracts are negotiated.

The small businessman must compete with all sources for a contract award even if the contract is "set-aside" as a small business award. The contracting officer is at liberty to go to large business to satisfy the requirement if he can

¹⁷Department of Defense, Armed Services Procurement Regulation (Washington: Government Printing Office, 1976), p. 2:1.

¹⁸Ibid.

¹⁹Ibid., p. 3:1.

²⁰Ibid., pp. 3:5-3:17.

get the item at a lower price. Although government policy requires the placement of purchases with small businesses, these businesses get no special favors regarding price and quality of the product.²¹

The Impact of Minority Capitalism on Employment

The initial policy effort in raising incomes of minority group members in response to the urban riots of 1966 and 1967 was to increase employment through programs designed to hire the "hard core unemployed" into firms in the larger, national economy. This policy effort was carried out under the sponsorship of the Administration of President Lyndon B. Johnson. Although the "hard core unemployment" program was not directed at increasing minority group ownership of business, it did lead directly to use of Section 8(a) of the Small Business Act to accomplish this purpose. It is instructive to consider the relationship between minority business ownership and employment of minority group members.

The manner in which minority group ownership of business benefits the minority community is influenced through its impact on employment. Small businesses are, almost by definition, small in terms of employment size. They

²¹H.N. Broom and Justin G. Longenecker, Small Business Management (Dallas: South-Western Publishing Company, 1975), p. 448; see also Department of Defense, op. cit., p. 1:15.

are judged as small because of sales volume.²² Large sales volume requires a large staff in either production, marketing, or administration and more often than not in all three. Small businesses also tend to use the sole proprietorship form of organization more often than large businesses²³ with the consequence that credit prospects rest almost exclusively on the ability of the owner/operator to secure financing. Sources of finance are almost indispensable to expansion in receipts and employment.

Of the 381,935 minority owned firms in the United States in 1972, 75,415 had paid employees. Firms with paid employees employed 456,009 persons. In other words, minority owned firms employed an average of six persons per firm in 1972.

²²See U.S., Department of Commerce, Office of Minority Business Enterprise, Federal Programs Assisting Minority Enterprise (Washington: Government Printing Office, 1971), p. vi; this reference gives the definition of a small business as follows:

In general a firm is considered "small" if its assets do not exceed \$5 million, if its net worth is not more than \$2.5 million, and if its average net income after taxes for the preceding two years was not more than \$250,000.

See also 13 Code of Federal Regulations, 218. The Small Business Administration considers a firm small if it is not dominant in its field of operations.

A firm is "not dominant in its field of operations" when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged.

²³Peter Mieszkowski, "Effects of Taxation: The Special Case of Small Business," The Vital Majority, ed. Deane Carson (Washington: Government Printing Office, 1973), p. 452.

However employment size rose more than proportionately with increases in business receipts. While firms with less than \$25,000 in receipts employed an average of two persons per firm, those with \$200,000 to \$499,999 in receipts employed an average of ten persons, and those with receipts in excess of one million dollars employed an average of 61 persons.²⁴ Comparable nonagricultural employment data for the economy as a whole in 1972 suggests that the employment potential for minority owned businesses was less than that for majority owned businesses. In 1972, 5,830,000 firms employed 72,764,000 persons. The average number of employees for nonagricultural firms for the entire economy was 12.5.²⁵ These figures indicate that minority economic advancement through employment gains from ownership is likely to be small. This finding conforms to the expectations. Since minority-owned firms tend to be smaller in terms of receipts they would be expected to have fewer employees per firm. Unless the relative size of minority-owned businesses is increased the employment-generating potential of these firms is not likely to be of major consequence. Alternatively, as presently constituted, a larger number of minority businesses would have to be created

²⁴U.S., Department of Commerce, Bureau of the Census, 1972 Survey of Minority-Owned Business Enterprises (Washington: Government Printing Office, 1975), p. 70.

²⁵U.S., Department of Commerce, Bureau of the Census, Statistical Abstracts of the United States, 1973 (Washington: Government Printing Office, 1973), pp. 228, 472, 585.

to generate a level of employment commensurate with that found in other firms. This analysis assumes that minority-owned firms employ members of minority groups more often than whites because of the likely proximity of minority employees to minority owned firms.

The Impact of Minority Capitalism on Minority Group Income

Private ownership and operation of business enterprises has represented one of the major avenues to middle class standards of living in the American economy.²⁶ Since minority group members own fewer businesses proportionately, they receive less business income. Moreover, the businesses which they do own are generally smaller than average in size and scope. The consequence of smaller size is an inability to capture economies of scale in both input and output markets. In 1965, 33 percent of minority owned businesses reported gross receipts of less than \$10,000 while only 19 percent of majority owned businesses had receipts that low. Thirty nine percent of black owned businesses had gross receipts of under \$10,000.²⁷ The large proportion of minority group firms which have low business receipts does not guarantee

²⁶Ivan H. Light, Ethnic Enterprise in America (Los Angeles: University of California Press, 1972), p. 4

²⁷Albert J. Reiss Jr., Minority Entrepreneurship, U.S., Congress, Senate, Select Committee on Small Business, Review of Small Business Administration's Program and Policies--1969, Hearing, 91st Cong., 1st Sess., October 15, 1969 (Washington: Government Printing Office, 1969), p. 732.

that they are marginal income sources on the whole but it does strengthen the implication that the traditional minority business receipt size decreases the likelihood that minority business ownership can be used to improve the economic position of this sector vis-a-vis the larger society.

The types of business which minority groups engage in most often also affect their income position. Reiss notes that there is a concentration of minority owned businesses in personal services and retail trade. Minority group businesses comprised 12.3 percent of all personal service but only 1.2 percent of manufacturing businesses in the Reiss study.²⁸ Minority owned businesses are also more frequently organized as sole proprietorships than majority businesses.²⁹ The impact of this fact is that equity capital is likely to be harder to raise for these businesses with the consequence that business receipts are more likely to stagnate through missed opportunities for expansion.

Income increases from self-employed management of business depends upon business growth. Business growth depends upon the availability of money capital.

²⁸Ibid., p. 718.

²⁹Ibid., pp. 723-5.

By being employed in the national economy, the Negro craftman is working with roughly the same amount of capital as his white counterpart. The self-employed Negro manager, however, by being limited mainly to the small amount of complementary capital available from the low level of ghetto savings, will have substantially lower expected income.³⁰

Brimmer and Terrell argue from this position that minority group members are likely to experience higher incomes (increased economic development) as salaried employees than as owner-operators of businesses.

A different but related impact on the income of minority-owned businesses is the locational decision of the firm. Minority-owned firms are more likely to be located in low income, ethnic areas than majority firms. Reiss' study points out that:

Only 3.2 percent of all majority operated establishments are located in ghettos as compared with a third of all Negro and 28 percent of all other minority operated businesses.³¹

The disproportionate location of minority owned businesses in these areas is disadvantageous on at least two counts: lower consumer income results in diminished purchases, and the increased cost of doing business in the ghetto because the cost of crime must be absorbed by the business or passed on to consumers. In either case it worsens the competitive position

³⁰Brimmer and Terrell, op. cit., p. 304.

³¹Reiss, op. cit., p. 721.

of the business.³² All of these factors, small scale of operations, concentration of minority-owned businesses in retail trade and services, type of business organization, and location adversely affect the prospects and profitability of minority-owned businesses. Although the prospects for increased income seem to be small from minority-owned business, minority group members continue to start businesses in hopes that somehow they will be different. They often fail and some try again. Entrepreneurship is a traditional way of advancement in the American economy but like many other concepts, the exercise of entrepreneurship by minority group members is more difficult in practice than it appears in theory.³³ An alleviation of barriers to business growth should increase income and the economic development contribution of minority owned businesses.

The Impact of an Entrepreneurial Tradition
on Minority Capitalism

There is no need to recount here the small percentage of American business which is owned by members of minority

³²For a detailed account of the impact of crime on minority business ownership see Reiss, *Ibid.*, pp. 740-86; see also U.S., Department of Commerce, Office of Minority Business Enterprise, Building Minority Enterprise (Washington: Government Printing Office, 1970), p. 2.

³³Roy F. Lee, The Setting for Black Business Development (Ithica, N.Y.: New York State School of Industrial and Labor Relations, 1973), p. 3.

groups. The President's Advisory Council on Minority Business Enterprise (PACME) has summed up the problem as follows:

High on the list of priorities for the decade of the seventies is the provision of a substantially increased stake in the American economy for members of minority groups. This will come about through expanded opportunities for ownership of economic resources. Enormous economic inequities, the product of centuries of disregard, discrimination, and institutional racism still exist, although the public and private sectors have moved to curtail active discrimination and the exclusion of minorities from economic opportunity. A major long-term commitment of resources, energy, and imagination is required if America is to remedy this centuries old injustice.³⁴

The situation referred to by PACME has detracted from the capability of minority businesses to grow and to enter the more remunerative business activities. There is associated with a dearth of minority business ownership both a cause and effect impact on minority group income. Minority businesses because of their size, gross receipts, location, and lack of access to capital do not generate much income for their owners. Simultaneously the lack of income prospects adversely impact on incentives to enter business by those with the greatest likelihood of success. The result is a situation where brave men with little knowledge of the requirements for success enter marginal businesses and lose whatever equity capital they have been able to raise. There is a shortage of minority

³⁴U.S., President's Advisory Council on Minority Business Enterprise, Minority Enterprise and Expanded Ownership: Blueprint for the Seventies (Washington: Government Printing Office, 1971), p. 5.

group persons who have the necessary formal and informal education to manage modern, large scale businesses.

Because there were few success models of minority business managers or owners, and limited opportunities, very few minority students chose business ownership as a career objective.³⁵

The institutional environment in which minority business enterprise must operate combined with the myriad problems which face all small businesses have served as a double barrier to minority group participation in entrepreneurial ventures.³⁶

Yet another problem which must be faced by potential minority group entrepreneurs is a lack of the formally or informally acquired management skills needed to operate a viable, competitive business.

The important role that competent management skills play in the successful operation and growth of a business has long been established. Approximately 90 percent of all business failures are attributed to poor management skills of the business owners.³⁷

It is likely that businesses owned by minority groups have failed more often than those owned by whites historically owing to the

³⁵U.S., Department of Commerce, Task Force on Education and Training for Minority Business Enterprise, Report, 1974 (Washington: Government Printing Office, 1974), p. 19.

³⁶See Robert McKersie, "Vitalize Black Enterprise," Black Business Enterprise, ed. Ronald W. Bailey (New York: Basic Books, Inc., 1971), p. 103.

³⁷U.S., Department of Commerce, Task Force on Education and Training for Minority Business Enterprise, op. cit., p. 24; see also Louis L. Allen, "Factors Affecting the Profitability of Small Firms," The Vital Majority, ed. Deane Carson (Washington: Government Printing Office, 1973), p. 242.

problems of securing working capital and the lack of an entrepreneurial tradition which could be passed on informally within the family. Garvin concludes that a lack of experience in the line of business contributed substantially to minority group business failures for the period 1967-1970.³⁸

In addition to lacking business experience, minority group persons have been underrepresented in formal business education programs.

In the sixty years following the inception of American graduate business education in 1908, less than six hundred minority persons received graduate degrees in business.³⁹

The Task Force on Education and Training for Minority Business Enterprise recommends that concentrated government activity to make training opportunities available to prospective and active minority entrepreneurs be made a priority goal.⁴⁰

Summary

The perpetuation of minority capitalism as a public policy goal flowered during the late 1960's and early 1970's under the direction of the Administrations of President Lyndon B. Johnson and Richard M. Nixon. Whatever the biases of

³⁸Wilfred J. Garvin, "Fostering Minority Business Ownership," The Vital Majority, ed. Deane Carson (Washington: Government Printing Office, 1973), pp. 423-5.

