

USING ECONOMIC DEVELOPMENT PROGRAMS AS TOOLS FOR URBAN REVITALIZATION: A COMPARISON OF EMPOWERMENT ZONES AND NEW MARKETS TAX CREDITS

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This note examines the Empowerment Zones/Enterprise Communities (EZ/EC) and the New Markets Tax Credits (NMTC) and their reliance on tax incentives to revitalize economically distressed, low-income areas. After examining the history, purpose, program requirements, and projects resulting from the two market-based initiatives, the author concludes that the current tax incentives primarily benefit private interests. While the goal of both programs is to reduce poverty in low-income areas through economic growth, the programs are built on two distinct theoretical frameworks. The EZ/EC program is built on a “place-based people” policy that focuses on building the community as a method to help the local residents. The NMTC program, in contrast, adopts a “pure place strategy.” This policy focuses on a specific geographical area rather than the economic needs of the area’s residents. Ultimately, these programs fall short of economic revitalization goals because they do not effectively promote sustainable social change. Finally, the note proposes that the tax-incentive programs should shift their focus from place-based restrictions to the development of human capital within the inner-city residents. This direct investment of resources, which would include training programs, counseling services, and more direct residential involvement on project advisory boards, would ultimately create solid social structures within economically depressed areas and support the goal of the economic initiatives in present and future years.

I. INTRODUCTION

Beginning with Ronald Reagan’s administration in the 1980s, the United States’ domestic policy gradually shifted away from income maintenance programs towards market-based initiatives as a solution to the

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deterioration of the nation's inner-cities.¹ Previously, the federal government's solution to poverty in low-income communities had been governed by monolithic programs, such as Model Cities, urban renewal, and urban development action grants.² These programs benefited from massive federal funding initiatives, but they seldom achieved the results needed to justify the expense.³ Many of these programs resulted in the mismanagement of funds and effectively destroyed entire communities by displacing homes and businesses.⁴ Under President Clinton's administration, a private-sector approach redefined the federal government's response to impoverished communities.⁵ Market-based initiatives effectively replaced support programs as the government's main antipoverty plan.

Two of these programs, the Empowerment Zones/Enterprise Communities (EZ/EC) and the New Markets Tax Credit (NMTC), heavily rely on private investments to assist low-income communities and achieve economic equality.⁶ Both use tax incentives to encourage capital investment in distressed areas. This note will compare EZs to NMTCs and evaluate the effectiveness of each program in assisting low-income communities and individuals in achieving economic growth and self-sufficiency. Part II examines the history and program requirements of the EZ/EC and NMTC programs and provides examples of projects and initial outcomes of each program. Part III discusses the theoretical policies underlying the programs and raises concerns regarding the programs' efforts at addressing the scope of residential involvement, threats of gentrification, and sustainable social change within the historically marginalized communities targeted by the EZ/EC and NMTC programs. Finally, Part IV concludes that reliance on tax incentives to spur economic development has primarily benefited private interests, and that the EZ/EC and NMTC programs should devote more resources to building social capital among individuals in order for low-income residents to benefit directly from their community's redevelopment.

1. Scott L. Cummings, *Community Economic Development as Progressive Politics: Toward a Grassroots Movement for Economic Justice*, 54 STAN. L. REV. 399, 421-24 (2001) [hereinafter Cummings, *Progressive Politics*].

2. Stuart M. Butler, *The Conceptual Evolution of Enterprise Zones*, in ENTERPRISE ZONES 27, 31 (Roy E. Green ed., 1991). For a description of these programs, see REBUILDING URBAN NEIGHBORHOODS 18-21 (W. Dennis Keating & Norman Krumholz eds., 1999) [hereinafter REBUILDING URBAN NEIGHBORHOODS].

3. See generally REBUILDING URBAN NEIGHBORHOODS, *supra* note 2, at 18-19 (detailing the backlash against urban renewal and the disappointing results of the Urban Development Action Grant program); Audrey G. McFarlane, *Race, Space, and Place: The Geography of Economic Development*, 36 SAN DIEGO L. REV. 295, 318-19 (1999) (stating that the Model Cities program experienced problems with funding and struggled with issues of community participation and control).

4. See *supra* note 3 and accompanying text.

5. See Cummings, *Progressive Politics*, *supra* note 1, at 425-29.

6. *Id.* at 428.

II. BACKGROUND

A. Enterprise/Empowerment Zones

1. Use of Enterprise Zones First Introduced in the United Kingdom

Originally proposed by the British urban-planning expert Peter Hall, enterprise zones were viewed as a radical solution to the problems that plagued inner-city communities.⁷ Introduced to the public in a 1978 speech delivered by Sir Geoffrey Howe, the concept symbolized a dramatic departure from policymakers' earlier attempts at centralized economic development policy.⁸ Modeled after approaches used in Hong Kong and other free trade zones that resulted in extraordinary economic growth,⁹ a designated zone area promoted private investment through the implementation of "low taxes, minimal government regulation of wages, labor, and safety, and minimal restrictions on imports and land use."¹⁰ In presenting his idea, Hall argued that the global restructuring of the economy, evidenced by a decline in industry and manufacturing during the 1970s, required that advanced industrial nations stay ahead of the competition through continuous innovation.¹¹ Despite these advances, a large pool of people remained structurally unemployed because changes in the economy made it difficult to find work utilizing their specific skill set.¹² Enterprise zones had the potential to provide jobs to structurally unemployed individuals through the "in-migration of large corporations

7. Peter Hall, *The British Enterprise Zones*, in ENTERPRISE ZONES, *supra* note 2, at 180–81. With the loss of industries and manufacturing, there has been a general decline in neighborhood business districts located within the inner-cities. Poverty has become concentrated in the inner-cities while the suburbs enjoy an increase in wealth and living standards. Kara Lamb, *Revitalization from the Inside Out: The Attempts to Move Towards an Urban Renaissance in the Cities of the United States and the United Kingdom*, 19 CONN. J. INT'L L. 159, 161–62 (2003). High concentrations of low-income individuals may result in rising rates of crime, welfare dependency, slum housing, and drug use. *Id.* at 162. These problems are generally associated with poverty. *Id.*

8. See Butler, *supra* note 2, at 28. Howe suggested that policymakers' attempts to solve inner-city problems by imposing "universal solutions" just made things worse, and that a few areas where past failures were the most prevalent should be targeted to employ radically different approaches. *Id.* at 28–29. The idea of such enterprise zones would be to set up test markets to enable fresh policies to "prime the pump of prosperity," and to establish potential for doing so elsewhere. *Id.* Howe argued "that instead of trying to micromanage economic activity with special grants and regulations, forcing entrepreneurs to work within an official straitjacket, government should simply create the best possible conditions for private enterprises in a set of inner-city zones." *Id.*

9. *Id.* at 29.

10. Lamb, *supra* note 7, at 164.

11. Hall, *supra* note 7, at 181.

12. *Id.* at 181–82. Hall argued that

the large pool of structurally unemployed people [] consist[ed] of two elements: first, older workers, especially male, displaced from contracting industries in which they formerly had special skills, and now forced to choose between unemployment and low-skill occupations; secondly, young workers, both male and female . . . lacking educational and industrial qualifications. The latter group . . . tend[s] to form a marginal group in declining inner cities.

Id. at 182 (quoting Peter Hall, *Enterprise Zones: A Justification*, 6 INT'L J. URB. & REGIONAL RES. 416, 418 (1982)).

seeking cheap labor” or “through indigenous innovation and trading up the skill curve.”¹³

England’s Tory government enacted the Local Government Planning and Land Act along with the Finance Act in 1980.¹⁴ These Acts created enterprise zones that enjoyed a mixture of fiscal benefits and administrative simplifications for ten years from the date of designation.¹⁵ The legislation’s main purpose was to attract “medium to large-scale capital-intensive industries to abandoned industrial areas that possessed few, if any, residents.”¹⁶ The program offered the following incentives: a local property tax exemption, a full deduction from corporate and income taxes for capital expenditures on industrial and commercial buildings, an exemption from the Development Land Tax for sales of undeveloped lands, and reduced administrative requirements, such as planning permission and government statistical reporting.¹⁷ Despite these relaxed regulations and tax incentives, these zones failed to generate increased industrial activity, and the program was considered a failure.¹⁸ The creation of the enterprise zones resulted in intra-metropolitan relocation as existing businesses moved into the designated areas in order to take advantage of the relaxed regulations, incentives, and lower costs.¹⁹ Although a 1987 study concluded that the enterprise zones created 13,000 net jobs, the expense of the program outweighed the benefits because the expected “trickle-down” effects proved limited.²⁰

2. *Introduction in the United States*

In the early 1980s, economist Stuart Butler, influenced by the British enterprise zone program, outlined a proposal for creating American enterprise zones.²¹ Butler’s outline included the goals of job creation, economic expansion, encouragement of local enterprise, social improvement, innovation, and experimentation.²² Unlike the British zones which were geared towards luring investment to abandoned industrial areas, the American model focused on reviving economically depressed

13. *Id.*

14. Lamb, *supra* note 7, at 165.

15. In the first round, during 1980–1981, eleven areas were designated as zones, and during the second round, in 1983–1984, an additional thirteen zones were designated. Hall, *supra* note 7, at 184.

