

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

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Minority Firms On Local Public Works Projects--Mixed Results

Four Members of Congress asked GAO to review the requirement that minority firms receive 10 percent of Federal funds for local public works projects. GAO found that the requirement has some benefits. Minority business firms received an increased share of Federal funds, and new firms were developed.

However, many problems resulted. Project costs increased, certain locations lacked minority firms, and the eligibility of many firms appeared questionable.

Directing Federal agencies to require that minority firms share in Federal procurements is commendable. However, such a requirement should be carried out flexibly, and minority firms should be certified as legitimate before participating on projects.



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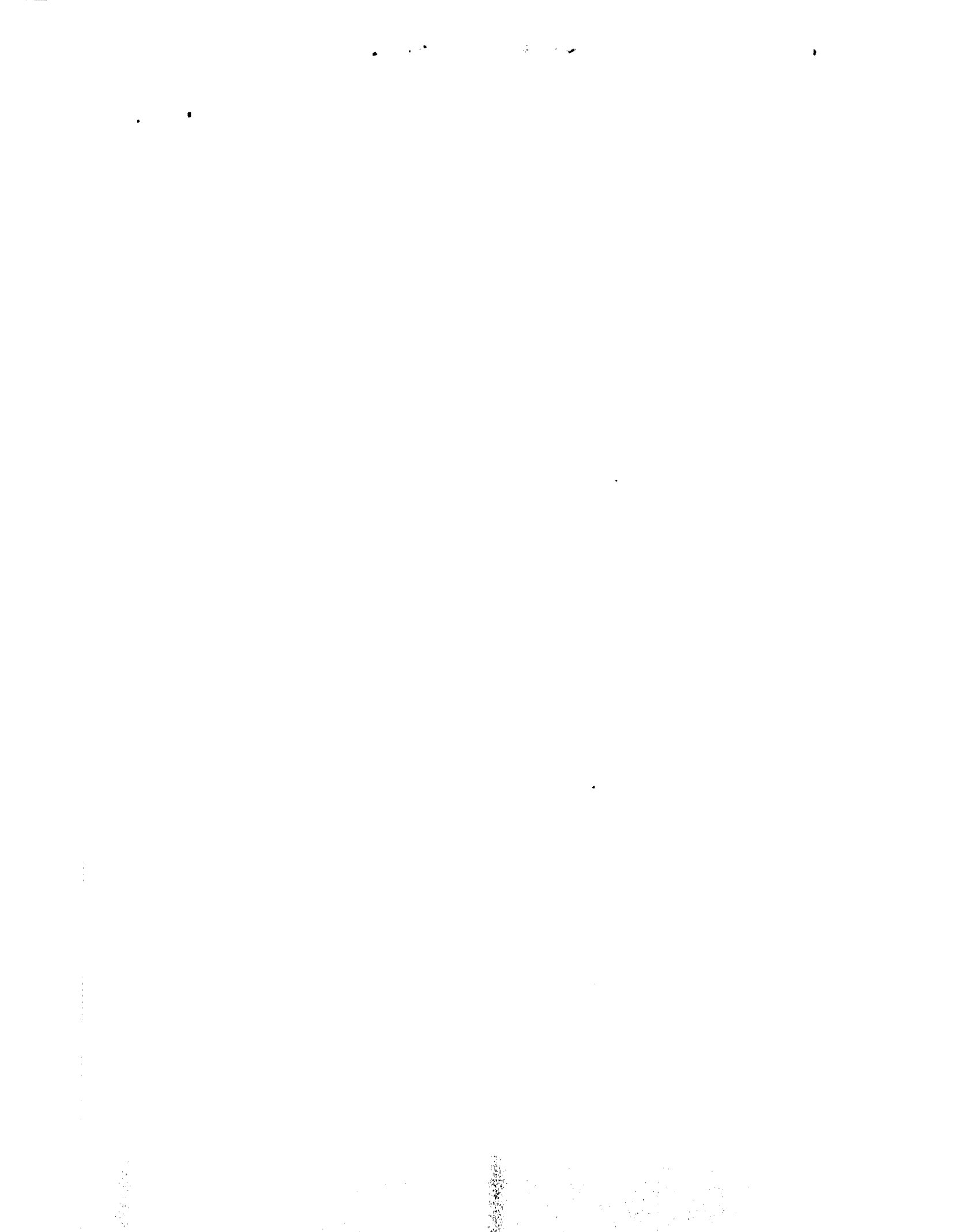
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Report

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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

The Public Works Employment Act of 1977, which established the second round of the local public works program, contained a provision that at least 10 percent of the \$4 billion of Federal funds authorized for the program be spent with minority firms. This report assesses the impact of the Economic Development Administration's implementation of the 10-percent minority provision.

We made our review pursuant to the requests of Congressman John Paul Hammerschmidt, Ranking Minority Member, Subcommittee on Economic Development, House Committee on Public Works and Transportation; and Senators John A. Durkin, James A. McClure, and Thomas J. McIntyre.

We are sending copies of this report to the Director, Office of Management and Budget, and the Secretary of Commerce.

James A. Atchefs
Comptroller General
of the United States



D I G E S T

The 10-percent minority provision requiring that at least \$400 million of \$4 billion of Federal funds under the second round of the Local Public Works Program be spent with minority firms has resulted in some benefits:

--Minority business firms received an increased share of Federal funds. (See pp. 7 to 9.)

--New minority firms were established, and existing minority firms gained valuable work experience. (See pp. 13 and 14.)

--Some prime contractors found minority firms that could be used on future work. (See pp. 14 and 15.)

Using minority firms did not cause appreciable delays to the start of the construction of projects. (See pp. 9 to 11.)

However, the 10-percent requirement was not without problems:

--The Economic Development Administration used about 25 percent of the \$15 million of administrative funds to monitor the minority provision. The agency requested and received additional funds to carry out the provision. (See pp. 16 and 17.)

--Project construction costs increased when contractors complied with the minority provision. Price quotes of minority firms averaged about 9 percent higher than normal prices and generally increased construction costs. (See pp. 17 to 20.)

- About 48 percent of rural projects and 51 percent of urban projects had difficulty finding minority firms. (See pp. 20 to 23.)
- Projects in certain States used out-of-State minority firms extensively, for example, 57 of 83 contracts awarded by New Hampshire projects went to out-of-State minority firms. (See pp. 23 and 24.)
- The eligibility of minority firms has been a persistent problem to the Economic Development Administration. Many firms listed as suppliers have been reclassified as "brokers" by the agency. (See pp. 25 to 27.)
- Some prime contractors established minority firms to take advantage of the program with no intent of continuing in business after the minority provision lapsed. For example, on a New Jersey project a partnership was formed between a prime contractor and a minority employee of the prime contractor. The minority member does not participate in managing the firm and believes the partnership will be dissolved when the second round is over. (See pp. 27 to 30.)
- Some minority firms were unable to obtain working capital or bonding, had difficulties with Federal paperwork, and sometimes were unable to meet contractual obligations. (See pp. 30 to 32.)

The Economic Development Administration's reporting system permits minority firm participation on some projects to be counted erroneously. Instances of underreporting and overreporting of minority participation were found when projects awarded prime contracts as well as subcontracts to minority firms. Also, some ineligible minority firms continue to be included in the agency's statistics. (See pp. 32 to 34.)

State and local chapters of the Association of General Contractors of America, Inc., believe that the minority provision has effectively eliminated competition. This has fostered some negative attitudes and resulted in court challenges to the

legality of the minority provision. On the other hand, minority contractor associations were in favor of the provision and liked its effect on minority firms. Several minority associations, however, believed that some prime contractors were setting up questionable firms to comply with the minority provision, thus preventing genuine minority firms from participating. (See pp. 35 to 37.)

GAO believes that several factors, some of them statutory and beyond the Economic Development Administration's control, combined to cause many of the problems discussed. Tight deadlines for getting projects started, 60 days for processing applications and 90 days for starting construction; the large appropriation of Federal funds, \$4 billion which had to be obligated in a short time period; and the Economic Development Administration's rigid application, stringent enforcement of the provision, combined at the same time to prevent the minority provision from achieving its maximum impact.

GAO believes, however, that the strong commitment to the minority provision and the Economic Development Administration's high priority on its success contributed to the increased use of minority firms during the second round of the Local Public Works Program.

RECOMMENDATIONS TO THE SECRETARY OF COMMERCE

Draft legislation for a new Labor Intensive Public Works Program was submitted but not acted on by the 95th Congress. It would have assigned administration to the Economic Development Administration, and included a minority provision which required a flexible range of 2 to 15 percent with an overall goal of 10 percent.

If similar legislation is enacted, the Secretary of Commerce should direct the Economic Development Administration to:

--Provide guidelines to grantees so that minority firms are certified legitimate before participating on projects.

- Direct grantees to assist prime contractors in locating qualified minority firms.
- Require grantees to have minority firms under binding contracts before starting construction and permit later substitution of minority firms only with the Economic Development Administration's approval.
- Direct grantees to monitor closely minority firms established by prime contractors and listed as subcontractors on the same projects as the prime contractors to preclude eligibility problems.
- Permit participation by minority suppliers, other than minority manufacturers, only to the extent of the commission or markup on sales rather than counting the total amount of sales toward the minority goal.
- Record minority participation more accurately to better account for the percentage goal attained in meeting the flexible minority requirement.

RECOMMENDATIONS TO THE CONGRESS

The Congress should design future minority provisions so as to minimize problems noted in this report. GAO recommends that future minority provisions:

- Impose a penalty, such as debarment from participating in future federally funded projects, on contractors that establish ineligible minority firms to circumvent the intent of the minority requirement.
- Use a flexible percentage for applying the minority requirement based on the availability of minority firms and/or percentage of minority population in certain areas measured against an overall goal.

Also, the Congress should consider whether a countercyclical program, such as the local public works program with its tight deadlines, represents

a suitable mechanism for implementing a minority provision.

AGENCY COMMENTS

The Assistant Secretary for Economic Development said the report is basically fair and accurate. He concurred with GAO's conclusions and recommendations. (See pp. 42 and 43.)



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ABBREVIATIONS

AGC	Associated General Contractors of America, Inc.
EDA	Economic Development Administration
GAO	General Accounting Office
LIPW	Labor Intensive Public Works Program
LPW	local public works
OMBE	Office of Minority Business Enterprise
SBA	Small Business Administration
UMTA	Urban Mass Transportation Administration

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CHAPTER 1

INTRODUCTION

The Local Public Works (LPW) Program was designed to (1) create private sector employment opportunities in areas of high unemployment through the construction or renovation of useful public facilities and (2) promote economic recovery by stimulating national and local economies. The Congress appropriated \$6 billion for the LPW program which was funded in two phases: \$2 billion for the first round and \$4 billion for the second round. The second round contained a provision requiring that at least 10 percent of the \$4 billion be spent with minority firms--contractors and suppliers.

This report responds to the requests by Representative John Paul Hammerschmidt, ranking minority member of the Subcommittee on Economic Development, House Committee on Public Works and Transportation; and Senators John A. Durkin; James A. McClure; and Thomas J. McIntyre. (See app. I and II.)

GAO was
~~We~~ were asked to assess the impact of the minority provision on the LPW program and to find out whether implementation of the provision has

- (1) delayed the start of construction of public works projects,
- (2) increased project construction costs,
- (3) caused problems because some geographic areas lack minority firms,
- (4) --required the use of out-of-State minority firms to comply with the provision, and
- (5) --resulted in establishing minority firms ineligible to participate in the program.

FIRST AND SECOND ROUNDS OF THE LPW PROGRAM

The Local Public Works Capital Development and Investment Act of 1976, (title I, Public Works Employment Act of 1976), enacted on July 22, 1976, established the LPW program. The act authorized funding of \$2 billion, which was subsequently appropriated by the Congress. It directed the Secretary of Commerce, through the Economic

Development Administration (EDA), to make grants to States and local governments for the total costs of LPW projects. To stimulate the economy and provide jobs quickly, EDA was required to process applications within 60 days of receipt, and construction was required to start no more than 90 days after project approval.

Because of the widespread demand for such projects, EDA received about 25,000 applications for about \$24 billion from States and local governments. By early February 1977, EDA had approved 2,062 projects, representing about \$2 billion of first round funds. We issued two reports dealing with local public works--a report to the Congress on the selection process used for the first round of the LPW program, and a letter report on labor used on first-round public works projects. 1/

The Public Works Employment Act of 1977 (title I, Public Law 95-28) enacted on May 13, 1977, amended the Local Public Works Capital Development and Investment Act of 1976. This act authorized the second round of the LPW program and an additional \$4 billion to continue stimulating the economy and to help fund the backlog of applications EDA had received under the first round. The 1977 act required EDA to implement several program changes to reduce first-round funding inequities among different areas and types of governmental units and to improve the selection process to target funds to areas of highest unemployment. The act also required applicants to choose projects according to local priorities based on community needs.

