

# NAVAL POSTGRADUATE SCHOOL MONTEREY, CALIFORNIA



## THESIS

**AN ECONOMIC ANALYSIS OF THE SMALL  
BUSINESS ADMINISTRATION'S 8(A) PROGRAM**

by

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June 1997

Principal Advisor:

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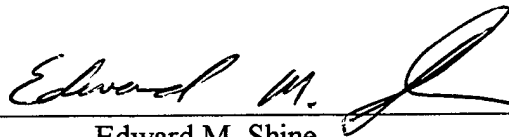
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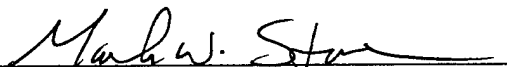
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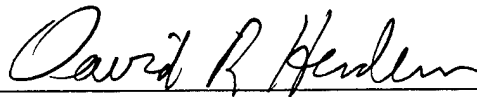
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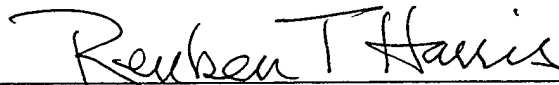
  
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## ABSTRACT

Since the late 1960s, the federal government has supported a policy of affirmative action with respect to the award of government contracts to small business firms owned and operated by members of select minority groups. Although originally structured to aid in the development of small business regardless of minority status, the Small Business Administration's 8(a) program fell victim to social and political pressures of the civil rights movement; becoming an instrument of affirmative action through federal procurement. With the apparent shift in the national social opinion towards quotas and set-asides based on minority affiliation, including the Supreme Court's recent ruling against such set-asides in *Adarand Constructors, Inc. v. Peña*, the future of the 8(a) program is uncertain. Minority set-aside programs have not historically been subject to cost/benefit analysis. This thesis analyzes the economic efficiency of the 8(a) program. Finally, the research concludes with an analysis of alternative initiatives sponsored by the United States Congress and the President.



**TABLE OF CONTENTS**

I. INTRODUCTION.....1

    A. BACKGROUND .....1

    B. OBJECTIVES.....3

    C. RESEARCH QUESTIONS .....3

        1. Primary Research Question .....3

        2. Secondary Research Questions.....4

    D. SCOPE.....4

    E. LIMITATIONS.....5

    F. ASSUMPTIONS.....5

    G. METHODOLOGY.....6

    H. ORGANIZATION OF THESIS.....6

II. AFFIRMATIVE ACTION IN THE UNITED STATES .....9

    A. DISCUSSION OF KEY TERMS.....9

    B. DEVELOPMENT OF AFFIRMATIVE ACTION POLICY.....13

        1. Post Civil War Policy Formulation.....14

        2. The Breakdown of Separate but Equal Societies.....14

        3. The Emergence of Equal Opportunity in Federal Contracting.....16

        4. Legal Challenges to “Separate but Equal” Policy.....17

        5. The Dawn of the Civil Rights Movement.....18

        6. Affirmative Action Policies.....19



7. A Shift to Minority Preferences and the Disparate Impact Theory. . . . .	21
8. Title VII Enforcement. . . . .	22
9. Affirmative Action Policy during the Johnson Administration. . . . .	23
10. The Philadelphia Plan. . . . .	25
11. Affirmative Action under Nixon. . . . .	26
12. The Small Business Administration's 8(a) Program. . . . .	27
C. CHAPTER SUMMARY. . . . .	29
III. PROVISIONS OF THE NEW 8(A) PROGRAM. . . . .	31
A. PURPOSE. . . . .	31
B. ELIGIBILITY. . . . .	32
1. Small Business. . . . .	32
2. Ownership. . . . .	32
3. Control and Management. . . . .	34
4. Social Disadvantage. . . . .	34
5. Economic Disadvantage. . . . .	35
6. Potential for Success. . . . .	35
7. Additional Requirements. . . . .	36
8. Two Year Rule Waiver. . . . .	36
C. BENEFITS OFFERED UNDER THE 8(A) PROGRAM. . . . .	37
D. CONTRACTING UNDER SBA'S 8(A) PROGRAM. . . . .	37

E.	PROGRAM STATISTICS.....	38
1.	Program Scope.....	38
2.	8(a) Firm Revenue.....	42
3.	Net Worth of Program Participants.....	43
4.	Business Makeup of 8(a) Participants.....	44
5.	Program Costs.....	45
6.	Status of Firms Exited from the 8(a) Program.....	46
F.	CHAPTER SUMMARY.....	47
IV.	PROGRAM PITFALLS: THE STATE OF AFFIRMATIVE ACTION TODAY.....	49
A.	ADMINISTRATIVE INEFFICIENCIES.....	50
1.	Lengthy processing for Certification of 8(a) Participants.....	50
2.	Annual Review of Business Plans.....	51
3.	Failure to Meet 8(a) and Non-8(a) Business Mix Levels.....	52
4.	8(a) Program Vulnerable to Contractor Abuse.....	53
B.	CONTRACT DOLLARS ARE CONCENTRATED IN A SMALL PERCENTAGE OF FIRMS.....	54
C.	POOR SUCCESS RATE UPON GRADUATION.....	54
D.	AFFIRMATIVE ACTION TODAY.....	56
1.	Adarand v. Pena.....	56
2.	Adarand's Effect on Federal Procuring Agencies.....	58
3.	Continuing Challenges to the 8(a) Program.....	59

4. Current Program Initiatives. . . . .	60
a. HUB Zone Act of 1997. . . . .	60
b. Executive order 13005. . . . .	62
E. CHAPTER SUMMARY. . . . .	63
V. ANALYSIS OF AFFIRMATIVE ACTION SET-ASIDE PROGRAMS. . . . .	65
A. ANALYSIS OF SBA'S 8(A) SET-ASIDE PROGRAM. . . . .	65
1. Underlying Issues and Assumptions of the Program. . . . .	65
2. 8(a) Program Administrative Costs. . . . .	67
3. 8(a) Program Impact on Procuring Agencies. . . . .	68
4. Inefficiency of the 8(a) Program in Developing Minority Business. . . . .	69
5. Benefits to Society?. . . . .	73
a. Employment. . . . .	73
b. Income Taxes Paid by Firms, Owners, and Employees. . . . .	75
c. The Economic Multiplier of Federal Contract Dollars. . . . .	76
B. THE INEFFICIENCY OF SUBSIDIES IN THE MARKETPLACE. . . . .	77
C. THE HUB ZONE ACT AND EMPOWERMENT CONTRACTING. . . . .	79
D. ADARAND'S LEGACY. . . . .	80
E. CHAPTER SUMMARY. . . . .	82

VI. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS. ....	85
A. SUMMARY. ....	85
B. CONCLUSIONS ON RESEARCH QUESTIONS. ....	87
1. Primary Research Questions. ....	87
2. Subsidiary Research Questions. ....	88
C. RECOMMENDATIONS. ....	91
D. RECOMMENDATIONS FOR FURTHER RESEARCH. ....	94
E. CONCLUSIONS. ....	94
LIST OF REFERENCES. ....	97
BIBLIOGRAPHY. ....	101
LIST OF INTERVIEWS. ....	107
INITIAL DISTRIBUTION LIST. ....	109

## LIST OF FIGURES

Figure 3.1	Fourteen Year History of MBE Expenditures .....	40
Figure 3.2	Total Federal Funding for MBE by Type .....	42

## LIST OF TABLES

Table 3.1	Fourteen Year History of Federal Assistance to MBEs .....	39
Table 3.2	Federal Agency 8(a) Procurement .....	41
Table 3.3	Industries Receiving Largest Amounts of 8(a) Contract Support .....	44
Table 3.4	Status of 8(a) Business Concerns that exited the Program .....	47
Table 4.1	Elapsed Processing Times for 8(a) Applications During Fiscal Year 1992. ....	51

## I. INTRODUCTION

### A. BACKGROUND

The magnitude of the Federal Government's outlays for procurement creates opportunities for implementing selected national socio-economic policies. The opportunities lie in the effect of legislation on Government contractors. Implementation of such policies through Federal procurement can have positive impacts on targeted special interest groups or society as a whole. However, the pursuit of social goals through Federal procurement also creates problems and inefficiencies in the procurement process.

At the very least, imposition of national goals and objectives on the procurement process add numerous obligations and administrative complexities for Government contracting officers. Legitimate questions arise as to how much extra costs and other burdens of socio-economic programs should be absorbed in the procurement process and how much should be supported by more explicit means.

The Federal procurement process is only one means available for achieving socio-economic objectives. The Government grants tax benefits, licenses; makes direct grants of money and equipment; and uses other instruments to achieve national purposes by encouraging certain types of behavior while discouraging others.

It may well be cost-effective for the Government and society at large to use the leverage of the procurement process for achieving selected national social objectives. It is doubtful that such achievement is cost-effective for the procurement process itself.

Although impossible to completely disengage the procurement process from the myriad of

social policies with which it has become thoroughly entwined over the past century, it is vitally important to have economic decision tools available when reviewing existing programs or contemplating new ones.

There are currently over fifty legislative “rules” under which the United States Government exercises socio-economic policies in Federal procurement. These “rules” take numerous forms. There are Executive Orders, articles of the United States Code, and numerous policy statements. These socio-economic programs can be categorized as to their intended purpose. There are numerous programs which, primarily, impose rules to improve working conditions for people employed by Government contractors. Other legislation favors buying products and services from American companies and ensuring Government contractors protect the environment and enhance quality of life for both humans and animals. The last group of legislation, which is the focus of this research, is one comprised of regulations designed to favor socially and/or economically disadvantaged groups in awarding Federal procurement contracts.

Several pieces of legislation deal specifically with mandated quotas and set-asides for both “minority” and “small business” in Federal procurement, namely, 15 U.S.C S644 (promoting contracting with small business); 15 U.S.C S637 (requiring contracting and subcontracting with minority businesses); Public Law 100-533 (promoting women-owned businesses).



## **B. OBJECTIVES**

This thesis has the following objectives:

- To develop a clearer understanding of socio-economic programs currently administered by the Small Business Administration under section 8(a) of the Small Business Act designed to assist small, small-disadvantaged, and small women-owned businesses in obtaining Federal contracts
- To examine inefficiencies and problems encountered with the socio-economic programs administered under section 8(a) of the Small Business Act mandated in Federal procurement contracting
- To analyze the social and political forces which led to affirmative action in the United States during the 1940s through 70s and determine if subsequent changes in these issues requires a change in the affirmative action programs that continue to this day.

## **C. RESEARCH QUESTIONS**

### **1. Primary Research Question**

Do benefits of the Federal Government's procurement policy mandating quotas and set-asides for small and small-disadvantaged businesses under the Small Business Administration's 8(a) program outweigh the associated economic costs and inefficiencies created under the program?

## 2. Subsidiary Research Questions

- What forces shaped the civil rights movement in the United States and led to the implementation of affirmative action in Federal contracting?
- What are the economic pitfalls of affirmative action, in general, and specifically in relation to the Small Business Administration's 8(a) program?
- Are Federal contract set-aside programs such as the 8(a) program an effective means to eliminate economic inequalities resulting from discrimination?
- What effects, if any, will the recent Supreme Court ruling in *Adarand Constructors Inc. v. Peña* have on the viability of current socio-economic mandates in Federal procurement and the formulation of future programs?

### D. SCOPE

The scope of this thesis is to provide information, analysis, and conclusions to aid in the development of future socio-economic programs that may be implemented through the Federal procurement system. Additionally, an examination of the social and political forces that have shaped affirmative action legislation and policy over the last forty years along with the current trends in affirmative action can be instructive in the development of more effective programs to combat economic inequalities caused by discrimination. This research does not report new empirical data. Instead, the research correlates existing data in an attempt to analyze the forces behind and the efficacy of affirmative action, specifically the Small Business Administration's 8(a) program.

## **E. LIMITATIONS**

Most limiting is the ability to quantify any social benefits affecting minority groups from the mandated quotas and set-asides under the 8(a) program. This study is further limited in the amount of data available surrounding subjective costs associated with the use of mandated set-asides and quotas in Federal procurement. Although scarce, some data does exist documenting administrative costs associated with enacting and enforcing socio-economic programs. Because implementation of social policy appears motivated more by political rhetoric rather than economic analysis, there is no great body of knowledge concerning economic models which lend themselves to such a study. Several factors, including an apparent change in public opinion over minority-based programs and recent landmark court decisions including the Supreme Court's ruling in *Adarand Constructors Inc. v. Peña*, are continuing to transform the issue of race-based preferences. Continued changes in both populous opinion and Government regulations may tend to invalidate the findings of this thesis.

## **F. ASSUMPTIONS**

This area of study was undertaken with the assumption that:

- Recent decisions issued under *Adarand v. Peña*, in addition to California's proposition 209 and various legislative proposals, both Federal and state, designed to end affirmative action, may mark the beginning of the end for some minority-based programs.
- The increasing pressure exerted on Federal dollars in the past decade and the

public popularity of a balanced budget force a practical look at all Federal procurement expenditures, including those programs with social policy goals at their heart.

- Public support for affirmative action programs has decreased over the past decade.
- This study may pose more questions than it answers, but in doing so it may direct further study in this area.

## **G. METHODOLOGY**

The methodology of this thesis entailed a collection of data from numerous sources. Personal and phone interviews were conducted with members of organizations that are either currently receiving or have received assistance under the 8(a) program; legislative bodies involved in the formulation of socio-economic policies and agencies administering socio-economic programs including the Small Business Administration, NASA, Department of the Navy, Department of the Air Force, Department of the Army, and the General Services Administration.

## **H. ORGANIZATION OF THESIS**

This thesis contains six chapters. Chapter I provides a brief introduction and outlines the objectives and research questions of the thesis. It establishes the framework and ground rules for the thesis.

Chapter II outlines the social and political climate that gave rise to Federal affirmative action policy. It includes a short legislative history about the enactment of

Federal social policy, particularly those affecting the affirmative action in the Federal procurement process.

Chapter III discusses the current state of affirmative action programs and policies, including those associated with set-asides and quotas mandated under the 8(a) program. This chapter reviews, in detail, the requirements imposed on the Federal procurement system by the Small Business Administration's 8(a) programs.

Chapter IV reviews documented deficiencies of the 8(a) Program. A discussion of the pertinent forces shaping affirmative action in this decade along with a review of the Supreme Court case and decision of *Adarand v. Peña* and its possible implications for other social-economic programs mandated through Federal procurement. The chapter concludes with a review of current initiatives headed by the executive and legislative branches of the Federal Government.

Chapter V presents an analysis of research on the changing political and social trends now affecting affirmative action popularity in the United States. This chapter will offer an economic analysis of the market inefficiencies created when artificial constraints are imposed on our quasi-free-market economy.

Chapter VI summarizes the thesis and offers answers to the primary and subsidiary questions of Chapter I. Specific recommendations are offered for improvements to the implementation process for current and future socio-economic programs mandated in Federal procurement. Areas for further research are identified and discussed.



## II. AFFIRMATIVE ACTION IN THE UNITED STATES

### A. DISCUSSION OF KEY TERMS

In order to analyze the social and political factors that gave rise to the Affirmative Action movement in the United States during the latter half of this century, we must have a common understanding of some key terms that appear in this writing. Numerous words and phrases used in every day language may hold one meaning to one individual and yet quite a different meaning to the next. Gaining a common literacy when discussing such controversial issues as affirmative action is paramount to any intelligent discussion of the subject.