16. Lamb, *supra* note 7, at 165.

17. *Id.* The more radical elements of the enterprise zone proposals, however, had been eliminated. Hall, *supra* note 7, at 184. These elements included incentives that allowed the free migration of labor, the encouragement of immigrant entrepreneurs, and reduced protection under the Employment Protection Acts. *Id.*

18. Lamb, *supra* note 7, at 165.

19. *Id.*

20. *Id.* at 165–66. According to the study, each additional job created cost approximately £8,500. *Id.* at 165.

21. *Id.* at 167.

22. *Id.*

neighborhoods.²³ Conditions in the inner cities had worsened, and “[f]ew businesses could be induced to locate in the ghettos, despite vacant land and surplus labor, due to fear of crime, redlining by banks, and a poorly educated workforce.”²⁴

Gaining national prominence during Reagan’s first presidential campaign, the enterprise zone proposal promoted the idea that private enterprise could solve the problems of distressed areas.²⁵ Past federal programs failed to achieve this goal.²⁶ Appealing to conservatives as a supply-side program to reverse urban decline, Republican Congressman Jack Kemp introduced an enterprise zone bill in May 1980.²⁷ Within a month of introducing the bill, Kemp convinced Congressman Robert Garcia, a liberal Democrat from the South Bronx, to cosponsor a slightly modified bill.²⁸ However, the goals of the two sponsoring Congressmen were divergent in that “enterprise zones for Kemp seemed to represent job creation, but for Garcia, the concept promoted more generally inner city revitalization.”²⁹ Instead of creating industrial parks like the British program, the American enterprise zones targeted incentives towards small businesses. As a key component to economic growth, research indicates that small firms are the most important generators of new jobs.³⁰ Small firms are better able to utilize existing buildings than larger firms, which often require new facilities.³¹ Further, small entrepreneurs are more willing to establish a business in a marginal neighborhood and to hire local, unskilled labor to fill their employment needs.³² Given the perceived economic impact of small businesses, federal enterprise zone proposals have primarily focused on incentives that are likely to appeal to smaller businesses.³³ According to some small entrepreneurs, “two of the most important determinants of their success or failure are everyday

23. See Butler, *supra* note 2, at 32–34.

24. Susan B. Hanson, *Comparing Enterprise Zones to Other Economic Development Techniques*, in ENTERPRISE ZONES, *supra* note 2, at 11.

25. Butler, *supra* note 2, at 31.

26. See *id.* at 31 (stating that expensive government programs, such as Model Cities, urban renewal, and urban development action grants achieved marginal results at best, and in some places, entire neighborhoods were destroyed, leaving wastelands).

27. *Id.*

28. *Id.*

29. Enid Beaumont, *Enterprise Zones and Federalism*, in ENTERPRISE ZONES, *supra* note 2, at 43.

30. Research conducted by David Burch shows that about two-thirds of all net jobs are created by firms with less than twenty employees. Butler, *supra* note 2, at 35–36. In poor urban communities, small enterprises are the only net producers of jobs. *Id.* at 36. In fact, Birch claims that “very large firms tend to be net destroyers of jobs.” *Id.* at 36. *Contra* Helen F. Ladd, *Spatially Targeted Economic Development Strategies: Do They Work?*, 1 CITYSCAPE 193, 196 (1994) (“[S]mall firms do not create as large a share of the jobs as claimed by Birch, and when their high failure rate is taken into account, small firms do not grow faster than large firms. Moreover, small firms offer lower wages, lower benefits, and less job security than large firms.”).

31. Butler, *supra* note 2, at 36.

32. *Id.*; see also Wilton Hyman, *Empowerment Zones, Enterprise Communities, Black Business, and Unemployment*, 53 WASH. U. J. URB. & CONTEMP. L. 143, 154 (1998).

33. Butler, *supra* note 2, at 36.

operating expenses, including the cost of labor, and their abilities to obtain capital for the start-up phase and for later expansion.”³⁴

Despite this bipartisan support, Congress repeatedly failed to pass effective enterprise zone legislation during the 1980s, even though such legislation gained popularity among the states. Congress did pass legislation in 1987 that created one hundred federal zones, though the legislation did not contain tax incentives and was never implemented.³⁵ In contrast, many states embraced the idea of enterprise zones.³⁶ By 1990, more than seventy-five percent of the states implemented some variation of an enterprise zone program.³⁷ Many states established enterprise zone programs in anticipation of future federal legislation and accompanying incentives, but soon realized the usefulness of enterprise zones as a development tool.³⁸ The federal government’s use of enterprise zones to spur revitalization and job growth did not gain momentum again until the Los Angeles Riots of 1992.³⁹

3. *Los Angeles Riots Prompt the Creation of EZ/ECs*

Resulting in approximately 60 deaths, 2,300 injuries, the destruction of 1,150 structures, and damage to an estimated 10,000 small businesses,⁴⁰ the Los Angeles Riots alerted the nation to the deterioration of the inner cities and revived debate on the use of enterprise zones to revitalize blighted communities.⁴¹ With new proposals introduced in the House and Senate, some doubted how a tax incentive program could cure urban ills.⁴² Congressmen questioned the effectiveness of enterprise zones as a revitalization tool without accompanying social legislation.⁴³ For example, Representative Charles B. Rangel, a New York Democrat whose district included Harlem, stated that “enterprise zones alone are ‘not going to do a bit of good. No business person so blinded by tax breaks is

34. *Id.*

35. Housing and Community Development Act of 1987, tit. VII, Pub. L. No. 100-242 (1988); Beaumont, *supra* note 29, at 41, 45–46. Although the Department of Housing and Urban Development (HUD) was given the authority to designate these zones, the program was never implemented because Jack Kemp, who became the Secretary of HUD, was unhappy with the program’s lack of tax incentives. Beaumont, *supra* note 29, at 45–46.

36. *E.g.*, Beaumont, *supra* note 29, at 43 (noting that Florida, Louisiana, Connecticut, Missouri, Ohio, Pennsylvania, and Rhode Island were some of the first states to adopt Enterprise Zone programs).

37. Lamb, *supra* note 7, at 168.

38. *Id.*

39. See REBUILDING URBAN NEIGHBORHOODS, *supra* note 2, at 28–29.

40. *Id.* at 28.

41. Jill Zuckman, *Riots Resurrect Enterprise Zones*, 50 CONG. Q. WKLY. REP. 1253, 1253 (1992).

42. *Id.* Referring to the Los Angeles Riots, Carl F. Horowitz, a Heritage Foundation policy analyst, stated that “[t]hese rioters were not rioting because they did not have an enterprise zone. . . . Korean merchants in Los Angeles managed to start and run thriving businesses despite little capital and poor neighborhoods.” *Id.*

43. *Id.*

going to go into an area with ex-cons, ex-addicts, high tensions and inadequate housing.”⁴⁴

President Clinton, recognizing these concerns and in response to the Los Angeles Riots, offered a variation of former legislative proposals.⁴⁵ Clinton’s proposal emphasized tax breaks and regulatory relief by placing more emphasis on wage credits and coordinating federal resources through the use of Social Services Block Grants in poor neighborhoods.⁴⁶ On August 10, 1993, Clinton signed into law the EZ/EC program as part of the Omnibus Budget Reconciliation Act of 1993.⁴⁷ The original legislation created nine EZs, which receive most tax incentives and social spending, and ninety-five ECs, which receive fewer benefits.⁴⁸ During the application process, communities were given the opportunity to identify specific strategies and activities to pursue unfettered by the federal restrictions that characterized previous attempts at revitalization.⁴⁹ Each proposal was evaluated on its consistency with the program’s four key principles: (1) economic opportunity; (2) community-based partnerships; (3) sustainable community development; and (4) strategic vision for change.⁵⁰ Additional rounds of competition for EZ/EC designation took place in 1998 and 2001.⁵¹ The rounds resulted in additional urban and rural zones and communities.⁵²

Established as a ten-year program, the EZ/EC initiative offers tax incentives to incoming businesses and existing businesses wanting to expand their operations within a designated community.⁵³ These businesses qualify for employment credits, also known as wage-tax credits, and in-

44. *Id.*; see also Jill Zuckman, *Enterprise Zone Alchemy ‘90s-Style Urban Renewal*, 50 CONG. Q. WKLY. REP. 2354, 2355 (1992) (noting that Representative Bill Gradison said that “he does not believe that enterprise zones will improve cities. ‘Until we improve the quality of education, health care and job training, the buildings are not going to make a difference.’”).

