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## Backgrounders

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Urban Enterprise Zones have been proposed by Congressmembers and by key Reagan Administration officials as a means of revitalizing deteriorating, socio-economically distressed urban neighborhoods. The enterprise zone concept, developed in Great Britain, is based on the assumption that tax credits and other benefits to business will attract businesses into such zones and create jobs, thus leading to community development and revitalization. The enterprise zones thus need not require any direct federal outlays, although they will result in "tax pependitures" (reductions in tax revenues).

The best publicized urban enterprise zone legislation now before Congress was introduced jointly by Representative Jack Kemp (R-NY) and Representative Robert Garcia (D-NY). Garcia, Chairperson of the Hispanic Congressional Caucus, has indicated his commitment to a strong role for community-based organizations such as community development corporations (CDCs) in the urban enterprise zones, but the extent to which legislation will call for a direct role for such groups is not clear. The value of enterprise zones to Hispanics may depend to a considerable extent upon whether final legislation assures a strong role for community development groups.

The attached backgrounder provides a brief analysis of current enterprise zone legislation, focusing on the Kemp-Garcia bill. The analysis provided draws heavily upon more extensive analyses carried out by the National Urban Coalition and the National Congress for Community Economic Development.



## I. INTRODUCTION

The basic purpose of an urban enterprise zone, as defined by Kenneth Kirchner of the National Urban Coalition, is "to attract business and create jobs within a depressed urban area (zone) through a series of tax credits." The enterprise zone concept is based on the premise that tax credits to business can encourage community economic development and thus revitalization of distressed urban areas, and that help to businesses will lead to new jobs for residents of the enterprise zone. President Reagan and other members of his Administration have endorsed the concept of urban enterprise zones, which appear likely to be the cornerstone of the Administration's urban policy. However, the Administration has not yet endorsed any specific proposal or plan for implementing urban enterprise zones; a public statement is expected in the next few months, based on the work of the Cabinet Council on Urban Enterprise Zones.

This paper will briefly examine the concept of enterprise zones from the perspective of community-based organizations, exploring potential roles for them in implementing the zones. It will briefly describe the origins of the enterprise zone concept and the provisions of the Kemp-Garcia proposal, compare the three major bills now under consideration by Congress, and detail the potential importance of the zones for Hispanic community-based organizations. It will also review the legislative outlook for urban enterprise zone legislation.

The analysis presented here draws heavily upon more extensive analyses prepared by Kenneth E. Kirchner, of the Government Affairs Office of the National Urban Coalition; and by Nesby Moore, Jr., Board of Directors, and Robert Zdenek, President, of the National Congress for Community Economic Development.

## II. THE ENTERPRISE ZONE CONCEPT: THE BRITISH EXPERIMENT

According to Kirchner, the enterprise zone concept was developed by Professor Peter Hall of Reading University in England, based on his observations of the "free trade posts" of Hong Kong and Singapore. He urged that Great Britain adopt the concept for use in revitalizing deteriorating urban centers, and Prime Minister Margaret Thatcher's conservative government this year responded by establishing 11 experimental urban enterprise zones. The major features of the British enterprise zones, as listed by Kirchner, are:

- . Exemption from the Development Land Tax;
- . Capital allowances of 100% on both industrial and commercial property;
- . Full exemption from local taxes; and
- . Reduction in "bureaucratic red tape" through a "streamlining of requirements and regulations."

While the British experiment is often cited as a successful model for replication and is used as a selling point in Kemp's attempt to win support for his bill, in fact these zones are just being implemented in Great Britain, and therefore not even a preliminary analysis of their success and potential will be available for at least a year; long-term impact cannot be measured for five years or more. It appears that Congressional action will be taken in the United States before any results of the British experiment are available.

## III. LEGISLATIVE PROPOSALS AND OUTLOOK

### A. Overview

Of the five urban enterprise zone bills thus far introduced in Congress, three versions are receiving serious consideration. These include:

- . Urban Jobs and Enterprise Zone Act - H.R. 3824 (Reps. Kemp - R, NY; and Garcia - D, NY); S. 1310 (Sens. Chafee - R, RI; and Boschwitz - R, MINN);

- Urban and Rural Revitalization Act - H.R. 1240 (Sens. Heinz - R, PA; and Riegle - D, MICH); and

- Targeted Assistance Revitalization Act (Rep. Rangel - D, NY).