Affirmative action in the United States has resulted from discrimination against certain groups of individuals. Racial inequality in this country began with the introduction of slavery in the 17<sup>th</sup> century which lasted until the end of the Civil War in 1865. This legalized inequality was fostered by prejudice and active discrimination toward certain minority groups. Even after laws requiring segregation and discrimination were stricken from record, prejudice and discrimination continued. It is important, at this point, to discuss the meaning of terms such as discrimination and prejudice.

Discrimination, in society, can be defined as the showing of favoritism in treatment. (Webster, 1962 p. 215) The effect of discrimination can both viewed as either negative, positive, or neutral. Prejudice, on the other hand, lacks action. It is defined as an opinion formed before the facts are known or preconceived. A prejudicial opinion is usually held in disregard of facts that contradict it. (Webster, 1962 p. 586)

It is important also to illustrate the difference between discrimination and prejudice. While discrimination is expressed in overt, concrete behavior, prejudice is expressed in attitude. However, it is usually assumed that the individuals who discriminate do so because of their personal prejudice though this is not always the case.

In the last several decades the term "discrimination" has acquired an unambiguously negative connotation. It conjures up the image of racial and/or sexual prejudice. Strictly speaking, the term is neutral in application. Discriminatory behavior may have consequences which are benign, malevolent, or innocuous. (Block & Walker p.6)

Acts of discrimination or preference are more than superficial interests, since they define the individuality. Individuality and the right of human beings to make choices are a fundamental characteristic of free societies and, presumably, ought to be preserved to the greatest extent possible. Discrimination is nothing more than the expression of prejudice or preference. And in that neutral sense, without assessing the consequences of the behavior, the right to discriminate is a desirable feature of free societies. Individual preferences may sometimes result in a majority preference which by its existence excludes or inconveniences some minority. Such is the case of the majority discrimination of blacks after the Civil War and up to the first half of the 20<sup>th</sup> century.

(Block & Walker, 1981 pp. 5-7)

With the introduction of Jim Crow laws in the late 19<sup>th</sup> century, named for an antebellum minstrel show character, Southern states created a racial caste system in the American south. Although slavery had been abolished, many whites continued to be believe that non-whites were inherently inferior and, to support this belief, sought



rationalizations through religion and science. The U.S. Supreme Court was inclined to agree with the white-supremacist judgment and in 1883 began to strike down foundations of the post-civil war reconstruction, declaring the Civil Rights Act of 1875 unconstitutional. In 1896 it legitimized the principle of "separate but equal" in its ruling under Plessy v. Ferguson. This high court ruling led to a profusion of Jim Crow laws. By 1914 every Southern state had passed laws that created two separate societies-- one black, the other white. This artificial structure was maintained by denying the franchise to blacks through the use of devices such as grandfather clauses, poll taxes, and literacy tests. It was further strengthened by the creation of separate facilities in every part of society, including schools, restaurants, health care institutions, and cemeteries. (Glazer, 1975 p.17)

By the same token, the expression of preferences by a minority group may sometimes exclude the majority. Many neighborhoods, clubs, and societies are instances where people conspire to express their individuality by blatantly rejecting the majority. The power to control is the key for either the majority or minority to discriminate against the other.

The negative aspects of discrimination that people are familiar with and which give discrimination such a bad connotation are usually of the majority type. There is no doubt that the majority can use the system of laws to exploit and disadvantage minorities, but there are numerous examples of minorities also practicing discrimination. Take, for instance, white South Africa, the minority, controlling blacks for decades. (Block & Walker p.7)

The term "Equal Opportunity" stands for a variety of legal doctrines and practical methods for preventing discrimination in employment, education, and housing. These

three areas of opportunity have been the most controversial in minority groups' quest for preferential treatment over the majority to "make up for years of discrimination." Its meaning has developed at the boundary between two competing concepts of equality: Equality of opportunity and Equality of result.

Equality of opportunity is, in its purest form, not controversial. The controversy has arisen in the way the concept of equal opportunity has been transformed in preferential treatment of some groups over others. The courts and the political branches of the U.S. Government have generally embraced the idea that people should have an equal opportunity to compete, to perform, and to succeed on their own merits, without being hindered by their race, sex, or other characteristic which they have no control over. (Block & Walker p. 23)

Equality of result, however, has been the subject of fierce political battles and complex court litigation. Its supporters point out that discrepancies in numbers often demonstrate a lack of equal opportunity. Such discrepancies can signal subtle and pervasive discrimination that cannot effectively be rooted out by trying to eliminate particular individual instances of bias. Simply eliminating intentionally discriminatory barriers is not sufficient, supporters argue, because members of groups that have historically been victims of individual and societal discrimination do not start from the unbiased social, educational, and economic situations that would permit true equality of opportunity. Critics of the equality-of-result position counter that it is designed to place people in jobs, schools, or housing solely on the basis of their membership in a protected group, in direct proportion to the size of the protected group in society at large, and without regard to individual merit. While neither view has entirely prevailed, the equal

opportunity movement attempts to reconcile these competing views in an effective and practical way. (Glazer p. 33)

One prevalent policy used to promote equal opportunity and fight discrimination has been the use of affirmative action laws. Affirmative action is a formal effort to provide increased employment opportunities for minority groups that have been historically denied equal consideration. (Block & Walker p. 27)

A common understanding and interpretation of the concepts surrounding civil rights and affirmative action in the United States has always been considered a monumental task. The following brief history of the formulation of Federal policy and policy implementation paint an eye-opening picture of the difficulty in reaching this common understanding. When such seemingly simple ideas as civil rights and equal opportunity are played out on the political battlefield, all too often the forest is obscured by the trees.

## **B. DEVELOPMENT OF AFFIRMATIVE ACTION POLICY**

The controversy over affirmative action policies and programs within Federal contracting activities is the main focus of this research. In order to understand current policies and programs of affirmative action in the Federal contracting, we must understand the social and political forces of the past that have formed affirmative action policies. As our system of Government allows for opposing views to be heard on all issues, it is inherently inefficient in accommodating those views in law and policy.

## **1. Post Civil War Policy Formulation**

The social pressures which culminated in the Civil War continued to break down walls of discrimination after the end of the war with the passage of the thirteenth, fourteenth, and fifteenth Amendments to the Constitution as well as the passage of numerous civil rights acts. Although no longer enslaved, the Black minority faced discrimination across the country. In 1883 the U.S. Supreme Court began to undermine the foundations of the post-Civil War reconstruction by declaring the Civil Rights Act of 1875 unconstitutional. In 1896 the court legitimized the principle of "separate but equal" in the landmark case Plessy v. Ferguson.

In the South, discrimination and exclusivism was directed primarily against African Americans, though Catholics and Jews received their share of prejudice, discrimination, and violence. In the West, the Chinese and Japanese were the main targets of a pervasive racism which included the Mexicans and Indians.

Discrimination during this period was partially a product of resistance to the increasing number of immigrants entering the country. Resistance to the habits and culture of immigrants as well as their affect on the political landscape of many big cities in which they settled.

## **2. The Breakdown of Separate but Equal Societies**

The dismantling of prejudice and discrimination in law and custom began in the 1930s. In the North, the ethnic groups created by the new immigration began to play a significant role in politics; and blacks, after the disenfranchisement of the late 19<sup>th</sup> century,

began again to appear in politics. With the end of the war against Hitler's racial genocide, anti-Semitism, so strong in the thirties, underwent a rapid and unexpected decline.

The "equal but separate" society remained the status quo until the middle of the 20<sup>th</sup> century. The major bastion of race discrimination was the South, and the legal subordination of African Americans remained strong throughout the 1930s and 1940s. Increasing social and political pressure finally made its effects felt during the Truman administration. The Armed Forces were desegregated and national demands for the enfranchisement of Southern blacks became stronger and began to receive the support of court decisions.

The first serious attempt to establish equal employment opportunity as a national policy occurred during World War II. In response to a threatened black protest march on Washington, DC, in June 1941 President Franklin D. Roosevelt issued Executive Order 8802 which prohibited discrimination in Government employment and declared it to be the duty of employers and labor organizations to provide for full and equitable participation of all workers in the defense industries, without discrimination because of race, creed, color, or national origin. To enforce the order, the president created a Fair Employment Practices Committee (FEPC) with authority to investigate complaints of discrimination and resolve them through negotiation. In 1943, Executive Order 9346 extended the anti-bias ban to Government contractors and reconstituted and strengthened the FEPC, allowing it to hold public hearings and issue findings of fact concerning discriminatory practices.

In addition to employers, organized labor was a major source of discrimination in private employment prior to Title VII. Labor unions were defined under state law as

private, voluntary associations and protected by the common law rule which asserted that private individuals could not be forced into an association against their will. Accordingly, unions were permitted to discriminate in their membership policies and organizational practices.

In the early twentieth century, racial discrimination was a basic feature of the development of organized labor. Through a process referred to as occupational eviction, blacks and other minorities were excluded from national craft unions by explicit provisions or tacit agreement. Industrial unions that organized unskilled labor admitted minorities to membership, but placed them in segregated units and separate lines of seniority and job assignment according to race.

In the legal framework of collective bargaining established by the National Labor Relations Act (NLRA) of 1935, employers accepted racial segregation and discrimination as a basic demand of organized labor. In effect, the NLRA legalized and enforced the discrimination practiced by the union movement. By giving organized labor formal recognition in national law, the act also made it possible to apply anti-discrimination pressure on the unions when jobs bias became an issue of civil rights concern in the 1940s. (Norgren & Hill, 1964 p. 205)

### **3. The Emergence of Equal Opportunity in Federal Contracting**

A series of executive orders required non-discrimination in Government contracts and in the Federal civil service. Government contract committees were authorized to publicize, and reconcile disputes, but not to impose sanctions for non-compliance. Contracting officers in executive departments and agencies, more concerned with

procuring goods and services than with ending discrimination, had the power to enforce non-discrimination requirements, but did not exercise that power. Consequently little progress was made against job bias. As support for civil rights enforcement spread in the 1950s, the potential of Federal contract programs for creating employment opportunities and actually increasing minority employment began to emerge. The President's Committee on Government Contracts, under the direction of then Vice-President Nixon, conducted surveys of the racial composition of the Federal workforce in several cities. In a few instances the Nixon Government contracts committee forced employers to hire blacks, using a tactic that would later be described as preferential treatment. At the end of the Eisenhower Administration, the Nixon-led committee considered a policy requiring Government contractors to supply monthly racial surveys of their minority hiring performance, with timetable for increasing black employment. (Belz pp. 14-15)

A major source of employment anti-discrimination policy was the Federal contract program in which the Government through executive orders establishes the conditions of doing business with it. President Kennedy's 1961 executive order was intended as a procedural guarantee of non-discrimination in recruitment and hiring practices. (Belz p. 2)

#### **4. Legal Challenges to "Separate but Equal" Policy**

The first true test of the "separate but equal" standard was tested in court cases dealing with segregation in education. *Brown v. Board of Education of Topeka, Kansas*, decided on May 17, 1954, was one of the most important cases in the history of the Supreme Court. The case dealt with the denial of admission of a black girl to an elementary school in Topeka, Kansas. Brought together under the *Brown* case were

others from South Carolina, Virginia, and Delaware. The issue the court was compelled to answer was whether the equal protection clause of the fourteenth Amendment prohibited racial segregation in the public schools.

In a brief, unanimous opinion delivered by Chief Justice Earl Warren, the court declared that, "separate education facilities are inherently unequal" and that racial segregation violates the equal protection clause of the fourteenth Amendment. The chief justice argued that separating children in the schools solely on racial grounds generated a feeling of inferiority as to their status in the community that may affect their hearts and minds in a way unlikely ever to be undone. The courts decision had far-reaching effects, influencing civil rights legislation and the civil rights movement of the 1960s. (Cushman p.87)

### **5. The Dawn of the Civil Rights Movement**

The turmoil created by the decision in *Brown v. Board of Education* continued to escalate through the late 1950s and into the 1960s. Opposing political and social pressures surrounding race relations and equality continued to escalate during this period. The political situation began to change after the *Brown v. Board of Education* decision. While the Republicans and Northern Democrats competed for the political support of blacks, the question of civil rights was increasingly recognized by the executive and legislative branches of the Federal Government as an issue demanding action by the Federal Government.



A decisive breakthrough occurred in 1957, when Congress passed the first civil rights legislation since the Civil War Reconstruction period. The act established the Civil Rights Commission and created the Civil Rights Division of the Justice Department.

The Federal Government seemed to reach a consensus on how to should respond to the reality of racial and ethnic-group prejudice and racial and ethnic differences. This consensus was characterized by three major pieces of legislation designed to bring balance to the issue of equal rights: the Civil Rights Act of 1964, the Voting Rights Act of 1965, and the Immigration Act of 1965. With the passage of legislation, the Federal Government intervened to end the one-hundred-year resistance of the white South to full political, civil, and social equality for Blacks and minorities as a whole. ( Glazer p. 3)

In the phrase reiterated many times in the Civil Rights Act of 1964, no distinction was to be made in the right to vote, in the provision of public services, the right to public employment, or the right to public education, on the ground of "race, color, religion, or national origin."

## **6. Affirmative Action Policies**

The Civil Rights Act of 1964 was intended to establish color-blind equal employment opportunity through a combination of voluntary compliance, agency conciliation, and judicial enforcement in civil litigation of the personal right of individuals not to be discriminated against because of race. Under the pressure of social upheaval and political necessity in the late 1960s, Federal courts and the civil rights bureaucracy abandoned this policy. They instead fashioned an administrative-judicial enforcement scheme that forced employees to give preferential treatment to racial and ethnic minorities

under a new theory of discrimination based on the concepts of group rights and equality of result. Establishing policies of race-conscious affirmative action and compensatory preferential treatment, courts and agencies posited group rights and equality of result as the new meaning of equal employment opportunity.