³⁹U.S., Department of Commerce, Task Force on Education and Training for Minority Enterprise, op. cit., p. 21.

⁴⁰Ibid., pp. 3-4, 47.

the political parties involved, minority capitalism was seen as a means whereby greater opportunity for participating in American economic life could be extended to nonwhite minorities. The problems of financing and greater human capital development by way of entrepreneurial expertise represent real obstacles to the development of minority business enterprises. These problems involve some circular causation and reinforce each other.

Some of the lack of financial backing is attributable to a bias in the institutional setting which has argued that minority group entrepreneurs are engaged in businesses which will not survive the competition to become really profitable enterprises. The predictions of failure in some cases have become self-fulfilling prophecies. The lack of prior success has led to the conclusion by lending institutions that future success is unlikely. Lending institutions must observe profitability guidelines. It is likely that some of the inability to raise money capital on the part of minority group members aspiring to entrepreneurship can be traced to conscious or institutional discrimination. In this respect the treatment of an individual differently because of preconceptions about his racial group is discriminatory. A lack of ability to find financial backing impacts directly on entrepreneurship.

Success models influence the career decisions of young people. If minority groups either do not own business proportionately or do not earn incomes from businesses

commensurate with whites both the fact of the shortfall and the signal to search for alternative means of livelihood will be communicated to younger members of these groups. The traditional lack of business success has, no doubt, influenced some better-qualified minority group members away from business ownership with the consequence that entrepreneurship is an underdeveloped art among minority group members.

The low income historically experienced by minority group members from business enterprises is not likely to be remedied in the short run. The institutional environment which has been partially responsible for the lack of business success will only change slowly. An equal opportunity to succeed or fail in business has not existed any more than an equal opportunity to succeed or fail in some other types of endeavor. In light of institutional strictures which decrease the probability of success in business, governmental activity to improve the prospects for equal opportunity in business ventures is warranted. There is no reason to believe that minority group members will do less well in business, as in other areas of the economy, if they are given an equal opportunity. An equal opportunity might mean more than the mere noninterference with current decisions. It might mean activities designed to overcome the effects of past denials. As President Johnson said:

You do not take a person who, for years, has been hobbled by chains and liberate him, bring him up to the starting line of a race and then say, "You are free to compete with all the others" and still justly believe that you have been completely fair.⁴¹

Minority capitalism attempts to provide the compensatory activity which President Johnson implied to be necessary to a "fair start" for minority group members in the area of business ownership.

⁴¹U.S., President Lyndon B. Johnson, "To Fulfill These Rights," Commencement Address at Howard University, Public Papers of the Presidents of the United States, 1965 (Washington: Government Printing Office, 1966), p. 636.

CHAPTER V

CONCEPTUALIZATION AND IMPLEMENTATION OF THE SECTION 8(a) PROGRAM

Introduction

The present chapter presents a summary view of how the Section 8(a) Program came into being and provides a discussion of the major social, political and philosophical issues which impacted on its implementation. Implementation met with resistance on several counts. To begin with, the program had to overcome the bureaucratic inertia associated with uncertainty about the proper relationship between government agencies. In addition the program was a natural enemy to nondisadvantaged small business firms since it threatened award of contracts which they had traditionally received.¹ Finally the program was perceived as providing preferential treatment to minority group members who were the beneficiaries of civil rights legislation and court orders and were "moving too fast" toward equality of opportunity.²

¹U.S., Comptroller General, General Accounting Office, Questionable Effectiveness of the 8(a) Procurement Program (Washington: Government Printing Office, 1975), p. 19.

²Thomas R. Dye, The Politics of Equality (New York: The Bobbs-Merrill Company, Inc., 1971), pp. 215-23.

The Section 8(a) Program is a domestic economic development program which has as its major goal the establishment and perpetuation of viable disadvantaged group businesses through government contracts for goods and services. Contracts are provided to help firms overcome the obstacles of growth to optimum size. After the firm has reached its business plateau it is expected to compete as an independent and self-sustaining enterprise. Nonwhite minority groups control a disproportionately small share of economic resources in the United States. The Federal Government took steps designed to increase participation by these groups through civil rights legislation and executive orders and through the Minority Business Enterprise Program during the decade of the nineteen sixties.

The urban racial disturbances of the mid-1960's appeared to confirm that even the Civil Rights Act of 1964 was not sufficient to defuse the potentiall explosive social situation which was in part attributed to a perceived lack of economic control over their destinies by minority group residents of ghetto areas. This lack of economic control was perceived as a lack of equality of opportunity. Based on their investigation the National Advisory Commission on Civil Disorders expressed this view of the opportunity structure as follows:

The expectations aroused by the great judicial and legislative victories of the civil rights movement have led to frustration, hostility, and cynicism in the face of the persistent gap between promise and fulfillment.³

The use of the Section 8(a) Program to attempt greater involvement of minority groups in the American economic mainstream, whether through increasing job opportunities as attempted during the Administration of President Lyndon B. Johnson or through increased ownership as attempted during the Administration of President Richard M. Nixon, represented vertical intervention in the market to accomplish a social goal.

Rationale and Focus of Attack for Contracting under Section 8(a)

The Section 8(a) Program was born out of the civil rights progress and civil strife of the last two decades. The guarantee of the full power of citizenship without the encumbrances of discrimination was implicit in the laws and executive orders issued on behalf of nonwhite minority group members. This program was but a part of the Federal Government's Minority Business Enterprise effort. It sought to complement Congressional action to prohibit discrimination in voting, housing, employment, and educational opportunity by seeking to remedy a manifestation of unequal access to one major type of remuneration--business ownership. Other programs which were

³U.S., National Advisory Commission on Civil Disorders, Report (Washington: Government Printing Office, 1968), p. 92.

a part of the Minority Business Enterprise effort were designed to provide financial assistance, business opportunities, and management and technical assistance to minority owned firms.⁴

The Social Setting

The decade of the nineteen sixties witnessed the largest wave of legislative, judicial, and executive actions to secure and extend civil rights to America's nonwhite minority groups of any similar period in the history of the country. It is significant that all three branches of the Federal Government were involved simultaneously in these efforts. This simultaneous involvement indicates the amount of sociopolitical interest in the socioeconomic plight of minority groups at that time. Civil rights protest activity had heightened the consciousness of America to decades of racial inequality during the decade prior to enactment of the Civil Rights Act of 1964.⁵

By 1968, when the authority contained in Section 8(a) of the Small Business Act was first used, minority group members were witnessing attempts by the Federal Government to protect their civil rights. Ironically it was after the passage of

⁴U.S., Department of Commerce, Office of Minority Business Enterprise, Federal Programs Assisting Minority Enterprise (Washington: Government Printing Office, 1971), pp. xi-xiii.

⁵U.S., President Lyndon B. Johnson, "To Fulfill These Rights," Commencement Address at Howard University, Public Papers of the Presidents of the United States, 1965 (Washington: Government Printing Office, 1966), p. 636.

major civil and voting rights acts that violence erupted in some of the major metropolitan areas of the country.

Other than those racial disturbances associated with civil rights demonstrations in the Southern states dating to the Montgomery, Alabama city bus boycott in 1955, the country had been relatively free of major racial violence prior to 1965.⁶ Then, in the Watts section of Los Angeles in August 1965, a series of major racial disturbances began which lasted through the Summer of 1967. The National Advisory Commission on Civil Disorders, appointed by President Johnson through Executive Order 11365, was charged with the responsibility of finding the cause of the violence, developing methods and techniques for averting or controlling the disorders, and defining the role which various governmental agencies should play in dealing with such disorders.⁷

The Watts riot resulted in 34 deaths, nearly 4,000 arrests and approximately thirty five million dollars in property damage.⁸ A total of forty three riots and disorders were reported during 1966.⁹ The major riot activity, however, occurred during 1967, culminating in the riot which shook Detroit, Michigan in July of that year. The Detroit Riot left

⁶National Advisory Commission on Civil Disorders, op. cit., pp. 19-20.

⁷Ibid., p. 295.

⁸Ibid., p. 20.

⁹Ibid., p. 21.

forty three dead, over 7,200 arrested, and over thirty two million dollars in property damage.¹⁰ The National Advisory Commission determined that 164 disorders occurred during the first nine months of 1967. Forty one disorders were classified as major or serious; the rest were classified as minor.¹¹ Major or serious disorders occurred in every section of the country and every city size.¹² The occurrence of riots in geographically dispersed areas indicates the widespread dissatisfaction of ghetto area minority groups with their lot. The National Advisory Commission noted that the riot activity was primarily directed against "symbols of White American Society. . . Authority and property. . . rather than against white persons."¹³

The primary cause of the violence according to the Commission was the racial attitudes of white America. "White racism is essentially responsible for the explosive mixture which has been accumulating in our cities since World War II."¹⁴ The frustrated hopes which resulted when expectations were unrealized from the judicial and legislative victories for civil rights and a sense of powerlessness to combat perceived political and economic exploitation made violence seem an effective alternative to "moving the system" through established procedures.¹⁵

¹⁰Ibid., pp. 60-1.

¹²Ibid., p. 66.

¹⁴Ibid., p. 91.

¹¹Ibid., p. 65.

¹³Ibid., p. 64.

¹⁵Ibid., pp. 92-3.

Watts and Detroit--and the disorders that in subsequent years engulfed such Northern centers as Newark, Buffalo, Kansas City, Cleveland, Chicago, St Louis, San Francisco, and many others--served as shocking and costly reminders that the mere removal of legal barriers to equality was not enough; that the principle of equality included economic as well as social equality; that fear and lack of communication were still rampant; and that frustration could readily lead to anger and thence to blind unreasoned violence.¹⁶

In this atmosphere of racial unrest and social upheaval the Section 8(a) Program was pressed into service as one policy attempt to alter the opportunity structure available to minority group members.

The Size of the Federal Procurement Establishment

A significant portion of America's resources is committed to the operation of government. All levels of government expended approximately 21.4 percent of the Gross National Product in 1974 when governmental purchases of goods and services totaled 301.1 billion dollars.¹⁷ The Federal Government portion of this amount was 111.7 billion dollars.¹⁸ The magnitude of federal procurement expenditures implies to policymakers with a purpose to serve that qualifying their programs under the federal procurement regulations is a worthwhile task. Likewise policymakers who believe that access

¹⁶Henry J. Abraham, Freedom and the Court (2nd ed.; New York: Oxford University Press, 1972), p. 291.

¹⁷Council of Economic Advisers, Economic Report of the President, 1976 (Washington: Government Printing Office, 1976), p. 171.

¹⁸Ibid.

to federal expenditures for any purpose should be unencumbered by social, ethnic, political, and racial membership might be inclined to express that belief through a redistribution of opportunity to ensure equality of participation in receipts. Thus the efforts to promote racial equality in benefit receipt and status which was begun by President Truman when he proclaimed the uniformed services integrated by executive order in 1948, has been carried on by every president since that time.¹⁹

Federal procurement is big business. The Congress has recognized the potential importance of procurement as a source of small business benefit. The Small Business Act expresses the intent of Congress that government procurement be used as a vehicle to help small businesses. Section two of the Small Business Act states that:

It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible the interests of small-business concerns, . . . to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services of the Government. . . be placed with small business enterprises. . . .²⁰

The amount of money annually involved indicates immediately why Congress is concerned with the distribution of procurement

¹⁹Abraham, *op. cit.*, pp. 296-8.