45. REBUILDING URBAN NEIGHBORHOODS, *supra* note 2, at 28–29.

46. *Id.* at 29. Immediately after the riots, President Bush refused to grant emergency aid to the riot areas and vetoed enterprise zone measures enacted by a Democratically controlled Congress. *Id.* at 28.

47. Janet Hook, *Social Policy*, 51 CONG. Q. WKLY. REP. 3388, 3391 (1993) [hereinafter *Social Policy*].

48. *Id.* HUD administers the urban programs while the United States Department of Agriculture is in charge of the rural zones. Winston Pitcoff, *EZ’er Said Than Done*, 112 SHELTERFORCE ONLINE (2000), <http://www.nhi.org/online/issues/112/EZEC.html>. The original legislation designated six urban empowerment zones and sixty-five urban enterprise communities. *Social Policy*, *supra* note 47, at 3391. The original six urban empowerment zones were located in Atlanta, Baltimore, Chicago, Detroit, New York City, and Philadelphia/Camden. REBUILDING URBAN NEIGHBORHOODS, *supra* note 2, at 29.

49. SCOTT HERBERT ET AL., U.S. DEP’T OF HOUS. & URBAN DEV., INTERIM ASSESSMENT OF THE EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES (EZ/EC) PROGRAM: A PROGRESS REPORT 1-2 (2001), http://www.huduser.org/Publications/pdf/ezec_report.pdf [hereinafter INTERIM ASSESSMENT].

50. *Id.* at i.

51. U.S. DEP’T OF HOUS. & URBAN DEV., *RC/EZ Initiative Timeline*, <http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/about/timeline.cfm> (last visited Sept. 6, 2005).

52. *Id.*

53. McFarlane, *supra* note 3, at 314. Companies that merely relocate to designated zone areas cannot take advantage of EZ tax incentives. *Id.*

creased depreciation expensing under Section 179 of the Internal Revenue Code.⁵⁴ The employment credit encourages businesses located in a designated zone to hire local employees by giving a tax credit for wages paid to a “qualified zone employee.”⁵⁵ A qualified zone employee must substantially perform all services within an EZ in a trade or business of the employer, and the employee’s principle residence must be located within the EZ.⁵⁶ Starting in 1994, employers were eligible for a credit of up to twenty percent of the first \$15,000 in wages paid to qualified zone employees.⁵⁷ The wage credit is gradually phased out over a ten-year period.⁵⁸

EZ businesses can also utilize increased Section 179 expensing.⁵⁹ Deductions allow businesses in designated zones to accelerate the depreciation of tangible property when it is purchased and used in the trade or business.⁶⁰ Another tax incentive available is tax-exempt bond financing, which offers lower interest rates than conventional loans to encourage business development.⁶¹ These low interest loans can be used by businesses in the acquisition or construction of an “enterprise zone facility” or any land “functionally related and subordinate” to the facility.⁶² As of 2000, bond financing assisted communities in leveraging an additional \$10 billion in local and private funds.⁶³

In addition to tax incentives, each area was granted use of Title XX Social Services Block Grant (Title XX/SSBG) funds.⁶⁴ The grant awarded \$100 million to urban EZs.⁶⁵ Grant money can be used to fund services that provide skills training, transportation, and counseling related to housing, employment, and financial management to disadvantaged adults and youth.⁶⁶ Programs promoting homeownership, education, or other economic independence activities are eligible for funding.⁶⁷ Grants can also be used to help with emergency and transitional housing.⁶⁸ Non-profit organizations and community colleges that offer train-

54. INTERIM ASSESSMENT, *supra* note 49, at 1-7. Enterprise communities are not eligible to receive wage tax credits or increased section 179 depreciation expensing, but they can utilize tax exempt facility bonds. *See infra* notes 60–63 and accompanying text.

55. I.R.C. § 1396(d) (2004); INTERIM ASSESSMENT, *supra* note 49, at 1-7.

56. I.R.C. § 1396(d)(1) (2004).

57. I.R.C. § 1396(a)–(c) (2004); INTERIM ASSESSMENT, *supra* note 49, at 1-7.

58. INTERIM ASSESSMENT, *supra* note 49, at 1-7.

59. *See* I.R.C. § 1397A (2004).

60. INTERIM ASSESSMENT, *supra* note 49, at 1-7.

61. *Id.*

62. I.R.C. § 1394 (2004). An “enterprise zone facility” is defined as “any qualified zone property the principal user of which is an enterprise zone business, and any land which is functionally related and subordinate to such property.” I.R.C. § 1394(b)(1).

63. *See generally* Pitcoff, *supra* note 48.

64. INTERIM ASSESSMENT, *supra* note 49, at 1-6.

65. *Id.* at ix. Rural empowerment zones received \$40 million in Title XX/SSBG funds while enterprise communities received \$3 million in grant funds. Hyman, *supra* note 32, at 158.

66. INTERIM ASSESSMENT, *supra* note 49, at 1-6.

67. *Id.*

68. *Id.*

ing to low-income individuals can also take advantage of Title XX/SSBG money⁶⁹ as can other programs that include services to help support and preserve the family structure, such as drug treatment or after-school programming.⁷⁰ Finally, Title XX/SSBG funds can be used to leverage public and private resources.⁷¹ According to estimates by HUD, the initial round of grants leveraged approximately \$4 billion in public and private investment.⁷²

4. *Assessment of EZ Outcomes*

In 2001, an interim assessment of the EZ/EC program was prepared for HUD to assess the program's initial outcomes.⁷³ In an evaluation of the six urban zones, the report concluded that, although total employment increased in the combined six zones between 1995 and 2000, this growth could not be directly attributed to the EZ designation.⁷⁴ Unless a specific zone program targeted activities that assisted in job creation, other factors unrelated to the EZ/EC program, such as national and regional economic conditions or underlying demographic shifts, could have caused the observed growth.⁷⁵ The report also questioned the impact of tax incentives on business formation and growth.⁷⁶ Respondents reported a modest use of tax incentives that, in most cases, did not have any influence on their hiring or investment decisions.⁷⁷ Although the intended goal was to attract and encourage small business development with these incentives, larger firms were more likely to take advantage of the federal tax breaks.⁷⁸ However, these large firms were less likely than small, resident-owned businesses to hire zone residents.⁷⁹ As a result, the tax incentives portion of the EZ/EC program created a negligible increase in employment opportunities for low-income residents.⁸⁰ Finally, while resident participation and influence varied greatly among sites,

69. *Id.* Funds are also provided to organizations that assist with the training and employment of low-income individuals in the construction, rehabilitation, or improvement of affordable housing, public infrastructure, or community facilities. *Id.*

70. *Id.*

71. *Id.*

72. Peter Eisinger, *Financing Economic Development: A Survey of Techniques*, 18 GOV'T FIN. REV., June 2002, at 20, 22.

73. *See generally* INTERIM ASSESSMENT, *supra* note 49.

74. *Id.* at 9-5.

75. *Id.*

76. *Id.*

77. *Id.* at 9-19.

78. *Id.* For a discussion on the importance of targeting small businesses to achieve economic growth, see *supra* notes 29-33 and accompanying text.

79. INTERIM ASSESSMENT, *supra* note 49, at 9-19.

80. *Id.* In businesses owned at least partly by residents, sixty-seven percent of employees are zone residents as compared to thirty-six percent on average in non-resident owned businesses. *Id.* at 3-10.

findings indicated that resident involvement generally declined within the zones after the conclusion of the initial planning process.⁸¹

Despite these overall findings, some individual EZs posted strong results and were able to meet their goals. For example, with its emphasis on job creation, the Baltimore EZ enjoyed positive economic growth, observing an increase in businesses assisted, jobs created, and residents trained and placed from 1995 through 2000.⁸² With the retirement of the Baltimore EZ in December 2004, officials estimated investments within the zone to be \$1.5 million over the ten-year period.⁸³ Nearly two-thirds of the Title XX/SSBG money went to fund workforce development initiatives, resulting in more than 12,000 zone residents finding employment inside and outside the EZ and in the creation of more than 5,700 jobs within the EZ.⁸⁴

In spite of these noteworthy successes, it is still unclear whether this progress is sustainable. For example, a study analyzing the outcomes of residents who participated in job training classes reported that only slightly more than half of the participants were working two years later.⁸⁵ In addition, the areas of the zone that experienced the worst blight received the fewest funds, resulting in little change.⁸⁶

Although some of Baltimore's achievement can be attributed to its focus on job creation, the involvement and support of local residents within the EZ cannot be disregarded. This is evidenced by the poor performance of EZs that lacked community support. Baltimore established a Community Advisory Council, consisting primarily of community resi-

81. *Id.* at 6-6. The report attributed this decline in residential input to the later involvement of powerful entities and individuals after the cities were awarded EZ status as well as the lack of roles for resident volunteers as the program shifted to the operational phase. *Id.*

82. *Id.* at 9-6. Despite this growth, Baltimore did not achieve all of its interim goals. *Id.* However, the performance of the Baltimore EZ was still significant in comparison to contiguous areas. From 1995 through 2000, the zone experienced a higher rate of employment growth (thirty-one percent in the zone versus two percent in the comparison area) and realized an acceleration in employment growth rates as compared to 1990 through 1995 (an increase of twenty-nine percent in the zone area versus eighteen in the comparison area). *Id.* The zone benefited from over \$197 million in leveraged funds through private investment that helped fund various activities within the zone. *Id.* at 9-7. In addition, the Baltimore EZ posted a 108% increase in the number of residents employed within the zone and a 158% increase in the number of resident-owned businesses within the zone. *Id.* at 9-6-9-7.