Affirmative action, which was created under the Kennedy Administration's revised contract program in 1961, acquired statutory basis in Title VII of the Civil Rights Act of 1964. This law provided the long-sought Federal fair employment practice measures by which, against its sponsors' intentions, equal employment opportunity was transformed into racial group equality of result. There were several key political reasons for Kennedy's choice to revise the Government contract program rather than seek civil rights legislation. Kennedy needed the support of southern Democrats in Congress who opposed any civil rights measures. The southern Democrats opposed contract compliance because it put pressure directly on businessmen rather than organized labor. Rather than enact legislation that would mandate that employers practice non-discrimination by requiring adherence to quota standards, the Kennedy order directed Federal contractors to "take affirmative action to ensure that individuals were treated without regard to race, creed, color, or national origin. (Belz p.18)

The term "Affirmative Action" had previously been used with reference to remedial measures in labor relations and employment discrimination situations. In Executive Order 10925, it referred to requirements that contractors post notices and make announcements of their non-discrimination obligation and agree to furnish information and reports about their employment practices. The Kennedy order created the President's Committee on Equal Employment Opportunity (PCEEO), which had the authority to

enforce the affirmative action obligation by imposing sanctions in the form of contract cancellation or contractor debarment. (Belz, 1991 p. 3)

### **7. A Shift to Minority Preferences and the Disparate Impact Theory**

The President's Committee subordinated individual complaint processing and conciliation to group-based preferential hiring pegged to statistical patterns of minority underrepresentation. Civil-rights attorneys capitalized on the apparent change in the fundamental philosophy behind the equal employment programs to further their causes. In order to avoid the need to prove in court the presence of discrimination, they devised a strategy to promote minority preference. The essential element of the strategy was the contention that a *prima facie* charge of discrimination should be based on the absence or scarcity of blacks in the work force. This approach, known as the Disparate Impact Theory of Discrimination, offered a promising alternative to individual complaint processing which fair employment lawyers were convinced was inadequate for achieving employment equality. The disparate-impact approach supplied the new standard for defining discrimination that the civil rights lobby considered necessary to eliminate deeply entrenched patterns of job bias and establish rules for permanent compliance with affirmative action employers.(Belz p. 21)

Critics of the new "affirmative action" policies contended that "a requirement of equal representation of every segment of the population in every working force would mean the end of freedom in the United States." Controversy surrounding preferential treatment provoked comment from President Kennedy. Stating that the past could not be

undone and that most blacks wanted equal rather than special treatment, the president said, "I think we ought not begin the quota system." (Belz p.22)

### **8. Title VII Enforcement**

The redefinition of American equality under the concepts of group rights and equality of result, begun under the Kennedy Administration's Government contract program, accelerated with the start of Title VII enforcement in 1965. Title VII, also known as the Dirksen-Mansfield Amendment, was intended to settle controversy over quotas and preferential treatment that existed in the early 1960s. This intent was expressed in the nondiscrimination principle that was the heart of the bill. It was clarified and reinforced by a series of amendments provoked by fears that the law would be used to require race-conscious preferential treatment. Though the sponsors of Title VII rejected the view that the amendment was intended, or capable of being interpreted, to promote race-conscious preferential treatment, several amendments intended to protect against such a possibility were accepted in order to keep the measure alive. (Belz pp. 22-24)

In light of other legislation of the period, Title VII constitutes a clear rejection of the demand for preferential treatment raised by civil rights groups in the early 1960s. The rule of law requires courts to apply statutes as written and intended. The introduction of race-conscious affirmative action, under the authority of the Civil Rights Act, makes the purpose and intent of Title VII both pertinent and contested.

Supporters of affirmative action argue that preferential practices are necessary to carry out the goal of improving economic conditions of minority groups by guaranteeing a right to equal employment. Critics contend that the purpose of Title VII is to improve the

economic status of minorities by guaranteeing equal employment opportunity based on the nondiscrimination principle. (Belz p.26)

### **9. Affirmative Action Policy during the Johnson Administration**

In September 1965 President Johnson issued a new executive order in response to demands made by civil rights organizations to strengthen compliance by companies doing business with the Federal Government. Executive Order 11246 abolished the President's Commission on Equal Employment Opportunity and transferred its function to the Secretary of Labor. The Office of Federal Contract Compliance was formed to issue regulations regarding contract compliance.

Affirmative action in contract compliance was directed at collective social and institutional discrimination, rather than individual discriminatory acts defined as denial of equal treatment in a procedural sense. Implicitly resting on the theory of disparate-impact discrimination, the executive order constituted a simpler and more direct form of Government coercion than Title VII because it was not concerned with the legal meaning of unlawful discrimination. The executive department agencies were not limited to providing relief only if unlawful practices were evident as was the case under Title VII.

The OFCC emphasized "results-oriented" affirmative action. One compliance office explained the new approach by saying, "All that is needed is to take the employer to the cliff and say, 'Look over, baby.'" Critics of affirmative action objected that under OFCC policy, contrary to the statutory and regulatory requirements governing public contracting, the precise scope and content of the affirmative action obligation was unclear. As conceived by OFCC, affirmative action was intended to be vague and imprecise. Only

in this form could it be successful. To specify the meaning of affirmative action in terms of minority hiring results was believed to constitute a quota policy in violation of Title VII. In order to avoid the prohibitions of the statutory nondiscrimination principle, the Government forced contractors to take affirmative action. (Belz p. 31)

Subsequently, pressure from both the civil rights lobby and critics of affirmative action led the Johnson Administration to adopt "hard and fast" quotas instead of the strategy of coerced yet non-specific minority hiring. These quotas developed as a technical requirement of contract compliance. In public contracting, the concept of contractor responsibility refers to the technical and financial capability, professional character and integrity, and tenacity of firms bidding for Government contracts. These are general qualifications that enable the Government to have confidence that a contractor will perform well. (Arnavas & Ruberry p. 4-13) The ability to meet the nondiscrimination requirement of Executive Order 11246 was considered an aspect of contractor responsibility. The concept of "bid responsiveness", on the other hand, refers to the ability of the contractor to meet specific requirements and specifications of a particular contract. In 1966, the OFCC started a policy of pre-award compliance reviews that shifted the affirmative action obligation from the area of contractor responsibility to that of bid responsiveness. Before award, the low-bid contractor was required to prove that it could meet the affirmative action obligation. This in effect made affirmative action an additional requirement of contracts, without identifying it in the bid specifications or stating specifically what it consisted of.

## **10. The Philadelphia Plan**

Racial discrimination in the construction industry provided the occasion for introducing quotas in the form of goals and timetables as a requirement of affirmative action in the Philadelphia Plan of 1969. In 1967, Federal contractors in the Cleveland and Philadelphia areas were forced to submit affirmative action plans assuring minority group representation in all trades in all phases of the work being conducted. A manning table stating the number of minority employees to be hired was the key feature of an affirmative action plan. Federal officials informed contractors that although the choice of methods was their own, an affirmative action plan must have the result of producing minority group representation. At the same time the OFCC prepared to extend the manning table requirement to all Federal agency and Federal-aid construction projects.

Republicans attacked quota policy implemented during the Johnson Administration by requesting the General Accounting Office (GAO) investigate the legality of the OFCC's manning table requirements imposed under the Philadelphia Plan. As a result, in 1968, the GAO advised the Department of Labor that pre-award negotiations on affirmative action were inconsistent with the rules of competitive bidding. The rules required that invitations to bid offer equal and unambiguous terms and conditions to all bidders; under the OFCC policy, Government contract agencies did not state minimum standards for equal employment opportunity. The GAO therefore concluded that a contract could wrongfully be denied to the low bidder based on the arbitrary decision of a contract compliance officer. In response, congress passed the Federal-aid Highway Act of 1968. The purpose of this law was to make the nondiscrimination requirement a matter of contractor responsibility rather than bid responsiveness and to prevent the development of a quota

system. The act did not expressly prohibit manning tables or goals, however, and the Department of Transportation simply ignored it. The Federal Highway Administration shifted minority hiring negotiations from the pre-award phase to the pre-bid qualification stage of the contracting process. (Belz pp.31-33)

### **11. Affirmative Action under Nixon**

The intensifying pursuit of preferential treatment under Executive Order 11246 was part of an increasingly race-conscious civil rights policy. The political maneuvering and tradeoffs between southern conservatives and Northern liberals were inherited by the incoming Nixon Administration. After four years of race riots and Black Power threats growing out of the civil rights movement, Nixon's election appeared to signal a return to law and order, a lessened emphasis on civil rights, and the restoration of more traditional equal rights concepts. At the same time, however, official commission reports concluded that the ghetto riots were caused by racism and discrimination. This conclusion was the basis on which more rigorous civil rights enforcement was demanded to prevent renewed urban violence. In such a preventative strategy, enforcement of equal employment opportunity was seen as especially important. (Mesaros, March 1997)

President Nixon was a strong supporter of civil rights. As chairman of the Government Contracts Committee in the Eisenhower Administration, he had been willing to press the issue of employment equality. But it was political factors that caused Nixon to devote more energies to this area of civil rights policy. Republicans saw an opportunity to gain politically by forcing the job issue and driving a wedge between key constituent groups in the Democratic coalition. At the same time, the Nixon Administration had



political reasons for relaxing civil rights enforcement in the field of school desegregation. Nixon had to accommodate white opposition to racially balanced school integration. These conflicting pressures led the Nixon Administration to take a more conservative position on race-conscious remedies in school desegregation and a more liberal one on preferential treatment in employment discrimination policy. (Belz p.35)

By formalizing and protecting the emerging policy of quota preferences, the Nixon Administration took a decisive step toward legalizing preferential treatment. In 1969, along with the Philadelphia Plan, Nixon revised the Federal Government's equal employment opportunity policy in the direction of preferential treatment. Later the same year, President Nixon issued Executive Order 11478 establishing "a continuing affirmative action program" for recruitment, employment, development, and advancement of members of the civil service.

## **12. The Small Business Administration's 8(a) Program**

It was during the Nixon Administration that the 8(a) program under the auspices of the Small Business Administration would be reformulated to become a tool of affirmative action policy. The Small Business Administration originally formed under the Small Business Act of 1958 (Public Law 85-536) was created to encourage and aid small business in the United States. In its creation, the Small Business Act claimed that the economic well-being of United States depended upon the expansion of free competition which, in turn, required special aid, protection and assistance be given to small business. With the signing of Executive Order 11458 on March 5, 1969, President Nixon set wheels

in motion that would formulate Federal policy of quotas and set-asides for minority businesses in Federal procurement.

An examination of the original language presented in the Small business Act, specifically that of Section 8(a), shows to be absent the current language subcategorizing small businesses according to whether they are owned and operated by members of disadvantaged minority groups. Also absent is the subsequent requirement to provide set-asides in the form of Federal contracts to such groups. (PL 85-536 sec 8(a))

Since the law's passage, nearly every session of Congress clarified and/or extended the coverage of the law. Throughout the life of the Small Business Act and the Small Business Administration, amendments have significantly altered the manner in which the law provided assistance to small business.

In his statement about a national program for minority business enterprise, President Nixon said, "I have often made the point that to foster the economic status and the pride of members of our minority groups we must seek to involve them more fully in our private enterprise system. Blacks, Mexican-Americans, Puerto Ricans, Indians, and others must increasingly be encouraged to enter the field of business, both in areas where they now live and in the larger commercial community—and not only as workers, but also as managers and owners."

In light of president Nixon's commitment to increase minority presence in business, the Small Business Administration modified the seldom utilized section 8(a) of the Small Business Administration. For many years the 8(a) program was simply a program to develop small business. During the post-war era, the Federal Government was concerned with maintaining economic growth and innovation most often fueled by small

business. The Small Business Act was passed to establish policy and create developmental programs such as 8(a). This modification changed in the emphasis of the program from that of strictly aiding small business in acquiring Government contracts to ensuring that representative numbers of minority businesses received such contracts.

### **C. CHAPTER SUMMARY**

This chapter explores the history of affirmative action in the United States. It provides a brief introduction into the social and political pressures which molded civil rights policies of the 1950s and 1960s into the affirmative action programs of today. Without judging the usefulness of affirmative action programs which emerged during this period, it is useful to understand the underlying motives that led to their formulation. It is interesting that political motives often weighed more heavily on program formulation and direction than did the desire to rid our nation of discrimination in the work place.



### **III. PROVISIONS OF THE NEW 8(a) PROGRAM**

As discussed in chapter two, the original mission of the Small Business Administration's 8(a) program was that of developing small business enterprise in America. The program, as originally written in the Small Business Act of 1953, authorized SBA to enter into contracts with Federal agencies and to subcontract work to small business concerns. However, for 15 years the SBA did not exercise the provisions of section 8(a) because SBA administrators believed that the effort to start and operate such a program would not be effective in producing the desired results.

When the program was finally used in 1968, as a result of mounting racial tension culminating in race riots in large urban areas, the program offered noncompetitive contracts to small businesses agreeing to locate in economically depressed areas and hire the unemployed and underemployed. During the pilot period, SBA asserted that a better solution to unemployment involved more than job creation, and that business ownership opportunities should be offered to minorities and other disadvantaged individuals. (Gore 1993 p. 9) Thus was born the more familiar program of minority set-asides known as the 8(a) program.

#### **A. PURPOSE**

The 8(a) program is administered by the Office of Minority Enterprise Development (MED) Program to assist socially and economically disadvantaged business persons to gain access to the resources necessary to develop small business and improve their ability to compete in the mainstream of the American economy. (SBA Online p. 1)

The 8(a) program provides participants access to a variety of business development services, including the opportunity to receive Federal contracts on a sole-source or limited-competition basis.

## **B. ELIGIBILITY**

The qualification criteria required of business concerns to be eligible for benefits provided under the 8(a) appear to be strict. The requirements of the program are summarized below.

### **1. Small Business**

A firm must qualify as a small business as defined in part 121 of SBA rules and regulations. The particular size standard to be applied is based on the primary industry classification of the applicant firm. (SBA pt. 121)

### **2. Ownership**

A firm must be at least 51 % unconditionally owned by an individual(s) who is a citizen of the United States and determined by SBA to be socially and economically disadvantaged.

a. In the case of a partnership, 51% of the partners' interest must be unconditionally owned by an individual(s) determined by SBA to be socially and economically disadvantaged.

b. In the case of a corporation, 51% of each class of voting stock and

51% of the aggregate of all outstanding shares of stock must be unconditionally owned by an individual(s) determined by the SBA to be socially and economically disadvantaged.

c. The individual(s) upon whom eligibility is based must receive at least 51% of the annual distribution of dividends paid on the voting stock of a corporate applicant firm.

d. One 8(a) firm may not hold more than a 10% equity ownership interest in any other 8(a) firm.

e. An individual in an 8(a) firm, whether or not disadvantaged, is prohibited from simultaneously holding an equity ownership interest exceeding 10% of another 8(a) firm.

f. A non-8(a) firm in the same or similar line of business is prohibited from having an equity owner interest in an 8(a) firm exceeding 10%.

g. With prior SBA approval, an 8(a) firm may continue participation in the program after a change of ownership. Prior SBA approval is not required when a change in ownership represents less than 10% interest in the firm or results from the death or incapacitation to serious or long-term illness or injury of a disadvantaged principal.

h. A program participant's request for SBA's approval of the issuance of a public offering is treated as a request for a change in the ownership and SBA will examine the firm's continued need for access to the business development resources of the 8(a) program.

### **3. Control and Management**

The management and daily business operations of a firm must be controlled by an owner(s) of the firm who has been determined to be socially and economically disadvantaged. For a disadvantaged person to control the firm, that person must have managerial or technical experience and competence directly related to the primary industry in which the firm is seeking 8(a) certification and assistance.

For those industries requiring professional licenses, SBA determines that the firm or individuals employed by the firm hold the requisite license(s). At least one socially and economically disadvantaged full-time manager must hold the position of President or Chief Executive Officer of the firm. This precludes outside employment or other business interests by the individual that conflict with the management of the firm or hinder it in achieving the objectives of its business development plan.

### **4. Social Disadvantage**

Socially disadvantaged individuals, as defined by the Small Business Act, are those who have been subjected to racial or ethnic prejudice or cultural bias because of their identities as members of groups without regard to their individual qualities. In the absence of evidence to the contrary, the numerous groups are considered to be socially disadvantaged.

