Market Constraints and Enterprise Zones

David Fasenfest
The University of Michigan

October 1984 No. 322

MARKET CONSTRAINTS AND ENTERPRISE ZONES

by
David Fasenfest
Department of Sociology
University of Wisconsin-Milwaukee
Milwaukee, WI

October, 1984

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> The aim of the bill is to encourage economic growth in depressed areas by increasing the rewards for employment, investment and production (Kemp, 1980:6).
>
> The Federal Zone program is unique, working as it would through special business incentives rather than direct, upfront federal assistance (Bollinger, 1983:3).
>
> It is a market-oriented approach, keyed to entrepreneurial activity, private sector job creation and community public/private partnerships. In contrast to past Federal efforts, it seeks to get government out of the way -- to reduce governmental burdens on the free enterprise system at the local, State and Federal levels (Pierce, 1983:2).

Introduction

The federal government is currently promoting a unified national policy under the name of Economic Enterprise Zones which is to be the foundation of industrial reconstruction of central cities suffering from high unemployment and capital flight. By providing economic and political incentives, the federal government hopes it can encourage the private sector to act in response to specific social needs. Critics argue that enterprise zones are a questionable approach to urban development: large corporations are only marginally affected by state tax incentives (Meir and Gelzer, 1982); private initiatives in Italy compared to similar enterprise zone programs in England demonstrate that legislated efforts to affect changes in market operations are not successful (Malone, 1982); Enterprise Zone legislation is not the remedy for urban stagnation, but rather a boon to private investors who will benefit from windfall tax advantages and subsidized production costs (Walton, 1982). Proponents of Enterprise Zones (Hall, 1977, 1982; Butler, 1980b, 1981; Bollinger,

1983) suggest that this program ushers in a new approach to confronting urban problems. But defining social problems within a market solving framework constrains the range of outcomes by requiring that these outcomes are consistent with the market's operation.

The quotes at the beginning of the paper reflect the general belief among legislative and administrative officials promoting the enterprise zone concept that urban redevelopment must come about by affecting changes in the market. Industrial decline is traced to failures in "normal" market operations due to distortions of market prices: Urban land costs are excessively high, given the low level of demand, because local real estate taxes are increasing to pay for services in communities facing rising social expenditures and a decreasing revenue base; Social welfare legislation and minimum wage laws have raised the threshold wage below which workers do not need to look for employment (or legally may not be paid) resulting in both high unemployment and an inablilty to attract labor intensive industries; Federal health and safety regulations imposed additional costs of production; Labor unions keep wages "artifically" high even though there is an excess supply of labor.

To bring these costs in line with "market" realities, advocates of enterprise zones propose a program which corrects the market by prohibiting or discouraging unions, recommending a reduction in the level of social services available in the zones, suspending regulations which impose costs and subsidizing or suspending local real estate taxes. To coax capital from other forms of investment, the legislation provides for the reduction of certain capital gain taxes and introduces other tax advantages to effectively increase the yield on investments made in zone areas. Through the use of these and other market mechanisms, proponents of enterprize zones predict recovery and restoration for depressed regions and cities.

This paper will outline: a) the major elements of the Enterprise Zone proposals; b) the criticisms of the plan; and finally c) the likely outcomes of the current redevelopment program drawing lessons from urban renewal. Criticism of EEZ policies have centered around two main themes: the adverse effects this program will have by exacerbating regional differences; the potential for misuse by large, capital intensive firms which will benefit from the provisions without really contributing to community development. In both instances the focus is on possible consequences of enterprise zones without fully examining constraints placed on outcomes by the nature of the policy itself. This analysis argues that a policy's reliance on market mechanisms structurally limited the range of outcomes of urban renewal, and suggests that Enterprise Zone proposals will repeat the same mistakes for similar reasons.

Urban Redevelopment Policy and the Market

The failure of urban renewal has been well documented (cf. Bellush and Hausknecht, 1966; Wilson, 1966 for a general outline of the discussion). Areas of the central city populated by the poor and minorities where cleared and the population displaced (Hartman, et al, 1974) for the benefit of land developers who constructed commercial office buildings and middle to upper income housing. This failure has generally been attributed to a misdirected program (Rothenberg, 1967; Welfeld, 1975), a misguided policy orientation (Jencks, 1972; Greer, 1975), or even a misleading policy objective (Marcuse, 1971).