The additional \$4 billion was appropriated on May 13, 1977, and had to be obligated by September 30, 1977. Funds were allocated primarily on the basis of unemployment data. States such as Arkansas, Iowa, New Hampshire, and Wyoming each received the minimum allocation of \$30 million. New York received about \$494 million, the most allocated to any State.

As of September 30, 1977, EDA had approved 8,554 projects under the second round of the LPW program, representing the \$4 billion appropriation. About 71 percent of second-round funds were used to finance projects originally submitted but not selected under the first round.

1/"Selection Process Used for First Round of Local Public Works Program--Adequate But Some Problems Experienced," CED-78-36, Mar. 30, 1978. "Study of Labor Used on Public Works Projects Funded Under the First Round of Local Public Works Program," CED-78-140, Aug. 4, 1978.

Approved first- and second-round projects had some similar and some different characteristics. Projects for improving water and sewer utilities and repairing streets and roads represented over 40 percent of first- and second-round approvals. Projects for constructing or renovating schools, municipal office buildings, recreational facilities, police and fire stations, community centers, and hospitals were also emphasized under both rounds. Cities and towns received over 58 percent of the approved first- and second-round projects. State, county, and school district applicants received most of the remaining projects.

Second-round projects were more effectively selected to reach areas with severe unemployment than first-round projects. Also, the average EDA grant for second-round projects (about \$469,000) was less than half the average grant for first-round projects (about \$952,000). EDA believes the smaller size of second-round projects should mean more rapid project completion and estimates that over 62 percent of second-round projects will be completed in less than a year, compared to only about 47 percent of first-round projects.

10-PERCENT MINORITY BUSINESS REQUIREMENT

The Public Works Employment Act of 1977, which authorized the second round of the LPW program, included a provision requiring that at least 10 percent of each EDA grant be spent with minority firms--contractors and suppliers. Therefore, at least \$400 million was earmarked for the minority business sector. Grantees were responsible for assuring that 10 percent of the grant would be spent with minority firms. Usually, grantees required their prime contractors to include assurances that 10 percent of the grant amount would be spent with minority subcontractors or suppliers. However, grantees could themselves enter into contracts with minority prime contractors or suppliers.

Representative Parren Mitchell, who introduced the 10-percent minority provision as part of House bill 11, cited the decline in the number of minority firms in construction industries as justifying a minority set-aside provision. Another factor cited was that the Federal Government has not actively pursued economic parity. During fiscal year 1976, Federal agencies purchased goods and services totaling \$68 billion, but less than 1 percent of the contracts were with the minority business sector.

Senator Edward Brooke, who introduced the 10-percent minority provision as an amendment to Senate bill 427,

pointed out that the set-aside concept had been used in the past--for example, the Small Business Administration's (SBA's) 8(a) procurement program. He also cited the set-aside provision already contained in the bill, whereby 2-1/2 percent of the \$4 billion was reserved for projects requested by Indian tribes or Alaska Native villages. Senator Brooke stressed that the provision would relieve the chronic unemployment in minority communities, because minority firms draw their work forces mostly from such communities.

In congressional debates it was asked whether the 10-percent minority requirement would delay the start of public works projects. However, Representative Mitchell and Senator Brooke said that EDA maintained rosters by State listing capable minority firms that could participate in the program.

Also, several Representatives and Senators were concerned about whether the 10-percent minority requirement would apply to areas or States having few minority firms. The Senate version of the amendment provided that accommodations be made for projects located in areas with less than 5-percent minority populations.

Although the Senate version was not adopted, the conference report on the proposed LPW legislation states that the minority provision shall depend on availability of minority business enterprises in the project area. The provision as enacted, however, gave the Secretary of Commerce the authority and discretion to waive the minority requirement when and if she decides to do so. It reads as follows:

"Except to the extent that the Secretary determines otherwise, no grant shall be made under this act for any local public works project unless the applicant gives satisfactory assurance to the Secretary that at least 10 per centum of the amount of each grant shall be expended for minority business enterprises. For purposes of this paragraph, the term 'minority business enterprise' means a business at least 50 per centum of which is owned by minority group members or, in case of a publicly owned business, at least 51 per centum of the stock of which is owned by minority group members. For the purpose of the preceding sentence, minority group members are citizens of the United States who are Negroes, Spanish-speaking, Orientals, Indians, Eskimos, and Aleuts."

It is quite clear that the statutory language does not limit the Secretary's freedom of action, as could easily have been accomplished had the Congress wished to do so, in deciding when or whether to grant a waiver in a specific case.

Several other Federal departments and agencies have made policies and implemented regulations establishing programs to increase contracting with minority firms. For example, the Environmental Protection Agency requires positive efforts including goals and timetables to increase the opportunity for minority firms to obtain contracts under grants awarded for construction of publicly owned water and sewage treatment projects. The Department of Transportation encourages increased use of firms owned and controlled by minorities and women. Direct procurements and contracts under Transportation's financial assistance programs must reflect appropriate goals for use of minority firms with written justification for the goals. Transportation's Urban Mass Transportation Administration (UMTA) also requires percentage goals to be established so that minority firms have the maximum opportunity to participate in UMTA-financed contracts.

SCOPE OF REVIEW

We interviewed EDA officials and reviewed policies, regulations, and procedures at headquarters in Washington, D.C., and regional offices in Atlanta, Georgia; Austin, Texas; Chicago, Illinois; Denver, Colorado; Philadelphia, Pennsylvania; and Seattle, Washington. We interviewed SBA and Office of Minority Business Enterprise (OMBE) officials of various field offices located within the six EDA regions.

We analyzed the files of 420 projects located in the 50 States, District of Columbia, Guam, Puerto Rico, and the Trust Territories of the Pacific to assess the nature and extent of EDA's implementation of the minority provision. The 420 project files represented a stratified random sample of the 8,554 second-round projects nationwide and accounted for \$617 million, or about 15 percent, of the \$4 billion of second-round funds. (See app. III for sampling plan.)

We conducted a nationwide telephone survey, and obtained usable responses from 389 grantees, 350 prime contractors, and 189 minority firms associated with the randomly sampled projects. The telephone survey provided some insight into the experiences of the various project participants in complying with the minority provision. Throughout the report, estimates of the adjusted universe based on our survey results were computed in accordance with accepted statistical practices for stratified samples. In other parts of the report, we merely state the absolute results of our sample in raw

numbers or percentages. Such results provide a reasonable but not a statistical estimate of the universe.

We also visited 33 of the sampled projects. These projects were located in 29 States and included a mix of small and large projects, rural and urban projects, and projects in various stages of completion. (See app. IV for list of States and characteristics of projects visited.) We visited sites primarily to confirm information obtained from grantees, prime contractors, and minority firms during the telephone survey and to observe minority firms at their place of business or performing on the project. We also contacted trade and minority contractor associations, non-bidding prime contractors, and nonminority subcontractors to seek their views and opinions on the minority provision.

Our fieldwork was conducted from May through August 1978. The second round of the LPW program was underway during that period, and our findings could be affected by subsequent actions as the second round progresses.

CHAPTER 2

SOME BENEFITS IN USING MINORITY

FIRMS ON PUBLIC WORKS PROJECTS

EDA's implementation of the minority provision resulted in some benefits. Minority firms' share of Federal funds under the second round of the LPW program was substantial compared with the results of past Federal attempts to bring the minority business sector into the economy's mainstream. EDA did not have to extend the start of construction for many projects, and only about one of every five projects had construction delays because of difficulties with using minority firms. Thus, a primary purpose of the minority provision--to give more Federal funds to minority firms--was achieved without significant delays to the start of LPW projects.

The 10-percent requirement included in the second round was the primary reason for the increased use of minority firms. Another factor was EDA's strong commitment to enforce the provision. The law afforded EDA broad discretion to determine those cases in which waivers should be granted. However, EDA elected to enforce the requirement stringently, and few projects were granted waivers.

Other benefits resulted from using minority firms on public works projects. New minority firms were established, and existing firms gained experience. Some prime contractors found that minority firms performed adequately and would be given the opportunity to compete on future subcontract work. In addition, minority firms which obtained contracts on LPW projects were able to provide employment for minority workers.

MINORITY FIRM SHARE OF FEDERAL FUNDS INCREASED

One purpose of the minority provision was to increase the share of Federal funds received by minority firms. The provision required that at least \$400 million, or 10 percent of the \$4 billion second-round authorization, be contracted with minority firms.

As of September 1, 1978, unconfirmed estimates indicate that about 16 percent, or \$634 million, will go to minority firms. However, EDA anticipates some slippage due to its monitoring efforts and correcting of reporting errors. In its September 1978 "Interim Report On 10 Percent Minority Business Enterprise Requirement," EDA estimates that minority firms will receive about \$560 million, or about 14 percent

of second-round funding, once final adjustments are made. The following table shows the minority participation presently being reported on a regional basis.

MINORITY PARTICIPATION BY REGION--SEPTEMBER 1, 1978

<u>EDA region</u>	<u>Total projects</u>	<u>Total second-round funds</u>	<u>Minority firms</u>	
			<u>Share of second-round funds</u>	<u>Percent of second-round funds</u>
(000,000 omitted)				
Atlantic	2,905	\$1,563	\$272	17
Southeast	1,114	436	55	13
Southwest	648	263	50	19
Midwest	1,204	538	67	13
Rocky Mountain	937	311	48	15
western	<u>1,632</u>	<u>806</u>	<u>142</u>	18
Total	<u>a/8,440</u>	<u>a/\$3,917</u>	<u>\$634</u>	16

a/Less than the totals of 8,554 projects and \$4 billion because 114 projects had not submitted minority reports as of Sept. 1978.

About 90 percent, or \$572 million of the \$634 million, represented contracts awarded to about 6,200 minority firms. The remaining 10 percent represented agreements on which binding contracts had not yet been negotiated. Minority firms have received contracts ranging from less than \$1,000 to over \$1 million; the average contract is about \$46,000.

Because the first round did not include a minority provision, EDA maintained no statistics on first-round funding that went to minority firms. However, 291 prime contractors indicated that they participated on comparable public works projects before the second round. About 68 percent of these prime contractors said that minority firms received 5 percent or less of contracts on earlier public works projects. Obviously, many of these public works projects were funded under the first-round authorization.

There are other indications that minority firms received few Federal procurement dollars before the second

round of the LPW program. In fiscal year 1977, the Government directed only \$1.1 billion to minority firms out of a total of \$85.5 billion in contracts with private business. Another indication is a comparison of SBA's 8(a) procurement program to the second round. Data shows that from 1967 through 1978--a 12-year period--\$459 million of SBA funds went to minority firms for construction work--as compared to the \$634 million of second-round funds during the short period of the LPW program.

Minority firm participation under the second round of the LPW program represents a significant increase over the first round of the program and past Federal attempts to bring the minority business sector into the economy's mainstream.

USING MINORITY FIRMS DID NOT
DELAY THE START OF LPW PROJECTS

Few projects under the LPW program's second round were extended because of the requirement that minority firms be used. Grantees are permitted to request extensions if construction cannot start within 90 days of project approval.

As of September 1, 1978, 1,288 extensions had been granted to the 8,554 projects nationwide. EDA identified only 183 extensions that were granted because of problems in meeting the minority provision. Assuming the 183 extensions represented individual projects, only about 2 percent of the 8,554 projects had to be extended due to the minority provision. The following chart provides a breakdown of extension data by region.

NUMBER AND REASON FOR EXTENSIONS

<u>EDA region</u>	<u>Total projects</u>	<u>High bids</u>	<u>Weather</u>	<u>Minority provision problems</u>	<u>Other (note a)</u>	<u>Total</u>
Atlantic	2,920	46	31	37	110	224
Southeast	1,126	55	3	34	32	124
Southwest	651	49	5	41	25	120
Midwest	1,254	59	16	20	61	156
Rocky Mountain	942	68	73	9	33	183
Western	<u>1,661</u>	<u>171</u>	<u>136</u>	<u>42</u>	<u>132</u>	<u>481</u>
Total	<u>8,554</u>	<u>448</u>	<u>264</u>	<u>183</u>	<u>393</u>	<u>1,288</u>

a/Most other reasons for extensions were insufficient bids and legal and environmental problems.

Because the Western region granted a significant number of extensions due to high bids, EDA headquarters asked the region to conduct a survey. The region contacted grantees, construction union representatives, and chapter representatives of Associated General Contractors of America, Inc. (AGC) in cities experiencing high bids to determine the condition of the construction market. Generally, the survey disclosed that a major reason for high bids was that local contractors had plenty of construction work without the LPW program.