Individuals who are not members of one of the recognized socially disadvantaged groups may establish their social disadvantage on the basis of clear and convincing evidence. That evidence must include the following elements:



- Social disadvantage must stem from color, ethnic origin, gender, physical handicap, or isolation from mainstream American society.
- The individual must demonstrate that he/she personally suffers social disadvantage, not merely claim membership in a non-designated group which can be considered socially disadvantaged.
- The individual's social disadvantage must have negatively affected his/her entry into and advancement in the business world.

#### **5. Economic Disadvantage**

For purposes of the 8(a) program, economically disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities. In determining economic disadvantage for purposes of the 8(a) program eligibility, SBA compares the firm's business financial profile with profiles of businesses in the same or similar lines of business which are not owned and controlled by socially and economically disadvantaged individuals.

#### **6. Potential for Success**

A firm must demonstrate that it has been in business in a primary industry classification in which it seeks 8(a) certification for two full years prior to the date of 8(a) application by submitting income tax returns showing revenues for each of the pervious two years. To determine whether a firm has the potential for success, SBA evaluates technical and managerial experience and competence of the individual(s) upon which

eligibility is based, the financial capacity of the applicant firm and the firm's record of performance on previous Federal and private sector contracts in the primary industry in which the firm is seeking 8(a) certification.

### **7. Additional Requirements**

Standards of conduct apply to firms enrolled in the program. Manufacturers and regular dealers must meet the requirements of the Walsh-Healey Public Contractors Act in their primary industry classification. Immediate family members living in the same household may not each use their individual disadvantaged status to qualify more than one business firm for 8(a) program participation if the firms are in the same or similar line of business.

### **8. Two-Year Rule Waiver:**

Public Law 101-574 allows a waiver of the two-year-in-business requirement for participation in the 8(a) program when the following criteria are met:

- The individual(s) upon whom eligibility is based have substantially demonstrated business management experience;
- The applicant has demonstrated technical expertise to carry out its business plan with a substantial likelihood for success;
- The applicant has adequate capital to carry out the business plan.
- The applicant has a record of successful performance in contracts from Governmental and non-Governmental sector in the primary industry category in which the applicant is seeking program certification.

- The applicant has demonstrated, or can demonstrate, the ability to obtain the personnel, facilities, equipment, and other requirements needed to perform such contracts. (Small Business Act sec 8(a))

### **C. BENEFITS OFFERED UNDER THE 8(A) PROGRAM**

Firms that meet the above mentioned eligibility criteria are entitled to enroll in the program. Enrolled firms may receive a variety of business development assistance including the following:

- Management and technical assistance
- Direct SBA loans
- Surety bond waivers\*
- Preferential transfer of Government surplus property
- Federal contracts awarded under special procedures

### **D. CONTRACTING UNDER SBAs 8(a) PROGRAM**

Federal agencies with procurement authority have been encouraged to establish goals for using small disadvantaged businesses as sources of supplies and services. Most agencies simply set a target goal in the form of a fixed percentage of total procurement dollars. For instance, the Department of Defense has established a goal of directing at

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\* The Miller Act requires construction contractors in the United States to furnish payments and performance bonds, otherwise known as surety bonds. Failure to furnish Miller Act bonds or furnishing forged bonds is a basis for termination of a contract for default.

least five percent of total procurement to small disadvantaged businesses. (Defense Contracting Regulations 1994 p. 7) Numerous and complex decision variables are addressed by all agencies in determining which procurement actions are appropriate for the 8(a) program. Agencies have both formal and informal procedures for carrying out their respective small disadvantaged business goals. While important in their own right, these decision practices are beyond the purview of this research.

When the decision is made to obtain goods and/or services from small disadvantaged business concerns through the 8(a) program, agencies contract with the Small Business Administration on a noncompetitive basis. The SBA, in turn, subcontracts with one or more firms enrolled in the 8(a) program. It is important to note that the cost of goods and/or services in excess of the procuring agencies' estimated current fair market prices is eligible for funding by SBA as a business development expense. (Federal Acquisition Regulations 1996 19.803)

## **E. PROGRAM STATISTICS**

### **1. Program Scope**

Federal contracts awarded under the program is the primary program element being studied by the researcher. Although contracts awarded under the 8(a) program are a small percentage of total contract dollars expended by all Federal agencies in a given fiscal year, expenditures under the 8(a) program have come to represent a significant

financial outlay to minority business enterprises\* over the past several decades as indicated by the data compiled by the Department of Commerce, presented in Table 3.1. In several instances raw data was not available for fiscal years subsequent to 1994. Therefore, in order to accurately compare all agency statistics, this research uses data from 1994.

**Fourteen Year History of Federal Assistance to Minority Business Enterprises  
Fiscal Years 1981-1994**

Fiscal year	8(a) Procurement			Fiscal Year Total
	by Federal Agencies	Direct/ Subcontract Procurement	Bonds, Guarantees, Loans, Grants	
1981	\$1,774,319,000	\$2,337,809,000	\$2,869,183,000	\$ 6,981,311,000
1982	\$1,914,191,000	\$2,451,521,000	\$2,079,783,000	\$ 6,445,495,000
1983	\$2,058,280,000	\$2,758,950,000	\$2,614,940,000	\$ 7,432,170,000
1984	\$2,497,141,000	\$3,526,130,000	\$3,497,100,175	\$ 9,520,371,175
1985	\$2,827,819,663	\$3,497,881,776	\$3,304,714,209	\$ 9,630,415,648
1986	\$3,097,883,894	\$3,613,583,815	\$3,312,038,829	\$ 10,023,506,538
1987	\$3,510,505,473	\$4,006,454,544	\$4,153,632,951	\$ 11,670,592,968
1988	\$3,647,122,487	\$4,171,246,614	\$3,837,949,591	\$ 11,656,318,692
1989	\$3,541,931,085	\$5,091,143,090	\$4,784,080,120	\$ 13,417,154,295
1990	\$3,740,695,929	\$5,696,586,074	\$4,481,448,563	\$ 13,918,730,566
1991	\$4,055,536,158	\$6,010,849,071	\$4,981,057,806	\$ 15,047,443,035
1992	\$4,784,047,308	\$6,955,587,907	\$4,947,471,797	\$ 16,687,107,012
1993	\$5,279,671,260	\$8,072,899,525	\$5,371,385,512	\$ 18,723,956,297
1994	<u>\$5,407,713,910</u>	<u>\$9,036,127,789</u>	<u>\$5,272,336,116</u>	<u>\$ 19,716,177,815</u>
Totals	\$48,136,858,167	\$67,226,770,205	\$55,507,121,669	\$170,870,750,041

Table 3.1 Fourteen Year History of Federal Assistance to MBEs Fiscal Years 1981-1994 (Department of Commerce 1994 p. 5)

\* The term Minority Business Enterprise has developed as a less controversial term used to describe those groups of individuals who are both socially and economically disadvantaged as defined earlier in the research.

Figure 3.1 chart illustrates the fairly constant percentage of expenditures represented by 8(a) contracting. Although actual dollar amounts expended by procuring agencies under the 8(a) program have grown in real terms, the portion of funds directed to Minority Business Enterprises vis-à-vis 8(a) has remained level.

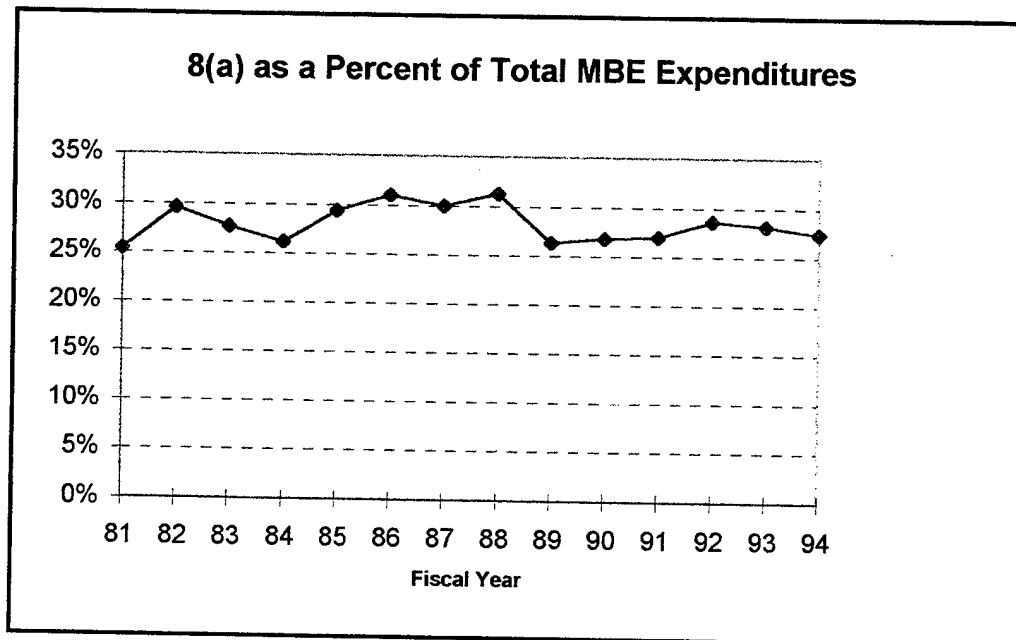


Figure 3.1 Fourteen Year History of 8(a) Expenditures as Percentage of Total MBE Expenditures (Department of Commerce 1994 p. 5)

Although not mandated, all agencies involved in procurement contracting are encouraged to use the 8(a) program. Table 3.2 illustrates to what degree agencies procure under the 8(a) program. Agencies with procurement expenditures in excess of \$500 million are listed below.

**Federal Agency 8(a) Procurement**

**FY 1994**

<b>Agency</b>	<b>Total Agency Procurement (In thousands)</b>	<b>8(a) Procurement (In thousands)</b>	<b>(a) Procurement Percentage</b>
Agriculture	3,897,520	125,834	3.2%
AID	3,177,949	44,862	1.4%
Commerce	802,854	79,189	9.8%
Defense	112,013,000	2,754,000	2.5%
Energy	9,404,716	340,471	3.6%
EPA	1,341,000	69,000	5.1%
GSA	6,461,874	200,365	3.1%
HHS	3,522,772	266,898	7.5%
HUD	685,259	60,028	8.7%
Interior	1,386,357	141,418	10.2%
Justice	2,194,348	116,923	5.3%
Labor	846,438	31,155	3.6%
NASA	11,619,633	314,251	2.7%
Postal Service	4,663,982	0	0.0%
State	616,592	77,262	12.5%
Transportation	2,471,917	394,044	15.9%
Treasury	1,351,261	194,936	14.4%
TVA	2,112,000	4,000	.2%
VA	4,114,752	131,227	3.1%
<b>Total</b>	<b>173,273,269</b>	<b>5,407,713</b>	<b>3.1%</b>

Table 3.2 Federal Agency Total Procurement and Agency 8(a) procurement for Fiscal Year 1994  
(Department of Commerce 1994 p.7)

The Small Business Administration's 8(a) program is a substantial portion of direct aid extended to Minority Business Enterprises (MBEs) by the Federal Government each year. Figure 3.2 presents comparative data of all Federal aid to MBEs is illustrated below:

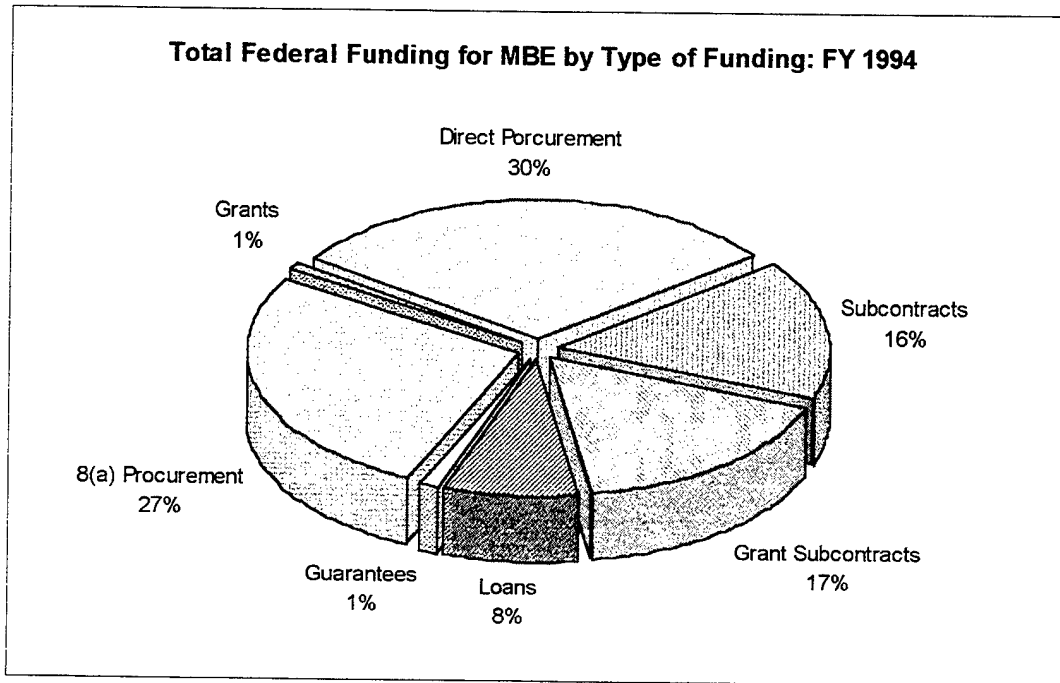


Figure 3.2 Total Federal Funding for MBE by Type of Funding: FY 1994  
(Department of Commerce, 1994 p.4)

## 2. 8(a) Firm Revenue

During fiscal year 1994, 984 firms were initially certified to participate in the 8(a) program. A total of 5,646 small disadvantaged business concerns participated in the program. This figure includes all firms that entered and exited the program throughout the year. Field offices estimate that these firms employed for 143,500 people. (United States Small Business Administration 1994 p. 7)

According to year-end financial statements submitted by participants for the fiscal year ending September 30 1994, the average total revenue per reporting firm was



approximately \$2.02 million. The average 8(a) revenue per firm was \$938,055, or 46 percent of the firm's total revenue. Total revenue for all firms reporting was \$8.2 billion; total 8(a) revenue was \$3.8 billion. (United States Small Business Administration 1994 p. 7)

### **3. Net Worth of Program Participants**

During fiscal year 1994, 984 firms were initially certified to participate in the 8(a) program. Table 3.3 presents data on the personal net worth of the 1,193 individuals that have used their eligibility to qualify the 984 firms. The average adjusted personal net worth\* of these individuals was \$134,021 (median adjusted net worth was \$102,400). The average adjusted personal net worth of individuals who have been enrolled in the program for less than one year was \$60,327 (median adjusted net worth was \$44,965). Compared to data from fiscal year 1991 where the average adjusted personal net worth was \$142,309 (median \$100,000) and \$52,913 (median \$50,000) respectively, there appears to be little growth or decline in the net worth of newly enrolled participants. (United States Small Business Administration 1991 p. 3)

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\* For program purposes, adjusted personal net worth is defined as personal net worth less the individual's equity in a primary residence and business.