This paper will examine the major provisions of the Kemp-Garcia bill and compare them with the provisions of the other two bills listed above.

#### B. Kemp-Garcia Proposal

The Kemp-Garcia Bill has been jointly introduced by Representative Jack Kemp, a conservative Republican from New York who is also the co-author of the Kemp-Roth tax cut proposals, and Representative Robert Garcia, a liberal Democrat from the South Bronx who is Chairperson of the Congressional Hispanic Caucus. Their proposed Urban Jobs and Enterprise Zone Act would place responsibility for the enterprise zones within the Department of Housing and Urban Development (HUD).

Designation of enterprise zones would require a formal application to HUD from a local government requesting that one or more zones be approved within its jurisdiction. The zone would have to be a continuous geographic area. If located within a metropolitan area (a Standard Metropolitan Statistical Area having a population of at least 50,000), it would have to include at least 4,000 residents. If located within a city with a population below 50,000, it would have to include at least 2,500 residents. (There would be no population requirements for Indian reservations.) Local governments would have to meet the requirements for federal assistance as specified for the UDAG (Urban Development Action Grant) program in order to qualify. Eligibility would also require that one of the following additional criteria be met:

- An unemployment rate over the past 18 months at least one and one-half times the national average for that same period;

- Designation by the Census Bureau as a low-income poverty area;

- Seventy percent of resident having a median income which is below 80% of the area's median income;
- A population decrease of at least ten percent between 1970 and 1980 within all census tracts; and/or
- Evidence of chronic abandonment, demolition, or substantial level of persons and businesses in arrears on taxes.

Applicant jurisdictions would also have to indicate in writing to the HUD Secretary their intent to take local action to reduce burdens on both employers and workers within the zone, through local tax relief and incentives, commitments for improvements in public services, or a promise to provide coordination of local activities within the zone. Governors would have the authority to request designation of enterprise zones on behalf of local jurisdictions, and would also have veto power over zone designations within their state.

The Kemp-Garcia bill would authorize the HUD Secretary to designate at least ten but not more than 25 enterprise zones annually for the first three years after enactment of the legislation. The designation would not be permanent; it would apply until December 1, 1996, following which a five-year phase-out period would begin, with all zone designations terminating on December 31, 2001.

Priority for enterprise zone designation would be given to areas with the following characteristics:

- Highest levels of unemployment, poverty, and other indicators of economic distress;
- Evidence of highest levels of local governmental commitment to the program;
- Evidence of highest levels of support from businesses and the community; and
- Evidence of state support and assistance for the enterprise zone revitalization effort,

as demonstrated through commitments similar to those of the local government.

The Kemp-Roth bill provides the following incentives to business:

- . Wage tax credits equal to 5% of the wages paid to CETA-eligible employees or to all employees where at least 40% of a business's employees are CETA-eligible;
- . Elimination of capital gains taxes for new businesses and for existing businesses which increase their employment by 100 or more in the year before the area is designated an enterprise zone;
- . Earned income and investment credits of 50% for businesses where at least 40% of employees are CETA-eligible, and similar 50% credits for their investors and financial lending institutions;
- . The right to use certain beneficial accounting methods for businesses with gross revenues below \$2 million;
- . Operating loss carryovers for a 20-year period; and
- . Regulatory "flexibility and relief" due to designation as "small entities."

Kirchner provides the following analysis of these incentives for private sector participation as contained in the Kemp-Garcia bill:\*

- . The 5% employer wage tax credit for each CETA-eligible employee hired is designed to encourage the hiring of unemployed, economically disadvantaged workers. But an employer must weigh the savings from the tax credit against the time and expense of training an inexperienced employee. For instance, if the employee earns \$10,000 a year, or \$200 a week, the employer receives a credit of \$500 (5% of \$10,000) -- an amount equal to two and one-half weeks of the worker's salary. If an employee can learn the necessary skills within two and one-half weeks, the employer will have a net monetary gain. But, if the worker requires more than two and one-half weeks of training, the employer will suffer a loss, turning on-the-job training into a liability. Few businesses in the past have taken advantage of

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\* The points which follow have been slightly edited, but are substantially quoted from Kirchner's analysis, prepared and disseminated by the National Urban Coalition.

the Targeted Jobs Tax Credit, which provides a credit to help defray the cost of job training. Few employers are willing to take the time and effort involved in job training and prefer to hire a more experienced worker. This is especially true in urban areas where youth unemployment has continually remained at epidemic proportions. There is skepticism that a 5% credit will be large enough to induce employers to train unskilled workers.