White (1980), in his analysis of renewal communities, identifies low income, predominantly non-white neighborhoods with higher than average concentrations of children as expected characterists of sites selected for the bulldozer. But surprisingly, he also discovered that these neighborhoods were characterized by higher than average concentrations of young, predominantly single middle income urban professionals. While raising the suggestion that urban renewal success was in reality just an artifact of the transformation the demographics of the neighborhood, White does not offer any insight into why the various neighborhoods were selected as renewal sites. I suggest that rather than viewing urban renewal as a program which failed (clearly it did not meet any of its stated goals), the program can be seen as achieving what any program designed to induce producers through market incentives could hope to achieve, to wit a pattern of outcomes conforming to rational business practices instead of stated policy objectives. When faced with competing alternatives, developers selected those sites with the greatest promise of attracting renters and buyers and ensuring the greatest returns (cf. Fasenfest, 1984 for an elaboration of this process and its implications).

A commitment to the utilization of market mechanisms to implement policy goals is deep seated. Urban renewal represents one example. This program failed to provide adequate levels of low income housing, but it did not result in a national program of planned housing construction nor in directed subsidies for projects to house low income families. The reappraisal of renewal did not include questioning the use of market manipulation to achieve policy objectives. Instead, policy analysts concluded that the problem lay in the attempt to apply a program too broadly or in the absence of adequate guidance to the private sector. Calling for more flexibility, Struyk (1977) claimed that local housing needs and housing markets were significantly different from one another and so the focus should be directed away from creating a national program and toward local initiatives. In that way, each policy can reflect the specific needs of the community. He neglected to mention how these programs are to be financed or what criteria would be used to determine need. Communities consisting of a large low income population and characterized by inadequate housing would lack the resources to either directly finance low income housing construction or indirectly finance various market incentive schemes. The result of local programs without a national agenda would be to exacerbate regional differences.

Policy proposals are still linked to the market failure as the source of the problem and market manipulation as the solution. Unless the government provides clear policy guidelines, however, the private sector has too many options to necessarily choose the desired course of action. Accordingly, Case (1972) posited that the solution to this confusion was to set up a clear matrix of criteria which reflect on the one hand, policy goals and on the other, needs of the private sector. In this way national policy would have addressed the needs of low income families living in substandard housing by drafting legislation which clearly defined the extent of market mechanisms to be permitted specifically tailor them to affect the desired social outcomes.

Another course of action, reflecting this tendency to rely on the market place, is the notion of public/private partnerships which Pierce (1983) identified as one purpose of the enterprise zone proposals. This entails a combination of private initiative in conjunction with local planning to direct the course of capital investments for the benefit of both the community and the private investor. By coordinating private investment with local government agencies, investors and developers are assured of favorable reactions and the maximum level of subsidies in return for granting local agencies some input into things like site selection and the scope of the project (cf. Fosler and Berger, 1982 for a review of public/private programs in a number of cities in the U.S.). However, these programs are still evaluated on market criteria; they must be first and foremost profitable for the developer. Therefore, the range of projects considered by the investors and approved by the local governments generally do not address social problems. On the contrary, these projects will reflect downtown commercial development or other outcomes similar to the results of renewal (cf. Cafferty and McCready, 1982 for a survey of Chicago's experience with planning and private development as a contrast to its urban renewal experiences).

All these approaches to addressing urban problems share a common orientation: the problem lies with imperfect markets, and the solution requires market incentives to restore equilibrium. Based on the experience with urban renewal as well as other programs, like the attempt to develop Black capitalists who would lead the revitalization of central city ghettos, it is possible to draw inferences on the likely outcome of enterprise zones. The central point, however, is not that enterprise zones may not achieve their intended goals. Rather, it is that by relying on the market place to produce the desired outcomes structurally mitigates against the likelihood that this outcome will come to pass.