83. Eric Siegel, *Goals Met, But Not Hopes; Development: As the City's Empowerment Zone Program Winds Down, Results are Mixed*, BALT. SUN, Dec. 26, 2004, at 1A.

84. *Id.* These numbers on employment exceeded the project's goals by twenty percent. Approximately a quarter of the money spent on job training was used to prepare residents to work in existing businesses and industries that lacked workers. *Id.*

85. *Id.*

86. *Id.* In support of this statement, one report found that physical investment was nearly \$400 million in the commercial-residential area that includes Harbor East and Fells Point, whereas investment in the poorer residential areas of Harlem Park and Sandtown-Winchester totaled less than \$50 million during the first six years of empowerment zone designation. *Id.* A more recent report assessing property values from 1997 to last year within the Baltimore EZ noted that property values in the Harbor East and Fells Point areas increased by fifty percent while Harlem Park enjoyed an increase of only 6.3%. *Id.* The street corners of Harlem Park evidence this disparity as "[o]n one street corner, police were arresting two young men on drug charges; on another, yellow tape blocked off a rowhouse that had apparently collapsed, leaving one fewer boarded-up house but one more pile of rubble." *Id.*

dents, that had the power to approve, disapprove, or modify preliminary decisions made by the Empower Baltimore Management Corporation (EBMC), a committee that oversaw the use of EZ funds.⁸⁷

In contrast, efforts by other cities, such as Chicago and Philadelphia/Camden, to involve community residents have been less successful, and these EZs have not performed as well.⁸⁸ Between 1995 and 2000, the Chicago zone posted a negative growth rate and experienced less growth than in the previous five-year period when compared to similar areas within the city.⁸⁹ Instead of taking into account the input of community activists in the implementation of the zone's plans, the city used the funding to strengthen existing city initiatives at the expense of community plans to alleviate poverty and reform local government.⁹⁰ The Philadelphia/Camden EZ experienced similar results as staff turnover, a reduction in staffing levels, and a lack of consistent support from the local government resulted in dissatisfaction among community activists.⁹¹ As illustrated by the above examples, cities that neglected to encourage resident empowerment failed to effectively market the zone areas as places to invest, making it difficult to achieve program goals.

B. *New Markets Tax Credits*

1. *Purpose*

As evidenced by his EZ/EC program, President Clinton adopted a policy to alleviate poverty through market expansion, marking a shift away from the income maintenance programs traditionally supported by Democrats.⁹² Advancing a pro-business agenda, Clinton refocused anti-poverty policy as a struggle to open up "new markets" overlooked by the economic boon enjoyed by the rest of the nation in the 1990s.⁹³ In November 1999, at the insistence of community development corporation

87. INTERIM ASSESSMENT, *supra* note 49, at 6-8. The working relationship between the EBMC and community residents evolved in response to HUD's insistence that Baltimore include greater community participation. *Id.* During the initial implementation period, community residents had little input into EBMC's decisions. *Id.* at 6-7-6-8.

88. *Id.* at 9-12-9-14.

89. *Id.* at 9-12. Between 1995 and 2000, the Chicago zone reported a negative three percent growth rate, while the comparison area experienced a growth rate of thirty-two percent. *Id.* In addition, in comparing the Chicago zone's growth rate from 1990 through 1995 to 1995 through 2000, the Chicago EZ grew at a slower rate than the other two Chicago analytic areas despite the EZ's use of tax incentives and Title XX/SSBG funds. *Id.* The Chicago EZ observed an increase of fourteen percent in comparison to the respective increases of thirty-eight percent and seventeen percent in the two analytic areas. *Id.* The report blames the disappointing growth within the zone relative to the comparison areas on a lack of community involvement and administrative inconsistencies. *Id.* at 9-12-9-13.

90. *Id.* at 9-13. During the initial application process, Chicago presented two competing proposals separately supported by community activists and local city officials. *Id.* The application was submitted without any indication of the underlying tension. *Id.* After receiving EZ status, the city's plan took precedence. *Id.* at 9-13.

91. *Id.* at 9-14.

92. Cummings, *Progressive Politics*, *supra* note 1, at 428.

93. *Id.*

advocates, Clinton and Speaker of the House, Dennis Hastert, publicly vowed to create new economic incentives to encourage investment in the country's distressed areas.⁹⁴ On December 21, 2000, Clinton fulfilled this promise by signing into law the NMTC program as part of the Community Renewal Tax Relief Act of 2000.⁹⁵ In an attempt to direct some business capital away from areas already experiencing rapid growth and to low-income communities, the targeted tax credits offered by NMTC enhance the economic return to the investor, an approach that has proven successful with the Low Income Housing Tax Credit program.⁹⁶ The goal of the NMTC program is to restore commerce and to create jobs through an infusion of outside capital.⁹⁷

2. *How the NMTC Program Works*

NMTC encourages capital investment in businesses located in low-income communities by providing tax incentives to investors who make qualified equity investments in community development entities (CDEs).⁹⁸ To qualify, a CDE must be a domestic corporation or partnership that meets the following criteria: (1) the organization's primary mission must be to serve or provide investment capital for low-income communities or persons; (2) the entity must maintain accountability to the community by including resident representation on any governing or advisory board; and (3) the entity must be certified as a CDE by the United States Treasury Department's Community Development Financial Institutions Fund (CDFI Fund), the agency that administers the NMTC program.⁹⁹ In exchange for tax credits, which may be claimed over seven years, investors supply capital to the CDEs who then invest the capital in low-income communities.¹⁰⁰

94. Gregory Maher, *At a Crossroad*, 90 NAT'L CIVIC REV. 199, 201 (2001); *see also* 145 CONG. REC. E1761 (daily ed. Aug. 5, 1999) (statement of Rep. Rangel) (acknowledging that many urban and rural communities continue to have severe economic problems).

95. Susan R. Jones, *Will New Markets Tax Credits Enhance Community Economic Development?*, 8 J. SMALL & EMERGING BUS. L. 229, 230 (2004).

96. *See* 145 CONG. REC. E1761 (daily ed. Aug. 5, 1999) (statement of Rep. Rangel).

97. *See* Maher, *supra* note 94, at 201-02; 145 CONG. REC. E1761 (daily ed. Aug. 5, 1999) (statement of Rep. Rangel).

98. *Tax Incentives for Renewal Communities: Hearings Before the House Ways and Means Subcomm. on Oversight*, 107th Cong. (2002) [hereinafter *Hearings*] (statement of Eric Solomon, Deputy Assistant Secretary for Regulatory Affairs, Dep't of Treasury), 2002 WL 1161320, at *8.

99. I.R.C. § 45D(c) (2005). In less than four years, over 1,950 entities have been certified as CDEs. Arthur A. Garcia, Director, Community Development Financial Institutions Fund, Remarks at the Boston Federal Home Loan Bank's New Markets Tax Credit Program Summit (Sept. 30, 2005), available at http://www.novoco.com/NMTC/Resources/GarciaRemarksBostonFHLB_093005.pdf [hereinafter Garcia Remarks].

100. U.S. GENERAL ACCOUNTING OFFICE, NEW MARKETS TAX CREDIT PROGRAM: PROGRESS MADE IN IMPLEMENTATION, BUT FURTHER ACTIONS NEEDED TO MONITOR COMPLIANCE 1 (2004), <http://www.unclefed.com/GAOReports/d04326.pdf> [hereinafter NEW MARKETS]. Although investors may include individuals, companies, or investment funds, the core groups of investors are expected to be banks and thrifts, insurance companies, investment banks, venture capital funds, and other investment fund and finance companies. Jones, *supra* note 95, at 232.