- The 5% employee wage tax credit is intended as an extra incentive for zone residents to take advantage of available employment. In addition to the prospect of full-time employment and steady wages, the credit will almost guarantee an income tax refund, using standard or itemized deductions. It is doubtful the credit will do much to change worker attitudes or employability. Self sufficiency through financial independence may be the best solution to the problem of dependency, and a contributing factor to the revitalization of the zone.

- The capital gains tax credits are more likely to benefit large corporations and capital intensive industries than labor intensive industries and small business. Many high technology corporations and capital intensive industries have large amounts of capital gains. Very few small businesses, the type needed for revitalization, show significant profits (let alone capital gains) during their first five years of operation. Some labor intensive industries may be able to benefit from this credit. If labor intensive businesses could be attracted to the zone, they would enhance the revitalization of the community. This would benefit the business through the elimination of all capital gains taxes, and benefit the community by providing employment and skills training to its residents. It is this type of compatibility that tax incentives should encourage. We feel high technology and capital intensive industries will have a more difficult time promoting this capability.

- The 50% exclusion of all earned income from taxation would, as with capital gains credits, disproportionately benefit high technology and capital intensive industries. Small businesses, because of their high risk nature, and small profit margins, particularly during their first five years of operation, may not reap benefits proportional to those enjoyed by capital intensive industries. As with the capital gains credits, selected labor intensive industries may be able to take advantage of this credit.

- The 50% credit to investors and financial lending institutions on interest earned is the only incentive designed to assist in capital formation. One of the biggest stumbling blocks for the small entrepreneur to overcome is the absence of start-up venture capital. David Birch of MIT states that between 85-

90% of all new businesses are started with personal savings. Residents of a distressed area interested in, and qualified to, operate a business would, in most cases, need substantial assistance in acquiring the needed start-up capital. Investment in an enterprise zone would be a considerable risk for investors to undertake. High failure rates, low profits, and the problems inherent in a distressed area, will promote much caution among financial lending institutions. The interest tax credit could serve as an incentive if investors and financial lending institutions feel that they could reduce their tax payments and generate a profit. Investors and lending institutions will be a key factor in determining the types of business locating within a zone. Capital formation and interest credits specifically designed to attract small business and labor intensive industries must be incorporated if zones are to succeed.

- The operating loss carryover is a necessary incentive to attract small businesses. Many small businesses fail to earn a profit in the first five years of operation. Allowing these businesses to carryover the beginning year's losses to the 20 following years will assist the business in achieving solvency and stability before paying on its early losses.
- The optional cash accounting method provisions should also benefit small businesses. This provision allows for a less complicated business accounting procedure by computing taxable income on the basis of cash receipts and disbursements without regard to inventories. This option is only available to businesses with gross receipts under \$2 million, thereby favoring the small entrepreneur.
- The designation of enterprise zones as "small entities" for the purpose of regulatory relief should be approached with caution. Regulatory relief may help relieve some of the unnecessary and burdensome federal regulations, but many local and state regulations also pose problems for new businesses. In some cases, local building, zoning, and other permit requirements are more of an impediment of development than federal regulations. Regulatory relief could also result in a lessening of safety and health regulations designed to protect employees and consumers, especially in labor intensive industries, where employees in the past have been subject to health and safety hazards.

### C. Other Proposals

The following comparisons can be made in reviewing the provisions of the three different versions of the Urban Jobs and Enterprise Zone legislation currently receiving consideration in Congress. The three proposed acts are



the Urban Jobs and Enterprise Zone Act, the Urban and Rural Revitalization Act, and the Targeted Assistance Revitalization Act.

