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Enterprise Zones: The Good, the Bad, and the Muddled.

Bruce Bartlett reviews the 25 years of enterprise zones, and he finds academic research mixed, with some published analyses showing positive economic effects, some showing no impact, and some with both positive and negative results.

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In recent weeks, there has been a flurry of new interest in targeting certain geographical areas for tax cuts, investment incentives, regulatory relief, and other measures designed to raise growth and reduce unemployment. President Obama calls them "promise zones" and designated the first five on January 8.1 On December 18, 2013, Sens. Rand Paul and Mitch McConnell, both Kentucky Republicans, introduced legislation to create what they call "free market enterprise zones" with a broad array of targeted incentives.2 Meanwhile, the existing enterprise zone law enacted in 1993 and the new markets tax credit created in 2000 expired at the end of 2013 along with several other extenders.

The idea of place-specific policies to revitalize depressed urban and rural communities has been around for a long time. During the 1968 presidential campaign, it was endorsed by both Democrat Robert Kennedy and Republican Richard Nixon, and the first legislation was introduced in 1969.3 Nixon called his proposal "core city tax credits," and the same rationale has been recycled ever since by members of both parties. A 1968 Nixon campaign document, "Nixon on the Issues," explains how it would work:

Tax incentives — whether direct credits, accelerated depreciation or a combination of the two — should be provided to those businesses that locate branch offices or new plants in poverty areas, whether in the core cities or in rural America. . . .

We need seed capital and seed effort in the ghetto. We need a self-perpetuating program which does not rest on barren subsidies which when removed merely return the ghettos of America to their original state. It will be important to devise tax credit programs so that each dollar of credit will have a maximum impact. Once private enterprise begins to develop in the ghetto, it will become cumulative and self-perpetuating. The economic iron curtains which now encompass the ghettos of this country will be dismantled and the people living there will gradually phase into the mainstream of American economic life.4

The Nixon proposal went nowhere, in large part because of House Ways and Means Committee Chair Wilbur Mills's hostility to tax credits. He feared, rightly, that they could too easily become a form of "backdoor spending."5

The modern history of enterprise zones begins in the late 1970s, when the idea surfaced in the United Kingdom. It was first proposed by professor Peter Hall of Reading University in 1977 and quickly picked up by Sir Geoffrey Howe, then a Conservative member of Parliament and later chancellor of the Exchequer under Prime Minister Margaret Thatcher.6

Hall and other supporters of the enterprise zone concept made clear that their inspiration came from the examples of Hong Kong and Singapore, city-states that had achieved great prosperity despite lacking any of the normal requirements for achieving it, such as land and natural resources.7 Hong Kong in particular has always loomed large in the thinking of free market economists, such as Milton Friedman, who have viewed it as the ultimate proof that their ideas will work anywhere if only given a chance.8

In the United States, the principal evangelist for enterprise zones was the late Rep. Jack Kemp. I know that when I worked for him from 1977 to 1978, it was an idea we were aware of by way of Arthur Laffer. Whether he came up with it independently, or knew about it from his days in the Nixon administration or from the British discussion, I don't know.

Kemp liked the idea because he genuinely cared about minorities and the urban poor. He thought tax cuts were the cure for pretty much every domestic problem, but he recognized that while a "rising tide lifts all boats," those living in the inner cities had sunk so far down that they needed a little extra help to achieve the American dream. Enterprise zones were a perfect way for him and the Republican Party to appeal to this constituency in a way that was consistent with their philosophy, which rejected Great Society-style urban planning and Washington-based solutions to local problems.9

During the 1980s, Kemp sponsored enterprise zone legislation with Rep. Robert Garcia, a Democrat who represented the notoriously poor South Bronx. Their legislation would have cut payroll taxes for employees in the zone, reduced the capital gains tax on investments in the zone, provided a lower corporate tax rate for businesses in the zone, and other tax incentives.10

A version of enterprise zones was enacted in 1987 that provided no federal tax provisions and mainly encouraged states to establish zones with their own incentives.11 So dismayed was Kemp, who became secretary of housing and urban development in 1989, by the lack of meat in the enterprise zone legislation that he refused to designate any zones in hopes of getting more substantive legislation that included federal tax cuts.12

