Racial Discrimination and Minority Business Enterprise

Evidence from the 1900 Census

Jon S. Wainwright

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EVIDENCE FROM THE 1990 CENSUS

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This book is dedicated to the memory of
Justice Harry Blackmun, Justice William Brennan,
and Justice Thurgood Marshall.

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Preface

This book grew out of my involvement in assisting a number of state and local governments throughout the country in responding to the new rules for affirmative action first prescribed by the United States Supreme Court in late 1989. In early 1990, I was fortunate enough to be invited by former U.S. Secretary of Labor Ray Marshall and former Federal Reserve Board Governor Andrew Brimmer to participate in a study of minority businesses and business owners being conducted on behalf of the City of Atlanta and Fulton County, Georgia. As a result of my involvement in this very early study, I had the opportunity over the next several years to work on related studies in Texas, Florida, California, Missouri, Minnesota, and elsewhere. One thing I learned during the course of my involvement with these research studies was that blacks, Hispanics, and Native Americans appear to be more disadvantaged in business enterprise activity than in virtually any other aspect of economic life.

Yet, despite the large disparities in business enterprise activity that have been consistently documented by state and local governments throughout the country during the 1990s, plaintiffs challenging state and local affirmative action policies have routinely asserted that such findings are not indicative of discrimination. Plaintiffs, and their expert witnesses, are fond of suggesting that the data used to calculate minority business disparities are flawed, and even if the data are not flawed, that the disparities in evidence are meaningless because the data were not geographically or industrially disaggregated enough. Similarly, they speculate that other factors besides discrimination might be responsible for the observed disparities. There is much more rhetoric than economics in these speculations. Never is any data presented showing that non-discriminatory factors can adequately account for the observed disparity. Instead contrived hypothetical examples are presented to persuade the judge that it is possible that this *could* happen.

Well, many things are possible, but not all are equally probable. Given the tremendous size of the racial and ethnic disparities I have observed over almost a decade of research, it seems to me very disingenuous for plaintiffs, plaintiffs' experts, and in some cases state and federal judges, to suggest that race and ethnicity plays no significant role in explaining the present day disadvantaged status of minority businesses in the United States. This book grew out of an effort to satisfy myself that the disparities facing minority business enterprises in this country are not as easily explained away as some would have us believe.

This book would never have been written without the generous support and encouragement I have received over the years from Ray Marshall of the University of Texas at Austin. I am also deeply indebted to Jorge Anchondo, Andrew Brimmer, Mario DePillis, David Evans, Mark Grayson, Colette Holt, Cheryl McVay, and Brian Trinque for their comments, criticism, and encouragement in the course of conducting my research. All remaining errors are mine alone.

I want to express my deepest thanks to my family—my wife Paddy, my parents Dave and Carol, and my children Katy, David, and Amy—for their steadfast encouragement and unflagging faith.

Jon S. Wainwright
Austin, Texas
1999

Tables and Figures

CHAPTER 1

Economists in the Courtroom

In contrast to wage and salary workers, the issue of racial and ethnic discrimination among self-employed business owners has received little attention from economists. As Aronson (1991, ix) observes:

> Self-employment is unquestionably the oldest way by which individuals offer and sell their labor in a market economy. At an earlier time, it was also the primary way. Despite this history, its principal features and the characteristics that differentiate self-employment from wage and salary employment have attracted the attention of only a handful of students of the labor market.

Recent changes in the law, however, have made the continued constitutionality of affirmative action in public sector contracting and procurement contingent upon documenting the existence of racial and ethnic disparities in self-employment and business enterprise, quantifying their magnitudes, and identifying whether they indicate the presence of economic discrimination within narrow geographic, industrial, and racial or ethnic boundaries. Given the extensive economic literature on racial discrimination in other contexts, particularly wage and salary employment, economists seem well suited to assist in making such assessments. This study is devoted, in small part, to this task.