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A variety of businesses and projects can receive investment capital from a CDE. Qualifying investments include direct loans to or equity investments in a “qualified active low-income community business” or other CDEs, or loans purchased from other CDEs.¹⁰¹ Technical assistance provided to businesses located within low-income communities also qualifies under the program.¹⁰² Therefore, the responsibilities of the CDEs include identifying potential projects or businesses that will benefit a community and convincing investors that they will be making sound economic decisions by investing in low-income communities.¹⁰³ To receive funds, a low-income community must meet the income requirements as evaluated by census tracts.¹⁰⁴ Accordingly, thirty-nine percent of all census tracts, which account for thirty-six percent of the nation’s population, qualify for NMTCs.¹⁰⁵

The NMTC program has allocated \$15 billion in tax credits, generating credits equal to thirty-nine percent of an investment, to be disbursed over a period of seven years.¹⁰⁶ To participate in the program, investors must commit their money to the CDE for the seven-year period, and, in return, they receive a tax credit worth five percent of their investment during the first three-credit allowance dates and six percent of their investment over the remainder of the period.¹⁰⁷ After seven years, investors receive the value of their equity stake in the CDE, which could either exceed or fall short of their initial investment depending on the profitability of the CDE’s investments.¹⁰⁸ The value of the credit alone is not sufficient to generate competitive rates of return, placing pressure on CDEs to make sound investment decisions in order to guarantee a return greater than the value of the credit.¹⁰⁹

In order for CDEs to offer NMTCs in exchange for qualified equity investments, the entity must apply for and receive an allocation of credit

101. See I.R.C. § 45D(d)(1). The term “qualified active low-income community business” refers to any corporation (including a non-profit corporation) or partnership that derives at least fifty percent of its total gross income from active operations within any low-income community. I.R.C. § 45(D)(d)(2)(A)(i). Also, a substantial part of its property must be located in and its services must be performed within any low-income community. I.R.C. § 45D(d)(2). The rental of real property is eligible to receive financial assistance as a qualified business as long as the property is not considered a residential rental property as defined in I.R.C. § 168(e)(2)(A) and substantial improvements have been made to the property. Beth Mullen, *New Markets Tax Credits—Possibilities and Pitfalls*, 13 J. AFFORDABLE HOUSING & COMMUNITY DEV. 31, 35 (2003).

102. See I.R.C. § 45D(d)(1).

103. Dimitri Pappas, *A New Approach to a Familiar Problem: The New Market Tax Credit*, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. 323, 325 (2001).

104. See I.R.C. § 45D(e).

105. NEW MARKETS, *supra* note 100, at 4.

106. Jones, *supra* note 95, at 230 n.4 (citing I.R.C. § 45D(f)(1) (2000)). The maximum allocations allowed are \$1 billion in 2001, \$1.5 billion in 2002 and 2003, \$2 billion in 2004 and 2005, and \$3.5 billion in 2006 and 2007. Pappas, *supra* note 103, at 328.

107. Pappas, *supra* note 103, at 326.

108. *Id.*

109. *Id.* at 326–27.

authority from the CDFI Fund.¹¹⁰ Allocation authority is awarded through a competitive application process. Priority is given to CDEs that have demonstrated success in providing capital or technical assistance to disadvantaged businesses or communities and who intend to invest substantially all of the investment capital into one or more businesses in which unrelated persons maintain majority equity interest.¹¹¹ The CDFI Fund evaluates NMTC applications based on the following criteria: (1) business strategy; (2) capitalization; (3) management capacity; and (4) community impact.¹¹²

3. *Delay in Awarding NMTC Allocations*

Although Congress authorized tax credits in 2001, the first round of credits were not released until the last week of August, 2003, and most projects, according to CDFI Fund officials, did not begin until the end of 2003.¹¹³ Due to these delays, the first four annual rounds were combined into two multiyear rounds with awards of \$2.5 billion in 2001 and 2002 and \$3.5 billion in 2003 and 2004.¹¹⁴ First round award winners were not announced until March 14, 2003.¹¹⁵ From 345 applicants, 66 CDEs were awarded allocation authority with awards ranging from \$500,000 to \$170 million with the average award totaling \$38 million.¹¹⁶ The second round, announced in May 2004, awarded 63 CDEs with allocation authority.¹¹⁷ During the most recent round of competition, 208 CDEs competed for \$2 billion of NMTCs.¹¹⁸ With awards ranging from \$5 million to \$100 million, the CDFI Fund awarded 41 CDEs with allocation authority in May

110. *Hearings*, *supra* note 98, at *8.

111. *Id.*

112. Jones, *supra* note 95, at 231. Currently, in the third allocation application round, more emphasis is placed on the business strategy and community impact sections of the application. Heidi Jarchow, *Garcia Shares Latest NMTC Developments*, NMTC MONTHLY REP., Nov. 2004, at 1, available at http://www.novoco.com/NMTC/Article_of_month/NMTC_article_of_month_1104.pdf. With regards to community impact, the Director of the Community Development Financial Institutions Fund stressed that “[t]ax credits must have an impact on the communities they serve and this is important.” *Id.*

113. NEW MARKETS, *supra* note 100, at 2.

114. *Id.* at 15.

115. Remarks by Tony T. Brown, Director Community Development Financial Institutions (CDFI), <http://www.treas.gov/press/releases/js130.htm> (last visited Sept. 6, 2005).

116. Jones, *supra* note 95, at 231.

117. In comparison to the first allocation round, the awards given during the second round exceeded those given during the first round. Jarchow, *supra* note 112, at 1. This illustrates the competitiveness and growth of the program. Second-round allocations ranged from \$2 million to \$150 million with an average award of \$56 million. *Id.*

118. The Community Development Financial Institution Fund, New Markets Tax Credit Program: Third Round (2005) Allocatees, <http://www.rapoza.org/NMTC/2005NMTC.FAQs.pdf> [hereinafter Third Round Allocatees]. CDEs competing during the third round of competition requested a total amount of \$22.9 billion in allocation authority. *Id.*

2005.¹¹⁹ The CDFI Fund plans to announce the fourth round of awardees in the spring of 2006.¹²⁰

4. *Projects Complete Under the NMTC Program*

Due to the delays of NMTC allocations, many projects utilizing NMTCs have not been completed,¹²¹ and some CDEs are behind in locating investment opportunities in low-income communities.¹²² Of the \$6 billion in allocation authority issued to CDEs during the first two rounds of competition, \$2.58 billion in qualified equity investments have been made, which represents forty-three percent of the total credits allocated during these rounds.¹²³ Since many transactions occurred in 2004, the CDFI Fund will not receive reports detailing the transaction-level data until the summer of 2005, and for subsequent transactions the project status is still unknown.¹²⁴ However, some projects have been completed, including projects that have combined NMTCs with historic tax credits.¹²⁵

In Washington D.C., NMTCs were used to attract capital to build a 226-room hotel in the city's Shaw neighborhood.¹²⁶ A historically African American neighborhood, residents living in the Shaw community experience a forty percent poverty rate and a fourteen percent unemployment rate.¹²⁷ Shaw is centrally located near the newly built Washington D.C. Convention Center and is close to downtown. 123 New Markets Investors, LLC, the CDE in charge of the hotel project, stated that the hotel will benefit the community by "transform[ing] a vacant city block, improv[ing] the streetscape, promot[ing] pedestrian traffic, improv[ing] neighborhood security, provid[ing] opportunities for ancillary businesses, and creat[ing] a significant number of jobs appropriate for unemployed or unskilled residents of Shaw (sixty-two percent of whom lack a high school diploma)."¹²⁸ The CDE's advisory board includes low-income residents from the Shaw community, as mandated by the regulations, and is responsible for increasing community awareness, attaining feedback, and distributing information to low-income community organizations.¹²⁹ 123 New Market Investors estimate that the project will create 275 con-

119. *Id.*

120. *Id.* With requests totaling \$22.9 billion, 208 applicants are competing during the third round for a portion of the \$2 billion tax credit allocation. *Id.*

121. See generally NEW MARKETS, *supra* note 100, at 12.

122. In addition to these delays, the statute authorizing the NMTC program allows CDEs five years from the date of allocation to locate qualified equity investments from investors. Garcia Remarks, *supra* note 99.

123. *Id.*

124. Third Round Allocatees, *supra* note 118.

125. Jefferson Armistead, *New Markets Tax Credits: Issues and Opportunities*, Apr. 2005, <http://www.picced.org/pubs/nmtc-report.pdf>.

126. Jones, *supra* note 95, at 233.

127. *Id.*

128. *Id.* at 233-34.