In comparing provisions for zone designation, both the Urban Jobs and Enterprise Zone Act and the Targeted Assistance Revitalization Act are fairly comprehensive. However, the Urban Jobs and Enterprise Zone Act gives the authority for making designations to the Secretary of HUD after the local government makes an application. The Targeted Assistance Revitalization Act leaves that decision to the governor; the Urban and Rural Revitalization Act places that decision with the Secretary of Commerce.

On the tax credit provision, the Urban Jobs and Enterprise Zone Act and the Targeted Assistance Revitalization Act specify different percentages of income tax credits for qualified workers. All three Acts insist that the worker must live in the area; the Targeted Assistance Revitalization Act allows for the job to be performed outside of the zone, as long as the business itself is located within the zone. The Urban Jobs and Enterprise Zone Act ties eligibility to CETA (Comprehensive Employment and Training Act) criteria.

There are differences in the amounts of tax percentages offered in the Capital Gains provisions in the Urban Jobs and Enterprise Zones Act and the Urban and Rural Revitalization act. The Targeted Assistance Revitalization Act offers none. Credits offered vary between the Urban Enterprise Zones bill and the Targeted Assistance Revitalization Act, while the Urban and Rural Revitalization Act offers none.

Both the Urban Jobs and Enterprise Zones Act and the Urban and Rural Revitalization Act offer other more comprehensive additional provisions. The attached chart shows a comparison of all of the Acts.

D. Legislative Outlook

The concept has been supported in several recent speeches by the President and the Secretary of Housing and Urban Development, Samuel Pierce. Congressman Kemp has said:

"Let us try to examine enterprise zones on their own merits. We should recognize that they can't simply substitute for existing direct assistance programs. But we should also recognize that they bring important new tools to help us meet our old challenges of restoring jobs, economic vitality and hope to America's poorest communities."

Congressman Garcia stated:

"The Enterprise Zone effort is not solely a federal action. Localities will need to offer coordinated economic development packages utilizing the tools they currently possess, including public works, community development monies, job training programs, and whatever economic development powers they may have.

According to Paul R. Bardack, aide to Congressman Garcia, the question is not if the Urban Jobs and Enterprise Zones bill will be passed; the question is when; will it be in this Congress or the next? Mr. Bardack anticipates a positive response from the Administration, the Congress, the private sector, the national non-profit organizations, and the lobbying community.

His opinion, however, directly conflicts with that of an aide from the office of Congressman Charles Rangel (D-NY). When asked for a brief interview on the subject, he responded: "To put it in a nutshell, it just won't happen." He is convinced that the Reagan tax programs

will eliminate the possibility of the U.S. being able to afford the tax credits which enterprise zones propose.

The Congressional Quarterly (June 6, 1981) views the legislative outlook as unclear. Although Commerce Secretary Malcolm Baldrige has made a statement pledging administrative support, and Baldrige, who is also head of the Administration's task force on enterprise zones, has said that enactment of some type of enterprise zone legislation is "top priority" for the 97th Congress, timing is seen as a problem. Any measure will probably be reviewed by two committees in each chamber, the tax writing panels and the committees with oversight of housing and urban development programs. Congressional committees are expected to begin to assess the potential value of the enterprise zones this fall.

#### IV. POTENTIAL IMPACT ON HISPANICS

The potential value of urban enterprise zones for Hispanic communities is now being assessed by Hispanic organizations and business owners. Local development corporations, cooperatives, and other Hispanic groups already involved in economic development generally view the enterprise zones as potentially useful in encouraging comprehensive community development -- provided Hispanic communities are included in the designated zones, and provided a strong role for community groups can be assured.

##### A. The Role of Community-Based Organizations

Assuring a strong role for community-based organizations in the proposed enterprise zones is a concern of the Rep. Garcia, co-author of the Kemp-Garcia bill. When he reintroduced the Urban Jobs and Enterprise Zone Act on June 3, 1981, as noted by the National Congress for Community Economic Development

(NCCED), Garcia "stated that community groups will have to play a significant role in enterprise zones and should be major beneficiaries of enterprise zone activity." As NCCED has stressed in testimony on the urban enterprise zone proposals, local development groups such as community development corporations (CDCs) "are particularly well suited to working within enterprise zones" because they possess the following characteristics:

- They are "private, usually non-profit, development institutions created to revitalize some of the nation's most distressed communities";
- They are "owned and controlled by the community through a board of directors which is composed of at least 51% low-income residents and/or representatives of other low-income organizations";
- They are engaged in "comprehensive development activities ranging from assisting small businesses to job placement to constructing commercial and industrial facilities";
- They have the ability to "coordinate and to link various various development activities, such as small business expansion and employment training, making both activities more effective in meeting long-term needs"; and
- They "provide the missing resources that prevent private sector market forces from bringing jobs and facilities" to distressed areas.