#### 4. Business Makeup of 8(a) Participants

##### Industries receiving Largest Amounts of 8(a) Contract Support Between October 1, 1993, and September 20, 1994

SIC Code	Description	Number	Dollar Amount
8711	Engineering Service	2,529	\$477,939,118
1542	General Contractors Non-residential	3,295	412,054,341
8731	Commercial Physical/ Biological Research	931	390,920,515
7379	Computer Related Services	1,674	305,116,512
1629	Dredging and Surface Cleanup	777	223,177,265
8744	Facilities Support/ Management Service	892	205,589,252
7349	Building Cleaning / Maintenance Service	1,823	170,251,580
7381	Detective Guard and Armored Car Service	461	120,822,248
3571	Electronic Computers	589	114,890,725
8742	Management Consulting Services	461	109,390,997

Table 3.3 Industries receiving largest amounts of 8(a) contract support between Oct 1, 1993, and Sept 30, 1994 (Small Business Administration May 1995 p. 25)

## 5. Program Costs

The SBA's Office of Minority Enterprise Development has the primary responsibility within the Federal Government for the administration of the 8(a) program. The following is a summary of the administrative, financial assistance, and management and technical assistance costs associated with the 8(a) program for fiscal year 1994.

<u>Program Administrative Costs</u>	\$27.5 million
Includes personnel, travel, supplies, training and similar administrative expenses.	
<u>Management and technical Assistance 7(j)</u>	\$6.2 million
Section 7(j) mandates that SBA obtain and maintain a qualified cadre of individuals and organizations to provide assistance to socially and economically disadvantaged individuals. (the figure shown reflects only the portion of 7(j) expenditures for 8(a) participant firms. Management and technical assistance under 7(j) was also provided to eligible non-8(a) firms and individuals.)	
<u>8(a) Loans to be repaid with interest</u>	\$2.4 million
<u>Advance Payments</u>	\$628,903
Advance payments are non-interest bearing loans made by SBA to an 8(a) participant in connection with the performance of a specific 8(a) contract to assist the firm in meeting financial requirements of performing the contract.	
Total 8(a) Program Costs (1994)	\$36.7 million

## **6. Status of Firms Exited from the 8(a) Program**

In January 1995, the district offices of the U.S. Small Business Administration conducted a survey of the 964 firms that had exited the 8(a) Program between October 1, 1991 and September 30, 1994. Of the 964 firms, 492 were determined to be independently operational, 41 had curtailed operations, 24 had been acquired by other firms owned and controlled by non-disadvantaged individuals, and 407 had ceased business operations. See Table 3.4 below.

Improvements in program management and oversight resulted in a significant increase in the number of firms that were processed for program termination. Companies are terminated from the 8(a) program for various reasons, including successful graduation and failure to comply with program requirements.

In fiscal year 1994, 21 percent of the firms evaluated had been terminated. This compares with 7 percent of the evaluated firms being terminated in fiscal year 1993. A large number of these firms had already ceased operating but were carried for a number of years as active participants. (United States Small Business Administration 1994 p. 11)

The reasons businesses ceased operations are numerous and may include reduced Federal contracting opportunities; economic conditions; retirement; illness or death of the owner; a decision to sell the business or start a new business venture; or the pursuit of other professional interests.

Status of 8(a) Business Concerns that Exited the Program  
between October 1, 1991 and September 30 , 1994

Status of Firm	Number	Percentage
Independently Operational	492	51%
Ceased Business Operations	407	42%
Curtailed Operations	41	4%
Acquired by Other Firms	24	3%
<b>Total</b>	<b>964</b>	<b>100%</b>

Table 3.4 Status of 8(a) Business Concerns that exited the program between October 1, 1991, and September 30, 1994 (U.S. Small Business Administration 1995 p.11)

#### F. CHAPTER SUMMARY

This chapter introduces the reformulated 8(a) minority development program. The program eligibility criteria and requirements for continued eligibility are presented in their most basic form. The benefits firms receive along with administrative costs of the program illustrate the magnitude of the program. A summary of key statistical data indicate to what degree the 8(a) program affects Federal agencies and which commercial industries benefit the most from the program. Data concerning the success rate of firms which exited the 8(a) program illustrates the success rate of the program in development viable small minority business enterprises.



#### **IV. PROGRAM PITFALLS: THE STATE OF AFFIRMATIVE ACTION TODAY**

Since the modification of the 8(a) program as a vehicle to create jobs in and promote the establishment of businesses owned and operated by socially and economically disadvantaged individuals, the program has suffered from persistent problems associated with administration and efficacy. Congress has made three major legislative attempts--in 1978, 1980, and 1988--to improve these aspects of the 8(a) program and to emphasize its business development aspects.

Of the numerous problems that have been cited as contributing to the inefficiency of the 8(a) program, several have existed for many years. The major recurring issues associated with the program include the lengthy and burdensome process of gaining access to the program, the 8(a) program's administrative inefficiency, the fact that most 8(a) program contracts are awarded to a small percentage of firms, and the fact that few firms are able to compete successfully in the open market upon leaving the 8(a) program. These and other issues are covered in further detail below.

Over the years, reports by GAO, SBA's Inspector General, and other have shown that SBA has continually had problems in administering the 8(a) program. These reports have made numerous recommendations to improve SBA's administration of the program. A report issued by the U.S. Commission on Minority Business Development concluded that no more could be done to correct SBA's lax responsibility toward the 8(a) program and recommended that most of SBA's 8(a) program authorities be transferred to a new agency, which would need to be created by statute, in the Department of Commerce. (GAO, Sept 1993 p.3) The report stated that SBA's lack of progress with regard to the

8(a) program is due more to an institutional aversion to the minority business programs than to some chronic resource limitation.

## **A. ADMINISTRATIVE INEFFICIENCIES**

### **1. Lengthy Processing for Certification of 8(a) Program Participants**

In 1992, the United States General Accounting Office (GAO) conducted investigations into 8(a) program difficulties and reported that one problem associated with the poor access to the program was that the certification process took too long. The Small Business Act requires SBA to process each application and decide on an applicant's eligibility for the program within 90 days of receiving a completed application. The investigation noted that (1) only 24 percent of the applications processed during the first 11 months of 1990 met the mandated time frame, (2) SBA was averaging 117 days to process an application, and (3) SBA was unable to determine where delays were occurring because of missing data in its manual application-tracking system.

During fiscal year 1992, SBA completed the processing of 846 applications. Analysis showed that SBA took an average of 170 days to decide whether to approve or decline each of these applications. Of the 846 applications, only 68, or about 8 percent, were processed in 90 days or less. Additionally, 531 applications, or about 63 percent, took at least 151 days to process. Table 4.1 shows the processing times for 1992 applications.



**Elapsed Times for 8(a) Applications Processed  
During Fiscal Year 1992**

Number of Days	Number of Applications	Percent of Applications
90 days and less	68	8.0
91 to 120	100	11.8
121 to 150	147	17.4
151 to 180	191	22.6
181 to 210	174	20.6
More than 210	166	19.6
Total	846	100.0

Table 4.1 Elapsed Times for 8(a) Applications Processed During Fiscal Year 1992 (GAO/RCED-93-145 1993 p.5)

**2. Annual Review of Business Plans**

Business plans are viewed as tools to aid an 8(a) firm's development by requiring that each plan analyze the firm's strengths and weaknesses, set forth its business development goals and objectives, and estimate its future 8(a) and non-8(a) contract activity. SBA is directed to (1) approve a firm's business plan before the firm becomes eligible for contract and (2) annually review each business plan with the firm and modify the plan, as needed, to make sure the firm's business development goals are realistic and to help the firm achieve them. (GAO, Sept 1993 p.5)

In Fiscal Year 1994, only 80 percent of firms receiving contracts under the 8(a) program had new or revised business plans that had been approved by SBA. Additionally, of the firms with approved business plans only 57 percent had been reviewed on an annual basis.

### **3. Failure to Meet 8(a) and Non-8(a) Business Mix Levels is Limited**

To increase the program's emphasis on business development and the viability of firms leaving the program, SBA is directed to establish levels of contract dollars that firms in the last five years of their program terms must achieve from non-8(a) sources. The non-8(a) business mix levels that SBA established increase during each of the 5 years, ranging from a minimum of 15 percent of a firm's total contract dollars during for the fifth year to a minimum of 55 percent of the total contract dollars in the final year. SBA field offices are responsible for determining whether firms achieve their non-8(a) business levels.

In 1995, data indicated that of 1,038 firms in the fifth through ninth year of their program, 63 percent of the firms met or exceeded the minimum non-8(a) business levels. This data also showed that firms that had been enrolled in the program longer did worse at meeting non-8(a) business levels. Only 37 percent of firms in their eighth or ninth years of the program met or exceeded the non-8(a) business levels.

In addition, firms that receive most of the 8(a) contract dollars often do not meet their non-8(a) business levels. During fiscal year 1994, 40 firms enrolled in the 8(a) program received more than \$10 million each in 8(a) contract awards for the year. Only nine of those firms met their non-8(a) business levels. The other 31 firms achieved an average of only 40 percent of their minimum non-8(a) business. Three firms, including one with only one year remaining in the 8(a) program, reported no non-8(a) business during fiscal year 1994. (GAO, April 1995 p.6)

#### **4. 8(a) Program Vulnerable to Contractor Abuse**

General Accounting Office investigations indicate that the 8(a) program is susceptible to abuse and fraud on the part of program participants. Random audits of companies that had initially been recommended for non-acceptance, but were enrolled into the 8(a) program indicated that most should not have been accepted. Adverse recommendations were typically the result of questions as to the eligibility of the firm or individual(s) applying for acceptance in the program.

In many cases, firms failed to inform SBA about the true equity ownership in the firm, in violation of SBA regulations. Additionally, firms misrepresented information to SBA about owner's personal qualifications including training and educational credentials. Other instances of contractors' attempts to take advantage of program benefits include purposely excluding items from financial statements, understating total revenue, and misrepresentation of firms' financial health.

SBA regulations require a review and determination of findings when issues concerning eligibility to enter and remain in the 8(a) program arise. During the period of review, contractors are not allowed to receive any new 8(a) contracts but may continue performance on contracts already awarded. In numerous cases in which a contractor had achieved program goals and was being considered for "early graduation," SBA continued to award significant contracts to these firms. In cases in which SBA became aware of misrepresentations made to remain eligible for program benefits, no action was taken to suspend such firms or preclude them from receiving further contracts under the program.

(GAO, Sept 1995 p.3)

## **B. CONTRACT DOLLARS ARE CONCENTRATED IN A SMALL PERCENTAGE OF FIRMS**

A long-standing problem associated with the 8(a) program is the concentration of contract dollars among a relatively few firms. In fiscal year 1994, 50 firms, or about 1 percent of the 5,155 firms in the program, received about 25 percent of the \$4.37 billion in total 8(a) contract dollars awarded during the fiscal year. As 8(a) contract dollars continue to be concentrated in a few firms, many firms do not receive any 8(a) program contracts. According to the SBA, of the 5,155 firms in the program at the end of fiscal year 1994, 2,885 firms (about 56 percent) did not receive any program contracts during the year. In the prior three years, 53 percent of the firms did not receive any program contracts. (GAO, April 1995 p.4)

A key reason for the continuing concentration of contract dollars among relatively few firms is the conflicting objectives confronting agency procuring officials. The primary objective of agency procuring officials is accomplishing their agency's mission at a reasonable cost, and the business development objectives of the 8(a) program are secondary. Moreover, agency procurement goals for the 8(a) program are stated in terms of the dollar value of contracts awarded. According to the SBA, the easiest way for agencies to meet this goal is to award a few large contracts to a few firms, preferably firms with which the agencies have had experience. (GAO, April 1995 p.5)

## **C. POOR SUCCESS RATE UPON GRADUATION FROM THE PROGRAM**

Over the life of the 8(a) program, audits have indicated a lack of effectiveness in preparing firms for the competitive marketplace upon graduation from the program. In

1975 audits then required by Public Law 93-386 concluded that SBA's success in helping disadvantaged firms become self-sufficient and competitive was minimal. Of the 110 firms evaluated, 73 had not reached self-sufficiency. Of the 73 firms that had not reached self-sufficiency, 20 deteriorated financially, 27 went out of business, and the remaining 26 had either a slight financial improvement or no change. (GGD-75-57, Apr. 16 1975 p. 12)

The data presented in Table 3.4 is illustrative of the poor success rate of firms that graduate from the 8(a) program. In 1986 the Senate Committee on Small Business conducted a national survey to determine the status of 8(a) firms that had graduated since the enactment of Public Law 96-481. In addition the survey was to assess the effectiveness of the business development aspects of the 8(a) program in preparing firms for the competitive marketplace. The survey was sent to 461 firms that had graduated from the program between October 1982 and February 1986. Most respondents indicated that they thought the program was an important tool for ensuring the inclusion of minority firms in the Federal procurement system. However, most were very concerned about the lack of progress in making the 8(a) program a true business development experience for participants, as intended by law, as well as other major deficiencies in the overall operation of the 8(a) program. These concerns seemed to overshadow the any positive aspects of the program. (U.S. Congress, Senate Committee on Small Business May 12, 198, p.22).

Personal interviews conducted by this researcher indicated that firms graduated from the program felt abandoned by the program. Program participants indicated a general lack of true concern for business development by program administrators. Firms receive occasional counseling and training as they first enter the program. The most emphasized area of the program seems to be the winning of contracts under 8(a). As

figures indicate in regards to the 8(a)/non-8(a) mix of business levels, few in the SBA are concerned with firms being weaned from the 8(a) contracts on which they become dependent..

#### **D. AFFIRMATIVE ACTION TODAY**

In the past five years a growing concern over the negative effects of affirmative action programs offering set-asides and quotas to groups categorized as socially and/or economically disadvantaged has received growing support from grass roots organizations and many state and local Governments. During this period 36 states have proposed legislation which would end preferential treatment based on race, sex, or national origin. Additionally, numerous lawsuits have questioned the constitutionality of such preferential treatment. In what is probably the most important court ruling on the subject of affirmative action programs, the Supreme Court's reversal of a lower court ruling in *Adarand Constructors Inc. v. Peña* (Department of Transportation) signified a challenge to the fundamental ideology underlining the Federal Government's affirmative action policies and programs.

##### **1. Adarand v. Pena**

The Adarand case originated in 1989, when a division of the U.S. Department of Labor awarded a contract for highway construction in Colorado to the Mountain Gravel & Construction Company. Mountain Gravel then solicited bids from subcontractors for the guardrail portion of the contract. Adarand Constructors presented the lowest bid which was both responsive and responsible as defined by the Federal Acquisition

Regulations. Mountain Gravel, however, awarded the work to the Gonzales Construction Company because the Federal Government gave it a bonus for choosing to work with a company certified as a small business controlled by “socially and economically disadvantaged” individuals as defined by the Small Business Act. (Adarand Constructors, Inc. v. Peña June 12, 1995 p. 10)

In a 5-4 ruling, the Supreme Court reversed a lower court’s decision that the set-aside was constitutional. The court remanded the case, instructing the lower courts to determine whether this Federal set-aside survives Constitutional scrutiny under the “strict scrutiny” test:

- There must be a compelling state interest, defined as a judicial, legislative, or administrative “finding” of constitutional or statutory violations of discrimination laws
- The statute must be narrowly tailored, meaning that Congress must examine all race-neutral remedies before considering racial preferences. Moreover, the remedy must be targeted to give relief to identified victims of past discrimination and cannot extend longer than the discriminatory effects it was intended to eliminate. (Nadler, August 1995 p. 3)

In its analysis, the court concluded that general historical discrimination does not constitute a “compelling state interest.” The court also rejected the argument that racial preferences are necessary when minority participation in a certain Government program is less than that minority’s percentage of total population (Disparate Impact Theory). Finally, the court implicitly rejected the argument that “diversity” is a compelling state

interest, holding that only specific factual findings of discrimination will satisfy the first part of the strict scrutiny test. (Sutherland, Sept, 1995 p. 3)

Justice Scalia, in his concurring opinion summed up the rationale behind the Supreme Court's decision stating:

... In my view, Government can never have a compelling interest in discriminating on the basis of race in order to make up for past racial discrimination in the opposite direction. Individuals who have been wronged by unlawful racial discrimination should be made whole; but under our Constitution there can be no such thing as either a creditor or debtor race. That concept is alien to the Constitution's focus upon the individual and its rejection of dispositions based on race or based on blood. To pursue the concept of racial entitlement, even for the most admirable and benign of purposes, is to reinforce and preserve for future mischief the way of thinking that produced race slavery, race privilege, and race hatred. In the eyes of Government, we are just one race here. It is American.