As Treasury's representative to the White House Domestic Policy Council's Economic Empowerment Task Force, I saw how frustrated Kemp was at the lack of interest in enterprise zones or domestic policy generally during the George H.W. Bush administration. But after riots broke out in Los Angeles in the spring of 1992, Bush suddenly needed to have something to say about helping minorities and the inner cities, and he endorsed enterprise zones.13 But no action was forthcoming from a Democratic Congress that was in no mood to give Bush or Kemp any sort of political victory in a presidential election year.14

Congress finally acted in early 1993 on a Clinton administration enterprise zone initiative that was widely viewed among conservatives as too modest to work. Kemp blasted the legislation, saying, "It's a tragedy. It's a hoax. It's not empowerment or enterprise, and anyone who voted for it should be ashamed."15 Sen. Joseph Lieberman was also critical of the Clinton initiative.16 The principal tax element was a 20 percent employer wage credit for the first $15,000 of wages of zone residents. There was also a provision permitting the expensing of up to $35,000 of capital equipment by qualifying businesses.

Subsequent legislation amended the enterprise zone legislation, but as of 2009 just $1.8 billion in total tax credits had been expended.17 In 2000 Congress established a new tax credit also designed to aid urban areas called the new markets tax credit. A much more substantial incentive, it was authorized to provide $15 billion in credits through 2007, and later expanded to $40 billion through 2012 and $3.5 billion in 2013. It provided a tax credit of 39 percent of qualifying investments.18

Evaluation of these various measures, state and federal, to stimulate particular locations based on various criteria and using incentives of greater and lesser magnitude is obviously difficult. Space prevents a thorough analysis, but a search of the academic literature found several studies that have examined enterprise zones and the new markets tax credit.

Studies finding no or negative effects include the following:

Oakley and Tsao (2006): “With the exception of a few isolated incidences where individual zones fared better than comparison areas, zone initiatives had little impact.”19

Bondonio and Greenbaum (2007): “EZ policies are found to positively affect the gross flows of employment, sales, and capital expenditures accounted for by the new establishments. . . . Among the new establishments, the EZ incentives are found to reduce payroll per employee, indicating the new jobs are low-paying. . . . EZ policies, finally, are found to significantly accelerate the loss of employment, sales, and capital expenditures accounted for by vanishing establishments, thus offsetting the gains to the other establishments and resulting in the finding of no zone impact common in other studies.”20

Elvery (2009): “The author finds no evidence that these enterprise zones affected the employment of zone residents.”21

Greenbaum and Landers (2009): “There is little evidence that they have succeeded.” However, the authors suggest that this may be because of political factors rather than failure of the enterprise zone idea.22

Kolko and Neumark (2010): “Overall, the evidence indicates that enterprise zones do not increase employment.”23

Hanson and Rohlin (2013): “Establishments can benefit by literally moving across the street into the EZ to enjoy the benefits of the program without incurring relocation costs associated with moving further from a customer base, employees, or losing other advantages of the immediate location. . . . If the goal of policy makers is to induce relocation, it seems that even this modest objective may come at a cost of destroying jobs and establishments in areas that compete with targeted places.”24

Studies finding a positive impact include the following:

O’Keefe (2004): “Estimates suggest that the enterprise zone designation raises employment growth about 3 percent each year during the first six years after the designation, but this effect does not persist in later years. The number of employees at each business in an enterprise zone also rises more than employment at businesses that do not have the same tax incentives.”25

Greenbaum and Engberg (2004): “Zones did lead to new business activity inside the zones. The number of [enterprise] births and employment, payroll, and shipments due to those births all increased significantly in the zones post-designation.”26

Couch, Atkinson, and Smith (2005): “The study found that qualifying as an enterprise zone had a positive effect on a county’s rate of job creation.”27

Ham et al. (2011): “We find that all three programs have positive, statistically significant impacts on local labor markets in terms of the unemployment rate, the poverty rate, the fraction with wage and salary income, and employment.”28