An analysis of EDA records and grantee responses to our telephone survey generally confirmed the limited number of extensions granted because of minority provision problems. A possible factor limiting the number of these extensions was the procedures EDA developed for processing second-round projects. Grantees had to submit various data to receive the 50-percent funding initially provided to most second-round projects. Evidence that construction started within 90 days after project approval had to be furnished to EDA. In addition, all bidders for prime contracts were required to set forth in their bid documents the names and addresses of the minority firms they intended to use, a brief description of the work each firm would perform, and the total amount that would be expended for the minority firms. Only those bids which provided for the necessary amounts to meet the

10-percent requirement were deemed responsive. Within five days after bid opening, the apparent low bidder had to list specific amounts it intended to spend for each minority firm.

Grantees had to file initial reports with EDA listing the names and addresses of each minority firm which would be used to meet the 10-percent requirement. To determine eligibility for the initial 50-percent funding, EDA generally elected to accept the information on minority firms and verify such information during the construction period.

As soon as contracts with minority firms were executed, grantees were required to file a report with EDA signed by the minority firm confirming the amount it was to receive for its work on the project. Grantees were required to submit additional reports when project construction was 40 percent complete in order to receive the remaining 50-percent funding. EDA would not release the entire 50-percent funding unless the reports indicated that executed contracts with minority firms amounted to at least 10 percent of the EDA grant.

Consequently, most projects were permitted to begin construction with only a plan for meeting the minority requirement. An EDA official said that as grantees were permitted to start construction and receive initial funding without having minority firms under binding contracts, requests for extensions because of problems with minority firms were limited.

About 19 percent, or one of every five projects, had delays after construction started because of problems with minority firms. The delays averaged about 5 weeks.

The following table shows the number of projects delayed due to problems with minority firms compared to the percentage of completed projects.

Comparison of Construction
Delays to Project Completion

<u>Percentage of completion</u>	<u>Total projects</u>	<u>Problems with minority firms</u>	
		<u>Delayed projects</u>	<u>Percent</u>
0- 20	58	8	14
21- 40	86	16	19
41- 60	62	15	24
61- 80	40	8	20
81-100	<u>79</u>	<u>16</u>	20
	<u>325</u>	<u>63</u>	19

The number of projects experiencing construction delays attributable to the minority requirement may increase as the 8,554 second-round projects near completion. According to EDA officials, delays on federally financed projects are not uncommon. Hence, they believed that the data in the above table is significant only if compared to the number of projects delayed due to other problems, such as weather, supply slippages, or problems with nonminority firms.

STRONG EDA COMMITMENT
TO MINORITY PROVISION

After passage of the Public Works Employment Act of 1977, EDA assigned a high priority to implementing the minority provision. EDA officials stressed to project applicants and to representatives of the construction industry that EDA was committed to meeting the minority requirement. Throughout the preapproval and postapproval stages of the LPW program, EDA headquarters and regional staff designated the 10-percent provision as critical to the second-round program's success. EDA headquarters established a special unit to monitor and help with implementation of the provision.

EDA developed procedures to stringently enforce the minority requirement and ensure that prime contractors sought out and used qualified minority subcontractors and suppliers. Grantees were provided with detailed instructions for dealing with bidders, and also were required to report on the prime contractors' performances in meeting the 10-percent minority requirement.

An EDA headquarters official asserted that the substantially increased use of minority firms would not have occurred without the agency's strong commitment and high priority given to the minority program. This strong commitment shows in the small number of waivers of minority requirements granted by EDA to the 8,554 projects. The following table shows the number of waivers granted during January-March 1978--when about 85 percent of the second-round projects had begun construction.

<u>Waiver status</u>	<u>3-Month waiver activity in 1978</u>			
	<u>January</u>	<u>February</u>	<u>March</u>	<u>Total</u>
Waivers requested	45	12	13	70
Pending decision	-	-	7	7
Withdrawn	0	7	10	17
Denied	16	0	0	16
Approved	18	3	9	30

These figures show that few waivers were requested, and few were approved. However, EDA reported that grantees sought about 1,000 waivers before projects were opened for bid. Because the waiver requests were submitted before receipt of contractor bids, the requests were denied as being premature. EDA's policy was to accept and review waivers only after projects opened for bid. Another factor was that many grantees did not apply for waivers because they knew that EDA would grant them only in extreme cases and only after extensive documentation of the efforts to meet the provision.

Obviously, the minority provision, legislated to apply only to the second round of the LPW program, was the primary reason that minority firms were used more in the second round than in the first. However, EDA's strong commitment to and stringent enforcement of the minority provision also proved effective in increasing the use of minority firms. Many grantees complying with the 10-percent minority requirement might have sought a waiver if EDA had been less committed to implementing the minority provision.

OTHER BENEFITS FROM
USING MINORITY FIRMS

In our telephone survey, we asked grantees and prime contractors whether they believed that the use of minority firms on LPW projects resulted in any benefits.

Grantee respondents on 151 of the 389 projects believed that the provision led to development of new minority firms or enabled existing ones to survive. For example, a California county official said that eight minority firms received contracts of \$3.4 million that enabled them to work on projects of larger magnitude than normal and also enabled some firms to continue in business. A Massachusetts local official reported that a minority firm was created as a joint venture between a nonminority contractor and a former minority employee of that contractor which appeared to be operating smoothly on the project. The minority member told us that he participated actively in managing the joint venture and that this experience has enabled him to bid independently on construction jobs as high as \$500,000.

Prime contractor respondents found the work performed by 90 percent of the 701 minority firms on the 350 projects to be acceptable. About 34 percent of the contractors said that the firms would be considered for future work and would be given the opportunity to submit bids. On one New Jersey project, a prime contractor admitted that he initially had a negative attitude toward the minority provision. However, after observing a minority firm's performance on the project, he was pleasantly surprised. He would not hesitate to use the firm if more work in the firm's area of expertise was required. On a Michigan project, a prime contractor said that the minority firm submitted the lowest bid, performed acceptably, and would be considered for future work.

The Utah chapter of the AGC conducted a survey of prime contractors on 18 projects representing about \$8.6 million of Utah's \$30 million allocation. The performance of the minority firms was rated as good to excellent by 12 of the 18 prime contractors surveyed. The AGC Carolinas branch surveyed bidders on second-round projects in North and South Carolina and received over 600 responses. Of these, 81 percent considered the minority firms to be competent in their specialities.

Grantee respondents on 128 of 389 projects believed that the minority provision provided employment for minorities that otherwise would not have been available. On a Florida project funded by an EDA grant of \$125,000, a local official said that his community had a large number of unemployed minority workers. The minority firm received a contract for \$110,000, and unemployed persons were hired by the minority firm.

Also mentioned less frequently in our telephone survey was that the minority provision has

--improved communications between minority firms
and prime contractors and

--provided the prime contractors with a wider range
of bidders for subcontract work.

Overall, more than half of the prime contractors saw no benefits in having a minority requirement. These prime contractors--unaccustomed to working with minority firms and disturbed at abandoning established relationships--disagree with the intent of the minority provision.

A number of minority firm representatives contacted during our site visits observed that the experience gained and the money received from working on LPW projects was helpful. At a California project, a minority firm's representative told us that the provision enabled the firm to obtain contracts it would not normally get. The representative was happy with the program and the amount of dollars received, and indicated that the provision helped the firm obtain technical expertise. At a New York project, the minority firm's representative stated that the provision enabled him to reestablish his business. Because the provision has forced prime contractors to deal with his firm, he is developing a track record that will enable him to stay in business when the LPW program is over.

CHAPTER 3

USING MINORITY FIRMS IS COSTLY

AND NOT WITHOUT PROBLEMS

Many problems resulted from using minority firms on public works projects. EDA was saddled with additional administrative costs, and construction costs on many projects were increased by contracting with minority firms. A lack of minority firms in some rural and urban areas made compliance with the minority requirement difficult for many grantees. Prime contractors on projects in certain States had to find and contract with out-of-State minority firms to meet the minority requirement. The questionable eligibility of many minority firms to participate in the LPW program has been a persistent problem for EDA. In some cases, EDA declared minority firms ineligible after much of the project construction had been completed, placing an added burden on the prime contractor.

Some minority firms had inadequate working capital, were unable to obtain bonding, and had problems with Federal paperwork and competitive bidding procedures. In some cases, minority firms participated on too many public works projects at one time and had difficulty meeting their contractual obligations.

Construction contractor associations--trade and minority--expressed some dissatisfaction with the implementation of the minority provision. A number of lawsuits have been filed by trade associations to block implementation.

Several factors related to the minority provision combined to cause many of these problems. These factors, some of them statutory and beyond EDA's control, were:

--Too tight deadlines--60 days to process applications and 90 days to start construction.

--Too rigid application--EDA's stringent enforcement policy.

--Too much money for such a short time period-- a \$4 billion second-round authorization that had to be obligated quickly.

INCREASED ADMINISTRATION COST

EDA's implementing and monitoring of the 10-percent minority provision required a disproportionate amount of the

initial \$15 million of LPW funds earmarked to administer the second round. In requesting a \$14 million supplemental appropriation, EDA reasoned that the time and staff needed to carry out the minority provision mandate required more administration funds.

The Congress appropriated \$15 million to EDA for administering the second round of the LPW program. EDA was to use these funds to hire temporary staff to implement and monitor the second round and to cover the cost of space, supplies, transportation, and other expenses. During the second-round peak processing period, about 500 temporary staff, and many of EDA's permanent staff, carried out second-round activities.

EDA regional officials said that, because administration of the minority provision was accorded such high priority, it required more staff time than most other facets of the LPW program. EDA headquarters estimates, on the basis of a study prepared by the LPW staff, that of the initial \$15 million administrative set-aside, \$3.5 million, or a little less than 25 percent, was expended for monitoring the minority business provision.

In June 1978 EDA requested a \$14 million supplemental appropriation to ensure adequate program management during fiscal years 1978 and 1979. EDA's request cited the workload of administering 8,554 second-round projects instead of the initially estimated 4,000 projects. The request also said that special provisions of the second round, such as the mandate about minority firms, increased administration costs. EDA noted that the staff time needed to monitor the provision was underestimated. In August 1978, \$3.8 million was added to EDA's fiscal year 1978 appropriation. Also, EDA's fiscal year 1979 appropriation enacted in October 1978, provided \$10.6 million for EDA administration of the second round.

INCREASED CONSTRUCTION COST

High bids have occurred on many second-round projects. Several factors contributed to high bids. In some cases, poor estimating by applicants or overbidding by prime contractors not needing the work resulted in high bids. In other cases, high bids resulted from the increased costs of doing business with minority firms.

We estimate that about 40 percent of the prime contractors on 7,196 projects had problems with the prices quoted by minority firms. (See app. III, table 3.) Most prime contractors stated that price quotes by minority firms generally increased costs because contracts were negotiated or

competition was limited to minority firms. The price quotes of minority firms averaged about 9 percent higher than normal prices.

The following table shows on a percentage basis the most common reasons cited by prime contractor respondents for the problems with minority firm price quotes.

Reasons for Problems with Minority Firm Quotes

<u>Reason</u>	<u>Percent</u>
Service/supply could have been obtained from a nonminority at a lower price.	28
Minority firm's price high because of guaranteed work.	22
Minority firm reluctant to submit quote.	18
Minority firm's cost of doing business higher.	11
Higher price because minority firm came from outside local area.	10
Other	11
Total	100

Instances of increased construction cost due to minority firms' higher prices were confirmed during most of our site visits. For example, a prime contractor on a Louisiana project furnished bid information showing that the quotes of the three minority firms were about 10 percent higher than non-minority competitors. To compensate, the prime contractor raised its overall bid by \$22,000, or 2 percent--from \$1,125,000 to \$1,147,000. The prime contractor on an Arizona project said that the 10-percent provision resulted in subcontracting work to minority firms which the prime contractor normally would have done. The minority firm's price was about \$4,100, or 10 percent higher. The prime contractor stated that the additional cost was passed on to the grantee through a higher bid.

EDA guidelines also stated that grantees and prime contractors were expected to use minority firms with less experience than available nonminority contractors and should provide technical assistance to minority firms. Grantees and prime contractors were expected to help minority firms obtain bonding or working capital, include them in any

overall bond, or waive bonding where feasible. We estimate that about 44 percent of the prime contractors on 7,196 projects had an added burden placed on them because they (1) had to assume some of the minority firms' administrative work, (2) had to purchase supplies for the minority firms (usually not done for other subcontractors), or (3) had to provide bonding or waive bonding for minority firms. (See app. III, table 4.)

For example, on a Texas project visited, the prime contractor stated that he had to pay one-third of the minority firm's payroll and purchase material for the minority firm. AGC surveys of contractors on second-round projects in North Carolina and Massachusetts disclosed that many prime contractors had to provide technical assistance or bonding for their minority firms. The Massachusetts contractors believed it was unfair to impose such risks on the prime contractors.

Although EDA officials agreed that such assistance was probably given more often to minority firms than is customarily given to subcontractors on construction projects, they believed that the amount of the true increase could be determined only if comparable data was gathered for nonminority firms.

