Shame of the Cities

Setting Aside Justice for the "Disadvantaged"

JONATHAN J. BEAN

"We are from the government, and we are here to help." In 1992, that message from the Small Business Administration (SBA) heartened Rebecca Browne (not her real name). A divorced mother of two, Browne owned a small construction firm in St. Louis. As a Native American, she qualified for the Section 8(a) program: the SBA could "set aside" contracts for her as a disadvantaged individual. Little did Browne know that she was entering a program with a scandalous history. In retrospect, blowing the whistle on its corruption may have caused her financial ruin. Today, she is homeless—her business destroyed by the indifference of government bureaucrats and the rapacity of big firms using minority "fronts" to take contracts away from honest businesses. Unfortunately, the set-aside scam has become a preferred way of doing business in America's largest cities.

The notorious 8(a) program dates back to 1968, when liberal activist Howard Samuels took over the SBA and used contract set-asides to promote "compensatory capitalism." At this point, the agency already had a track record of racial favoritism: before the ink was dry on the Civil Rights Act, SBA officials were offering Economic Opportunity Loans to disadvantaged business owners and racially profiling applicants. Theoretically race neutral, these loans and set-asides were soon reserved almost exclusively for minorities (Bean 2001). Facing court challenges, the SBA maintained the fiction of color-blindness and even noted the problems with identifying racial status: "Would a person who is one-quarter Indian be eligible? One-sixteenth? How is racial

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background proven?" (U.S. GAO 1975, 51). The agency ignored these good questions as it pursued policies it could not openly defend.

In 1978, Congress directed the SBA to *presume* that African Americans, Hispanics, and Native Americans were "socially disadvantaged." The agency later added Asian Americans, an assortment of dark-skinned immigrant groups, and even natives of "disadvantaged" Japan. In addition, 8(a) firms were supposed to be *economically disadvantaged,* a term left undefined. It is not surprising, then, that affluent minorities took advantage of 8(a). Race trumped class: poor light-skinned people could apply for disadvantaged status, but SBA officials acted as if "no whites need apply" (Bean 2001, 102–4).

The 8(a) program faced withering criticism from Congress, the General Accounting Office (GAO), and the media (*The New Republic* dubbed it "affirmative action for the rich" [TRB 1985]). Violating its own regulations, the SBA took contracts from small white-owned firms and gave them to minority contractors, in essence robbing Peter to pay Paul. The program showered contracts on a few 8(a) firms while giving others nothing. Agency officials lacked the business expertise needed to provide practical help to struggling firms. Most 8(a) firms never graduated from their dependency on government contracts; those that did failed in the competitive marketplace (Bean 2001).

Obsessed with meeting quotas, SBA officials encouraged minority entrepreneurs to partner with white-owned businesses (the slogan on the street was, "get yourself a black and get on board" [Bean 2001, 101]). Terrific scandals resulted as unscrupulous whites and opportunistic minorities formed sham partnerships. SBA officials looked the other way as these minority fronts gobbled up 8(a) dollars. One front, Wedtech, implicated members of Congress, White House aides, SBA officials, and civil rights leaders in "an elaborate soap opera of crime" (Thompson 1990, 275). Similarly, the Whitewater scandal began with an illegal SBA-backed loan to Susan McDougall, a millionaire who qualified as "disadvantaged" because she lived in the underprivileged state of Arkansas (Bean 2001, 126)!

Congress reacted to the Wedtech scandal by passing toothless reform legislation in 1988. The "economically disadvantaged" thereafter had to have a personal net worth less than $250,000, *excluding* business and home—a limit that places many so-called disadvantaged business owners in the top tenth of wealth holders. In practice, little changed. SBA officials failed to enforce the eligibility requirements. Fronts remained a reality. A few large firms reaped the lion's share of contracts, while most 8(a) companies received nothing. What happened to these firms after they graduated from the program? The GAO reports that the "SBA has no way to tell how well the 8(a) program is working" because it doesn't survey 8(a) firms "in a meaningful way" (U.S. GAO 2000, 21). One suspects that the "Small Scandal Administration" doesn't want to know.

Rebecca Browne became eligible for 8(a) preferences after the post-Wedtech reforms went into effect. Before she entered the program, her story was a classic Hor-

atio Alger success tale. In 1982, she started a small construction business, with her children working by her side. By dint of hard work and perseverance, she built a successful business. Once in the 8(a) program, however, Browne faced a maze of regulations and received little help from unknowledgeable SBA officials. Worse yet, the corruption shocked her. Big contractors were paying minorities with no experience to create bogus front firms. Yard workers and T-shirt embossers were heading firms receiving millions of dollars in government contracts. White contractors paid them handsomely to swindle a system intended to help the underprivileged. The minority contractors did not perform the contract work; instead, they subcontracted it to their "sponsors." Browne resisted pressure to front and reported the illegal activity to government agencies, but they took no meaningful action. She then paid a price for her whistle blowing: her equipment was damaged; she received threatening phone calls; and burglars broke into her home. Warned of death threats, she fled St. Louis and tried to start over, but it was too late. She now lives in hiding, fearing for her safety (interviews with author 2002; private papers in possession of author).