INSTITUTIONAL AND NEOCLASSICAL THEORIES OF ECONOMIC DISCRIMINATION

Labor economists have been influencing law and public policy on matters of discrimination for almost sixty years. Although many economists mark the beginning of the profession's involvement in matters of racial discrimination with the publication of Gary Becker's ([1957] 1971) now classic *The Economics of Discrimination*, it began much earlier. Gunnar Myrdal's *An American Dilemma: The Negro Problem and Modern Democracy*, published in 1944, impacted an entire generation of social scientists, jurists, and policy makers (Myrdal [1944] 1962). It remains unparalleled in the scope and depth with which it examined "the Negro problem" in the United States in the years leading up to World War II. That same year, the publication of Herbert Northrup's Harvard Ph.D. thesis (Northrup [1994] 1971) was the first of several detailed professional inquiries that were to arise into employment discrimination against minorities, particularly blacks, in the South and within trade unions (*e.g.* Ginzberg 1956; Marshall 1965, 1967).

These early institutionalist investigations are important because they combined political, psychological, sociological, and economic theory with historical perspective, case studies, and quantitative data to better understand what discrimination is, how it arises, and how it can be changed. As such, these studies were enormously relevant and useful to public policy and the law. *An American Dilemma* and *Organized Labor and the Negro* were both cited extensively by the U.S. Supreme Court in the 1954 *Brown vs. Board of Education I* (74 S.Ct. 686) and 1955 *Brown vs. Board of Education II* (75 S.Ct. 753) decisions. Similarly, the work of Northrup, Ginzberg, and Marshall played an important role in bringing about fundamental changes in trade union practices towards minorities.

Institutionalists have been critical of Becker's theory of employment discrimination,[1] arguing that the abstractions necessary to conduct the analysis within the confines of price theory and competitive equilibrium render it essentially useless for purposes of informing public policy. Marshall (1974), for example, is a proponent of this view. According to Marshall and Christian (1978, 220–27):

> Explicit and implicit definitions of discrimination used in a theory or conceptual framework have important implications for policies to combat discrimination. Becker [1957], Arrow [1972a; 1972b], and Welch [1967] consider discrimination to be based on attitudes or preju-

dices which cause people to want to avoid associating with or hiring particular individuals. Thus Becker and Arrow speak of a "taste for discrimination" for which maximizing agents are willing to pay. Moreover, in Becker's theory whites are concerned about physical distance from blacks and are willing to pay a premium not to associate with them.

We have found the neoclassical definition and formulation of discrimination to have very limited value either in understanding the employment disadvantages of blacks or in prescribing policies to eliminate them. We have also found it important to distinguish [institutional discrimination], from the specific, overt discriminatory actions of particular decision makers. We have therefore found *behavior* models (which look at the behavioral characteristics of employers, unions, white workers, black workers, government agencies, and their interactions with each other and the environment within which they operate) to be more useful than the narrow formulations of the neoclassical model. . . .

Thus, employer discrimination is better understood in a social rather than an isolated individual context. Although isolated economic tendencies, as outlined in neoclassical models, define *theoretical* tendencies drawn from restrictive assumptions, they are not necessarily predictive of *actual* behavior, because economic tendencies can be counteracted by social forces. In making employment decisions which maximize profits, employers must therefore consider the reactions of customers, unions, present employees, government agencies, black organizations, and the public, all of which can influence costs, revenues, and the ability to operate. . . .

The neoclassical model is therefore likely to produce misleading policy conclusions, principally because it exaggerates the importance of market forces in overcoming discrimination. We agree that market forces tend to eliminate racial discrimination but think that this tendency may never change employment patterns because it is counteracted by important forces not included in the neoclassical model. . . .