About two-thirds of the prime contractor respondents who cited added burdens in dealing with minority firms incurred additional costs after construction began. For example, one prime contractor stated that he had subcontracted with a minority firm that later defaulted and went broke. The prime contractor had to pay for some supplies and some of the minority firm's payroll at a cost of about \$9,000. This prime contractor told us that this type of increased cost reduced his profit on the contract.

Construction costs on some second-round projects escalated because the prime contract award did not go to the low bidder. Analysis of bid information on 343 of the sample projects indicated that higher bidding contractors received the award on 14 of these projects because low bidders were declared nonresponsive for not meeting the 10-percent minority requirement. For example, a New Jersey project which we visited had an increased cost of about \$6,800 because the third low bidder received the award. Since the prime contractor submitting the lowest bid failed to identify the minority firms to be used on the project, the bid of \$182,160 was declared nonresponsive. The next low bid of \$185,000 was rejected because the grantee's investigation indicated the minority firm listed by the prime contractor was not bona fide. The prime contractor

submitting the third low bid of \$188,940 received the contract award.

A North Carolina project visited had an increased cost of over \$21,000 because the low bidders on two prime contracts were declared nonresponsive for not meeting the minority requirement. The next low bidder on both contracts submitted bids totaling \$91,519 compared to the low bids which totaled \$69,963. The winning prime contractor used the same minority supplier to comply with the 10-percent requirement on both prime contracts. However, EDA later determined the supplier to be not bona fide. As the project was almost complete, the grantee requested and was granted a waiver regarding that supplier.

Some cost increases resulting from the 10-percent minority requirement were expected. In introducing the provision in the House, Representative Mitchell said that minority firms needed such a provision because they were unable to compete with larger, older, and more established companies that were usually successful in underbidding minority firms. EDA has indicated that generally some cost increases should not be considered unreasonable in contracting with minority firms, since many such firms have built-in cost problems because they are small, undercapitalized, and without the credit standing needed to order supplies and material.

While our site visits generally confirmed increased costs because of the provision, two cases were noted in which the prime contractors had overstated the cost in the telephone survey. In the first instance, the prime contractor on a Utah project said during the telephone survey that the quote from a minority firm was \$2,000 higher than a nonminority firm. However, during the site visit, we examined bid documentation which indicated the cost increase was only \$1,056, a difference of 47 percent. In the other case, analysis of the prime contractor's bid data on a Texas project indicated the minority firm's bid was \$4,000, or 4 percent, higher than the nonminority firm's bid. However, the prime contractor had indicated during the telephone survey that \$10,000 in increased cost resulted from the quote of the minority firm, an overstatement of \$6,000.

LACK OF MINORITY FIRMS IN SOME PLACES

We classified the randomly sampled projects as rural or urban using EDA criteria. Projects located within standard metropolitan statistical areas were classified as urban. All other projects were classified as rural. An estimated 48 percent of the prime contractors on 3,500 rural

projects and an estimated 51 percent of the prime contractors on 3,696 urban projects had problems locating minority firms to satisfy the 10-percent requirement. (See app. III, tables 5A and 6A.)

Urban projects in the Atlantic and Midwest regions and rural projects in the Atlantic and Rocky Mountain regions had the greatest difficulty locating minority firms. In contrast, rural and urban projects in the Southwest and Western regions had the least difficulty. About 49 percent of the prime contractors that had problems finding minority firms said they went outside their normal market area to do so.

Prime contractors described several types of problems that arose in the search for minority firms, as shown in the following table.

Problems Finding Minority Firms

<u>Reason</u>	<u>Number of times cited</u>		
	<u>Rural projects</u>	<u>Urban projects</u>	<u>Total</u>
Absence of qualified minority firms in local area.	28	57	85
Unable to locate any minority firms.	28	44	72
Unable to ascertain if minority firms were qualified.	30	41	71
Took too long to find minority firms.	27	32	59
Available minority firms lacked particular skill needed.	23	34	57
Available minority firms were overbooked.	14	17	31

Examples of contractors' comments follow.

A prime contractor on an urban project in Alabama:

"No qualified minority firms in the local area. Project consisted of laying pipeline and constructing a water tank. Did not know of any minority firms that construct water tanks. Tried to

find a minority firm who supplied pipe and was finally successful."

A prime contractor on a rural project in Montana:

"There are generally problems finding minority firms because many projects are in small towns where there are none. There are few qualified minority firms in many project areas in the States of Montana, Wyoming, and Idaho. Also, there is a large demand for the few minority firms that do exist because of the EDA projects."

A prime contractor on an urban project in New York:

"Particular skill of pile driving needed on project was not available thru a minority firm."

A prime contractor on an urban project in California:

"Very hard to locate minority firms. Too many EDA jobs came out at one time--minority firms had too much work."

A prime contractor on a rural project in Arkansas:

"With this being a rural area, the implementation of the provision was pushed too fast. There was not enough time to locate minority firms."

A prime contractor on an urban project in Wisconsin:

"In sewer construction, finding a qualified minority firm is a fantastic problem--especially to the extent of 10 percent."

The problems of locating minority firms were confirmed during several of our site visits. For example, the prime contractor on a North Dakota project said he was unable to locate minority firms because there were no qualified firms locally. Finally, the prime contractor had to resort to an out-of-State minority supplier whose price on a \$33,000 contract was \$1,400 higher than the prime contractor's supplier. At the EDA Rocky Mountain region, we found that the minority supplier for the one project we visited was also being used on 44 other LPW projects in North and South Dakota. The supplier had contracts totaling \$541,000, and it appeared that the supplier was the only minority firm used on at least 33 of the 45 projects.

In our opinion, prime contractors unable to locate subcontractors locally saw the use of suppliers as the easiest and quickest way to comply with the 10-percent requirement. In some instances, minority suppliers were used because the nature of the construction was not suited to subcontracting, or the prime contractors normally performed all work. For example, several prime contractors on sewer construction projects said that they usually did all their own work and therefore had to rely on minority suppliers to meet the 10-percent minority requirement.

Some grantees complained that finding minority firms was difficult for prime contractors because listings of minority firms furnished by various Federal agencies or organizations were deficient. The listings usually contained less than half the existing minority firms, included many minority firms no longer in business, and in some cases described skills that minority firms really did not possess. The inadequacy of the minority firm listings was confirmed during several site visits.

For example, the grantee for one project was the State of New Jersey. A State official told us that the State received funds to finance about 11 second-round projects. He stated that one of the State's biggest problems was identifying minority firms in the State, since no single source compiled this data. As a last resort, the State awarded a \$200,000 grant to a university development center to compile such a list. Although accuracy was somewhat questionable, the list named over 400 minority firms in the State and was given to prospective bidders. The State official said that many prime contractors reported that they were unable to locate qualified minority firms and that the State-furnished list was of little use. A city official on a Florida project told us that lists provided by the Urban League and an OMBE-funded organization were not useful. The lists included all types of minority firms, such as beauty shops and auto repair shops. In most cases, the lists did not identify special skills possessed by the minority firms.

Out-of-State minority firms

EDA guidelines directed prime contractors to use minority firms from as wide a market area as economically feasible. Out-of-State minority firms were to be used if prime contractors, in the normal course of business, went beyond State borders. However, out-of-State minority firms were not required to be used when their prices did not remain competitive and dealing with them became too burdensome.

EDA records showed that as of September 26, 1978, about 13,200 contracts had been awarded to minority firms. Only about 11 percent of the contracts went to out-of-State minority firms. However, several States used out-of-State minority firms quite extensively, as shown in the following chart.

States With Largest Percentage
of Out-Of-State Minority Firms

<u>State</u>	<u>Number of projects</u>	<u>Minority firms</u>		
		<u>Under contract</u>	<u>Out-of -State</u>	<u>Percent out- of-State</u>
New Hampshire	68	83	57	69
Wyoming	77	76	39	51
Vermont	109	136	68	50
Kentucky	83	67	31	46
Kansas	106	142	53	37
North Dakota	101	128	41	32

In some instances, using out-of-State minority firms was logical--when a project was located close to a State boundary and the adjoining State contained a concentration of available minority firms, or when using out-of-State firms was a normal business practice. Unfortunately, statistics are not available on the frequency that out-of-State minority firms are used on construction projects not having a minority requirement.

However, about 45 percent of the prime contractors in our sample that used out-of-State minority firms said they normally subcontracted within the State but had to go out of State to comply with the minority provision. For example, an AGC chapter representative contacted during our visit to a New Hampshire project stated that the 57 out-of-State minority firms on New Hampshire projects had to be used because available minority firms in the State were few in number. The representative believes that contracting in this manner defeats the purpose of the LPW program. Data developed at the EDA Atlantic region showed that minority firms on New Hampshire projects received contracts totaling \$2,330,650. However, only about 28 percent of the \$2,330,650 went to minority firms located in New Hampshire.

ELIGIBILITY OF MANY MINORITY FIRMS IS QUESTIONABLE

The questionable eligibility of many minority firms used on LPW projects has been a persistent problem for EDA. EDA conducted a special investigation of 1,386 minority firms and declared 449, or about 32 percent, ineligible to meet all or a portion of the 10-percent requirement. During our 33 field visits, we identified 12 minority firms whose eligibility appears questionable, although they continue to be counted toward the 10-percent requirement. In addition, the city of New York in its investigation of minority firms used on city projects found serious problems concerning eligibility.

Under EDA's criteria, in order for a minority firm to be considered a legitimate firm, it must have at least 50 percent minority-group ownership that is real and continuing and not created solely to meet the 10-percent requirement. For example, the minority-group members must have control over management, interest in capital, and earnings commensurate with the percentage of minority ownership claimed. The minority firm must perform significant work or services or provide supplies under the contract and not act merely as a funnel. In short, the contractual relationship must also be bona fide.

During the early stages of the second round (September 1977 through January 1978), EDA declared very few minority firms ineligible. Generally, EDA accepted minority firms reported by grantees if the firms appeared on various lists prepared by SBA, OMBE-affiliated local organizations, and other State and local public and private organizations. Firms not on the lists were scheduled for future review after initial funds had been released to the grantee. EDA's policy was to release initial funding of 50 percent so as not to delay projects because of unverified minority firms.

After most of the initial funding had been released, EDA reviewed unverified minority firms. Questionnaires filled out by such firms were reviewed and followed up through telephone calls. EDA declared few minority firms ineligible based on review of the questionnaires. The early determinations that minority firms were ineligible usually resulted from complaints or questions raised by (1) minority firms that believed they were cut from the program unfairly or (2) unsuccessful bidders for prime contracts.

By March 1978, EDA realized that the eligibility of minority firms was emerging as a larger problem than had been realized. The volume of complaints about eligibility of

minority firms grew. EDA headquarters survey teams reported that several investigations disclosed minority firms that had minority owners with little or no role in management, or provided few or no services and were usually fronts for non-minority firms. Also, these investigations identified suppliers that served no useful commercial function, were an unnecessary intermediary between the regular suppliers and the prime contractor, and existed merely to take advantage of the 10-percent requirement. EDA stated that these types of minority firms undermined the purpose of the minority provision and made it harder for qualified minority firms to obtain second-round funding. In addition, EDA computer data revealed that many recently formed minority firms were participating on several projects over a large geographic area, which appeared highly suspicious to EDA officials.

EDA established special field teams in each region to investigate minority firm legitimacy starting in April 1978. EDA targeted its review to those situations most likely to have abuse. Consequently, many minority suppliers were reviewed to determine if such suppliers were functioning merely as brokers. In addition, various minority construction contractors, after considering the number, size, and variety of contracts, as well as the volume of complaints, were selected for review.

The special field teams were generally effective in identifying minority firms ineligible for partial or whole credit toward meeting the 10-percent requirement, as shown by the following table.

Results of EDA Special Investigation

	<u>Number</u>	<u>Percent</u>
Minority firms investigated:		
Suppliers	721	
Contractors	<u>665</u>	
Total	<u>1,386</u>	<u>100</u>
Minority firms declared:		
Brokers	222	16
Non-bona fide suppliers	141	10
Non-bona fide contractors	<u>86</u>	6
Total	<u>449</u>	32

The 222 minority firms declared as brokers had about \$30 million of contract awards. However, only about \$3 million of the \$30 million, which represented the commission or markup taken on the contracts, was counted toward the 10-percent requirement. The non-bona fide suppliers and contractors had over \$15 million of contract awards that were not counted toward the 10-percent requirement.

An analysis of the supporting documentation used by the EDA Atlantic region's field team to declare suppliers and contractors non-bona fide indicated the primary reasons were:

- Minority members did not participate enough in management of the firm, or the firm was established as part of the prime contractor to meet the 10-percent requirement.
- Minority status of minority members did not qualify under the law; for example, Portuguese descent.
- Minority subcontractor firms subcontracted most of the work to nonminority subcontractors.