²⁰U.S., Congress, House, Select Committee on Small Business, Text of Public Law 85-536 (Small Business Act (Washington: Government Printing Office, 1970), p. 1. similar declarations of congressional policy date to the Armed Services Procurement Act of 1947.

expenditures. Contract awards to all businesses by federal agencies, including the Department of Defense, amounted to 52.36 billion dollars in fiscal year 1974.²¹ The Congress has been continuously interested in the proportion of the total procurement amount which was awarded to small businesses. Information responding to a House Small Business Committee request on small business awards for 1974 indicated that small businesses received contract awards for 20.5 percent of 34.52 billion dollars awarded by the Department of Defense; 8 percent of 2.12 billion dollars awarded by the National Aeronautics and Space Administration; 39 percent of 1.56 billion dollars awarded by the General Services Administration, and 23 percent of 14.16 billion dollars awarded by all other Civilian Executive agencies.²² Congressional pressure has been responsible, in part, for executive agency attention to the Small Business Program.²³ Constituency plays a part in the determination of benefit receipt from federal expenditures.

In a representative government, such earthy matters as the distribution and award of government contracts are of considerable concern to those who are elected to look after the interests of the individual states, districts, and territories.²⁴

²¹U.S., Congress, House, Permanent Select Committee on Small Businesses. The Position of Small Business in Government Procurement (1974) (Washington: Government Printing Office, 1974), pp. 8, 113, 123.

²²Ibid., pp. 113, 123.

²³Ibid., p. 1.

²⁴Merton J. Peck and Frederic M. Sherer, The Weapons Acquisition Process (Boston: President and Fellows of Harvard College, 1962), p. 95.

The President's Test Program on Hard-Core Unemployment

[The Section 8(a) Program's] use was initiated in support of the Test Cities Program under President Johnson's administration as a result of the civil disturbances during 1967.²⁵

The racial disturbances in the urban ghettos must have represented a particularly troublesome policy area for an administration which prided itself on its accomplishments in the civil rights area. The conclusion which emerged from the report of the National Advisory Commission on Civil Disorders confirmed that one of the major problems as perceived by the rioters was a lack of meaningful work in ghettos. It was toward the goal of creating work experiences in the ghetto areas that the administration turned its energies while continuing to attempt to wage its "war on poverty." The "Test Cities Program" was an adjunct of the war on poverty program.

President Johnson launched the Test Cities Program on October 2, 1967 by Memorandum to the Secretaries of Defense, Commerce, Labor, Health, Education, and Welfare, Housing and Urban Development; Administrators of the General Services Administration and Small Business Administration; and Director of the Office of Economic Opportunity. The program sought to:

²⁵U.S., Congress, Senate, Select Committee on Small Business, Small Business Administration's 8(a) Contract Procurement Program, Hearing 94th Cong., 2nd Sess., January 21, 1976 (Washington: Government Printing Office, 1976), p. 261.

. . .mobilize the resources of private industry and the federal government to help find jobs and provide training for America's hard-core unemployed. The heart of this new effort is to reach the forgotten and neglected--those citizens handicapped by poor health, hampered by inadequate education, hindered by years of discrimination, and by-passed by conventional training programs.²⁶

Section 8(a) was used under the Test Cities Program to give preference in award to those government contractors who were located in areas of "concentrated unemployment or underemployment" as determined by the Bureau of Employment Security in the Department of Labor. The contractor was required to agree in advance that no fewer than 25 percent of the laborers used in contract performance would be "disadvantaged workers."²⁷ Provisions were made that firms not located in target areas could qualify for preference awards by certifying that a significant portion of the work would be subcontracted to a firm which was so located. The Test Cities Program was fully implemented in the Department of Defense by March 1968 after the Armed Services Procurement Regulation had been amended and the Small Business Administration had announced its intention to use Section 8(a) authority to subcontract with firms who agreed to comply with stipulations of the program.

²⁶U.S., President Lyndon B. Johnson, "Memorandum on Inaugurating a Test Program to Reduce Hard Core Unemployment," Public Papers of the Presidents of the United States, 1967 (Washington: Government Printing Office, 1968), p. 887.

²⁷Letter, Administrator, Bureau of Employment Security to Assistant Secretary of Defense (Installations and Logistics), October 10, 1967 (Enclosure Z), p. 1.

Throughout the remainder of 1968, the program was refined. The Department of Defense had to insure that it complemented rather than clashed with the department's Labor Surplus Area Program which was already in operation.²⁸ A Congressional Committee made the following recommendations in December 1968:

Section 8(a) of the Small Business Act should be utilized to the fullest extent for development of entrepreneurship in ghetto areas. Large companies should be encouraged to set up self-sufficient divisions in poverty areas that can later be spun off as small businesses.²⁹

In addition,

Provisions and guidelines should be incorporated into the Armed Services Procurement Act and the Federal Property and Administrative Services Act under which contracts can be negotiated when one of the purposes of procurement is reduction of serious and persistent unemployment and the encouragement of business enterprise in ghetto areas. Procurement Regulations should then be appropriately revised to reflect this statutory purpose.³⁰

The Political Climate

The force of ghetto racial disturbances insured that solutions to the problems they portended for the society would

²⁸The Labor Surplus Area Program awards contracts preferentially to firms located in areas where unemployment is unusually high.

²⁹U.S., Congress, Senate, Select Committee on Small Business, Selected Problems of Small Business in the Area of Federal Procurement, Senate Report Number 1671, 90th Cong., 2nd Sess., December 3, 1968 (Washington: Government Printing Office, 1968), p. 3.

³⁰Ibid.

be subject to political controversy during the presidential election campaign of 1968. Richard M. Nixon proposed his solution to these problems during his "Bridges to Human Dignity" radio speeches on April 25 and May 2, 1968. It was during these speeches that the Nixon conception of the Black Capitalism idea was explained.³¹

To anyone schooled in the historic Republican philosophy, the "Bridges" speeches represented only a carrying forward of time-honored principles to meet new needs.³²

The program proposed by Nixon was in clear contrast to that being carried out by the Johnson Administration.

The Jobs Versus Ownership Controversy

The stage was set for a political determination of the manner in which the authority contained in Section 8(a) of the Small Business Act would be used to intervene in the income determination of America's nonwhite minority groups. There was by late 1968 no issue as to whether it would be used. For the Johnson Administration the authority was considered another prong of its attack on poverty and lack of economic opportunity which led to the racial unrest; for candidate Nixon the authority represented an opportunity to increase the capability of minority group members to overcome the obstacles to business ownership and prosperity through the workings of

³¹John McClaughry, "Black Ownership and National Politics," Black Economic Development, eds. William F. Hadad and G. Douglas Pugh (Englewood Cliffs: Prentice Hall, Inc., 1969), p. 38.

³²Ibid.

the market. On the one hand Section 8(a) was seen as a way to provide jobs; on the other hand it was seen as a way to provide ownership. After his election President Nixon turned to the implementation of his way by issuing Executive Order 11458, "Prescribing Arrangements for Developing and Coordinating a National Program for Minority Business Enterprise"³³ on March 5, 1969. This Executive Order established the Office of Minority Business Enterprise within the Department of Commerce and ordered the federal bureaucracy into action to "contribute to the establishment, preservation, and strengthening of minority business enterprise."³⁴ Executive Order 11458 was superseded by Executive Order 11625, "Prescribing Additional Arrangements for Developing and Coordinating a National Program for Minority Business Enterprise," on October 13, 1971.³⁵ The later Executive Order broadened the scope of the previous order by giving the Secretary of Commerce greater powers to expend funds in support of pilot and demonstration projects and in general to coordinate the entire minority business enterprise program

³³See U.S., President Richard M. Nixon, "Executive Order 11458," Weekly Compilation of Presidential Documents, 5, No. 10 (March 10, 1969), 372-3.

³⁴Ibid., p. 372.

³⁵See U.S., President Richard M. Nixon, "Executive Order 11625," Weekly Compilation of Presidential Documents, 7, No. 42 (October 18, 1971), 1404-6.

throughout the federal government.³⁶ These activities were to be carried out, in fact, by the Office of Minority Business Enterprise created by Executive Order 11458 and placed in the Department of Commerce.

The Federal Organization to Implement the Section 8(a) Program

The Section 8(a) Program has gone through several changes in management emphasis since 1968. Initially the program tried to enroll all applicant firms which could be found; later the program tried to broker the maximum number of contracts. Finally in 1975 the program emphasis shifted to providing the broad spectrum of Small Business Administration services to a smaller number of firms.³⁷ During the entire period of implementation the federal organization was basically the same. Two federal agencies, the Small Business Administration and the Office of Minority Business Enterprise, have responsibilities which span the entire minority business enterprise effort.

The Small Business Administration has played a central role in the Section 8(a) Program from the beginning. The

³⁶U.S., President Richard M. Nixon, "Presidential Message to Congress on Minority Business Enterprise," Weekly Compilation of Presidential Documents, 7, No. 42 (October 18, 1971), 1403.

³⁷U.S., Congress, Senate, Select Committee on Small Business, Small Business Administration's 8(a) Contract Procurement Program, Hearing, 94th Cong., 2nd Sess., January 21, 1976 (Washington: Government Printing Office, 1976), p. 262.

success of the program still falls to the initiative and ingenuity of this relatively small agency in the federal bureaucracy. The Small Business Administration must play the role of advocate if the program is to succeed. It is the primary point of contact for firms who wish to engage in contracting under Section 8(a). In addition to the Section 8(a) Program SBA is involved in loan and loan guarantee programs, the surety bonding program, and various management assistance programs.

The Small Business Administration is organized into ten regions, with each region having supervisory responsibility for several district field offices within its region. There are 101 district offices some of which have branch offices. The procurement center representative in the district office is the person who is primarily responsible for securing contracts from government agencies to support the Section 8(a) Program.³⁸ In 1973 the Small Business Administration employed approximately 4,000 persons to conduct its operations.³⁹ Of this number 262 persons were employed in direct support of

³⁸For Organizational detail of the Small Business Administration see Title 13, Code of Federal Regulations (Part 101)(Washington: Government Printing Office, 1976), pp. 4-28. Regional offices one through ten are located respectively in Boston, New York, Philadelphia, Atlanta, Chicago, Dallas, Kansas City, Denver, San Francisco, and Seattle.

³⁹U.S., Office of Management and Budget, Special Analyses: Budget of the United States Government for Fiscal Year 1974 (Washington: Government Printing Office, 1974), p. 95.

minority enterprise programs.⁴⁰ It can be concluded that these minority business enterprise specialists are spread rather thinly when consideration is given the fact that Section 8(a) contracts alone for fiscal year 1973 numbered 1976 awarded to 1067 firms. These contracts had to be administered by 202 Regional and District employees. Approximately one hundred of these same employees had to provide management and technical assistance and procurement assistance to the entire small business universe.⁴¹ Moreover, the Section 8(a) Program is but one of several minority business enterprise programs.

The Office of Minority Business Enterprise (OMBE) was created by Executive Order 11458 in March 1969. This new agency was placed in the Department of Commerce and given the responsibility for being a "clearinghouse operation" which would coordinate and oversee the federal minority enterprise effort and stimulate private sector initiatives.⁴² OMBE has grown in both scope and influence since its creation. It started as an agency which employed thirty six people and

⁴⁰U.S., Congress, House, Permanent Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise and Franchising, Government Minority Enterprise Programs--Fiscal Year 1974, Vol. I, Hearings, 93rd Cong., 1st Sess., October 3, 4, 1973 (Washington: Government Printing Office, 1973), p. 204.

⁴¹Ibid.