129. *Id.* at 234.

struction jobs with twenty percent of those jobs going to poor residents living within the census tract.¹³⁰ The hotel is projected to create sixty-one long-term jobs.¹³¹ The wages of the jobs created due to the project will be more than double the current median income for the tract.¹³² In addition to providing jobs, the hotel is expected to increase home values, increase business activity for resident-owned businesses, and generate an estimated \$1,293,000 in local taxes through the 14.5% D.C. Hotel Occupancy Tax.¹³³

Three projects that combined NMTCs with the historic tax credits include the Arthur S. Flemming Center in Washington D.C., the Dia:Beacon in Beacon, New York, and the Hippodome Performing Arts Theatre in Baltimore, Maryland.¹³⁴ Under this “twinned” tax approach, the investor benefits from a greater NMTC yield, and the historic tax credit developments benefit from increased equity.¹³⁵ Approximately thirty-eight percent of national historic districts are located in census tracts that experience greater than twenty percent poverty rates.¹³⁶ Receiving an allocation of \$127 million, the sixth largest award allocation in NMTC’s first round, these three projects were initiated by the National Trust Community Investment Corporation.¹³⁷ This corporation is a for-profit subsidiary of the National Trust for Historic Preservation, a non-profit group that has worked to preserve America’s historic resources.¹³⁸

In an attempt to “revitalize low-income communities rich in building stock but poor in capital,” the Arthur Flemming Center, also located in the Shaw neighborhood, utilized the twinned tax approach and received almost \$572,000 in equity investment.¹³⁹ The Center rents space to public welfare nonprofit organizations at below-market rates in addition to serving as the headquarters for an organization that provides communal space and offers a variety of classes for the elderly.¹⁴⁰ The

130. *Id.*

131. *Id.* Of these sixty-one hotel jobs, eleven are managerial positions, and fifty are staff positions. *Id.*

132. *See id.* (“The average annual construction wage will be \$30,000 and the average annual hotel-operations wage will be \$29,980.” The tract’s current median income is \$14,603.)

133. *Id.*

134. *E.g.*, Jones, *supra* note 95, at 235–36; Donald S. Holm III & Erica Stewart, *New Market Tax Credits in Action—With an Historic Flavor*, NMTC REP., Dec. 2003, at 1–2, available at http://novoco.com/NMTC/Article_archive.shtml.

135. Ruth Sparrow, *Opportunities and Issues in Combining NMTCs and Historic Credits*, NMTC REP., Oct. 2003, at 2–3, available at http://www.novoco.com/NMTC/Article_archive.shtml. The historic tax credit equals twenty percent of the qualified rehabilitation expenditures of certified historic structures, and ten percent of the qualified rehabilitation expenditures for other qualified rehabilitation buildings. *Id.* at 2. The historic tax credits indirectly increase to the extent that NMTC equity finances part of the qualified rehabilitation expenditures. *Id.* However, NMTC is dependent on the amount of equity invested in the deal and may include the aggregate of the historic tax credit equity, NMTC equity, and permanent financing. *Id.*

136. Jones, *supra* note 95, at 235.

137. *Id.*

138. *Id.*; Holm & Stewart, *supra* note 134, at 1.

139. Jones, *supra* note 95, at 235–36.

140. *Id.*

Dia:Beacon is a former Nabisco Box Printing Factory that served as a major employer for the area until its closure in 1991.¹⁴¹ Now a museum that houses collections by major contemporary artists, the project utilized \$766,899 in NMTC equity funds to create an operating reserve, which is used to help cover projected operating deficits for the first five years of operation.¹⁴² During its first year of operation, Dia:Beacon created sixty new jobs and welcomed 145,000 visitors.¹⁴³

Finally, the Hippodrome Theater, built in 1914 and one of the first theaters to show motion pictures, is a reminder of former economic activity on Baltimore's deteriorating West Side.¹⁴⁴ With \$9 million of twinned equity venture contributions, the project plans to restore three historic landmark buildings.¹⁴⁵ With the anticipation of attracting 410,000 patrons during its first year of operation, the 2,250-seat theater plans to offer 200 events per year, including the Baltimore Symphony Orchestra, touring Broadway productions, and various community events.¹⁴⁶ It is estimated that the opening of the Hippodrome Theater will help stimulate more than \$850 million in investment dollars for the West Side.¹⁴⁷

III. ANALYSIS

A. *The EZ and the NMTC Programs: Conflicting Policy Rationales to Achieve Urban Revitalization*

Although the stated goal of both the EZ/EC and NMTC programs is to achieve poverty reduction through economic growth in low-income communities, the programs employ fundamentally different policy approaches in an attempt to achieve the desired outcomes.

1. *EZs and Place-Based People Strategy*

Utilizing a place-based people strategy, the EZ/EC program adopts the policy view that the government must build or revitalize communities in order to help local residents.¹⁴⁸ Accordingly, "people cannot be separated from place, and . . . an antipoverty strategy needs to treat individuals in the context of their community."¹⁴⁹ In enacting the EZ/EC program, Congress realized that social structures would be important to

141. Holm & Stewart, *supra* note 134, at 1.

142. New Markets Tax Credit Coalition, Profile of Dia:Beacon, <http://www.newmarketstaxcreditcoalition.org/reportsETC/reports.frameset.htm> (last visited Nov. 6, 2005).

143. *Id.*

144. *Id.* at 1-2.

145. *Id.* at 2.

146. *Id.*

147. *Id.*

148. Ladd, *supra* note 30, at 195.

149. *Id.* (quoting Butler, *supra* note 2, at 35).

achieving the goals of urban revitalization.¹⁵⁰ By employing strategies to increase the economic status and social capital of low-income residents, the EZ/EC program recognized that the economic and social health of a community's residents are inextricably linked to economic development prospects.¹⁵¹ Given this focus, the EZ/EC program awarded \$100 million in Title XX/SSBG funds to urban zones to help provide skill training and counseling services to local residents.¹⁵² Furthermore, businesses located within the zone that hired "qualified zone employees" received wage tax credits.¹⁵³ These aspects of the EZ/EC program helped ensure that local residents would also benefit from the revitalization of the area through employment opportunities and improved social structures.

2. *NMTC Program and Pure-Place Strategy*

In contrast to the place-based people strategy underlying the EZ/EC program, NMTC utilizes a pure-place strategy. Unlike the place-based people strategy, the pure-place approach does not focus on the economic well-being of local residents as one of its primary goals. Although the main objective of NMTC is to encourage economic development within a defined area, no incentives exist to target jobs or services towards local, low-income residents.¹⁵⁴ Instead, the program looks to improve the economic well-being of individuals extending far beyond the defined area with the belief that "pockets of blight are detrimental to the economic vitality of the larger jurisdiction."¹⁵⁵ NMTC limits investment by CDEs to low-income communities as defined by census tract.¹⁵⁶ The program treats these areas "as discrete economic unit[s] in need of rebuilding" with the goal of creating new investments, jobs, and development projects within these defined spaces.¹⁵⁷ Targeting a geographic space and not necessarily the needs of the people within that space,

150. See *supra* notes 43–46 and accompanying text. "Social structures include schools and training resources, the criminal justice system, medical services, the housing stock, resources for alleviating the extent and consequences of poverty and unemployment, and 'social capital'; that is, structures that promote social cohesion, stability, and control." Laurence E. Lynn, Jr., *Social Structures as Economic Growth Tools*, 1 CITYSCAPE 245, 245 (1994).

151. For a discussion on how the social environment affects business location decisions, see Lynn, *supra* note 150, at 248–49.

152. See *supra* notes 64–71 and accompanying text.

153. See *supra* notes 54–58 and accompanying text.

154. The only scenario under which a "qualified active low-income community business" under the NMTC program would be able to utilize employment credits or Title XX/SSBG funding is if the census tract falls within the boundaries of an EZ. See *supra* notes 64–72 and accompanying text. In this case, the business would be able to benefit from both programs. See also NEW MARKETS TAX CREDIT COALITION, NEW MARKETS TAX CREDIT: A PROGRESS REPORT 12–16 (May 2005), available at <http://www.newmarketstaxcreditcoalition.org/reportsETC/CaseStudies/05ProgressReport.pdf> (noting that Arbor Park Place in Cleveland and the Beth Center in Chicago are NMTC projects that have utilized EZ-related funds).

155. Ladd, *supra* note 30, at 197.

156. I.R.C. § 45(D)(e) (2005).

157. Cummings, *Progressive Politics*, *supra* note 1, at 442.

NMTC does not guarantee economic mobility to low-income residents through job placement and fails to address other issues such as schools, job training, and housing that are key components in the attainment of long-term economic success.