The corruption in SBA minority enterprise programs extends beyond 8(a). Racketeers also have used loan dollars, channeled through Specialized Small Business Investment Companies (SSBICs), to defraud the government. These federally licensed firms do indeed lend money to disadvantaged businesses, but the lucre occasionally ends up in the hands of unethical businesspeople. For example, David Hale's SSBIC made the illegal Whitewater loan to Susan McDougall (Bean 2001, 126). In another case, involving the Tennessee Equity Capital Corporation (TECC), the owner, Walter Cohen, used SBA funds to take over minority firms, which he then used as fronts to secure government contracts. One victim of the racket, African American business owner John L. Pointer, blew the whistle in 1991. A jury subsequently convicted Cohen of fraud, and a judge placed TECC in SBA receivership (*John L. Pointer et al. v Tennessee Equity Capital Corporation et al.,* No. M1999-01934-COA-R3-CV [2001], available at www.tsc.state.tn.us/PDF/tca/014/PointerJ.pdf). Meanwhile, John Pointer, a former professional football player and owner of Pointer Oil Company, never got a chance to prove himself in business. Adding insult to injury, the SBA successfully fought his efforts to secure restitution, arguing that his company was never profitable and therefore suffered no losses. The SBA, which failed to regulate TECC operations in the first place, has washed its hands of the matter, blaming the small business owners it was supposed to help ("Government Watch" 1995).

Minority-front scandals have recently erupted across the nation. In the past several years, state and federal investigators have uncovered such fronts in St. Louis, Atlanta, San Francisco, Tampa, Pittsburgh, Chicago, and other cities (Christian 2001; "Dubious Diversity" 2000; "A Penalty Too Puny" 2000; "Troubled S.F. Agency" 2000; Tuft 2001a, 2001b; "What's New: California" 2000; Whitt 2000; "Who's in the Cookie Jar?" 2001; Williams and Finnie 2001). In St. Louis, the city's first black mayor, Freeman Bosely Jr., and four of his cronies each paid $125 to buy a majority share of a partnership with a cement contractor that then received con-

tract set-asides (Tuft 2001a, 2001b). Another large St. Louis company was fined $800,000 for employing a minority front ("Missouri Penalizes" 2001). The former mayor of Atlanta, Bill Campbell, was also embroiled in minority-front scandals during his tenure in office. The *Atlanta Journal-Constitution* editorialized that Campbell "presided over the most corrupt administration in city history. . . . [T]he stench of patronage and favoritism permeates every department and every proceeding at City Hall" ("Campbell Fostered Climate" 2001, A13). Campbell has since joined a Pittsburgh firm also accused of fronting for a large broadcasting company (Eversley 2002). The same theme runs throughout these minority set-aside scandals: greedy white contractors, demagogic black politicians, and government bureaucrats indifferent to the ongoing criminal activity have hijacked the legacy of the civil rights movement. The result is a higher tax burden and a growing public cynicism toward government at all levels.

Minority firms that refuse to go along are not the only victims of the set-aside scam. Small business owners with the "wrong" skin color or national origin cannot compete for these contracts. This group includes not only whites, but also immigrants from North Africa, the Middle East, and parts of Asia. No matter how economically disadvantaged, these businesspeople—men and women, native born and immigrant—are treated as second-class citizens.

A few of these business owners have protested the government's discriminatory practices. Tim Fay, owner of FayComm, a video and CD production company, has waged a lonely campaign to highlight the unfairness of set-asides. In 1987, the Federal Emergency Management Agency refused to allow Fay's four-person firm to bid on a lucrative contract and instead gave it to Technical Resources, Inc., a "disadvantaged" firm with one hundred employees and $11 million in annual revenue, all of which was the result of noncompetitive set-aside awards. Ten years later, after repeatedly losing jobs to the "disadvantaged," Fay created Adversity.Net (www.adversity.net), an Internet site packed with case studies, legal decisions, and horror stories involving local, state, and federal set-asides.

Other small businesses have turned to the courts. Randy and Valery Pech, owners of Adarand Constructors, a small maker of highway guardrails, fought all the way to the U.S. Supreme Court. In *Adarand Constructors, Inc. v Pena, Secretary of Transportation et al.* (515 U.S. 200 [1995]), the Court offered hope to the Pechs and to other small contractors when it ruled that the Department of Transportation (DOT) set-aside program must undergo strict judicial scrutiny. President Bill Clinton responded with an insincere pledge to "mend" affirmative action. The DOT and SBA, meanwhile, have failed to give Congress basic information about the operation of their set-aside programs (U.S. GAO 2000, 4, and 2001).

Both major political parties are to blame for the continuing shame of set-asides. Democrats have used 8(a) to pander to their ethnic constituencies. Republican candidates extol the virtues of small business and color-blindness, yet they abdicate these principles once in office (Bolick 1996). Fearing the epithet *racist,* Republican presi-

dents have consistently caved in to party moderates parading their "compassion" for the disadvantaged. George W. Bush continues in this tradition. During the presidential campaign, he drew a Clintonesque distinction between "affirmative access" and "affirmative action," yet his administration has defended the set-asides challenged by *Adarand*. Furthermore, his DOT has announced a new policy: If challenged, set-aside applicants must document their racial pedigree—a chilling requirement that affirmative action critic Roger Clegg (2001) likens to Nazi attempts to trace bloodlines.

Twenty-two years ago, Louisiana businessman Kirk Fordice wrote to President Ronald Reagan, complaining that "the 8(a) program is snowballing along . . . and leaving legitimate small business contractors bloody, beaten and bankrupt" (Fordice 1981). Hard-working business owners such as Rebecca Browne, Kirk Fordice, and Tim Fay are still waiting for the snowball to melt and for justice to be done. Recent history suggests that day may be a long time coming.

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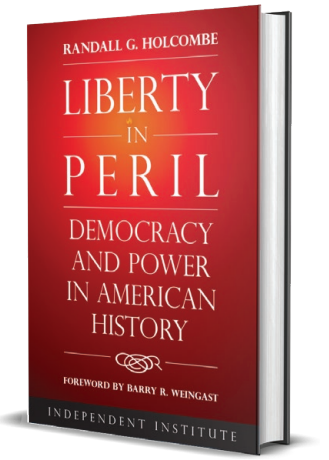

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