## **2. Adarand's Effect on Federal Procuring Agencies**

Although a landmark case for affirmative action programs in Federal procurement, Adarand's effects may take years to come to fruition. The manner in which Government agencies contract for goods and services with minority-owned businesses remains virtually unchanged at this time.

The Department of Justice issued interim advice to agency heads on the impact of Adarand on minority procurement activities. The 37-page memo known as the Dellinger memo advises agencies not to suspend current affirmative actions programs until they have been properly evaluated in light of Adarand's "strict scrutiny" standard. In order to help agencies evaluate their programs, the memo presents a list of questions to ask in reviewing specific programs. Among the areas the memo recommends considering are the following:



- Is race or ethnicity being used as a decision criterion as the result of a legislative mandate or with congressional approval? If not, it may be on shaky ground.
- Is the program justified solely on the basis of general societal discrimination or the statistical under-representation of a particular group? If so, in light of Adarand, it's definitely on shaky ground.
- Has the agency considered other, race-neutral criteria to accomplish its objectives, e.g. income, education level, geographical location? After all it may be possible to accomplish the same objectives using such race-neutral criteria.
- Is the program still necessary to accomplish its original objectives, or have they already been attained? (Dellinger 28 June 1995)

### **3. Continuing Challenges to the 8(a) Program**

The decision in *Adarand v. Peña* seems to have opened the floodgates of opposition to minority set-aside programs. Of the eight legal challenges made since *Adarand*, four have specifically targeted the 8(a) program. The first challenge to the 8(a) program was filed by a small company, C.S. McCrossan, on the basis that the program violated the right to equal protection under the fifth Amendment to the Constitution and the right to enter into contracts free of discrimination under the Civil Rights Act of 1866. The second challenge was filed by Science Applications International Corp. because contracts it had executed for over 19 years were set aside for procurement from an 8(a) firm. The third challenge, Dyna Lantic Corp. used *Adarand* as a spring board to challenge the constitutionality of the program. It is very ironic that the last of the four challenges to

the 8(a) set-aside program came from a former 8(a) firm whose program eligibility had expired. Ellsworth Associates Inc. challenged the program after it was denied a contract it had performed before because it was reserved for an 8(a) firm. At this time their eligibility had run out. (Kim, Dec 1996)

#### **4. Current Program Initiatives**

Numerous senators and representatives have introduced legislation to end the practice of preferences in Federal employment and contracting on the basis of race, color, national origin, or sex. Those leading the way with such measures include Representatives Helms and Faircloth of North Carolina, Representative Canady of Florida, Representative Radanovich of California, Senator Bond of Missouri, and the now-retired Senator Dole of Kansas. Several of these bills have either been tabled or died in committee. The most promising initiative that has garnered support from members of both parties is that introduced by Senator Bond-the "HUB Zone Act of 1997."

##### **a. HUB Zone Act of 1997**

The HUB Zone Act is based on the premise that preferential treatment in awarding Federal contracts on the basis of a perceived social and economic disadvantage of a group of individuals due to racial or ethnic discrimination targets a narrow group of individuals in need of economic assistance. The bill contends that by offering preferential treatment in the award of Federal contracts to businesses operating in "historically underutilized business zones" the Federal contracting system can be a more effective tool for the stimulation of economic growth in certain regions of the country. The bill's author also points out that work forces found in these business zones are comprised to a large

extent by members of minority groups usually targeted under other affirmative action programs. Contracts that would be covered under the act exceed the dollar value of the simplified acquisition threshold (currently at \$100,000) and do not exceed \$5,000,000. (HUB Zone Act of 1997 p. 3)

The HUB Zone Act contains qualifying criteria both in terms of definition of a "historically underutilized business zone" and company demographics which must be met in order to participate in the program. Of obvious importance is the requirement that at least 35 percent of employees reside in the business zone in order to qualify. It is important to discuss sections of the act dealing with the relationship of the HUB Zone contracts program to that of other contracting preferences. In the case of 8(a) program, HUB Zone would take precedence over 8(a) firm preferences. This proposed relationship certainly is a major point of contention among SBA administrators and 8(a) eligible firms.

The HUB Zone Act makes several amendments to the Small Business Act including a change in the qualifying language of the act. It modifies language of the Small Business Act by striking the phrase "...small business concerns owned and controlled by socially and economically disadvantaged individuals" and inserting "qualified small business concerns located in historically underutilized zones, small business concerns owned and controlled by socially and economically disadvantaged individuals". This change in language along with the overriding position the HUB Zone would have over 8(a) contract preferences all but declares the ability of the 8(a) program to conduct preferential contracting with minority businesses. In April 1997 press release, Aida Alvarez, head of the U.S. Small Business Administration, commented that although the objectives of the HUB Zone Act are to be applauded, implementation of such a program

would be costly to her agency and difficult to implement. She, on the other hand, stressed the advantages of plans based on the president's Executive Order 13005, Empowerment Contracting.

**b. Executive Order 13005**

With only slight differences from the legislative proposed HUB Zone Act, President Clinton has offered Executive order 13005 on May 21, 1996. The purpose of the order is to "strengthen the economy and to improve the efficiency of the Federal procurement system by encouraging business development that expands the industrial base and increases competition". (Clinton, p.2) It calls for the establishment of empowerment contracting programs throughout Federal agencies. These Empowerment Contracting programs target general areas of economic distress. For the purposes of this executive order, an area of "general economic distress" is defined as any census tract that has a poverty rate of at least 20 percent (urban and rural communities alike). The order also includes other areas as defined by pre-existing programs to be Federal Empowerment Zones, Supplemental Empowerment Zones, Enhanced Enterprise Community, or Enterprise Community. (Clinton, p.3)

This order envisions offering "appropriate" incentives to both qualified large and small business to encourage business activity in areas of general economic distress. Incentives may include price or evaluation credit on offers made for Government contracts. While the HUB Zone Act would attempt to incentivize small business to establish operations in economically distressed areas, Empowerment Contracting shows no favor towards large or small business in attempting to revitalize economically distressed communities. At this point in time, Empowerment Contracting does not

mandate the use of a fixed percentage of local labor as criteria for receiving benefits, but rather lays the ground work for future quotas by stating that a significant number of residents from the economically distressed area shall be employed.

On September 13, 1996, the Department of Commerce published proposed guidelines for implementing Executive Order 13005. Amendments to the FAR (currently underway) are based on the Department of Commerce' proposed guidelines. Interim and final changes to the FAR and FAR supplements will follow the evaluation of phase I of the Empowerment Contracting implementation.

#### **E. CHAPTER SUMMARY**

This chapter reviews some of the major pitfalls of the 8(a) program. For many years Federal agencies tasked with audit responsibilities have remarked on several areas of concern in the Small Business Administration's 8(a) program. Some administrative problems have been addressed and corrected over the years while other issues appear to be inherent in this type of aid program.

The Federal Government's measurement of program success has, in some cases, led to problems concerning the distribution of contract dollars. While objectifying program goals by establishing agency 8(a) contract quotas, the Federal Government has created opportunities for agency and contractor abuses.

The Supreme Court's decision in *Adarand Constructors, Inc. v. Peña* has fueled the often controversial issue of affirmative action and specifically affirmative action programs which offer quotas and set-asides based on a minority affiliation. With growing resentment of and opposition to these programs, both the legislative and executive

branches of the Federal Government hope to seize the opportunity to restructure the way in which the Federal Government implements socio-economic policy.

## **V. ANALYSIS OF AFFIRMATIVE ACTION SET-ASIDE PROGRAMS**

The analysis presented in this research examines both the efficacy of the SBA's 8(a) contracting program and the effect such programs have on the nation's economy as a whole. Aspects of the 8(a) program examined here include the cost of program administration and the cost to procuring agencies versus the apparent benefits provided to both minority groups and procuring agencies alike. The author then examines the economic impact of set-aside and quota programs on overall market efficiency.

The concept of compensation for past discrimination is a dangerous one. It can be extended indefinitely. Who is to determine what is proper compensation for minority groups that have experienced discrimination in the past? In the late 1960s and early 1970s when affirmative action policy was formulated, proponents argued that it was only a temporary measure to compensate minority groups for past wrongs. Now, a generation of Americans has grown up knowing only a reality with affirmative action set-aside programs. It is certainly easy to imagine that generation commenting on why we have such affirmative action programs, "It's always been that way!"

### **A. ANALYSIS OF SBA's 8(a) SET-ASIDE PROGRAM**

#### **1. Underlying Issues and Assumptions of the Program**

Social issues that have led to affirmative action programs such as the SBA's 8(a) program, are somewhat amorphous and constantly changing. The ability to objectify and measure benefits of social policies implemented through the 8(a) program is complicated

by the differing opinions of what those benefits should be. The lack of mechanisms available to gather and interpret cost information further blurs objectivity by obscuring some costs while magnifying others. This situation applies not just to the efficacy of the 8(a) program, but also to numerous other Government programs and policies that reduce economic freedom.

As understood by the author, the purpose of the 8(a) program is to combat the effects of past and continuing discrimination against certain minority groups in the area of business development. The program rests on the assumption that minority businesses have been discriminated against in securing capital, receiving technical and management assistance, and receiving business in the past. In determining the efficacy of the program, the researcher questions whether this assumption is valid and what, if any, objective facts support it.

Proponents of affirmative action in the form of quotas and set-asides argue that the lack of representative numbers of businesses owned and operated by minority groups compared to the percentage of the population they represent is proof of discrimination. This position, discussed earlier, is known as the "Disparate-Impact Theory." The disparate-impact theory conveniently ignores other economic and social factors that may play more important roles in the entrepreneurial endeavors of minorities. Rather, proponents contend that these other explanatory factors are in themselves a result of past discrimination and therefore further justify the need for programs such as 8(a).



## **2. 8(a) Program Administrative Costs**

While costs are certainly objective, distinguishing which costs are directly attributable to the 8(a) program remains inexact. These costs can be categorized as costs incurred for program administration and costs associated with procuring agencies paying non-competitive prices for goods and services when procuring through SBA's 8(a) program.

Referring back to information presented in Chapter Three, 8(a) program costs for fiscal year 1994 totaled \$36.7 million. Approximately 75 percent of costs included in this figure are those required to administer the program (i.e. paying salaries, maintaining capital assets etc.). If the 8(a) program did not exist, these costs also would not be incurred by the Federal Government. The next largest cost associated with the program is \$6.2 million for technical and training assistance given program participants. But for the program's existence, these costs would not be incurred. Other cost categories (loans repaid with interest, advance payments) are not critical in the analysis since they represent no real expense in the long run.

To illustrate the relation of expenses to benefits derived by participants, it is beneficial to allocate costs among program participants. During fiscal year 1994, 5,646 businesses participated in the 8(a) program. Administrative and technical/training expenses per company, therefore, are \$5,968. For the program to be worthwhile therefore, each firm should receive almost \$6,000 in administrative, technical/training benefit from the program per year.

### 3. 8(a) Program Impact on Procuring Agencies

Section 8(a) of the Small Business Act allows price inefficiency in awarding agency contracts to minority firms under the program. The program sets the maximum allowable inefficiency of 10 percent above competitive fair market prices\* as a basis for contract award to 8(a) firms. Assume that all contracts awarded under the 8(a) program exceeded the fair market value for goods and services by only 5 percent. For fiscal year 1994, the total contract and modification dollars awarded under the 8(a) program were approximately \$4.38 billion. This means that the Government paid approximately \$219 million for inefficiency built into the program under a conservative assumption that prices paid were only half the allowable 10 percent increase over fair market price.

A study conducted by the Army Corps of Engineers on the inefficiencies in awarding dredging contracts to 8(a) firms indicated that the price for certain contracts awarded under the 8(a) program were 21 percent above the fair market price of the services. (DoD, Sept 1996 p. 15) While the differences between fair market price and price awarded to 8(a) firms are not reflected in procuring agency budgets, they are paid out of Federal funds. Regardless of where the funds originate, this large cost associated with the program represents no added value to the procuring.

Procuring agencies, in addition to paying more for contracted goods and services, expend a large amount of resources in ensuring requirements are properly screened for potential award under the 8(a) program. The Federal Acquisition Regulations require contracting officers to follow specific procedures and guidelines to ensure all contract

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\* The Federal Acquisition Regulations (FAR Part 19.001) defines "fair market price" as the price based on reasonable cost under normal competitive conditions and not on lowest possible cost.

actions are reviewed for possible award to small disadvantaged business.(FAR Part 19.202) The decision to use small disadvantaged firms under the 8(a) program is often made by Federal agencies knowing that additional time and effort must be expended in the administration of such contracts.

#### **4. The Inefficiency of the 8(a) Program in Developing Minority Business**

Since the main objective of the SBA's 8(a) program is to counteract so-called institutionalized discrimination towards minorities in business by encouraging and developing minority-owned businesses, it is important to analyze whether the program attains this goal. The ability to analyze the program's efficacy is severely limited due to the lack of a control group or population to benchmark the 8(a) program results against.

With available data, a comparison can be made between firms participating in the 8(a) program and other small businesses in the United States that do not receive preferential treatment on Federal contracts. A measure of long-term business development is the survival rate of businesses over a period of time. Substantive business development programs should enhance a firm's ability to remain viable. Does the SBA's 8(a) program better a firm's ability to survive in our economy?

Statistics offered in chapter three offer insight into the of the 8(a) program's effectiveness in developing companies' ability to survive. Of 8(a) firms which exited the program between October 1, 1991, and September 30, 1994, 46 percent ceased or severely curtailed operations. At first, this may seem to be an abysmal success rate for minority business development through the 8(a) program, but as the president's 1993 report on small business points out, approximately 50 percent of small businesses fail in

the first five years of operations. Therefore when compared to the statistics reported for all small businesses, regardless of minority status, certainly doesn't look all that bad.

While comparing favorably with failure rates of small businesses in the United States, is a meager 4 percentage points statistically significant enough to draw conclusions on the efficacy of the program? A more critical question, given the amount of assistance offered 8(a) firms, would be whether there should be a much greater success rate among firms graduated from the program. With a program length of nine years over which firms qualify for set-aside contracts, low interest loans and grants, advance payments, and technical and training assistance 8(a) firms have a tremendous advantage over other small businesses.