Enterprise Zones: Legislation for Change

The concept of enterprise zones was introduced in Britain by Peter Hall (1977, 1982) as a policy alternative for cities finding traditional avenues of business attraction closed, or else having to depend on service sector expansion for potential economic growth. Hall maintained that even the latter option was unstable and economically unviable in areas formerly characterized by high paying industrial employment (Luria and Russell, 1981 make the same point for Detroit). Instead, cities had to respond to new realities of international and interregional competition by creating enclaves which would offer industry comparative advantages to locate within them. These enclaves would be free of governmental control and hindrances (i.e., regulations and taxes) located in the most depressed regions and cities of the country. In the short run, the increase in employment might be marginal since some of the jobs would be transfered from other areas. The real benefit of EEZs are their long run development into innovative areas and growth centers, with secondary spillover effects into the surrounding communities. In short, EEZs are attempts to recapture the growth and technologial transformation characteristic of early stages of the Industrial Revolution.

These ideas were quickly picked up in the United States and promoted as the new program for urban problems (Butler, 1980a). The initial proposals called for the elimination of rent control, suspension of minimum wage legislation and the creation of Free Trade zones in depressed urban areas (Butler, 1980b, 1981). The legislative history of the EEZ in the United States began with the introduction of legislation entitled Jobs and Enterprise Zone Act of 1980 (H.R. 7563) under the joint sponsorship of Representatives Kemp and Garcia. Representing opposite political and social positions (Kemp is a conservative Republican from a predominantly white middle-class district in upstate New York while Garcia is a progressive Democrat from one of the worst areas of the South Bronx), this joint sponsorship reflected the wide range of support EEZ has had as a program for meaningful change (US Congress. House, 1981; 1982). This legislation called for: (i) lower employer contributions into social security; (ii) reduced capital gains tax; (iii) fifteen percent reduction in business taxes across the board; (iv) accelerated depreciation on the first half million dollars of investments; (v) loss carry forward up to ten years; (vi) encouragement for creating Foreign Trade Zones in urban areas (Kemp, 1980).

The Kemp-Garcia proposal had many problems. A business community study conducted by New York City found that the 1980 proposal lacked sufficient incentives for business location, and small businesses in New England complained that the legislation favored larger businesses over smaller ones (cited in Goldsmith, 1982a:437-438). EEZ legislation failed to provide startup capital, crucial for smaller businesses, focusing instead on carrying forward losses and offering other tax incentives which primarily benefitted existing large firms or investors. In response to these criticisms, the legislation went through a number of alterations.

The underlying goal incorporated into this legislation is to create an environment conducive to economic revitalization and job creation by removing tax, regulatory and other government burdens, improving municipal infrastructures and services, and involving private enterprises and community organizations. The program calls for no federal appropriations (rather, a reduction in federal obligations) and the requirement that sites be designated by local and state governments who will offer major tax incentives and regulatory relief of their own which will encourage job creation, stimulate business growth and induce the physical revitalization of the urban infrastructure (US Congress. Senate, 1981). Under provisions of the current legislation, an area is eligible if it can satisfy the following:

1. have a continuous boundary with a minimum population of 4,000 in a jurisdiction with a population over 50,000;
2. be situated in a neighborhood which would normally qualify for an Urban Development Action Grant;
3. be in a area of severe economic decline characterized by either an unemployment rate 1.5 times the national average, a poverty rate of twenty percent or more in all census tracts, at least seventy percent of all households with incomes below eighty percent of the local median household income, or a twenty percent decrease in the local population.

Tax incentives remain the primary mechanism to effect the desired changes in private investment decision making. The new bill calls for the elimination of capital gains tax within the zone, varying tax credits on investments in private personal property and new construction, and the ability to carry the credits back three years and forward up to fifteen years or the life of the zone, whichever is longer.