EDA's special field teams completed investigations in July 1978. However, EDA is continuing to conduct indepth reviews of minority firm contracts as grantees submit additional reports.

Our 33 site visits revealed that the problem of ineligible minority firms was quite extensive. The legitimacy of 12 of 47 minority firms contacted during site visits appears questionable according to EDA criteria. EDA had not declared these 12 minority firms ineligible, and as of the time of our field visits, they continue to be counted toward the 10-percent requirement.

On a New Jersey project, for example, we believe a partnership, formed in December 1977 between a minority employee and the prime contractor, was established to meet the minority provision. The minority member of the partnership stated that he (1) had been an employee of the prime contractor prior to the partnership, (2) is performing the same type of work under the partnership, (3) does not participate in management or administrative matters, and (4) believes the partnership will be dissolved when the minority provision is no longer in effect.

A second example concerns an Oklahoma project where a minority firm received a \$31,851 landscaping subcontract.

The firm had no landscaping employees or equipment. The firm's owners had other professions; instead of doing the landscaping, they subcontracted the work to a nonminority firm. The landscaper used by the minority firm had been the initial low bidder at \$27,436 but had been rejected because the prime contractor needed a minority firm to comply with the provision. The minority firm submitted the winning bid of \$31,851 by negotiating a contract with the nonminority landscaper at his original bid price of \$27,436 and adding about 14 percent, or \$4,415 on as profit. In our opinion, a contractual arrangement such as described above is not eligible for meeting the 10-percent requirement.

On a Michigan project, we identified a minority firm whose eligibility appears highly questionable. The corporation was formed in December 1977, with a minority and the prime contractor each listed as a 50-percent owner. However, the prime contractor provided the capital, office, and warehouse space and assumed all management and administrative responsibilities. The minority member's role was supervising work at the job site. Furthermore, almost all the so-called minority firm's work was on five different LPW projects as a subcontractor to the same prime contractor.

Our findings were brought to the attention of EDA headquarters officials, who ordered a review of expenditures for the 12 questioned firms. EDA agreed that six firms were ineligible for all or a portion of the credit toward the 10-percent requirement. They reported that as part of EDA's normal monitoring procedures, two of these firms had been investigated after our field visits and, consistent with our findings, were declared only partially eligible toward the 10-percent requirement. EDA had not investigated the other four firms, but it agreed that they were ineligible for any credit toward the minority requirement. EDA officials told us that EDA had received information on two of the four firms through its normal monitoring procedures that should have triggered an indepth investigation.

EDA believed that the remaining six firms were eligible despite our findings, which indicates the difficulty in making these decisions. For example, EDA disagreed with our findings on the Michigan firm described above. An EDA investigation of this firm revealed much of the information we reported, and EDA originally disqualified this firm. However, the firm appealed the decision, and further investigation by EDA uncovered sufficient data to lead EDA to reverse the decision and allow full credit. EDA found that the minority owner had 12 years of experience in the construction industry and for 3 years was an equal partner with a nonminority in another construction firm. This other firm

had previously been a subcontractor for the prime contractor on other projects but was dissolved because of financial difficulties. The prime contractor, as 50-percent owner of the new minority firm, provided office space and performed most management functions. However, the minority owner contributed a substantial amount of equipment, participated in the solicitation and negotiation of business deals, signed all payroll checks, and was the onsite supervisor for the firm. Therefore, EDA believes that despite some facts that suggest this firm is not independent of the prime contractor, the assistance provided by the prime contractor should be viewed as technical assistance to a viable, independent minority firm.

The city of New York has also begun a full-scale investigation because of extensive problems with ineligible minority firms. The city received second-round funds of about \$192 million covering 82 projects. As of July 1978, projects in New York City had about 350 prime contractors and about 130 minority firms under contract. Because of numerous complaints received, the city's Department of Investigation is reviewing the eligibility of minority firms. Initially, 43 minority firms were investigated, of which 6 were declared ineligible. The 6 firms were participating on 40 contracts on second-round projects. Two of the six minority firms have instituted litigation challenging the city's action declaring them ineligible. The city plans to investigate all minority firms listed on city projects.

Discovery of the ineligibility of minority firms has caused a significant increase in the number of waiver requests from grantees. EDA had received only 70 requests for waivers and approved only 30 through March 1978, when EDA established the special field teams. By August 31, 1978, EDA reported 675 waiver requests, with 418 granted in part and 155 granted in full.

EDA officials told us that most waiver requests were from grantees that had minority firms declared ineligible. In most cases, the determination of ineligibility was not made until the project was already well underway. They told us that rarely was there convincing evidence that the grantee or contractor acted in other than good faith. Because of the unique nature and rapid implementation of the minority business requirement, the rules were not always clearly understood. For these reasons, EDA wished to avoid penalizing minority firms, prime contractors, or grantees except in cases of bad faith. Hence, EDA did not require that grantees or prime contractors cancel or otherwise vary their contracts with minority firms, even when EDA would not give full credit

for expenditures to those firms. Instead, EDA granted waivers if the grantee established that either all the project work had already been put under contract or that no qualified minority firm was available to perform services not already under contract.

OTHER PROBLEMS

We also noted the following problems that were created when EDA implemented the 10-percent minority provision.

- Many minority firms had problems obtaining performance bonds and working capital loans. Less frequently mentioned minority problems included unfamiliarity with bidding procedures or paperwork associated with Federal projects, lack of experience doing large jobs, and more contract work than they could handle.
- The percentage of minority firm participation is in error because ineligible firms continue to be counted and EDA's records of minority firm participation contain many instances of over-reporting and underreporting toward the 10-percent requirement.
- Twenty-seven lawsuits have been filed to block implementation of the minority provision. While most lawsuits have been unsuccessful, the impact of the U.S. Supreme Court decision in the Bakke case on future legislation requiring a set-aside for minority firms is unclear.

Problems of minority firms

To achieve maximum minority firm participation, EDA guidelines directed that minority firms should not ordinarily be disqualified even though such firms lack working capital or cannot obtain bonding. The guidelines required grantees and prime contractors to help minority firms to obtain bonding or working capital, include minority firms under any overall project bond, or waive the bond requirement when feasible.

In addition, through field offices located throughout the country, SBA administers programs to assist small and disadvantaged business firms that meet SBA criteria for assistance. SBA is prepared to provide a 90-percent guarantee for the bond of any minority firm participating on an LPW project and will also offer direct or guaranteed loans for such firms.

In late September 1977, EDA and SBA signed an agreement which provided that EDA would transfer funds to SBA for

additional personnel to expedite the processing and servicing of minority firm applications for surety bond and working capital loan guarantees. However, SBA has provided little assistance to minority firms on LPW projects. As of September 1978, about 6 percent of the 6,200 minority firms participating on LPW projects had been provided bond or loan guarantees as follows.

Extent OF SBA Assistance to Minority Firms

	<u>Number of applications</u>	<u>Number approved</u>	<u>Amount of approvals</u>
Loan guarantees	136	120	\$ 6,515,000
Bid bond guarantees	121	114	15,506,000
Performance bond guarantees	<u>160</u>	<u>159</u>	<u>15,166,000</u>
Total	<u>417</u>	<u>393</u>	<u>\$37,187,000</u>

Also, 35 of 189 minority firms contacted in our nationwide telephone survey complained about SBA assistance. Most minority representatives who had problems said that they could not obtain working capital loans or surety bond guarantees from SBA or that SBA took too long to process applications.

For example, a minority firm received a subcontract of \$144,000 on a New Jersey project without having a bond because the minority owner advised the prime contractor that a bond was not required under the LPW program. However, the minority owner indicated that he experienced severe bonding problems on his other work. He indicated that SBA and bonding companies require a company to have a track record on larger jobs, but he is unable to obtain large jobs without a bond. He believes he has the equipment and manpower to bid on jobs up to \$250,000, but he throws the plans and specifications away because he knows he cannot get the bond coverage. On a Florida project, the owner of a minority firm stated that he applied for an SBA loan when he bid on the LPW job; however, SBA took 6 months to deny the loan. He feels that a timely SBA denial would have allowed him to seek a loan from other sources before his working capital was gone.

Our discussions with an SBA headquarters official about minority firm complaints disclosed that several factors limit the extent of SBA assistance. Minority firms interested in obtaining bond or loan guarantees from SBA must first deal

with a surety bond company or finance institution. The firms must submit considerable data on credit and finance, prepare voluminous forms, and provide evidence of a "track record" (past performance as an established construction firm). Further complications occur because many surety companies are reluctant to process small bonds and deal with the paperwork involved in getting SBA to guarantee the bond.

Besides these impediments, the SBA official stated that the anticipated demand from minority firms under the LPW program never materialized. For example, while only 393 loans and bond guarantees were approved, only 417 minority firms applied. He indicated that few minority firms sought SBA assistance because prime contractors on the LPW program did not generally require bonds from minority subcontractors and used some of their resources to finance minority firms. As noted on page 19, prime contractors we contacted confirmed that the nature and extent of assistance given to minority firms placed an increased burden on them. Thus, minority firm complaints concerning the need for assistance in obtaining bond coverage and working capital appear to be less directed to the LPW program and more directed to past attempts at obtaining bonds or loans from surety companies or finance institutions guaranteed by SBA.

Minority firms mentioned other problems, such as unfamiliarity with bidding procedures or paperwork associated with Federal projects and contracting on larger jobs or more jobs than their performance capacity. For example, a minority firm on a Florida project that has been in business since 1960 received a subcontract for \$63,000. The minority owner stated that his firm is not accustomed to doing work of this magnitude so the prime contractor has had to provide assistance. He also said that he is not familiar with the paperwork requirement associated with Federal projects and is not experienced in preparing bid packages.

On an Arizona project, a minority firm representative indicated that he was participating on 10 different LPW projects. He stated that there were too many projects available within a 2- or 3-month period. Most minority firms are geared to handle only a few projects at one time. He believes that the program should have been spread over a longer period of time.

Problems in reporting minority firm participation

As of September 1, 1978, EDA had unconfirmed reports that about \$634 million, or about 16 percent, of the \$4 billion second-round appropriation was going to minority firms.

EDA recognizes that some reported amounts for minority firms are in error and is taking corrective action to reconcile the reports. However, several situations were noted which we believe are significant in terms of accurately reporting minority firm participation.

EDA has put considerable effort into determining the eligibility of minority firms participating on LPW projects. This included the special field team investigations, which resulted in reducing the overall participation rate by \$42 million because of suppliers reclassified as brokers, and minority suppliers and contractors declared non-bona fide. However, we believe the minority firm participation rate is still overstated. For example, our site visits disclosed that 12 minority firms continue to be counted in EDA's overall statistics that may not be eligible.

The minority firm percentage of LPW projects is further overstated because of duplicate reporting of EDA grant amounts. EDA's reporting system requires grantees to submit forms when binding prime contracts or subcontracts are awarded to minority firms. On some projects, prime contracts were awarded to minority firms, which in turn awarded subcontracts to other minority firms. EDA's records contain a number of instances in which both prime contracts and subcontracts awarded to minority firms were mistakenly counted against the grant amount. Also, EDA's records contain instances in which minority firm participation was counted in excess of the total EDA grant amount.

For example, a California project included in our random sample was funded by EDA in the amount of \$1,849,870 and received local funds in the amount of \$8,243,305 for a total project amount of \$10,093,175. The grantee submitted forms to EDA for the prime contract totaling \$8,745,000 which was awarded to a minority firm, and six subcontracts totaling \$2,509,802, which were awarded to minority firms. EDA's reporting system reflected the combined total of \$11,254,802 awarded to minority firms (prime contractor and subcontractors) against the total EDA grant of only \$1,849,870. Therefore, minority firm participation on this project was overstated by \$9,404,932 and was reported as 608 percent rather than the 100 percent represented by the EDA grant amount.

Additional instances of erroneous reporting were noted for projects in Puerto Rico. Under the second round, Puerto Rico received EDA grants totaling \$169 million to fund 274 projects. Seventeen Puerto Rican projects that received \$30 million of EDA funds were included in our sample. Analysis of bid data disclosed that 14 projects were awarded to minority prime contractors of which 12 projects were

competitively bid. The extensive use of minority prime contractors in Puerto Rico has resulted in over 51 percent minority participation reported by EDA for these 17 projects.

In one case, a minority prime contractor awarded subcontracts to minority firms which were also reported to EDA and credited against the minority participation rate. The Puerto Rican project received an EDA grant of \$1,790,000. The prime contractor was a minority firm which received a contract of \$1,435,000. The minority prime contractor awarded contracts totaling \$564,000 to four minority subcontractors. EDA's reporting system incorrectly included the \$564,000 of subcontracts as well as the prime contract of \$1,435,000 as meeting the 10-percent minority requirement.