Other types of local development corporations (LDCs) with similar characteristics but without the formal CDC designation also exist in urban communities and could be similarly utilized.

NCCED notes that while the urban enterprise zone concept is presented primarily as a tax bill, the legislation could be strengthened significantly by increasing the designated role of community-based organizations. Community-based development organizations and other community-based programmatic groups can perform a variety of activities in enterprise zone areas. NCCED has provided an analysis of these activities, which it divides into the following three major categories: (1) small business assistance, (2) job development, and (3) management services. The NCCED analysis follows (slightly edited and expanded for the NCLR audience).

## 1. Small Business Assistance

- Packaging for small businesses - Many CDCs and other Hispanic development groups have "packaged" small businesses for entrepreneurs that receive financing from lending institutions. One of the major problems that potential small businesses face is the difficulty in putting together a financial package that a lending institution will fund. Groups could provide this assistance in the enterprise zone areas through the formation of business development centers (BDCs).
- Small business technical assistance - CDCs and other development organizations have been providing a range of services to small businesses ranging from doing feasibility studies to structuring management plans. Few mechanisms have the capacity to provide this type of assistance to businesses in distressed communities. Enterprise zones could contract with local development corporations to provide either general or specific assistance to indigenous businesses.
- Small business financing - Distressed communities suffer from a lack of both equity and debt capital. There are few lending institutions in these communities. Local development corporations could provide a revolving loan guarantee fund to small businesses. Small Business Administration (SBA) programs often do not reach entrepreneurs in severely distressed communities. A line of guarantee will enhance the likelihood that lending institutions will make "risky" loans to small businesses.
- Finder's fee - CDCs and other entities could receive finder's fees from the enterprise zone for inducing businesses to locate branch plants or relocate in enterprise zone areas. An enterprise zone must encourage both indigenous business formation and the locating of businesses from other areas in the enterprise zone.
- Incubator facilities - An incubator facility can provide low cost space for start-up business until the businesses are able to generate enough revenues to rent or own a facility. Local development corporations could construct these incubator facilities since many have build or renovated commercial and industrial facilities.

## 2. Employment and Training

- Job training - Many Hispanic community-based organizations (CBOs) have operated a variety of job training programs focused on strengthening attitudinal and job skills of unemployed people.

Many residents in distressed communities lack basic job skills, and it will be crucial in enterprise zones to provide targeted job training programs for these individuals.

Job placement - CBOs have had considerable success in placing CETA eligible individuals into private sector jobs. The ultimate success of many businesses in enterprise zones will be based on employee output. Moreover, to be eligible for benefits under the Kemp-Garcia bill, business would have to have 40 percent of their employees be CETA-eligible. CBOs could be contracted with to provide job placement service linking CETA-eligible individuals with the applicable business.

### 3. Management and Other Services

- Management of enterprise zones - Successful enterprise zones should operate on principles similar to industrial parks, which are well managed and have specific goals, i.e., locating growth firms in a community. Local development corporations could contract to carry out a variety of general management services ranging from managing an enterprise zone to providing management services for commercial centers in enterprise zones.
- Public services in enterprise zones - CBOs and local development corporations could contract to provide public services such as crime prevention, construction of public facilities (lights, curbs, etc.), or day care services in enterprise zones.
- Monitoring of enterprise zone performance - Community groups with a broad community base would be excellent mechanisms for assessing the impact of enterprise zones benefits on community residents. CBOs could be contracted with to monitor enterprise zones several years after the zones have been established.