Finally, the bill is informed by a philosophy which sees the "welfare trap", wherein individuals are supposedly reluctant to take employment when the net return of the job is lower than the welfare received, as a primary cause of continued high unemployment among the urban poor. In this manner, people become chronically unemployed since they never get the entry level experience which will presumably enable them to rise on the economic ladder. Consequently, the bill provides incentives to both workers to encourage them to reject welfare payments and employers to encourage them to hire the economically disadvantaged. Employees are to receive an income tax credit of five percent of the first $10,500 earned in the zone while employers receive a credit equal to fifty percent of the workers wage for the first three years dropping ten percent each year thereafter. In addition, the employer receives a total payroll credit of ten percent of the first $17,500 paid to all qualified (i.e., zone resident) employees which can be carried back three years and forward either fifteen years or the life of the zone, whichever is longer.

According to testimony before the Senate Finance Committee (Pierce, 1983) there are currently twenty states with EEZ legislation enacted, three states with legislation pending, nine states ammending other existing legislation with EEZ type provisions and one state with an administrative EEZ program (see Figure 1 below).

Georgia's legislation is restricted to development in Atlanta while Rhode Island's program is tied to the passage of similar legislation on a national level before any of its provisions can be implemented.

Figure 1 about here

Provisions of the Illinois legislation will serve as an example of the types of programs states are enacting. The original legislation was passed by the Illinois legislature but vetoed by the Governor; subsequently it passed over the Governor's veto. The Bill's major provisions are the suspension of zoning and building codes, the abolition of property taxes, the weakening of environmental, and health and safety regulations, and a right to work provision designed to thwart labor organizing which will discourage business investment. Reduced levels of welfare and unemployment benefits would have a devastating effect on local residents of designated zones while local businesses would actually have to increase their labor costs due to cancelation of training programs currently funded by the public sector. In addition, homesteading provisions in the legislation do not really matter to low income renters. The only potential beneficiaries will be middle and upper income families who can afford the maintenance and rehabilitation investments in their property, and it would displace low income families as the area becomes gentrified (cf. Mier and Gelzer, 1982 for a critical review of this and other state programs).

Criticisms of Economic Enterprize Zones

Economic revitalization through the creation of EEZs is based on two assumptions: the free market is the best regulator of investment allocation decisions; localities, not the federal government, should take the lead in

Figure 1. Status of State Enterprise Zone Legislation

-States with Legislation Enacted:

Arkansas
Connecticut
Florida
Georgia (for Enterprise Zones in Atlanta)
Illinois
Indiana
Kansas
Kentucky
Louisiana
Maryland
Minnisota
Mississippi
Missouri
Nevada
New Jersey
Ohio
Oklahoma
Rhode Island (effective upon passage of Federal legislation)
Texas
Virginia

-States with 1983 New Legislation Pending:

California
Michigan
Wisconsin

-States with 1983 Amendments to Existing Legislation:

Connecticut
Illinois
Kansas
Louisiana
Maryland
Minnesota
Missouri
Rhode Island
Virginia

-States with Administrative Enterprise Zone Programs:

Pennsylvania

Source: Testimony by S. Pierce before the Senate Finance Committee, April 22, 1983.

determining the location and scope of zones free of all government intervention. The current inability of central cities to attract businesses and create jobs is attributed to artificially high costs of doing business in the city. Land is expensive, taxes are high and regulations impose nonproduction related expenses. As a result, even the low cost of labor associated with areas of very high unemployment (at times two or three timeshigher than the national average) cannot induce business investment into those areas.

In addition, the focus of these zones proportedly will be on the creation of small businesses, which are more likely to reinvest locally, and account for the majority of new jobs created in the economy (Birch, 1980). EEZs, conceived as a program designed to reintroduce the entreprenuerial spirit, are therefore a necessary ingredient to begin the long road to recovery. Contrary to conventional views, Yago, et al (1983) demonstrate that while small businesses account for most new jobs in large cities, corporate capital flight results in a net job loss for the region. The effect of a large number of firms hiring a few workers is quickly offset by a few large plants laying off its workers and moving to another area. Consequently, EEZs are off the mark if they are targetted at small businesses as the means to revitalize an area and increasing local employment.