In comparing statistical success rates of 8(a) graduates and non-8(a) small businesses, certain biases in the data must be taken into account. First, figures compiled by the SBA showing a failure rate of 46 percent applies only to those firms that fully participated in the 8(a) program and graduated after nine years. The number of firms that dropped out of the program, for whatever reason, is not accounted for in this statistic. Perhaps if data concerning the status of firms that did not remain in the program until graduation were available, the failure rate would be considerably greater. Second, the data reported by the SBA represents a different period in the life of firms compared to data presented in the President's report on small business. According to the President's report on small business for 1993, the failure rate for small business in the first five years of operation is approximately 50 percent. It stands to reason that the first several years of business operations are perhaps the most difficult. New business must obtain capital, hire employees, build a customer base, in addition to learning the basics of running a business.

On the other hand, the data presented by the SBA on firms exiting the 8(a) program shows failure rates for 8(a) firms after nine years in business. After nine years of operating a business, 8(a) firms have survived well past the presumably more difficult early years of a firm's existence. After nine years, these firms perhaps should have an established customer base, a history of good credit with which to obtain additional capital, and nine years experience managing the business operations. These differences in data collection provide more powerful implications about the lack of effectiveness than do the statistics by themselves.

If it were somehow possible to simulate the progress of minority firms without the aid of programs such as 8(a), would a significantly higher percentage of minority firms fail compared to those non-minority small businesses? And, if so, could their disproportionate failure rate be directly linked to acts of discrimination from financial institutions and the customer base? Of course, without the ability to run such a simulation and objectively account for any differences in results, empirical data may never be available to answer these questions. The data available to us now casts strong doubts on SBA's assertion of successfully meeting their primary goal.

Several sources cited earlier, including GAO reports and interviews with SBA administrators and employees of 8(a) firms, substantiate the opinion that more importance is placed on the receipt of Federal procurement contracts vis-à-vis the 8(a) program than ensuring firms learn the basics of business development (basic business tools, realistic business goals, thoughtful management, mentoring programs, and experience). The trend of concentrating on contract awards gives participating firms a sense of artificial competitiveness and a false sense of minority advancement. The apparent inability of the

program to develop viable minority-owned firms is attributable to several problems associated with the program. Although the program's charter requires financial, technical, and managerial assistance, these take a back seat to the allure of putting Federal procurement dollars in the hands of participating firms. The Federal Government's policy of establishing target goals for all agencies in awarding contracts to small disadvantaged businesses through the SBA's program reinforces the SBA's emphasis on contract awards. The SBA, and certainly all Federal agencies that procure goods and services, are "graded" on their ability to meet their goal.

There is an inherent problem with establishing goals based on a percentage of overall contract dollar outflows. In meeting agency goals, procurement officials need only be concerned with the total dollar value of contracts awarded and not the number of contract actions issued. Agencies satisfy established goals by issuing a fairly small number of high dollar contracts through the 8(a) program. Who loses? The majority of the 5,000 firms enrolled in the program. This thinking is consistent with findings made by numerous GAO studies that contracts are typically awarded to only a handful of firms.

Of equal importance is the polarity of goals that have been forced upon the SBA: maintaining the volume of 8(a) contracts and developing competitive disadvantaged businesses. The award of increasing amounts of 8(a) contracts has become the single most important measure of the program's success while true business development is of secondary importance. Perhaps the problem lies with implementation rather than the concept originally envisioned under the program.

In effect, the SBA functions as nothing more than a "contract broker" merely acting as a link between the Federal agencies and the 8(a) firms. With such emphasis

placed on meeting quotas, our system assesses such programs by measuring the resources committed to the program rather than the actual benefits derived by minority business enterprises. The program is lost in the woods and can't seem to find its way out.

## **5. Benefits to Society?**

In defense of the 8(a) program, SBA reports several benefits produced by the program. However, the alleged benefits are not really benefits at all of the 8(a) program. The SBA annually reports on the progress of the 8(a) program. In this report, the SBA suggests that the 8(a) program produces several benefits including job creation, broadening of the tax base, and economic stimulus through the multiplier effect. An analysis of these suggested benefits follows.

### **a. Employment**

In 1994 SBA records report that a total of 143,500 jobs were produced by firms enrolled in the 8(a) program. On the average, only 46 percent of firm's business was Government 8(a) contracts. Therefore, only 46 percent of 143,500 or 66,010 jobs can really be attributed to the 8(a) program.

While the program reports that over 143,000 jobs were created by firms participating in the 8(a) program it is unknown how many of these jobs are filled by members of minority groups. Additionally, average revenue reported by participating firms which resulted directly from 8(a) contract was only 46 percent of total revenue. Is it possible, then, to say that only 46 percent of revenue resulted from award of 8(a) contracts? Would these firms be able to maintain themselves if this 46 percent of their revenue was removed? Again, although important to the analysis of 8(a) program

efficiency, these questions may never be answered other than with subjective comment and speculation.

Although empirical data shows the number of individuals employed by 8(a) firms, job creation as a benefit of the 8(a) program is suspect to say the least. In analyzing employment benefits, an important distinction must be made between creation of jobs and shifting of jobs. SBA's assertion of job creation assumes people employed by 8(a) firms would remain unemployed in the absence of the 8(a) program. Such a claim is highly unlikely.

The forces of supply and demand of labor dictate that the labor force will be used in the most efficient manner. Labor supply will be attracted to jobs offering the most tangible and intangible benefits. Only by receiving subsidies, in the form of higher contract prices to 8(a) firms, can 8(a) firms redirect labor that would otherwise be employed elsewhere. Because Federal agencies would spend contracting dollars to procure goods and services regardless of whether the 8(a) program existed or not, the SBA's claim of job creation is specious; instead labor resources are reallocated.

In the absence of the 8(a) program, a certain number of individuals currently employed by 8(a) firms would lose employment in these firms. But they would then find jobs elsewhere.

It seems apparent that the SBA's claim of increased employment does not stand up to scrutiny. Although increased employment may be a worthy goal for other Government programs, it is not a goal of the 8(a) program. In the words of the SBA, the mission of Minority Enterprise Development (MED), pursuant to section 8(a) of the Small Business Act, is to "assist disadvantaged businesses to participate more fully and



successfully in the mainstream national economy.” Nowhere in program objectives is employment, minority or otherwise, mentioned as an objective. To claim a benefit of increased employment without such a program goal seems irresponsible.

**b. Income Taxes Paid by Firms, Owners, and Employees**

The SBA begs us to notice that the 8(a) program makes additional contributions to society in the form of both Federal and state taxes. Job creation certainly does fuel the economic engine. The circle is made complete when increased economic activity returns to the public coffers in the form of taxes. While the actual benefits of our Federal tax system are better left for another thesis, the expansion of the tax base is an important byproduct of many Federal programs.

To focus on such a subordinate benefit as adding to the tax base seems to cover up deficiencies in meeting major program objectives. Again, such a claim of benefit is highly suspect. Has the 8(a) program expanded the revenue base on which taxes are collected or simply directed revenue to minority owned firms? The 8(a) program may not have increased the outlay of Federal procurement funds. Even if the 8(a) program did cause the Federal Government to increase outlays in real terms, the additional tax dollars spent on procurement reduce the amount of disposable income in the economy. The net effect is no positive change in the tax base. Also, more tax dollars are wasted because of the inefficiencies of the program in terms of higher procurement costs and administrative costs of the 8(a) program. The argument presented is a weak one.

Two arguments against SBA’s claim of increasing the tax base can be made. As with the creation of jobs, the 8(a) program shifts, rather than creates, additional revenue to 8(a) firms. Actually, this shifting of revenue from larger businesses to smaller

8(a) firms may, in fact, decrease tax collections on the same amount of revenues depending upon the respective companies' tax brackets. Because 8(a) firms deliver goods and services at higher than fair market price, cost inefficiencies negate any increase in tax revenue for the Federal Government.

Federal programs are supported by tax revenues. Tax revenues pay administrative costs and, in the case of the 8(a) program, for agency procurements that are the major focus of the 8(a) program. In the absence of the 8(a) program, all administrative costs and premiums paid in conjunction with contract awards to 8(a) firms would not be incurred. Savings would ultimately appear in the form of lower taxes. Reducing taxes increases disposable income. On the margin, increased disposable income stimulates economic growth which would truly enlarge the country's tax base.

**c. The Economic Multiplier of Federal Contract Dollars**

Another benefit of the 8(a) program claimed by the SBA, is that Federal contract dollars directed to 8(a) firms provide a stimulus for community-based employment and business development. Sometimes known as the multiplier effect, the SBA's claim that such benefit results from the inefficient allocation of Federal contract dollars appears naïve at best. In analyzing this claim of benefit, the argument is once again based on the reallocation of contract dollars rather than an actual increase in Federal outlays. If these dollars remained in the private sector, would there also not be a multiplier effect? Which is more effective, the multiplier effect of the competitive marketplace or the multiplier effect of Government spending. There is perhaps little difference. The fairly unchanging level of Federal contract dollars will stimulate secondary economic activity no matter who spends contract dollars.

## B. THE INEFFICIENCY OF SUBSIDIES IN THE MARKETPLACE

Economists have identified five cases of market failures (externalities) that are used to justify Government intervention in the economy: positive externalities (public goods), negative externalities (e.g. pollution), natural monopolies, high risk and uncertainty, information failures, and the existence of barriers to entry and exit. Specifically, the existence of entry barriers has been used to justify Government intervention with respect to the practice of discrimination.

Economic theory has been used as a rationale for the formation of Federal contract goal-setting policy. It appears that both Congress and the executive branch have argued a rational economic justification for the Federal procurement preference programs. In theory, one of the basic assumptions of an efficient market is the absence of barriers to market entry. Freedom to enter (exit) the marketplace enhances competition, therefore allowing the forces of supply and demand to balance each other at a pareto-optimal level. Any barrier to free entry is a barrier to exchange, causing the market to operate inefficiently.

Certainly at issue is the question of how much, if any, minorities are barred from entry into commercial markets. Proponents of preferential set-aside programs argue that the disproportionately low number of viable minority businesses compared to minority population levels is proof enough of barriers to entry. This "disparate" view assumes no other factors could be responsible for the lack of minority businesses.

Unfortunately market efficiency is not the only force present in the Federal Government's use of the contracting system to direct market behavior. Political factors appear to play as much a part in policy formulation as pure market theory. These additional forces convolute and often times circumvent the purely economic reasons for Government intervention. During the latter 1960s there may have been significant evidence supporting the existence of barriers to market entry for minorities. With easing of racial tension and the growth of a society more tolerant of ethnic diversity, the argument supporting continued use of affirmative action preferences is certainly weakened. There seems little evidence of continued barriers to entry for minority businesses in our competitive economy. There are numerous Government created barriers to entry. One common form these barriers take is that of licensing requirements for more than eight hundred occupations. Perhaps the Federal Government should focus attention on removing these barriers to market entry.

The effect of barriers to entry on a free market economy must include a discussion of the negative effects of policies that use quotas and set-asides to counteract the effect of discrimination. Contract set-asides used in the 8(a) program create market inefficiencies. Set-asides are similar to Government subsidies or price supports.

To illustrate the effect of subsidies in the Federal contracts market let us examine two companies bidding for the same Government contract. One non-8(a) company would bid a price of \$100,000 for the contract. This price is a fair market bid for contract requirements specified in the contract. Cost for this company would total \$90,000, resulting in a profit of \$10,000. An 8(a) company, on the other hand, might bid a contract price of \$110,000 of which \$10,000 is profit. Because the preferential contract treatment

afforded 8(a) firms, the 8(a) firm would receive the Government contract although its bid was higher. The subsidy offered under the 8(a) program allows participating firms to be less efficient than other firms competing without Government subsidies. These inefficiencies may result from higher wages paid to employees, higher production costs, or poor overall management. Firms unable to operate efficiently will be attracted to programs offering such subsidies. Because these firms do not operate efficiently, too much of the subsidy is eaten up in the firms' inefficiencies.

The 8(a) program encourages the inefficient allocation of resources such as labor, capital, and industrial capacity. Minority business firms receiving contracts through the 8(a) program do so in the absence of free and open competition experienced by non-minority owned businesses in the marketplace. This Government subsidy program, like all others, removes incentives for firms to operate in an efficient manner. Subsidies give recipients a false sense that they are operating at a level competitive against other firms seeking to capture market share in any industry. As barriers to entry force the economy to operate at less than the optimal level, so too will subsidies have the adverse effect of causing the marketplace to operate at less than an optimal state.

### **C. THE HUB ZONE ACT AND EMPOWERMENT CONTRACTING**

Empowerment Contracting appears to be President Clinton's effort to pre-empt the similar effort (i.e., HUB zone Act) introduced by Senator Bond. Empowerment Contracting resembles and closely follows the HUB Zone Act, and basically embraces the same fundamental concept. Specifically, both programs appear to be the products of the political parties' attempt to comply with constitutional standards set forth in the U.S.

Supreme Court's decision in the Adarand case. Both programs replace the use of minority-based criteria with preferences to those companies that hire employees from economically distressed communities.

While both the President's Empowerment Contracting and the legislature's HUB Zone Act abandon the use of preferences based on minority group status, they do not completely abandon the policy of providing preferential treatment on basis other than full and open competition. Therein lies the downfall of all such programs. Contrary to the theory of pareto-optimality, Government set-aside programs do make certain groups of individuals better off at the expense of those individuals excluded from program participation.

Ultimately, if either of these programs is enacted, the Government will continue to practice preferential treatment and market intervention. No matter the degree of good intent underlying such programs, their worth will be questioned when they also encounter problems now plaguing the SBA's 8(a) program. Individuals will find ways to abuse them. Inefficiency will always be inherent in programs designed to redirect the forces of a free market economy. But ultimately these programs must produce greater marginal benefit to withstand an onslaught of scrutiny similar to that now being experienced by the 8(a) program.

#### **D. ADARAND'S LEGACY**

Adarand has and will continue to have a profound impact on the issue of race-based affirmative action, particularly those program that use quotas and set-asides to combat discrimination in the workplace and in receiving Federal contracts. This decision

prompted many Federal agencies, including DoD, to either alter or suspend aspects of their affirmative action programs.

Both the legislative and executive branches have taken this opportunity to present new programs that may better serve the economic inequalities present in our nation. The Clinton administration maintains strong support for the goals of the 8(a) program. To defend the 8(a) program, the president issued Executive Order 12928 on September 28, 1994.

This order re-emphasized the continuing need for programs such as 8(a). The order remarks on the standards set in *Adarand v. Pena*, while encouraging agencies to maintain goal-oriented objectives in awarding Federal contracts to minority-owned firms. The President's position on the use of minority set-aside program to further affirmative action seems unwavering despite challenges to such programs laid down in *Adarand v. Pena*.