3. *People-Oriented Strategy as an Alternative*

Instead of adopting a form of the place-based policies, some advocates argue that the federal government should place more resources in programs that provide assistance for people regardless of where they live. Known as a pure people-oriented strategy, this policy primarily focuses on increasing human capital and mobility so people can relocate to areas that provide more opportunities.¹⁵⁸ Although place-based strategies may make it easier to achieve community participation goals and to target resources within a defined geographic space more efficiently, this policy might be inconsistent with what is best for local residents.¹⁵⁹ “[T]argeting efforts based on a geographic area is less important than building linkages and informal networks across borders.”¹⁶⁰

Proponents of this policy argue that place-based strategies encourage businesses to locate in areas lacking economic development potential.¹⁶¹ This results in a less efficient outcome when compared to resident mobility programs. Lending support to this argument is the assertion that place-based strategies like the EZ/EC and NMTC programs create a bias towards the establishment of traditional line black businesses because the programs do not offer incentives to encourage the creation of emerging line black businesses that must locate outside of the designated census tract due to economic reasons.¹⁶² Traditional line black businesses are personal service providers that are small-scale, labor intensive, and require little start-up capital.¹⁶³ Often located in low-income communities, these businesses create few jobs, experience high rates of failure, and are owned and operated by individuals with low levels of education.¹⁶⁴ The HUD interim report found that over seventy percent of zone businesses owned by residents were in the retail trade and service industries.¹⁶⁵ In contrast, emerging line black businesses are larger, require

158. Ladd, *supra* note 30, at 194.

159. See generally Pitcoff, *supra* note 48.

160. *Id.*

161. Ladd, *supra* note 30, at 194.

162. Hyman, *supra* note 32, at 163.

163. *Id.* at 160. Examples include “beauty parlors, barbershops, and other retail establishments that serve a predominantly minority clientele.” *Id.*

164. *Id.*

165. INTERIM ASSESSMENT, *supra* note 49, at 3–9. A large percentage of the growth in zone business employment of local residents occurred in the service industries. *Id.* at 3–5. The large growth of service industries within EZs is supported by data from the Baltimore EZ. The Baltimore EZ indicates that service businesses comprised the largest business category that received loans during 2004. See generally Siegel, *supra* note 83. Service businesses received more than \$5 million in loans, followed by restaurants and food services with \$2.6 million. *Id.*

more start-up capital, and experience lower failure rates.¹⁶⁶ These businesses operate in industries historically closed to African Americans such as business services, finance, construction, manufacturing, and wholesaling.¹⁶⁷

Since studies have shown that minority-owned businesses are more likely to hire minority residents than non-minority-owned businesses, it is important that the EZ/EC and NMTC programs promote the development of black-owned businesses.¹⁶⁸ Although possessing the greatest potential for creating jobs for minorities and therefore impacting the economic health of residents and the businesses they frequent, emerging line black businesses that choose not to locate within a designated EZ for economic reasons do not receive tax incentives.¹⁶⁹ In response to this dilemma, the EZ/EC program policy should be modified to allow tax incentives for businesses that employ zone residents regardless of their geographic location. By extending tax incentives to businesses regionally, more employment opportunities would be available to zone residents. These rigid and fixed boundaries also limit resident mobility and choice by making benefits contingent on a zone resident's continued residence and connection to the low-income community.¹⁷⁰ A business that hired an employee due to the availability of tax credits might not have the same incentive to retain that employee if he moved from the zone.

B. Focus on Economic Expansion Disregards the Underlying Causes of Urban Decay

The goal of market-based initiatives, like the EZ/EC and NMTC programs, is to encourage capital investment and business expansion within economically depressed communities.¹⁷¹ To achieve this goal, the programs must present low-income communities as attractive business environments.¹⁷² This directly conflicts with the idea of politically mobilizing low-income communities to rally against institutional arrangements.¹⁷³ Low-income communities are the result of "intersecting political decisions and private actions."¹⁷⁴ In fact, these urban enclaves, popularly referred to as "ghettos," are "legal and political constructions, created and delimited by a history of residential segregation, federally sponsored mortgage redlining, racially disparate zoning practices, urban

166. Hyman, *supra* note 32, at 162.

167. *Id.*

168. *Id.* at 159.

169. *See id.* at 165–66.

170. McFarlane, *supra* note 3, at 346.

171. *See supra* notes 53–55, 78, 92–98 and accompanying text.

172. *See* McFarlane, *supra* note 3, at 297.

173. Cummings, *Progressive Politics*, *supra* note 1, at 451.

174. *Id.*

renewal policies, and spatially concentrated public housing.”¹⁷⁵ In addition, “political and legal decisions regarding the geographic scope of desegregation orders, the requirements for municipal secession, and the financing of public school education” have greatly influenced the boundaries of neighborhoods.¹⁷⁶ The importance of this spatial intersection between race and poverty and its effect on shaping the boundaries of low-income communities cannot be underestimated. As an example of this hyper-segregation, each of the six original EZs were geographically located in areas that not only experienced a high concentration of poverty, but also served as concentrated enclaves for African Americans. The population of poor African Americans living within these zones ranged from thirty-seven to ninety percent.¹⁷⁷ By using low-income census tracts as boundaries to efficiently target tax incentives, the EZ/EC and NMTC programs reinforce this spatial isolation without challenging the underlying structure that created these boundaries. Driven by capital investment and the goals of economic development, the EZ/EC and NMTC programs fail to promote the social change necessary to support sustainable communities.¹⁷⁸

Market-based forces heavily rely on the creation of jobs to influence mobility among local residents and to help build sustainable communities. However, the link between jobs and neighborhood revitalization may be too tenuous given the political and private actions that combined to help create the poverty and isolation within the inner cities. Given this limitation, there is no guarantee that employment opportunities will necessarily follow from economic development. Market-based strategies, without any type of regulation, are likely to produce “jobs that pay low wages, do not provide health care benefits, and provide no opportunity for training and upward mobility.”¹⁷⁹ This finding is supported by the fact that most of the jobs created by the EZ/EC program were in the relatively low-skilled, low-paying service industry.¹⁸⁰ In fact, a study examining whether public subsidies for economic development translate into economic benefits for local residents shows that these policies have failed to spur overall job growth at a regional level and benefit the businesses that receive the public subsidies at the expense of low-income communities.¹⁸¹ Furthermore, market-driven initiatives to help alleviate poverty have provided the impetus for the removal of government pro-

175. *Id.* For a more in-depth discussion on the forces that helped shape the condition of the nation’s inner cities, see generally McFarlane, *supra* note 3, at 333–36.

176. Cummings, *Progressive Politics*, *supra* note 1, at 451–52.

177. McFarlane, *supra* note 3, at 337.

178. Cummings, *Progressive Politics*, *supra* note 1, at 453.

179. Scott L. Cummings, *Between Markets and Politics: A Response to Porter’s Competitive Advantage Thesis*, 82 OR. L. REV. 901, 916 (2003) [hereinafter Cummings, *Between Markets and Politics*].

180. See *supra* notes 162–65 and accompanying text.

181. Cummings, *Progressive Politics*, *supra* note 1, at 449.

grams from distressed communities.¹⁸² This creates a greater burden on those residents who have not benefited from economic development.

C. Residential Involvement

Another criticism of the EZ/EC and NMTC programs is the potential lack of community input. Taking into account the experiences of other federal programs, the EZ/EC program adopted the community participation and comprehensive planning elements of the Model Cities program with the belief that sustainable change depends on the active participation of community residents.¹⁸³ However, the level of community participation within the EZ/EC program has varied across cities.¹⁸⁴ Likewise, NMTC encourages participation by mandating resident representation on any CDE advisory or governing board.¹⁸⁵ However, given the bottom-line concerns that drive investment decisions, the amount of residential influence and authority is questionable. As the entity in charge of identifying potential projects or investments that will benefit the community, a CDE must also convince prospective investors of the profitability of the investment.¹⁸⁶ A potential conflict of interest arises because the pressure to attract investment capital may supersede the goal of pursuing projects that benefit residents.¹⁸⁷ Unfortunately, tax credits alone are not sufficient to generate a competitive rate of return for investors. Marketed as an investment program instead of a social assistance program, investors may have more input than community residents on the type of projects pursued in order to guarantee a positive rate of return.¹⁸⁸

The procedures that have been put in place to empower local residents through representation on planning and advisory committees often do not successfully give a substantial voice to community groups. Instead, the participatory schemes under the EZ/EC and NMTC programs have the effect of re-regulating community residents under different layers of government bureaucracy or under the control of powerful private entities.¹⁸⁹ “Empowerment, then, is not an organic concept, but rather the product of the very governance techniques erected to confer authority on low-income communities.”¹⁹⁰ Contrary to the stated objectives of

182. *Id.* at 453.

183. McFarlane, *supra* note 3, at 320 (emphasizing similarities between the two programs including: “federal agency coordination and public-private partnerships,” “[a] community-wide planning process,” and “city control of funding and governance board composition”).

184. *See supra* notes 81, 87–91 and accompanying text.

185. I.R.C. § 45D(c)(1)(B) (2005).

186. Pappas, *supra* note 103, at 325.

187. *Id.* at 327.

188. *Id.* at 326–27.

189. Scott L. Cummings, *Recentralization: Community Economic Development and the Case for Regionalism*, 8 J. SMALL & EMERGING BUS. L. 131, 141 (2004).

190. *Id.*

the EZ/EC and NMTC programs, government rules and private sector involvement often have the effect of constricting residential involvement.¹⁹¹ This effectively reduces notions of local autonomy. This lack of residential involvement in dictating their neighborhood's development often reinforces the subordinating structure of relations between government officials, private business, and marginalized communities.