⁴²U.S., President Richard M. Nixon, "Message to Congress," Weekly Compilation of Presidential Documents (October 18, 1971), op. cit., p. 1400.

had a budget request for fiscal year 1970 of 1.5 million dollars.⁴³ By 1974 OMBE had a budget of approximately 42 million dollars and employed in excess of 200 people. The agency was reorganized in 1973. The result of that reorganization was to shift the majority of the OMBE staff, which had been located in Washington, D.C., to Regional Offices around the country.⁴⁴ OMBE has affiliated itself with most of the local minority group-oriented development corporations throughout the country. OMBE awards contracts for management assistance and provides loan and grant financing for minority small businessmen and business development organizations through these private organizations.

The potential for conflict between the Small Business Administration and the Office of Minority Business Enterprise has been high. This has been especially true where the two agencies have been simultaneously involved in the same facet of the minority business enterprise effort. Such potential is illustrated in the Minority Enterprise Small Business

⁴³Testimony by Director, Office of Minority Business Enterprise, U.S., Congress, Senate, Select Committee on Small Business, Review of Small Business Administration's Programs and Policies--1969, 91st Cong., 1st Sess., June 11, 1969 (Washington: Government Printing Office, 1969, p. 157.

⁴⁴U.S., Congress, House, Permanent Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise and Franchising, Government Minority Enterprise Programs--Fiscal Year 1974, Vol. 2, Hearing, 93rd Cong., 2nd Sess., March 21, 1974 (Washington: Government Printing Office, 1974), p. 65. OMBE Regional Offices are located in New York, Washington, D.C., Atlanta, Chicago, Dallas, and San Francisco.

Investment Companies (MESBICs). The SBA licenses and supervises MESBICs yet OMBE is involved in initiating MESBIC activity. MESBICs may be involved in loans to firms with which OMBE is involved in providing management and technical assistance by contract with other private firms. Furthermore SBA may be providing management and technical assistance to the same firm as well as procurement assistance through the Section 8(a) Program, either simultaneously or in tandem. It was not until 1974 that the two agencies set up a series of committees at the national level to address these areas of potential conflicts.⁴⁵

Implementation of the Section 8(a) Program

Implementation of the Section 8(a) Program was given as a charge to all federal agencies which engaged in procurement activities. The amount of support which could be given the program was determined by the type and amount of contracts awarded by the federal agencies. The Department of Defense has consistently had more contracts both in terms of number and amounts than any other federal agency. It was apparently for this reason that Secretary of Defense Clifford argued that the Department of Defense had not lived up to its obligation and potential for devoting sufficient thinking and resources to "those aspects of our domestic problems which

⁴⁵Ibid., p. 13.

are important to our total national security.⁴⁶ Defense expenditures represented the largest single item in federal outlays in the period after World War II until they were overtaken by expenditures for income security programs in 1974.⁴⁷

The size of defense procurement expenditures accounted for the inclusion of the Department of Defense as one of the initial agencies to which President Johnson's memorandum of October 2, 1967 was sent. Aside from the Department of Defense the only other "general purchaser" agency included was the General Services Administration. All other agencies were "action agencies" in the war on poverty effort.

The final argument in favor of using Section 8(a) of the Small Business Act as a major tool to implement a program of Minority Business Development came during a meeting of a joint Department of Defense/General Services Administration Legal Council Review on December 3, 1969. In a letter to the Administrator, General Services Administration, the legal counsels stated the substance of their review of statutory authority which might be used to divert procurements to help minority group businesses. They determined that all other

⁴⁶Clark M. Clifford, "Address to the National Security Industrial Association," Department of Defense Press Release, September 26, 1968, p. 6.

⁴⁷Council of Economic Advisers, op. cit., p. 247.

alternatives would require enabling statutory authority and concluded that:

Because of the problems outlined above concerning other statutory provisions, section 8(a) of the Small Business Act appears to provide the only satisfactory legal authority upon which to base a continuing Government-wide program designed to give minority business a preference in procurement.⁴⁸

Operation of the Section 8(a) Program

The program works similarly in all federal procuring agencies. The agency is charged to work with the Small Business Administration to identify those of its future contract procurements which are likely candidates for the Section 8(a) Program. The Small Business Administration's Procurement Center Representative is then responsible for searching the SBA portfolio of Section 8(a) firms to effect a match between the procurement requirements and business firm capabilities. When a firm is found with the set of capabilities required for performing the contract, the Procurement Center Representative certifies to the procuring agency that the Small Business Administration is capable of performing the contract work. A contract is negotiated between the Small Business Administration and the procuring agency; then a separate contract is

⁴⁸Letter from General Services Administration Legal Counsel, "Interagency Procurement Task Force for Minority Businessmen," December 3, 1969, p. 3, a copy of this letter was transmitted to the Assistant Secretary of Defense (Installations and Logistics) by Memo from the General Counsel, General Services Administration on December 11, 1969.

negotiated between the Small Business Administration and the Section 8(a) firm.

Procuring agencies are prohibited by statute usually in the annual appropriations acts from paying price differentials to alleviate economic dislocations. This restriction has been interpreted to mean that price differentials could not be paid to Section 8(a) firms.⁴⁹ Yet some small, minority-owned businesses, especially those which are totally new, have costs which preclude them from offering goods and services at a price as low as their fair market value. In recognition of these facts the Congress appropriated Business Development Expense (BDE) money to the Small Business Administration beginning in fiscal year 1972.⁵⁰ The SBA is authorized to make BDE expenditures to Section 8(a) firms to cover the difference between what the procuring agency would pay for the product under competitive bidding and the amount that SBA determines to be necessary.

Business development expense funds are included in the contract price in situations determined essential to the fulfillment of program objectives such as: The need for additional equipment or tooling; low labor productivity due to inexperience, expected high waste or rejection rates; need to develop quality control systems; improvement of supplier relations, et cetera.⁵¹

⁴⁹Ibid.

⁵⁰General Accounting Office, op. cit., pp. 4-5.

⁵¹Testimony, Administrator, Small Business Administration, U.S., Congress, House, Select Committee on Small Business, Subcommittee on Minority Business Enterprise and Franchising, Government Minority Enterprise Programs--Fiscal Year 1974, Vol. 1, op. cit., pp. 12-13.

BDE is paid to the 8(a) firm by the procuring agency as deliveries are made. The Small Business Administration then reimburses the procuring agency for the BDE portion of the contract. Congress appropriated 30 million dollars in Business Development Expense for fiscal years 1972-1974. The Small Business Administration paid out 16.1 million dollars of this amount in payments to 284 Section 8(a) firms.⁵²

⁵²General Accounting Office, op. cit., p. 5.

CHAPTER VI

ANALYSIS OF THE ECONOMIC DEVELOPMENT IMPACT AND COST TO THE AIR FORCE OF THE SECTION 8(a) PROGRAM

Introduction

This chapter presents an evaluation of the Section 8(a) Program. The program evolved in a manner typical of social programs implemented by the Federal Government. It has grown in both scope and expenditures devoted to it since fiscal year 1968. Precise expenditure amounts for program implementation are unavailable, however commitment of resources to increase the number of contractors in the program and the number of contracts awarded to them have risen. Contrary to the development of many government programs, the Section 8(a) Program was implemented on a test basis prior to full-scale implementation (the fact bears reiteration that the test program was different than the current program in that the latter concentrated on producing jobs rather than producing ownership). It is this type of program evaluation through a test effort which is suggested by Williams and

Evans.¹ The program has undergone several changes in direction as more has been learned about the environment in which minority business enterprise was to be perpetuated. Williams and Evans argue that this is an important part of social program evaluation.

No previous comprehensive attempt has been made to evaluate the Section 8(a) Program's overall effectiveness. This study bridges that gap by analyzing the economic development effectiveness of contracts awarded in the program by the United States Air Force. An analysis of the cost to the Air Force for program participation is also conducted. The contribution which the program has made to the perpetuation of self-sustaining minority owned businesses is used as a standard of effectiveness.

Goals of the Program

The Section 8(a) Program in its initial implementation as a business ownership and development program concentrated on creating and providing growth opportunities for as many minority-owned businesses as possible. This task agreed in substance with the view President Nixon expressed during the 1968 election campaign that:

¹Walter Williams and John W. Evans, "The Politics of Evaluation: The Case of Head Start," The Annals of the American Academy of Political and Social Science, 385, (September 1969), 118-32.

What we have to do is get private enterprise into the ghetto, and get the people of the ghetto into private enterprise--not only as workers, but as managers and owners.²

Nixon also expressed the view that federal policy should be directed at improving private employment incentives and increasing the availability of job information for ghetto dwellers for the sake of improving job mobility.³ Three issues relating to program goals will be discussed. The first of these relates to the number of businesses helped by the program as opposed to the size growth of those businesses which were helped. The second issue revolves around whether the dollar volume of contracts or the number of contracts awarded is a better measure of program effectiveness. The third issue is whether contracts of one type are preferable to other types in developing viable businesses.

Quantity Versus Quality of Business

The authority contained in Section 8(a) was first used in fiscal year 1968. The Section 8(a) Program has been used to funnel government contracts to only those businesses owned and controlled by socially or economically disadvantaged individuals. The majority of Section 8(a) contracts have been awarded to businesses owned and controlled by members

²Richard M. Nixon, "Capital in the Ghettos," Race and Poverty, ed. John F. Kain (Englewood Cliffs: Prentice-Hall, Inc., 1969), p. 166.

³Ibid., pp. 164-5

of minority groups, however, 58 contracts which totaled 5.7 million dollars were awarded to white owned firms during the period fiscal year 1973-1975.⁴ This contracting activity appears to confirm the Small Business Administration (SBA) view expounded since the program's inception that it was to be used as a tool to alleviate social and economic disadvantage, regardless of racial identity. The program was implemented to counter the trend among minority groups to own a disproportionately small number of businesses which had disproportionately small receipt size. There was a trade-off to be made regarding whether the Section 8(a) Program would concentrate on providing what contracts it could acquire from other government agencies to many small minority-owned firms or to a few select firms with a view toward bringing them quickly to their business plateau. In the initial stages of the program the Small Business Administration (SBA) acquired as many contracts as the other agencies were willing to make available to it and for which it had contractors capable of performing contracts. Section 8(a) contract availability has always depended upon other agencies' requirements and willingness to submit contracts for Section 8(a) Program consideration. In

⁴Testimony by Administrator, Small Business Administration, U.S., Congress, House, Committee on Small Business, Subcommittee on SBA Oversight and Minority Enterprise, Small Business Administration Programs, Hearing, 94th Cong., 1st Sess., March 4, 1975 (Washington: Government Printing Office, 1975), p. 21.

some instances the inability of SBA to secure additional contracts when needed has led to business deterioration for firms in the program.⁵

The issue of social and economic disadvantage is related to business quality through the impact of the socioeconomic climate. The major reason for the predominate award of Section 8(a) contracts to minority group firms is that, ". . . minorities make up the bulk of persons who have been socially or economically disadvantaged."⁶

The primary goal of this program is to create successful, self-sufficient firms. The concept of "graduation" from the Section 8(a) Program has always been one facet of its implementation. The contracts awarded to Section 8(a) firms are intended to help these firms attain the goals specified in the business plans which are approved by the Small Business Administration prior to award of the first contract to each firm. The business plan:

⁵See U.S., Comptroller General of the United States, General Accounting Office, Questionable Effectiveness of the 8(a) Procurement Program (Washington: Comptroller General of the United States, 1975), p. 9.

⁶Testimony by Administrator, Small Business Administration, U.S., Congress, House, Permanent Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise and Franchising, Government Minority Enterprise Programs--Fiscal Year 1974 (Vol. I), Hearing, 93rd Cong., 1st Sess., October 3, 1973 (Washington: Government Printing Office, 1974), p. 6.