Busso, Gregory, and Kline (2013): “We find that EZ designation substantially increased employment in zone neighborhoods and generated wage increases for local workers without corresponding increases in population or the local cost of living."29

Freedman (2013): "I find that EZ designation has a positive effect on residential employment, increasing opportunities mainly in lower-paying industries. . . . EZ designation is associated with increases in home values."30

Reynolds and Rohlin (2014): "We find that the tax incentives offered by the program notably enhance the quality of business environment for firms in the area while modestly improving the quality of life for the individuals living in the area."31

Studies finding mixed results include the following:

Landers (2006): "EZ property values are bid up by businesses seeking to expand or locate operations in the EZs. This would reduce amounts that these businesses would otherwise spend on capital assets or labor."32

Glaeser and Gottlieb (2008): "Most large-scale place-oriented policies have had little discernable impact. Some targeted policies such as Empowerment Zones seem to have an effect but are expensive relative to their achievements."33

Krupka and Noonan (2009): "We find a sizeable and significant positive effect on home values and varying effects on other outcomes of interest. . . . A possible interpretation is that federal money is being spent to knock down low-value homes, increasing the median value in a neighborhood."34

Government Accountability Office (2010): "Although improvements in poverty, unemployment, and economic growth had occurred in the EZs and ECs, our econometric analysis of the eight urban EZs could not tie these changes definitively to the EZ designation."35

Finally, three studies have specifically examined the new markets tax credit:

Gurley-Calvez et al. (2009): "The authors' results suggest at least a portion of NMTC investment by individual investors is 'new' investment financed through a decrease in consumption. . . . On the corporate side, the authors find no change in corporate investment levels in response to the NMTC. . . . The authors infer that corporations have most likely shifted investment funds from higher income communities to NMTC-eligible communities."36

Freedman (2012): "I tentatively conclude that while there appear to be some positive effects of subsidized investment in disadvantaged neighborhoods, the benefits associated with subsidized investment are modest."37

Urban Institute (2013): "NMTC investments per job generated for early-year projects were estimated to have been between $32,658 and $79, 265, with an average of $53,162."38

Simply looking at the data, however, does not necessarily tell us whether a program such as enterprise zones or the new markets tax credit are effective or worth the cost. We don't know the alternate use of the resources involved that might have yielded better or worse results. And sometimes the political benefit of showing concern for a particular constituency that feels neglected may justify the cost even if the objective results are less than overwhelming.

Moreover, some ideas can be embraced by both parties for completely different reasons, meaning that they are almost impossible to stop no matter what the objective analysis shows. Slate political reporter Dave Weigel said he thinks enterprise zones fall into this zone of bipartisan inevitability. As he wrote on January 10:

Republicans, in good faith, love the idea of urban renewal based on tax relief; Democrats love to have one thing embraced by the right. The evidence that, say, a supply-side tax cut to the top income level will grow the economy, is no stronger than the evidence for an enterprise zone. Doesn't matter: Republicans favor it. Rand Paul, in particular, has pointed to the urban-relief plan as a solution that disproves any claims that his party is callous. Earlier this week, when he was talking to reporters on the Hill, Paul responded to a question about "how it would look" when the party voted against unemployment insurance by rattling off the black unemployment rate and citing the Freedom Zone curative.39

But judging the outcome on a political basis cuts both ways. Sometimes a program that may work well in principle might appear wasteful from a public relations viewpoint. Regarding the new markets tax credit, Bloomberg published an exposé in 2011 finding that much of the money went to subsidize the building of luxury hotels and that big banks were the primary beneficiaries.40 This led Sen. Tom Coburn, R-Okla., to urge abolition of the program.41

It is beyond the scope of this review to say whether enterprise zones are good or bad policy. For one thing, the methods of the published studies vary a great deal in terms of data used and time periods and locations studied. Obviously, it would be desirable to have a comprehensive study that could determine what successful and unsuccessful enterprise zones have in common and make appropriate reforms.