Focusing the legislation on the community level, however, has many ramifications. Setting aside for the moment the constraints imposed on policy implementation by employing market mechanisms, any program which locates site selection and criteria determination on the local level creates as many problems as it solves. Economic decline is implicitly viewed as a product of the natural evolution of the economy; prosperous regions, therefore, possess the right matrix of factors for growth.

Goldsmith (1981a) has maintained that decline is a part of development, and that a healthy economic climate, associated with growth, is also characterized by deprivation. Pointing to the poverty that accompanied the prosperity of Manchester, England (at the height of the Industrial Revolution) and Sao Paulo, Brazil (a modern example of a prosperous city in a developing nation), Goldsmith concluded that there "is profit in decline" (1981:23). Economic decline is not a function of negative incentives driving businesses out. Rather, it is connected to changes in the nature of a global economy (Goldsmith, 1982, 1981b) and to capital flight (Bluestone and Harrison, 1982) while solutions focus on introducing local economies into the logic of interregional and international production (Markusen, 1980).

EEZ policy will further exacerbate the problem of community decline as communities begin to perceive the competition as one between communities and not between communities and capital. According to Logan (1983), the community will all but disappear in national urban policy. Scrambling for selection as a redevelopment site, communities will have to identify and promote benefits they can provide capital in return for local development. This will mean that many of the most needy communities will actually be bypassed as EEZs are located in those qualifying communities with the greatest level of present resources to offer corporations. As concessions increase, development will no longer yield all the promised returns as the benefits are offset by forgone revenues. Communities will begin to ask what sorts of local benefits offered can stimulate growth rather than examining and evaluating the kinds of growth that can benefit communities. As Weiss (1980) pointed out in his examination of urban renewal and its impact on communites, local communities have to organize in order to shape benefits in a way which serve the community and usually a bad bargin is worse than no bargin at all. Communities will be tempted to give up more than the new program promises to return.

Community development is a function of an association of community based organizations, banks and capital investors, private businesses, and the local government. However, Goldstein (1980) stated that all these factors do not share a common interest and vision of outcome in community development. In general, local development is dominated by shifting perceptions of the requirements of capital accumulation. Current EEZ policy is little more than an attempt to keep regional decline defined within the context of market problems and provide private sector solutions (Massey, 1982). Describing what she calls a new regionalism, Markusen (1980) stated that EEZ policies are attempts to rationalize spatial restructuring at a time when capital movement is most problematic. This program tries to use regional trauma over the impact of plant closings to pave the way for new rounds of capital accumulation. Distressed areas are offered subsidies or presented with packages like EEZ reportedly designed with local development in mind while growing areas receive infrastructural subsidies. Hill (1983) has aptly pointed out the contradiction inherent in the New Federalism (informing the current EEZ proposal) between economic and community development. Decentralization of power, reliance on markets, and the requirement that problems are to be addressed by local initiatives will do little for, and perhaps even worsen, the local situation if the problems faced are national.

Proponents of EEZs ignore the political and social content and ideological function implicit in this program. The program is couched in terms of technical criteria which define "working" in ways which ignore social and political consequences (Massey, 1982). In fact, EEZ legislation is little more than another attempt by capital to maintain its level of profits during periods of economic crisis while at the same time trying to undermine the strength and opposition of organized labor (Harrison, 1982). One of the last things EEZ will accomplish, in spite of its claims to the contrary, will be the creation of the conditions for long run growth. While EEZs might work in the short run, they will be little more than an experiment in carefully controlled nonplanning (Goldsmith, 1982b). However, if the EEZ actually does achieve its purpose of long run growth then it will reproduce the conditions which gave rise to local decline in the first place (demands by labor and rising factor costs) unless the state continues to impose restrictions to insure this "free market" operation.