. . . projects, on a multiyear basis the amount of subcontracting assistance needed to reach self-sufficiency. Each firm also projects the growth in commercial [non-government] sales which it believes it needs to become self-sufficient.⁷

When a firm has reached self-sufficiency it is "graduated" from the program and should no longer need Section 8(a) contract support. Twenty-nine firms had graduated from the program by 1973.⁸ Some Section 8(a) firms may have been self-sufficient when they entered the program.⁹

While some firms might not have had a genuine requirement for Section 8(a) assistance to become self-sufficient at optimum size, some firms were also entered into the program which could not be helped by it. According to the Administrator of the Small Business Administration:

In the early years of program operation, there was, perhaps too little attention given to the selection of firms for program participation. As a consequence, SBA's 8(a) portfolio included firms which the program could not significantly assist. There are several factors which identify this type of firm: (1) absence of the availability of suitable contracting opportunities; (2) a disproportionate number of firms approved in relation to the potential market for their collective services or product; (3) lack of interest in the program; (4) lack of potential management and technical skills; (5) financial

⁷General Accounting Office, op. cit., p. 2.

⁸Testimony, Administrator, Small Business Administration, Government Minority Enterprise Programs, op. cit., p. 11

⁹General Accounting Office, op. cit., p. 8.

problems that could not be resolved by SBA's resources; and (6) an unwillingness to supply SBA with requisite information.¹⁰

In its attempt to garner program support from other agencies the Small Business Administration may have actually overextended its capability to provide for self-sufficiency of firms in the program.

Dollar Volume Versus Number of Contracts

One of the factors which determines whether a firm will survive and become competitive in the marketplace is its sales. Some new businessmen will choose to produce a good or service which is not conducive to survival in their localities. Despite the best efforts at screening by whatever experts, some will be inept at management or change their commitment to business goals. The Section 8(a) Program could not be expected to help those disadvantaged businessmen achieve self-sufficiency who should not have been in the program because of personal or market miscalculations. Too many contracts in too short a time period could jeopardize the Section 8(a) contractor's ability to develop the private market which would have to sustain the firm after it had graduated from the Section 8(a)

¹⁰U.S., Congress, Senate, Select Committee on Small Business, Small Business Administration 8(a) Contract Procurement Program, Hearing, 94th Cong., 2nd Sess., January 21, 1976 (Washington: Government Printing Office, 1976), p. 303.

Program. On the other hand, insufficient contracts could delay the achievement of self-sufficiency.

The dollar volume of contracts awarded and the number of contracts awarded increased in every year between 1968 and 1975. This contrasts with the average contract amount which has varied considerably with a downward, then slightly upward trend. Table IV summarizes the history of the program. The number of contracts awarded decreased for the first time in fiscal year 1975.¹¹ This decrease was consciously instituted at SBA in an effort to provide more management and marketing assistance to Section 8(a) firms to help them develop their commercial and competitive government procurement markets.¹² The Small Business Administration still uses the business plan as the device to promote self-sufficiency but provides more of the traditional SBA services to Section 8(a) client firms.

¹¹Ibid., p. 221.

¹²Ibid., pp. 304-5.

TABLE IV
SUMMARY OF SECTION 8(a) CONTRACT AWARDS
FISCAL YEAR 1968 TO 1974

Fiscal Year	Contracts Awarded	Dollar Value of Contracts	Average Contract Amount	Companies Awarded Contracts
1968	8	\$10,493,524	\$1,311,690	7
1969	28	8,857,771	316,348	21
1970	199	22,520,209	131,166	145
1971	813	68,624,077	84,654	506
1972	1646	142,319,905	86,464	924
1973	1976	212,963,115	107,774	1097
1974	2246	272,141,414	121,167	1132

Source: U.S., Small Business Administration, Status Report of 8(a) Contracts: June 1974.

Types of Contracts

The types of Section 8(a) contracts awarded are important in determining the business development prospects for disadvantaged firms. The type of contract available for award impacts on the capability of a firm to survive in the post-Section 8(a) environment at the same time that it affects the current product choice. The incentive feature of a Section 8(a) contract which is set aside noncompetitively may influence a contractor to expand into a product line which is undesirable from a competitive market standpoint and which may not be in the best interest of community economic

development. In addition the contractor's ability to maintain his business in future years may depend critically upon the continued existence of a particular contract requirement and his ability to bid successfully on it.

Minority-owned businesses have had a tendency to be less sophisticated than business as a whole because of capital availability, management potential and market access.¹³ The Section 8(a) Program attempted to capitalize on the business experience which did exist by providing contracts which did not require sophisticated equipment or managerial expertise in their performance. Consequently the majority of contracts awarded under the program have been service or small construction contracts. Table V depicts the number and cumulative dollar amounts awarded for the last three fiscal years. The average contract amount, by contract type, shown in Table V is 148,249 dollars for service contracts; 76,585 dollars for construction contracts; and 540,238 dollars for manufacturing and supply contracts. There were seven times as many service as manufacturing contracts awarded but manufacturing contracts contributed three times as much per contract to business sales volume.

¹³Edward H. Jones, Blacks in Business (New York: Grosset and Dunlap Company, 1971), Cha. 5-6.

TABLE V
SECTION 8(a) CONTRACT AWARDS, BY TYPE, 1974-1976

Fiscal Year	Service Contracts		Construction Contracts		Manufacturing and Supply Contracts	
	Number	Amount	Number	Amount	Number	Amount
1974	1250	46,668,112	888	64,763,986	167	66,867,617
1975	1098	163,973,875	886	63,403,874	157	93,439,509
1976*	354	89,927,035	211	23,852,610	37	29,316,258
TOTALS	2702	400,569,022	1985	152,020,470	351	189,623,384

Source: U.S., Senate, Select Committee on Small Business, Small Business Administration 8(a) Contract Procurement Program, Hearing, January 21, 1976 (Washington: Government Printing Office, 1976), pp. 218-20.

*The FY 1976 figures are for July 1, 1975 to December 31, 1975 only.

Analysis of Program Effectiveness

The remainder of the present chapter presents the quantitative portion of the study. The data used to evaluate the effectiveness of the program were obtained from Small Business Administration reports on the Section 8(a) Program, Department of the Air Force data tapes on contract awards, and Bureau of the Census publications on population. The values for variables generated from these sources are used to conduct a multiple linear regression analysis to indicate the economic development effectiveness of the Section 8(a) Program.

The complete array of data could not be found for all contracts written by the Department of the Air Force to support the Section 8(a) Program. Some data were not available on 32 contracts awarded to 19 firms. These contracts were awarded in cities for which the Bureau of the Census did not provide statistics on population. Although the primary data source for population was the 1970 General Social and Economic Characteristics PC(1) series for each state published by the Bureau of the Census, the Census Bureau's 1973 County and City Data Book was used when information for a city could not be found in the former source. The cities for which information could not be found apparently did not exist when statistics were compiled for the County and City Data Book. For the sake of comparability none of the data were analyzed for contractors (or contracts) when population data were not available.

The Model

The minority group sector of the United States is underdeveloped from the standpoint of income which accrues to it. The Section 8(a) Program was implemented to overcome one aspect of that underdevelopment--underrepresentation of minority group members in prosperous business enterprises. The Section 8(a) Program is designed to provide guaranteed sales of sufficient quantity to increase the likelihood that individual minority-owned businesses will survive and to improve the chances for their owners to enter the economic mainstream.

The analysis of Section 8(a) Program effectiveness considers the relationship between twelve variables associated with the Section 8(a) contracts written by Department of the Air Force procurement offices between fiscal years 1968 and 1976 and awarded to disadvantaged firms. A multiple regression analysis was performed on these contracting firms and on individual contract awards to determine the relationship between total amount of award to the firms and the other ten variables; and dollar value of contracts and the other eleven variables, including total awards to each firm. The regression equations attempt to quantify the effectiveness of the Section 8(a) Program as an economic development tool.

The regression equation postulates a linear relationship between the variables and takes the form:

Development

$$\text{Effectiveness} \cong S = f(N, Y, T, D, G, M, V, P, C, R) \quad (\text{Equation 1})$$

Where:

S = Total dollar amount of Air Force Section 8(a) contracts awarded this firm since FY 1968

N = Number of Air Force Section 8(a) contracts awarded the firm

Y = Fiscal year in which the first Section 8(a) contract was awarded the firm

T = Type of contracting done by the firm:

1 = Manufacturing

2 = Service

3 = Construction

D = Percentage of the population nonwhite in the city of contract award

G = Minority group of the firm

1 = Black

2 = Puerto Rican

3 = American Indian

4 = Spanish American

5 = Asian

6 = Eskimos and Aluets

7 = Undetermined (None in the sample analyzed)

8 = Others - including whites

M = Total number of Section 8(a) contracts awarded this firm by all other federal agencies

V = Total dollar value of Section 8(a) contracts awarded this firm by all other federal agencies

P = Population size in 1970 of the city of award

C = Business class of the firm

1 = Manufacturing

2 = Construction

3 = Services

R = Small Business Administration region in which the firm is located (Regions are numbered 1 through 10)

An alternative formulation of the model specifies the dependent variable as the dollar amount of each Section 8(a) contract written. In this formulation, (Y) is the year of contract award. The other variables in the equation remain the same and (S) is an independent variable. The alternative formulation is expressed as:

Development

Effectiveness $\approx A = f(S, N, Y, T, D, G, M, V, P, C, R)$ (Equation 2)

Where: A = Dollar amount of this contract

There were 365 observations on Section 8(a) firms when the regression equation was as specified in equation 1. The number of observations increased to 935 when the regression equation was as specified in equation 2. The latter formulation uses the dollar value of each Section 8(a) contract awarded by the Air Force from program implementation through November 30, 1975 as the dependent variable, while the former formulation uses the total dollar value of Air Force Section 8(a)

contracts awarded to each firm as the dependent variable for the same period.

The linear form of the regression equations may be expressed as follows:

For equation 1, $S = \text{Alpha} + b_1N + b_2Y + b_3T + b_4D + b_5G + b_6M + b_7V + b_8P + b_9C + b_{10}R + u$;

For equation 2; $A = \text{Alpha} + b_1S + b_2N + b_3Y + b_4T + b_5D + b_6G + b_7M + b_8V + b_9P + b_{10}C + b_{11}R + u$.

Where: Alpha is the intercept term, b_1 through b_{11} are beta coefficients, and u is a randomly distributed error term with mean zero.

Theoretical basis of the model. The problems that minority businessmen have in generating sufficient sales to support a business and raising the required revenue to meet operating expenses are directly alleviated by the Section 8(a) Program. Sales are funneled directly to the business with the consequence that they reduce uncertainty about the disposition of output prior to production. Minority-owned firms face difficulties in growing to optimum size given their market limitations. This program insures sales volume through government contracts and thereby serves to stabilize business receipts sufficiently to permit growth.

Total Air Force contract support for Section 8(a) firms. One of the dependent variables in this analysis is the total dollar contract amount awarded each contractor through the Small

Business Administration by the Department of the Air Force (S). This value is considered one measure of the effectiveness of the Section 8(a) Program. If sales which would otherwise have gone to nonminority group firms are diverted to minority group firms it should strengthen the business prospects of the latter relative to the former, other things equal. The dollar value of the total contract amount becomes sales to the firm. While larger sales volume does not guarantee success, it provides one of the success ingredients most often lacking in minority small business enterprises. Total dollar amount of contracts awarded (S) could be the difference between survival and failure of the business enterprise.

Amount of individual contract awards. The other dependent variable used in this analysis is the dollar value of each Section 8(a) contract awarded through the Small Business Administration by the Department of the Air Force (A). This value is likewise considered one measure of the effectiveness of the Section 8(a) Program. Each Section 8(a) contract has economic development potential for firms in the program. While total contract amount (S) measures the effectiveness of the program from the standpoint of the firm, the amount of individual contract awards (A) measures the development effectiveness of the program from a disaggregated perspective.