D. *The Threat of Gentrification*

Finally, as with most economic development initiatives that target low-income, inner-city communities, gentrification poses a threat. Rather than benefiting low-income communities, these programs often displace community residents.¹⁹² With the influx of capital, land prices are likely to increase within the targeted zone or census tract.¹⁹³ Although landowners will benefit from this rise in value, renters are likely to feel the effects of the increase when landlords raise rents to offset higher costs.¹⁹⁴ Any increase in wages attributed to economic development efforts within the designated zone or census tract may be offset by the increase in housing costs.¹⁹⁵ Some residents may be forced to move.

To prevent this from occurring, local zone officials and CDEs that encourage investments in low-income communities should actively manage development in order to promote sustainable growth that acknowledges the potential impact on low-income residents.¹⁹⁶ This goal can be accomplished by either ensuring that low-income residents are presented with employment opportunities that pay a living wage so that they can take advantage of the redevelopment benefits or by protecting affordable enclaves within an area from encroachment by for-profit developers.¹⁹⁷

Some inner-city areas benefiting from EZ funding or NMTC investment are centrally located. This provides an attractive option for higher-income residents who would like to relocate closer to the amenities offered by the city. For example, the Shaw neighborhood in Washington D.C. is a prime area for upscale redevelopment. Near downtown and likely to see an increase in economic activity with the opening of the new convention center, residents within this community are in danger of displacement as development continues and perceptions of the area change.¹⁹⁸ In fact, given the development potential of the area, it is likely that the hotel project would have been built without the extra financing

191. *Id.*

192. Cummings, *Between Markets and Politics*, *supra* note 179, at 917.

193. Ladd, *supra* note 30, at 202.

194. *Id.*

195. *Id.*

196. Cummings, *Between Markets and Politics*, *supra* note 179, at 918.

197. *Id.*

198. See Neil Irwin, *Not Quite What They Hoped For: Convention Center Neighbors Struggle*, WASH. POST, Feb. 9, 2004, at E03.

provided through the NMTC.¹⁹⁹ Thus, these tax credits could have been used for another less commercially viable project.

IV. RECOMMENDATION

The EZ/EC and NMTC programs heavily rely on market-based initiatives to help revitalize distressed communities and to encourage social mobility among low-income residents. Although economic growth has occurred within these targeted areas, the beneficiaries of these initiatives have largely been private businesses and investors who have taken advantage of the tax incentives offered by both programs. Apart from the employment credit offered under the EZ/EC program, these incentives fail to directly link economic growth to resident employment or opportunity. Small businesses, although the most likely employers of minority, low-income residents, are least likely to take advantage of these tax benefits.²⁰⁰ Under NMTC, CDEs are unlikely to invest in small businesses given that the program is primarily viewed as an investment opportunity.²⁰¹ Instead, CDEs will continue to concentrate their efforts on large development projects, such as the Dia:Beacon and the Hippodrome Theater, with the expectation that this type of project will yield large investor returns and stimulate further development within the community. Although not guaranteed, these projects may provide some trickle-down benefits for residents through employment opportunities.

Given the relative ineffectiveness of the private market at linking economic development to resident opportunity, these tax incentives should be accompanied by programs that focus on increasing the human capital of low-income residents. By awarding Title XX/SSBG money to fund skills training programs and counseling services, the EZ/EC program recognized the importance of building resident capacity to achieve the goals of urban revitalization.

Despite this integral connection between people and place, the federal government, under the administration of President George W. Bush, discontinued awarding Title XX/SSBG money under the EZ/EC program.²⁰² As a result, EZs designated in 2001 did not receive any direct federal funding.²⁰³ Relying solely on tax credits to spur economic devel-

199. See Jones, *supra* note 95, at 237–38.

200. See *supra* notes 30–32, 76–80 and accompanying text.

201. See *supra* notes 106–09 and accompanying text.

202. Charlie Frago, *Lack of Data, Funding, Staff Hinders Development Zones*, ARK. DEMOCRAT-GAZETTE, Feb. 1, 2005, at 7B; see also Martha Bridegam, *Empowerment Zones In the Zone: Targeted Areas Seek Alternatives to Grant Funding*, AFFORDABLE HOUSING FIN., Nov.–Dec. 2002, available at <http://www.housingfinance.com/afh/articles/2002/02NovDecEmpowermentZones/index.html> (stating that under the second Bush Administration, the focus of the program has shifted from a grant-making/community development program of the Clinton era to a supply-side business incentives program).

203. Frago, *supra* note 202, at 7B. Funding for the second round EZs is subject to annual congressional appropriations and is therefore unpredictable. Bridegam, *supra* note 202.

opment, EZs can no longer fund programs necessary to prepare low-income residents for possible employment opportunities or to ensure the stability of the neighborhood. This thinking is counterintuitive; obstacles to economic development that exist within low-income communities, “such as small businesses’ need for technical assistance, high crime rates, the limited skills of zone residents, and the lack of child care” support the argument for a more activist government.²⁰⁴ Without access to federal grants, residents who live in areas experiencing the worst blight will remain unaffected by economic development initiatives because of the private sector’s hesitation to deal with the issues presented in these high-poverty areas.

The EZ/EC and NMTC programs’ complete reliance on tax credits to spur economic development within a targeted area is flawed. These programs should focus more on establishing solid social structures to support economic development initiatives within low-income communities. Resources need to be directed at improving schools, providing job training, and addressing other concerns such as transportation, child care, and substance abuse. Resident involvement is key in identifying the strengths, weaknesses, and opportunities that exist within the community.

Although the EZ/EC and NMTC programs require resident participation, the level of involvement varies among EZs and CDEs. Both programs should provide a more definitive role for residents by mandating equal representation on advisory boards. In addition, given the potential conflict CDEs face in balancing the needs of the community against the interests of private investors, NMTC should require CDEs to involve residents in the evaluation of potential development projects in order to ensure that the needs of the community do not succumb to the goals of private investment. Currently, under the NMTC program, a CDE must include residents on its advisory board.²⁰⁵ The extent of their representation, however, is left up to the individual CDE.²⁰⁶ This active involvement by residents in the development of their communities increases the likelihood of long-term economic success within the area given that the development is supported by members of the community. Also, resident involvement decreases the possibility of gentrification by allowing residents to protect certain areas of the community from encroachment by for-profit developers.

Although the geographic boundaries imposed by the EZ/EC and NMTC programs simplify the process of targeting benefits, these place-based restrictions limit the mobility of residents and penalize businesses not located within the geographic boundaries. The EZ/EC program

204. Ladd, *supra* note 30, at 200.

205. See *supra* note 99 and accompanying text.

206. The statute requires resident involvement through representation on advisory boards, but does not specify the extent of such involvement. See I.R.C. § 45D(c) (2005).

should not limit tax incentives to businesses located within the zone. Instead, any business that hires a resident from the EZ should qualify for the employment credit. The availability of the employment tax credit to businesses outside the zone would expand the employment opportunities available to residents. Given that a large percentage of businesses that locate within EZs are service and retail oriented,²⁰⁷ residents who are able to attain employment outside the zone may earn a higher salary working within a regional industry or for an emerging line black business. This increase in disposable income will benefit businesses within the EZ. In addition, a resident that moves from the EZ should not be penalized for his upward mobility. The requirement that employees must reside within an EZ for employers to receive the employment credit isolates low-income individuals and maintains the public and private institutional arrangements that have created a segregated society. Restricting the residence of low-income individuals to “ghetto” communities reinforces these boundaries within society and limits the mobility of low-income individuals.

Finally, given the uncertainty of the pure-place strategy in directing benefits towards low-income residents, the NMTC program should adopt program incentives that link resources geared toward building human capacity to investor profitability. For example, if a development project utilizing NMTCs provided training or guaranteed employment to residents within the census tract, the project would receive tax credits similar to the EZ/EC program. This would result in a greater return for the investor. Residents within the community will become invested in a project if they can see how the project will eventually benefit them. This investment makes it more likely that the project will be sustainable. Also, as the CDFI Fund increases its emphasis on community impact during the evaluation of project proposals, CDEs that can document a direct benefit to the community through job training programs or increased employment opportunities have a better chance at receiving funding through the NMTC program.

V. CONCLUSION

The implementation of the EZ/EC and NMTC programs presented a dramatic shift in the federal government’s antipoverty policy. Adopting a market-based solution in an effort to alleviate poverty within the nation’s distressed areas, both programs heavily rely on tax incentives to attract private investments to low-income communities. Underlying the programs is the belief that development within these communities will provide economic opportunities for residents and result in self-sufficiency. However, tax incentives alone are not enough to ensure that residents will directly benefit from the infusion of private capital within

207. See *supra* notes 162–65 and accompanying text.

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their communities. Instead, the EZ/EC and NMTC programs need to adopt a more comprehensive approach towards revitalizing distressed communities by offering resources that increase the social capital of residents.