Stuart Butler of the Heritage Foundation, an early supporter of the enterprise zone program, emphasized to me that he had always viewed it as just one piece of a development strategy that also included noneconomic elements such as education policy. In his words, "I should emphasize that even the original Jack Kemp enterprise zone idea was never meant to be a complete solution. The idea was to create the economic environment most conducive to enterprise risk-taking. In this environment, other strategies, not just commercial but things like school reform, improved policing, better welfare policy, etc., would be more likely to help trigger economic as well as social improvement."

It might be argued that social change is the essential ingredient in successful place-based development strategies, something that thus far has been beyond the scope of the enterprise zone concept.42

FOOTNOTES

1 White House, "Fact Sheet: President Obama's Promise Zones Initiative" (Jan. 8, 2014) . The promise zone initiative was first proposed last year. See White House, "Fact Sheet: The President's Plan to Ensure Hard Work Leads to a Decent Living," Feb. 15, 2013.

2 S. 1852, 113th Cong., 1st sess. (Dec. 18, 2013).

3 Bernard L. Weinstein, "State Tax Incentives to Promote Investment in Urban Poverty Areas: An Evaluation," 47 Land Econ. 421 (1971); Robert B. Semple, "A Kennedy Plan Seeks Slum Jobs and Lower Rents," The New York Times, July 5, 1967, at 1; Robert A. Wright, "Tax Credit Backed by Percy as Way to Best Aid Ghetto," The New York Times, Dec. 17, 1968, at 67.

4 A copy of this document was given to me by Martin Anderson of the Hoover Institution, who worked for Nixon during the 1968 campaign. See Robert B. Semple Jr., "Nixon Gives Plan for Aiding Slums," The New York Times, May 3, 1968, at 26.

5 Leonard Sloane, “Nixon and Mills Scan Tax Credits,” The New York Times, Dec. 5, 1968, at 25.

6 David M. Maloney, “A Critical Analysis of the ‘Enterprise Zone’ Concept and Its Application,” Tax Notes, Jan. 19, 1987, p. 261.

7 Hall, “Enterprise Zones: A Justification,” 6 Int’l J. Urban & Reg’l Research 416 (1982); Jonathan Schiffer, “Urban Enterprise Zones: A Comment on the Hong Kong Model,” 7 Int’l J. Urban & Reg’l Research 429 (1983).

8 See Alvin Rabushka, Hong Kong: A Study in Economic Freedom (1979); Friedman, Free to Choose (1980), at 34, 37, 57, and 61.

9 David Osborne, “The Kemp Cure-All,” The New Republic, Apr. 3, 1989, at 21; James Traub, “Jack Kemp Faces Reality,” The New York Times Magazine, May 7, 1989, at 38.

10 Robert W. Benjamin, “The Kemp-Garcia Enterprise Zone Bill: A New, Less Costly Approach to Urban Redevelopment,” 9 Fordham Urban L. J. 659 (1980).

11 “Major Provisions of Housing Authorization Bill,” Cong. Q., Nov. 14, 1987, at 2819.

12 Gwen Ifill, “‘Enterprise Zone’ Tax Breaks Urged,” The Washington Post, Mar. 22, 1989.

13 Rochelle L. Stanfield, “Battle Zones,” National Journal, June 6, 1992, at 1348.

14 Jason DeParle, “How Jack Kemp Lost the War on Poverty,” The New York Times Magazine, Feb. 28, 1993, at 26.

15 Quoted in Laurie McGinley, “Some Advocates of Enterprise-Zone Concept Find Little to Cheer in Democrats’ Legislation,” The Wall Street Journal, Aug. 9, 1993, at A14.

16 Guy Gugliotta, “Cities Putting Enterprise Zones to Work,” The Washington Post, June 1, 1993, at A1.

17 Joint Committee on Taxation, “Incentives for Distressed Communities: Empowerment Zones and Renewal Communities,” JCX-38-09 (Oct. 5, 2009) ; Congressional Research Service, “Empowerment Zones, Enterprise Communities, and Renewal Communities: Comparative Overview and Analysis,” Feb. 14, 2011 .