Number of Air Force contracts awarded. The number of contracts awarded a firm (N) over the life of the program contributes

directly to business activity. A contract award might be crucial to the continued existence of a firm at certain times. The Small Business Administration's Business Development Specialist is in the best position to determine what this critical timing is. He should ensure that sufficient work is likely to be available to provide contracts for the firm before entering it in the Section 8(a) Program.

Fiscal year of first contract award. The fiscal year of first contract award (equation 1) or fiscal year in which this contract was awarded (equation 2) (Y) is important for separate analysis. The trend of contract types and amounts are indicative of the strength of commitment to the success of the program by contracting officers and SBA personnel. It should be expected that the number and amount of awards, and consequently, the individual and total Air Force contribution to the program would increase as it becomes established and is perceived as a permanent fixture by procurement contracting officers.

Type of contracting done by the firm. The type of contract (T) contributes to the effectiveness of the Section 8(a) Program through its impact in determining the types of firms in the program. Manufacturing enterprises are likely to be the most desirable types of businesses for minority group members to engage in both because of the potential versatility in meeting general production requirements and because they might have the greatest growth potential. Contract construction appears to

offer the next best alternative. Service contracts offer limited opportunities for long term remuneration because of the limitations in market size. Manufacturing contracts also tend to be larger in size than those for construction or services.

Nonwhite population. Proportion of the population of the city of award which is nonwhite (D) should affect the amount of contract dollars awarded to minority groups under Section 8(a) because of the availability of minority group members who could own businesses. Unless the propensity to own businesses among this group is perverse in a particular location, the value of Air Force contracts awarded should increase with increases in this variable. The dollar amount of contracts awarded should also be positively related to this variable since an increasing business population should produce more highly competent businessmen.

Minority group of the contractor. The minority group of the contracting firm (G) is expected to impact on the dollar value of contracts for primarily sociological reasons. The perception of the minority groups in an area as more or less responsible and the amount of institutional contact which has taken place between minority group members and members of the majority race will go a long way toward determining to what extent contracts will be set-aside for the program. In addition the history of business ownership among minority groups in the area will have an impact. Nonghetto businesses might be more likely

to be perceived as being capable than ghetto businesses because there has been less institutional contact between ghetto businesses and the procurement establishment.

Number of non-Air Force contracts. The total number of Section 8(a) contracts awarded by other federal agencies (M) is closely related to the number of Air Force contracts. A firm will probably be better off if it receives contract awards from several, rather than just one government agency since the chances of receipt of a contract when it is most needed will be improved. Quality performance for one agency is likely to lead to an increase in both the number and dollar value of contracts for Section 8(a) firms.

Dollar value of non-Air Force contracts. The total dollar value of all Section 8(a) contracts from other federal agencies (V) is a corollary of (M). This variable permits an assessment of the non-Air Force monetary impact of the program on firms which have been awarded Air Force contracts.

Population size. The population of the city of award (P) improves the chances that Section 8(a) contracts will be awarded by increasing the availability of businesses willing to perform contract work. This variable assumes a relationship between business participation and sophistication, and population size.

Business class. The business class of the contractor (C) is a corollary of the type of contract (T). The difference

between the variables is that a contractor assigned to one business class may perform contracts of another type. For example, a contract construction firm may perform a service contract such as building maintenance (janitorial).

Region. The region of contract award (R) affects the amount of contract work performed through availability of minority group members and consequently minority group firms. There are relatively fewer minority group members in the northern plains and Northwest areas of the country. This variable is closely related to the minority group (G) of the contracting firm since different minority groups are prevalent in different sections of the country.

Analysis of Results

Overall results. Regression analyses were conducted using equation 1 and equation 2, above. The overall results of the model were statistically significant for each specification of the dependent variable. The R^2 value obtained was .273 when S was specified as the dependent variable (equation 1), and .307 when A was so specified (equation 2). Both dependent variables were sensitive to changes in the system of independent variables included in the model.

The F-ratio tests the null hypothesis, $H_0:R = 0$. That is, that the multiple correlation is zero in the population from which the sample was drawn. The F-test statistic

showed statistical significance in each formulation of the model. The F- test ratio was statistically significant at the 99 percent confidence level for each specification of the dependent variable. The F- test ratio was 5.10 for equation 1, and 15.51 for equation 2. The critical number for a sample of this size and number of degrees of freedom at the 99 percent confidence level is 2.70 for equation 1 and 2.66 for equation 2. The overall regression results led to rejection of the null hypothesis. That is, the overall system of independent variables were determined to be significant in explaining deviations of both dependent variables from their mean values.

Results for individual independent variables. Dummy variables were created for type of contract (T), minority group of the Section 8(a) firm (G), business class of the firm (C), and region of contract award (R) because the differences between the sub-categories of these variables were non-cardinal. The regression results and theoretical expectation regarding the sign of the beta coefficient will be discussed for each independent variable. A t-statistic is computed for each independent variable. The t-test statistic is used to determine the statistical significance of independent variables in the regression equations. The t-test statistic is computed as

beta divided by the standard error of beta and is considered significant when the absolute value of this ratio exceeds two (2).¹⁴

(1) Number of Air Force Section 8(a) Contracts (N).

The beta values for this variable were statistically significant for both specifications of the dependent variable using the t-test statistic. A positive sign was expected for both regression equations. However, the sign was negative for equation 2 indicating that the dollar amount of contracts decreased as the number of contracts increased. This result probably obtained from the fact that large contracts are not frequently awarded in the program and when they are awarded, the awards are for lengthy periods.

(2) Year of first Section 8(a) contract award (Y)

for equation 1 and year in which this contract was awarded (Y) for equation 2. The beta values for this variable were statistically significant for both specifications of the dependent variable. The positive sign on the beta coefficient for equation 2 is expected since as firms demonstrate their capabilities in performing contracts in the program, procurement officers would be expected to become less apprehensive in awarding contracts. The negative sign on the beta coefficient

¹⁴See J. Johnston, Econometric Methods (2nd ed.; New York: McGraw-Hill Book Company, 1972), Cha. 2; see also Norman H. Nie and others, Statistical Package for the Social Sciences (2nd ed.; McGraw-Hill Book Company, 1975), pp. 325-40.

for equation 1 is likewise expected since firms which entered the program late would not be expected to have been awarded as much in total contract amount as firms which began earlier.

(3) Percentage of the population which was nonwhite in the city of award (D). The beta values for this variable were not statistically significant for either specification of the dependent variable. In addition, the coefficients had negative signs which indicates that there was an inverse relationship between this variable and each dependent variable. This suggests that the Section 8(a) Program probably did not take full advantage of contracting opportunities afforded in areas with large concentrations of minority group members to the detriment of the minority group economic development contribution of the program.

(4) Number of Section 8(a) contracts awarded the firm by all other federal agencies (M). The beta value for this variable was not statistically significant for equation 1, but was statistically significant for equation 2. The coefficient carried a negative sign in both equations which suggests for equation 1 that one agency tended to provide the contracts which made up the total contract value for firms in the program; and for equation 2 that contracts were awarded by other agencies less frequently as the dollar amount of Air Force contracts increased.

(5) Dollar value of Section 8(a) contracts awarded to this firm by other federal agencies (V). The beta values for

this variable were statistically significant for both specifications of the dependent variable. The beta values were positively related to the dependent variables. This result was expected since a good reputation should increase confidence in the firm's ability to perform and thus lead to larger contract awards.

(6) Population of the city of award in 1970 (P). The beta values for this variable were not statistically significant for either specification of the dependent variable. The sign of the beta coefficient was positive for equation 1, but negative for equation 2.

(7) Type of contract (T). This variable was subdivided into the three types of contracts and analyzed as three dummy variables. The variable T3 was used as the reference category. The beta values for T1 and T2 were statistically significant for equation 1; only T2 was statistically significant for equation 2. The beta coefficient was positive for both specifications of the dependent variable.

(8) Minority group of the contracting firm (G). This variable was subdivided into the eight racial groups and analyzed as eight dummy variables. The variable G1 was used as the reference category. (Category G7 was also left out of the analysis since it had no contract awards.) The beta value for G4 was the only statistically significant variable for equation 1. Both G3 and G5 were statistically significant

for equation 2. The beta values for all G values, except G2, had positive signs for equation 1. Only G3, G4 and G8 had positive signs for equation 2.

(9) Business class of the contractor (C). This variable was subdivided into the three business classes and analyzed as three dummy variables. The variable C3 was used as the reference category. The beta values for neither C1 nor C2 were statistically significant for either specification of the model. The beta values for C1 were positive and those for C2 negative for both specifications of the model.

(10) Region of contract award (R). This variable was subdivided into the ten Small Business Administration regions and analyzed as ten dummy variables. The variable R1 was used as the reference category. None of the beta values for the dummy variables (R2 to R10) were statistically significant for either specification of the model. The beta values were negative for R3, R8 and R10 for equation 1; they were negative for all except R4 and R6 for equation 2.

(11) Total dollar amount of Air Force Section 8(a) contracts awarded the firm (S). The beta value for this variable was statistically significant when A was specified as the dependent variable. The beta coefficient was positively related to the dependent variable.

Observations on Program Effectiveness

The analysis presented here suggests that the Section 8(a) Program has been somewhat effective in alleviating one aspect of the economic underdevelopment problem of the United States minority group sector. It has provided support which helps the firms in the program. On the other hand the program has helped a limited number of minority group businesses.

The program does not appear to provide either dollar amount of contracts or total contract value which is responsive to firms located in areas where minority group members are concentrated. It should be noted that agencies whose operating locations are in large cities more often than Air Force bases would probably have a different distribution of contracts. Still, if SBA concentrated its efforts on increasing awards in areas of high minority group concentration it might better serve the cause of minority group economic development.

An attempt to involve several agencies in the contracting needs of firms in the program would probably increase the economic development contribution of the program. While SBA is limited in the number of contracts which it can make available to firms, greater effort to involve several agencies should make adequate contract support more readily attainable for its client firms.

Section 8(a) Program Cost to the Air Force

As noted in chapter one, the Section 8(a) Program is one of several programs appended to the procurement process which are designed to accomplish socioeconomic objectives. The matter of the costs of such programs has been debated in military circles for several years. This was especially true over the last few years when constant dollar defense expenditures have tended to decline.¹⁵ This section of the study attempts to estimate the cost of the program to the Air Force, and by implication to other federal agencies. The subsequent cost analysis assumes that the contract price negotiated with the Small Business Administration under Section 8(a) is fair and reasonable and that contracts are terminated so as to minimize costs to the Air Force to the same extent under Section 8(a) as for other contracts in cases of substandard performance.

An analysis was conducted of the cost to the Air Force of Section 8(a) Program implementation. The analysis was based upon a survey questionnaire which was sent to the Base Procurement Office at eighty one active Air Force installations.¹⁶ After follow-up on the questionnaire a total of seventy six questionnaire answer sheets were returned. This analysis was

¹⁵Barry M. Blackman, Edward M. Gramlick, and Robert W. Hartman, Setting National Priorities: The 1976 Budget (Washington: The Brookings Institution, 1975), p. 91.

¹⁶A copy of the questionnaire is included as Appendix D.

designed to construct a rough estimate of the cost of the program to the federal agencies which awarded Section 8(a) contracts.

The questionnaire contained 39 questions which asked for responses primarily on a fiscal year basis so that the "phase-in" features of the program could be discerned. It was also expected that resource commitment would increase in the later years of program operation.