Thus there are many potential roles for CBOs and especially for development groups within the enterprise zones. Both Community Development Corporations and Local Development Corporations can be incorporated as legal entities with or without designation as such by a funding source.\* For example, a neighborhood group can form a CDC and engage in business ventures, such as development of an industrial park or housing, or delivery of social services. States vary in their legal provisions, but

each federal agency makes designations in accordance with its own set of regulations. The Small Business Administration makes loan guarantees for LDC's under its 502/503 program. Title VII of the Equal Opportunity Act funds administrative costs and provides business venture development funds for CDCs under its guidelines for economic development activities. With the coming of enterprise zones Hispanic CBOs interested in becoming involved in economic development may find it important to assure an appropriate legal structure.

What is simply not yet known is the extent to which the urban enterprise zone legislation -- assuming some legislation is indeed passed -- will either require or encourage specific involvement by local development corporations or other community-based organizations. There is considerable concern that if such involvement is not mandated in the legislation, the benefits of the enterprise zones to Hispanic communities will be limited. The current proposals do not include provisions for assuring such involvement by community groups. However, several states, including Illinois and Massachusetts, have introduced state legislation to complement the enterprise zone, primarily by making funds available to local development corporations involved in projects within economically depressed target areas.

#### B. Other Hispanic Issues

Many uncertainties surround the enterprise zone debate. In addition to the question of the extent of involvement for community-based organizations, Hispanic benefits depend upon the following:

- Whether Hispanic communities are designated as enterprise zones. Legislation has already been introduced in a number of state legislatures, and before the City Council of the District of Columbia, to create enterprise zones. For example, the District is moving to designate its entire area as an enterprise zone. This quick action is being taken in many locales because the Kemp-Garcia legislation limits the total number of enterprise zones nationally to just 25 initially. Even if a city with a large Hispanic population is successful in obtaining an enterprise zone designation, there is no guarantee that the Hispanic neighborhoods will be included. Still to be determined is whether there will be a maximum size limit on the zones -- whether whole cities will be accepted or whether there will be an attempt to limit coverage to small geographic areas within cities.
- Whether there will be coordination of urban enterprise zone resources with social service and other programs. Some Administration officials have expressed the concern often stated by community leaders, namely that tax credits alone are not sufficient to generate development. Congressman Kemp himself notes that enterprise zones can't "simply substitute for existing direct assistance programs." The value of the enterprise zones for low-income people may depend upon the extent to which other resources will be combined with the tax credits to create comprehensive revitalization.
- Whether citizen participation and monitoring will be mandated and accomplished. Some groups fear the enterprise zones as providing the potential for exploitation by developers. As Willie Vasquez, Director of the Office of Latino Affairs in the District of Columbia puts it, the situation is one in which "danger and opportunity" must be weighed. Citizen involvement and outside monitoring of some form will be needed to assure that large, highly technical businesses do not find ways to exploit the tax benefits without initiating jobs for low-income residents -- who may lack needed technical skills. Easing of regulations, Vasquez warns, could mean increased pollution, land speculation, displacement of low-income elderly people, and other negative effects along with business development. Thus the protections in the legislation and the extent of enforcement of civil rights provisions will be of critical importance.

The potential of the urban enterprise zones for Hispanic Americans thus cannot yet be determined, and will depend to a considerable extent upon the final form of the legislation and upon what areas are in fact designated as enterprise zones. However, as Mr. Vasquez puts it,



"The Enterprise Zone effort is not solely a Federal action. Localities will need to offer coordinated economic development packages utilizing the tools they currently possess, including public works, community development monies, job training programs, and whatever economic development powers they may have."

#### V. CONCLUSIONS

If the enterprise zone legislation is passed, and if it contains strong provisions for involvement of community-based organizations, as well as some form of citizen participation and outside monitoring, and incentives for coordination of resources, then Hispanic communities included in designated enterprise zones may benefit substantially in terms of jobs and community revitalization. If these provisions are not included, or if Hispanic communities are not included in designated enterprise zones, then effects may be minimal, or even negative. For if there is a serious effort to assure that a coordinated, comprehensive "package" of economic development and human service resources is provided to the enterprise zones, cutbacks nationally in funds for such programs will mean that a community finds itself with low priority for local, state, and federal funding for economic development or human services.

In the debate to come, the participation of Hispanics will be of considerable importance. Moreover, immediate action at the state and local level is needed in order to assure that Hispanic communities are included in the areas now being selected for designation as enterprise zones.