Finally, benefits which do emerge from EEZs will undoubtedly flow to banks and large corporations since they will be the only ones able to command sufficient levels of capital to take advantage of the EEZ provisions (Goldsmith, 1982b). In general, new businesses are at a disadvantage when compared to firms already existing in the EEZ, small businesses when compared to larger businesses. A similar pattern of benefit distribution was evident in the program to construct adequate low income housing. Urban renewal legislation was modified a number of times to permit an increasing proportion of the renewal project to be allocated to nonresidential construction. This change reflected the growing use of renewal for commercial business district redevelopment and market pressure to approve projects which would attract developers and consumers. Under EEZ legislation, providing market incentives to ensure investment and development in depressed area of major urban centers require that these incentives be targeting actors with sufficient command over investment capital. The focus of the EEZ program shifts away from providing easy access to capital and toward tax advantages and loss carry forward provisions most readily utilized by major capital investment projects.

Summary

However the programs might be altered or reconstructed, as long as the emphasis remains the reconciliation of social policy objectives with market mechanisms, the outcomes will generally be a disappointment from the standpoint of those policy goals. Private control over resources will mean that those resources will be invested in projects which produce the greatest return to their investors defined in the most narrow sense. Social benefits and costs do not enter into the same calculus used by individuals when calculating private benefits and costs. The process of formulating regulations for pollution control recognized this divergence, and was predicated on privatizing many of the social costs of pollution (cf. Peskin and Seskin, 1975 on water pollution and regulation; Crenson, 1971 on air pollution and regulation). The question remains: should the producer pay these social costs in the form of lower profit margins or the consumer in the form of high product prices?.

Capital construction investments do not generate such clearly definable social costs and benefits from a market standpoint. While standard quality housing or jobs for the poor are admirable social objectives, it is hard to argue that residents of a middle income suburban community suffer negative externalities if the urban poor are underhoused or out of work, unless they either have to pay directly (e.g., higher taxes to finance social welfare expenditures) or indirectly (e.g., crime and delinquency). In addition, unlike a plant which pollutes and can be readily identified, the social costs of problems like poor housing or high unemployment are not so easily identified. Firms which leave a community do not readily assume or accept any social responsibility for the economic and social dislocations which follow. Only recently have communities tried to come to terms with the role firm level decisions play in the local community (cf. Kamara, 1983; Lynd, 1982; Buss and Stevens, 1982 for the relationship between company and community in the massive steel plant shutdowns in Ohio and Pennsylvania).

In general, public policy and local legislation has been ineffective since plants can generally move well beyond the jurisdictions of local communities, or else state legislatures and courts are reluctant to interfere with basic market "rights" associated with the private ownership of capital. It is only when a community can recognize that its only strength within a market defined relationship is as consumers, and they are fortunate enough to be situated in a significant position vis-a-vis the producer, then the firm must pause before acting. For example, community groups, religious councils, labor councils, and labor unions of southern California, GM's largest single market for their cars, have recently organized a threatened boycott of all GM products should the firm go ahead with plans to close its last operating facility in that part of the country. It remains to be seen how successful this tactic turns out to be. In any case, however, not all communities can succeed with such a program, nor are all firms (e.g., steel mills in the Ohio River valley) vulnerable to such a tactic.

Structuring public policies, whether concerned with housing construction or industrial production and employment, to work through the market ensures the continuation of most of these same problems. Social programs are administered and evaluated by planning agencies and development departments whose personnel make decisions based on administrative criteria set down in the program. When these criteria reflect market relations, then efficiency and optimality rather than social consequence determines the final outcome. To that end, middle income housing makes more sense for urban renewal than low income, state subsidized housing. Similarly, large multiplant firms relocating from other sites rather than small, new businesses will characterize redevelopment in the urban enterprise zones.

By defining social problems as market problems, social policy constrains the range of possible outcomes consistent with market solutions. This results in solutions which accept and reproduce market social relations, to wit the private ownership and control over the means of production. Enterprise zone legislation repeats this pattern of defining social problems and solutions as a market problem solving process. Economic activity in depressed urban areas will be stimulated by these legislative proposals, but in a manner which will benefit capital first and foremost. Furthermore, communities will be forced to compete with each other as firms consider relocating into these newly constructed zones in the same way that earlier firms threatened to move abroad in response to wage demands and changes in local tax policies.

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by
David Fasenfest
Department of Sociology
University of Wisconsin-Milwaukee
Milwaukee, WI

October, 1984

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