The questionnaire began by trying to gather information necessary for a determination of agency expenditures in support of the Section 8(a) Program. The first eleven questions were committed to this goal. It became necessary to make assumptions about the within-grade distribution of personnel and percent of time spent because of data analysis limitations. The mid-point of the modal classes for grade and time spent on the Section 8(a) Program were used as the measures to obtain cost figures.

Question number 1 asked for the grade of the individual directly responsible for operation of the program at the local level (the Small Business Specialist). The modal response to this question was General Schedule Employee grade twelve (GS 12). The midpoint of the salary schedule for that grade before October 1, 1976 was GS 12, step 5 at an annual salary of 21,970 dollars.

Question numbers 2 through 9 requested information on the percentage of his/her time spent by the Small Business

Specialist on the Section 8(a) Program for each fiscal year from 1969 through 1976. The modal response was "0-5 percent" for each fiscal year. Fifty four procurement offices responded in this category for 1969 and the number steadily decreased to thirty nine for 1976. The decrease in the "0-5 percent" category was due primarily to an increase in the "6-16 percent" category. The midpoint of the modal class is 2.5 percent.

In addition, the information obtained from question numbers 10 and 11 provides a measure of the grade and time spent by the assistant to the Small Business Specialist. The modal grade for assistants was GS 9-10 (\$17,523) and the modal time spent was 0-5 percent. When this information is combined with that obtained from question number 1, a summary of program cost to the eighty one Air Force installations surveyed is as follows:

Salary paid to Small Business Specialists	\$21,970
Percent of time spent on Section	
8(a) procurement	2.5
Salary paid to other procurement	
personnel	\$17,523
Percent of time spent on Section	
8(a) procurement	2.5;

Estimated dollar cost of time spent per installation per year =
 $(\$21,970 \times .025) + (\$17,523 \times .025) = \$549.25 + \$438.08 = \$987.33.$

The aggregate dollar cost of the program to the Air Force is
 then: $\$987.33 \times 81 = \$79,973.73.$

While this estimate is not precise it does indicate the approximate dollar cost to the Air Force of participation in the Section 8(a) Program. Since the pay grades and amount of time spent increases more slowly than contract awards, the cost per contract decreases as the number of contracts increase.

The nonmonetary costs of the Section 8(a) Program are more difficult to estimate. The questionnaire asked the respondents to give their subjective appraisals of the cost of the program to the Air Force and to evaluate whether the program had adverse impacts on the primary mission. When the respondents were asked to rate the program on a scale from 1 to 10 in terms of excessive cost to the procurement process, relative to normal procurement, the responses were bimodal. Nineteen percent rated it "5" and 24 percent rated it "7." It is likely that procurement personnel would have rated any program designed to accomplish socioeconomic goals through the procurement process fairly high. When asked if the program had adverse impacts on the missions of their organizations and the mission of the Air Force, 72 and 74 percent respectively thought it did not. Fifty seven percent thought that the program had more favorable than unfavorable impacts.

CHAPTER VII

SUMMARY AND CONCLUSIONS

This study has analyzed the economic development aspects and cost to the Department of the Air Force of the implementation of the Section 8(a) Program. The program was pressed into service to counter the persistent tendency for nonwhite minority group members to own less businesses proportionately and to receive less income from businesses which they did own than white members of the society. The Section 8(a) Program was designed to promote economic development among nonwhite minority group members by increasing their opportunities to participate in the mainstream of the American economy.

This study began by recounting the conditions which gave rise to the need for national socioeconomic policies to combat minority group underdevelopment in the United States. The minority group underdevelopment problem goes beyond the poverty problem and the issues of the functional or size distribution of income. Minority group members receive less income in all categories because their "life chances" for economic success are less than average. Nonwhite minority group members experience inferior economic positions on

virtually all counts relevant to measurement of economic success in American society.¹

For purposes of this study an underdeveloped sector is defined so as to include members of any group with common, identifiable characteristics which experiences incomes lower than average for the society. Defined in this manner, the minority group sector of the United States, though part of an advanced economy, exhibit the underdevelopment characteristics of underdeveloped countries. One of the primary indicators of its underdevelopment is the persistence of an income level lower than that for the society as a whole. The reasons for low income are undoubtedly the partial result of the interactions of many social and economic variables. This study concludes that a part of the income divergence between minority group and majority group races is the result of discrimination which has resulted in restricted access for minority group members to institutions and the more remunerative of the society's economic activities. One of the activities to which access has been limited because of historical circumstance or institutional discrimination is business ownership. Several writers have concluded that the elimination of discrimination would result in a larger Gross National Product for the society.

¹See Thomas Mayer, "The Position and Progress of Black America," *Economics*, ed. David Mermelstein (New York: Random House, Inc., 1970), pp. 297-307.

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In addition a reduction in discrimination should result in decreased public expenditures for income maintenance. The market will not rectify income disparity to the extent that market imperfections or monopoly elements are present in the economy.

Income disparity based upon limited institutional and market access exhibit the characteristics of a public good since an increase in such access increases the competition for, and thus threatens, individual economic positions. Although there would be an increase in economic welfare (income) if income disparity were reduced, the incentive to do so only exists at the national level because only at that level are the externalities associated with income disparity captured.

A review of economic development theory indicates that many of the problems which confront the majority of persons in underdeveloped countries also confront the majority of persons in underdeveloped sectors. Their economic positions are influenced by a series of variables which interact in a circular causation pattern so as to influence the tendency for their incomes to remain low. Some of these variables are human and physical capital formation, entrepreneurial skill, self-perception, and socioeconomic mobility. The primary attempts to combat underdevelopment in the minority group sector of the United States have been through public policy programs designed to increase institutional access by promoting equality of opportunity and minority group business ownership.

This study has been primarily concerned with the economic development impact of one facet of the program which attempts to promote minority business ownership. The Section 8(a) Program attempts to promote minority business enterprise by diverting government contracts for goods and services to firms which are owned and controlled by socially and economically disadvantaged persons (primarily minority group members). The Minority Business Enterprise Program calls for commitment of resources by the Small Business Administration and the Office of Minority Business Enterprise to provide management and technical assistance as well as financial assistance and training to minority owned firms to help them overcome the obstacles to growth and survival.

The Minority Business Enterprise Program (of which the Section 8(a) Program is a part) was an outgrowth of an awareness that minority group members owned and controlled an exceptionally small proportion of the economic resources of the country. It evolved out of the concept of black capitalism which sought to help overcome the institutional obstacles to survival faced by black businesses. These obstacles are even greater for minority group small businessmen than for small businessmen as a whole. Minority capitalism has not been very successful as an economic development tool. The conventional minority owned firm has had low employment and receipt size owing partially to a lack of institutional access and a mainstream entrepreneurial tradition. The institutional

barriers which have confronted minority businessmen include sources of credit and finance, entrepreneurial education and training opportunities, and distribution channels. In order to be successful in creating viable businesses and raising income for the minority group sector, minority capitalism might have to be complemented by activities which are compensatory in nature and which are designed to account for past overt and institutional discrimination in the ability to obtain the necessary requisites for a reasonable chance for success on the part of minority group firms.

The major thrust in implementation of the Section 8(a) Program came in response to the racial unrest in the nation's ghetto areas between 1965 and 1968. That racial unrest was the result of a perception by ghetto dwellers that they had no real stake and no voice in the economic decision of the country. The decision was made to redistribute the proceeds of the massive federal procurement process so as to increase the share of expenditures going to disadvantaged businessmen. The procurement process has been used as a device to accomplish socioeconomic policy goals since 1947. The Section 8(a) authority was first used in 1968 as a means to increase employment opportunities for disadvantaged ghetto area residents by giving preference in contract awards to firms which hired them; the authority has been used since 1969 as a device to promote viable minority owned businesses.

Data were collected from Small Business Administration, Department of the Air Force, and Bureau of the Census sources on Air Force Section 8(a) contracts awarded between fiscal years 1968 and 1976. A multiple linear regression analysis was conducted on these data to determine whether the Section 8(a) Program has contributed to the economic development of the minority group sector. The total dollar value of Air Force contract awards to each firm and the dollar value of each Air Force contract awarded in the Section 8(a) Program were used as surrogates (dependent variables) for the economic development effectiveness of the program. The system of independent variables in the regression equation led to the conclusion that the Section 8(a) Program has been an effective economic development tool. Both dependent variables were particularly sensitive to changes in the number of Air Force contracts awarded and the dollar volume of contracts awarded by other federal agencies. This indicates that Small Business Administration efforts to increase the number and size of contracts in the early years of program operation were not misguided. On the other hand, a continuation of current program emphasis of providing the full range of Small Business Administration services to a smaller number of Section 8(a) firms should prove beneficial to firms in the program. This should permit a better screening of the existence of procurement requirements to satisfy the needs of Section 8(a) firms and provide more thorough knowledge of the capabilities and

limitations of the firms. Some of the firms in the program will fail or not be helped toward viability, but this is probably true for firms in the universe of small businesses which receive procurement assistance from the Small Business Administration. The program should not be expected to do more (nor less) than provide an equal opportunity to succeed or fail on their merits for disadvantaged business firms.

The Section 8(a) Program alone does not appear to be inordinately expensive to the procurement apparatus of federal agencies which participate in it. It is likely that the total of socioeconomic programs implemented through the procurement process is taxing to that process. The political decision process determines which socioeconomic policies are, and which are not, sufficiently important to the national interest to be carried out through procurement and national defense mechanisms. Programs similar to the Section 8(a) Program certainly do detract from the capability of federal procuring agencies to devote all of their effort to carrying out their primary objectives. For accounting purposes, it seems appropriate that national policies should carry labels which permit their identification with various national goals.

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APPENDIX

APPENDIX A

TEXT OF SECTION 8(a), SMALL BUSINESS ACT

Section 8(a) of Public Law 85-536 (Small Business Act)
as amended reads:

Sec. 8(a). It shall be the duty of the [Small Business] Administration and it is hereby empowered, whenever it determines such action is necessary--

(1) to enter into contracts with the United States Government and any department, agency, or officer thereof having procurement powers obligating the Administration to furnish articles, equipment, supplies, or materials to the Government. In any case in which the Administration certifies to any officer of the Government having procurement powers that the Administration is competent to perform any specific Government Procurement Contract to be let by any such officer, such officer shall be authorized in his discretion to let such procurement contract to the Administration upon such terms and conditions as may be agreed upon between the Administration and the procurement officer; and

(2) to arrange for the performance of such contracts by negotiating or otherwise letting subcontracts to small business concerns or others for the manufacture, supply, or assembly of such articles, equipment, supplies, or materials, or parts thereof, or servicing or processing in connection therewith, or such management services as may be necessary to enable the Administration to perform such contracts.

APPENDIX B

SOCIOECONOMIC PROGRAMS IMPLEMENTED
THROUGH THE PROCUREMENT PROCESS

The following brief descriptions of socioeconomic programs carried out through the Federal procurement processes are provided to acquaint the reader with this area of public policy. The Small Business Set-Aside Program is mandated by Public Law 85-536 and is intended to assure that small business concerns receive a "fair" proportion of the total purchases and contracts for property and services for the Federal Government.

The Buy American Act was enacted to explicitly limit purchases of goods and services for public use to those mined, manufactured or produced by domestic businesses unless it can be demonstrated that it is not in the public interest to purchase them from domestic sources or the cost of purchasing from domestic sources is unreasonable.

The Davis Bacon Act requires that contractors and subcontractors awarded contracts in excess of 2,000 dollars be required to pay laborers who work on the site at least the minimum prevailing wage rate for the area. The contract must include a stipulation that this act will be complied with.