On another Puerto Rican project that received an EDA grant of \$2,700,000, the award of a \$2,537,000 prime contract to a minority firm was not included in EDA's statistics. In this case, the grantee had submitted forms to EDA for only three minority subcontractors receiving contracts totaling \$818,500.

We noted that the Department of Transportation's Urban Mass Transportation Administration follows a different approach to credit minority firm participation. UMTA's policy is that minority firms should have the maximum opportunity to participate on contracts financed by UMTA. Instructions provide that minority firm participation be credited only with that portion of the contract performed by minority firms and that portion subcontracted to minority firms. For example, if a minority contractor proposes to perform 50 percent of a contract valued at \$500,000 and subcontracts 25 percent to nonminority firms and 25 percent to minority firms, minority participation credit will be 75 percent, or \$375,000. Instructions further provide that minority firm credit on joint ventures between minorities and nonminorities be based on minority share of the profits, not the total contract amount. In contrast to UMTA's policy, EDA allows the total contract amount to be credited for minority firm participation.

Accurate statistics on the amount of participation by minority firms under the LPW program is critical for evaluating the program. Limits on staff time prevented us from determining the overall extent of the error. However, EDA is aware of the types of errors noted and is in the process of revising its statistics to assure greater accuracy. According to EDA, such reporting errors were taken into account in estimating the \$560 million of minority participation.

Court challenges to the minority provision

As of August 1978, 27 lawsuits had been filed challenging the constitutionality of the 10-percent minority provision. All but four were filed by an AGC chapter or AGC headquarters. One of the four non-AGC lawsuits was filed by the State of Vermont, and the remaining three by individual contractors. Most of the suits claim that the minority provision eliminates competition in the construction industry, and that it amounts to a racial quota that excludes nonminorities from at least 10 percent of the work under the LPW program.

Only 2 of 27 lawsuits have been decided against EDA's implementation of the provision. One was voided by the U.S. Supreme Court. In that case, the district court initially ruled that future public works programs having the 10-percent provision could not be carried out in Los Angeles, California. The district court's ruling was appealed to the U.S. Supreme Court. In July 1978, the Supreme Court vacated the district judge's order and returned the lawsuit to the district court to consider the question of mootness. On October 20, 1978, the district court ruled that the case was not moot and reinstated its prior order. The Department of Justice is currently considering whether or not the decision should be appealed, but according to EDA officials, the order will not affect second-round projects in Los Angeles. The other decision, in a lawsuit filed by the State of Vermont, affected only a single Vermont contractor. Thus, the net effect of these 27 lawsuits has been to restrain enforcement of the 10-percent provision with respect to one Vermont contractor.

While the lower courts have generally upheld the legality of the minority provision, the June 28, 1978, U.S. Supreme Court decision in the case of the Regents of the University of California vs. Bakke stated that without a finding of past discrimination by a university against minorities, the university may not use racial quotas for student admissions. Since the Supreme Court's decision, the United States Court of Appeals, Second Circuit of the State of New York, again upheld the constitutionality of the minority provision. The Court of Appeals, which made its ruling in September 1978, considered the Supreme Court's decision.

OTHER PARTIES' OPINIONS

During our 33 site visits, we obtained comments on implementation of the 10-percent minority provision from trade and minority associations, nonminority subcontractors, and nonbidding prime contractors.

Twenty-seven trade associations, mostly State and local chapters of AGC were contacted. AGC representatives generally did not favor the minority provision. Their most common complaints were that the minority provision (1) reduced competition, (2) increased cost, and (3) burdened prime contractors with finding minority firms and assisting the firms to perform. A sample of these comments follows.

A Louisiana AGC representative stated:

"The minority provision limited competition and inflated cost. It was, in essence, asking established businesses to train competitors by encouraging contractors to help minority firms with financing, bonding, and other problems. Also, questionable minority firms were established just to profit from the Federal dollars the provision offers."

A Wisconsin AGC representative stated:

"The minority firms benefit but the prime contractors do not benefit. The provision created animosity and resentment on the part of the prime contractors. Also, the provision might deter some contractors from bidding on LPW projects."

An Idaho AGC representative stated:

"The provision has jeopardized the free enterprise system. Many prime contractors had to reject low bids from long time subcontractors in favor of minority firms."

During our site visit to a project in North Carolina, the AGC representative told us that the AGC Carolinas branch survey of 600 bidder responses offered the following opinions.

- Seventy-one percent of the bidders increased their bid because of the minority requirement.
- Fifty-five percent could not locate minority suppliers or subcontractors within a reasonable market area.
- Fifty-eight percent had difficulty in determining whether the minority firms were bona fide.
- Forty-nine percent had to assist minority firms to prepare bids.

--Forty-three percent believed that well-established minority firms had overextended themselves because of the LPW program.

Thirty-four minority contractor associations, half of which were OMBE affiliates, were contacted. Attempts to contact minority associations during visits to 11 projects, 10 of which were located in rural areas, proved unsuccessful. Minority association representatives generally favored the minority provision. They believed the provision strengthened minority firms by giving them a chance to gain experience and establish a track record on larger jobs. While in general agreement with the intent of the minority provision, some minority association representatives warned that qualified minority firms have been excluded from the program because prime contractors established non-bona fide firms to circumvent the requirements.

A total of 36 nonminority subcontractors and nonbidding prime contractors were contacted. The subcontractors were either unsuccessful bidders that lost out to minority firms or subcontractors that prime contractors said they would have used if the 10-percent provision was not in effect. Sixteen of the 36 nonminority subcontractors and nonbidding prime contractors believed that the minority provision did not affect their business because their firms had an existing heavy workload. On the other hand, several nonminority subcontractors were disappointed and indicated it was costly to work up bid proposals, submit the low bid, and then lose out because the prime contractor had to accept the higher bid of a minority firm to meet the 10-percent requirement. Some non-bidding prime contractors said that concern about complying with the 10-percent minority requirement was a primary reason why they did not bid on LPW projects.

FACTORS CAUSING MANY OF THE PROBLEMS

The Public Works Employment Act of 1977 directed EDA to assure that 10 percent, or \$400 million, of the \$4 billion second-round authorization be spent with minority firms. The law also imposed statutory deadlines requiring EDA to distribute the \$4 billion rapidly by approving or disapproving grant applications within 60 days after receipt and to have construction started within 90 days after project approval. The appropriation of \$4 billion, which had to be obligated by September 30, 1977, and the statutory deadlines imposed were legislated so that the LPW program objectives of providing a timely fiscal stimulus and creating substantial employment opportunities could be achieved.

EDA was faced with the competing tasks of meeting the minority provision's objective--a provision EDA did not have to deal with under the first round of the LPW program--while achieving the basic program objectives of stimulating the economy and creating jobs. With the basic program objectives in mind, EDA did not have enough time to develop the most effective system for carrying out the minority provision. Although EDA was granted broad discretion in implementing the provision, it elected to enforce it stringently by not granting early waivers. EDA relied upon grantees for assurance that the provision would be met and to monitor compliance as construction proceeded. That approach seemed reasonable.

We believe the above factors, some of them statutory and beyond EDA's control, combined at the same time to handicap the LPW program. The tight deadlines for program implementation--60 days for processing applications and 90 days for starting construction--the large appropriation of Federal funds--\$4 billion which had to be obligated quickly--and EDA's rigid enforcement of the minority provision caused many of the problems discussed in this report. According to EDA officials, the large appropriation was significant only because of the tight deadlines which compounded the administrative problems. They believed that nationwide the minority business community was easily able to absorb the statutory \$400 million minority business goal, although in some areas unavailability of minority firms was a problem.

A change in any one of these factors would minimize the problems. For example, given the same amount of money and EDA's rigid application, lengthening the deadlines for carrying out the program would have reduced problems such as minority firms that were overextended, unavailable, or ineligible. Given the same amount of money and the tight deadlines, EDA's relaxation of its rigid application would have helped solve some of the problems. Lastly, given the tight deadlines and EDA's rigid application, a smaller dollar authorization than \$4 billion to be obligated in the same period of time would have helped reduce some of the problems. Of course, any of these changes would also have a price. The first and third changes would undermine the countercyclical nature of the program, and the second change would result in fewer contracts for minority firms.

Nonetheless, in our opinion, changing all three of these interacting factors would go a long way toward minimizing many of the problems.

PROPOSED PUBLIC WORKS LEGISLATION

In March 1978, the President proposed the Labor Intensive Public Works Program (LIPW), designed to address the problems of unemployed youths and minorities. The new program would have been used primarily to fund rehabilitation of existing facilities, which would provide more employment opportunities than the new construction that was emphasized under the LPW program. The LIPW program, to be administered by EDA, would have provided \$1 billion per year for 3 years beginning in fiscal year 1979.

Draft legislation for the proposed LIPW program was submitted to the Congress on May 25, 1978, and contained a minority provision. However, rather than the fixed percentage used in the LPW program, the new program required that the share for minority firms reflect the percentage of minorities in the area served by the grantee or in areas from which minority firms might reasonably be expected to travel to perform services. The minimum requirements would have ranged between 2 and 15 percent with an overall goal that at least 10 percent of the funds nationally be spent on contracts with minority firms.

The second session of the 95th Congress had not acted on the bill to authorize the LIPW program before it adjourned in October 1978.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS

CONCLUSIONS

The use of minority firms on LPW projects resulted in some benefits. Firms in the minority business sector received an increased share of Federal funds under the second round of the LPW program. The strong commitment to the minority provision and the high priority placed on its success by EDA contributed to the increased use of minority firms. In certain instances, new minority firms were established and existing minority firms were aided by the infusion of Federal money. Prime contractors found the work performed by minority firms acceptable, thus establishing new sources for future work. Some minority firms gained valuable work experience from participating on LPW projects.

Implementation of the 10-percent minority provision, however, has been costly and not without problems. Increased administration and construction costs resulted from using minority firms. A lack of available minority firms made compliance with the 10-percent requirement difficult in many locations. The questionable eligibility of minority firms has been a persistent problem confronting EDA in its administration of the provision. Some minority firms participated in too many public works projects, became overextended, and experienced difficulty meeting contract requirements.

Construction trade associations, such as the AGC, expressed dissatisfaction with the implementation of the provision. Several AGC chapters, concerned that the provision eliminated competition, have filed lawsuits to block its implementation. Representatives of minority associations, although in favor of the provision, complained that many genuine minority firms did not share in second-round funding because ineligible firms were established to circumvent the provision's intent.

In our opinion, a countercyclical program, such as the LPW program, does not represent the ideal mechanism for effective implementation of a minority provision. We believe (1) tight deadlines for getting LPW projects started, (2) rigid application of the minority provision by EDA, and (3) the substantial amount of Federal funds thrust upon minority firms in such a short period of time combined to cause many of the problems noted. Without these factors the problems noted would have been minimized and EDA could

have administered and implemented the provision more easily.

The benefits of directing Federal agencies to include a provision or policy requiring that minority firms share in Federal procurements are quite evident. Minority firms--generally characterized as small, lacking sufficient working capital, unable to obtain adequate bonding capacity, and suffering from unfamiliarity with Federal paperwork and competitive bidding procedures--need considerable financial, technical, and managerial assistance if they are to become self-sufficient. The development and strengthening of minority entrepreneurs is a necessary first step.

However, a minority provision or policy should be designed so that the social and economic benefits can be increased and at the same time, many of the problems discussed in this report can be reduced or eliminated. To meet a goal of 10 percent participation, flexible percentages should be established based on the availability of minority firms. The legitimacy of minority firms should be certified before receiving contracts as part of meeting a minority requirement. Only a supplier's commission or markup on sales should be counted toward the minority goal. Exceptions could be made for suppliers who manufacture their product such as a concrete pipemaker. Also, Federal funds should be released gradually so that assistance provided to minority firms is extended over a longer period to better prepare such firms to become competitive within the construction industry.

RECOMMENDATIONS TO THE SECRETARY OF COMMERCE

A new LIPw program had been proposed. Draft legislation for the new program assigned administration to EDA and contained a minority provision. However, rather than apply the fixed percentage under the LPW program, the proposed program would have required a flexible range between 2 to 15 percent in proportion to the minority population or the availability of minority firms in an area with the overall goal of 10 percent.

We recommend that the Secretary of Commerce direct EDA, if this legislation is introduced and passed by the Congress, to:

- Provide guidelines to grantees so that the legitimacy of minority firms be certified before they participate on projects.

- Direct grantees to assist prime contractors in locating qualified minority firms.
- Require grantees to have minority firms under binding contracts before starting construction and permit later substitution of minority firms only with EDA's approval.
- Direct grantees to monitor closely minority firms established by prime contractors and listed as subcontractors on the same projects as the prime contractors to preclude eligibility problems.
- Permit participation by minority suppliers, other than minority manufacturers, only to the extent of the commission or markup on sales rather than counting total amount of sales toward the minority goal.
- Record minority participation more accurately to better account for the percentage goal attained in meeting the flexible minority requirement.