The Department of Defense also responded to the decision in *Adarand v. Pena* by suspending the "Rule of Two" set-aside contract program. This rule mandated that DoD prime contracts be reserved for small disadvantaged businesses whenever two or more qualified bidders are present. (Office of Assistant Secretary of Defense, October 23, 1995 p.1)

Although the Supreme Court has raised the bar that affirmative action programs must clear, there appears to be sufficient political backing of these programs to keep them alive. It is important that seven justices expressed continued support for affirmative action, and the Court emphasized that "Government is not disqualified from acting in response to" the lingering effects of racial discrimination. Only Justices Thomas and

Scalia hold the view that no race-based measures will pass strict scrutiny. Scalia's view that there are no "creditor" or "debtor" races under the constitution, and Thomas' dismissal of benign racial preferences as "racial paternalism" that "can be as poisonous and pernicious as any other form of discrimination" represent major shifts in judicial opinion since the days when courts upheld legal discrimination.

The strict scrutiny standard established in *Adarand* demands that the proponents of racial preference programs identify "compelling Governmental interests" that a program will serve. Previous cases examining state and local measures have found that alleviating generalized "societal discrimination" is an insufficient justification for imposing racial classifications.

While the Court's decision in *Adarand v. Pena* focused attention from all branches of Government on the issue of the use of the Federal procurement system for the implementation of socio-economic policy, it has brought us no closer to resolution on the matter. The effects of *Adarand* will continue to shape the Federal Government's policies in this area for some time.

## **E. CHAPTER SUMMARY**

This analysis offers several arguments concerning the inefficiency and efficacy of the 8(a) program in accomplishing the goal of increasing minority ownership and participation in business. The inefficiency of the program along with the program success are important measures of overall program worth to society, in particular, those groups of individuals it is designed to help.



A lack of empirical data concerning costs incurred, both financial and effort expended, by procuring agencies in adhering to program guidelines and agency goals hinders analysis. Also, the inability to actually measure, with any certainty, the true benefits accrued by minority groups further complicates analysis.

The 8(a) contract set-aside program is a Government subsidy. A presentation of the effects of subsidies on overall market efficiency concludes that, subsidies, in whatever form, clearly hurt the efficiency of the economy in the long run. Subsidies act as crutches. When these "crutches" are removed, individuals or groups may not have developed the tools necessary to compete in our open market society.

With the results of *Adarand v. Pena* yet unknown, Government branches and agencies posture for control over the affirmative action issues. Both Congress and the White House have proposed new programs to enhance the economic health of urban and rural areas in which a majority of minority firms are located. Although not strictly based on racial preferences, the HUB Zone Act and Empowerment Contracting offer preference in the award of Federal contracts on the basis of location rather than factors such as price and quality. These new measures still represent Government subsidies which will further weaken businesses ability to compete in the open market.

The only certainty in this area of Government policy is continued change. Affirmative action programs will encounter further obstacles after the Supreme Court's decision in *Adarand v. Pena*. It is also certain that certain elements of Government will continue to fight for affirmative action programs such as 8(a).



## **VI. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS**

### **A. SUMMARY**

In analyzing any Government socio-economic program, it is important to understand from what view the analysis is conducted. One may argue a process or end-state view of justice. To analyze using the process view of justice means to judge the process with little or no regard for the outcome of the program or policy which it supports. It is very easy, examining a situation from this viewpoint, to doom Government programs for their lack of efficiency.

The end-state view of justice, on the other hand, states that the ends justify the means. Whatever inefficiencies are inherent in the process is of little importance. To some extent, our democracy functions according to the end-state view. This characteristic is evident in the Government's dedication to audit and control of contractor operations. For many years the amount of oversight grew in response to the well-publicized incidence of contractor fraud. In this case, the desired end-state is the professional behavior, honesty, and conscientious conduct of contractors. By auditing everything that a contractor does in relation to Government contracts, we ensure that we dissuade contractor abuse or detect abuse when it does occur. Until recently, very little attention has been paid to the inefficiencies associated with such policies. The recent trends towards disengagement from contractor activities is due, in part, to simple cost-benefit analysis of efforts in this area. It is perhaps no longer necessary to maintain an auditing and surveillance infrastructure that can cost ten dollars for every dollar of contractor abuse that is recouped.

While the two views presented here represent extremes of the efficiency continuum, another important consideration is whether any policy or program produces the desired results. Also, what unintentional results are produced? This issue is particularly relevant to the end-state view. If the ends justify the means, then it is vital that the means actually produce the desired results.

Within the literature and through interviews conducted, there were certainly strong arguments that the 8(a) program does not necessarily deliver the intended results of fighting discrimination and increasing minority participation in business. There were also indications of unintended consequences both for minority businesses and contracting agencies including abuse by participating firms, significantly higher procurement costs, and constitutional challenges to the set-aside programs.

The goals of the 8(a) program may be well intended, but the manner in which the program has been implemented has caused it not to realize its intended goal. Regardless of an inefficiencies associated with the program, if the 8(a) program does not deliver concrete results, it will continue to stir controversy.

This researcher understands that powerful interest groups demand the continued use of affirmative action programs. Knowing this, the conclusions and recommendations presented below suggest a move away from policies advocating set-asides and quotas which tend to encourage feelings of discrimination against “favored” groups and a refocus of efforts to attack the root causes of discrimination through education and true business development.

## B. CONCLUSIONS ON RESEARCH QUESTIONS

### 1. Primary Research Question

**Do benefits of the Federal Government's procurement policy mandating quotas and set-asides for small disadvantaged businesses under the Small Business Administration's 8(a) program outweigh the associated economic costs and inefficiencies inherent in the program?**

The benefits of the 8(a) program are highly suspect. The SBA claims many benefits can be attributed to the program including increased employment, enlargement of the Federal tax base, and the multiplier effects of Government expenditures. Should a minority development program take credit for such benefits? Because Federal agency procurement would occur in the absence of the 8(a) program, so too would these unintended benefits. Therefore, claims of such hollow benefits appear to be more an attempt to rally program support than meaningful of the program.

There is, however, strong evidence that the 8(a) program falls short in reaching its primary goals of assisting minority business enterprises to become more successful in the mainstream national economy. The high failure rate of firms graduating from the program seems conservative and the many administrative problems associated with running the program indicate questionable results. After years of auditing the 8(a) program and repeatedly encountering the same deficiencies, the GAO recommended that responsibility for the program be turned over to a newly formed agency under the control of the Department of Commerce. This recommendation says a lot about the Small Business Administration's abilities and the efficacy of the program in general. Recent legal challenges to the 8(a) program, in particular, *Adarand Constructor Inc. v. Pena*, point to a

fundamental change in thinking regarding programs such as 8(a). The 8(a) program will continue to be challenged in the courts.

The 8(a) program was reformulated from its original form to increase minority participation in the business world during a time when such measures were considered to be an appropriate way to fight discrimination and combat violence that accompanied the Civil Rights movement of the 1960s. The integration of minorities in our country, though not complete, has come a long way since *Brown v. Board of education of Topeka, Kansas* in 1954. Perhaps benefits accrued during the early years of the program were worth much more to society than their costs, but the program is currently unable to provide clear indications of its benefit to minority businesses and our society as a whole.

## **2. Subsidiary Research Questions**

- **What forces shaped the civil rights movement in the United States and led to the implementation of affirmative action in Federal contracting?**

Both social and political forces played important roles in the birth of the civil rights movement in the United States. The integration of minorities in America's Armed Services and legal challenges against the standard of "separate but equal" provided catalysts for the civil rights movement. In the early 1960s, the term "Equal Opportunity" was first used to describe measures undertaken by the Kennedy administration to ensure that members of all minority groups had opportunities equal to those of white America under the law.

Programs designed to increase participation by minorities in the workplace, specifically in companies doing business with the Government, were developed. Over

time these programs, including the 8(a) program, were used as political tools. Although the 8(a) program was initially designed to spur small business, regardless of minority affiliation, it was put to use as a tool for the advancement of minorities in business.

- **What are the economic pitfalls of affirmative action, in general, and specifically in relation to the Small Business Administration's 8(a) Program?**

Affirmative action that establishes desired levels of minority participation in the form of quotas and set-asides has the result of inefficiently allocating economic resources. When the forces of open market economies are artificially constrained by Government mandated levels of minority participation, market inefficiencies occur. Quotas and set-asides can be viewed like any other Government subsidy. Subsidies draw economic resources such as capital and labor from efficient activities and towards inefficient activities. Presumably, market forces normally allocate these resources where they are needed. In other words, in a competitive environment, firms most efficient at using resources will capture a larger share of demand for a particular product or service.

The 8(a) program gives preference to minority firms in award of Government contracts over non-minority firms. This preference creates a non-level playing field. Minority firms may bid as much as 10 percent over market value and still receive Government contracts. This "price" subsidy incurs additional costs on the Federal budget. The aggregate amount of "overpayment" can be substantial.

- **Are Federal contract set-aside programs such as the 8(a) program an effective means to eliminate economic inequalities resulting from discrimination?**

In order to substantiate the effectiveness of any program, some standard must be established to measure progress. The standards currently employed by the 8(a) program cannot accurately measure how well the program has reduced economic discrimination. Most procurement agencies have established arbitrary goals to measure their level of minority business utilization. The Department of Defense's goal that 5 percent of all procurements will go to minority firms is a good example. The problem with these arbitrary goals is the mandate that a percentage of dollars flow to minority firms, not a percentage of contract actions. Agencies can easily and quickly reach annual goals by awarding several, large-dollar-value contracts to minorities. This practice has been documented in numerous GAO studies and audits. This practice may help a handful of minority firms, but does little to combat the perceived economic inequalities.

The problem lies in the implementation of socio-economic policies. The Small Business Administration has focused more on reaching or exceeding established goals for minority participation in Federal contracts than in teaching skills necessary for minority firms to be successful, competitive businesses.

The current 8(a) program is not effective in eliminating perceived economic inequalities resulting from discrimination. On the contrary, the failure rate of firms exiting the program indicates that minority firms are no more successful than non-minority firms.



- **What effects, if any, will the recent Supreme Court ruling in *Adarand Constructors, Inc. v. Peña* have on the viability of current socio-economic mandates in Federal procurement and the formulation of new programs?**

The Supreme Court's ruling in *Adarand Constructors Inc. v. Peña* renewed the controversy over minority set-aside programs. Whether this judicial precedence will eventually bring the end to programs such as the 8(a) program will probably not be answered for some time. The democratic White House made it clear that it will continue to support affirmative action efforts including those offering quotas and set-asides to minorities.

The case of *Adarand* has opened the door for more challenges to the 8(a) program and others programs like it. While not all challenges to the 8(a) program have received the attention that *Adarand* did, they are all important in providing a judicial framework to judge these programs.

*Adarand* has also spurred new legislation designed to increase economic activity in historically underutilized areas. Legislation such as the HUB Zone Act de-emphasizes preferential treatment of minorities, focusing rather on urban and rural areas which are alleged to need economic stimulation.

### **C. RECOMMENDATIONS**

The following recommendations are offered by the researcher and are based on the researcher's assessment of the literature reviewed and the interviews conducted.

1. The SBA should end the use of Federal contract set-asides as a means of developing minority business firms. Available data does not support the efficacy of these set-asides as a viable means to develop healthy, competitive businesses, but rather indicates that firms come to rely too heavily on preferential Government contracts instead of developing other markets. The failure rate of firms graduating from the program indicates 8(a) firms fare no better, and perhaps worse, than non-minority firms. A GAO report of March, 1996 showed that the longer companies stay in the 8(a) program, receiving preferential Government contract awards, the less likely they are to develop outside business that would sustain once they graduate from the program. (England, 1995 p.2)

Additionally, requirements for firms to reach and maintain an appropriate mix of 8(a) and non-8(a) business must be modified. At present, SBA can not determine a firm's mix of 8(a) and non-8(a) business. There seems to be no way, under current program guidelines to enforce established mix goals. SBA controls only the amount of 8(a) contracts a firm receives while having no control of the amount of non-8(a) business a firm generates. It seems futile to establish a goal that cannot be controlled.

2. Abolish any unsubstantiated race-based agency goals and quotas currently implemented in Federal procurement. The statutory requirement establishing Government-wide goals of awarding five percent of total Federal contracts to minority firms appears inconsistent with the Fourteenth Amendment and the rule of strict scrutiny as interpreted in *Adarand v. Peña*. The arbitrary goals produce inconsistent goals for Government contracting officers. The need to reach these goals encourages agencies to

award large dollar contracts to a very few minority firms instead of allocating a larger number of contract actions to more minority firms.

3. Develop meaningful metrics to measure the 8(a) program's overall goal of encouraging minority business ownership. Success based on meeting or exceeding arbitrary number of contract awards does not provide a meaningful measure of minorities' ability to compete in business. SBA must analyze key indicators of successful businesses and apply them to the evaluation of program participants. The application of realistic measurements of business success is meaningful only in the absence of the artificial environment created by non-competitive contract set-asides. Therefore, the removal of preferential contract awards, recommended above, is key to the successful implementation of meaningful program metrics. Program graduation should be based on a firm's ability to function in a competitive business environment rather than on the length of time it participates in the program.

4. Critically examine current alternatives to the 8(a) program, including the HUB Zone Act and Empowerment contracting. These current initiatives also represent a form of subsidy to certain segments of the economy at the exclusion of others. While subsidies may bring economic growth to many rural and urban areas, they will create costs and inefficiencies in the marketplace. Replacing one bad program with another will only cause a new set of unintended consequences for Federal procurement agencies and the economy.

Both the HUB Zone Act and Empowerment contracting intend to re-allocate resources to areas of the country that have historically been underused by business. There

are good economic reasons why businesses have stayed away from areas targeted under both initiatives. Most are purely economic. Will the subsidies offered under these initiatives attract viable businesses to these areas or create opportunities for program abuse?

If implemented, programs under the HUB Zone Act or the Empowerment Contracting program should be undertaken in select areas for a specified trial period. At the end of such a trial period, an assessment of program effectiveness and any unintended consequences should be made to determine program feasibility and future use.

#### **D. RECOMMENDATIONS FOR FURTHER RESEARCH**

- Based on recommendation number 3, further research should be conducted into the development of effective metrics measuring the success of the 8(a) program.
- In depth research should be conducted into current legislative initiatives for developing alternative socio-economic programs such as the HUB Zone Act and Empowerment Contracting.
- Research focusing on alternative methods of helping minority business and underutilized areas of the country instead of the use of subsidies should be conducted.

#### **E. CONCLUSIONS**

The Federal Government does a lot of things, but does few of them efficiently. Such is the nature of Government. Ensuring constitutional freedoms and the equal treatment of all

citizens are worth the sacrifice of efficiency. The dilemma arises when our Government spends a lot of money on socio-economic programs which result in no clear advancement of the targeted social group, the economy, or society as a whole. In this day of shrinking Federal budgets, it is incumbent on all in Government to examine what we do and why we do it. Certain questions should be asked.

- Are the social factors that gave rise to the use of 8(a) program as a minority business development tool still apparent?
- Are socio-economic programs such as the 8(a) program effective in reaching their established goals?
- Are the costs associated with socio-economic programs such as the 8(a) program worth the benefits received?

Although the United States has made tremendous progress in creating an integrated society, racial discrimination still exists today. The means to wipe out discrimination may never be found. The current structure of the 8(a) program make it virtually impossible to answer the last two questions posed above. The program must establish better methods of helping both small and small minority businesses along with more realistic methods of measuring program successes. The current approach to combating economic discrimination has proved less than successful. It also gives firms a false sense of competitiveness by providing non-competitive subsidies. This practice can only hurt minority firms seeking to be treated as equals in our society.



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