The Walsh-Healy Act stipulates conditions of employment for all governmental contracts written for more than 10,000

dollars. The contract must stipulate and the contractor must comply with the following provisions of law:

- (1) The contractor must be a manufacturer or regular dealer in products used in the performance of the contract;
- (2) The contractor must pay not less than the minimum wage to employees engaged in performing the contract;
- (3) No contractor employee may be required to work more than eight hours a day and forty hours a week without compensation of one and one-half times his normal rate of pay.
- (4) Male employees engaged in fulfilling the contract must be at least sixteen years old and females at least eighteen years old, and no convict labor may be used.
- (5) Contractors must ensure that the work environment is neither unsafe, unsanitary, nor hazardous.

The Service Contract Act provides that every contract in excess of 2,500 dollars for services to the Government must specify:

- (1) That the minimum wage will be paid each employee engaged in contract performance.
- (2) That fringe benefits be furnished employees inclusive of hospital or medical care, death or retirement pensions, compensation for occupational injuries or illness or insurance to provide any of these; unemployment benefits, life insurance and vacation and holiday pay.

(3) That the work environment must be free of conditions which are unsanitary or hazardous to the health or safety of employees.

APPENDIX C

COURT CHALLENGES TO THE SECTION 8(a) PROGRAM

The diversion of contracts from other small businesses to the Section 8(a) Program resulted in a loss of business to non-Section 8(a) firms which they sought to recapture through civil court actions. The Section 8(a) Program had been challenged in court twenty one times as of October 3, 1974.¹ Most of these challenges were based on the assertion that the program was unconstitutional in that it denied equal protection under the Fifth Amendment to other than nonwhite minority group members. The case involving Ray Ballie Trash Hauling, Inc. was the major court case in that it went through the entire appeal procedure to the United States Supreme Court. The appeal process for this case is recounted in this appendix.

The Small Business Administration (SBA) secured a Section 8(a) contract for collection and removal of refuse from Homestead Air Force Base for a period of two years beginning on July 1, 1970. The Small Business Administration negotiated a similar subcontract with All American Waste, Inc. for performance of the services in the prime contract. Upon learning of SBA intent to award the contract to All American

¹U.S., Congress, House, Permanent Select Committee on Small Business, Subcommittee on Minority Small Business Enterprise and Franchising, Government Minority Enterprise Programs--Fiscal Year 1974, Hearing, 93rd Cong., 1st Sess., October 3, 1973 (Washington: Government Printing Office, 1973), pp. 21-2.

Waste for the second consecutive year, Ray Ballie Trash Hauling, Inc. and four other contractors engaged in similar work demanded of SBA that they be permitted to bid on the contract. The plaintiffs initiated court action against the Administrator of the Small Business Administration, the Secretary of the Department of the Air Force, the Homestead Air Force Base Procurement Officer and All American Waste, Inc. on June 29, 1971 after SBA executed the second subcontract with All American Waste, Inc. The plaintiffs sought a permanent injunction enjoining SBA from letting the Homestead AFB contract without competitive bidding. The District Court of the Southern District of Florida issued an order that the prior contract with All American be extended for thirty days. Later orders extended this period until judgment on the merits of the case.

On October 29, 1971 the District Court declared the second contract to be unlawful and illegal and ordered that the Homestead Air Force Base services be contracted for, using maximum competition feasible among the plaintiffs and similarly situated small business, as soon as possible.

The case was appealed to the Fifth Circuit Court of Appeals which issued its judgment on January 5, 1973. The Court had to first decide whether the case was moot (All American did not perform satisfactorily and the second contract had been terminated. A contract was then negotiated with one of the plaintiffs for the remainder of FY 1972.) The Court

determined that the case was not moot since SBA intended to continue the Section 8(a) Program. The Appeal Court ruling states that: "The district court held that the Section 8(a) program is not authorized by statute and violates the equal protection clause of the Fifth Amendment. We Reverse."

The case was appealed to the United States Supreme Court from the Fifth Circuit Court of Appeals. The Supreme Court refused to hear the case in 1974, thus letting the Appeals Court ruling stand.

APPENDIX D

QUESTIONNAIRE

COST TO THE AIR FORCE OF PARTICIPATING
IN THE SECTION 8(a) PROGRAM

This survey is designed to gather information which will permit an assessment of the Section 8(a) Minority Enterprise Procurement Program. The information requested, when combined with information extracted from a data file of Air Force Section 8(a) contracts, will permit a researcher to assess the probable cost and effectiveness of the program from an Air Force point of view. The information gathered from the survey will attempt to measure the yearly cost of the program to the Air Force. The information requested will be aggregated in frequency distributions and will not be divulged in such a manner as to permit identification of your base or anyone associated with your procurement activity. The same questionnaire is being sent to each Air Force Procurement Office in the Continental United States. It is extremely important to the research results that responses be received from 100 percent of the Procurement Offices. Please attempt to answer each question in the form asked. However, you are encouraged to *emphly* your answer to any question on the last page of the questionnaire. Feel free to use additional pages if more space is needed.

The answers to the questions asked in this survey will be computerized using Optical Character Reader (OCR) in the interest of decreasing the amount of time required to answer the questions and increasing the accuracy of data tabulation. Please read the instructions at the top of the enclosed answer sheet carefully before completing the survey.

Headquarters Air Force Military Personnel Center letter dated 22 July 1976 is quoted for your information. "The survey, Cost to the Air Force of Participating in the Section 8(a) Program, and related letter of request have been reviewed and approved. The survey has been assigned survey control number (SCN) 76-160." This research is sponsored by the Air Force Business Research Management Center, Wright-Patterson AFB OH.

INSTRUCTIONS

1. Select the response number (0-9) which most closely corresponds with your answer for each numbered question.
2. Enter the answer number you choose on the answer sheet (OCR Form 2) opposite the same question number in accordance with the answer sheet instructions.

Question
Number

1. What is the grade of your Small Business Specialist?

0. 01-04
1. 05
2. GS-4 - GS-6
3. GS-7 - GS-8
4. GS-9
5. GS-10
6. GS-11
7. GS-12
8. GS-13
9. Over GS-13

What average percentage of his/her time did your Small Business Specialist spend in activities directly related to the Section 8(a) Program in each fiscal year? (Use the following percentage classes in your answers to questions 2 through 9)

0. 0 - 5 percent
1. 6 - 16 percent
2. 17 - 27 percent
3. 28 - 38 percent
4. 39 - 49 percent
5. 50 - 60 percent
6. 61 - 71 percent
7. 72 - 82 percent
8. 83 - 93 percent
9. 94 - 100 percent

- | | | | |
|----|---------|-------|---------|
| 2. | FY 1969 | _____ | (0 - 9) |
| 3. | FY 1970 | _____ | (0 - 9) |
| 4. | FY 1971 | _____ | (0 - 9) |
| 5. | FY 1972 | _____ | (0 - 9) |
| 6. | FY 1973 | _____ | (0 - 9) |
| 7. | FY 1974 | _____ | (0 - 9) |
| 8. | FY 1975 | _____ | (0 - 9) |
| 9. | FY 1976 | _____ | (0 - 9) |

Question
Number

10. If any person in your organization other than the Small Business Specialist has spent a significant amount of time on Section 8(a) matters, please indicate his/her grade.

0. E6 or below; GS-4 or below
1. E7 - E9
2. 01 - 03
3. 04 - 05
4. GS-4 - GS-6
5. GS-7 - GS-8
6. GS-9 - GS-10
7. GS-11
8. GS-12
9. GS-13 or over

11. Please indicate the approximate amount of time spent on Section 8(a) matters for the person discussed in question 10.

0. 0 - 5 percent
1. 6 - 14 percent
2. 15 - 23 percent
3. 24 - 32 percent
4. 33 - 41 percent
5. 42 - 50 percent
6. 51 - 59 percent
7. 60 - 68 percent
8. 69 - 77 percent
9. over 77 percent

Question
Number

Please estimate the number of Section 8(a) contracts written by your activity for each fiscal year. (Use the following number classes in your answers to questions 12 through 19)

0. 0 - 5 contracts
1. 6 - 11 contracts
2. 12 - 17 contracts
3. 18 - 23 contracts
4. 24 - 29 contracts
5. 30 - 35 contracts
6. 36 - 41 contracts
7. 42 - 47 contracts
8. 48 - 53 contracts
9. over 53 contracts

- | | | |
|-----|---------|-------|
| 12. | FY 1969 | _____ |
| 13. | FY 1970 | _____ |
| 14. | FY 1971 | _____ |
| 15. | FY 1972 | _____ |
| 16. | FY 1973 | _____ |
| 17. | FY 1974 | _____ |
| 18. | FY 1975 | _____ |
| 19. | FY 1976 | _____ |

Question
Number

How many Section 8(a) contracts written by your activity have been terminated for the good of the government in each fiscal year? (Use the following number classes in your answers to questions 20 through 27)

0. No contracts
1. 0 - 2 contracts
2. 3 - 5 contracts
3. 6 - 8 contracts
4. 9 - 11 contracts
5. 12 - 14 contracts
6. 15 - 17 contracts
7. 18 - 20 contracts
8. 21 - 23 contracts
9. over 24 contracts

- | | | |
|-----|---------|-------|
| 20. | FY 1969 | _____ |
| 21. | FY 1970 | _____ |
| 22. | FY 1971 | _____ |
| 23. | FY 1972 | _____ |
| 24. | FY 1973 | _____ |
| 25. | FY 1974 | _____ |
| 26. | FY 1975 | _____ |
| 27. | FY 1976 | _____ |

Section 8(a) business firms are similar to firms not subject to Section 8(a) in terms of size, type of product, etc. Please compare contract terminations for Section 8(a) and non-Section 8(a) firms by fiscal year. (Use the following responses in your answer to questions 28 through 35)

1. The percentage of Section 8(a) contracts terminated was exceedingly high.
2. The percentage of Section 8(a) contracts terminated was far above average.
3. The percentage of Section 8(a) contracts terminated was above average.
4. The percentage of Section 8(a) contracts terminated was slightly above average.
5. The percentage of Section 8(a) contracts terminated was about the same.

Question
Number

6. The percentage of Section 8(a) contracts terminated was slightly below average.
7. The percentage of Section 8(a) contracts terminated was below average.
8. The percentage of Section 8(a) contracts terminated was far below average.
9. The percentage of Section 8(a) contracts terminated was exceedingly low.

- | | | |
|-----|---------|-------|
| 28. | FY 1969 | _____ |
| 29. | FY 1970 | _____ |
| 30. | FY 1971 | _____ |
| 31. | FY 1972 | _____ |
| 32. | FY 1973 | _____ |
| 33. | FY 1974 | _____ |
| 34. | FY 1975 | _____ |
| 35. | FY 1976 | _____ |

36. It has been asserted that, in general, the Section 8(a) Program imposes excessive costs on the procurement process by delaying procurements beyond the actual "need" date, unacceptably increasing procurement lead time, and generating substandard contractor performance. Please provide your assessment of the cost to the Air Force of this program compared to normal procurement. Use a scale of 1 (low cost) to 9 to evaluate the cost of this program to the Air Force.
37. Do you believe that the Section 8(a) Program has had an adverse impact on the mission of your organization?
1. Yes
 2. No
38. Do you believe that the Section 8(a) Program has had an adverse impact on the mission of the Air Force?
1. Yes
 2. No

Question
Number

39. Do you believe that the Section 8(a) Program has had more favorable than unfavorable impacts?

1. Yes
2. No

40. The answer sheets for this questionnaire severely limits the scope of the answers which can be given. You are encouraged to include any comments which you believe to be germane to this investigation on a separate sheet of paper or on the questionnaire. If your comment is related to one of the questions, please reference the question number.

THANK YOU FOR YOUR COOPERATION. PLEASE RETURN THE SURVEY IN THE ENCLOSED RETURN ENVELOPE AS SOON AS YOU CAN.