Our main argument, then, is that discrimination does not necessarily result from the attitudes of individual decision makers. As a result, we think public policy should be directed toward changing the context within which people operate as well as toward changing their attitudes and tastes. Consequently, we are more interested in determining what kinds of changes need to be done to improve black employment opportunities than we are in the highly technical and difficult analytical task

> of isolating the impact of racial prejudice on black employment patterns. We think institutional discrimination is so pervasive that it influences such productivity factors as education, on-the-job training, and skills training, making it difficult to pinpoint these factors in the total constellation of forces determining black employment patterns. [Marshall and Christian's italics]

In the traditional view, discrimination is everywhere and always an individual and essentially overt phenomenon. In the institutionalist view, in contrast, discriminatory actions and prejudices also—and more importantly—filter through the institutions of the labor market.[2] Under both theories, however, one important way in which discrimination manifests itself is as quantitative differences in earnings or occupational attainment that cannot be accounted for by differences in productive ability.

ECONOMISTS IN THE COURTROOM

In contrast to theory, far less controversy exists regarding the usefulness of the statistical and econometric methods developed by Thurow (1969), Ashenfelter (1972), Oaxaca (1973), Blinder (1973), and others, for determining whether or not economic discrimination exists at all—as opposed to how it arises or how it changes. These quantitative methods recognize that due to human capital investment (*e.g.* Willis 1986), compensating differentials (*e.g.* Rosen 1986), or sectoral assignment problems (*e.g.* Sattinger 1993), racial wage differentials can still arise between groups even in the absence of discrimination.

Essentially, these empirical procedures attempt to control statistically for differences in the endowments of human and financial capital ("qualifications" or "productivity") between minority and non-minority groups and individuals. The proportion of an observed disparity that remains unexplained after such qualifications are accounted for is attributed to racial and ethnic differences in the market mechanisms that generate employment opportunities and incomes ("discrimination"). To the extent that the differences in qualifications and productivity across races are themselves not attributable to labor market discrimination, these adjusted, or net, differentials provide better measures of discrimination than the unadjusted, or gross, differentials that don't account for such differences. Oaxaca and Ransom (1994) detail the current state of the art regarding the empirical techniques for estimating such adjusted differentials.

The broader acceptance among economists in all camps of these empirical techniques—in contrast to competing theoretical approaches—is no doubt because determining whether or not economic discrimination exists is a far more straightforward problem than determining why discrimination arises or how it can be changed. For present purposes I restrict myself to the former exercise, recognizing that, while necessary, in and of itself such an exercise is certainly not sufficient to yield answers to the questions that most interest observers like Marshall and Christian. As I have mentioned, however, a series of recent decisions by the U.S. Supreme Court requiring public agencies to produce quantitative evidence of discrimination prior to pursuing race-conscious affirmative action policies has given renewed importance and relevance to this kind of exercise.

This type of economic empiricism concerning the relationship between discrimination and racial disparities in earnings *among wage and salary workers* has played an important role in U.S. courts during the last twenty-five years. According to Ashenfelter and Oaxaca (1987, 321):

> Although [Becker's] *The Economics of Discrimination* has left a large scholarly legacy, we believe the empirical methods associated with the study of race and sex discrimination . . . have had a far larger impact on how Title VII of the 1964 Civil Rights Act is enforced than is commonly understood by economists.

The quantitative decomposition of observed racial and ethnic differentials into "qualifications" and "discrimination" components has slowly gained acceptance in U.S. courts as a viable form of evidence of employment discrimination. This trend began in the early 1970s. Examples of early cases include *United States v. U.S. Steel* (371 F.Supp. 1045, N.D. Ala.) in 1973, *Wade v. Mississippi Cooperative Extension Service* (528 F.2d 508, 5th Cir.) in 1974, and *Kyriazi v. Western Electric Company* (476 F.Supp. 335, D. N.J.) in 1979. In many of the early cases, although regression techniques were utilized in discovery, the published opinions contained little or no discussion of the use of such techniques. Several later cases explicitly addressed the use of regression analyses and began delineating the conditions under which such analyses would be deemed relevant. Important cases in this regard include the Supreme Court's 1973 decision in *Casteñeda v. Partida* (51 L.Ed.2d 498), the U.S. District Court decision in *Vuyanavich v. Republic National Bank* (505 F.Supp. 224, N.D. Tex.), and the Supreme Court's 1986 decision in *Bazemore v. Friday* (92 L.Ed.2d 315).[3]