RECOMMENDATIONS TO
THE CONGRESS

The Congress should design future minority provisions so as to minimize the problems noted in this report. We recommend that the future minority provisions:

- Impose a penalty, such as debarment from participating on future federally funded projects, on contractors that establish ineligible minority firms to circumvent the intent of the minority requirement.
- Use a flexible percentage for applying the minority requirement based on the availability of minority firms and/or percentage of minority population in certain areas measured against an overall goal.

Also, the Congress should consider whether a countercyclical program, such as the LPW program with its tight deadlines, represents a suitable mechanism for implementing a minority provision.

AGENCY COMMENTS

We asked the Assistant Secretary for Economic Development and other EDA officials responsible for implementing and

administering the minority provision to review the draft of our report; their comments were considered in preparing the final report. They said that the report is basically fair and accurate. They concurred with our conclusions and recommendations.

JOHN PAUL HAMMERSCHMIDT
THIRD DISTRICT, ARKANSAS

HOME ADDRESS:
HARRISON, ARKANSAS

WASHINGTON ADDRESS:
2160 RAYBURN BUILDING
WASHINGTON, D.C. 20515
PHONE: 225-4301

Congress of the United States
House of Representatives
Washington, D.C. 20515

December 21, 1977

COMMITTEES:
PUBLIC WORKS AND
TRANSPORTATION
SUBCOMMITTEES:
AVIATION
ECONOMIC DEVELOPMENT
WATER RESOURCES
VETERANS' AFFAIRS
SUBCOMMITTEES:
CEMETERIES AND BURIAL BENEFITS
COMPENSATION, PENSION, AND
INSURANCE
MEDICAL FACILITIES AND BENEFITS
SELECT COMMITTEE ON AGING

Honorable Elmer B. Staats
Comptroller General of the
United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Staats:

The Public Works Employment Act of 1977 (PL 95-28) contained a rather unique provision to insure maximum minority business participation in the construction of public works facilities. Section 103 of this Act contained a provision requiring that 10% of each grant be expended with minority business enterprises. Based on the new authorization contained in this measure, minority businesses were in effect guaranteed \$400 million in contracts. The Economic Development Administration, which is responsible for administering this program, has been very diligent in attempting to implement this provision to the fullest extent possible. However, a number of allegations have been made suggesting that this requirement has impeded progress of the Local Public Works projects and has in some cases considerably increased the total cost of projects. In view of these allegations and because a provision of this type, if deemed an effective way to increase minority participation, will probably be utilized in other legislative proposals, I am requesting the General Accounting Office to conduct an investigation regarding the implementation of this provision and its impact on the public works program.

In this investigation I would hope that GAO officials would be able to discuss the impact of this provision with minority businessmen, labor officials, prime contractors, sub-contractors, and local officials. It is particularly important, I believe, to see that people from various geographic areas are interviewed as there may be marked differences in the application of this provision in urban centers, rural communities or parts of the Nation where there is a small minority population.

There are several specific questions that I am requesting your investigators address. The Public Works Jobs Bill also contains a requirement that construction must begin within 90 days. This requirement was made a part of the law in order to create jobs as quickly as possible and to see that the construction of public works facilities was undertaken without undue delays. There has been some information suggesting in some cases these time requirements have not been met because contractors have been unable to obtain sufficient minority business participation. Any information that you might be able to obtain on this subject would be very valuable.

In addition, there have been allegations that in some cases minority business enterprises have been established just to participate in this program. It has been

- continued -

Honorable Elmer B. Staats
Page two
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further suggested that some of these businesses are not bona fide minority enterprises. Certainly, if this allegation is true it would nullify the intent of this requirement to see that established and bona fide minority enterprises participate in this program. One further allegation has suggested that construction costs on projects have risen considerably because of the minority business requirement. Although specific details on this matter are not available, an examination of the bidding procedure, particularly with respect to sub-contracting, may be beneficial in assessing where cost increases have occurred, if they are in fact taking place.

As Ranking Minority Member of the Economic Development Subcommittee which has jurisdiction over this program, I am most interested in the effectiveness of the Local Public Works Jobs program. I think any concrete information which your investigators may be able to provide me will be most useful should the Committee consider further legislation of this kind.

I would hope that you could begin your investigation at once and provide me with at least a preliminary outline as soon as possible after Congress reconvenes in January. Should you wish more specific direction or wish to discuss your outline, I would suggest that you contact Edythe Edwards with the Economic Development Subcommittee of the Public Works and Transportation Committee.

Thank you for your prompt assistance in this regard.

Very truly yours,


JOHN PAUL HAMMERSCHMIDT
Member of Congress

JPH/edj

JOHN A. DURKIN
NEW HAMPSHIRE

United States Senate

WASHINGTON, D.C. 20510

February 6 , 1978

Mr. Elmer B. Staats
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Staats:

We hereby request a study by you of the implementation by the Economic Development Administration of the Department of Commerce of the 10% Minority Business Enterprise (MBE) requirement of the Local Public Works Capital Development and Investment Act of 1977, P.L. 95-28, in New Hampshire, Maine, Vermont, Idaho, and those states with small minority populations as defined by the Act.

Based on information we have received from community and state officials, labor leaders, contractors, and representatives of minority groups, we believe that EDA has implemented the MBE program in ways directly contrary to the legislation and the Congressional intent behind it as evidenced in floor consideration and in the Conference Report on the Act. This has been especially true in small states such as ours which have very few bona fide minority business enterprises and very few minorities to do the contracting and subcontracting work involved in public works projects.

Specifically, the Act and the Federal Regulations to implement it published May 27, 1977, give the Secretary of Commerce acting through the Assistant Secretary of Commerce for Economic Development authority to waive the 10% requirement for grantees. And as the Congressional intent as expressed through floor debate and the Conference report makes clear, waivers should be granted when minority businesses are not available in local project areas, normally within single states, in sufficient numbers to meet the 10% level.

EDA has systematically avoided granting waivers, with consequent damage to the Local Public Works program and those it is meant to benefit.

The point about waivers was made clear in two ways: by a Senate floor colloquy between Senator Durkin and Senator Edward Brooke, author of the MBE requirement amendment, during consid-

Mr. Elmer B. Staats
February 6, 1978
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eration of the bill March 10, 1977, and in the Conference Report. We refer you to the Congressional Record of March 10, 1977, S. 3910, for the discussion between the two Senators in which Senator Brooke makes clear, in response to a question from Senator Durkin, that public works grantees are not to go out of state to find minority contractors when such are not available within state. We also refer you to the Conference Report on H.R. 11, dated April 28, 1977, P. 11, in which it is stated that the MBE requirement is ". . . dependent on the availability of minority business enterprises located in the project area."

EDA officials have apparently ignored the legislation and both these expressions of Congressional intent by deciding, as expressed by Assistant Secretary of Commerce for Economic Development Robert Hall in a letter to Senator Durkin dated December 16, 1977, copy enclosed, that waivers of the 10% provision will be granted only if contractors bidding on projects ". . . tried to locate minority businesses from as wide an area as economically reasonable."

At the outset, you should be aware of what we have been informed are some of the actual results of the EDA misinterpretation of the 10% provision. Primarily it has meant that grantees in our states and the contractors applying for the grants have been forced to go well out of the local project areas, often into distant states, to find minority business contractors when only small numbers of them are available within the states in question. We realize that general competitive bidding may sometimes lead communities to accept general contractors from out of state, but that does not mean that EDA should force grantees to go out of state to find minority contractors.

The obvious concomitant result has been that contractors and subcontractors in the high unemployment local market areas are not getting the contracts to stimulate the local economy. Thus, EDA's actions run directly counter to the primary aim of the Act.

Indirectly legitimate minority businessmen have also been hurt by the EDA actions because the EDA has engendered what appear to be illegitimate minority businesses established solely to meet the 10% requirement, an activity which EDA claims on the one hand it will not accept, but which, on the other hand, it encourages.

EDA's actions have also led to inflated prices for many of the contracts in circumstances where the minority

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Page Three

businesses have charged exorbitant prices either because they are illegitimate or because their business is well outside the local project area and extra costs become involved. This unnecessary inflation has meant, in many cases, that important projects have had to be dropped or scaled down, which in turn has meant a reduction in job creation.

All of these points are more emerged in a public hearing conducted by Senator Durkin in Concord, New Hampshire, December 20, 1977, at which Mr. Walter Farr, Chief Counsel of EDA, appeared. Public witnesses including local government officials, state officials, subcontractors, and contractors explained in graphic detail why EDA's misinterpretation of the law has been so detrimental to the public works program. For your information, a transcript of that public hearing is included.

We suggest several lines of inquiry be pursued, e.g.:

1. In New Hampshire, Maine, Vermont, Idaho, and other states with small minority populations, has EDA administered the MBE provision in line with the Local Public Works Act and the Congressional intent behind it?
2. In those states, has EDA administered the MBE provision in such a way as to create jobs in the local project area as the Act requires?
3. Has EDA's administration of the MBE provision led to inflated prices for projects with the consequent loss of potential jobs?
4. Has EDA adequately monitored the MBE's which have been awarded funds under the Act to insure that they are bona fide?
5. Has EDA expeditiously considered requests for waivers, and has it placed unreasonable burdens on the grantees which apply for waivers of the 10% requirement?
6. Has EDA established sufficient guarantees for contractors so that in a case in which a minority sub-contractor cannot complete work on a project due to business problems or due to a judgment by EDA that the MBE is not bona fide, the contractor will not be judged in default on the contract and forced to complete the work out of his or her own pocket? If not, what have been the consequences for grantees, contractors, and bonding companies?

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Page Four

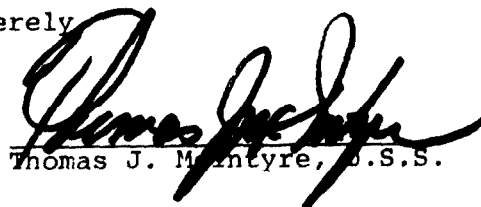
This list is not exhaustive, of course.

We would be pleased to meet you and your staff to discuss further the matters we have outlined. Please contact Mr. Harris Miller, Legislative Director to Senator Durkin, on 224-3324, to make arrangements for any meetings.

We look forward to a speedy and thorough examination by you of the EDA implementation of the MBE requirement. When a government agency maladministers a program as badly as we have been informed EDA has, it is incumbent upon the Congress through the General Accounting Office to investigate and issue a full report to the American people.

Sincerely,


John A. Durkin, U.S.S.


Thomas J. McIntyre, U.S.S.


James A. McClure, U.S.S.

Enclosure

TECHNICAL ASPECTS OF SAMPLING PLAN ANDQUESTIONNAIRE METHODOLOGYSAMPLE SELECTION

The Economic Development Administration provided us with a magnetic tape listing of all second-round local public works projects. We stratified the projects into four categories by grant dollar amount and took random samples from each category. Our purpose in stratifying by dollar amount was to permit estimates of the financial impact of minority firm problems.

The strata were as follows:

EDA grant award (000 omitted)	<u>Universe</u>	<u>Sample size</u>
0 - 499	6,065	126
500 - 999	1,335	71
1,000 - 2,999	898	147
3,000 and over	257	76
Total	<u>a/8,555</u>	<u>420</u>

a/This is the figure EDA reported in January 1978. Currently, EDA reports 8,554.

The sampling was done to meet

--a 95-percent confidence level and

--a plus or minus 5-percent acceptable sampling error rate.

QUESTIONNAIRE METHODOLOGY

Questionnaires were developed for grantees, prime contractors, and representatives of minority business firms. Questionnaires were completed by telephone for grantees and prime contractors for each sample project required to meet the 10-percent provision. In situations where projects had more than one prime contract, the largest prime contractor with minority subcontractors was interviewed.

About 25 percent of the sample projects were selected for telephone contacts with minority business firms in a two-stage process. Thirty-three projects were selected for site visits to obtain more detailed information than that provided by telephone. Minority firms affiliated with these projects were called. This group of minority firms was supplemented with a 20-percent random sample of minority firms from the remaining projects. For each selected firm, we telephoned minority firm representatives working for the prime contractor we interviewed.

The following tables present summary information and projections made from the questionnaire results.

TABLE ITabulation of Questionnaire Responses

	<u>Grantees</u>	<u>Prime contractors</u>
Questionnaire random sample	420	420
Projects removed from sample:		
Puerto Rico (see table 2)	17	17
Error set aside (see table 2)	<u>7</u>	<u>7</u>
Questionnaires attempted	<u>396</u>	<u>396</u>
Minority prime contractors (see table 2)	-	27
Nonresponses, declined to participate, could not be reached	<u>7</u>	<u>19</u>
Questionnaires completed	<u>389</u>	<u>350</u>

Minority Firms

Questionnaires attempted	203
Nonresponses, declined to participate, could not be reached	<u>14</u>
Questionnaires completed	<u>189</u>

Note: Grantee and minority firm questionnaire sample results are used in the report as raw scores and percentages. Prime contractor questionnaire results are used similarly, but in addition, several projections are made. Tables 2 through 7 contain the projection results.