18 CRS, “New Markets Tax Credit: An Introduction,” Jan. 10, 2013 .

19 Deirdre Oakley and Hui-Shien Tsao, “A New Way of Revitalizing Distressed Urban Communities? Assessing the Impact of the Federal Empowerment Zone Program,” 28 J. Urban Affairs 443 (2006).

20 Daniele Bondonio and Robert T. Greenbaum, “Do Local Tax Incentives Affect Economic Growth? What Mean Impacts Miss in the Analysis of Enterprise Zone Policies,” 37 Reg’l Sci. & Urban Econ. 121 (2007).

21 Joel A. Elvery, “The Impact of Enterprise Zones on Resident Employment,” 23 Econ. Dev. Q. 44 (2009).

22 Greenbaum and Jim Landers, “Why Are State Policy Makers Still Proponents of Enterprise Zones? What Explains Their Action in the Face of a Preponderance of the Research?” 32 Int’l Reg’l Sci. Rev. 466 (2009). On political interference undermining enterprise zone effectiveness, see Jim F. Couch and J. Douglas Barrett, “Alabama’s Enterprise Zones: Designed to Aid the Needy?” 32 Pub. Fin. Rev.

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23 Jed Kolko and David Neumark, “Do Some Enterprise Zones Create Jobs?” 29 J. Policy Anal. & Mgmt. 5 (2010). See also Neumark and Kolko, “Do Enterprise Zones Create Jobs? Evidence From California’s Enterprise Zone Program,” 68 J. Urban Econ. 1 (2010).

24 Andrew Hanson and Shawn Rohlin, “Do Spatially Targeted Redevelopment Programs Spill Over?” 43 Reg’l Sci. & Urban Econ. 86 (2013). See also Hanson and Rohlin, “The Effect of Location-Based Incentives on Establishment Location and Employment Across Industry Sectors,” 39 Pub. Fin. Rev. 195 (2011); Hanson and Rohlin, “Do Location-Based Tax Incentives Attract New Business Establishments?” 51 J. Reg’l Sci. 427 (2011).

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26 Greenbaum and John B. Engberg, “The Impact of State Enterprise Zones on Urban Manufacturing Establishments,” 23 J. Policy Anal. & Mgmt. 315 (2004).

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31 C. Lockwood Reynolds and Rohlin, “Do Location-Based Tax Incentives Improve Quality of Life and Quality of Business Environment?” 54 J. Reg’l Science 1 (2014).

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33 Edward L. Glaeser and Joshua D. Gottlieb, “The Economics of Place-Making Policies,” Brookings Papers on Econ. Activity (2008), at 155.

34 Douglas J. Krupka and Douglas S. Noonan, “Empowerment Zones, Neighborhood Change and Owner-Occupied Housing,” 39 Reg’l Sci. & Urban Econ. 386 (2009).

35 GAO, “Revitalization Programs: Empowerment Zones, Enterprise Communities, and Renewal Communities” (Mar. 10, 2010) .

36 Tami Gurley-Calvez et al., “Do Tax Incentives Affect Investment? An Analysis of the New Markets Tax Credit,” 37 Pub. Fin. Rev. 371 (2009).

37 Freedman, “Teaching New Markets Old Tricks: The Effects of Subsidized Investment on Low-Income Neighborhoods,” 96 J. Pub. Econ. 1000 (2012).

38 Urban Institute, “New Markets Tax Credit (NMTC) Program Evaluation: Final Report,” Apr. 2013, at 122.

39 Weigel, “It’s the One Thing Rand Paul and Barack Obama Agree On, and It Doesn’t Work,” Slate, Jan. 10, 2014. Note: I am quoted in this report as having a negative opinion of enterprise zones, but subsequent research has led me to have a more balanced view.

40 “Rich Take From Poor as U.S. Subsidy Law Funds Luxury Hotels,” Bloomberg News, Feb. 8, 2011.

41 Coburn, “Back in Black,” July 2011, at 562.

42 See Jennifer Forbes, “Using Economic Development Programs as Tools for Urban Revitalization: A Comparison of Empowerment Zones and New Markets Tax Credits,” 2006 Univ. Ill. L.R. 177 (2006).

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