TABLE 2
Applicable Universe of Projects
For Prime Contractor Questionnaire

	Projects awarded by grant amount				Total
	\$ 0-\$0.5 million	\$0.5 million-\$1 million	\$1 million-\$3 million	Over \$3 million	
1A. Universe	6,065	1,335	898	257	8,555
1B. Puerto Rican projects (note a)	184	40	41	9	274
1C. Adjusted universe- preliminary	5,881	1,295	857	248	8,281
2A. Random sample tele- phone questionnaires less Puerto Rican pro- jects	<u>123</u>	<u>68</u>	<u>140</u>	<u>72</u>	<u>403</u>
2B. Deletions:					
Minority prime contractors (note b)	10	3	6	8	27
Error set asides (note c)	1	0	5	1	7
Nonresponses, declined to parti- cipate, could not be reached	<u>6</u>	<u>4</u>	<u>4</u>	<u>5</u>	<u>19</u>
Total deletions	<u>17</u>	<u>7</u>	<u>15</u>	<u>14</u>	<u>53</u>
3A. Applied to sample (2A÷2B)	106	61	125	58	350
3B. Percent (3A÷2A)	86.2	89.7	89.3	80.6	
<u>Estimate of Adjusted Universe-Final</u>					
4A. Number (3Bx1C)	<u>5,069</u>	<u>1,162</u>	<u>765</u>	<u>200</u>	<u>7,196</u>
4B. Percent (sum of 4A÷1C)					86.9

a/Puerto Rican projects were deleted because most prime contracts were awarded to minority firms, which was not typical in other areas of the country.

b/Questionnaire design focused on the relationship between prime contractors and minority subcontractors and suppliers. Consequently, for minority prime contractors, the questionnaire could not be completed.

c/Some projects funded in round two were projects that were mistakenly not funded under round one. These projects were not required to meet the 10-percent provision.

TABLE 3

Estimate of Number of Projects Where
Prime Contractors Had Problems With
Prices Quoted by Minority Firms

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million- \$1 million</u>	<u>\$1 million- \$3 million</u>	<u>Over \$3 million</u>	
1. Adjusted universe (table 2)	5,069	1,162	765	200	7,196
2. Usable responses	103	59	121	56	339
3. Sample projects with problem					
3A. Number	39	24	55	39	157
3A. Percent $(3A \div 2) \times 100$	37.9	40.7	45.5	69.6	-
<u>Estimate of Total Projects with Problem</u>					
4A. Number $(3B \times 1)$	<u>1,921</u>	<u>473</u>	<u>348</u>	<u>139</u>	<u>2,881</u>
4b. Percent $(4A \div 1) \times 100$	-	-	-	-	40.0

TABLE 4

Estimate of Projects Where Using
Minority Firms Placed
Burden on Prime Contractor

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million-\$1 million</u>	<u>\$1 million-\$3 million</u>	<u>Over \$3 million</u>	
1. Adjusted universe (table 2)	5,069	1,162	765	200	7,196
2. Usable responses	103	60	119	56	338
3. Sample projects citing problem					
3A. Number	41	31	66	29	167
3B. Percent (3A÷2)x100	39.8	51.7	55.5	51.8	-

Estimate of Total Projects Citing Burden

4A. Number (3Bx1)	<u>2,017</u>	<u>601</u>	<u>425</u>	<u>104</u>	<u>3,147</u>
4B. Percent (4A÷1)x100	-	-	-	-	43.7

TABLE 5

		<u>Estimate of Number of Urban Projects</u>				
		<u>Projects awarded by grant amount</u>				<u>Total</u>
		<u>\$0-\$0.5 million</u>	<u>\$0.5 million-\$1 million</u>	<u>\$1 million-\$3 million</u>	<u>Over \$3 million</u>	
1.	Adjusted universe (table 2)	5,069	1,162	765	200	7,196
2.	Usable responses	105	60	125	58	348
3.	Sample urban projects					
3A.	Number	46	38	91	53	228
3B.	Percent (3A÷2)x100	43.8	63.3	72.8	91.4	-
		<u>Estimate of Total Urban Projects</u>				
4A.	Number (3Bx1)	2,220	736	557	183	3,696
4B.	Percent (4A÷1)x100	-	-	-	-	51.4

TABLE 5A

Estimate of Urban Projects
with Problems Finding Minority Firms

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million-\$1 million</u>	<u>\$1 million-\$3 million</u>	<u>Over \$3 million</u>	
1. Estimate of total urban projects (table 5)	2,220	736	557	183	3,696
2. Usable responses	45	36	87	52	220
3. Sample projects with problems					
3A. Number	23	18	41	32	114
3B. Percent $(3A \div 2) \times 100$	51.1	50.0	47.1	61.5	-
<u>Estimate of Total Projects With Problem</u>					
4A. Number (3Bx1)	<u>1,134</u>	<u>368</u>	<u>262</u>	<u>113</u>	<u>1,877</u>
4B. Percent $(4A \div 1) \times 100$	-	-	-		50.8

TABLE 5B

Estimate of Urban Projects
without Problems Finding Minority Firms

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million-\$1 million</u>	<u>\$1 million-\$3 million</u>	<u>Over \$3 million</u>	
1. Estimate of total urban projects (table 5)	2,220	736	557	183	3,696
2. Usable responses	45	36	87	52	220
3. Sample projects without problems					
3A. Number	22	18	46	20	106
3B. Percent (3A÷2)x100	48.9	50.0	52.9	38.5	-
	<u>Estimate of Total Projects Without Problem</u>				
4A. Number (3Bx1)	<u>1,086</u>	<u>368</u>	<u>295</u>	<u>70</u>	<u>1,819</u>
4B. Percent (4A÷1)x100	-	-	-		49.2

TABLE 6

Estimate of Number
of Rural Projects

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million- \$1 million</u>	<u>\$1 million- \$3 million</u>	<u>Over \$3 million</u>	
1. Adjusted universe (table 2)	5,069	1,162	765	200	7,196
2. Usable responses	105	60	125	58	348
3. Sample rural projects					
3A. Number	59	22	34	5	120
3B. Percent (3A÷2)x100	56.2	36.7	27.2	8.6	-
	<u>Estimate of Total Rural Projects</u>				
4A. Number (3Bx1)	<u>2,849</u>	<u>426</u>	<u>208</u>	<u>17</u>	<u>3,500</u>
4B. Percent (4A÷1)x100	-	-	-		48.6

TABLE 6A

Estimate of Rural Projects
with Problems Finding Minority Firms

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5</u> <u>million</u>	<u>\$0.5 million-</u> <u>\$1 million</u>	<u>\$1 million-</u> <u>\$3 million</u>	<u>Over \$3</u> <u>million</u>	
1. Estimate of total rural projects (table 6)	2,849	426	208	17	3,500
2. Usable responses	56	22	33	5	116
3. Sample projects with problems					
3A. Number	25	13	24	2	64
3B. Percent $(3A \div 2) \times 100$	44.6	59.1	72.7	40.0	-
<u>Estimate of Total Projects With Problem</u>					
4A. Number (3Bx1)	1,271	252	151	7	1,681
4B. Percent $(4A \div 1) \times 100$	-	-	-	-	48.0

TABLE 6B

Estimate of Rural Projects
Without Problems Finding Minority Firms

	<u>Projects awarded by grant amount</u>				<u>Total</u>
	<u>\$0-\$0.5 million</u>	<u>\$0.5 million-\$1 million</u>	<u>\$1 million-\$3 million</u>	<u>Over \$3 million</u>	
1. Estimate of total rural projects (table 6)	2,849	426	208	17	3,500
2. Usable responses	56	22	33	5	116
3. Sample projects without problems					
3A. Number	31	9	9	3	52
3B. Percent (3A÷2)x100	55.4	40.9	27.3	60.0	-
<u>Estimate of Total Projects Without Problem</u>					
4A. Number (3Ax1)	<u>1,578</u>	<u>174</u>	<u>57</u>	<u>10</u>	<u>1,819</u>
4B. Percent (4A÷1)x100	-	-	-	-	52.0

TABLE 7

Projections of Random Sample
(95-Percent Confidence Level)

<u>Table</u>	<u>Description</u>	<u>Universe estimate</u>		<u>Range based on sampling error at the 95-percent confidence level</u>	
		<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>
3	Projects in which prices quoted by minority firms was a problem	2,881	40.0	2,381 to 3,375	33.1 to 46.9
4	Projects in which minority requirement placed burden on prime contractor	3,147	43.7	2,648 to 3,641	36.8 to 50.6
5	Urban projects	3,696	51.4	3,202 to 4,195	44.5 to 58.3
5A	Urban projects with problems finding minority firms	1,877	50.8	1,659 to 2,096	44.9 to 56.7
5B	Urban projects without problems finding minority firms	1,819	49.2	1,604 to 2,033	43.4 to 55.0
6	Rural projects	3,500	48.6	3,000 to 3,994	41.7 to 55.5
6A	Rural projects with problems finding minority firms	1,681	48.0	1,473 to 1,887	42.1 to 53.9
6B	Rural projects without problems finding minority firms	1,819	52.0	1,606 to 2,034	45.9 to 58.1

LIST OF PROJECTS VISITED BY GAO

<u>Project location</u>	<u>Demographic area</u>	<u>EDA grant amount</u>	<u>Percentage of project completed</u>	<u>Number of minority firms</u>	<u>Amount of minority firm contracts</u>
Atlantic region	-	\$ -	-	-	-
Maryland Project A	Rural	354,000	50	1	35,400
Massachusetts Project A	Urban	1,000,000	5	7	186,315
New Hampshire Project A	Urban	1,375,000	7	2	341,625
New Jersey Project A	Rural	2,154,000	20	4	349,425
Project B	Urban	3,235,000	2	6	413,050
New York Project A	Rural	1,160,000	10	1	41,800
Project B (note a)	Urban	1,250,000	18	1	160,000
Pennsylvania Project A	Urban	244,000	20	1	74,487
Project B	Urban	3,533,000	3	3	257,625
Vermont Project A	Rural	1,180,000	30	1	136,000
West Virginia Project A	Rural	1,044,000	6	1	143,000
Southeast region	-	-	-	-	-
Alabama Project A	Urban	179,000	32	1	24,000

a/This project was selected for a site visit, but at the request of EDA's General Counsel the visit was not made. The prime contractor and minority subcontractor were involved in litigation with the city of New York over the legitimacy of the minority firm.

APPENDIX IV

APPENDIX IV

<u>Project location</u>	<u>Demographic area</u>	<u>EDA grant amount</u>	<u>Percentage of project completed</u>	<u>Number of minority firms</u>	<u>Number of minority firm contracts</u>
Florida Project A	Urban	\$ 559,695	20	1	63,444
Georgia Project A	Urban	5,000,000	5	2	30,600
North Carolina Project A	Rural	265,000	65	3	46,588
Midwest region	-	-	-	-	-
Illinois Project A	Urban	2,862,740	6	1	287,000
Michigan Project A	Urban	110,000	20	1	30,000
Project B	Rural	1,693,000	6	2	276,766
Ohio Project A	Rural	334,500	90	2	42,785
Wisconsin Project A	Urban	1,264,700	5	2	257,000
Southwest region	-	-	-	-	-
Arkansas Project A	Rural	671,700	41	3	79,227
Louisiana Project A	Urban	1,256,429	23	3	83,943
Oklahoma Project A	Urban	245,954	82	1	31,851
Texas Project A	Urban	3,268,436	55	6	337,740
Rocky Mountain region	-	-	-	-	-
Colorado Project A	Urban	1,200,000	70	1	174,016

APPENDIX IV

APPENDIX IV

<u>Project location</u>	<u>Demographic area</u>	<u>EDA grant amount</u>	<u>Percentage of project completed</u>	<u>Number of minority firms</u>	<u>Number of minority firm contracts</u>
Kansas					
Project A	Rural	\$ 10,880	98	1	1,088
North Dakota					
Project A	Rural	313,000	34	1	33,062
Utah					
Project A	Rural	558,000	5	2	60,191
Western region	-	-	-	-	-
Arizona					
Project A	Urban	1,692,000	92	2	170,000
California					
Project A	kural	307,000	60	2	69,850
Project B	Urban	1,496,200	7	1	2,366
Idaho					
Project A	Rural	271,000	56	3	35,375
Oregon					
Project A	Rural	95,000	37	2	9,539
Washington					
Project A	Rural	<u>125,438</u>	40	<u>1</u>	<u>14,250</u>
Total for 33 projects visited:		<u>39,058,672</u>		<u>72</u>	<u>4,139,408</u>

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